

SOHU COM INC
Form 10-Q
August 08, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2016

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER 0-30961

Sohu.com Inc.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Delaware
(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

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

Level 18, SOHU.com Media Plaza

Block 3, No. 2 Kexueyuan South Road, Haidian District

Beijing 100190

People's Republic of China

(011) 8610-6272-6666

(Address, including zip code, of registrant's principal executive offices and registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

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

Class	Outstanding at June 30, 2016
Common stock, \$.001 par value	38,721,684

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****SOHU.COM INC.****CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)****(In thousands, except par value)**

	As of	
	December 31, 2015	June 30, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,245,205	\$ 1,148,070
Restricted time deposits	227,285	0
Short-term investments	174,515	118,820
Accounts receivable, net	273,617	215,577
Prepaid and other current assets (including \$15,820 and \$32,782, respectively, due from a related party as of December 31, 2015 and June 30, 2016)	158,890	250,731
Total current assets	2,079,512	1,733,198
Long-term investments, net	62,093	69,561
Time deposits	0	135,393
Restricted time deposits	136,694	9,270
Fixed assets, net	508,692	508,156
Intangible assets, net	55,415	38,884
Goodwill	154,219	153,421
Prepaid non-current assets	6,254	5,453
Other assets	39,315	26,166
Total assets	\$ 3,042,194	\$ 2,679,502
LIABILITIES		
Current liabilities:		
Accounts payable (including accounts payable of consolidated variable interest entities (VIEs) without recourse to the Company of \$23,757 and \$12,742, respectively, as of December 31, 2015 and June 30, 2016)	\$ 129,025	\$ 158,052
Accrued liabilities (including accrued liabilities of consolidated VIEs without recourse to the Company of \$79,012 and \$74,747, respectively, as of December 31, 2015 and June 30, 2016)	309,657	309,212
Receipts in advance and deferred revenue (including receipts in advance and deferred revenue of consolidated VIEs without recourse to the Company of \$55,319 and \$46,542, respectively, as of December 31, 2015 and June 30, 2016)	135,385	123,372

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Accrued salary and benefits (including accrued salary and benefits of consolidated VIEs without recourse to the Company of \$11,357 and \$11,431, respectively, as of December 31, 2015 and June 30, 2016)	99,631	86,980
Taxes payable (including taxes payable of consolidated VIEs without recourse to the Company of \$21,424 and \$10,413, respectively, as of December 31, 2015 and June 30, 2016)	67,480	35,638
Deferred tax liabilities (including deferred tax liabilities of consolidated VIEs without recourse to the Company of \$1,490 and \$1,417, respectively, as of December 31, 2015 and June 30, 2016)	24,884	25,461
Short-term bank loans (including short-term bank loans of consolidated VIEs without recourse to the Company of nil as of both December 31, 2015 and June 30, 2016)	344,500	0
Other short-term liabilities (including other short-term liabilities of consolidated VIEs without recourse to the Company of \$106,976 and \$145,587, respectively, as of December 31, 2015 and June 30, 2016, and due to a related party of \$13,005 and \$29,631, respectively, as of December 31, 2015 and June 30, 2016.)	154,017	206,998
Total current liabilities	1,264,579	945,713
Long-term accounts payable (including long-term accounts payable of consolidated VIEs without recourse to the Company of \$2,858 and nil as of December 31, 2015 and June 30, 2016)	4,600	17,749
Long-term taxes payable (including long-term taxes payable of consolidated VIEs without recourse to the Company of nil and \$13,908 as of December 31, 2015 and June 30, 2016)	24,732	33,306
Deferred tax liabilities (including deferred tax liabilities of consolidated VIEs without recourse to the Company of nil as of both December 31, 2015 and June 30, 2016)	17,531	13,573
Total long-term liabilities	46,863	64,628
Total liabilities	1,311,442	1,010,341
Commitments and contingencies		
SHAREHOLDERS EQUITY		
Sohu.com Inc. shareholders' equity:		
Common stock: \$0.001 par value per share (75,400 shares authorized; 38,653 shares and 38,722 shares, respectively, issued and outstanding as of December 31, 2015 and June 30, 2016)	45	45
Additional paid-in capital	798,357	817,893
Treasury stock (5,889 shares as of both December 31, 2015 and June 30, 2016)	(143,858)	(143,858)
Accumulated other comprehensive income	50,151	31,223
Retained earnings	536,327	453,017
Total Sohu.com Inc. shareholders' equity	1,241,022	1,158,320
Noncontrolling interest	489,730	510,841
Total shareholders' equity	1,730,752	1,669,161
Total liabilities and shareholders' equity	\$ 3,042,194	\$ 2,679,502

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

Table of Contents**SOHU.COM INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)****(In thousands, except per share data)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2016	2015	2016
Revenues:				
Online advertising:				
Brand advertising (including revenues generated from a related party of nil and \$10, respectively, for the three months ended June 30, 2015 and 2016, and of nil and \$862, respectively, for the six months ended June 30, 2015 and 2016)	\$ 150,849	\$ 112,887	\$ 284,670	\$ 238,390
Search and search-related	135,206	160,152	240,332	293,966
Subtotal of online advertising revenues	286,055	273,039	525,002	532,356
Online games	172,350	99,227	357,344	201,756
Others	35,161	47,872	66,552	93,978
Total revenues	493,566	420,138	948,898	828,090
Cost of revenues:				
Online advertising:				
Brand advertising	99,847	93,654	204,399	179,290
Search and search-related	58,552	71,998	108,471	134,090
Subtotal of cost of online advertising revenues	158,399	165,652	312,870	313,380
Online games	43,929	25,380	93,414	51,513
Others	18,872	21,226	37,070	40,212
Total cost of revenues	221,200	212,258	443,354	405,105
Gross profit	272,366	207,880	505,544	422,985
Operating expenses:				
Product development	100,771	88,959	202,962	171,638
Sales and marketing (including expenses generated for a related party of nil and \$202, respectively, for the three months ended June 30, 2015 and 2016, and of nil and \$216, respectively, for the six months ended June 30, 2015 and 2016)	103,977	117,966	187,105	208,013
General and administrative	49,720	29,650	94,884	57,257

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Total operating expenses	254,468	236,575	484,951	436,908
Operating profit /(loss)	17,898	(28,695)	20,593	(13,923)
Other income /(loss)	(437)	(24,573)	2,717	(20,649)
Net interest income	6,228	5,040	12,263	10,179
Exchange difference	(687)	3,866	(870)	2,844
Income /(loss) before income tax expense	23,002	(44,362)	34,703	(21,549)
Income tax expense	11,519	2,430	27,819	14,298
Net income /(loss)	11,483	(46,792)	6,884	(35,847)
Less: Net income attributable to the noncontrolling interest shareholders	38,682	16,232	65,203	47,463
Net loss attributable to Sohu.com Inc.	\$ (27,199)	\$ (63,024)	\$ (58,319)	\$ (83,310)
Net income /(loss)	11,483	(46,792)	6,884	(35,847)
Other comprehensive income /(loss)	11,616	(30,215)	12,785	(28,840)
Comprehensive income /(loss)	23,099	(77,007)	19,669	(64,687)
Less: Comprehensive income attributable to noncontrolling interest shareholders	40,613	5,420	65,850	37,551
Comprehensive loss attributable to Sohu.com Inc.	(17,514)	(82,427)	(46,181)	(102,238)
Basic net loss per share attributable to Sohu.com Inc.	\$ (0.70)	\$ (1.63)	\$ (1.51)	\$ (2.15)
Shares used in computing basic net loss per share attributable to Sohu.com Inc.	38,587	38,691	38,556	38,678
Diluted net loss per share attributable to Sohu.com Inc.	\$ (0.71)	\$ (1.64)	\$ (1.53)	\$ (2.17)
Shares used in computing diluted net loss per share attributable to Sohu.com Inc.	38,587	38,691	38,556	38,678

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

Table of Contents**SOHU.COM INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)****(In thousands)**

	Six Months Ended June 30,	
	2015	2016
Cash flows from operating activities:		
Net income /(loss)	\$ 6,884	\$ (35,847)
Adjustments to reconcile net income /(loss) to net cash provided by operating activities:		
Amortization of intangible assets and purchased video content in prepaid expense	96,956	62,500
Depreciation	41,254	34,685
Impairment of intangible assets	7,082	5,171
Provision for allowance for doubtful accounts	1,128	3,103
Share-based compensation expense	30,767	2,977
Investment loss from equity investments	3,104	814
Change in fair value of short-term investments and time deposits	(802)	(4,899)
Others	449	(571)
Changes in assets and liabilities, net of acquisition:		
Accounts receivable	(37,226)	49,697
Prepaid and other assets	(563)	6,419
Accounts payable	(953)	16,116
Accrued liabilities and other short-term liabilities	37,277	51,405
Receipts in advance and deferred revenue	6,448	(9,372)
Taxes payable	(647)	(33,272)
Deferred tax	9,183	2,721
Net cash provided by operating activities	200,341	151,647
Cash flows from investing activities:		
Purchase of intangible and other assets	(73,406)	(81,382)
Purchase of fixed assets	(55,295)	(47,688)
Matching loan to a related party	(13,086)	(18,115)
Purchase of long-term investments	(16,657)	(12,715)
Cash received related to restricted time deposits and time deposits, net	31,422	225,462
Proceeds from /(purchase of) financial instruments, net	(5,848)	24,060
Return of funds from a third party	0	3,619
Consideration received from disposition of 7Road.com Limited (7Road)	50,610	0
Other cash proceeds related to investing activities	3,148	978
Net cash provided by /(used in) investing activities	(79,112)	94,219
Cash flows from financing activities:		
Matching loan from a related party	12,900	17,041
Exercise of share-based awards in subsidiary	7	291
Issuance of common stock	2,019	0

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Repayments of loans from offshore banks	0	(344,500)
Repurchase of Changyou American depositary shares (ADSs)	(1,329)	0
Other cash proceeds related to financing activities	570	0
Net cash provided by /(used in) financing activities	14,167	(327,168)
Effect of exchange rate changes on cash and cash equivalents	5,114	(15,833)
Reclassification of cash and cash equivalents to held-for-sale assets	(14,871)	0
Net increase /(decrease) in cash and cash equivalents	125,639	(97,135)
Cash and cash equivalents at beginning of period	876,340	1,245,205
Cash and cash equivalents at end of period	\$ 1,001,979	\$ 1,148,070
Supplemental cash flow disclosures:		
Barter transactions	1,334	8,845
Supplemental schedule of non-cash investing activity:		
Consideration payable for acquisitions	5,000	0

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

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SOHU.COM INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)

Six Months Ended June 30, 2015

(In thousands)

	Sohu.com Inc. Shareholders' Equity						
	Total	Common Stock	Additional Paid-in Capital	Treasury Stock	Accumulated Other Comprehensive Income	Retained Earnings	Noncontrolling Interest
Beginning balance	\$ 1,688,906	\$ 44	\$ 650,148	\$ (143,858)	\$ 109,402	\$ 585,925	\$ 487,245
Issuance of common stock	2,022	1	2,021	0	0	0	0
Repurchase of Changyou ADSs	(1,329)	0	(905)	0	0	0	(424)
Share-based compensation expense	30,817	0	15,126	0	0	0	15,691
Settlement of share-based awards in subsidiary	0	0	1,567	0	0	0	(1,567)
Purchase of noncontrolling interest in RaidCall	0	0	458	0	0	0	(458)
Disposal of partial equity interest in a VIE	192	0	0	0	0	0	192
Net income attributable to Sohu.com Inc. and noncontrolling interest shareholders	6,884	0	0	0	0	(58,319)	65,203
Accumulated other comprehensive income	12,785	0	0	0	12,138	0	647
Ending balance	\$ 1,740,277	\$ 45	\$ 668,415	\$ (143,858)	\$ 121,540	\$ 527,606	\$ 566,529

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

Table of Contents**SOHU.COM INC.****CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)****Six Months Ended June 30, 2016**

(In thousands)

	Sohu.com Inc. Shareholders' Equity						
	Additional			Accumulated			
	Total	Common	Paid-in	Treasury	Comprehensive	Retained	Noncontrolling
		Stock	Capital	Stock	Income	Earnings	Interest
Beginning balance	\$ 1,730,752	\$ 45	\$ 798,357	\$ (143,858)	\$ 50,151	\$ 536,327	\$ 489,730
Share-based compensation expense	2,998	0	(631)	0	0	0	3,629
Settlement of share-based awards in subsidiary	336	0	18,834	0	0	0	(18,498)
Contribution from noncontrolling interest shareholder	0	0	1,333	0	0	0	(1,333)
Disposal of noncontrolling interest	(238)	0	0	0	0	0	(238)
Net income /(loss) attributable to Sohu.com Inc. and noncontrolling interest shareholders	(35,847)	0	0	0	0	(83,310)	47,463
Accumulated other comprehensive loss	(28,840)	0	0	0	(18,928)	0	(9,912)
Ending balance	\$ 1,669,161	\$ 45	\$ 817,893	\$ (143,858)	\$ 31,223	\$ 453,017	\$ 510,841

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

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SOHU.COM INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. The Company and Basis of Presentation

Nature of Operations

Sohu.com Inc. (NASDAQ: SOHU), a Delaware corporation organized in 1996, is a leading Chinese online media, search and game service group providing comprehensive online products and services on PCs and mobile devices in the People's Republic of China (the PRC or China). Sohu.com Inc.'s businesses are conducted by Sohu.com Inc. and its subsidiaries and VIEs (collectively referred to as the Sohu Group or the Group). The Sohu Group consists of Sohu, which when referred to in this report, unless the context requires otherwise, excludes the businesses and the corresponding subsidiaries and VIEs of Sogou Inc. (Sogou) and Changyou.com Limited (Changyou), Sogou and Changyou. Sogou and Changyou are indirect controlled subsidiaries of Sohu.com Inc. Sohu is a leading Chinese language online media content and services provider. Sogou is a leading online search, client software and mobile Internet product provider in China. Changyou is a leading online game developer and operator in China as measured by the popularity of its PC game Tian Long Ba Bu (TLBB) and its mobile game TLBB 3D, and engages primarily in the development, operation and licensing of online games for PCs and mobile devices. Most of the Group's operations are conducted through the Group's indirect wholly-owned and majority-owned China-based subsidiaries and VIEs.

Through the operation of Sohu, Sogou and Changyou, the Sohu Group generates online advertising revenues, including brand advertising revenues and search and search-related revenues; online games revenues; and other revenues. Online advertising and online games are the Group's core businesses.

Sohu's Business

Brand Advertising Business

Sohu's main business is the brand advertising business, which offers to users, over Sohu's matrices of Chinese language online media, various content, products and services across multiple Internet-enabled devices such as PCs, mobile phones and tablets. The majority of Sohu's products and services are provided through Sohu Media Portal, Sohu Video and Focus.

Sohu Media Portal. Sohu Media Portal is a leading online news and information provider in China. It provides users comprehensive content through www.sohu.com for PCs, the mobile phone application Sohu News APP and the mobile portal m.sohu.com;

Sohu Video. Sohu Video is a leading online video content and service provider in China through tv.sohu.com for PCs and the mobile phone application Sohu Video APP; and

Focus. Focus (www.focus.cn) is a leading online real estate information and services provider in China.

Revenues generated by the brand advertising business are classified as brand advertising revenues in the Sohu Group's consolidated statements of comprehensive income.

Other Business

Sohu also engages in other business, which includes the filming business, interactive broadcasting services, paid subscription services, and sub-licensing of purchased video content to third parties. Revenues generated by Sohu from other business are classified as other revenues in the Sohu Group's consolidated statements of comprehensive income.

Sogou's Business

Search and Search-related Business

The search and search-related business primarily offers advertisers pay-for-click services, as well as online marketing services on Web directories operated by Sogou. Pay-for-click services enable advertisers' promotional links to be displayed on the Sogou search result pages and Sogou Website Alliance members' Websites where the links are relevant to the subject and content of such Web pages. Both pay-for-click services and online marketing services on Web directories operated by Sogou expand distribution of its advertisers' promotional links and advertisements by leveraging traffic on Sogou Website Alliance members' Websites. The search and search-related business benefits from Sogou's collaboration with Tencent Holdings Limited (together with its subsidiaries, Tencent), which provides Sogou access to traffic and content generated from users of products and services provided by Tencent.

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Revenues generated by the search and search-related business are classified as search and search-related revenues in the Sohu Group's consolidated statements of comprehensive income.

Other Business

Sogou also engages in other business primarily by offering Internet value-added services (IVAS) with respect to the operation of Web games and mobile games developed by third parties, as well as other services and products provided to users. Revenues generated by Sogou from other business are classified as other revenues in the Sohu Group's consolidated statements of comprehensive income.

Changyou's Business

Changyou's business lines consist of the online game business, the platform channel business and other business.

Online Game Business

Changyou's online game business offers to game players (a) PC games, which are interactive online games that are accessed and played simultaneously by hundreds of thousands of game players through personal computers and require that local client-end game access software be installed on the computers used; (b) mobile games, which are played on mobile devices and require an Internet connection; and (c) Web games, which are online games that are played through a Web browser with no local game software installation requirements. Web games became a relatively insignificant part of Changyou's online games business following the sale of 7Road's operating company Shenzhen 7Road in August 2015. Changyou's games are operated under the item-based revenue model, meaning game players can play the games for free, but can choose to pay for virtual items, which are non-physical items that game players can purchase and use within a game, such as gems, pets, fashion items, magic medicine, riding animals, hieroglyphs, skill books and fireworks. Revenues derived from the operation of online games are classified as online game revenues in the Sohu Group's consolidated statements of comprehensive income.

Changyou's flagship game is TLBB, a PC based client-end game. For the three and six months ended June 30, 2016, revenues from the PC game TLBB were \$51.5 million and \$106.9 million, respectively, accounting for approximately 52% and 53%, respectively, of Changyou's online game revenues, approximately 40% and 41%, respectively, of Changyou's total revenues and approximately 12% and 13%, respectively, of the Sohu Group's total revenues. For the three and six months ended June 30, 2015, revenues from the PC game TLBB were \$80.6 million and \$167.1 million, respectively, accounting for approximately 47% of Changyou's online game revenues for both periods, approximately 40% and 41%, respectively, of Changyou's total revenues and approximately 16% and 18%, respectively, of the Sohu Group's total revenues.

Platform Channel Business

Changyou's platform channel business consists primarily of the operation of the 17173.com Website, the Dolphin Browser and RaidCall. The 17173.com Website, one of the leading game information portals in China, provides news, electronic forums, online videos and other information services on online games to game players. The Dolphin Browser is a gateway to a host of user activities on mobile devices, with the majority of its users based in Europe, Russia and Japan. RaidCall provides online music and entertainment services, primarily in Taiwan. Revenues generated by the 17173.com Website are classified as brand advertising revenues and revenues generated by the Dolphin Browser and RaidCall are classified as other revenues in the Group's consolidated statements of comprehensive income.

Other Business

Changyou also operates a cinema advertising business, which consists of Changyou's offering of pre-film cinema advertising slots, which are advertisements shown before the screening of a movie in a cinema theatre. Revenues generated by Changyou's cinema advertising business are classified as other revenues in the Sohu Group's consolidated statements of comprehensive income.

Basis of Consolidation and Recognition of Noncontrolling Interest

The consolidated financial statements include the accounts of Sohu.com Inc. and its wholly-owned and majority-owned subsidiaries and consolidated VIEs. All intercompany transactions are eliminated.

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The Sohu Group's VIEs are wholly or partially owned by certain employees of the Group as nominee shareholders. For consolidated VIEs, management made evaluations of the relationships between the Sohu Group and the VIEs and the economic benefit flow of contractual arrangements with the VIEs. In connection with such evaluation, management also took into account the fact that, as a result of such contractual arrangements, the Group controls the shareholders voting interests in these VIEs. As a result of such evaluation, management concluded that the Sohu Group is the primary beneficiary of its consolidated VIEs.

Noncontrolling Interest Recognition

Noncontrolling interests are recognized to reflect the portion of the equity of majority-owned subsidiaries and VIEs which is not attributable, directly or indirectly, to the controlling shareholders. The primary majority-owned subsidiaries and VIEs of the Sohu Group which are consolidated in the Group's consolidated financial statements with noncontrolling interest recognized are Sogou and Changyou.

Basis of Presentation

These financial statements have been prepared in accordance with United States of America generally accepted accounting principles (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements and related footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

The accompanying unaudited condensed consolidated interim financial statements reflect all normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of the results for the interim periods presented. Results for the six months ended June 30, 2016 are not necessarily indicative of the results expected for the full fiscal year or for any future period.

2. Segment Information

The Sohu Group's segments are business units that offer different services and are reviewed separately by the chief operating decision maker (the CODM), or the decision making group, in deciding how to allocate resources and in assessing performance. The Group's CODM is Sohu.com Inc.'s Chief Executive Officer. There are three segments in the Group, consisting of the Sohu segment, the Sogou segment, and the Changyou segment.

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

	Three Months Ended June 30, 2015				
	Sohu	Sogou	Changyou	Eliminations	Consolidated
Revenues (1)	\$ 146,508	\$ 147,491	\$ 202,154	\$ (2,587)	\$ 493,566
Segment cost of revenues	(100,984)	(60,399)	(59,635)	424	(220,594)
Segment gross profit	45,524	87,092	142,519	(2,163)	272,972
SBC (2) in cost of revenues	(508)	(54)	(44)	0	(606)

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Gross profit	45,016	87,038	142,475	(2,163)	272,366
Operating expenses:					
Product development (3)	(23,443)	(32,561)	(39,760)	1,227	(94,537)
Sales and marketing (1)	(51,103)	(21,596)	(32,820)	2,404	(103,115)
General and administrative	(16,586)	(4,346)	(17,782)	(168)	(38,882)
SBC (2) in operating expenses	(8,791)	(2,059)	(7,047)	(37)	(17,934)
Total operating expenses	(99,923)	(60,562)	(97,409)	3,426	(254,468)
Operating profit /(loss)	(54,907)	26,476	45,066	1,263	17,898
Other income /(expense) (3)	(1,045)	3	1,905	(1,300)	(437)
Net interest income	663	1,468	4,097	0	6,228
Exchange difference	(244)	(283)	(160)	0	(687)
Income /(loss) before income tax expense	(55,533)	27,664	50,908	(37)	23,002
Income tax expense	(1,926)	(2,084)	(7,509)	0	(11,519)
Net income /(loss)	\$ (57,459)	\$ 25,580	\$ 43,399	\$ (37)	\$ 11,483

Note (1): The elimination mainly consists of revenues and expenses generated from marketing services among the Sohu, Sogou and Changyou segments.

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

Note (3): The elimination mainly consists of leasing income and expenses generated from a building that Sohu leases to Sogou.

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	Three Months Ended June 30, 2016				
	Sohu	Sogou	Changyou	Eliminations	Consolidated
Revenues (1)	\$ 116,305	\$ 175,548	\$ 129,160	\$ (875)	\$ 420,138
Segment cost of revenues	(95,571)	(75,035)	(41,867)	159	(212,314)
Segment gross profit	20,734	100,513	87,293	(716)	207,824
SBC (2) in cost of revenues	73	0	(17)	0	56
Gross profit	20,807	100,513	87,276	(716)	207,880
Operating expenses:					
Product development (3)	(24,027)	(34,563)	(29,778)	1,108	(87,260)
Sales and marketing (1)	(76,245)	(29,508)	(13,054)	1,002	(117,805)
General and administrative	(12,831)	(4,173)	(11,906)	0	(28,910)
SBC (2) in operating expenses	1,403	(608)	(3,395)	0	(2,600)
Total operating expenses	(111,700)	(68,852)	(58,133)	2,110	(236,575)
Operating profit /(loss)	(90,893)	31,661	29,143	1,394	(28,695)
Other income /(expense) (3) (4)	856	(27,757)	3,522	(1,194)	(24,573)
Net interest income /(expense)	(17)	1,824	3,233	0	5,040
Exchange difference	997	419	2,450	0	3,866
Income /(loss) before income tax benefit /(expense)	(89,057)	6,147	38,348	200	(44,362)
Income tax benefit /(expense)	3,517	(935)	(5,012)	0	(2,430)
Net income /(loss)	\$ (85,540)	\$ 5,212	\$ 33,336	\$ 200	\$ (46,792)

Note (1): The elimination mainly consists of revenues and expenses generated from marketing services among the Sohu, Sogou and Changyou segments.

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

Note (3): The elimination mainly consists of leasing income and expenses generated from a building that Sohu leases to Sogou.

Note (4): In the second quarter of 2016, the Sohu Group recognized a one-time expense of \$27.8 million that was related to a donation by Sogou to Tsinghua University related to setting up a joint research institute focusing on artificial intelligence technology.

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	Six Months Ended June 30, 2015				
	Sohu	Sogou	Changyou	Eliminations	Consolidated
Revenues (1)	\$ 277,874	\$ 263,799	\$ 410,851	\$ (3,626)	\$ 948,898
Segment cost of revenues	(206,479)	(111,366)	(125,203)	552	(442,496)
Segment gross profit	71,395	152,433	285,648	(3,074)	506,402
SBC (2) in cost of revenues	(663)	(107)	(88)	0	(858)
Gross profit	70,732	152,326	285,560	(3,074)	505,544
Operating expenses:					
Product development (3)	(48,654)	(61,712)	(83,978)	2,392	(191,952)
Sales and marketing (1)	(95,926)	(38,943)	(54,726)	3,597	(185,998)
General and administrative	(31,585)	(6,917)	(38,335)	(256)	(77,093)
SBC (2) in operating expenses	(12,143)	(6,943)	(10,907)	85	(29,908)
Total operating expenses	(188,308)	(114,515)	(187,946)	5,818	(484,951)
Operating profit /(loss)	(117,576)	37,811	97,614	2,744	20,593
Other income /(expense) (3)	(57)	90	5,342	(2,658)	2,717
Net interest income	1,845	2,685	7,733	0	12,263
Exchange difference	(236)	(290)	(344)	0	(870)
Income /(loss) before income tax expense	(116,024)	40,296	110,345	86	34,703
Income tax expense	(4,551)	(3,314)	(19,954)	0	(27,819)
Net income /(loss)	\$ (120,575)	\$ 36,982	\$ 90,391	\$ 86	\$ 6,884

Note (1): The elimination mainly consists of revenues and expenses generated from marketing services among the Sohu, Sogou and Changyou segments.

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

Note (3): The elimination mainly consists of leasing income and expenses generated from a building that Sohu leases to Sogou.

	Six Months Ended June 30, 2016				
	Sohu	Sogou	Changyou	Eliminations	Consolidated
Revenues (1)	\$ 247,877	\$ 322,877	\$ 259,000	\$ (1,664)	\$ 828,090
Segment cost of revenues	(181,993)	(139,606)	(83,724)	217	(405,106)
Segment gross profit	65,884	183,271	175,276	(1,447)	422,984

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SBC (2) in cost of revenues	11	0	(10)	0	1
Gross profit	65,895	183,271	175,266	(1,447)	422,985
Operating expenses:					
Product development (3)	(46,563)	(65,285)	(60,375)	2,281	(169,942)
Sales and marketing (1)	(127,616)	(56,607)	(25,610)	1,995	(207,838)
General and administrative	(25,034)	(7,563)	(23,553)	0	(56,150)
SBC (2) in operating expenses	1,502	(2,352)	(2,128)	0	(2,978)
Total operating expenses	(197,711)	(131,807)	(111,666)	4,276	(436,908)
Operating profit /(loss)	(131,816)	51,464	63,600	2,829	(13,923)
Other income /(expense) (3) (4)	2,012	(27,593)	7,369	(2,437)	(20,649)
Net interest income	578	3,528	6,073	0	10,179
Exchange difference	663	338	1,843	0	2,844
Income /(loss) before income tax benefit /(expense)	(128,563)	27,737	78,885	392	(21,549)
Income tax benefit /(expense)	870	(2,422)	(12,746)	0	(14,298)
Net income /(loss)	\$ (127,693)	\$ 25,315	\$ 66,139	\$ 392	\$ (35,847)

Note (1): The elimination mainly consists of revenues and expenses generated from marketing services among the Sohu, Sogou and Changyou segments.

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

Note (3): The elimination mainly consists of leasing income and expenses generated from a building that Sohu leases to Sogou.

Note (4): In the second quarter of 2016, the Sohu Group recognized a one-time expense of \$27.8 million that was related to a donation by Sogou to Tsinghua University related to setting up a joint research institute focusing on artificial intelligence technology.

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	As of December 31, 2015				
	Sohu	Sogou	Changyou	Eliminations	Consolidated
Cash and cash equivalents	\$ 430,804	\$ 244,484	\$ 569,917	\$ 0	\$ 1,245,205
Accounts receivable, net	176,759	28,986	67,959	(87)	273,617
Fixed assets, net	223,939	70,447	214,306	0	508,692
Total assets (1)	\$ 1,356,263	\$ 387,875	\$ 1,779,506	\$ (481,450)	\$ 3,042,194

Note (1): The elimination for segment assets mainly consists of elimination of intracompany loans between the Sohu segment and the Changyou segment, and elimination of long-term investments in subsidiaries and consolidated VIEs.

	As of June 30, 2016				
	Sohu	Sogou	Changyou	Eliminations	Consolidated
Cash and cash equivalents	\$ 312,087	\$ 267,815	\$ 568,168	\$ 0	\$ 1,148,070
Accounts receivable, net	129,632	42,688	43,342	(85)	215,577
Fixed assets, net	213,339	91,000	203,817	0	508,156
Total assets (1)	\$ 1,315,161	\$ 442,599	\$ 1,565,551	\$ (643,809)	\$ 2,679,502

Note (1): The elimination for segment assets mainly consists of elimination of intracompany loans between the Sohu segment and the Changyou segment, and elimination of long-term investments in subsidiaries and consolidated VIEs.

3. Share-Based Compensation Expense

Sohu (excluding Fox Video Limited), Sogou, Changyou, and Fox Video Limited (Sohu Video) have incentive plans for the granting of share-based awards, including stock options, share options and restricted share units, to members of the boards of directors, management and other key employees.

Sohu (excluding Sohu Video), Sogou, and Changyou Share-based Awards

For Sohu (excluding Sohu Video) stock options that Sohu granted before 2006 and Sohu restricted share units, Sogou share-based awards, and Changyou share-based awards under the Changyou 2008 Share Incentive Plan, share-based compensation expense is recognized as costs and expenses in the consolidated statements of comprehensive income based on the fair value of the related share-based awards on their grant dates.

For Tencent restricted share units that Tencent had granted to employees who transferred to Sogou with the Soso search-related businesses, share-based compensation expense is recognized in the consolidated statements of comprehensive income based on the then-current fair value at each reporting date.

For 1,068,000 Sohu stock options contractually granted on February 7, 2015, 13,000 Sohu stock options contractually granted on May 1, 2016, 2,400,000 Changyou share options converted from restricted share units on February 16, 2015, and 1,998,000 Changyou share options contractually granted on June 1, 2015, awards are expected to vest and become exercisable in four equal installments over a period of four years, with each installment vesting upon satisfaction of a service period requirement and certain subjective performance targets. Under ASC 718-10-25, no grant date can be established until a mutual understanding is reached between the companies and the recipients clarifying the subjective performance requirements. In accordance with ASC 718-10-55, as the service inception date

preceded the grant date, compensation expense was accrued beginning on the service inception date, and was re-measured and will be re-measured on each subsequent reporting date before the grant date is established, based on the then-current fair value of the awards. The estimate of the awards' fair value will be fixed in the period in which the grant date occurs, and cumulative compensation expense will be adjusted based on the fair value at the grant date. In determining the fair value of stock options and share options granted by Sohu and Changyou, the public market price of the underlying shares at each reporting date was used, and a binomial valuation model was applied.

Table of Contents***Sohu Video Share-based Awards***

On January 4, 2012, Sohu Video, the holding entity of Sohu's video division, adopted a 2011 Share Incentive Plan (the Video 2011 Share Incentive Plan) which provides for the issuance of up to 25,000,000 ordinary shares of Sohu Video (representing approximately 10% of the outstanding Sohu Video shares on a fully-diluted basis) to management and key employees of the video division and to Sohu management. As of June 30, 2016, grants of options for the purchase of 16,368,200 ordinary shares of Sohu Video had been contractually made, of which options for the purchase of 4,972,800 ordinary shares were vested.

For purposes of ASC 718-10-25, as of June 30, 2016, no grant date had occurred, because the broader terms and conditions of the option awards had neither been finalized nor mutually agreed upon with the recipients. Therefore the fair value of the awards is not determinable and cannot be accounted for. In accordance with ASC 718-10-55, the Company's management determined that the service inception date with respect to vested option awards for the purchase of 4,972,800 shares had preceded the grant date. Therefore, the Group began to recognize compensation expense for Sohu Video share-based awards in the second quarter of 2014 and re-measured, and will re-measure, the compensation expense on each subsequent reporting date based on the then-current fair values of the awards until the grant date is established.

Share-based Compensation Expense Recognition

Share-based compensation expense was recognized in costs and expenses for the three and six months ended June 30, 2015 and 2016, respectively, as follows (in thousands):

Share-based compensation expense	Three Months Ended June 30		Six Months Ended June 30,	
	2015	2016	2015	2016
Cost of revenues (1)	\$ 606	\$ (56)	\$ 858	\$ (1)
Product development expenses	6,235	1,699	11,011	1,696
Sales and marketing expenses	862	161	1,107	175
General and administrative expenses	10,837	740	17,791	1,107
	\$ 18,540	\$ 2,544	\$ 30,767	\$ 2,977

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

Share-based compensation expense	Three Months Ended June 30		Six Months Ended June 30,	
	2015	2016	2015	2016
For Sohu (excluding Sohu Video) share-based awards (1)	\$ 8,360	\$ (618)	\$ 12,737	\$ (890)
For Sogou share-based awards (2)	2,144	595	6,936	2,325
For Changyou share-based awards	7,091	3,412	10,994	2,138
For Sohu Video share-based awards (1)	945	(845)	100	(596)
	\$ 18,540	\$ 2,544	\$ 30,767	\$ 2,977

Note (1): The negative amounts represent re-measured compensation expense based on the then-current fair value of the awards on June 30, 2016.

Note (2): Compensation expense for Sogou share-based awards also includes compensation expense for Tencent restricted share units that Tencent had granted to employees who transferred to Sogou with the Soso search-related businesses.

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There was no capitalized share-based compensation expense for the three and six months ended June 30, 2015 and 2016.

4. Fair Value Measurements***Fair Value of Financial Instruments***

The Sohu Group's financial instruments include cash equivalents, short-term investments, accounts receivable, prepaid and other current assets, long-term investments (including available-for-sale equity securities), time deposits, restricted time deposits, accounts payable, accrued liabilities, receipts in advance and deferred revenue, other short-term liabilities and long-term accounts payable.

U.S. GAAP establishes a three-tier hierarchy to prioritize the inputs used in the valuation methodologies in measuring the fair value of financial instruments. This hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three-tier fair value hierarchy is:

Level 1 - observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 - include other inputs that are directly or indirectly observable in the market place.

Level 3 - unobservable inputs which are supported by little or no market activity.

Financial Instruments Measured at Fair Value

The following table sets forth the financial instruments, measured at fair value, by level within the fair value hierarchy as of December 31, 2015 (in thousands):

Items	Fair value measurements at reporting date using Quoted Prices			
	As of December 31, 2015	in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents	\$ 727,232	\$ 0	\$ 727,232	\$ 0
Restricted time deposits	363,979	0	363,979	0
Short-term investments	174,515	0	174,515	0
Available-for-sale equity securities	14,301	14,301	0	0
Total	\$ 1,280,027	\$ 14,301	\$ 1,265,726	\$ 0

The following table sets forth the financial instruments, measured at fair value by level within the fair value hierarchy, as of June 30, 2016 (in thousands):

Fair value measurements at reporting date using

Items	As of June 30, 2016	Quoted Prices	Significant	Significant
		in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Cash equivalents	\$ 531,705	\$ 0	\$ 531,705	\$ 0
Short-term investments	118,820	0	118,820	0
Available-for-sale equity securities	12,873	12,873	0	0
Time deposits	135,393	0	135,393	0
Restricted time deposits	9,270	0	9,270	0
Total	\$ 808,061	\$ 12,873	\$ 795,188	\$ 0

Cash Equivalents

The Sohu Group's cash equivalents mainly consist of time deposits and money market funds with original maturities of three months or less. The fair values of cash equivalents are determined based on the pervasive interest rates in the market. The Group classifies the valuation techniques that use the pervasive interest rates input as Level 2 of fair value measurements. Generally there are no quoted prices in active markets for identical cash equivalents at the reporting date. In order to determine the fair value, the Group must use the discounted cash flow method and observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Table of Contents*Short-term Investments*

In accordance with ASC 825, for investments in financial instruments with a variable interest rate indexed to performance of underlying assets, the Sohu Group elected the fair value method at the date of initial recognition and carried these investments at fair value. Changes in the fair value are reflected in the consolidated statements of comprehensive income as other income /(expense). To estimate fair value, the Group refers to the quoted rate of return provided by banks at the end of each period using the discounted cash flow method. The Group classifies the valuation techniques that use these inputs as Level 2 of fair value measurements.

As of June 30, 2016, the Sohu Group's investment in financial instruments was \$118.8 million, consisting of investments by Changyou. The investment instruments were issued by commercial banks in China, and have a variable interest rate indexed to performance of underlying assets. Since these investments' maturity dates are within one year, they are classified as short-term investments. For the three and six months ended June 30, 2015, the Sohu Group recorded in the consolidated statements of comprehensive income changes in the fair value of short-term investments in the amounts of \$0.8 million and \$1.2 million, respectively. For the three and six months ended June 30, 2016, the Sohu Group recorded in the consolidated statements of comprehensive income changes in the fair value of short-term investments in the amounts of \$1.0 million and \$2.5 million, respectively.

Available-for-Sale Equity Securities

Available-for-sale equity securities are valued using the market approach based on the quoted prices in active markets at the reporting date. The Group classifies the valuation techniques that use these inputs as Level 1 of fair value measurements. On August 12, 2014, Sohu acquired approximately 6% of the total outstanding common shares of Keyeast Co., Ltd., a Korean-listed company (Keyeast), for a purchase price of \$15.1 million. The Sohu Group classified this investment as available-for-sale equity securities under long-term investments, and reported it at fair value. As of June 30, 2016, the fair value of the Keyeast available-for-sale equity securities held by Sohu was \$12.9 million. An unrealized loss representing the change in fair value of \$2.2 million in the aggregate was recorded as accumulated other comprehensive income /(loss) in the Sohu Group's consolidated balance sheets.

Time Deposits

The Sohu Group's time deposits represent Changyou's time deposits placed with banks with original maturities of more than three months. Time deposits are valued based on the prevailing interest rate in the market, which is also the interest rate stated in the contracts with the banks. The Sohu Group classifies the valuation techniques that use the prevailing interest rate input as Level 2 of fair value measurements.

Restricted Time Deposits

Restricted time deposits are valued based on the prevailing interest rates in the market using the discounted cash flow method. The Sohu Group classifies the valuation techniques that use these inputs as Level 2 of fair value measurements.

Collateral related to Sogou Incentive Shares Trust Arrangements

In February 2013, Sohu deposited \$9.0 million in cash into restricted time deposit accounts at a bank as collateral for credit facilities provided by the bank to certain Sogou employees. The facilities were intended to fund the employees' early exercise of Sogou share options and related PRC individual income tax. Sohu is not subject to any additional potential payments other than the restricted time deposit amounts, and believes that the fair value of its guarantee

liability is immaterial.

Changyou Loans from Offshore Banks, Secured by Time Deposits

Commencing in 2012, Changyou drew down loans from offshore branches of certain banks, which are secured by an equivalent or greater amount of RMB deposits by Changyou in the onshore branches of such banks. The loans from the offshore branches of the lending banks are classified as short-term and long-term bank loans based on the loans payment terms.

In the first quarter of 2016, Changyou had repaid all of the remaining bank loans of \$344.5 million, and restricted time deposits of \$354.7 million that secured these loans had been released. For the three and six months ended June 30, 2016, interest income from the restricted time deposits securing the loans was nil and \$0.7 million, respectively, and interest expense on the bank loans was nil and \$0.6 million, respectively. For the three and six months ended June 30, 2015, interest income from the restricted time deposits securing the loans was \$3.6 million and \$7.3 million, respectively, and interest expense on the bank loans was \$1.8 million and \$3.6 million, respectively.

Table of Contents***Other Financial Instruments***

The fair values of other financial instruments are estimated for disclosure purposes where the financial instruments carrying values approximate their fair values.

Long-term Investments**Long-term Investment in SoEasy**

Under an agreement between Sohu and SoEasy Internet Finance Group Limited (SoEasy) entered into in August 2014, Sohu invested \$4.8 million and \$16.3 million in SoEasy on August 2014 and April 2015, respectively. In February 2016, Sohu invested an additional \$10.5 million in SoEasy. Sohu accounted for its investments in SoEasy under long-term investments. These investments include both preferred shares and common shares. Sohu accounted for its investment in SoEasy s preferred shares under the cost method, since they were not considered to be common shares in substance and had no readily determinable fair value. Sohu accounted for its investment in SoEasy s common shares under the equity method, since Sohu can exercise significant influence but does not own a majority of SoEasy s equity capital or control SoEasy. As of June 30, 2016, the carrying value of Sohu s investment in SoEasy was \$25.1 million.

Long-term Investment in Zhihu

In September 2015, Sogou paid \$12.0 million in cash for approximately 3% of the equity capital of Zhihu Technology Limited (Zhihu), a company that engages primarily in the business of operating an online question and answer-based knowledge and information sharing platform. Sogou accounted for the investment in Zhihu using the cost method, since Sogou does not have significant influence over Zhihu.

Short-term Receivables and Payables

Accounts receivable and prepaid and other current assets are financial assets with carrying values that approximate fair value due to their short-term nature. Short-term accounts payable, accrued liabilities, receipts in advance and deferred revenue, short-term bank loans and other short-term liabilities are financial liabilities with carrying values that approximate fair value due to their short term nature.

For short-term bank loans, the rates of interest under the agreements with the lending banks were determined based on the prevailing interest rates in the market. The Sohu Group classifies the valuation techniques that use these inputs as Level 2 of fair value measurements. For other short-term receivables and payables, the Group estimated fair values using the discounted cash flow method, which is unobservable in the market. The Group classifies the valuation technique as Level 2 of fair value measurements.

Long-term Payables

Long-term accounts payable are financial liabilities with carrying values that approximate fair value due to any changes in fair value, after considering the discount rate, being immaterial. For long-term accounts payable, the Group estimated fair values using the discounted cash flow method, which is unobservable in the market. The Sohu Group classifies the valuation technique as Level 2 of fair value measurements.

Table of Contents**5. Goodwill**

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

	Sohu	Sogou	Changyou	Total
Balance as of December 31, 2015				
Goodwill	\$ 72,980	5,945	181,529	260,454
Accumulated impairment losses	(35,788)	0	(70,447)	(106,235)
	\$ 37,192	\$ 5,945	\$ 111,082	\$ 154,219
Transactions in 2016				
Foreign currency translation adjustment	(314)	(124)	(360)	(798)
Balance as of June 30, 2016	\$ 36,878	\$ 5,821	\$ 110,722	\$ 153,421
Balance as of June 30, 2016				
Goodwill	\$ 72,666	\$ 5,821	\$ 181,169	\$ 259,656
Accumulated impairment losses	(35,788)	0	(70,447)	(106,235)
	\$ 36,878	\$ 5,821	\$ 110,722	\$ 153,421

6. Taxation

Sohu.com Inc. is subject to United States (U.S.) income tax, and Changyou s income that is from a U.S. source is generally subject to U.S. income tax. The majority of the subsidiaries and VIEs of the Sohu Group are based in mainland China and are subject to income taxes in the PRC. These China-based subsidiaries and VIEs conduct substantially all of the Sohu Group s operations, and generate most of the Sohu Group s income or losses.

The Group did not have any penalties or significant interest associated with tax positions for the three and six months ended June 30, 2016, nor did the Group have any significant unrecognized uncertain tax positions for the three and six months ended June 30, 2016.

PRC Corporate Income Tax

The PRC Corporate Income Tax Law (the CIT Law) applies an income tax rate of 25% to all enterprises but grants preferential tax treatment to High and New Technology Enterprises (HNTEs). Under this preferential tax treatment, HNTEs can enjoy an income tax rate of 15% for three years, but need to re-apply after the end of the three-year period. If at any time during the three-year period the relevant tax bureau questions whether an enterprise continues to qualify as an HNTE, the enterprise can be subject to further tax examination and may not be able to continue to enjoy the preferential tax rate. In addition, the CIT Law and its implementing regulations provide that a Software Enterprise can enjoy an income tax exemption for two years beginning with its first profitable year and a 50% reduction to a rate of 12.5% for the subsequent three years. An entity that qualifies as a Key National Software Enterprise (KNSE) can enjoy a further reduced preferential income tax rate of 10% for two years, but needs to re-apply after the end of the two-year period.

Principal Entities Qualified as HNTEs

As of June 30, 2016, the following principal entities of the Sohu Group were qualified as HNTEs and were entitled to an income tax rate of 15%.

For Sohu's Business

Beijing Sohu Internet Information Service Co., Ltd. (Sohu Internet). Sohu Internet is qualified as an HNTE for 2016 and 2017, and will need to re-apply for HNTE qualification in 2018.

Beijing Sohu New Era Information Technology Co., Ltd. (Sohu Era), Beijing Sohu New Media Information Technology Co., Ltd. (Sohu Media) and Guangzhou Qianjun Network Technology Co., Ltd (Guangzhou Qianjun). These three companies are each qualified as HNTEs for 2016, and will need to re-apply for HNTE qualification in 2017.

For Sogou's Business

Beijing Sogou Information Service Co., Ltd. (Sogou Information). Sogou Information is qualified as an HNTE for 2016 and 2017, and will need to re-apply for HNTE qualification in 2018.

Beijing Sogou Technology Development Co., Ltd. (Sogou Technology). Sogou Technology is qualified as an HNTE for 2016, and will need to re-apply for HNTE qualification in 2017.

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For Changyou's Business

AmazGame and Gamease. AmazGame and Gamease are each qualified as HNTEs for 2016, and will need to re-apply for HNTE qualification in 2017.

Principal Entities Qualified as Software Enterprises

For Sohu's Business

Beijing Sohu New Momentum Information Technology Co., Ltd. (Sohu New Momentum). In 2016, Sohu New Momentum is in the first of three years in which it is entitled to a 50% reduction to a rate of 12.5% as a Software Enterprise.

For Sogou's Business

Sogou Technology recently filed documents for qualification as a KNSE for 2015 pursuant to new requirements for obtaining such qualification that were issued on May 4, 2016. As of the date of this report Sogou Technology had not received a response to the filing.

Beijing Sogou Network Technology Co., Ltd (Sogou Network) recently filed documents for qualification as a Software Enterprise for 2015 pursuant to new requirements for obtaining such qualification that were issued on May 4, 2016. As of the date of this report Sogou Network had not received a response to the filing.

For Changyou's Business

AmazGame. In 2013 and 2014, AmazGame was qualified as a KNSE and enjoyed a preferential income tax rate of 10% and recently filed documents for qualification as a KNSE for 2015 pursuant to new requirements for obtaining such qualification that were issued on May 4, 2016. As of the date of this report AmazGame had not received a response to the filing.

Beijing Changyou Gamespace Software Technology Co., Ltd. (Gamespace). In 2016, Gamespace is in the third of three years in which it is entitled to a 50% reduction to a rate of 12.5% as a Software Enterprise.

PRC Withholding Tax on Dividends

The CIT Law imposes a 10% withholding income tax for dividends distributed by foreign-invested enterprises in the PRC to their immediate holding companies outside Mainland China. A lower withholding tax rate will be applied if there is a tax treaty arrangement between Mainland China and the jurisdiction of the foreign holding company. A holding company in Hong Kong, for example, will be subject to a 5% withholding tax rate under an arrangement between the PRC and the Hong Kong Special Administrative Region on the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital if such holding company is considered a non-PRC resident enterprise and holds at least 25% of the equity interests in the PRC foreign invested enterprise

distributing the dividends, subject to approval of the PRC local tax authority. However, if the Hong Kong holding company is not considered to be the beneficial owner of such dividends under applicable PRC tax regulations, such dividend will remain subject to a withholding tax rate of 10%.

In order to fund the distribution of a dividend to shareholders of the Sohu Group's majority-owned subsidiary Changyou, Changyou's management determined to cause one of its PRC subsidiaries to declare and distribute a cash dividend of all of its stand-alone 2012 earnings and half of its stand-alone subsequent years' earnings to its direct overseas parent company, Changyou.com (HK) Limited (Changyou HK). As of June 30, 2016, Changyou had accrued deferred tax liabilities in the amount of \$25.5 million for PRC withholding tax.

With the exception of that dividend, the Sohu Group does not intend to have any of its PRC subsidiaries distribute any undistributed profits of such subsidiaries to their direct overseas parent companies, but rather intends that such profits will be permanently reinvested by such subsidiaries for their PRC operations.

PRC Value-Added Tax

On May 1, 2016, the transition from the imposition of PRC business tax (Business Tax) to the imposition of value-added tax (VAT) was expanded to all industries in China, and as a result all of the Sohu Group's revenues have been subject to VAT since that date. To record VAT payable, the Group adopted the net presentation method, which presents the difference between the output VAT (at a rate of 6%) and the available input VAT amount (at the rate applicable to the supplier).

Table of Contents***U.S. Corporate Income Tax***

Sohu.com Inc. is a Delaware corporation that is subject to U.S. corporate income tax on its taxable income at a rate of up to 35%. Subject to certain limitations, the net operating losses (NOLs) of a corporation in the U.S. that are carried forward from prior years may be used to offset the corporation's taxable income. As of the end of the 2012 taxable year, Sohu.com Inc. had no further NOLs available for offsetting any U.S. taxable income. To the extent that portions of its U.S. taxable income, such as Subpart F income or a dividend, are determined to be from sources outside of the U.S., subject to certain limitations, Sohu.com Inc. may be able to claim foreign tax credits to offset its U.S. income tax liabilities. Any remaining liabilities are accrued in the Company's consolidated statements of comprehensive income and estimated tax payments are made when required by U.S. law.

Uncertain Tax Positions

The Group is subject to various taxes in different jurisdictions, primarily the U.S. and the PRC. Management reviews regularly the adequacy of the provisions for taxes as they relate to the income and transactions of the Group. In order to assess uncertain tax positions, the Sohu Group applies a more likely than not threshold and a two-step approach for tax position measurement and financial statement recognition. For the two-step approach, the first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely to be realized upon settlement.

7. Commitments and Contingencies***Contractual Obligations***

The following table sets forth our contractual obligations as of June 30, 2016 (in thousands):

<u>As of June 30, 2016</u>	
Purchase of content and services - video	\$ 156,448
Purchase of cinema advertisement slot rights	102,740
Purchase of bandwidth	72,502
Operating lease obligations	29,693
Purchase of content and services - others	15,926
Expenditures for operating rights for licensed games with technological feasibility - PC games	15,750
Purchase of fixed assets	12,380
Expenditures for operating rights for licensed games with technological feasibility - mobile games	3,719
Expenditures for titles of games in development	1,041
Fees for operating rights for licensed games in development mobile games	409
Others	6,431
Total	\$ 417,039

Litigation

The Sohu Group is a party to various litigation matters which it considers routine and incidental to its business. Management does not expect the results of any of these actions to have a material adverse effect on the Group's business, results of operations, financial condition and cash flows.

Table of Contents***PRC Law and Regulations***

The Chinese market in which the Sohu Group operates poses certain macro-economic and regulatory risks and uncertainties. These uncertainties extend to the ability to operate an Internet business and to conduct brand advertising, search and search-related, online game, and other services in the PRC. Though the PRC 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 and are unclear with respect to which segments of these industries foreign-owned entities, like the Sohu Group, may operate. The Chinese government may issue from time to time new laws or new interpretations of existing laws to regulate areas such as telecommunication, information and media. The Sohu Group's legal structure and scope of operations in China could be subject to restrictions, which could result in limits on its ability to conduct business in the PRC. Certain risks related to PRC law that could affect the Sohu Group's VIE structure are discussed in Note 8 - VIEs.

Regulatory risks also encompass interpretation by PRC tax authorities of current tax law, including the applicability of certain preferential tax treatments.

The Sohu Group's sales, purchase and expense transactions are generally denominated in RMB and a significant portion of its assets and liabilities are denominated in RMB. The RMB is not freely convertible into foreign currencies. In China, foreign exchange transactions are required by law to be transacted only by authorized financial institutions. Remittances in currencies other than RMB by its subsidiaries in China may require certain supporting documentation in order to effect the remittance.

8. VIEs***Background***

PRC laws and regulations prohibit or restrict foreign ownership of companies that operate Internet information and content, Internet access, online games, mobile, value added telecommunications and certain other businesses in which the Sohu Group is engaged or could be deemed to be engaged. Consequently, the Sohu Group conducts certain of its operations and businesses in the PRC through its VIEs. The Sohu Group consolidates in its consolidated financial statements all of the VIEs of which the Group is the primary beneficiary.

VIEs Consolidated within the Sohu Group

The Sohu Group adopted the guidance of accounting for VIEs, which requires VIEs to be consolidated by the primary beneficiary of the entity. Management made evaluations of the relationships between the Sohu Group and its VIEs and the economic benefit flow of contractual arrangements with the VIEs. In connection with such evaluation, management also took into account the fact that, as a result of contractual arrangements with its consolidated VIEs, the Sohu Group controls the shareholders' voting interests in those VIEs. As a result of such evaluation, the management concluded that the Sohu Group is the primary beneficiary of the VIEs which the Group consolidates.

All of the consolidated VIEs are incorporated and operated in the PRC, and the Group's principal VIEs are directly or indirectly owned by Dr. Charles Zhang, the Sohu Group's Chairman and Chief Executive Officer, or other executive officers and employees of the Sohu Group identified below. Capital for the consolidated VIEs was funded by the Sohu Group through loans provided to Dr. Charles Zhang and other executive officers and employees, and was initially recorded as loans to related parties. These loans are eliminated for accounting purposes against the capital of the VIEs upon consolidation.

Under contractual agreements with the Sohu Group, Dr. Charles Zhang and those other executive officers and employees of the Sohu Group who are shareholders of the consolidated VIEs are required to transfer their ownership in these entities to the Group, if permitted by PRC laws and regulations, or, if not so permitted, to designees of the Group at any time as requested by the Group to repay the loans outstanding. All voting rights of the consolidated VIEs are assigned to the Sohu Group, and the Group has the right to designate all directors and senior management personnel of the consolidated VIEs, and also has the obligation to absorb losses of the consolidated VIEs. Dr. Charles Zhang and those other executive officers and employees of the Sohu Group who are shareholders of the consolidated VIEs have pledged their shares in the consolidated VIEs as collateral for the loans. As of June 30, 2016, the aggregate amount of these loans was \$9.3 million.

Under its contractual arrangements with the consolidated VIEs, the Sohu Group has the power to direct activities of the VIEs, and can have assets transferred freely out of the VIEs without any restrictions. Therefore, the Group considers that there is no asset of a consolidated VIE that can be used only to settle obligations of the VIEs, except for registered capital and PRC statutory reserves of the VIEs. As of June 30, 2016, the registered capital and PRC statutory reserves of the consolidated VIEs totaled \$60.2 million. As all of the consolidated VIEs are incorporated as limited liability companies under the PRC Company Law, creditors of the consolidated VIEs do not have recourse to the general credit of the Sohu Group for any of the liabilities of the consolidated VIEs. Currently there is no contractual arrangement that could require the Sohu Group to provide additional financial support to the consolidated VIEs. As the Sohu Group is conducting certain business in the PRC mainly through the consolidated VIEs, the Group may provide such support on a discretionary basis in the future, which could expose the Group to a loss.

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The Sohu Group classified the consolidated VIEs within the Sohu Group as principal VIEs or immaterial VIEs based on certain criteria, such as the VIEs' total assets or revenues. The following is a summary of the principal VIEs within the Sohu Group:

Basic Information for Principal VIEs and Subsidiaries of Principal VIEs

For Sohu's Business

High Century

Beijing Century High Tech Investment Co., Ltd. ("High Century") was incorporated in 2001. As of June 30, 2016, the registered capital of High Century was \$4.6 million and Dr. Charles Zhang and Wei Li held 80% and 20% interests, respectively, in this entity.

Heng Da Yi Tong

Beijing Heng Da Yi Tong Information Technology Co., Ltd. ("Heng Da Yi Tong") was incorporated in 2002. As of June 30, 2016, the registered capital of Heng Da Yi Tong was \$1.2 million and Dr. Charles Zhang and Wei Li held 80% and 20% interests, respectively, in this entity.

Sohu Internet

Sohu Internet was incorporated in 2003. As of June 30, 2016, the registered capital of Sohu Internet was \$1.6 million and High Century held a 100% interest in this entity.

Donglin

Beijing Sohu Donglin Advertising Co., Ltd. ("Donglin") was incorporated in 2010. As of June 30, 2016, the registered capital of Donglin was \$1.5 million and Sohu Internet held a 100% interest in this entity.

Tianjin Jinhu

Tianjin Jinhu Culture Development Co., Ltd. ("Tianjin Jinhu") was incorporated in 2011. As of June 30, 2016, the registered capital of Tianjin Jinhu was \$0.5 million and Ye Deng and Xuemei Zhang each held a 50% interest in this entity.

Guangzhou Qianjun

Guangzhou Qianjun was acquired in November 2014. As of June 30, 2016, the registered capital of Guangzhou Qianjun was \$3.3 million and Tianjin Jinhu held a 100% interest in this entity.

Focus Interactive

Beijing Focus Interactive Information Service Co., Ltd. (Focus Interactive) was incorporated in July 2014. As of June 30, 2016, the registered capital of Focus Interactive was \$1.6 million and Heng Da Yi Tong held 100% of the equity interests in this entity.

For Sogou s Business

Sogou Information

Sogou Information was incorporated in 2005. As of June 30, 2016, the registered capital of Sogou Information was \$2.5 million and Xiaochuan Wang, Sogou s Chief Executive Officer, High Century and Tencent held 10%, 45% and 45% interests, respectively, in this entity.

Table of Contents**For Changyou's Business****Gamease**

Gamease was incorporated in 2007. As of June 30, 2016, the registered capital of Gamease was \$1.3 million and High Century held a 100% interest in this entity.

Guanyou Gamespace

Beijing Guanyou Gamespace Digital Technology Co., Ltd. (Guanyou Gamespace) was incorporated in 2010. As of June 30, 2016, the registered capital of Guanyou Gamespace was \$1.5 million and Beijing Changyou Star Digital Technology Co., Ltd (Changyou Star) held a 100% interest in this entity.

Shanghai ICE

Shanghai ICE Information Technology Co., Ltd. (Shanghai ICE) was acquired by Changyou in 2010. As of June 30, 2016, the registered capital of Shanghai ICE was \$1.2 million and Gamease held a 100% interest in this entity.

Wuhan Baina Information

Baina (Wuhan) Information Technology Co., Ltd. (Wuhan Baina Information) was acquired by Gamease in July 2014. As of June 30, 2016, the registered capital of Wuhan Baina Information was \$3.0 million and Changyou Star and Yongzhi Yang held 60% and 40% interests, respectively, in this entity.

Financial Information

The following financial information of the Sohu Group's consolidated VIEs (including subsidiaries of VIEs) is included in the accompanying consolidated financial statements (in thousands):

	As of	
	December 31, 2015	June 30, 2016
ASSETS:		
Cash and cash equivalents	\$ 131,270	\$ 158,284
Accounts receivable, net	135,925	95,124
Prepaid and other current assets	101,951	102,417
Intercompany receivables due from the Company's subsidiaries	140,396	186,630
Total current assets	509,542	542,455
Long-term investments, net	15,960	15,026
Fixed assets, net	7,362	6,184

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Intangible assets, net	18,266	16,121
Goodwill	36,351	35,965
Other non-current assets	12,057	7,869
Total assets	\$ 599,538	\$ 623,620
LIABILITIES:		
Accounts payable	\$ 23,757	\$ 12,742
Accrued liabilities	79,012	74,747
Receipts in advance and deferred revenue	55,319	46,542
Other current liabilities	141,247	168,848
Intercompany payables due to the Company's subsidiaries	175,178	172,683
Total current liabilities	474,513	475,562
Other long-term liabilities	2,858	13,908
Intercompany payables due to the Company's subsidiaries	21,717	20,770
Total liabilities	\$ 499,088	\$ 510,240

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	Three months ended June 30,		Six months ended June 30,	
	2015	2016	2015	2016
Net revenue	\$ 311,563	\$ 228,018	\$ 616,594	\$ 446,682
Net income /(loss)	\$ (9,691)	\$ 9,924	\$ (17,539)	\$ 15,516

	Six months ended June 30,	
	2015	2016
Net cash provided by operating activities	\$ 40,573	\$ 30,899
Net cash provided by /(used in) investing activities	44,587	(931)
Net cash provided by financing activities	\$ 569	\$ 0

*Summary of Significant Agreements Currently in Effect**Agreements Between Subsidiaries, Consolidated VIEs and Nominee Shareholders*

Loan and share pledge agreement between Sohu Media and the shareholders of High Century: The agreement provides for loans to the shareholders of High Century for them to make contributions to the registered capital of High Century in exchange for the equity interests in High Century, and the shareholders pledge those equity interests to Sohu Media as security for the loans. The agreement includes powers of attorney that give Sohu Media the power to appoint nominees to act on behalf of the shareholders of High Century in connection with all actions to be taken by High Century. Pursuant to the agreement, the shareholders executed in blank transfers of their equity interests in High Century, which are held by the Sohu Group's legal department and may be completed and effected at Sohu Media's election.

Loan and share pledge agreement between Sohu Focus (HK) Limited (Focus HK) and the shareholders of Heng Da Yi Tong: The agreement provides for loans to the shareholders of Heng Da Yi Tong for them to make contributions to the registered capital of Heng Da Yi Tong in exchange for the equity interests in Heng Da Yi Tong, and the shareholders pledge those equity interests to Focus HK as security for the loans. The agreement includes powers of attorney that give Focus HK the power to appoint nominees to act on behalf of the shareholders of Heng Da Yi Tong in connection with all actions to be taken by Heng Da Yi Tong. Pursuant to the agreement, the shareholders executed in blank transfers of their equity interests in Heng Da Yi Tong, which are held by the Sohu Group's legal department and may be completed and effected at Focus HK's election.

Loan and share pledge agreements between Sogou Technology and the shareholders of Sogou Information. The loan agreement provides for a loan to Xiaochuan Wang, the individual shareholder of Sogou Information, to be used by him to make contributions to the registered capital of Sogou Information in exchange for his equity interest in Sogou Information. The loan is interest free and is repayable on demand, but the shareholder may repay the loan only by transferring to Sogou Technology his equity interest in Sogou Information. Under the pledge agreement, all of the shareholders of Sogou Information pledge their equity interests to Sogou Technology to secure the performance of their obligations under the various VIE-related agreements. If any shareholder of Sogou Information breaches any of his or its obligations under any VIE-related agreements, Sogou Technology is entitled to exercise its right as the beneficiary under the share pledge agreement. The share pledge agreement terminates only after all of the obligations of the shareholders under the various VIE-related agreements are no longer in effect.

Exclusive equity interest purchase right agreements between Sogou Technology, Sogou Information and the shareholders of Sogou Information. Pursuant to these agreements, Sogou Technology and any third party designated

by it have the right, exercisable at any time when it becomes legal to do so under PRC law, to purchase from the shareholders of Sogou Information all or any part of their equity interests at the lowest purchase price permissible under PRC law.

Business operation agreement among Sogou Technology, Sogou Information and the shareholders of Sogou Information. The agreement sets forth the right of Sogou Technology to control the actions of the shareholders of Sogou Information. The agreement has a term of 10 years, renewable at the request of Sogou Technology.

Powers of Attorney executed by the shareholders of Sogou Information in favor of Sogou Technology with a term of 10 years, extendable at the request of Sogou Technology. These powers of attorney give Sogou Technology the right to appoint nominees to act on behalf of each of the three Sogou Information shareholders in connection with all actions to be taken by Sogou Information.

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Loan agreements and equity pledge agreements between Fox Information Technology (Tianjin) Limited (Video Tianjin) and the shareholders of Tianjin Jinhu. The loan agreements provide for loans to the shareholders of Tianjin Jinhu for them to make contributions to the registered capital of Tianjin Jinhu in exchange for the equity interests in Tianjin Jinhu. Under the equity pledge agreements, the shareholders of Tianjin Jinhu pledge to Video Tianjin their equity interests in Tianjin Jinhu to secure the performance of their obligations under the loan agreements and Tianjin Jinhu s obligations to Video Tianjin under their business agreements. The loans are interest free and are repayable on demand, but the shareholders can only repay the loans by transferring to Video Tianjin their equity interests in Tianjin Jinhu.

Equity interest purchase right agreements between Video Tianjin, Tianjin Jinhu and the shareholders of Tianjin Jinhu. Pursuant to these agreements, Video Tianjin and any third party designated by it have the right, exercisable at any time when it becomes legal to do so under PRC law, to purchase from the shareholders of Tianjin Jinhu all or any part of their equity interests at the lowest purchase price permissible under PRC law.

Business operation agreement among Video Tianjin, Tianjin Jinhu and the shareholders of Tianjin Jinhu. The agreement sets forth the right of Video Tianjin to control the actions of the shareholders of Tianjin Jinhu. The agreement has a term of 10 years, renewable at the request of Video Tianjin.

Powers of Attorney executed by the shareholders of Tianjin Jinhu in favor of Video Tianjin with a term of 10 years, extendable at the request of Video Tianjin. These powers of attorney give Video Tianjin the right to appoint nominees to act on behalf of each of the Tianjin Jinhu shareholders in connection with all actions to be taken by Tianjin Jinhu.

Loan agreements and equity pledge agreements between AmazGame and the sole shareholder of Gamease and between Gamespace and the sole shareholder of Guanyou Gamespace. The loan agreements provide for loans to the respective shareholders of Gamease and Guanyou Gamespace for the shareholders to make contributions to the registered capital of Gamease and Guanyou Gamespace in exchange for 100% of the equity interests in Gamease and Guanyou Gamespace. The loans are interest free and are repayable on demand, but the shareholders can only repay the loans by transferring to AmazGame and Gamespace, as the case may be, their equity interests in Gamease and Guanyou Gamespace. Under the equity pledge agreements, the respective shareholders of Gamease and Guanyou Gamespace pledge to AmazGame and Gamespace, their equity interests in Gamease and Guanyou Gamespace to secure the performance of their obligations under the loan agreements and Gamease s and Guanyou Gamespace s obligations to AmazGame and Gamespace under the various VIE-related agreements. If the shareholders breach their obligations under any VIE-related agreements (Gamease s or Guanyou Gamespace s breach of any of its obligations under the various applicable VIE-related agreements will be treated as its shareholder s breach of its obligations), including the equity pledge agreements, AmazGame and Gamespace are entitled to exercise their rights as the beneficiaries under the applicable equity pledge agreements, including all rights the respective shareholders have as shareholders of Gamease or Guanyou Gamespace.

Equity interest purchase right agreements among AmazGame, Gamease and the sole shareholder of Gamease and among Gamespace, Guanyou Gamespace and the sole shareholder of Guanyou Gamespace. Pursuant to these agreements, AmazGame and Gamespace have the right, exercisable at any time if and when it is legal to do so under PRC law, to purchase from the respective shareholders of Gamease and Guanyou Gamespace all or any part of their equity interests in Gamease and Guanyou Gamespace at a purchase price equal to their initial contributions to registered capital of Gamease and Guanyou Gamespace.

Powers of attorney executed by the sole shareholder of Gamease in favor of AmazGame and by the sole shareholder of Guanyou Gamespace in favor of Gamespace, with a term of 10 years. These powers of attorney give the respective boards of directors of AmazGame and Gamespace the exclusive right to appoint nominees to act on behalf of their

respective shareholders in connection with all actions to be taken by Gamease and Guanyou Gamespace.

Business operation agreements among AmazGame, Gamease and the sole shareholder of Gamease and among Gamespace, Guanyou Gamespace and the sole shareholder of Guanyou Gamespace. These agreements set forth the right of AmazGame and Gamespace to control the actions of Gamease and Guanyou Gamespace, as the case may be, and the respective shareholders of Gamease and Guanyou Gamespace. Each agreement has a term of 10 years.

Share pledge agreement among Baina Zhiyuan (Beijing) Technology Co., Ltd (Beijing Baina Technology) Wuhan Baina Information and the shareholders of Wuhan Baina Information, which are Gamease and Yongzhi Yang, pursuant to which the shareholders pledged to Beijing Baina Technology their equity interests in Wuhan Baina Information to secure the performance of their obligations and Wuhan Baina Information's obligations under the various VIE-related agreements. If the shareholders breach their obligations under any VIE-related agreements (Wuhan Baina Information's breach of any of its obligations under the various VIE-related agreements will be treated as the shareholders' breach of their obligations), including the share pledge agreement, Beijing Baina Technology is entitled to exercise its rights as the beneficiary under the share pledge agreement, including all rights of the shareholders as shareholders of Wuhan Baina Information.

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Call option agreement among Beijing Baina Technology, Wuhan Baina Information, Changyou Star and Yongzhi Yang. This agreement provides to Beijing Baina Technology and any third party designated by Beijing Baina Technology the right, exercisable at any time during the term of the agreement, if and when it is legal to do so under PRC law, to purchase from Changyou Star and Yongzhi Yang all or any part of their shares in Wuhan Baina Information or to purchase from Wuhan Baina Information all or part of its assets or business at the lower of RMB1.00 (approximately \$0.15) or the lowest purchase price permissible under PRC law.

Business Operation Agreement among Beijing Baina Technology, Wuhan Baina Information, Changyou Star and Yongzhi Yang. This agreement grants Beijing Baina Technology effective control of Wuhan Baina Information.

Business Arrangements Between Subsidiaries and Consolidated VIEs

Exclusive technology consulting and service agreement between Sohu Era and Sohu Internet. Pursuant to this agreement Sohu Era has the exclusive right to provide technical consultation and other related services to Sohu Internet, in exchange for a percentage of the gross revenue of Sohu Internet. The agreement has an initial term of two years, and is renewable at the request of Sohu Era.

Business cooperation agreement between Sogou Technology and Sogou Information. Pursuant to this agreement, Sogou Information provides Internet information services to Sogou Technology's customers in exchange for a fee payable to Sogou Information. The agreement has a term of 10 years, and is renewable at the request of Sogou Technology.

Exclusive technology consulting and service agreement between Sogou Technology and Sogou Information. Pursuant to this agreement Sogou Technology has the exclusive right to provide technical consultation and other related services to Sogou Information in exchange for a fee. The agreement has a term of 10 years and is renewable at the request of Sogou Technology.

Exclusive technology consulting and service agreement between Video Tianjin and Tianjin Jinhu. Pursuant to this agreement Video Tianjin has the exclusive right to provide technical consultation and other related services to Tianjin Jinhu in exchange for a fee. The agreement has a term of 10 years and is renewable at the request of Video Tianjin.

Technology support and utilization agreements between AmazGame and Gamease and between Gamespace and Guanyou Gamespace. Pursuant to these agreements, AmazGame and Gamespace have the exclusive right to provide certain product development and application services and technology support to Gamease and Guanyou Gamespace, respectively, for a fee equal to a predetermined percentage, subject to adjustment by AmazGame or Gamespace at any time, of Gamease's and Guanyou Gamespace's respective revenues. Each agreement terminates only when AmazGame or Gamespace is dissolved.

Services and maintenance agreements between AmazGame and Gamease between Gamespace and Guanyou Gamespace. Pursuant to these agreements, AmazGame and Gamespace, respectively, provide marketing, staffing, business operation and maintenance services to Gamease and Guanyou Gamespace, respectively, in exchange for a fee equal to the cost of providing such services plus a predetermined margin. Each agreement terminates only when AmazGame or Gamespace, as the case may be, is dissolved.

Exclusive Services agreement between Beijing Baina Technology and Wuhan Baina Information. Beijing Baina Technology agrees to provide Wuhan Baina Information with technical services, business consulting, capital equipment lease, market consulting, integration of systems, research and development of products and maintenance of systems. Service fees are to be determined with reference to the specific services provided, based on a transfer pricing

analysis.

Certain of the contractual arrangements described above between the VIEs and the related wholly-owned subsidiaries of the Sohu Group are silent regarding renewals. However, because the VIEs are controlled by the Sohu Group through powers of attorney granted to the Sohu Group by the shareholders of the VIEs, the contractual arrangements can be, and are expected to be, renewed at the subsidiaries' election.

Table of Contents***VIE-Related Risks***

It is possible that the Sohu Group's operation of certain of its operations and businesses through VIEs could be found by PRC authorities to be in violation of PRC law and regulations prohibiting or restricting foreign ownership of companies that engage in such operations and businesses. While the Sohu Group's management considers the possibility of such a finding by PRC regulatory authorities under current law and regulations to be remote, on January 19, 2015, the Ministry of Commerce of the PRC, or (the MOFCOM) released on its Website for public comment a proposed PRC law (the Draft FIE Law) that appears to include VIEs within the scope of entities that could be considered to be foreign invested enterprises (or FIEs) that would be subject to restrictions under existing PRC law on foreign investment in certain categories of industry. Specifically, the Draft FIE Law introduces the concept of actual control for determining whether an entity is considered to be an FIE. In addition to control through direct or indirect ownership or equity, the Draft FIE Law includes control through contractual arrangements within the definition of actual control. If the Draft FIE Law is passed by the People's Congress of the PRC and goes into effect in its current form, these provisions regarding control through contractual arrangements could be construed to reach the Sohu Group's VIE arrangements, and as a result the Sohu Group's VIEs could become explicitly subject to the current restrictions on foreign investment in certain categories of industry. The Draft FIE Law includes provisions that would exempt from the definition of foreign invested enterprises entities where the ultimate controlling shareholders are either entities organized under PRC law or individuals who are PRC citizens. The Draft FIE Law is silent as to what type of enforcement action might be taken against existing VIEs that operate in restricted or prohibited industries and are not controlled by entities organized under PRC law or individuals who are PRC citizens. If a finding were made by PRC authorities, under existing law and regulations or under the Draft FIE Law if it becomes effective, that the Sohu Group's operation of certain of its operations and businesses through VIEs is prohibited, regulatory authorities with jurisdiction over the licensing and operation of such operations and businesses would have broad discretion in dealing with such a violation, including levying fines, confiscating the Sohu Group's income, revoking the business or operating licenses of the affected businesses, requiring the Sohu Group to restructure its ownership structure or operations, or requiring the Sohu Group to discontinue all or any portion of its operations. Any of these actions could cause significant disruption to the Sohu Group's business operations, and have a severe adverse impact on the Sohu Group's cash flows, financial position and operating performance.

In addition, it is possible that the contracts among the Sohu Group, the Sohu Group's VIEs and shareholders of its VIEs would not be enforceable in China if PRC government authorities or courts were to find that such contracts contravene PRC law and regulations or are otherwise not enforceable for public policy reasons. In the event that the Sohu Group was unable to enforce these contractual arrangements, the Sohu Group would not be able to exert effective control over the affected VIEs. Consequently, such VIE's results of operations, assets and liabilities would not be included in the Sohu Group's consolidated financial statements. If such were the case, the Sohu Group's cash flows, financial position and operating performance would be severely adversely affected. The Sohu Group's contractual arrangements with respect to its consolidated VIEs are in place. The Sohu Group's management believes that such contracts are enforceable, and considers the possibility remote that PRC regulatory authorities with jurisdiction over the Sohu Group's operations and contractual relationships would find the contracts to be unenforceable.

The Sohu Group's operations and businesses rely on the operations and businesses of its VIEs, which hold certain recognized and unrecognized revenue-producing assets. The recognized revenue-producing assets include goodwill and intangible assets acquired through business acquisitions. Goodwill primarily represents the expected synergies from combining an acquired business with the Sohu Group. Intangible assets acquired through business acquisitions mainly consist of customer relationships, non-compete agreements, user bases, copyrights, trademarks and developed technologies. Unrecognized revenue-producing assets mainly consist of licenses and intellectual property. Licenses include operations licenses, such as Internet information service licenses and licenses for providing content.

Intellectual property developed by the Sohu Group mainly consists of patents, copyrights, trademarks, and domain names. The Sohu Group's operations and businesses may be adversely impacted if the Sohu Group loses the ability to use and enjoy assets held by these VIEs.

9. Sohu.com Inc. Shareholders' Equity

Takeover Defense

Sohu intends to adopt appropriate defensive measures in the future on a case by case basis as and to the extent that Sohu's Board of Directors determines that such measures are necessary or advisable to protect Sohu stockholder value in the face of any coercive takeover threats or to prevent an acquirer from gaining control of Sohu without offering fair and adequate price and terms.

Treasury Stock

Treasury stock consists of shares repurchased by Sohu.com Inc. that are no longer outstanding and are held by Sohu.com Inc. Treasury stock is accounted for under the cost method. For the six months ended June 30, 2016 and 2015, the Company did not repurchase any shares of its common stock.

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Stock Incentive Plan

Sohu (excluding Sohu Video), Sogou, Changyou, and Sohu Video have incentive plans for the granting of share-based awards, including options and restricted share units, to their directors, management and other key employees.

1) Sohu.com Inc. Share-based Awards

Sohu's 2000 Stock Incentive Plan

Sohu's 2000 Stock Incentive Plan (the "Sohu 2000 Stock Incentive Plan") provided for the issuance of up to 9,500,000 shares of common stock, including those issued pursuant to the exercise of stock options and upon vesting and settlement of restricted share units. Most of these awards vest over a period of four years. The maximum term of any issued stock right under the Sohu 2000 Stock Incentive Plan is ten years from the grant date. The Sohu 2000 Stock Incentive Plan expired on January 24, 2010. A new plan (the "Sohu 2010 Stock Incentive Plan") was adopted by Sohu's shareholders on July 2, 2010.

There has been no share-based compensation expense recognized under the Sohu 2000 Stock Incentive Plan since 2015, as the requisite service periods for all these awards had been completed by the end of 2014. No cash has been received under the Sohu 2000 Stock Incentive Plan since 2016, as all of these awards had been exercised by the end of 2015.

Sohu's 2010 Stock Incentive Plan

On July 2, 2010, the Company's shareholders adopted the Sohu 2010 Stock Incentive Plan, which provides for the issuance of up to 1,500,000 shares of common stock, including stock issued pursuant to the vesting and settlement of restricted share units and pursuant to the exercise of stock options. The maximum term of any stock right granted under the Sohu 2010 Stock Incentive Plan is ten years from the grant date. The Sohu 2010 Stock Incentive Plan will expire on July 1, 2020. As of June 30, 2016, 335,180 shares were available for grant under the Sohu 2010 Stock Incentive Plan.

i) Summary of stock option activity

On February 7, 2015 and May 1, 2016, the Company's Board of Directors approved contractual grants to members of the Company's management and key employees of options for the purchase of an aggregate of 1,068,000 and 13,000 shares of common stock, respectively, with nominal exercise prices of \$0.001. These stock options vest and become exercisable in four equal installments over a period of four years, with each installment vesting upon the satisfaction of a service period requirement and certain subjective performance targets. These stock options are substantially similar to restricted share units except for the nominal exercise price, which would be zero for restricted share units.

Under ASC 718-10-25 and ASC 718-10-55, no grant date can be established for these stock options until a mutual understanding is reached between the Company and the recipients clarifying the subjective performance requirements. If the service inception date preceded the grant date, compensation expense should be accrued beginning on the service inception date, and re-measured on each subsequent reporting date before the grant date is established, based on the then-current fair value of the awards. To determine the fair value of these stock options, the public market price of the underlying shares at each reporting date is used and a binomial valuation model is applied.

On February 7, 2016, 253,250 of these stock options had been granted and had become vested, as a mutual understanding of the subjective performance targets had been reached between the Company and the recipients, the

targets had been satisfied, and the service period requirements had been fulfilled. The cumulative share-based compensation expense for these granted stock options has been adjusted and fixed based on the fair value at the grant date of \$10.8 million.

A summary of stock option activity under the Sohu 2010 Stock Incentive Plan as of and for the six months ended June 30, 2016 is presented below:

Options	Number Of Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value (1) (in thousands)
Outstanding at January 1, 2016	0	\$		\$
Granted	253	0.001		
Exercised	(51)	0.001		
Forfeited or expired	0			
Outstanding at June 30, 2016	202	0.001	8.61	7,657
Vested at June 30, 2016	202	0.001	8.61	7,657
Exercisable at June 30, 2016	202	0.001	8.61	7,657

Note (1): The aggregated intrinsic value in the preceding table represents the difference between Sohu's closing stock price of \$37.86 on June 30, 2016 and the nominal exercise prices of the stock options.

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For the three and six months ended June 30, 2016, total share-based compensation expense recognized for these stock options was negative \$1.0 million and negative \$1.7 million, respectively. For the three and six months ended June 30, 2015, total share-based compensation expense recognized for these stock options was \$7.8 million and \$11.6 million, respectively.

ii) Summary of restricted share unit activity

A summary of restricted share unit activity under the Sohu 2010 Stock Incentive Plan as of and for the six months ended June 30, 2016 is presented below:

Restricted Share Units	Number of Units (in thousands)	Weighted-Average Grant-Date Fair Value
Unvested at January 1, 2016	32	\$ 70.24
Granted	11	51.00
Vested	(6)	61.92
Forfeited	(3)	76.95
Unvested at June 30, 2016	34	64.90
Expected to vest after June 30, 2016	27	63.40

For the three and six months ended June 30, 2016, total share-based compensation expense recognized for restricted share units was \$0.4 million and \$0.8 million, respectively. For the three and six months ended June 30, 2015, total share-based compensation expense recognized for restricted share units was \$0.6 million and \$1.2 million, respectively.

As of June 30, 2016, there was \$1.1 million unrecognized compensation expense related to unvested restricted share units. The expense is expected to be recognized over a weighted average period of 0.64 years. The total fair value on their respective vesting dates of restricted share units that vested during the three and six months ended June 30, 2016 was \$0.1 million and \$0.3 million, respectively. The total fair value on their respective vesting dates of restricted share units that vested during the three and six months ended June 30, 2015 was \$0.2 million and \$0.3 million, respectively.

2) *Sogou Inc. Share-based Awards***Sogou 2010 Share Incentive Plan**

Sogou adopted a share incentive plan on October 20, 2010. The number of Sogou ordinary shares issuable under the plan was 41,500,000 after an amendment that was effective August 22, 2014 (as amended, the Sogou 2010 Share Incentive Plan). Awards of share rights may be granted under the Sogou 2010 Share Incentive Plan to management and employees of Sogou and of any present or future parents or subsidiaries or variable interest entities of Sogou. The maximum term of any share right granted under the Sogou 2010 Share Incentive Plan is ten years from the grant date. The Sogou 2010 Share Incentive Plan will expire on October 19, 2020. As of June 30, 2016, Sogou had contractually granted options for the purchase of 38,550,375 ordinary shares under the 2010 Sogou Share Incentive Plan.

Of the contractually granted options for the purchase of 38,550,375 shares, options for the purchase of 31,350,375 shares vest and become exercisable upon a service period requirement being met, as well as Sogou's achievement of performance targets for the corresponding period. Subject to achievement of the applicable performance targets, of these options for the purchase of 31,350,375 shares, options for the purchase of 30,131,125 shares vest and become exercisable in four equal installments and options for the purchase of 1,219,250 shares vest and become exercisable in two to four installments over varying periods. Of these options for the purchase of 31,350,375 shares, the terms of options for the purchase of 980,000 shares, which had previously included as vesting conditions a service period requirement and Sogou's completion of an IPO of its ordinary shares (Sogou's IPO), were amended in the first quarter of 2016 to remove as a condition of vesting completion of Sogou's IPO and add as a condition of vesting achievement of performance targets. For purposes of recognition of share-based compensation expense, each installment is considered to be granted as of the date that the performance target has been set. As of June 30, 2016, Sogou had granted options for the purchase of 23,010,197 shares under the 2010 Sogou Share Incentive Plan. As of June 30, 2016, options for the purchase of 22,923,259 shares had become vested and exercisable because both the service period and the performance requirements had been met, and of such vested options, options for the purchase of 22,918,596 shares had been exercised.

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Of the contractually granted share options, options for the purchase of 7,200,000 shares vest and become exercisable in five equal installments, with (i) the first installment vesting upon Sogou's IPO and the expiration of all underwriters lockup periods applicable to Sogou's IPO, and (ii) each of the four subsequent installments vesting on the first, second, third and fourth anniversary dates, respectively, of the closing of Sogou's IPO. The completion of an IPO is considered to be a performance condition of the awards. An IPO is not considered to be probable until it is completed. Under ASC 718, compensation cost should be accrued if it is probable that the performance condition will be achieved and should not be accrued if it is not probable that the performance condition will be achieved. As a result, no compensation expense will be recognized related to these options until the completion of an IPO, and hence no share-based compensation expense was recognized for the three months ended June 30, 2016 for the options for the purchase of 7,200,000 shares that are subject to vesting upon completion of Sogou's IPO.

As of June 30, 2016, for purposes of recognition of share-based compensation expense, Sogou had granted options for the purchase of 30,210,197 shares, of which options for the purchase of 7,291,601 shares were outstanding. A summary of share option activity under the Sogou 2010 Share Incentive Plan as of and for the six months ended June 30, 2016 is presented below:

Options	Number Of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
	(in thousands)		
Outstanding at January 1, 2016	12,209	\$ 0.369	
Granted	0		
Exercised	(3,800)	0.001	
Forfeited or expired	(1,117)	0.001	
Outstanding at June 30, 2016	7,292	0.617	6.61
Vested at June 30, 2016 and expected to vest thereafter	92		
Exercisable at June 30, 2016	5		

For the three and six months ended June 30, 2016, total share-based compensation expense recognized for share options under the Sogou 2010 Share Incentive Plan was \$0.1 million and \$1.2 million, respectively. For the three and six months ended June 30, 2015, total share-based compensation expense recognized for share options under the Sogou 2010 Share Incentive Plan was \$1.1 million and \$3.9 million, respectively.

As of June 30, 2016, there was \$0.1 million of unrecognized compensation expense related to the unvested share options. The expense is expected to be recognized over a weighted average period of 0.35 years.

The fair value of the ordinary shares of Sogou was assessed using the income approach /discounted cash flow method, with a discount for lack of marketability, given that the shares underlying the award were not publicly traded at the time of grant, and was determined with the assistance of a qualified professional appraiser using management's estimates and assumptions. This assessment required complex and subjective judgments regarding Sogou's projected

financial and operating results, its unique business risks, the liquidity of its ordinary shares and its operating history and prospects at the time the grants were made.

The fair value of the options granted to Sogou management and key employees was estimated on the date of grant using the Binomial option - pricing model (the BP Model) with the following assumptions used:

Assumptions Adopted

Average risk-free interest rate	2.12%~2.77%
Exercise multiple	2~3
Expected forfeiture rate (post-vesting)	0%~12%
Weighted average expected option life	6
Volatility rate	47%~50%
Dividend yield	0%
Fair value	3.58~3.93

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Sogou estimated the risk-free rate based on the market yields of U.S. Treasury securities with an estimated country-risk differential as of the valuation date. An exercise multiple was estimated as the ratio of the fair value of the shares over the exercise price as of the time the option is exercised, based on consideration of research studies regarding exercise patterns based on historical statistical data. In Sogou's valuation analysis, a multiple of two was applied for employees and a multiple of three was applied for management. Sogou estimated the forfeiture rate to be 0% for Sogou management's share options granted as of June 30, 2016 and 12% for Sogou employees' share options granted as of June 30, 2016. The life of the share options is the contract life of the option. Based on the option agreement, the contract life of the option is 10 years. The expected volatility at the valuation date was estimated based on the historical volatility of comparable companies for the period before the grant date with length commensurate with the expected term of the options. Sogou has no history or expectation of paying dividends on its ordinary shares. Accordingly, the dividend yield is estimated to be 0%.

Sohu Management Sogou Share Option Arrangement

Under an arrangement providing for Sogou share-based awards to be available for grants to members of Sohu's Board of Directors, management and other key employees (Sohu Management Sogou Share Option Arrangement), which was approved by the boards of directors of Sohu and Sogou in March 2011, Sohu has the right to provide to members of Sohu's Board of Directors, management and other key employees the opportunity to purchase from Sohu up to 12,000,000 ordinary shares of Sogou at a fixed exercise price of \$0.625 or \$0.001 per share. Of these 12,000,000 ordinary shares, 8,800,000 are Sogou ordinary shares previously held by Sohu and 3,200,000 are Sogou ordinary shares that were newly-issued on April 14, 2011 by Sogou to Sohu at a price of \$0.625 per share, or a total of \$2.0 million. As of June 30, 2016, Sohu had contractually granted options for the purchase of 10,717,500 Sogou ordinary shares to members of Sohu's Board of Directors, management and other key employees under the Sohu Management Sogou Share Option Arrangement.

Of the contractually granted options for the purchase of 10,717,500 shares, options for the purchase of 8,302,500 shares vest and become exercisable in four equal installments, with each installment vesting upon a service period requirement for Sohu's management and key employees being met, as well as Sogou's achievement of performance targets for the corresponding period. The performance target for each installment is set at the beginning of each vesting period. Accordingly, for purposes of recognition of share-based compensation expense, each installment is considered to be granted as of that date. As of June 30, 2016, Sohu had granted options for the purchase of 8,232,500 shares under the Sohu Management Sogou Share Option Arrangement. As of June 30, 2016, options for the purchase of 8,232,500 shares had become vested and exercisable because both the service period and the performance requirements had been met, and vested options for the purchase of 7,512,500 shares had been exercised.

As of December 31, 2015, options for the purchase of 15,000 ordinary shares of Sogou granted to members of Sohu Board of Directors had vested and become exercisable, as the service period requirement for vesting had been met.

The remaining options for the purchase of 2,400,000 shares vest and become exercisable in five equal installments, with (i) the first installment vesting upon Sogou's IPO and the expiration of all underwriters' lockup periods applicable to the IPO, and (ii) each of the four subsequent installments vesting on the first, second, third and fourth anniversary dates, respectively, of the closing of Sogou's IPO. All installments of the options for the purchase of 2,400,000 shares that are subject to vesting upon the completion of Sogou's IPO were considered granted upon the issuance of the options. The completion of a firm commitment IPO is considered to be a performance condition of the awards. An IPO event is not considered to be probable until it is completed. Under ASC 718, compensation cost should be accrued if it is probable that the performance condition will be achieved and should not be accrued if it is not probable that the performance condition will be achieved. As a result, no compensation expense will be recognized related to these options until the completion of an IPO, and hence no share-based compensation expense was recognized for the three

months ended June 30, 2016 for these options for the purchase of 2,400,000 shares.

As of June 30, 2016, for purposes of recognition of share-based compensation expense, Sohu had granted options for the purchase of 10,647,500 shares, of which options for the purchase of 3,131,500 shares were outstanding. A summary of share option activity under the Sohu Management Sogou Share Option Arrangement as of and for the six months ended June 30, 2016 is presented below:

Options	Number Of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
	(in thousands)		
Outstanding at January 1, 2016	3,664	\$ 0.623	
Granted	0		
Exercised	(532)	0.625	
Forfeited or expired	0		
Outstanding at June 30, 2016	3,132	0.623	6.27
Vested at June 30, 2016 and expected to vest thereafter	732		
Exercisable at June 30, 2016	732		

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For the three and six months ended June 30, 2016, total share-based compensation expense recognized for share options under the Sohu Management Sogou Share Option Arrangement was nil and \$0.3 million, respectively. For the three and six months ended June 30, 2015, total share-based compensation expense recognized for share options under the Sohu Management Sogou Share Option Arrangement was \$0.1 million and \$0.7 million, respectively.

As of June 30, 2016, there was no unrecognized compensation expense related to the unvested share options.

The method used to determine the fair value of share options granted to members of Sohu's Board of Directors, management and other employees was the same as the method used for the share options granted to Sogou's management and key employees as described above, except for the assumptions used in the BP Model as presented below:

Assumptions Adopted

Average risk-free interest rate	2.12%~2.15%
Exercise multiple	3
Expected forfeiture rate (post-vesting)	0%
Weighted average expected option life	5
Volatility rate	47%
Dividend yield	0%
Fair value	3.31

Option Modification

In the first and second quarter of 2013, a portion of the share options granted under the Sogou 2010 Share Incentive Plan and the Sohu Management Sogou Share Option Arrangement were exercised early, and the Sogou ordinary shares issued upon exercise were transferred to trusts with the original option grantees as beneficiaries. The trusts will distribute the shares to those beneficiaries in installments based on the vesting requirements under the option agreements. Although these trust arrangements caused a modification of the terms of these share options, the modification was not considered substantive. Accordingly, no incremental fair value related to these shares resulted from the modification, and the remaining share-based compensation expense for these shares will continue to be recognized over the original remaining vesting period. As of June 30, 2016, options for the purchase of 11,370,000 shares granted under the Sogou 2010 Share Incentive Plan had been exercised early but had not been distributed to the beneficiaries of the trusts. All of the early-exercised shares that were distributed to those beneficiaries by the trusts in accordance with the vesting requirements under the option agreements have been included in the disclosures under the heading "Sogou 2010 Share Incentive Plan" above.

Tencent Share-based Awards Granted to Employees Who Transferred to Sogou with Soso Search-related Businesses

Certain persons who became Sogou employees when Tencent's Soso search-related businesses were transferred to Sogou on September 16, 2013 had been granted restricted share units under Tencent's share award arrangements prior to the transfer of the businesses to Sogou. These Tencent restricted share units will continue to vest under the original Tencent share award arrangements provided the transferred employees continue to be employed by Sogou during the requisite service period. After the transfer of the Soso search-related businesses to Sogou, Sogou applied the guidance in ASC 505-50 to measure the related compensation expense, based on the then-current fair value at each reporting date, which is deemed to have been incurred by Tencent as an investor on Sogou's behalf. To determine the then-current fair value of the Tencent restricted share units granted to these employees, the public market price of the underlying shares at each reporting date was applied. Because Sogou is not required to reimburse Tencent for such

share-based compensation expense, the related amount was recorded by Sogou as a capital contribution from Tencent.

As of June 30, 2016, unvested Tencent restricted share unit awards held by these employees provided for the issuance of up to 168,050 ordinary shares of Tencent, taking into consideration a five-for-one split of Tencent's shares that became effective in May 2014. For the three and six months ended June 30, 2016, share-based compensation expense of \$0.5 million and \$0.8 million, respectively, related to these Tencent restricted share units was recognized in the Group's consolidated statements of comprehensive income. For the three and six months ended June 30, 2015, share-based compensation expense of \$0.9 million and \$2.4 million, respectively, related to these Tencent restricted share units was recognized in the Group's consolidated statements of comprehensive income. As of June 30, 2016, there was \$0.6 million of unrecognized compensation expense related to these unvested restricted share units. This amount is expected to be recognized over a weighted average period of 1.61 years.

Table of Contents*3) Changyou.com Limited Share-based Awards**Changyou's 2008 Share Incentive Plan*

Changyou's 2008 Share Incentive Plan (the "Changyou 2008 Share Incentive Plan") originally provided for the issuance of up to 2,000,000 ordinary shares, including ordinary shares issued pursuant to the exercise of share options and upon vesting and settlement of restricted share units. The 2,000,000 reserved shares became 20,000,000 ordinary shares in March 2009 when Changyou effected a ten-for-one share split of its ordinary shares. Most of the awards granted under the Changyou 2008 Share Incentive Plan vest over a period of four years. The maximum term of any share right granted under the Changyou 2008 Share Incentive Plan is ten years from the grant date. The Changyou 2008 Share Incentive Plan will expire in August 2018.

Prior to the completion of Changyou's initial public offering, Changyou had granted under the Changyou 2008 Share Incentive Plan 15,000,000 ordinary shares to its former chief executive officer Tao Wang, through Prominence Investments Ltd., which is an entity that may be deemed under applicable rules of the Securities and Exchange Commission to be beneficially owned by Tao Wang. Through June 30, 2016, Changyou had also granted under the Changyou 2008 Share Incentive Plan restricted share units, settleable upon vesting by the issuance of an aggregate of 4,614,098 ordinary shares, to certain members of its management other than Tao Wang, and certain other Changyou employees.

i) Share-based Awards granted before Changyou's IPO

All of the restricted ordinary shares and restricted share units granted before Changyou's IPO became vested by the end of 2013. Hence there was no share-based compensation expense recognized with respect to such restricted ordinary shares and restricted share units since their respective vesting dates.

ii) Share-based Awards granted after Changyou's IPO

Through June 30, 2016, in addition to the share-based awards granted before Changyou's IPO, Changyou had granted restricted share units, settleable upon vesting with the issuance of an aggregate of 1,581,226 ordinary shares, to certain members of its management other than Tao Wang and to certain of its other employees. These restricted share units are subject to vesting over a four-year period commencing on their grant dates. Share-based compensation expense for such restricted share units is recognized on an accelerated basis over the requisite service period. The fair value of restricted share units was determined based on the market price of Changyou's ADSs on the grant date.

A summary of activity for these restricted share units as of and for the six months ended June 30, 2016 is presented below:

Restricted Share Units	Number of Units (in thousands)	Weighted-Average Grant-Date Fair Value
Unvested at January 1, 2016	20	\$ 14.25
Granted	0	
Vested	0	
Forfeited	0	

Unvested at June 30, 2016	20	14.25
Expected to vest after June 30, 2016	20	14.25

For the three and six months ended June 30, 2016, total share-based compensation expense recognized for the above restricted share units was \$22,000 and \$44,000, respectively. For the three and six months ended June 30, 2015, total share-based compensation expense recognized for the above restricted share units was \$31,000 and negative \$11,000, respectively. The negative \$11,000 resulted from Changyou's true-up of share-based compensation expense for forfeited restricted share units that would have become vested during the first quarter of 2015.

As of June 30, 2016, there was \$66,000 of unrecognized compensation expense related to these unvested restricted share units. The expense is expected to be recognized over a weighted average period of 0.67 years. The total fair value of these restricted share units vested during the three and six months ended June 30, 2016 was nil and nil, respectively. The total fair value of these restricted share units vested during the three and six months ended June 30, 2015 was \$0.4 million and \$0.7 million, respectively.

Table of Contents**Changyou 2014 Share Incentive Plan**

On June 27, 2014, Changyou reserved 2,000,000 of its Class A ordinary shares under the Changyou.com Limited 2014 Share Incentive Plan (the "Changyou 2014 Share Incentive Plan") for the purpose of making share incentive awards to certain members of its management and key employees. On November 2, 2014, the number of Class A ordinary shares reserved under the Changyou 2014 Share Incentive Plan increased from 2,000,000 to 6,000,000. The maximum term of any share right granted under the Changyou 2014 Share Incentive Plan is ten years from the grant date. The Changyou 2014 Share Incentive Plan will expire in June 2024. As of June 30, 2016, 2,884,000 shares were available for grant under the Changyou 2014 Share Incentive Plan.

i) Summary of share option activity

On November 2, 2014, Changyou approved the contractual grant of an aggregate of 2,416,000 Class A restricted share units to certain members of its management and certain other employees. On February 16, 2015, Changyou's Board of Directors approved the conversion of 2,400,000 of these Class A restricted share units into options for the purchase of Class A ordinary shares at an exercise price of \$0.01. On June 1, 2015, Changyou's Board of Directors approved the contractual grant of options for the purchase of an aggregate of 1,998,000 Class A ordinary shares to certain members of its management and certain other employees at an exercise price of \$0.01. These share options vest in four equal installments over a period of four years, with each installment vesting upon satisfaction of a service period requirement and the achievement of certain subjective performance targets. These share options are substantially similar to restricted share units except for the nominal exercise price, which would be zero for restricted share units.

Under ASC 718-10-25 and ASC 718-10-55, no grant date can be established until a mutual understanding is reached between the Company and the recipients clarifying the subjective performance requirements. If the service inception date preceded the grant date, compensation expense should be accrued beginning on the service inception date, and re-measured on each subsequent reporting date before the grant date is established, based on the then-current fair value of the awards. To determine the fair value of these share options, the public market price of the underlying shares at each reporting date is used and a binomial valuation model is applied.

On November 2, 2015 and June 1, 2016, 450,000 and 329,000, respectively, of these share options had been granted and had become vested, as a mutual understanding of the subjective performance targets had been reached between Changyou and the recipients, the targets had been satisfied, and the service period requirements had been fulfilled. The cumulative share-based compensation expense for these granted share options has been adjusted and fixed based on their fair value of \$4.7 million and \$3.2 million, respectively, at the grant date.

A summary of share option activity under the Changyou 2014 Share Incentive Plan as of and for the six months ended June 30, 2016 is presented below:

Options	Number Of Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value (1) (in thousands)
Outstanding at January 1, 2016	450	\$ 0.01	8.84	\$ 5,580
Granted	329	0.01		

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Exercised	(225)	0.01		
Forfeited or expired	0			
Outstanding at June 30, 2016	554	0.01	8.60	5,546
Vested at June 30, 2016	554	0.01	8.60	5,546
Exercisable at June 30, 2016	554	0.01	8.60	5,546

Note (1): The aggregated intrinsic value in the preceding table represents the difference between Changyou's closing price of \$20.04 per ADS, or \$10.02 per Class A ordinary share, on June 30, 2016 and the nominal exercise prices of the share options.

For the three and six months ended June 30, 2016, share-based compensation expense recognized for these share options under the Changyou 2014 Share Incentive Plan was \$3.4 million and \$2.1 million, respectively. For the three and six months ended June 30, 2015, share-based compensation expense recognized for these share options under the Changyou 2014 Share Incentive Plan was \$7.1 million and \$11.0 million, respectively.

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ii) Summary of restricted share unit activity

On November 2, 2014, Changyou had contractually granted under the 2014 Share Incentive Plan an aggregate of 16,000 Class A restricted share units to an employee. These Class A restricted share units are subject to vesting over a four-year period commencing on their grant dates. The fair values as of the grant dates of the restricted share units were determined based on market price of Changyou's ADSs on the grant dates.

Due to the termination of employment of an employee during the second quarter of 2015 prior to vesting of the restricted share units held by the employee, Changyou reversed share-based compensation expense in the amount of \$17,000. There was no unrecognized compensation expense for these restricted share units after the second quarter of 2015, as all of them were forfeited during that quarter.

4) Sohu Video Share-based Awards

On January 4, 2012, Sohu Video adopted the Video 2011 Share Incentive Plan, under which 25,000,000 ordinary shares of Sohu Video are reserved for the purpose of making share incentive awards to management and key employees of Sohu Video and to Sohu management. The maximum term of any share incentive award granted under the Video 2011 Share Incentive Plan is ten years from the grant date. The Video 2011 Share Incentive Plan will expire on January 3, 2021. As of June 30, 2016, grants of options for the purchase of 16,368,200 ordinary shares of Sohu Video had been contractually made and were subject to vesting in four equal installments, with each installment vesting upon a service period requirement being met, as well as Sohu Video's achievement of performance targets for the corresponding period. For purposes of ASC 718-10-25, as of June 30, 2016, no grant date had occurred, because the broader terms and conditions of the option awards had neither been finalized nor mutually agreed upon with the recipients. As of June 30, 2016, options for the purchase of 4,972,800 ordinary shares were vested.

For the three and six months ended June 30, 2016, total share-based compensation expense recognized for vested options under the Video 2011 Share Incentive Plan was negative \$0.8 million and negative \$0.6 million, respectively. For the three and six months ended June 30, 2015, total share-based compensation expense recognized for vested options under the Video 2011 Share Incentive Plan was \$0.9 million and \$0.1 million, respectively.

The fair value of the options contractually granted to management and key employees of Sohu Video and to Sohu management was estimated on the reporting date using the BP Model, with the following assumptions used:

Assumptions Adopted

Average risk-free interest rate	1.76%
Exercise multiple	2.8
Expected forfeiture rate (post-vesting)	19%
Weighted average expected option life	5.5
Volatility rate	55.6%
Dividend yield	0%
Fair value	0.75

10. Related Party Transactions*Changyou's Loan Arrangements with SoEasy*

Commencing in April 2015, certain subsidiaries of Changyou and certain subsidiaries of SoEasy entered into a series of loan agreements pursuant to which the subsidiaries of Changyou are entitled to draw down HK dollar-denominated or U.S. dollar-denominated loans from the SoEasy subsidiaries and the SoEasy subsidiaries are entitled to draw down equivalent RMB-denominated loans from the subsidiaries of Changyou, to facilitate each other's business operations. All of the loans carry a fixed rate of interest equal to the current market interest rate. During the first quarter of 2016, Changyou drew down from SoEasy U.S. dollar-denominated loans of approximately \$29.9 million and granted RMB-denominated loans to SoEasy of approximately \$30.2 million. During the second quarter of 2016, Changyou repaid to SoEasy U.S. dollar-denominated loans of approximately \$12.9 million and received from SoEasy RMB-denominated loans of \$12.1 million. As of June 30, 2016, Changyou had U.S. dollar-denominated loans payable to SoEasy in a total amount of approximately \$29.4 million, which was recorded in other short-term liabilities. As of the same date, Changyou had RMB-denominated loans receivable from SoEasy in a total amount of approximately \$29.4 million, which was recorded in prepaid and other current assets. For the three and six months ended June 30, 2016, Changyou incurred interest expense of \$0.2 million and \$0.3 million, respectively, and earned interest income of \$0.4 million and \$0.7 million, respectively. As of June 30, 2016, total interest expense payable to SoEasy amounted to \$0.2 million, which was recorded in other short-term liabilities; and total interest income receivable from SoEasy was \$0.4 million, which was recorded in prepaid and other current assets.

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For the three and six months ended June 30, 2016, the Sohu Group generated brand advertising revenue from SoEasy of \$10,000 and \$862,000, respectively. For the three and six months ended June 30, 2016, the Group incurred sales and marketing expense for SoEasy of \$202,000 and \$216,000, respectively.

11. Sogou Transactions

On September 16, 2013, Sogou entered into a series of agreements with Tencent, Sohu Search and Photon Group Limited (Photon) pursuant to which Sogou issued Series B Preferred Shares and Class B Ordinary Shares to Tencent for a net amount of \$448 million in cash and Tencent transferred its Soso search-related businesses and certain other assets to Sogou (collectively, the Sogou-Tencent Transactions). Also on that date, Sogou entered into Repurchase Option Agreements with Sohu Search and Photon, and a Repurchase/Put Option Agreement with China Web Search (HK) Limited (China Web), with respect to all of the Series A Preferred Shares of Sogou held by Sohu Search and China Web, and a portion of the Series A Preferred Shares of Sogou held by Photon. Also on that date, Sogou, Sohu Search, Photon, Mr. Xiaochuan Wang, four other members of Sogou s management (collectively, the Sohu Parties) and Tencent entered into a Shareholders Agreement (the Shareholders Agreement) under which the parties agreed to vote their Sogou shares in all elections of directors to elect three designees of Sohu Search and two designees of Tencent.

In June 2014, Sogou repurchased approximately 4.2 million of its Class A Ordinary Shares from noncontrolling shareholders, a majority of whom were employees of the Group, for an aggregate purchase price of \$41.6 million. In March 2014, September 2015, and September 2015, respectively, Sogou purchased from China Web, Sohu Search and Photon, pursuant to the Repurchase Option Agreements entered into in September 2013, 14.4 million, 24.0 million and 6.4 million Series A Preferred Shares of Sogou, for an aggregate purchase price of \$47.3 million, \$78.8 million and \$21.0 million, respectively. After these repurchases, the Sohu Group holds approximately 36% of the outstanding equity capital of Sogou, assuming that all share options under the Sogou 2010 Share Incentive Plan and all share options under the Sohu Management Sogou Share Option Arrangement are granted and exercised and that all of the 4.2 million Class A Ordinary Shares Sogou repurchased in June 2014 were issued to shareholders other than Sohu.com Inc.

Pursuant to the Shareholders Agreement, the Sohu Group holds approximately 52% of the total voting power and control the election of the Board of Directors of Sogou, assuming that Tencent s non-voting Class B Ordinary Shares are converted to voting shares, and