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

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**FORM 10-Q**

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

**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2004**

OR

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

**FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_**

*COMMISSION FILE NUMBER 0-30961*

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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 October 29, 2004
Common stock, \$.001 par value	36,495,870

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

	September 30, 2004	December 31, 2003
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 118,208	\$ 99,109
Accounts receivable, net	21,226	12,381
Prepaid and other current assets	5,121	4,050
Current portion of long-term investments in marketable debt securities	4,517	29,245
	<hr/>	<hr/>
Total current assets	149,072	144,785
Long-term investments in marketable debt securities	14,544	14,216
Fixed assets, net	9,204	6,846
Goodwill	43,669	31,664
Intangible assets, net	7,960	4,082
Other assets, net	4,812	3,462
	<hr/>	<hr/>
	\$ 229,261	\$ 205,055
	<hr/>	<hr/>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 1,338	\$ 1,101
Accrued liabilities	31,916	22,315
	<hr/>	<hr/>
Total current liabilities	33,254	23,416
Zero coupon convertible senior notes	90,000	90,000
	<hr/>	<hr/>
Total liabilities	123,254	113,416
Commitments and contingencies (Note 7)		
Shareholders' equity:		
Common Stock: \$0.001 par value per share (75,400 authorized, 36,447 and 36,101 shares issued and outstanding at September 30, 2004 and December 31, 2003)	36	36
Additional paid-in capital	143,332	140,218
Treasury Stock	(19,724)	(2,003)
Deferred compensation	(4)	(14)
Accumulated other comprehensive income	62	232
Accumulated deficit	(17,695)	(46,830)
	<hr/>	<hr/>
Total shareholders' equity	106,007	91,639
	<hr/>	<hr/>
	\$ 229,261	\$ 205,055
	<hr/>	<hr/>

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
<b>Revenues:</b>				
Advertising (including \$104, \$0, \$349 and \$0 from related parties, respectively)	\$15,473	\$ 8,748	\$39,869	\$20,025
Non-advertising:				
Wireless (including \$0, \$7,403, \$0 and \$26,858 from related parties, respectively)	8,145	11,693	31,706	31,160
E-commerce (including \$0, \$692, \$0, and \$2,851 from related parties, respectively)	1,486	692	4,175	2,851
Other (including \$0, \$335, \$0 and \$669 from related parties, respectively)	836	947	3,392	1,804
Subtotal of non-advertising revenues	10,467	13,332	39,273	35,815
<b>Total revenues</b>	<b>25,940</b>	<b>22,080</b>	<b>79,142</b>	<b>55,840</b>
<b>Cost of revenues:</b>				
Advertising (including \$0, \$36, \$0 and \$108 from related parties, respectively)	3,576	1,973	9,736	5,325
Non-advertising:				
Wireless (including \$0, \$1,831, \$0 and \$7,598 from related parties, respectively)	3,021	3,876	11,334	9,643
E-commerce (including \$28, \$629, \$94 and \$2,528 from related parties, respectively)	1,450	629	4,082	2,528
Other (including \$0, \$271, \$0 and \$698 from related parties, respectively)	340	423	1,094	932
Subtotal of non-advertising cost of revenues	4,811	4,928	16,510	13,103
<b>Total cost of revenues</b>	<b>8,387</b>	<b>6,901</b>	<b>26,246</b>	<b>18,428</b>
<b>Gross profit</b>	<b>17,553</b>	<b>15,179</b>	<b>52,896</b>	<b>37,412</b>
<b>Operating expenses:</b>				
Product development	2,462	1,968	6,433	5,642
Sales and marketing	4,600	2,839	11,982	7,366
General and administrative	2,210	1,181	5,534	3,575
Amortization of intangibles	368	—	905	—
<b>Total operating expenses</b>	<b>9,640</b>	<b>5,988</b>	<b>24,854</b>	<b>16,583</b>
<b>Operating profit</b>	<b>7,913</b>	<b>9,191</b>	<b>28,042</b>	<b>20,829</b>
Other expense	(190)	(552)	(594)	(743)
Interest income	641	532	1,849	1,202
<b>Net income before taxes</b>	<b>8,364</b>	<b>9,171</b>	<b>29,297</b>	<b>21,288</b>
Income tax expense	38	6,500	162	6,500
<b>Net income</b>	<b>8,326</b>	<b>2,671</b>	<b>29,135</b>	<b>14,788</b>
<b>Basic net income per share</b>	<b>\$ 0.23</b>	<b>\$ 0.07</b>	<b>\$ 0.80</b>	<b>\$ 0.42</b>
Shares used in computing basic net income per share	36,392	35,824	36,332	35,289
<b>Diluted net income per share</b>	<b>\$ 0.21</b>	<b>\$ 0.07</b>	<b>\$ 0.73</b>	<b>\$ 0.38</b>
Shares used in computing diluted net income per share	40,644	41,643	40,772	39,728

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)**

	Nine Months Ended September 30,	
	2004	2003
Cash flows from operating activities:		
Net income	\$ 29,135	\$ 14,788
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of other assets	4,228	3,638
Amortization of intangible assets	905	—
Tax benefits from stock options	153	6,500
Other	434	580
Changes in assets and liabilities:		
Accounts receivable	(8,800)	(3,376)
Accounts receivable from a related party	—	(6,006)
Prepaid and other current assets	(1,335)	(1,118)
Accounts payable	39	95
Accrued liabilities	9,298	14,204
Net cash provided by operating activities	34,057	29,305
Cash flows from investing activities:		
Long term investments in marketable debt securities	—	(19,108)
Proceeds from maturities of marketable debt securities	24,231	—
Acquisition, net of cash acquired	(16,952)	—
Acquisition of fixed assets	(5,193)	(2,288)
Acquisition of other assets	(2,279)	(1,416)
Cash included in variable interest entities	—	2,642
Net cash used in investing activities	(193)	(20,170)
Cash flows from financing activities:		
Zero coupon convertible senior notes, net	—	87,750
Repurchase of common stock	(17,721)	—
Issuance of common stock	2,956	1,441
Net cash provided by/(used in) financing activities	(14,765)	89,191
Net increase in cash and cash equivalents	19,099	98,326
Cash and cash equivalents at beginning of period	99,109	18,929
Cash and cash equivalents at end of period	\$118,208	\$117,255

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)

	Nine Months Ended September 30,	
	2004	2003
<b>Common stock</b>		
Balance, beginning of period	\$ 36	\$ 35
Issuance of common stock	—	1
Balance, end of period	36	36
<b>Additional paid-in capital</b>		
Balance, beginning of period	140,218	129,881
Issuance of common stock	2,962	1,496
Tax benefit from stock options	153	6,500
Compensatory stock options	(1)	(25)
Balance, end of period	143,332	137,852
<b>Treasury stock</b>		
Balance, beginning of period	(2,003)	(2,003)
Repurchase of common stock	(17,721)	—
Balance, end of period	(19,724)	(2,003)
<b>Accumulated deficit</b>		
Balance, beginning of period	(46,830)	(73,187)
Net income	29,135	14,788
Balance, end of period	(17,695)	(58,399)
<b>Accumulated other comprehensive income/(loss)</b>		
Balance, beginning of period	232	547
Net unrealized losses on marketable debt securities	(168)	(90)
Foreign currency translation adjustment	(2)	(11)
Balance, end of period	62	446
<b>Deferred Compensation</b>		
Balance, beginning of period	(14)	(42)
Compensatory stock options	10	22
Balance, end of period	(4)	(20)
<b>Total stockholders' equity</b>	<b>\$ 106,007</b>	<b>\$ 77,912</b>
<b>Comprehensive Income:</b>		
Net income	29,135	14,788
Other comprehensive loss:		
Net unrealized losses on marketable debt securities	(168)	(90)
Foreign currency translation adjustment	(2)	(11)
<b>Total comprehensive income</b>	<b>28,965</b>	<b>14,687</b>
<b>Number of Shares</b>		
<b>Common stock</b>		
Balance, beginning of period	36,101	34,611
Issuance of common stock	1,346	1,371
Repurchase of common stock	(1,000)	—
Balance, end of period	36,447	35,982

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

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

### 1. THE COMPANY AND BASIS OF PRESENTATION

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

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

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

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

### 2. SEGMENT INFORMATION

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

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

### 3. ACQUISITION

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

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

Tangible assets acquired	\$ 2,176
Identifiable intangible assets	4,526
Goodwill	11,897
	<hr/>
Liabilities assumed	(446)
	<hr/>
Total	\$18,153
	<hr/>

The excess of purchase price over tangible assets and identifiable intangible assets (mainly including content, platform, customer relationships, trademark and non-compete agreements) acquired and liabilities assumed was recorded as goodwill. Identifiable intangible assets associated with the acquisition are amortized over their expected useful lives of one to fifteen years. The allocation of the purchase price is based on the final valuation report from a third party that was finalized in the third quarter of 2004.

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

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
<b>Numerator:</b>				
Net income	\$ 8,326	\$ 2,671	\$29,135	\$14,788
<b>Effect of dilutive securities:</b>				
Liquidated damages	9	—	166	—
Amortization of offering costs for the zero coupon convertible senior notes	189	166	589	166
Net income adjusted for dilutive securities	\$ 8,524	\$ 2,837	\$29,890	\$14,954
<b>Denominator:</b>				
Weighted average basic common shares outstanding	36,392	35,824	36,332	35,289
<b>Effect of dilutive securities:</b>				
Stock options	2,241	4,180	2,429	3,887
Zero coupon convertible senior notes	2,011	1,639	2,011	552
Weighted average diluted common shares outstanding	40,644	41,643	40,772	39,728
Basic net income per share	\$ 0.23	\$ 0.07	\$ 0.80	\$ 0.42
Diluted net income per share	0.21	\$ 0.07	\$ 0.73	\$ 0.38



[Table of Contents](#)**5. STOCK BASED COMPENSATION**

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net income as reported:	\$ 8,326	\$ 2,671	\$29,135	\$14,788
Add: Stock-based compensation expense included in reported net income	(3)	5	10	22
Deduct: Stock-based compensation expense determined under fair value based method	(2,031)	(1,233)	(4,978)	(2,611)
Pro forma net income attributable to common shareholders	\$ 6,294	\$ 1,443	\$24,167	\$12,199
Basic net income per share:				
As reported	\$ 0.23	\$ 0.07	\$ 0.80	\$ 0.42
Pro forma	\$ 0.17	\$ 0.04	\$ 0.67	\$ 0.35
Diluted net income per share:				
As reported	\$ 0.21	\$ 0.07	\$ 0.73	\$ 0.38
Pro forma	\$ 0.16	\$ 0.04	\$ 0.61	\$ 0.31

**6. VARIABLE INTEREST ENTITIES (“VIEs”) AND RELATED PARTY TRANSACTIONS***(1) VIEs*

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

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

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

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

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

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

c) Beijing Hengda Yitong Internet Technology Development Co., Ltd. (“Hengda”)

Hengda was incorporated in the PRC in 2002 and engages in Internet access and wireless services in the PRC on behalf of the Company. The registered capital of Hengda is \$1,210,000. High Century and Li Wei hold 80% and 20% interests in Hengda, respectively.

d) Beijing Sohu Internet Information Service Co., Ltd. (“Sohu Internet”)

Sohu Internet was incorporated in the PRC in 2003 and engages in Internet information and wireless services in the PRC on behalf of the Company. The original registered capital was \$605,000 and High Century and Li Wei held 80% and 20% interests in Sohu Internet, respectively. Hengda made a \$605,000 investment in Sohu Internet in December 2003, and, as a result, the registered capital is now \$1,210,000, with Hengda, High Century and Li Wei holding 50%, 40% and 10% interests, respectively.

e) Beijing Goodfeel Information Technology Co., Ltd. (“Goodfeel”)

Goodfeel was incorporated in the PRC in 2001 and engages in value added wireless services in the PRC. The registered capital of Goodfeel is currently \$1,208,000. In May 2004, High Century and Sohu Internet acquired 73% and 27% interests in Goodfeel, respectively. In July 2004, High Century and Hengda invested \$613,000 and \$473,000 in Goodfeel, respectively, so that High Century owned a 58.1% interest in Goodfeel with the remaining 41.9% interest owned by Hengda.

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

As of September 30, 2004, the aggregate accumulated losses of the above VIEs were approximately \$415,000 and have been reflected in the consolidated financial statements.

### *(2) Related party transactions*

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

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The following table summarizes related party transactions during the three and nine months ended September 30, 2004 and 2003, respectively (in thousands):

Name or description of Related party	Description of transactions	Three Months Ended September 30,		Nine Months Ended September 30,	
		2004	2003	2004	2003
Beijing Sohu	Wireless revenues	—	7,403	—	26,858
	Wireless cost of revenues	—	1,831	—	7,598
	Ecommerce revenues	—	692	—	2,851
	Ecommerce cost of revenues	—	607	—	2,441
	Service provided by Beijing Sohu	—	36	—	108
Hengda	Other revenues from a related party	—	335	—	669
	Cost of other revenues	—	271	—	698
Qinfan, a company controlled by Dr. Zhang's brother	Delivery service provided by Qinfan	28	22	94	87
An investee of one of the Company's shareholders	Advertising revenues	104	—	319	—
A Company whose founder, Chief Executive Officer and Chairman is one of the directors of the Company	Advertising revenues	—	—	30	—

In August 2004, we made a \$997,000 investment in a game developing company (the "Investee") which licensed the Company to operate an online game in 2003. As of September 30, 2004, the Company had included (i) \$159,000 of receivables from the Investee in prepaid and other current assets and (ii) \$190,000 of net licensing fees paid to the Investee in 2003 as non-current assets. During the three months ended September 30, 2004, the Company recorded \$25,000 of amortization of the licensing fees paid to the Investee.

### 7. COMMITMENTS AND CONTINGENCIES

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

In September 2004, the Company entered into a preliminary agreement with a landlord, pursuant to which the Company will lease certain office and warehouse space. The preliminary agreement includes terms that the lease with respect to approximately 10,372 square meters of the office space will commence on January 1, 2005, the lease with respect to approximately 2,584 square meters of the office space will commence on September 1, 2005 and the lease with respect to approximately 2,580 square meters of the office space will commence on February 1, 2006, with each term ending on December 31, 2009. Upon the expiration of the lease terms, the Company has an option to renew the lease for an additional three-year period.

### 8. RECENT ACCOUNTING PRONOUNCEMENT

In June 2004, the Emerging Issue Task Force ("EITF") reached a consensus on Issue No. 03-01, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("EITF No. 03-01"). This Issue addresses when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. EITF No. 03-01 is effective for reporting periods beginning after June 15, 2004. The Company does not believe that the adoption of EITF No. 03-01 will have a significant impact on its financial statements.

## 9. SUBSEQUENT EVENTS

In October 2004, the Board of Directors of the Company continued and expanded the stock repurchase program announced by the Company in April 2004. Under the expanded program, the Company plans to purchase from time to time up to \$20 million worth of outstanding shares of its common stock in the open market. This includes approximately \$12.2 million which remains unspent from the amount approved in April 2004 and an additional \$7.8 million approved by the Board in October 2004.

In October 2004, to further satisfy PRC regulations, the Company entered into loan and share pledge agreements with Deng Xiufeng and Zhou Jing, two employees of the Company, pursuant to which the Company extended loans of \$702,000 to Deng Xiufeng and \$506,000 to Zhou Jing to purchase all of the shares of Goodfeel. Deng Xiufeng will purchase the 58.1% interest in Goodfeel from High Century and Zhou Jing will purchase the 41.9% interest in Goodfeel from Hengda. In November 2004, the Company entered into loan and share pledge agreements with Wang Jianjun and Wang Xin, two employees of the Company, pursuant to which the Company extended loans of \$241,546 to Wang Jianjun and \$966,184 to Wang Xin to purchase all of the shares of Hengda. Wang Jianjun will purchase the 20% interest in Hengda from Li Wei and Wang Xin will purchase the 80% interest in Hengda from High Century. The share transfers have been registered with local authorities in the PRC.

Under the loan and share pledge agreements, the four employees of the Company who are shareholders of Goodfeel and Hengda are required to transfer their ownership in these entities to the Company, if permitted by PRC laws and regulations, or, if not so permitted, to designees of the Company at any time to repay the loans outstanding. All voting rights of Goodfeel and Hengda are assigned to the Company, and the Company has the right to designate all directors and senior management personnel of Goodfeel and Hengda. The four employees of the Company who are shareholders of Goodfeel and Hengda have pledged their shares in Goodfeel and Hengda as collateral for the loans. The Company believes that the arrangements have no significant impact on the financial statements of the Company.

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

*As used in this report, references to "us," "we," "our," "our company," "Sohu" and "Sohu.com" are to Sohu.com Inc., and, except where the context requires otherwise, our subsidiaries ChinaRen Inc. (or ChinaRen), Sohu.com (Hong Kong) Limited (or Sohu Hong Kong), Sohu.com Limited, Kylie Enterprises Limited, All Honest International Limited, Sohu ITC Information Technology (Beijing) Co., Ltd. (or Beijing ITC), Beijing Sohu New Era Information Technology Co., Ltd. (or Sohu Era), and Beijing Sohu Interactive Software Co., Ltd. (or Sohu Software), and our VIEs Beijing Sohu Online Network Information Services, Ltd. (or Beijing Sohu), Beijing Century High Tech Investment Co., Ltd. (or High Century), Beijing Hengda Yitong Internet Technology Development Co., Ltd. (or Hengda), Beijing Sohu Internet Information Service Co., Ltd. (or Sohu Internet), and Beijing Goodfeel Information Technology Co., Ltd. (or Goodfeel) and these references should be interpreted accordingly. Unless otherwise specified, references to "China" or "PRC" refer to the People's Republic of China and do not include the Hong Kong Special Administrative Region, the Macau Special Administrative Region or Taiwan. This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding our expectations, beliefs, intentions or future strategies that are signified by the words "expect," "anticipate," "intend," "believe," or similar language. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Our business and financial performance are subject to substantial risks and uncertainties. Actual results could differ materially from those projected in the forward-looking statements. In evaluating our business, you should carefully consider the information set forth below under the caption "Risk Factors." Readers are cautioned not to place undue reliance on these forward-looking statements.*

## OVERVIEW

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

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

## CRITICAL ACCOUNTING POLICIES AND MANAGEMENT ESTIMATES

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

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

Sponsorship contracts may include services similar to those in our 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.

Wireless revenues and corresponding cost of revenues are included within non-advertising revenues and cost of revenues. Wireless revenues are derived from providing short messaging services (“SMS”), multimedia messaging services (“MMS”), web application protocol services (“WAP”) and interactive voice response services (“IVR”), mainly consisting of alumni club and other community products, e-mail, ring tone and logo downloads, news, and various other mobile related products, to mobile phone users. Wireless service fees are charged on a monthly or per message basis. Wireless revenues and cost of revenues are recognized in the month in which the service is performed, provided no significant Sohu obligations remain. We rely on a number of mobile network operators in China to bill mobile phone users for wireless service fees. In order to meet ownership requirements under PRC law which restrict or prohibit wholly foreign owned enterprises from providing Internet information and value added telecommunication services such as wireless, we rely on Beijing Sohu, Sohu Internet and Goodfeel to contract with the mobile operators. Generally, (i) within 15 to 90 days after the end of each month, Beijing Sohu, Sohu Internet or Goodfeel receives a statement from each of the operators confirming the amount of wireless service charges billed to that operator’s mobile phone users and (ii) within 30 to 120 days after delivering a monthly statement, each operator remits the wireless service fees, net of its service fees, for the month to Beijing Sohu, Sohu Internet or Goodfeel, which are required to transfer the funds to our subsidiary Sohu Era under contractual arrangements. 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 are unable to collect certain wireless services fees from an operator in certain circumstances due to technical issues with the operator’s network. This is referred to as the “failure rate,” which can vary from operator to operator. At the end of each reporting period, where an operator has not provided Beijing Sohu, Sohu Internet or Goodfeel with the monthly statement for any month confirming the amount of wireless service charges billed to that operator’s mobile phone users for the month, Sohu, using information generated from its

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own internal system and historical data, makes estimates of the failure rate and collectable wireless service fees and accrues revenue accordingly. The quarterly historical differences in our estimated revenue which was recorded in the financial statements compared to the actual revenue have ranged from an underestimation of \$400,000 (gross margin underestimate of \$300,000) to an overestimation of \$160,000 (gross margin overestimate of \$120,000) since 2002 when wireless revenues represented a significant portion of our total revenues. We believe we have the ability to make a reasonable estimate. However, material differences could result in the amount and timing of our revenue and non-advertising cost of revenue for any period because of differences between the actual failure rate per an operator's statement and our internal records. For the three months ended September 30, 2004, 94% of our wireless revenues had been confirmed by the monthly statements received from the mobile operators.

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

Our management must determine whether to record revenue for our wireless and e-commerce business lines using the gross or net method of reporting. Determining whether revenue should be reported gross or net is based on an assessment of various factors, principally whether Sohu is acting as the principal in offering services to the customer or whether Sohu is acting as an agent in the transaction. To the extent Sohu is acting as a principal in a transaction Sohu reports as revenue the payments received on a gross basis and reports as costs of revenue the amounts attributable to goods and services provided by third party operators and other vendors. To the extent Sohu is acting as an agent in a transaction Sohu reports as revenue the payments received less commissions and other payments to third parties, i.e., on a net basis. The determination of whether Sohu is serving as principal or agent in a transaction is judgmental in nature and based on an evaluation of the terms of an arrangement. Based on our assessment, our wireless revenues are recorded on a gross basis. We have primary responsibility for fulfillment and acceptability of the wireless services. The content and nature of the wireless services are designed and developed by us (either independently or with third parties) and originate from our Web sites, our links located on third parties' Web sites, or one of our dedicated phone numbers. The mobile operators that we contract with to deliver these services to the end customers are not involved in the design or development of the services that are provided by us. The end customer purchases the wireless content, community access or value added services, such as our online dating, mobile email and mobile alumni club that Sohu provides. The end customer receives identical services from us regardless of which third party mobile operator is used to deliver the message. In addition, when customers register on Sohu's Web sites to use wireless services, they execute an online contract with us that sets forth our obligations to the customer and the terms of the service that will be provided. Sohu has determined that in addition to the indicators of gross reporting, there are also certain indicators of net reporting, including the fact that the mobile operators set maximum prices that Sohu can charge and that the contracts call for the assumption of credit risk by the mobile operators after a certain fixed percentage is paid by Sohu as an estimated bad debt expense. This is part of the overall fees paid to the operators. The mobile operators also have the right to set regulations and procedures associated with using their platform. However, Sohu has determined that the gross revenue reporting indicators are stronger, because Sohu is the primary obligor, adds value to the products, has inventory risk related to content and products, and has reasonable pricing latitude.

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

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

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Our management must make estimates of the uncollectability of our accounts receivables. Management specifically analyzes accounts receivable, historical bad debts, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. Our accounts receivable balance was \$21.2 million net of allowance for doubtful accounts of \$0.7 million as of September 30, 2004. If the financial condition of Sohu's customers or telecom operators were to deteriorate, resulting in their inability to make payments, additional allowance might be required.

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

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

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

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

As of September 30, 2004, we had not recorded any impairment of our intangibles and goodwill. We are reviewing whether there is any indication of such impairment, which we expect to be completed in the fourth quarter of 2004.

## **RESULTS OF OPERATIONS FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003**

### **REVENUES**

Total revenues were \$25.9 million and \$79.1 million for the three and nine months ended September 30, 2004, respectively, as compared to \$22.1 million and \$55.8 million for the corresponding periods in 2003.

### **Advertising Revenues**

Advertising revenues increased by \$6.7 million to \$15.5 million for the three months ended September 30, 2004 and increased by \$19.8 million to \$39.9 million for the nine months ended September 30, 2004 as compared to the corresponding periods in 2003. The increase of \$6.7 million for the three months ended September 30, 2004 from the corresponding period in 2003 consisted of: (i) \$9.9 million from new advertisers, as more companies used the Internet as an advertising medium; (ii) a \$1.3 million net increase in revenues from the advertisers who advertised with us in the three months ended September 30, 2003 and who continued to do so in the three months ended September 30, 2004; and (iii) a \$1.0 million increase in fees we receive for listing companies in our search directory, offset by a reduction of \$5.5 million in revenues from some of our 2003 advertisers not advertising on our Web site in the three months ended September 30, 2004. The increase of \$19.8 million for the nine months ended September 30, 2004 from the corresponding period in 2003 consisted of: (i) \$21.4 million from new advertisers, as more companies used the Internet as an advertising medium; (ii) a \$4.7 million net increase in revenues from the advertisers who advertised with us in the nine months ended September 30, 2003 and who continued to do so in the nine months ended September 30, 2004; and (iii) a \$3.1 million increase in fees we receive for listing companies in our search directory, offset by a reduction of \$9.4 million in revenues from some of our 2003 advertisers not advertising on our Web site in the nine months ended September 30, 2004. During the three months ended September 30, 2004, revenues of \$2.0 million were generated from our 2004

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Olympic channel. No single customer accounted for more than 10% of total advertising revenues for each of the three and nine months ended September 30, 2004 and 2003. Revenue from advertising barter transactions was not recognized but offset cost of advertising revenues. As of September 30, 2004 and 2003, we had \$5.4 million and \$4.0 million of deferred revenues, respectively.

We expect advertising revenues to be flat or increase in the fourth quarter of 2004 as compared to the third quarter of 2004.

### **Non-advertising Revenues**

Non-advertising revenues are derived principally from wireless, e-commerce and other services. Non-advertising revenues decreased by \$2.9 million to \$10.5 million for the three months ended September 30, 2004 and increased by \$3.5 million to \$39.3 million for the nine months ended September 30, 2004 as compared to the corresponding periods in 2003.

*Wireless.* Wireless revenues decreased by \$3.5 million to \$8.1 million for the three months ended September 30, 2004 and increased by \$546,000 to \$31.7 million for the nine months ended September 30, 2004 as compared to the corresponding periods in 2003. The decrease for the three months ended September 30, 2004 from the corresponding period in 2003 was primarily due to a decrease of \$6.9 million in SMS revenue, as a result of the high churn rate of our older products and stricter billing policies enforced by mobile operators, offset by (i) an increase of \$1.9 million in revenues from MMS, WAP and IVR and (ii) revenues of \$1.5 million as a result of the acquisition of Goodfeel. The increase for the nine months ended September 30, 2004 from the corresponding period in 2003 was primarily due to: (i) an increase of \$4.3 million in revenues from MMS, WAP and IVR and (ii) revenues of \$2.0 million as a result of the acquisition of Goodfeel, offset by a decrease of \$5.8 million in revenues from SMS.

During the three months ended September 30, 2004, wireless revenues of \$1.1 million were derived from MMS services. Effective September 1, 2004, our MMS services were temporarily suspended by China Mobile Communication Corporation ("CMCC") for a one-year period. As a result, we expect no MMS revenues to be derived in the fourth quarter of 2004. We expect SMS revenue to decrease further in the fourth quarter of 2004 as a result of tightened controls over new billing procedures and practices by CMCC and China Unicom Co., Ltd. ("Unicom"). We expect our overall wireless revenues to decrease in the fourth quarter of 2004 as compared to the third quarter of 2004. There could be further decreases in the future.

*E-commerce.* E-commerce revenues are earned primarily from sales of consumer products through Sohu's Web site. In 2001, we established store.sohu.com, where we undertake fulfillment e-commerce activities and conduct e-commerce transactions. Our e-commerce products consist of over 4,000 consumer products, such as books, health care products, videos, music and computer equipment. We purchase products from suppliers, stock the goods in our warehouse and, upon receiving the orders, arrange for delivery to our customers. Fulfillment is provided by delivery companies or through postal services. Substantially all sales are done on a cash on delivery basis. E-commerce revenues increased by \$794,000 to \$1.5 million for the three months ended September 30, 2004 and increased by \$1.3 million to \$4.2 million for the nine months ended September 30, 2004 as compared to the corresponding periods in 2003.

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

## **COSTS AND EXPENSES**

### **Cost of Revenues**

Total cost of revenues was \$8.4 million and \$26.2 million for the three and nine months ended September 30, 2004, respectively, as compared to \$6.9 million and \$18.4 million for the corresponding periods in 2003.

### **Advertising Cost of Revenues**

Advertising cost of revenues increased by \$1.6 million to \$3.6 million for the three months ended September 30, 2004 and increased by \$4.4 million to \$9.7 million for the nine months ended September 30, 2004 as compared to the corresponding periods in 2003. Advertising cost of revenues includes personnel costs and personnel overhead, content purchases, depreciation and bandwidth. The increase for the three months ended September 30, 2004 from the corresponding period in 2003 was primarily due to a \$601,000 increase in office and depreciation expense, a \$429,000 increase in content and license fees, a \$351,000 increase in personnel expense, a \$104,000 increase in retail revenues sharing with partners, a \$45,000 increase in traveling and entertainment expenses and a \$73,000 increase in other items including training expense and professional fees. The increase for the nine months ended September 30, 2004 from the corresponding period in 2003 was primarily due to a \$1.6 million increase in office and depreciation expense, a \$1.1 million increase in personnel expense, a \$926,000 increase in content and license fees, a \$429,000 increase in retail revenues sharing with partners, a \$195,000 increase in traveling and entertainment expenses and a \$200,000 increase in other items including training expense and professional fees. Our advertising gross margin for the three and nine months ended September 30, 2004 was 77% and 76% as compared to 77% and 73% for the corresponding periods in 2003. Our gross margin for the three months ended September 30, 2004 was unchanged due primarily to the higher



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cost of sports channels including our 2004 Olympic channel. Our gross margin improved for the nine months ended September 30, 2004 because of the fixed nature of the advertising costs of revenues, which have not increased at the same rate as revenues.

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

Non-advertising cost of revenues decreased by \$117,000 to \$4.8 million for the three months ended September 30, 2004 and increased by \$3.4 million to \$16.5 million for the nine months ended September 30, 2004, as compared to the corresponding periods in 2003. The increases are consistent with revenue growth.

*Wireless.* Wireless cost of revenues decreased by \$855,000 to \$3.0 million for the three months ended September 30, 2004 and increased by \$1.7 million to \$11.3 million for the nine months ended September 30, 2004, as compared to the corresponding periods in 2003. Wireless cost of revenues consists mainly of collection and wireless transmission charges paid to third party network operators, expenses related to notices of penalties and complaints from CMCC subsidiaries based on allegations of the breach of certain provisions of agreements with the mobile network operators, and fees or royalties paid to third party content providers for services and content associated with our wireless services. The collection and transmission charges vary between third party operators and include a gateway fee of \$0.006 to \$0.0151 per message, depending on the volume of the monthly total wireless messages, and a collection fee of 15% to 30% of total fees collected by the third party operators from mobile phone users and paid to us. Content costs are immaterial as compared to collection and transmission charges. Wireless cost of revenues does not include allocations for Web site operating costs. Our wireless gross margin was 63% and 64% for the three and nine months ended September 30, 2004, respectively, as compared to 67% and 69% for the three and nine months ended September 30, 2003. Wireless gross margin decreased primarily because revenues from high gross margin products decreased. We expect wireless gross margins to decrease by a few points in the coming quarters, after which gross margins are expected to stabilize.

*E-commerce.* E-commerce cost of revenues was \$1.5 million and \$4.1 million for the three and nine months ended September 30, 2004, as compared to \$0.6 million and \$2.5 million for the three and nine months ended September 30, 2003, respectively. E-commerce cost of revenues consists mainly of the purchase price of consumer products sold and inbound and outbound shipping charges. E-commerce cost of revenues does not include allocations for Web site operating costs. The change in e-commerce cost of revenues from the comparative period in 2003 is attributable to the change in sales volume. Our e-commerce gross margin was 2% for each of the three and nine months ended September 30, 2004, respectively, as compared to 9% and 11% for the three and nine months ended September 30, 2003. For the three months ended September 30, 2004, approximately 3.5 percentage points of the reduction in gross margin were attributable to our providing free delivery for orders greater than \$6 and approximately 3.5 percentage points of the reduction were attributable to our lowering sales prices of our products, both of which we instituted in response to product pricing pressures from our competitors in e-commerce, including Joyo, Bertelsmann Online and Dang Dang, and our initiative to gain market share among consumers in Beijing. For the nine months ended September 30, 2004, approximately 3.5 percentage points of the reduction in gross margin were attributable to our providing free delivery for orders greater than \$6 and approximately 5.5 percentage points of the reduction were attributable to our lowering sales prices of our products.

### **Product Development Expenses**

Product development expenses increased by \$494,000 to \$2.5 million for the three months ended September 30, 2004 and increased by \$791,000 to \$6.4 million for the nine months ended September 30, 2004, as compared to the corresponding periods in 2003. The increase for the three months ended September 30, 2004 from the corresponding period in 2003 was primarily due to a \$560,000 increase in personnel expense for additional employees to support our increased investment in our products and online games development and a \$49,000 increase in other items including traveling and entertainment expenses, professional fees and communications, offset by a \$115,000 decrease in office and depreciation expense. The increase for the nine months ended September 30, 2004 from the corresponding period in 2003 was primarily due to a \$1.1 million increase in personnel expense for additional employees and a \$150,000 increase in other items including traveling and entertainment expenses, professional fees and communications, offset by a \$461,000 decrease in office and depreciation expenses.

### **Sales and Marketing Expenses**

Sales and marketing expenses increased by \$1.8 million to \$4.6 million for the three months ended September 30, 2004 and increased by \$4.6 million to \$12.0 million for the nine months ended September 30, 2004, as compared to the corresponding periods in 2003. The increase for the three months ended September 30, 2004 from the corresponding period in 2003 was primarily due to a \$972,000 increase in advertising and promotion expense to support our marketing strategy, a \$349,000 increase in personnel expenses, primarily the result of increased bonuses and commissions from increased advertising revenues, a \$202,000 increase in traveling and entertainment expenses, a \$154,000 increase in bad debt expense, and a \$84,000 increase in other items including office and depreciation expense and professional fees. The increase for the nine months ended September 30, 2004 from the corresponding period in 2003 was primarily due to a \$2.2 million increase in

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advertising and promotion expense, a \$1.1 million increase in personnel expenses, primarily the result of increased bonuses and commissions, a \$529,000 increase in traveling and entertainment expenses, a \$490,000 increase in bad debt expense, and a \$273,000 increase in other items including office and depreciation expense and professional fees.

### **General and Administrative Expenses**

General and administrative expenses increased by \$1.0 million to \$2.2 million for the three months ended September 30, 2004 and increased by \$2.0 million to \$5.5 million for the nine months ended September 30, 2004, as compared to the corresponding periods in 2003. The increase for the three months ended September 30, 2004 was primarily due to a \$673,000 increase in professional fees, a \$170,000 increase in personnel expenses, a \$94,000 increase in other items including office, depreciation and training expenses, and a \$92,000 increase in traveling and entertainment expenses. The increase for the nine months ended September 30, 2004 was primarily due to a \$851,000 increase in professional fees, a \$641,000 increase in personnel expenses, a \$155,000 increase in traveling and entertainment expenses and a \$311,000 increase in other items including office, depreciation and training expenses.

### **Amortization of Intangibles**

Amortization of intangibles of \$368,000 and \$905,000 for the three and nine months ended September 30, 2004, respectively, was related to the acquisitions of the Focus.cn and 17173.com Web sites in the fourth quarter of 2003 and of Goodfeel in the second quarter of 2004. There was no amortization of intangibles recorded during the three and nine months ended September 30, 2003.

### **Operating Profit**

As a result of the foregoing, we had an operating profit of \$7.9 million and \$28.0 million for the three and nine months ended September 30, 2004 as compared to \$9.2 million and \$20.8 million for the three and nine months ended September 30, 2003.

### **Other Expense**

For the three and nine months ended September 30, 2004, other expense of \$190,000 and \$594,000, respectively, consisted mainly of amortization of the offering costs of our zero coupon convertible senior notes. For the three and nine months ended September 30, 2003, other expense of \$552,000 and \$743,000, respectively, consisted mainly of valuation allowances for long-term loans to related parties and amortization of the offering costs of our zero coupon convertible senior notes.

### **Interest Income**

For the three and nine months ended September 30, 2004, interest income was \$641,000 and \$1.8 million, as compared to \$532,000 and \$1.2 million for the three and nine months ended September 30, 2003. The increases were mainly due to our increased cash balance and marketable securities, as a result of our private placement of zero coupon convertible senior notes in July 2003 and an increase in our profits, and to a lesser extent an increase in interest rates.

### **Income Tax Expense**

Income tax expense decreased to \$38,000 and \$162,000 for the three and nine months ended September 30, 2004, respectively, as compared to \$6.5 million of income tax expense for each of the corresponding periods in 2003. The decreases in income tax expense are the result of a tax restructuring undertaken during the three months ended September 30, 2003.

### **Net Income**

As a result of the foregoing, we had net income of \$8.3 million and \$29.1 million for the three and nine months ended September 30, 2004, as compared to net income of \$2.7 million and \$14.8 million for the corresponding periods in 2003.

## **LIQUIDITY AND CAPITAL RESOURCES**

We have financed our operations principally through sales of equity securities and convertible notes, and cash provided by operations. From inception through September 30, 2004, we have raised net proceeds of \$39.2 million through the sale of preferred stock in private placements, \$52.4 million from the sale of common stock in our initial public offering and \$87.4 million through the sale of zero coupon convertible senior notes, as described below. Sohu invests its excess cash in marketable debt securities of high quality investment grade. As of September 30, 2004, we had cash, cash equivalents, and investments in marketable debt securities totaling approximately \$137.3 million as compared to \$142.6 million as of December 31, 2003.

We completed a private placement on July 14, 2003 of \$90.0 million principal amount of zero coupon convertible senior notes due July 2023, which resulted in net proceeds to Sohu of approximately \$87.4 million after deduction of the initial purchaser's discount and our offering expenses. The notes do not pay any interest, have a zero yield to maturity, and are convertible into Sohu's common stock at a conversion price of \$44.76 per

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share, subject to adjustment. Each \$1,000 principal of the notes is initially convertible into 22.3414 shares of Sohu's common stock. Each holder of the notes will have the right, at the holder's option, to require Sohu to repurchase all or any portion of the principal amount of the holder's notes on July 14 in 2007, 2013 and 2018 at a price equal to 100% of the outstanding principal amount. Sohu may also redeem all or a portion of the notes for cash at any time on or after July 14, 2008 at 100% of the principal amount of the notes if the closing price of Sohu's common stock for each of the 30 consecutive trading days prior to such time was at least 130% of the conversion price or at such time at least 90% of the initial aggregate principal amount of the notes have been converted, repurchased or redeemed. In addition, upon a change of control event, each holder of the notes may require Sohu to repurchase some or all of its notes at a repurchase price equal to 100% of the principal amount of the notes plus accrued and unpaid interest. We have filed a registration statement with the Securities and Exchange Commission to register for resale the notes and the common stock issuable upon conversion of the notes, which registration statement was declared effective by the Securities and Exchange Commission on July 8, 2004. Because the registration statement was not declared effective by January 10, 2004, we were required to pay liquidated damages of \$166,000, consisting of interest on the outstanding principal of the notes at the initial annual rate of 0.25% for the first 90 days after January 10, 2004 and thereafter until July 8, 2004 at the annual rate of 0.50%.

In October 2004, our Board of Directors continued and expanded the stock repurchase program we announced in April 2004. Under the expanded program, we plan to purchase from time to time up to \$20.0 million worth of outstanding shares of our common stock in the open market. This includes approximately \$12.2 million which remains unspent from the amount approved in April 2004, and an additional \$7.8 million approved by the Board in October. Any such purchases will depend upon market conditions. Management does not believe the repurchases will have a material effect on Sohu's liquidity.

Net cash provided by operating activities was approximately \$34.1 million for the nine months ended September 30, 2004, and was primarily attributable to our net income of \$29.1 million, depreciation and amortization of other assets of \$4.2 million, amortization of intangibles of \$905,000, and other adjustments of \$587,000 for non-cash activities, offset by \$798,000 of cash used as working capital. Net cash provided by operating activities was \$29.3 million for the nine months ended September 30, 2003, primarily due to our net income of \$14.8 million for the period, tax benefits from stock options of \$6.5 million, depreciation and amortization of \$3.6 million, other adjustments of \$580,000, and a decrease of \$3.8 million in working capital.

Net cash used in investing activities was \$193,000 for the nine months ended September 30, 2004, and was primarily attributable to \$17.0 million used in the acquisition of Goodfeel, the purchase of fixed assets of \$5.2 million and the acquisition of other assets of \$2.3 million, largely offset by cash received from matured marketable debts of \$24.2 million. Net cash used in investing activities was \$20.2 million for the nine months ended September 30, 2003, primarily due to long term investments in marketable debt securities of \$19.1 million, the purchase of fixed assets for \$2.3 million and the acquisition of other assets of \$1.4 million, partially offset by \$2.6 million in cash included in VIEs.

Net cash used in financing activities was \$14.8 million for the nine months ended September 30, 2004 and was attributable to \$17.7 million of repurchases of one million shares of our common stock offset by \$3.0 million of proceeds from the issuance of common stock pursuant to our stock incentive plan. Net cash provided by financing activities was \$89.2 million for the nine months ended September 30, 2003, due to net proceeds of \$87.8 million from the private placement of our zero coupon convertible senior notes and proceeds of \$1.4 million from issuance of common stock pursuant to our stock incentive plan.

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

### **Risk Factors**

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

We incurred significant net losses from our inception in August 1996 through the quarter ended June 30, 2002. We had an accumulated deficit of approximately \$17.7 million at September 30, 2004. We may incur substantial net losses in the future due to the relative high risk associated with our revenue and the high level of planned operating and capital expenditures, including sales and marketing costs, personnel hires, and product development. Although we recorded net profits varying from \$112,000 to \$11.6 million from the quarter ended September 30, 2002 through the quarter ended September 30, 2004, we may not sustain profitability or our profitability could decrease.

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

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

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

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

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

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

There are many companies that provide or may provide Web sites and online destinations targeted at Internet users in China. Our major competitors in China include (i) U.S. listed and China based companies, such as Sina Corporation, Netease, Shanda, Tom Online, Kongzhong, and Linktone; (ii) Hong Kong listed companies such as Tencent; and (iii) major United States Internet companies, such as Yahoo! Inc and Google. These competitors may also improve or enhance their positions in the PRC Internet market through mergers and acquisitions. In addition, we may face competition from existing or new domestic PRC Internet companies. 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

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- larger customer bases.

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

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

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

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

We derive a significant portion of our revenues, and expect to derive a significant portion of our revenues for the foreseeable future, from the sale of advertising on our Web sites. Advertising revenues represented approximately 50% and 36% of our total revenues for the nine months ended September 30, 2004 and September 30, 2003, respectively.

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

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

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

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

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

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

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

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

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

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

We derive a significant portion of our revenues from wireless services. We derive our wireless revenue from providing SMS, MMS,

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WAP and IVR, mainly consisting of alumni club and other community products, e-mail, ringtone and logo downloads and news, to mobile phone users. For the nine months ended September 30, 2004 and September 30, 2003, wireless revenues represented approximately 40% and 56%, respectively, of our total revenues. Wireless revenues decreased in the first, second and third quarters of 2004. Wireless revenues may decrease further in the future due to the possibilities that:

- Our consumers may not understand our services or the fees they are being charged, may not be satisfied with our services and/or may not use our services on a regular basis;
- Consumers may cancel their services at any time without notice;
- Currently over 50% of our SMS revenue is from consumers who subscribe for individual services for which we charge a monthly fee ranging from approximately \$0.36 to \$3.60. During the quarter ended September 30, 2004, we continued to churn out of our old community products, which led to a downward trend of our wireless revenues from SMS services.
- We rely on revenue growth from new wireless services such as WAP and IVR. We are not certain that revenues from these services will become a significant portion of our total wireless revenues.
- We face intense competition from a number of companies who may launch competing or better products than us at any time. In addition, there are limited barriers to entry in this area;
- Changes in government policy could restrict or curtail the services which we provide; and
- The maximum SMS fees we are able to charge mobile phone users may be reduced. Certain CMCC subsidiaries have required us to reduce fees in the past, and other CMCC subsidiaries may require us to reduce fees in the future.
- CMCC and its subsidiaries are establishing a new billing platform, have required us to switch to this platform in certain provinces, and may require us to switch to this platform in other provinces in the near future. The new platform resulted and may result in higher failure rates or lower revenues associated with changes in the billing procedures. As a result, SMS revenues may further decrease.
- Effective September 1, 2004, our MMS services were temporarily suspended by CMCC for a one-year period. As a result, we expect no MMS revenues to be derived during the suspension period.

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

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

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

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

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

- We provide wireless services through our Web site and record the delivery of the service in our internal systems. However, in order to recognize revenue and get paid for services provided, we rely on billing confirmations from CMCC and Unicom as to the actual amount of services they have billed to their mobile customers. We are unable to collect wireless service fees from an operator in certain circumstances due to technical issues with the operator's network. We refer to these failures as an operator's "failure rate," which can vary from operator to operator. An operator's failure rate can vary from month to month, ranging from 0% to 86% and may change at any time without notice. If an operator encounters technical problems, increases in the failure rate for that operator could occur.
- CMCC and its subsidiaries are establishing a new billing platform, have required to switch to this platform in certain provinces, and may require us to switch to this platform in other provinces in the near future. The new platform resulted and may result in higher failure rates or lower revenues associated with changes in the billing procedures.
- The service fees we pay for using an operator's infrastructure are set based on the negotiation of annual contracts. Our contract with Unicom will expire in March 2005. Our contracts with CMCC expire at various times from November 2004 to May 2006. Our negotiating power is limited and if an operator increases its service fees, or does not comply with the terms of our contract, our gross margin and profitability could be materially reduced. Based on recent communications with an operator, certain subsidiaries of the operator are considering increasing their service fees.
- We rely on the operators to collect on our behalf the wireless service fees which they have billed to the mobile customers. If an operator refuses to pay us or limits the amount of wireless service fees which can be billed in a month, our revenues could be adversely affected. We also are required to follow the operators' guidance in setting up wireless service fees. If an operator requires us to reduce the wireless service fees charged to mobile customers, our revenue could decrease significantly.
- An operator could launch competing services at any time.
- The refusal of an operator to allow us to supply certain services or its refusal to allow us to charge our desired prices for our services could disrupt our wireless services. For example, effective September 1, 2004, our MMS services have been temporarily suspended by CMCC for one year, based on allegations that Beijing Sohu breached certain provisions of its agreement with a CMCC subsidiary.
- CMCC set up rules for ranking of WAP service providers on its Monternet browser, which has a significant impact on WAP revenues. CMCC may change the rules at any time. In the third quarter of 2004, the ranking of Goodfeel went down from first page to second page on the Monternet browser. As a result, the growth of WAP revenues was lower than expected. Our ranking may drop further.
- If CMCC or Unicom were unwilling to cooperate with us, we would not be able to find substitute partners.
- Pursuant to the regulations of CMCC and Unicom, Sohu has the right to charge consumers who have registered to be billed on a monthly basis even if they do not use our services in any month or on a regular basis. If CMCC and Unicom were to disallow us from billing consumers who do not actively use our services, our wireless revenue would be adversely affected.
- CMCC and Unicom have both recently changed their operating regulations and may make any further changes at any time. Such recent or any such future changes could result in our being required to pay penalties for breaching or being alleged to have breached certain provisions of our agreement with CMCC or Unicom under new billing rules or revised operation procedures, or having our service discontinued with or without notice. Changes in these operating regulations could also have a material impact on our revenue. For example, in July 2003, CMCC disallowed us from using third party Web sites which do not have Internet content provider licenses, or Web site union, to promote our e-subscriptions products.

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

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

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

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

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

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

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

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

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

We are required under generally accepted accounting principles to review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization, and slower growth rates in our industry. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined. At September 30, 2004, our goodwill and amortizable intangible assets arising from acquisitions were \$51.6 million.

***We will not be able to attract visitors, advertisers, wireless, e-commerce and online game 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, wireless, e-commerce and online game customers, we may need to substantially increase our expenditures for creating and maintaining brand loyalty. If our revenues do not increase proportionately, our results of operations and liquidity will suffer.

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



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### ***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 websites 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 websites 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 and we may lose certain exclusive deals when they are up for renewal.

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

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

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

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

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

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

We have limited operational, administrative and financial resources, which may be inadequate to sustain the growth we want to achieve. As our audience and their Internet use increase, as the demands of our audience and the needs of our customers change and as the volume of online advertising, wireless, e-commerce and online gaming 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.

### ***The relocation of our Beijing head office may adversely affect our business.***

We plan to move our Beijing head office to Beijing Zhongguancun Science Park in late 2004 and early 2005. This move may adversely affect our business in a number of ways, including the following:

- Our current office is located in the mid-eastern part of Beijing, which is a well-developed business district and attracts many well-known international companies, while our new office is in the northwestern part of Beijing, which is a newly-developed area and lacks abundant business facilities. This may inconvenience our business associates when they visit Sohu.

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- Because (i) the new office is located in a relatively remote area, especially when compared to the area where our current office located, and (ii) many employees have purchased real estate near the area where our current office is located, a significant number of our employees may leave Sohu.
- We may lose some business and our revenue could be affected as a result of the change in address and telephone number caused by the office move.

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

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

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

We conduct our Internet and value added telecommunication operations solely in the PRC through our indirect wholly owned subsidiaries, Beijing ITC and Sohu Era, and VIEs Sohu Internet, Beijing Sohu, Hengda and Goodfeel. We are a Delaware corporation, while Sohu Hong Kong, our indirect wholly owned subsidiary and the parent company of Beijing ITC and Sohu Era, is a Hong Kong corporation and a foreign person under PRC law. In order to meet ownership requirements under PRC law which restrict or prohibit wholly foreign owned enterprises, or WFOEs, from operating in certain industries such as Internet information, wireless, Internet access, e-commerce and certain other industries, we have established Beijing Sohu, High Century, Hengda and Sohu Internet, which are companies incorporated in the PRC and owned by Dr. Zhang and certain other employees of Sohu. As of September 30, 2004, Sohu had invested \$5.2 million in Beijing Sohu, High Century, Hengda and Sohu Internet through loans to officers and employees. In 2000, we extended loans of \$242,000 to Dr. Zhang and a Sohu employee to set up Beijing Sohu. Pursuant to a restructuring in May 2000, we transferred certain of our assets and operations to Beijing Sohu, a PRC company that is 80% owned by Dr. Zhang. In 2001 and 2002, we made loans totaling \$4.6 million to Dr. Zhang and an employee of the company to establish High Century for the purposes of undertaking additional investments in the PRC where foreign ownership is prohibited or restricted. In 2002, we loaned \$242,000 to an employee of the company for the purpose of funding an investment in Hengda, a company incorporated in the PRC which engages in Internet access services in the PRC on behalf of Sohu. The \$242,000 investment represents a 20% interest in Hengda, with High Century holding the remaining 80% interest. In June 2003, we loaned \$121,000 to an employee of the company for the purpose of funding an investment in Sohu Internet, a company incorporated in the PRC which engages in Internet information services in the PRC on behalf of Sohu. The \$121,000 investment represents a 10% interest in Sohu Internet with High Century and Hengda holding 40% and 50% interests, respectively. In May 2004, High Century and Sohu Internet acquired 73% and 27% interests, respectively, in Goodfeel. In July 2004, High Century and Hengda invested \$613,000 and \$473,000 in Goodfeel, respectively, so that High Century owned a 58.1% interest in Goodfeel with the remaining 41.9% interest owned by Hengda. In October 2004, we loaned \$1,208,000 to two employees of the company to purchase the interests in Goodfeel from High Century and Hengda. In November 2004, we loaned \$1,208,000 to another two employees of the company to purchase the interests in Hengda from the original shareholders. We do not have any direct ownership interest in Beijing Sohu, High Century, Hengda, Sohu Internet or Goodfeel.

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

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

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

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

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

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

At September 30, 2004, Sohu had provided long-term loans of \$5.2 million to Dr. Zhang, Sohu's chief executive officer and a major Sohu shareholder, and certain of our employees. The long-term loans are used to finance investments in Beijing Sohu and High Century, which are owned 80% by Dr. Zhang and 20% by certain of our employees, Hengda, which is owned 80% by High Century and 20% by an employee, and Sohu Internet, which is owned 50% by Hengda, 40% by High Century and 20% by an employee. Beijing Sohu, High Century, Hengda and Sohu Internet are used to facilitate our participation in telecommunications, Internet content and certain other businesses in China where foreign ownership is either prohibited or restricted. In addition, in May 2004, High Century and Sohu Internet acquired 73% and 27% interests, respectively, in Goodfeel. In July 2004, High Century and Hengda invested \$613,000 and \$473,000 in Goodfeel, respectively, so that High Century owned a 58.1% interest in Goodfeel with the remaining 41.9% interest owned by Hengda. In October 2004, we loaned \$1,208,000 to two employees of the company to purchase the interests in Goodfeel from High Century and Hengda. In November 2004, we loaned \$1,208,000 to another two employees of the company to purchase the interests in Hengda from the original shareholders.

The agreements contain provisions that, subject to PRC law, (i) the loans can only be repaid to us by transferring the shares of Goodfeel, High Century, Hengda, Sohu Internet or Beijing Sohu to us, (ii) the shares of Goodfeel, High Century, Hengda, Sohu Internet or Beijing Sohu cannot be transferred without our approval, and (iii) we have the right to appoint all directors and senior management personnel of Goodfeel, High Century, Hengda, Sohu Internet and Beijing Sohu. Dr. Zhang and the other employee borrowers have pledged all of their shares in Goodfeel, High Century, Hengda, Sohu Internet and Beijing Sohu as collateral for the loans and the loans bear no interest and are due on demand after October 2006, in the case of Goodfeel, after November 2003, in the case of High Century, the earlier of a demand or 2010, in the case of Beijing Sohu, after November 3, 2006, in the case of Hengda, and after June 2004, in the case of Sohu Internet, or, in any case, at such time as Dr. Zhang or the other employee borrowers, as the case may be, is not an employee of Sohu. Sohu does not intend to request repayment of the loans as long as PRC regulations prohibit it from directly investing in businesses being undertaken by the VIEs.

Because these loans can only be repaid by the borrowers' transferring the shares of the various entities, our ability to ultimately realize the effective return of the amounts advanced under these loans will depend on the profitability of Goodfeel, Beijing Sohu, Hengda, Sohu Internet and High Century, which is uncertain.

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Furthermore, because of uncertainty associated with PRC law, ultimate enforcement of the loan agreements is uncertain. Accordingly, we may never be able to collect these loans or exercise influence over High Century, Hengda, Sohu Internet, Beijing Sohu and Goodfeel.

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

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

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

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

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

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

The Ministry of Information Industry, or MII, has stated that the activities of Internet content providers are subject to regulations not only by MII but also by various other PRC government authorities, depending on the specific activities conducted by the Internet content provider. Various government authorities have stated publicly that they are in the process of preparing new laws and regulations that will govern these activities. The areas of regulations currently include online advertising, online news reporting, online publishing, online securities trading, wireless and the provision of industry-specific (e.g., drug-related) information over the Internet. Other aspects of our online operations may be wireless subject to regulations in the future.

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

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

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

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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.

### ***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.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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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 subsidiaries, Beijing ITC, Sohu Era and Sohu Software, are wholly-foreign owned enterprises, or WFOEs, because they are wholly-owned by our indirect subsidiary, Sohu Hong Kong, a foreign person under PRC law. Beijing ITC, Sohu Era and Sohu Software are subject to laws and regulations applicable to foreign investment in mainland China. However, these laws, regulations and legal requirements are relatively recent, and their interpretation and enforcement involve uncertainties. These uncertainties could limit the legal protections available to us and other foreign investors, including you. In addition, we cannot predict the effect of future developments in the PRC legal system, particularly with regard to the Internet, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the preemption of local regulations by national laws.

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

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

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

We are a holding company with no operating assets other than investments in Chinese operating entities, including Beijing ITC, Sohu Era, and Sohu Software, through an intermediate holding company, Sohu.com Limited, our wholly-owned subsidiary in the Cayman Islands, and our variable interest entities, Beijing Sohu,



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High Century, Hengda, Sohu Internet and Goodfeel. We may need to rely on dividends and other distributions on equity paid by Sohu.com Limited for our cash requirements in excess of any cash raised from investors and retained by us. If Beijing ITC, Sohu Era, and Sohu Software incur debt on their own behalf in the future, the instruments governing the debt may restrict Beijing ITC's, Sohu Era's and Sohu Software's ability to pay dividends or make other distributions to us. In addition, PRC legal restrictions permit payment of dividends by Beijing ITC, Sohu Era, and Sohu Software only out of their net income, if any, determined in accordance with PRC accounting standards and regulations. Under PRC law, Beijing ITC, Sohu Era and Sohu Software are also required to set aside 10% of their net income each year to fund certain reserve funds until these reserves equal 50% of the amount of paid-in capital. These reserves are not distributable as cash dividends. Furthermore, dividends received by Sohu.com Inc. would be subject to taxation at United States tax rates of 34% or 35%. We do not expect any dividends or other distributions on equity from Sohu.com Limited in the foreseeable future.

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

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

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

We currently expect most of our income to be earned from Sohu Era. In addition to the office in Beijing Zhongguancun Science Park, Sohu Era also has offices outside Beijing Zhongguancun Science Park where portions of its operations are located. We believe that substantially all of Sohu Era's services are ultimately delivered in Beijing Zhongguancun Science Park. However, the relevant tax authorities could challenge whether Sohu Era is operating outside Beijing Zhongguancun Science Park, which could result in a withdrawal of the approval of the tax benefits by the tax authorities. We plan to move all of Sohu Era's operations into Beijing Zhongguancun Science Park in early 2005.

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

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

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

Currently, Beijing ITC or Sohu Era 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 or Sohu Era may also retain foreign exchange in its current account (subject to a ceiling approved by the SAFE) to satisfy foreign exchange liabilities or to pay dividends. However, the relevant PRC governmental authorities may limit or eliminate our ability to purchase and retain foreign currencies in the future.

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

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

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

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

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

The market price of our common stock has been volatile and is likely to continue to be so. The initial public offering price of our common stock in July 2000 was \$13.00 per share. The trading price of our common stock subsequently dropped to a low of \$0.52 per share on April 9, 2001. On July 15, 2003, the trading price of our common stock reached a record high of \$43.40. During the nine months ended September 30, 2004, the trading price of our common stock ranged from a low of \$13.56 per share to a high of \$40.15. On October 29, 2004, the closing price of our common stock was \$16.75 per share.

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

The price for our common stock may fluctuate in response to a number of events and factors, such as quarterly variations in operating results, announcements of technological innovations or new products and media properties by us or our competitors, changes in financial estimates and recommendations by securities analysts, the operating and stock price performance of other companies that investors may deem comparable to us, and news reports relating to trends in our markets or general economic conditions. Additionally, volatility or a lack of positive performance in our stock price may adversely affect our ability to retain key employees, all of whom have been granted stock options or other stock awards.

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

There were 36,447,331 shares of our common stock outstanding as of September 30, 2004, as well as options to purchase an additional 3,848,400 shares of our common stock. Of the outstanding shares, 25,424,216 were issued prior to the initial public offering of our common stock. These shares are either freely tradable without restriction under Rule 144(k) under the Securities Act of 1933 or are tradable subject to the notice, volume and manner of sale restrictions of Rule 144 under the Securities Act.

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

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

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

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

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

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

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

Our chief executive officer, Dr. Zhang, beneficially owns approximately 23% of the outstanding shares of our common stock and is our largest stockholder. Our chief executive officer, together with our other executive officers and members of our Board of Directors, beneficially own approximately 26% of the outstanding shares of our common stock. Accordingly these stockholders acting together will have significant influence in determining the outcome of any corporate transaction or other matter submitted to the stockholders for approval, including mergers, consolidations, the sale of all or substantially all of our assets, election of directors and other significant corporate actions. They will also have significant influence in preventing or causing a change in control. In addition, without the consent of these stockholders, we could be prevented from entering into transactions that could be beneficial to us. The interests of these stockholders may differ from the interests of the other stockholders.

***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.

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

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

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

#### **FOREIGN CURRENCY EXCHANGE RATE RISK**

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

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

#### **INVESTMENT RISK**

Sohu invests in marketable debt securities to preserve principal while at the same time maximizing yields without significantly increasing risk. These marketable debt securities are classified as available-for-sale because we may dispose of the securities prior to maturity and they are thus reported at the market value as of the end of the period. As of September 30, 2004, unrealized gains of \$67,000 were recorded as accumulated other comprehensive income in shareholders’ equity.

#### **INTEREST RATE RISK**

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

Investments in fixed rate debt securities carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates. Due in part to these factors, our future interest income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell securities, which have declined in market value due to changes in interest rates.

### **ITEM 4. CONTROLS AND PROCEDURES**

Our chief executive officer and chief financial officer, after evaluating the effectiveness of our “disclosure controls and procedures” (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this quarterly report (the “Evaluation Date”), have concluded that as of the Evaluation Date our disclosure controls and procedures were effective and designed to ensure that material information relating to Sohu would be made known to them by others within the company.

During the period covered by this quarterly report, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

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

**ITEM 2. UNREGISTERED SALES OF EQUITY 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 September 30, 2004, we did not use any proceeds from the offering. The remaining net proceeds from the offering have been invested in cash, cash equivalents, and marketable debt securities. The use of the proceeds from the offering does not represent a material change in the use of proceeds described in the prospectus contained in the Registration Statement on Form S-1 described above.

**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**

Please see the Exhibit Index attached hereto.

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**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: November 9, 2004

**SOHU.COM INC.**

By: /s/ Carol Yu

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Chief Financial Officer (Principal  
Financial Officer)

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

**EXHIBITS INDEX**

- 10.1 Preliminary Agreement among Beijing Sohu New Era Information Technology Co. Ltd. and Vision Huaqing (Beijing) Development Co. Ltd. (portions of this exhibit have been omitted pursuant to a request for confidential treatment and have been filed separately with the SEC)
- 10.2 Loan and Share Pledge Agreement between Sohu.com Inc. and Deng Xiufeng
- 10.3 Loan and Share Pledge Agreement between Sohu.com Inc. and Zhou Jing
- 10.4 Loan and Share Pledge Agreement between Sohu.com Inc. and Wang Jianjun
- 10.5 Loan and Share Pledge Agreement between Sohu.com Inc. and Wang Xin
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of Charles Zhang
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of Carol Yu
- 32.1 Section 1350 Certification of Charles Zhang
- 32.2 Section 1350 Certification of Carol Yu

**Preliminary Agreement**

This agreement is executed by the parties below on September 12, 2004:

(1) Vision Huaqing (Beijing) Development Co. Ltd. (hereinafter referred to as "Party A")

Address: A-1201, Innovative Plaza, Tsinghua Science Park, Haidian District, Beijing

Legal representative: Yali Hong

Title: Chairman of the Board

Tel: 8610-62790008

Fax: 8610-62790058

(2) Beijing Sohu New Era Information Technology Co., Ltd. (hereinafter referred to as "Party B")

Address: Room 3001, Teng Da Building, 168 Xizhimenwai Avenue, Haidian District, Beijing.

Legal representative: Charles Zhang

Title: Chairman of the Board

Tel: 8610-65102160

Fax: 8610-65101889

**WHEREAS,**

A. Vision International Center ("Vision Center") constructed/funded by Party A is to be put into operation, and is to be leased \* when applicable.

B. Party B intends to rent \* part of the area of Vision Center when finished, and Party A agrees to lease \* part of the area of Vision Center to Party B.

C. The parties agree to enter into the binding legal agreement with regards to Party B's expected rent \* of part of the area of Vision Center prior to the completion of the construction of and the issuance of ownership certificate for Vision Center, the major contents of which will be incorporated into the future Vision Center house lease contract \* between the parties.

**The symbol "\*" in this exhibit indicates places where information has been omitted pursuant to a request for confidential treatment and filed separately with the Commission.**



NOW THEREFORE, the parties agree as follows upon equal and friendly consultation:

I. Lease

1.1 Position and Area of Subject House

1.1.1 The parties agree that Party B will preserve the rent of house Floor 8 to Floor 15 ( actually 6 floors as there are no Floor 13 and 14) from Party A with the position/area below:

<u>Floor</u>	<u>Building area (square meters)</u>	<u>Floorage area (square meters)</u>	<u>Floorage area rate (%)</u>
15/F	2,598	2,049	79
12/F	2,595	2,047	79
11/F	2,591	2,043	79
10/F	2,588	2,041	79
9/F	2,584	2,037	79
8/F	2,580	2,034	79
Total	15,536	12,251	79

1.1.2 The parties agree that the area of the Subject House of Party A under clause 1.1 is only interim with the actual area subject to the measurement of the state-approved measurement organizations (with the certification of professional measurement organizations issued by central government authority). The rent shall be calculated as per the actual building area. In case the actual area dwindles, Party A shall refund Party B the over rent and the interest thereof at the same-period bank loan interest rate.

1.1.3 Lease term and commencement date

1.1.3.1 The lease term for the area under clause 1.1.1 shall end on December

31, 2009, 5 years for stories from 10 to 15, 4 years and 4 months for the 9<sup>th</sup> story and 3 years and 11 months for the 8<sup>th</sup> story. Upon the expiration, Party B is entitled to renew the term for another 3 years under the conditions hereunder.

1.1.3.2 The lease commencement dates of the above stories under clause 1.1 are:

- (1) Stories 10, 11, 12 and 15: January 1, 2005
- (2) Story 9: September 1, 2005
- (3) Story 8: February 1, 2006

1.1.4 Rent and property management fee

1.1.4.1 The leased area under clause 1.1.1 is subject to the rent in the first 3 years at RMB \* yuan per month/m<sup>2</sup> of building area (exclusive of property management fee, same below), the rent in the 4<sup>th</sup> and 5<sup>th</sup> year subject to market-based adjustment. However, Party A promises that the adjusted rent shall not exceed 120% of the original rent standard. Although under clause 1.1.3.2, the commencement of the date for various stories of Vision Center is different, the starting date for rent adjustment shall be January 1, 2005.

1.1.4.2 Upon the expiration of the 5-year lease term, Party B may renew for another 3 years at the rent set as per the current market price upon mutual consultation. Otherwise, the rent shall be the mean value of the evaluated value set by 2 independent appraisers mutually engaged by the parties (the parties shall evenly share the evaluation cost).

1.1.4.3 The property management fee is RMB \* yuan/month/ m<sup>2</sup> of building area, which shall be subject to adjustment based on the standard published by the property management company.

1.1.4.4 Party B shall pay Party A the current-month rent and property management fee within the first five (5) working days of each month to the bank account designated by Party A. Party A shall provide Party B the invoices upon the receipt of the payment.

1.1.5 Rent-free period

1.1.5.1 Party A promises to exempt the rent of Party B for a certain period each year in the 5-year term, during which Party B only pays the property management fee and energy consumption cost.

**The symbol ‘\*’ in this exhibit indicates places where information has been omitted pursuant to a request for confidential treatment and filed separately with the Commission.**

1.1.5.2 The Subject House from the 10<sup>th</sup> to 15<sup>th</sup> story is subject to 8-month rent-free period in the 5-year lease term, including 2 months each in the first 3 years and 1 month each in the late 2 years. The rent-free period in the 8<sup>th</sup> and 9<sup>th</sup> story shall be calculated in proportion to the actual lease term, i.e. 2 months each in the first 3 years for the 8<sup>th</sup> and 9<sup>th</sup> stories, 1 month for the 9<sup>th</sup> story in the 4<sup>th</sup> years, 10 days for the 4 months in the 5<sup>th</sup> years, 28 days for the 8<sup>th</sup> story in the 11 months of the 4<sup>th</sup> year. The commencement dates of the rent-free period are:

- (1) January 1 each year for the 10<sup>th</sup>, 11<sup>th</sup>, 12<sup>th</sup> and 15<sup>th</sup> stories;
- (2) September 1 for the 9<sup>th</sup> story;
- (3) February 1 for the 8<sup>th</sup> story.

#### 1.1.6 Furbishing period

1.1.6.1 Party A agrees to grant Party B the rent-free furbishing period for the Subject House.

1.1.6.2 The furbishing period is 4.5 months for the 10<sup>th</sup>, 11<sup>th</sup>, 12<sup>th</sup> and 15<sup>th</sup> stories from August 15, 2004. From August 15, 2004, Party B may enter into the Subject House for design, and start the furbishing from September 1. The furbishing period is 2 months for the 9<sup>th</sup> story from July 1, 2005, 2 months for the 8<sup>th</sup> story from December 1, 2005.

1.1.6.3 Party B shall bear the property management fee and energy consumption fee in the furbishing period, starting on the date when Party A's renovation formally begins.

#### 1.2 Warehouse Lease

1.2.1 Party A agrees to lease the 3 warehouses of 110 m<sup>2</sup> of building area in the 2<sup>nd</sup> underground floor of Vision Center during the lease term hereunder to address business needs of Party B.

1.2.2 The warehouse rent is RMB \* yuan/month/ m<sup>2</sup> of building area without property management fee. The rent shall be increased by 5% every two years.

**The symbol ‘\*’ in this exhibit indicates places where information has been omitted pursuant to a request for confidential treatment and filed separately with the Commission.**

- 1.2.3 Party B shall pay the warehouse rent as per the provisions under clause 1.1.4.4.
- 1.3 Parking lot lease
- 1.3.1 Party A agrees, to meet the needs of Party B, when Party B rents \* a total of 4 stories of Vision Center, Party A will provide Party B 8 rent-free VIP parking places in the underground parking lot (Party B shall bear the property management fee) for the term equivalent to the lease term or long term (some 45 years). When Party B rents \* above-5 stories, Party A will provide Party B 10 rent-free VIP parking places in the underground parking lot (Party B shall bear the property management fee) for the term equivalent to the lease term or long term (some 45 years). However, if the stories occupied by Party B is less than the above mentioned standard, Party A is entitled to reduce the numbers of the rent-free VIP parking lots (one rent-free VIP parking lot for half of the story).
- 1.3.2 Party A agrees that, in the lease term \*, if requested by Party B, Party A will provide Party B at least 140 parking places in the underground parking lot and the parking lots in Vision Center, including at least 95 parking places in the underground parking lot (exclusive of the above rent-free VIP parking places). However, if the stories occupied by Party B is less than the above mentioned standard, Party A is entitled to reduce the numbers of the parking lots based on the ratio every parking lot equals to 110 square meter.
- 1.3.3 The unit rent of parking places under clause 1.3.2 is RMB \* yuan each month, subject to the market-based adjustment every 5 years. (recommend to drop the rent of the parking places other than those in the underground parking lot).
- 1.3.4 Party A agrees Party B may pay Party B the lump RMB \* yuan for each parking place under clause 1.3.2 for the 45-year use of such parking place.
- 1.3.5 The property management fee for each parking place rented or used by Party B is RMB \* yuan per month.
- 1.3.6 The payment term of the parking place rent and property management fee is the same with that under clause 1.1.4.4.

**The symbol ‘\*’ in this exhibit indicates places where information has been omitted pursuant to a request for confidential treatment and filed separately with the Commission.**

- 1.4 Sub-lease
- 1.4.1 Without prejudice against the quality and image of Vision Center, Party B may sub-lease Vision Center rented by it, the whole or as a part, to its affiliates (affiliates refer to the companies wholly owned or controlled by Party B, “control” refers to the right directly or indirectly controlling the management and decision making, by voting shares, contract or other manner, same below), to which Party A shall give assistance.
- 1.4.2 Except for the cases under clause 1.4.1, without prior written consent of Party A, Party B shall not sub-lease Vision Center, warehouse and parking places to any third party.
- 1.5 Execution earnest and deposit
- 1.5.1 Within seven (7) days after the execution hereunder, Party B shall pay Party A RMB \* yuan as the earnest of signing Vision Center lease contract (8-15-story 1-month rent and property management fee under clause 1.1.1). The parties will enter into the formal lease contract within ten (10) days after Vision Center available for lease and after the execution hereunder. In case failing to do so, the parties agree to postpone the execution the latest at December 15, 2004. In case of failing to execute the written contract before the above deadline due to the causes of Party B, Party A is entitled to confiscate the earnest of Party B, and enter into formal lease contract with any other tent for the Subject House. In case of failing to enter into the contract before the above deadline due to the causes of Party A, Party A shall refund Party B the amount twice of the earnest. In case of failing to enter into the contract before the above deadline without the fault of any party, Party A shall refund the earnest to Party B.
- 1.5.2 Within seven (7) days after the execution of the formal lease contract, Party B shall pay Party A the deposit equivalent to 2-month rent and property management fee of the Subject House (from 8<sup>th</sup> floor to 15<sup>th</sup> floor) (the earnest under clause 1.5.1 converted to deposit). Within seven (7) days after the lease term \*, Party A shall refund the deposit to Party B in one lump without interest, net of any overdue payable of Party B to Party A.
- 1.6 Preemptive rent right of the 7<sup>th</sup> floor

**The symbol “\*” in this exhibit indicates places where information has been omitted pursuant to a request for confidential treatment and filed separately with the Commission.**

- 1.6.1 Party A agrees, after execution of Vision Center lease contract and Party B's residence in Vision Center, when the 7<sup>th</sup> floor of Vision Center is available for lease, under the same conditions for any third party, Party B and Party B affiliates have the preemptive right to rent the 7<sup>th</sup> floor. Party A will notify Party B in writing one (1) month in advance to exercise such right, stating major lease conditions like rent and lease term. Delayed response of Party B shall be deemed as waiver of such right.
- 1.7.1 Short-term renewal upon expiration
- 1.7.2 Upon the expiration of the lease term under clause 1.1.3 or the 7<sup>th</sup> floor, as requested by Party B, Party A agrees to grant the short-term renewal of 3 months at the longest.
- 1.7.3 The short-term lease term rent shall be 150% of the then market rent or mutually standard, whichever is higher.
- 1.8 Purpose of the leased house
- 1.8.1 The purpose of Vision Center is office and attached business facilities. Party B is entitled to use the leased Vision Center as office, administrative, technical support and training centers within the above stipulated purposes.
- 1.9 Leased house facilities
- 1.9.1 Air-conditioning system
- 1.9.1.1 The Vision Center rented by Party B is equipped with 2 systems+2 systems air conditioning system at the wind flow of 50 m<sup>3</sup>/person/hour (each person 12 m<sup>2</sup> of building area).
- 1.9.1.2 The normal air-conditioning supply hours are 8:00 a.m. through 19:00 p.m. on working days (Monday through Friday, except for public holidays).
- 1.9.1.3 In case Party B requires additional hours of air-conditioning service besides the normal supply, Party B shall notify Party A in writing twenty four (24) hours in advance, at \* yuan per each additional hour for each floor. If the subject floor has the building area over 1,250 m<sup>2</sup>, the additional-house price shall be RMB \* yuan/hour/m<sup>2</sup>.

**The symbol ‘\*’ in this exhibit indicates places where information has been omitted pursuant to a request for confidential treatment and filed separately with the Commission.**

- 1.9.1.4 Party B may install independent air conditioners at the leased house, particularly the equipment room and other rooms in need of around-clock air conditioning. If such act entails the cooling water system furnished by Party A, Party A may provide the cooling-water system at RMB \* yuan/hour to assist with such act of Party B. In case Party B installs air-conditioning system, Party A will provide proper position at the top of the building to accommodate the outdoor air conditioner without any fee, provided that Party B shall bear any renovation/additional cost thus incurred.
- 1.9.2 Power supply
- 1.9.2.1 Party A provides dual power supplies with the total capacity of 5,700KVA, emergency power supply 450KVA, including some 100KW as the tenant standby power supply shared by tenants as per the leased areas in principle. It is feasible to provide 380V power supply. Party A shall satisfy Party B's requirement for power supply and expansion of capacity. However, Party B's renovation on power supply shall be reviewed and approved by Party A's consulting company. Party B shall bear reasonable professional consulting service fee, capacity expansion fee and renovation fee.
- 1.9.3 Lifts
- 1.9.3.1 The Vision Center leased by Party A is equipped with 6 passenger lifts, 2 goods lifts and 1 escalator.
- 1.9.3.2 If Party B rents \* over-4-floor area (inclusive) of Vision Center, Party A shall adjust the original lifts control system without prejudice of the lift utilization efficiency and specific requirements of Party B. After the adjustment, 1 lift will be dedicated to Party B stopping at the 1 floor underground, the 1 floor and the floors of Party B instead of any other floors. The 6 lifts are still under central control, and Party B dedicated lift shall operate as aforesaid. Party B is entitled to place and/or post the logo, mark and promotion ads of Party B in the dedicated lift.
- 1.9.4 Communication
- 1.9.4.1 Party A promises that the building will provide all tenants with:
- (1) 2400 direct-dialing telephone lines:

**The symbol ‘\*’ in this exhibit indicates places where information has been omitted pursuant to a request for confidential treatment and filed separately with the Commission.**

- (2) Network service providers including China education net, China Telecom, China Netcom and Small Netcom. Party A shall fully assist with the connection of above service providers as per the arrangement between Party A and the service providers;
- (3) Kilomega IT backbone network;
- (4) 1,000mbps integrated network system optical fiber and Cat6UPT cable, designed capacity up to 1 pair of information points in every 5 square meters;
- (5) Support wireless Internet access in floor 1 and public area (including the lobby and garden outside the ground floor);
- (6) 5-cm ground layer for wiring slots of Party B;
- (7) To ensure standby of Netcom physical network connection, Party A will fully help China Netcom to add loop physical route within scope of Vision Center.

1.9.4.2 Besides the charges from providers, Party A shall not charge any additional cost. Meanwhile, Party A shall help China Network to connect the optical fiber to the main equipment room of Party B in the mansion, and permit China Network to use the physical routes of the mansion like the silo and pipelines as per the arrangement between Party A and China Netcom. As requested, Party A shall ensure optical fiber connection finished prior to November 1, 2004.

#### 1.9.5 Firefighting

1.9.5.1 The firefighting spray system and smoke sensor in the office area are installed as open office design concept.

1.9.5.2 As it is not proper to install spray system in key departments like the equipment room in the leased area of Party B, as assisted by Party A, Party B may replace the original spray system with the gas firefighting system at the cost of Party B subject to the firefighting acceptance. Meanwhile, Party B shall ensure to adopt the firefighting facilities compliant with Vision Center in renovating the office-area firefighting system (exclusive equipment room). Party B shall bear any cost for leasing or purchase of firefighting system thus incurred.



- 1.9.6 Security monitoring system
- 1.9.6.1 Vision Center is equipped with TV monitoring system, exit/entry control system, around-clock supervision system and control center.
- 1.9.6.2 Party B may install its own exit/entry monitoring system at the leased area \* exits/entries.
- 1.10 Delivery conditions of the leased house
- 1.10.1 Cement flat floor.
- 1.10.2 Installed smoke sensors and spray system as per the current firefighting standard.
- 1.10.3 The mansion is equipped with the central air conditioning system. The tenant may install/renovate the air conditioners as per refurbishing layout of the leased area.
- 1.11 Refurbishing of leased house
- 1.11.1 Except any IT wiring, network and other weak-current projects, installation of additional air conditioners and outdoor machines, which shall be conducted at Party B's cost by an engineering company designated by Party A, all the refurbishing plan of the leased area of Party B are subject to the prior approval of Party A at the cost of Party B. If necessary, Party A will provide the main-machine installation position and silo, cold-media pipe wiring without any charge.
- 1.11.2 Except for the electromechanical project (exclusive those under clause 1.11.1), Party B is entitled to independently engage architecture engineers and contractors for planning, design and refurbishing.
- 1.11.3 Party A will provide Party B the refurbishing cost list prepared by the Party A's designated engineering company according to clause 1.11.1. Meanwhile, in case of any test or renovation of the indoor air conditioners and firefighting system of the leased house of Party B by any company designated by Party B, Party B shall notify Party A in advance and negotiate about the charge standard, and indemnify Party A any loss thus incurred.
- 1.11.4 Party B shall respond to the refurbishing plan of Party B within seven (7) working days. In case of any refurbishing delay of Party B due to the delayed response of Party A, Party B is entitled to claim any loss thus incurred from Party A.

**The symbol ‘\*’ in this exhibit indicates places where information has been omitted pursuant to a request for confidential treatment and filed separately with the Commission.**

- 1.11.5 Party B shall abide by refurbishing regulations of Party A, Party A shall provide Party B the refurbishing manual prior to August 20, 2004.
- 1.11.6 Party A agrees, to address the refurbishing needs of Party B, after the execution of this agreement, to provide Party B some offices in the mansion or Tsinghua Science Park with the building area around 100 square meters as the temporary refurbishing command center of Party B during the refurbishing period of the leased house in 2004, which shall be equipped with the office desks/chairs and broad-band network access, provided that Party B shall bear the Internet access fee, energy consumption fee and property management fee of such offices during the refurbishing period.
- 1.12 Party B's entry into the mansion
- 1.12.1 During the lease term, Party B may enter into the mansion around the clock, including weekends and public holidays.
- 1.12.2 Notwithstanding clause 1.12.1, Party B shall submit the reasonable management of the entry/exit by the property management company of the mansion.
- 1.13 Advance termination of the lease contract
- 1.13.1 Party B shall not terminate the lease contract for any reason within three (3) years of the lease, i.e. from the commencement date to December 31, 2007.
- 1.13.2 After 3-year lease term, i.e. from January 1, 2008, Party B may notify Party B of the termination thereof 9-month in advance in writing, or pay Party B the 9-month rent in place of the notice. In this case, Party B's deposit to Party A turns into the indemnification of Party B to Party A.
- 1.14 Restoration to original conditions upon expiration
- 1.14.1 Upon the termination thereof, Party B shall restore the leased area to the original conditions or the conditions mutually agreed.
- 1.14.2 After the termination thereof, Party A shall not require Party B to maintain or leave any fixed and/or valuable devices and facilities in the leased house.

- 1.1.4.3 Except for the devices and facilities retained or left in the leased house as mutually agreed, Party B shall dismantle and move out any such facilities upon the termination of the lease term. Otherwise, Party A is entitled to dispose of any articles of Party B left in the leased area, and Party B shall bear the disposal cost incurred to Party A.
- 1.15 Miscellaneous
- 1.15.1 In case \* Party A wishes to transfer the mansion to any third party in the lease term, Party A shall cause such third party bound by the lease contract. The lease contract shall still be valid.
- 1.15.2 Party A confirms that the construction materials of the houses leased to Party B are up to the national safety standards, and shall service the houses as per the environment protection laws.
- 1.15.3 Party A shall equip the mansion leased to Party B with the following utilities, shops, plunge bath, bank, coffee bar, restaurant, laundry shop and post office.
- 1.15.4 Party A promises to provide the eatery of adequate seats in the lease term, and provide Party B employees free meal tickets of the mansion restaurant and other restaurants in Tsinghua Science Park for the working days in the first 3-month residence of Party B in the mansion. The free meal ticket is valued at RMB 15 yuan per person and 1000 tickets per working day. The parties shall jointly determine the ticket rates of various restaurants upon consultation.
2. \*
- 3. Other benefits promised by Party A**
- 3.1 External signs
- 3.1.1 When Party B rents \* office area in the mansion up to 4 floors, Party A promises that Party B may erect non-ads corporate sign at the proper position in the east surface of the mansion top during the lease term \*.
- 3.1.2 Party A promises that, when Party A is the owner of the whole or part of the area in the mansion, Party A shall not challenge Party B's sign under clause 3.1 on the ground of the impact on Party A's benefits, and Party B agrees to pay Party A the compensation thereof RMB \* yuan within seven (7) days after the execution hereto.
- 3.1.3 If the whole or part of the mansion changes the ownership, Party B shall consult with the other ownership for the sign use right (including the potential economic compensation for other owners as agreed).

**The symbol "\*" in this exhibit indicates places where information has been omitted pursuant to a request for confidential treatment and filed separately with the Commission.**

- 3.1.4 The sign appearance, mode, size and position of Party B are subject to prior written consent of Party A based on the requirements of competent government agencies and other organizations and Party A's requirements on the mansion image. Party A shall respond to it within three (3) working days after the receipt of the sign design plan of Party B. Any delayed response shall be deemed as Party A's approval of such design plan.
- 3.1.5 As approved by Party A, Party B may erect corporate sign after paying Party A the sign use fee under clause 3.1.2.
- 3.1.6 Party A promises not to place or erect any logo and/or corporate signs other than those of Party A at any position of the external vertical wall above the 4<sup>th</sup> floor of the mansion.
- 3.2 Naming right
- 3.2.1 \*
- 3.2.2 Party B shall bear the application, production cost and other cost in exercising the naming right under clause 3.2.2.
- 3.3 Ads
- 3.3.1 When \*, provided that Party B's ads mode/content does not prejudice against the overall image of the mansion with the written consent of Party A, science park and Tsinghua University, Party A agrees that Party B may erect ads bulletin on the top of the mansion. Party B shall, at its own cost, obtain the approval of competent government agencies, to which Party A is obligated to assist with. \*.
- 3.3.2 If the whole or part of the mansion changes owners, Party B shall consult with other owners about the building-top ads bulletin use right (including possible economic compensation to other owners as agreed), or abide by applicable government regulations.
- 3.3.3 Party A promises not to place or erect the ads of any competitor of Party B at any position of the mansion. The "competitor" herein refers to those engaged in identical or similar business with Party B, including SINA, NETEASE, TOM, KONG ZHONG and other same-level companies as approved by Party A.

**The symbol '\*' in this exhibit indicates places where information has been omitted pursuant to a request for confidential treatment and filed separately with the Commission.**

3.4 \*

**4. Miscellaneous**

4.1 This agreement is made in two (2) copies with each party holding one (1) copy, and shall take effect upon the signatures and stamps of the parties.

4.2 This agreement is governed by the laws of PRC.

4.3 This agreement is preservation agreement, based on which the parties shall enter into the formal lease \* agreements. In principal, Party B shall adopt the standard lease agreement of Party A, provided the parties may amend the agreement upon separate consultation.

4.4 Any dispute arising out of the interpretation and performance of this agreement shall be settled friendly. Any dispute failing friendly consultation may be submitted to China International Economic and Trade Arbitration Committee for arbitration in Beijing by either party.

Party A: (stamp) Vision Huaqing (Beijing) Development Co. Ltd.

Legal representative: /s/ Yali Hong  
\_\_\_\_\_

Party B: (stamp) Beijing Sohu New Era Information Technology Co., Ltd.

Legal representative: /s/ Charles Zhang  
\_\_\_\_\_

**The symbol ‘\*’ in this exhibit indicates places where information has been omitted pursuant to a request for confidential treatment and filed separately with the Commission.**

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***Loan and Share Pledge Agreement***

---

*between*

Sohu.com, Inc.

*and*

Deng Xiufeng

October 2004

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**THIS LOAN AND SHARE PLEDGE AGREEMENT** (this "**Agreement**") is entered into on this 27th day of October 2004 in Beijing, People's Republic of China ("**PRC**")

among

(1) **Sohu.com, Inc.**, a U.S. corporation, of Delaware, U.S. ("**Party A**"),

and

(2) **Deng Xiufeng**, a PRC citizen whose ID number is 110108197011292234 and residential address is 14, South Chaoyangmen Avenue, FESCO, Beijing, PRC ("**Party B**")

(individually a "**Party**" and together the "**Parties**").

#### **RECITALS**

- A. Party B wish to acquire 58.1% shareholding of Beijing G. Feel Technology Co., Ltd. in Beijing, PRC.
- B. The Domestic Company is and will continue to engaged in the business of providing value-added mobile data services (including the development and sales, through Monternet, of ring tones, pictures and K-Java games for mobile phones) in the PRC (the "**Business**").
- C. Party B wishes to borrow the amount specified in Article 2.1 below (the "**Loan**") from Party A, and Party A has agreed to provide the Loan to Party B on an interest-free basis, for the sole purpose of financing the acquisition of the shares of the Domestic Company and developing the Domestic Company's business, which shall specifically include the entering into of a series of agreements with Party A and its Affiliates (as defined below).
- D. As security for the Loan and the performance of this Agreement, Party B has agreed to pledge his portion of the equity interest in the Domestic Company (the "**Shares**") to Party A.



NOW, **THEREFORE**, the Parties agree as follows:

1. DEFINITIONS AND INTERPRETATIONS

1.1 **Definitions.** Unless otherwise indicated, the following terms in this Agreement shall have the meanings set forth below:

<b>“Affiliate”</b>	any affiliate entity or business associate of Party A, including without limitation the WFOE – Sohu ITC Information Technology (Beijing) Co., Ltd.
<b>“Certificate”</b>	as defined in Article 3.1.9;
<b>“Conversion Date”</b>	as defined in Article 7.2.1;
<b>“Conversion Notice”</b>	as defined in Article 7.1;
<b>“Designee”</b>	an individual, corporation or other appropriate entity designated by Party A to be the recipient of a Share Transfer;
<b>“Event of Default”</b>	as defined in Article 6;
<b>“Loan Date”</b>	with respect to Party B, the date on which the portion of the Loan amount borrowed by Party B is paid into her designated bank account;
<b>“PRC Law”</b>	any published and available laws and regulations of the PRC;
<b>“Repayment Date”</b>	as defined in Article 2.3;
<b>“RMB”</b>	Renminbi, the lawful currency of the PRC;
<b>“Share Transfer”</b>	as defined in Article 7.2.1;
<b>“USD”</b>	United States Dollar, the lawful currency of the United States of America.
<b>“WFOE”</b>	A wholly-owned subsidiary established by Party A in the PRC.

1.2 **Interpretations.** The headings herein are for reference purposes only and do not affect the meaning or interpretation of any provision hereof. Any reference herein to an Article or Appendix is to an article or appendix of this Agreement. The use of the plural shall include the use of the singular, and vice versa.

Unless otherwise indicated, a reference herein to a day, month or year is to a calendar day, month or year. A reference to a business day is to a day on which commercial banks are open for business in both the PRC and the U.S. The use of the masculine shall include the use of the feminine, and vice versa.

2. AMOUNT AND REPAYMENT OF THE LOAN

- 2.1 **Loan Amount.** Party A agrees, subject to the terms and conditions of this Agreement, to cause its Affiliate to extend the Loan to Party B in a total amount of RMB 5,810,000. The Loan shall be interest-free.
- 2.2 **Provision of Loan.** The Loan shall be deemed to have been provided to Party B on the Loan Date.
- 2.3 **Date of Repayment.** The Loan, together with any other moneys owing under this Agreement by Party B, shall become repayable upon the earliest to occur of any of the following events (each a "**Repayment Date**"):
- 2.3.1 in full, on the occurrence of an Event of Default;
  - 2.3.2 in full, on the resignation or removal of Party B from the position of director, chairman of the Board of Directors, general manager, supervisor of the Domestic Company;
  - 2.3.3 in full, with respect to Party B, the date on which such Party's employment relationship with Party A or any Affiliate terminates for any reason;
  - 2.3.4 in full, where Party A intends to replace this Agreement with another agreement, the date of the written notice from Party A to Party B confirming such intention; or
  - 2.3.5 in full or in part, at Party A's sole discretion upon any date selected by Party A after the second anniversary of the date of signing of this Agreement.
- 2.4 **Method of Repayment.** Repayment will be made only by means of converting the Loan into Shares, as described in Article 7 below, with the final amount of the Loan being due and repayable on the final Conversion Date. The Loan may not be repaid prior to the Repayment Date or by any means not specifically permitted in this Article 2.4 without the express written consent of Party A.

3. UNDERTAKINGS AND WARRANTIES OF PARTY B

3.1 **Undertakings and Warranties.** Party B hereby undertakes and warrants to Party A that:

- 3.1.1 the Loan will be used solely for the purpose of purchasing the 58.1% shareholding of the Domestic Company;
- 3.1.2 he has and shall maintain the full power and authority to enter into this Agreement, to borrow the Loan and to perform his obligations hereunder;
- 3.1.3 there are no civil or criminal, claims, actions, suits, investigations or proceedings pending or, to his knowledge, threatened against her;
- 3.1.4 there is no provision of any Agreement, enforceable judgement or order of any court binding on his or affecting her property, which would in any way prevent or materially adversely affect his execution or performance of this Agreement;
- 3.1.5 the execution and performance of this Agreement and the realization of Party A's rights hereunder will not violate any mortgage right, contract, judgement, decree or law which is binding upon his or his assets;
- 3.1.6 upon his investment in the Domestic Company, he shall be the sole legal and beneficial owner of his Shares, free and clear of all pledges and encumbrances other than the security interest created by this Agreement;
- 3.1.7 he shall cause the pledge of his respective Shares to Party A to be recorded on the Domestic Company's register of shareholders;
- 3.1.8 upon the completion of the transfer of the shares of the Domestic Company, he shall provide to Party A a certificate from the Domestic Company evidencing his ownership of the Shares (a "**Certificate**") together with an Assignment Agreement, substantially in the form attached hereto as an Appendix;

- 3.1.9 for the duration of this Agreement, he will not cause the Domestic Company, without the written consent of Party A, to engage directly or indirectly in any business activities which compete with those of Party A other than those described in Recital B above;
- 3.1.10 he will, at any time and at Party A's expense, defend the Shares against any third party claims;
- 3.1.11 without the consent of Party A, except as expressly permitted hereunder, he will not arrange for or otherwise permit or cause the issuance of any new shares of capital stock of the Domestic Company;
- 3.1.12 he shall do or cause to be done all such acts, and execute or cause to be executed any necessary documents and registrations, such that the conversion of the Loan, the Share Transfers and all other transactions contemplated hereunder are effected in a legal and valid manner; and
- 3.1.13 he shall maintain as strictly confidential the existence and provisions of this Agreement, as well as of any correspondence, resolutions, ancillary agreements and any other documentation associated herewith.

4. COVENANTS

- 4.1 **Affirmative Covenants.** Party B hereby covenants that he will furnish to Party A, within 10 days after the end of each month after the completion of the acquisition of the shares of the Domestic Company has been established, with financial statements of the Domestic Company and such additional information as Party A may from time to time reasonably request
- 4.2 **Further Covenants.** Party B further covenants that, from the date hereof until full repayment of the Loan has been effected, he will not, and will ensure that the Domestic Company does not, except with the prior written consent of Party A:
  - 4.2.1 incur or assume any debt that is not due and payable in the ordinary course of its business (except indebtedness to Party A hereunder or as otherwise specifically permitted hereunder);

- 4.2.2 incur or assume any mortgage, pledge or other encumbrance of any kind upon any assets of the Domestic Company, whether now owned or hereafter acquired;
- 4.2.3 enter into any agreement, arrangement, commitment or understanding to, or actually acquire all or part of the substantial assets of any third party;
- 4.2.4 enter into any agreement, arrangement, commitment or understanding to, or actually sell, lease, or otherwise dispose of any assets of the Domestic Company except in the ordinary course of business;
- 4.2.5 enter into any agreement, arrangement, commitment or understanding to, or actually, make loans or advances to any third party;
- 4.2.6 enter into any agreement, arrangement, commitment or understanding to, or actually, assume, guarantee, endorse or otherwise become liable for the obligation of any third party or other entity; or
- 4.2.7 permit the Domestic Company to conduct any business not expressly described in Recital B of this Agreement.

4.3 ***Rights of Party A.***

- 4.3.1 Party B agrees that he shall obtain Party A's written approval prior to undertaking any of the following, namely:
  - 4.3.1.1 appointing and removing the directors of the Domestic Company;
  - 4.3.1.2 appointing and removing the general manager of the Domestic Company; and
  - 4.3.1.3 approving the terms of employment of the general manager.
- 4.3.2 Party B agrees that he shall obtain Party A's written approval prior to undertaking any of the following, namely:

- 4.3.2.1 appointing and removing of the senior management personnel and any key personnel of the Domestic Company; and
- 4.3.2.2 approving the terms of employment of the senior management personnel and key personnel of the Domestic Company.

5. SHARE PLEDGE

- 5.1 **Share Pledge.** As security for the performance in full of the obligations of Party B under this Agreement, Party B hereby pledges to Party A, and creates in favor of Party A or the Designee (as appropriate), a first priority security interest in all of the rights, title and interest in and to:
- 5.1.1 the Shares; and
  - 5.1.2 all of her incidental rights with respect to the Shares, now or hereafter acquired.
- Such security interest is to be perfected by compliance by Party B with Article 3.1.9 of this Agreement.
- 5.2 **Power of Attorney.** Party B hereby irrevocably grants to Party A or the Designee (as appropriate) full power of attorney for the purpose of carrying out the provisions of this Agreement, as well as taking any action and executing any instrument which Party A in good faith deems necessary to accomplish for purposes of this Agreement.

6. EVENTS OF DEFAULT

The occurrence of any of the following events shall constitute a default of the Loan hereunder and a breach of this Agreement by Party B (as appropriate) (an “*Event of Default*”):

- 6.1 a Share Transfer has not been effected by Party B within 20 working days after the corresponding Conversion Date or such time as may otherwise be agreed upon by the Parties;
- 6.2 Party B is in breach of any of the terms and conditions hereof, and such breach has not been rectified for a period of 10 days after receipt of Party A’s written notice requesting such rectified;

- 6.3 any undertaking or warranty made by Party B herein shall prove to have been false or misleading in any material respect;
- 6.4 Party B makes any arrangement with his respective creditors or takes or suffers any similar action in consequence of debt; or
- 6.5 any judgment is made under any applicable law against Party B which exceeds USD 50,000.

7. LOAN CONVERSION

- 7.1 **Share Conversion.** As of the Repayment Date, the Loan shall be convertible into Shares on the basis that 100 percent of the Loan amount equals 100 percent of the Shares. For the avoidance of doubt, if 10 percent of the Loan were repayable by Party B, then Party B would be required to transfer 10% of the total number of the Shares to Party A. The Loan shall become repayable to such extent as Party A may from time to time request, until the entire Loan amount has been repaid. Party A shall request to convert all or a percentage of the Loan by means of a written notice to Party B that specifies the percentage of the Loan to be converted into Shares ("**Conversion Notice**").
- 7.2 **Share Transfer.**
  - 7.2.1 Within 20 working days after receipt of a Conversion Notice ("**Conversion Date**"), Party B shall effect the transfer of the portion of the Shares designated in the Conversion Notice, either to Party A directly or to the Designee specified by Party A in the Conversion Notice (each a "**Share Transfer**").
  - 7.2.2 For the avoidance of doubt, upon the completion of the conversion of the Loan and the transfer of all of the Shares of Party B (whether pursuant to this Article 7 or an Event of Default), Party A shall hold as many of the Shares as is permissible under PRC Law, and the remainder of the Shares (if applicable) shall be held by the Designees, with Party B no longer holding any Shares. At such time, this Agreement shall be deemed to have terminated, and the obligations of Party B hereunder to have been fulfilled (with the exception of those under 3.1.13 and 3.1.14).

7.3 **Delay.** Party B undertakes to notify Party A immediately of any delay in effecting a Share Transfer or completing the procedures described in Article 7.2 above, together with the reason for such delay and revised effective date of the Share Transfer.

7.4 **Repayment of Loan.** The corresponding portion of the Loan shall be deemed to have been repaid as of the effective date of each Share Transfer. Once Party B has completed the Share Transfer in accordance with the provisions of this Article 7, the Loan shall be deemed to have been repaid in full and Party B shall be deemed to have performed her repayment obligations hereunder.

8. MISCELLANEOUS

8.1 **Notices and Delivery.** All notices and communications among the Parties shall be made in writing and in the English language by facsimile transmission with confirmation of transmission, delivery in person (including courier service) or registered airmail letter to the appropriate correspondence addresses set forth below:

Party A

Sohu.com, Inc.  
15/F, Tower 2, Bright China Chang An Building, 7 Jianguomen  
Nei Avenue, Beijing 100005  
Tel : 8610-6510-2160  
Fax : 8610-6510-2159

Party B

Deng Xiufeng  
Tel : 8610—6510—2160

8.2 **Timing.** The time of receipt of the notice or communication shall be deemed to be:

8.2.1 If by facsimile transmission with confirmation of transmission, at the time displayed in the corresponding transmission record, unless such facsimile is sent after 5:00 p.m. or on a non-business day in the place where it is received, in which case the date of receipt shall be deemed to be the following business day;



- 8.2.2 if in person (including express mail), on the date that the receiving Party or a person at the receiving Party's address signs for the document; or
- 8.2.3 if by registered mail, on the 10<sup>th</sup> day after the date that is printed on the receipt of the registered mail.
- 8.3 **Payments.** All amounts payable by Party B hereunder shall be paid in RMB.
- 8.4 **Amendments.** The provisions of this Agreement may not be waived, modified or amended except by an instrument in writing signed by the Parties (which instrument shall be attached as an Appendix hereto).
- 8.5 **No Waiver.** Failure or delay on the part of any Party to exercise any right under this Agreement shall not operate as a waiver thereof.
- 8.6 **Severability.** The invalidity of any provision of this Agreement shall not affect the validity of any other provision of this Agreement which is unrelated to that provision.
- 8.7 **Survival.** The confidentiality obligations of the Parties hereunder shall remain in full force and effect regardless of the termination of this Agreement for any reason.
- 8.8 **Taxes and Duties.** Party A shall be responsible for all stamp duties and other governmental fees, taxes and reasonable out-of-pocket expenses (including reasonable legal fees) incurred by the Parties in connection with the conversion of the Loan and each Share Transfer made hereunder and in the preparation of this Agreement.
- 8.9 **Successors.** This Agreement shall be binding upon the Parties and upon their respective successors and assigns (if any).
- 8.10 **Assignment.** Party B may neither assign nor otherwise transfer his rights or obligations under this Agreement without the prior written consent of Party A.
- 8.11 **Governing Law.** The execution, validity, interpretation and implementation of this Agreement and the settlement of disputes thereunder shall be governed by PRC Law.

- 8.12 **Arbitration.** All disputes arising out of or in connection with this Agreement shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce as administered by the International Court of Arbitration of the International Chamber of Commerce in Hong Kong by a sole arbitrator appointed in accordance with the said Rules conducted in the English language.
- 8.13 **Entire Agreement.** This Agreement and the Appendix hereto constitute the entire agreement between the Parties and supersede all prior discussions, negotiations and agreements. The Appendix form an integral part hereof and have the same legal effect as this Agreement. If there is any inconsistency between the provisions of this Agreement and any of the Appendix, the provisions of this Agreement shall prevail to the extent of such inconsistency.
- 8.14 **Language.** This Agreement will be signed in 3 originals in English languages, with 1 original for each Party.

**IN WITNESS WHEREOF**, the Parties hereto have executed or caused this Agreement to be executed by their duly authorised representatives (as the case may be) as of the date first indicated above.

***For and on behalf of Sohu.com, Inc.***

By /s/ Carol Yu

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Name: Carol Yu

Title: Chief Financial Officer

***By Deng Xiufeng***

/s/ Deng Xiufeng

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***Loan and Share Pledge Agreement***

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*between*

Sohu.com, Inc.

*and*

Zhou Jing

October 2004

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**THIS LOAN AND SHARE PLEDGE AGREEMENT** (this "**Agreement**") is entered into on this 27th day of October 2004 in Beijing, People's Republic of China ("**PRC**").

among

(1) **Sohu.com, Inc.**, a U.S. corporation, of Delaware, U.S. ("**Party A**"),

and

(2) **Zhou Jing**, a PRC citizen whose ID number is 510102197405256144 and residential address is 7-11-201 Qinchun Garden, Xiasanqi, Haidian District Beijing, PRC ("**Party B**")

(individually a "**Party**" and together the "**Parties**").

#### **RECITALS**

- A. Party B wish to acquire 41.9% shareholding of Beijing G. Feel Technology Co., Ltd. in Beijing, PRC..
- B. The Domestic Company is and will continue to engaged in the business of providing value-added mobile data services (including the development and sales, through Monternet, of ring tones, pictures and K-Java games for mobile phones) in the PRC (the "Business").
- C. Party B wishes to borrow the amount specified in Article 2.1 below (the "**Loan**") from Party A, and Party A has agreed to provide the Loan to Party B on an interest-free basis, for the sole purpose of financing the acquisition of the shares of the Domestic Company and developing the Domestic Company's business, which shall specifically include the entering into of a series of agreements with Party A and its Affiliates (as defined below).
- D. As security for the Loan and their performance of this Agreement, Party B has agreed to pledge her portion of the equity interest in the Domestic Company (the "**Shares**") to Party A.

NOW, **THEREFORE**, the Parties agree as follows:

1. DEFINITIONS AND INTERPRETATIONS

1.1 **Definitions.** Unless otherwise indicated, the following terms in this Agreement shall have the meanings set forth below:

<b>“Affiliate”</b>	any affiliate entity or business associate of Party A, including without limitation the WFOE – Sohu ITC Information Technology (Beijing) Co., Ltd.
<b>“Certificate”</b>	as defined in Article 3.1.9;
<b>“Conversion Date”</b>	as defined in Article 7.2.1;
<b>“Conversion Notice”</b>	as defined in Article 7.1;
<b>“Designee”</b>	an individual, corporation or other appropriate entity designated by Party A to be the recipient of a Share Transfer;
<b>“Event of Default”</b>	as defined in Article 6;
<b>“Loan Date”</b>	with respect to Party B, the date on which the portion of the Loan amount borrowed by Party B is paid into her designated bank account;
<b>“PRC Law”</b>	any published and available laws and regulations of the PRC;
<b>“Repayment Date”</b>	as defined in Article 2.3;
<b>“RMB”</b>	Renminbi, the lawful currency of the PRC;
<b>“Share Transfer”</b>	as defined in Article 7.2.1;
<b>“USD”</b>	United States Dollar, the lawful currency of the United States of America.
<b>“WFOE”</b>	A wholly-owned subsidiary established by Party A in the PRC.

1.2 **Interpretations.** The headings herein are for reference purposes only and do not affect the meaning or interpretation of any provision hereof. Any reference herein to an Article or Appendix is to an article or appendix of this Agreement. The use of the plural shall include the use of the singular, and vice versa.

Unless otherwise indicated, a reference herein to a day, month or year is to a calendar day, month or year. A reference to a business day is to a day on which commercial banks are open for business in both the PRC and the U.S. The use of the masculine shall include the use of the feminine, and vice versa.

2. AMOUNT AND REPAYMENT OF THE LOAN

- 2.1 **Loan Amount.** Party A agrees, subject to the terms and conditions of this Agreement, to cause its Affiliate to extend the Loan to Party B in a total amount of RMB 4,190,000. The Loan shall be interest-free.
- 2.2 **Provision of Loan.** The Loan shall be deemed to have been provided to Party B on the Loan Date.
- 2.3 **Date of Repayment.** The Loan, together with any other moneys owing under this Agreement by Party B, shall become repayable upon the earliest to occur of any of the following events (each a "**Repayment Date**"):
- 2.3.1 in full, on the occurrence of an Event of Default;
  - 2.3.2 in full, on the resignation or removal of Party B from the position of director, general manager, supervisor of the Domestic Company;
  - 2.3.3 in full, with respect to Party B, the date on which such Party's employment relationship with Party A or any Affiliate terminates for any reason;
  - 2.3.4 in full, where Party A intends to replace this Agreement with another agreement, the date of the written notice from Party A to Party B confirming such intention; or
  - 2.3.5 in full or in part, at Party A's sole discretion upon any date selected by Party A after the second anniversary of the date of signing of this Agreement.
- 2.4 **Method of Repayment.** Repayment will be made only by means of converting the Loan into Shares, as described in Article 7 below, with the final amount of the Loan being due and repayable on the final Conversion Date. The Loan may not be repaid prior to the Repayment Date or by any means not specifically permitted in this Article 2.4 without the express written consent of Party A.



3. UNDERTAKINGS AND WARRANTIES OF PARTY B

3.1 ***Undertakings and Warranties.*** Party B hereby undertakes and warrants to Party A that:

- 3.1.1 the Loan will be used solely for the purpose of purchasing the 41.9% shareholding of the Domestic Company;
- 3.1.2 she has and shall maintain the full power and authority to enter into this Agreement, to borrow the Loan and to perform her obligations hereunder;
- 3.1.3 there are no civil or criminal, claims, actions, suits, investigations or proceedings pending or, to her knowledge, threatened against her;
- 3.1.4 there is no provision of any Agreement, enforceable judgement or order of any court binding on her or affecting her property, which would in any way prevent or materially adversely affect her execution or performance of this Agreement;
- 3.1.5 the execution and performance of this Agreement and the realization of Party A's rights hereunder will not violate any mortgage right, contract, judgement, decree or law which is binding upon her or her assets;
- 3.1.6 upon her investment in the Domestic Company, she shall be the sole legal and beneficial owner of his Shares, free and clear of all pledges and encumbrances other than the security interest created by this Agreement;
- 3.1.7 she shall cause the pledge of her respective Shares to Party A to be recorded on the Domestic Company's register of shareholders;
- 3.1.8 upon the establishment of the Domestic Company, she shall provide to Party A a certificate from the Domestic Company evidencing her ownership of the Shares (a "Certificate") together with an Assignment Agreement, substantially in the form attached hereto as an Appendix;

- 3.1.9 for the duration of this Agreement, she will not cause the Domestic Company, without the written consent of Party A, to engage directly or indirectly in any business activities which compete with those of Party A other than those described in Recital B above;
- 3.1.10 she will, at any time and at Party A's expense, defend the Shares against any third party claims;
- 3.1.11 without the consent of Party A, except as expressly permitted hereunder, she will not arrange for or otherwise permit or cause the issuance of any new shares of capital stock of the Domestic Company;
- 3.1.12 she shall do or cause to be done all such acts, and execute or cause to be executed any necessary documents and registrations, such that the conversion of the Loan, the Share Transfers and all other transactions contemplated hereunder are effected in a legal and valid manner; and
- 3.1.13 she shall maintain as strictly confidential the existence and provisions of this Agreement, as well as of any correspondence, resolutions, ancillary agreements and any other documentation associated herewith.

4. COVENANTS

- 4.1 **Affirmative Covenants.** Party B hereby covenants that she will furnish to Party A, within 10 days after the end of each month after the Domestic Company has been established, with financial statements of the Domestic Company and such additional information as Party A may from time to time reasonably request
- 4.2 **Further Covenants.** Party B further covenants that, from the date hereof until full repayment of the Loan has been effected, she will not, and will ensure that the Domestic Company does not, except with the prior written consent of Party A:
  - 4.2.1 incur or assume any debt that is not due and payable in the ordinary course of its business (except indebtedness to Party A hereunder or as otherwise specifically permitted hereunder);
  - 4.2.2 incur or assume any mortgage, pledge or other encumbrance of any kind upon any assets of the Domestic Company, whether now owned or hereafter acquired;

- 4.2.3 enter into any agreement, arrangement, commitment or understanding to, or actually acquire all or part of the substantial assets of any third party;
- 4.2.4 enter into any agreement, arrangement, commitment or understanding to, or actually sell, lease, or otherwise dispose of any assets of the Domestic Company except in the ordinary course of business;
- 4.2.5 enter into any agreement, arrangement, commitment or understanding to, or actually, make loans or advances to any third party;
- 4.2.6 enter into any agreement, arrangement, commitment or understanding to, or actually, assume, guarantee, endorse or otherwise become liable for the obligation of any third party or other entity; or
- 4.2.7 permit the Domestic Company to conduct any business not expressly described in Recital B of this Agreement.

4.3 ***Rights of Party A.***

- 4.3.1 Party B agrees that she shall obtain Party A's written approval prior to undertaking any of the following, namely:
  - 4.3.1.1 appointing and removing the directors of the Domestic Company;
  - 4.3.1.2 appointing and removing the general manager of the Domestic Company; and
  - 4.3.1.3 approving the terms of employment of the general manager.
- 4.3.2 Party B agrees that she shall obtain Party A's written approval prior to undertaking any of the following, namely:
  - 4.3.2.1 appointing and removing of the senior management personnel and any key personnel of the Domestic Company; and

4.3.2.2 approving the terms of employment of the senior management personnel and key personnel of the Domestic Company.

5. SHARE PLEDGE

5.1 **Share Pledge.** As security for the performance in full of the obligations of Party B under this Agreement, Party B hereby pledges to Party A, and creates in favor of Party A or the Designee (as appropriate), a first priority security interest in all of the rights, title and interest in and to:

5.1.1 the Shares; and

5.1.2 all of her incidental rights with respect to the Shares, now or hereafter acquired.

Such security interest is to be perfected by compliance by Party B with Article 3.1.9 of this Agreement.

5.2 **Power of Attorney.** Party B hereby irrevocably grants to Party A or the Designee (as appropriate) full power of attorney for the purpose of carrying out the provisions of this Agreement, as well as taking any action and executing any instrument which Party A in good faith deems necessary to accomplish for purposes of this Agreement.

6. EVENTS OF DEFAULT

The occurrence of any of the following events shall constitute a default of the Loan hereunder and a breach of this Agreement by Party B (as appropriate) (an "**Event of Default**"):

6.1 a Share Transfer has not been effected by Party B within 20 working days after the corresponding Conversion Date or such time as may otherwise be agreed upon by the Parties;

6.2 Party B is in breach of any of the terms and conditions hereof, and such breach has not been rectified for a period of 10 days after receipt of Party A's written notice requesting such rectified;

6.3 any undertaking or warranty made by Party B herein shall prove to have been false or misleading in any material respect;

- 6.4 Party B makes any arrangement with her respective creditors or takes or suffers any similar action in consequence of debt; or
- 6.5 any judgment is made under any applicable law against Party which exceeds USD 50,000.

7. LOAN CONVERSION

- 7.1 **Share Conversion.** As of the Repayment Date, the Loan shall be convertible into Shares on the basis that 100 percent of the Loan amount equals 100 percent of the Shares. For the avoidance of doubt, if 10 percent of the Loan were repayable by Party B, then Party B would be required to transfer 10% of the total number of the Shares to Party A. The Loan shall become repayable to such extent as Party A may from time to time request, until the entire Loan amount has been repaid. Party A shall request to convert all or a percentage of the Loan by means of a written notice to Party B that specifies the percentage of the Loan to be converted into Shares ("**Conversion Notice**").
- 7.2 **Share Transfer.**
  - 7.2.1 Within 20 working days after receipt of a Conversion Notice ("**Conversion Date**"), Party B shall effect the transfer of the portion of the Shares designated in the Conversion Notice, either to Party A directly or to the Designee specified by Party A in the Conversion Notice (each a "**Share Transfer**").
  - 7.2.2 For the avoidance of doubt, upon the completion of the conversion of the Loan and the transfer of all of the Shares of Party B (whether pursuant to this Article 7 or an Event of Default), Party A shall hold as many of the Shares as is permissible under PRC Law, and the remainder of the Shares (if applicable) shall be held by the Designees, with Party B no longer holding any Shares. At such time, this Agreement shall be deemed to have terminated, and the obligations of Party B hereunder to have been fulfilled (with the exception of those under 3.1.13 and 3.1.14).
- 7.3 **Delay.** Party B undertakes to notify Party A immediately of any delay in effecting a Share Transfer or completing the procedures described in Article 7.2 above, together with the reason for such delay and revised effective date of the Share Transfer.

7.4 **Repayment of Loan.** The corresponding portion of the Loan shall be deemed to have been repaid as of the effective date of each Share Transfer. Once Party B has completed the Share Transfer in accordance with the provisions of this Article 7, the Loan shall be deemed to have been repaid in full and Party B shall be deemed to have performed her repayment obligations hereunder.

8. MISCELLANEOUS

8.1 **Notices and Delivery.** All notices and communications among the Parties shall be made in writing and in the English language by facsimile transmission with confirmation of transmission, delivery in person (including courier service) or registered airmail letter to the appropriate correspondence addresses set forth below:

Party A

Sohu.com, Inc.  
15/F, Tower 2, Bright China Chang An Building, 7 Jianguomen  
Nei Avenue, Beijing 100005

Tel : 8610-6510-2160

Fax : 8610-6510-2159

Party B

Zhou Jing

Tel : 8610—6510—2160

8.2 **Timing.** The time of receipt of the notice or communication shall be deemed to be:

8.2.1 If by facsimile transmission with confirmation of transmission, at the time displayed in the corresponding transmission record, unless such facsimile is sent after 5:00 p.m. or on a non-business day in the place where it is received, in which case the date of receipt shall be deemed to be the following business day;

8.2.2 if in person (including express mail), on the date that the receiving Party or a person at the receiving Party's address signs for the document; or

- 8.2.3 if by registered mail, on the 10<sup>th</sup> day after the date that is printed on the receipt of the registered mail.
- 8.3 **Payments.** All amounts payable by Party B hereunder shall be paid in RMB.
- 8.4 **Amendments.** The provisions of this Agreement may not be waived, modified or amended except by an instrument in writing signed by the Parties (which instrument shall be attached as an Appendix hereto).
- 8.5 **No Waiver.** Failure or delay on the part of any Party to exercise any right under this Agreement shall not operate as a waiver thereof.
- 8.6 **Severability.** The invalidity of any provision of this Agreement shall not affect the validity of any other provision of this Agreement which is unrelated to that provision.
- 8.7 **Survival.** The confidentiality obligations of the Parties hereunder shall remain in full force and effect regardless of the termination of this Agreement for any reason.
- 8.8 **Taxes and Duties.** Party A shall be responsible for all stamp duties and other governmental fees, taxes and reasonable out-of-pocket expenses (including reasonable legal fees) incurred by the Parties in connection with the conversion of the Loan and each Share Transfer made hereunder and in the preparation of this Agreement.
- 8.9 **Successors.** This Agreement shall be binding upon the Parties and upon their respective successors and assigns (if any).
- 8.10 **Assignment.** Party B may neither assign nor otherwise transfer his rights or obligations under this Agreement without the prior written consent of Party A.
- 8.11 **Governing Law.** The execution, validity, interpretation and implementation of this Agreement and the settlement of disputes thereunder shall be governed by PRC Law.
- 8.12 **Arbitration.** All disputes arising out of or in connection with this Agreement shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce as administered by

the International Court of Arbitration of the International Chamber of Commerce in Hong Kong by a sole arbitrator appointed in accordance with the said Rules conducted in the English language.

- 8.13 **Entire Agreement.** This Agreement and the Appendix hereto constitute the entire agreement between the Parties and supersede all prior discussions, negotiations and agreements. The Appendix form an integral part hereof and have the same legal effect as this Agreement. If there is any inconsistency between the provisions of this Agreement and any of the Appendix, the provisions of this Agreement shall prevail to the extent of such inconsistency.
- 8.14 **Language.** This Agreement will be signed in 3 originals in English languages, with 1 original for each Party.



**IN WITNESS WHEREOF**, the Parties hereto have executed or caused this Agreement to be executed by their duly authorised representatives (as the case may be) as of the date first indicated above.

***For and on behalf of Sohu.com, Inc.***

By /s/ Carol Yu

\_\_\_\_\_

Name: Carol Yu

Title: Chief Financial Officer

***By Zhou Jing***

/s/ Zhou Jing

\_\_\_\_\_

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***Loan and Share Pledge Agreement***

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*between*

Sohu.com, Inc.

*and*

Wang Jianjun

November 2004

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**THIS LOAN AND SHARE PLEDGE AGREEMENT** (this “**Agreement**”) is entered into on this 3rd day of November 2004 in Beijing, People’s Republic of China (“**PRC**”)

among

(1) **Sohu.com, Inc.**, a U.S. corporation, of Delaware, U.S. (“**Party A**”),

and

(2) **Wang Jianjun**, a PRC citizen whose ID number is 330106196912230093 and residential address is 19, Xijiekou Avenue, Haidian District, Beijing, PRC (“**Party B**”)

(individually a “**Party**” and together the “**Parties**”).

**RECITALS**

- A. Party B wish to acquire 20% of the shares of Beijing Heng Da Yi Tong Digital Network Technology Co., Ltd. (the Domestic Company) in Beijing, PRC.
- B. The Domestic Company is and will continue to engaged in the business of providing value-added telecommunication services in the PRC (the “**Business**”).
- C. Party B wishes to borrow the amount specified in Article 2.1 below (the “**Loan**”) from Party A, and Party A has agreed to provide the Loan to Party B on an interest-free basis, for the sole purpose of financing the acquisition of the shares of the Domestic Company and developing the Domestic Company’s business, which shall specifically include the entering into of a series of agreements with Party A and its Affiliates (as defined below).
- D. As security for the Loan and the performance of this Agreement, Party B has agreed to pledge his portion of the equity interest in the Domestic Company (the “**Shares**”) to Party A.

NOW, **THEREFORE**, the Parties agree as follows:

1. DEFINITIONS AND INTERPRETATIONS

1.1 **Definitions.** Unless otherwise indicated, the following terms in this Agreement shall have the meanings set forth below:

<b>“Affiliate”</b>	any affiliate entity or business associate of Party A, including without limitation the WFOE – Sohu ITC Information Technology (Beijing) Co., Ltd.
<b>“Certificate”</b>	as defined in Article 3.1.9;
<b>“Conversion Date”</b>	as defined in Article 7.2.1;
<b>“Conversion Notice”</b>	as defined in Article 7.1;
<b>“Designee”</b>	an individual, corporation or other appropriate entity designated by Party A to be the recipient of a Share Transfer;
<b>“Event of Default”</b>	as defined in Article 6;
<b>“Loan Date”</b>	with respect to Party B, the date on which the portion of the Loan amount borrowed by Party B is paid into her designated bank account;
<b>“PRC Law”</b>	any published and available laws and regulations of the PRC;
<b>“Repayment Date”</b>	as defined in Article 2.3;
<b>“RMB”</b>	Renminbi, the lawful currency of the PRC;
<b>“Share Transfer”</b>	as defined in Article 7.2.1;
<b>“USD”</b>	United States Dollar, the lawful currency of the United States of America.
<b>“WFOE”</b>	A wholly-owned subsidiary established by Party A in the PRC.

1.2 **Interpretations.** The headings herein are for reference purposes only and do not affect the meaning or interpretation of any provision hereof. Any reference herein to an Article or Appendix is to an article or appendix of this Agreement. The use of the plural shall include the use of the singular, and vice versa.

Unless otherwise indicated, a reference herein to a day, month or year is to a calendar day, month or year. A reference to a business day is to a day on which commercial banks are open for business in both the PRC and the U.S. The use of the masculine shall include the use of the feminine, and vice versa.

2. AMOUNT AND REPAYMENT OF THE LOAN

- 2.1 **Loan Amount.** Party A agrees, subject to the terms and conditions of this Agreement, to cause its Affiliate to extend the Loan to Party B in a total amount of RMB 2,000,000. The Loan shall be interest-free.
- 2.2 **Provision of Loan.** The Loan shall be deemed to have been provided to Party B on the Loan Date.
- 2.3 **Date of Repayment.** The Loan, together with any other moneys owing under this Agreement by Party B, shall become repayable upon the earliest to occur of any of the following events (each a "**Repayment Date**"):
- 2.3.1 in full, on the occurrence of an Event of Default;
  - 2.3.2 in full, on the resignation or removal of Party B from the position of director, chairman of the Board of Directors, general manager, supervisor of the Domestic Company;
  - 2.3.3 in full, with respect to Party B, the date on which such Party's employment relationship with Party A or any Affiliate terminates for any reason;
  - 2.3.4 in full, where Party A intends to replace this Agreement with another agreement, the date of the written notice from Party A to Party B confirming such intention; or
  - 2.3.5 in full or in part, at Party A's sole discretion upon any date selected by Party A after the second anniversary of the date of signing of this Agreement.
- 2.4 **Method of Repayment.** Repayment will be made only by means of converting the Loan into Shares, as described in Article 7 below, with the final amount of the Loan being due and repayable on the final Conversion Date. The Loan may not be repaid prior to the Repayment Date or by any means not specifically permitted in this Article 2.4 without the express written consent of Party A.

3. UNDERTAKINGS AND WARRANTIES OF PARTY B

3.1 **Undertakings and Warranties.** Party B hereby undertakes and warrants to Party A that:

- 3.1.1 the Loan will be used solely for the purpose of purchasing the 20% shareholding of the Domestic Company;
- 3.1.2 he has and shall maintain the full power and authority to enter into this Agreement, to borrow the Loan and to perform his obligations hereunder;
- 3.1.3 there are no civil or criminal, claims, actions, suits, investigations or proceedings pending or, to his knowledge, threatened against her;
- 3.1.4 there is no provision of any Agreement, enforceable judgement or order of any court binding on his or affecting her property, which would in any way prevent or materially adversely affect his execution or performance of this Agreement;
- 3.1.5 the execution and performance of this Agreement and the realization of Party A's rights hereunder will not violate any mortgage right, contract, judgement, decree or law which is binding upon his or his assets;
- 3.1.6 upon his investment in the Domestic Company, he shall be the sole legal and beneficial owner of his Shares, free and clear of all pledges and encumbrances other than the security interest created by this Agreement;
- 3.1.7 he shall cause the pledge of his respective Shares to Party A to be recorded on the Domestic Company's register of shareholders;
- 3.1.8 upon the completion of the transfer of the shares of the Domestic Company, he shall provide to Party A a certificate from the Domestic Company evidencing his ownership of the Shares (a "**Certificate**") together with an Assignment Agreement, substantially in the form attached hereto as an Appendix;

- 3.1.9 for the duration of this Agreement, he will not cause the Domestic Company, without the written consent of Party A, to engage directly or indirectly in any business activities which compete with those of Party A other than those described in Recital B above;
- 3.1.10 he will, at any time and at Party A's expense, defend the Shares against any third party claims;
- 3.1.11 without the consent of Party A, except as expressly permitted hereunder, he will not arrange for or otherwise permit or cause the issuance of any new shares of capital stock of the Domestic Company;
- 3.1.12 he shall do or cause to be done all such acts, and execute or cause to be executed any necessary documents and registrations, such that the conversion of the Loan, the Share Transfers and all other transactions contemplated hereunder are effected in a legal and valid manner; and
- 3.1.13 he shall maintain as strictly confidential the existence and provisions of this Agreement, as well as of any correspondence, resolutions, ancillary agreements and any other documentation associated herewith.

4. COVENANTS

- 4.1 **Affirmative Covenants.** Party B hereby covenants that he will furnish to Party A, within 10 days after the end of each month after the completion of the acquisition of the shares of the Domestic Company has been established, with financial statements of the Domestic Company and such additional information as Party A may from time to time reasonably request
- 4.2 **Further Covenants.** Party B further covenants that, from the date hereof until full repayment of the Loan has been effected, he will not, and will ensure that the Domestic Company does not, except with the prior written consent of Party A:
  - 4.2.1 incur or assume any debt that is not due and payable in the ordinary course of its business (except indebtedness to Party A hereunder or as otherwise specifically permitted hereunder);



- 4.2.2 incur or assume any mortgage, pledge or other encumbrance of any kind upon any assets of the Domestic Company, whether now owned or hereafter acquired;
- 4.2.3 enter into any agreement, arrangement, commitment or understanding to, or actually acquire all or part of the substantial assets of any third party;
- 4.2.4 enter into any agreement, arrangement, commitment or understanding to, or actually sell, lease, or otherwise dispose of any assets of the Domestic Company except in the ordinary course of business;
- 4.2.5 enter into any agreement, arrangement, commitment or understanding to, or actually, make loans or advances to any third party;
- 4.2.6 enter into any agreement, arrangement, commitment or understanding to, or actually, assume, guarantee, endorse or otherwise become liable for the obligation of any third party or other entity; or
- 4.2.7 permit the Domestic Company to conduct any business not expressly described in Recital B of this Agreement.

4.3 ***Rights of Party A.***

- 4.3.1 Party B agrees that he shall obtain Party A's written approval prior to undertaking any of the following, namely:
  - 4.3.1.1 appointing and removing the directors of the Domestic Company;
  - 4.3.1.2 appointing and removing the general manager of the Domestic Company; and
  - 4.3.1.3 approving the terms of employment of the general manager.
- 4.3.2 Party B agrees that he shall obtain Party A's written approval prior to undertaking any of the following, namely:
  - 4.3.2.1 appointing and removing of the senior management personnel and any key personnel of the Domestic Company; and

5. SHARE PLEDGE

5.1 **Share Pledge.** As security for the performance in full of the obligations of Party B under this Agreement, Party B hereby pledges to Party A, and creates in favor of Party A or the Designee (as appropriate), a first priority security interest in all of the rights, title and interest in and to:

5.1.1 the Shares; and

5.1.2 all of her incidental rights with respect to the Shares, now or hereafter acquired.

Such security interest is to be perfected by compliance by Party B with Article 3.1.9 of this Agreement.

5.2 **Power of Attorney.** Party B hereby irrevocably grants to Party A or the Designee (as appropriate) full power of attorney for the purpose of carrying out the provisions of this Agreement, as well as taking any action and executing any instrument which Party A in good faith deems necessary to accomplish for purposes of this Agreement.

6. EVENTS OF DEFAULT

The occurrence of any of the following events shall constitute a default of the Loan hereunder and a breach of this Agreement by Party B (as appropriate) (an “**Event of Default**”):

6.1 a Share Transfer has not been effected by Party B within 20 working days after the corresponding Conversion Date or such time as may otherwise be agreed upon by the Parties;

6.2 Party B is in breach of any of the terms and conditions hereof, and such breach has not been rectified for a period of 10 days after receipt of Party A’s written notice requesting such rectified;

- 6.3 any undertaking or warranty made by Party B herein shall prove to have been false or misleading in any material respect;
- 6.4 Party B makes any arrangement with his respective creditors or takes or suffers any similar action in consequence of debt; or
- 6.5 any judgment is made under any applicable law against Party B which exceeds USD 50,000.

7. LOAN CONVERSION

- 7.1 **Share Conversion.** As of the Repayment Date, the Loan shall be convertible into Shares on the basis that 100 percent of the Loan amount equals 100 percent of the Shares. For the avoidance of doubt, if 10 percent of the Loan were repayable by Party B, then Party B would be required to transfer 10% of the total number of the Shares to Party A. The Loan shall become repayable to such extent as Party A may from time to time request, until the entire Loan amount has been repaid. Party A shall request to convert all or a percentage of the Loan by means of a written notice to Party B that specifies the percentage of the Loan to be converted into Shares ("**Conversion Notice**").
- 7.2 **Share Transfer.**
  - 7.2.1 Within 20 working days after receipt of a Conversion Notice ("**Conversion Date**"), Party B shall effect the transfer of the portion of the Shares designated in the Conversion Notice, either to Party A directly or to the Designee specified by Party A in the Conversion Notice (each a "**Share Transfer**").
  - 7.2.2 For the avoidance of doubt, upon the completion of the conversion of the Loan and the transfer of all of the Shares of Party B (whether pursuant to this Article 7 or an Event of Default), Party A shall hold as many of the Shares as is permissible under PRC Law, and the remainder of the Shares (if applicable) shall be held by the Designees, with Party B no longer holding any Shares. At such time, this Agreement shall be deemed to have terminated, and the obligations of Party B hereunder to have been fulfilled (with the exception of those under 3.1.13 and 3.1.14).

7.3 **Delay.** Party B undertakes to notify Party A immediately of any delay in effecting a Share Transfer or completing the procedures described in Article 7.2 above, together with the reason for such delay and revised effective date of the Share Transfer.

7.4 **Repayment of Loan.** The corresponding portion of the Loan shall be deemed to have been repaid as of the effective date of each Share Transfer. Once Party B has completed the Share Transfer in accordance with the provisions of this Article 7, the Loan shall be deemed to have been repaid in full and Party B shall be deemed to have performed her repayment obligations hereunder.

8. MISCELLANEOUS

8.1 **Notices and Delivery.** All notices and communications among the Parties shall be made in writing and in the English language by facsimile transmission with confirmation of transmission, delivery in person (including courier service) or registered airmail letter to the appropriate correspondence addresses set forth below:

Party A

Sohu.com, Inc.

15/F, Tower 2, Bright China Chang An Building, 7 Jianguomen Nei Avenue, Beijing 100005

Tel : 8610-6510-2160

Fax : 8610-6510-2159

Party B

Wang Jianjun

Tel : 8610—6510—2160

8.2 **Timing.** The time of receipt of the notice or communication shall be deemed to be:

8.2.1 If by facsimile transmission with confirmation of transmission, at the time displayed in the corresponding transmission record, unless such facsimile is sent after 5:00 p.m. or on a non-business day in the place where it is received, in which case the date of receipt shall be deemed to be the following business day;

- 8.2.2 if in person (including express mail), on the date that the receiving Party or a person at the receiving Party's address signs for the document; or
- 8.2.3 if by registered mail, on the 10<sup>th</sup> day after the date that is printed on the receipt of the registered mail.
- 8.3 **Payments.** All amounts payable by Party B hereunder shall be paid in RMB.
- 8.4 **Amendments.** The provisions of this Agreement may not be waived, modified or amended except by an instrument in writing signed by the Parties (which instrument shall be attached as an Appendix hereto).
- 8.5 **No Waiver.** Failure or delay on the part of any Party to exercise any right under this Agreement shall not operate as a waiver thereof.
- 8.6 **Severability.** The invalidity of any provision of this Agreement shall not affect the validity of any other provision of this Agreement which is unrelated to that provision.
- 8.7 **Survival.** The confidentiality obligations of the Parties hereunder shall remain in full force and effect regardless of the termination of this Agreement for any reason.
- 8.8 **Taxes and Duties.** Party A shall be responsible for all stamp duties and other governmental fees, taxes and reasonable out-of-pocket expenses (including reasonable legal fees) incurred by the Parties in connection with the conversion of the Loan and each Share Transfer made hereunder and in the preparation of this Agreement.
- 8.9 **Successors.** This Agreement shall be binding upon the Parties and upon their respective successors and assigns (if any).
- 8.10 **Assignment.** Party B may neither assign nor otherwise transfer his rights or obligations under this Agreement without the prior written consent of Party A.
- 8.11 **Governing Law.** The execution, validity, interpretation and implementation of this Agreement and the settlement of disputes thereunder shall be governed by PRC Law.

- 8.12 **Arbitration.** All disputes arising out of or in connection with this Agreement shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce as administered by the International Court of Arbitration of the International Chamber of Commerce in Hong Kong by a sole arbitrator appointed in accordance with the said Rules conducted in the English language.
- 8.13 **Entire Agreement.** This Agreement and the Appendix hereto constitute the entire agreement between the Parties and supersede all prior discussions, negotiations and agreements. The Appendix form an integral part hereof and have the same legal effect as this Agreement. If there is any inconsistency between the provisions of this Agreement and any of the Appendix, the provisions of this Agreement shall prevail to the extent of such inconsistency.
- 8.14 **Language.** This Agreement will be signed in 3 originals in English languages, with 1 original for each Party.

**IN WITNESS WHEREOF**, the Parties hereto have executed or caused this Agreement to be executed by their duly authorised representatives (as the case may be) as of the date first indicated above.

***For and on behalf of Sohu.com, Inc.***

By: /s/ Carol Yu

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Name: Carol Yu

Title: Chief Financial Officer

***By Wang Jianjun***

/s/ Wang Jianjun

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***Loan and Share Pledge Agreement***

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*between*

Sohu.com, Inc.

*and*

Wang Xin

November 2004



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**THIS LOAN AND SHARE PLEDGE AGREEMENT** (this "**Agreement**") is entered into on this 3rd day of November 2004 in Beijing, People's Republic of China ("**PRC**")

among

(1) **Sohu.com, Inc.**, a U.S. corporation, of Delaware, U.S. ("**Party A**"),

and

(2) **Wang Xin**, a PRC citizen whose ID number is 110108197111105483 and residential address is 14, Chaoyangmen South Avenue, Chaoyang District, Beijing, PRC ("**Party B**")

(individually a "**Party**" and together the "**Parties**").

**RECITALS**

- A. Party B wish to acquire 80% of the shares of Beijing Heng Da Yi Tong Digital Network Technology Co., Ltd., (the Domestic Company) in Beijing, PRC.
- B. The Domestic Company is and will continue to engaged in the business of providing value-added telecommunication services in the PRC (the "Business").
- C. Party B wishes to borrow the amount specified in Article 2.1 below (the "**Loan**") from Party A, and Party A has agreed to provide the Loan to Party B on an interest-free basis, for the sole purpose of financing the acquisition of the shares of the Domestic Company and developing the Domestic Company's business, which shall specifically include the entering into of a series of agreements with Party A and its Affiliates (as defined below).
- D. As security for the Loan and their performance of this Agreement, Party B has agreed to pledge her portion of the equity interest in the Domestic Company (the "**Shares**") to Party A.

NOW, **THEREFORE**, the Parties agree as follows:

1. DEFINITIONS AND INTERPRETATIONS

1.1 **Definitions.** Unless otherwise indicated, the following terms in this Agreement shall have the meanings set forth below:

<b>“Affiliate”</b>	any affiliate entity or business associate of Party A, including without limitation the WFOE – Sohu ITC Information Technology (Beijing) Co., Ltd.
<b>“Certificate”</b>	as defined in Article 3.1.9;
<b>“Conversion Date”</b>	as defined in Article 7.2.1;
<b>“Conversion Notice”</b>	as defined in Article 7.1;
<b>“Designee”</b>	an individual, corporation or other appropriate entity designated by Party A to be the recipient of a Share Transfer;
<b>“Event of Default”</b>	as defined in Article 6;
<b>“Loan Date”</b>	with respect to Party B, the date on which the portion of the Loan amount borrowed by Party B is paid into her designated bank account;
<b>“PRC Law”</b>	any published and available laws and regulations of the PRC;
<b>“Repayment Date”</b>	as defined in Article 2.3;
<b>“RMB”</b>	Renminbi, the lawful currency of the PRC;
<b>“Share Transfer”</b>	as defined in Article 7.2.1;
<b>“USD”</b>	United States Dollar, the lawful currency of the United States of America.
<b>“WFOE”</b>	A wholly-owned subsidiary established by Party A in the PRC.

1.2 **Interpretations.** The headings herein are for reference purposes only and do not affect the meaning or interpretation of any provision hereof. Any reference herein to an Article or Appendix is to an article or appendix of this Agreement. The use of the plural shall include the use of the singular, and vice versa.

Unless otherwise indicated, a reference herein to a day, month or year is to a calendar day, month or year. A reference to a business day is to a day on which commercial banks are open for business in both the PRC and the U.S. The use of the masculine shall include the use of the feminine, and vice versa.

2. AMOUNT AND REPAYMENT OF THE LOAN

- 2.1 **Loan Amount.** Party A agrees, subject to the terms and conditions of this Agreement, to cause its Affiliate to extend the Loan to Party B in a total amount of RMB 8,000,000. The Loan shall be interest-free.
- 2.2 **Provision of Loan.** The Loan shall be deemed to have been provided to Party B on the Loan Date.
- 2.3 **Date of Repayment.** The Loan, together with any other moneys owing under this Agreement by Party B, shall become repayable upon the earliest to occur of any of the following events (each a "**Repayment Date**"):
- 2.3.1 in full, on the occurrence of an Event of Default;
  - 2.3.2 in full, on the resignation or removal of Party B from the position of director, general manager, supervisor of the Domestic Company;
  - 2.3.3 in full, with respect to Party B, the date on which such Party's employment relationship with Party A or any Affiliate terminates for any reason;
  - 2.3.4 in full, where Party A intends to replace this Agreement with another agreement, the date of the written notice from Party A to Party B confirming such intention; or
  - 2.3.5 in full or in part, at Party A's sole discretion upon any date selected by Party A after the second anniversary of the date of signing of this Agreement.
- 2.4 **Method of Repayment.** Repayment will be made only by means of converting the Loan into Shares, as described in Article 7 below, with the final amount of the Loan being due and repayable on the final Conversion Date. The Loan may not be repaid prior to the Repayment Date or by any means not specifically permitted in this Article 2.4 without the express written consent of Party A.

3. UNDERTAKINGS AND WARRANTIES OF PARTY B

3.1 ***Undertakings and Warranties.*** Party B hereby undertakes and warrants to Party A that:

- 3.1.1 the Loan will be used solely for the purpose of purchasing the 80% shareholding of the Domestic Company;
- 3.1.2 she has and shall maintain the full power and authority to enter into this Agreement, to borrow the Loan and to perform her obligations hereunder;
- 3.1.3 there are no civil or criminal, claims, actions, suits, investigations or proceedings pending or, to her knowledge, threatened against her;
- 3.1.4 there is no provision of any Agreement, enforceable judgement or order of any court binding on her or affecting her property, which would in any way prevent or materially adversely affect her execution or performance of this Agreement;
- 3.1.5 the execution and performance of this Agreement and the realization of Party A's rights hereunder will not violate any mortgage right, contract, judgement, decree or law which is binding upon her or her assets;
- 3.1.6 upon her investment in the Domestic Company, she shall be the sole legal and beneficial owner of his Shares, free and clear of all pledges and encumbrances other than the security interest created by this Agreement;
- 3.1.7 she shall cause the pledge of her respective Shares to Party A to be recorded on the Domestic Company's register of shareholders;
- 3.1.8 upon the establishment of the Domestic Company, she shall provide to Party A a certificate from the Domestic Company evidencing her ownership of the Shares (a "Certificate") together with an Assignment Agreement, substantially in the form attached hereto as an Appendix;

- 3.1.9 for the duration of this Agreement, she will not cause the Domestic Company, without the written consent of Party A, to engage directly or indirectly in any business activities which compete with those of Party A other than those described in Recital B above;
- 3.1.10 she will, at any time and at Party A's expense, defend the Shares against any third party claims;
- 3.1.11 without the consent of Party A, except as expressly permitted hereunder, she will not arrange for or otherwise permit or cause the issuance of any new shares of capital stock of the Domestic Company;
- 3.1.12 she shall do or cause to be done all such acts, and execute or cause to be executed any necessary documents and registrations, such that the conversion of the Loan, the Share Transfers and all other transactions contemplated hereunder are effected in a legal and valid manner; and
- 3.1.13 she shall maintain as strictly confidential the existence and provisions of this Agreement, as well as of any correspondence, resolutions, ancillary agreements and any other documentation associated herewith.

4. COVENANTS

- 4.1 **Affirmative Covenants.** Party B hereby covenants that she will furnish to Party A, within 10 days after the end of each month after the Domestic Company has been established, with financial statements of the Domestic Company and such additional information as Party A may from time to time reasonably request
- 4.2 **Further Covenants.** Party B further covenants that, from the date hereof until full repayment of the Loan has been effected, she will not, and will ensure that the Domestic Company does not, except with the prior written consent of Party A:
  - 4.2.1 incur or assume any debt that is not due and payable in the ordinary course of its business (except indebtedness to Party A hereunder or as otherwise specifically permitted hereunder);
  - 4.2.2 incur or assume any mortgage, pledge or other encumbrance of any kind upon any assets of the Domestic Company, whether now owned or hereafter acquired;

- 4.2.3 enter into any agreement, arrangement, commitment or understanding to, or actually acquire all or part of the substantial assets of any third party;
- 4.2.4 enter into any agreement, arrangement, commitment or understanding to, or actually sell, lease, or otherwise dispose of any assets of the Domestic Company except in the ordinary course of business;
- 4.2.5 enter into any agreement, arrangement, commitment or understanding to, or actually, make loans or advances to any third party;
- 4.2.6 enter into any agreement, arrangement, commitment or understanding to, or actually, assume, guarantee, endorse or otherwise become liable for the obligation of any third party or other entity; or
- 4.2.7 permit the Domestic Company to conduct any business not expressly described in Recital B of this Agreement.

4.3 ***Rights of Party A.***

- 4.3.1 Party B agrees that she shall obtain Party A's written approval prior to undertaking any of the following, namely:
  - 4.3.1.1 appointing and removing the directors of the Domestic Company;
  - 4.3.1.2 appointing and removing the general manager of the Domestic Company; and
  - 4.3.1.3 approving the terms of employment of the general manager.
- 4.3.2 Party B agrees that she shall obtain Party A's written approval prior to undertaking any of the following, namely:
  - 4.3.2.1 appointing and removing of the senior management personnel and any key personnel of the Domestic Company; and

5. SHARE PLEDGE

5.1 **Share Pledge.** As security for the performance in full of the obligations of Party B under this Agreement, Party B hereby pledges to Party A, and creates in favor of Party A or the Designee (as appropriate), a first priority security interest in all of the rights, title and interest in and to:

5.1.1 the Shares; and

5.1.2 all of her incidental rights with respect to the Shares, now or hereafter acquired.

Such security interest is to be perfected by compliance by Party B with Article 3.1.9 of this Agreement.

5.2 **Power of Attorney.** Party B hereby irrevocably grants to Party A or the Designee (as appropriate) full power of attorney for the purpose of carrying out the provisions of this Agreement, as well as taking any action and executing any instrument which Party A in good faith deems necessary to accomplish for purposes of this Agreement.

6. EVENTS OF DEFAULT

The occurrence of any of the following events shall constitute a default of the Loan hereunder and a breach of this Agreement by Party B (as appropriate) (an “**Event of Default**”):

6.1 a Share Transfer has not been effected by Party B within 20 working days after the corresponding Conversion Date or such time as may otherwise be agreed upon by the Parties;

6.2 Party B is in breach of any of the terms and conditions hereof, and such breach has not been rectified for a period of 10 days after receipt of Party A’s written notice requesting such rectified;

6.3 any undertaking or warranty made by Party B herein shall prove to have been false or misleading in any material respect;



- 6.4 Party B makes any arrangement with her respective creditors or takes or suffers any similar action in consequence of debt; or
- 6.5 any judgment is made under any applicable law against Party which exceeds USD 50,000.

7. LOAN CONVERSION

- 7.1 **Share Conversion.** As of the Repayment Date, the Loan shall be convertible into Shares on the basis that 100 percent of the Loan amount equals 100 percent of the Shares. For the avoidance of doubt, if 10 percent of the Loan were repayable by Party B, then Party B would be required to transfer 10% of the total number of the Shares to Party A. The Loan shall become repayable to such extent as Party A may from time to time request, until the entire Loan amount has been repaid. Party A shall request to convert all or a percentage of the Loan by means of a written notice to Party B that specifies the percentage of the Loan to be converted into Shares ("**Conversion Notice**").
- 7.2 **Share Transfer.**
  - 7.2.1 Within 20 working days after receipt of a Conversion Notice ("**Conversion Date**"), Party B shall effect the transfer of the portion of the Shares designated in the Conversion Notice, either to Party A directly or to the Designee specified by Party A in the Conversion Notice (each a "**Share Transfer**").
  - 7.2.2 For the avoidance of doubt, upon the completion of the conversion of the Loan and the transfer of all of the Shares of Party B (whether pursuant to this Article 7 or an Event of Default), Party A shall hold as many of the Shares as is permissible under PRC Law, and the remainder of the Shares (if applicable) shall be held by the Designees, with Party B no longer holding any Shares. At such time, this Agreement shall be deemed to have terminated, and the obligations of Party B hereunder to have been fulfilled (with the exception of those under 3.1.13 and 3.1.14).
- 7.3 **Delay.** Party B undertakes to notify Party A immediately of any delay in effecting a Share Transfer or completing the procedures described in Article 7.2 above, together with the reason for such delay and revised effective date of the Share Transfer.

7.4 **Repayment of Loan.** The corresponding portion of the Loan shall be deemed to have been repaid as of the effective date of each Share Transfer. Once Party B has completed the Share Transfer in accordance with the provisions of this Article 7, the Loan shall be deemed to have been repaid in full and Party B shall be deemed to have performed her repayment obligations hereunder.

8. MISCELLANEOUS

8.1 **Notices and Delivery.** All notices and communications among the Parties shall be made in writing and in the English language by facsimile transmission with confirmation of transmission, delivery in person (including courier service) or registered airmail letter to the appropriate correspondence addresses set forth below:

Party A

Sohu.com, Inc.  
15/F, Tower 2, Bright China Chang An Building, 7 Jianguomen  
Nei Avenue, Beijing 100005  
Tel : 8610-6510-2160  
Fax : 8610-6510-2159

Party B

Wang Xin  
Tel : 8610—6510—2160

8.2 **Timing.** The time of receipt of the notice or communication shall be deemed to be:

8.2.1 If by facsimile transmission with confirmation of transmission, at the time displayed in the corresponding transmission record, unless such facsimile is sent after 5:00 p.m. or on a non-business day in the place where it is received, in which case the date of receipt shall be deemed to be the following business day;

8.2.2 if in person (including express mail), on the date that the receiving Party or a person at the receiving Party's address signs for the document; or

- 8.2.3 if by registered mail, on the 10<sup>th</sup> day after the date that is printed on the receipt of the registered mail.
- 8.3 **Payments.** All amounts payable by Party B hereunder shall be paid in RMB.
- 8.4 **Amendments.** The provisions of this Agreement may not be waived, modified or amended except by an instrument in writing signed by the Parties (which instrument shall be attached as an Appendix hereto).
- 8.5 **No Waiver.** Failure or delay on the part of any Party to exercise any right under this Agreement shall not operate as a waiver thereof.
- 8.6 **Severability.** The invalidity of any provision of this Agreement shall not affect the validity of any other provision of this Agreement which is unrelated to that provision.
- 8.7 **Survival.** The confidentiality obligations of the Parties hereunder shall remain in full force and effect regardless of the termination of this Agreement for any reason.
- 8.8 **Taxes and Duties.** Party A shall be responsible for all stamp duties and other governmental fees, taxes and reasonable out-of-pocket expenses (including reasonable legal fees) incurred by the Parties in connection with the conversion of the Loan and each Share Transfer made hereunder and in the preparation of this Agreement.
- 8.9 **Successors.** This Agreement shall be binding upon the Parties and upon their respective successors and assigns (if any).
- 8.10 **Assignment.** Party B may neither assign nor otherwise transfer his rights or obligations under this Agreement without the prior written consent of Party A.
- 8.11 **Governing Law.** The execution, validity, interpretation and implementation of this Agreement and the settlement of disputes thereunder shall be governed by PRC Law.
- 8.12 **Arbitration.** All disputes arising out of or in connection with this Agreement shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce as administered by

the International Court of Arbitration of the International Chamber of Commerce in Hong Kong by a sole arbitrator appointed in accordance with the said Rules conducted in the English language.

- 8.13 **Entire Agreement.** This Agreement and the Appendix hereto constitute the entire agreement between the Parties and supersede all prior discussions, negotiations and agreements. The Appendix form an integral part hereof and have the same legal effect as this Agreement. If there is any inconsistency between the provisions of this Agreement and any of the Appendix, the provisions of this Agreement shall prevail to the extent of such inconsistency.
- 8.14 **Language.** This Agreement will be signed in 3 originals in English languages, with 1 original for each Party.

**IN WITNESS WHEREOF**, the Parties hereto have executed or caused this Agreement to be executed by their duly authorised representatives (as the case may be) as of the date first indicated above.

**For and on behalf of Sohu.com, Inc.**

By: /s/ Carol Yu

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Name: Carol Yu

Title: Chief Financial Officer

**By Wang Xin**

/s/ Wang Xin

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I, Charles Zhang, certify that:

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

Date: November 9, 2004

/s/ Charles Zhang

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Chief Executive Officer and Chairman of the  
Board of Directors

I, Carol Yu, certify that:

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

Date: November 9, 2004

/s/ Carol Yu

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Chief Financial Officer

SOHU.COM INC.

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

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

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition of the Company as of September 30, 2004 and results of operations of the Company for the three and nine months ended September 30, 2004.

/s/ Charles Zhang

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

November 9, 2004



SOHU.COM INC.

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

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

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition of the Company as of September 30, 2004 and results of operations of the Company for the three and nine months ended September 30, 2004.

/s/ Carol Yu

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Carol Yu, Chief Financial Officer  
November 9, 2004