

SOHU COM INC
Form 10-K
February 26, 2010
Table of Contents

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

FORM 10-K

(MARK ONE)

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

For the fiscal year ended December 31, 2009

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)

98-0204667
(I.R.S. Employer

of incorporation)

Identification No.)

Level 12, Sohu.com Internet Plaza

No. 1 Unit Zhongguancun East Road, Haidian District

Beijing 100084

People's Republic of China

(Address of principal executive offices)

(011) 8610-6272-6666

(Registrant's Telephone Number, Including Area Code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Common Stock, \$0.001 Par Value

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange

Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Edgar Filing: SOHU COM INC - Form 10-K

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 definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer 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 aggregate market value of common stock held by non-affiliates of the registrant, based upon the last sale price on June 30, 2009 as reported on the NASDAQ Global Select Market, was approximately \$1,552 million.

As of January 31, 2010, there were 37,766,593 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for Sohu's 2009 Annual Meeting of Stockholders to be filed on or about April 30, 2010 are incorporated into Part III of this report.

Table of Contents**SOHU.COM INC.****Table of Contents**

	PAGE
<u>PART I</u>	
Item 1	<u>Business Overview</u> 1
Item 1A	<u>Risk Factors</u> 30
Item 1B	<u>Unresolved Staff Comments</u> 62
Item 2	<u>Properties</u> 62
Item 3	<u>Legal Proceedings</u> 62
Item 4	<u>Submission of Matters to a Vote of Security Holders</u> 62
<u>PART II</u>	
Item 5	<u>Market for the Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> 63
Item 6	<u>Selected Financial Data</u> 64
Item 7	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 67
Item 7A	<u>Quantitative and Qualitative Disclosure About Market Risk</u> 88
Item 8	<u>Financial Statements and Supplementary Data</u> 88
Item 9	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u> 89
Item 9A	<u>Controls and Procedures</u> 89
Item 9B	<u>Other Information</u> 89
<u>PART III</u>	
Item 10	<u>Directors, Executive Officers and Corporate Governance</u> 89
Item 11	<u>Executive Compensation</u> 90
Item 12	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u> 90
Item 13	<u>Certain Relationships and Related Transactions, and Director Independence</u> 90
Item 14	<u>Principal Accountant Fees and Services</u> 90
<u>PART IV</u>	
Item 15	<u>Exhibits and Financial Statement Schedules</u> 90
	<u>Signatures</u> 92
	Index to Consolidated Financial Statements
	Exhibit Index

Table of Contents**PART I**

As used in this report, references to us, we, our, our company, our group, Sohu and Sohu.com are to Sohu.com Inc. and, except where the context requires otherwise, our wholly-owned, majority-owned subsidiaries and variable interest entities (VIEs), Sohu.com Limited, Sohu.com (Hong Kong) Limited (Sohu Hong Kong), Kylie Enterprises Limited, All Honest International Limited, Sohu.com (Game) Limited (Sohu Game), Go2Map Inc., Sohu.com (Search) Limited, Sogou Inc., Sogou (BVI) Limited, Sogou Hong Kong Limited, 21 East Entertainment Limited (21 East HK), Beijing Sohu New Era Information Technology Co., Ltd. (Sohu Era), Beijing Sohu Interactive Software Co., Ltd. (Sohu Software), Go2Map Software (Beijing) Co., Ltd. (Go2Map Software), Beijing Sogou Technology Development Co., Ltd. (Sogou Technology), Beijing Sohu New Media Information Technology Co., Ltd. (Sohu Media), Beijing Sohu Software Technology Co., Ltd. (New Software), Beijing Fire Fox Digital Technology Co., Ltd. (Beijing Fire Fox , also known as Beijing Huohu Digital Technology Co., Ltd., or Huohu), Beijing Century High Tech Investment Co., Ltd. (High Century), Beijing Sohu Entertainment Culture Media Co., Ltd. (Sohu Entertainment , formerly known as Beijing Hengda Yitong Internet Technology Development Co., Ltd., or Hengda), Beijing Sohu Internet Information Service Co., Ltd. (Sohu Internet), Beijing GoodFeel Information Technology Co., Ltd. (GoodFeel), Beijing Tu Xing Tian Xia Information Consultancy Co., Ltd. (Tu Xing Tian Xia), Beijing Feng Yang Tian Lang Advertising Co., Ltd. (Feng Yang Tian Lang), Beijing Sogou Information Service Co., Ltd. (Sogou Information), Beijing 21 East Culture Development Co., Ltd. (21 East Beijing), New 21 East Art Development (Beijing) Co., Ltd. (New 21 East), and our independently-listed majority-owned subsidiary Changyou.com Limited (Changyou , formerly known as TL Age Limited) as well as following majority-owned subsidiaries and the VIE of Sohu that are directly and indirectly held by Changyou: Changyou.com HK Limited (Changyou HK , formerly known as TL Age Hong Kong Limited), Changyou.com (US) Inc. (formerly known as AmazGame Entertainment (US) Inc.), Changyou.com (UK) Company Limited (Changyou UK), ChangyouMy Sdn. Bhd (Changyou Malaysia), Beijing AmazGame Age Internet Technology Co., Ltd. (AmazGame), Changyou.com Korea Limited (Changyou Korea), and Beijing Gamease Age Digital Technology Co., Ltd. (Gamease), and these references should be interpreted accordingly. Unless otherwise specified, references to China or PRC refer to the People's Republic of China and do not include the Hong Kong Special Administrative Region, the Macau Special Administrative Region or Taiwan. This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding our expectations, beliefs, intentions or future strategies that are signified by the words expect, anticipate, intend, believe, or similar language. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Our business and financial performance are subject to substantial risks and uncertainties. Actual results could differ materially from those projected in the forward-looking statements. In evaluating our business, you should carefully consider the information set forth below under the caption Risk Factors. Readers are cautioned not to place undue reliance on these forward-looking statements.

ITEM 1. BUSINESS OVERVIEW**Our Company**

Our company, Sohu, is a leading Internet company in China providing hundreds of millions of Chinese Internet users with news, information, video content, entertainment and communication. We operate one of the most comprehensive matrices of Chinese language Web properties and one of the most popular online games in China. Substantially all of our operations are conducted through our indirect wholly and majority-owned China-based subsidiaries and variable interest entities (collectively the Sohu Group).

We were incorporated in Delaware in August 1996 as Internet Technologies China Incorporated, and launched our original Website, itc.com.cn, in January 1997. In February 1998, we re-launched our Website under the domain name Sohu.com and, in September 1999, we renamed our company Sohu.com Inc.

Our Business

Our businesses mainly consist of advertising (composed of brand advertising and sponsored search), online game (conducted via Changyou.com Limited, Changyou), and wireless, among which brand advertising and online game are the two core businesses of the Sohu Group.

Advertising Business

Our advertising business, including brand advertising services and sponsored search services, offers various products and services to our users (such as free-of-charge premier content, interactive community, integration search and other competitive Internet services), and provides advertising services to advertisers on our matrices of Chinese language Web properties consisting of:

Edgar Filing: SOHU COM INC - Form 10-K

sohu.com, a leading mass portal and online media destination;

17173.com, a leading online game information portal;

focus.cn, a top real estate Website;

chinaren.com, a leading online alumni club; and

sogou.com, an interactive proprietary search engine.

-1-

Table of Contents

Brand advertising services provide advertisements on our portal Websites to companies seeking to increase their brand awareness online. For the year ended December 31, 2009, brand advertising services generated \$177.1 million or 34% of total revenues of \$515.2 million.

Sponsored search services provide priority placements in our search directory and pay-for-click services to customers, especially small and medium-sized enterprises.

Online Game Business

Our online game business is conducted via Sohu's majority-owned subsidiary Changyou. For the year ended December 31, 2009, our online game business generated \$267.6 million or 52% of total revenues of \$515.2 million.

Changyou is a leading online game developer and operator in China as measured by the popularity of one of our games, Tian Long Ba Bu (TLBB). TLBB, which was launched in May 2007, was ranked by International Data Corporation (IDC), for 2008 as the fourth most popular online game overall in China and the second most popular online game in China among locally-developed online games. Changyou engages in the development, operation and licensing of our massively multi-player online role-playing games (MMORPGs), which are interactive online games that may be played simultaneously by hundreds of thousands of game players. Changyou currently operates three MMORPGs, TLBB, which we developed in-house, Blade Online (BO), which we licensed from third parties, and Blade Hero 2 (BH2), the sequel to BO). For the three months ended December 31, 2009, these games had approximately 80.9 million aggregate registered accounts, 2.4 million aggregate active paying accounts, 990,000 aggregate peak concurrent users and average revenue per active paying account of Renminbi (RMB)196.

TLBB is a martial arts game with 2.5D graphics that is adapted from the popular Chinese martial arts novel *Tian Long Ba Bu*, which means Novel of Eight Demigods, written by the famous writer Louis Cha. Millions of copies of his novels have been sold in numerous languages, and they have been adapted into various movies and television series. Since its launch, TLBB has won various awards in China, including 2008 Best Self-Developed Online Games (First Place) and 2008 and 2009 Most Liked Online Games by Game Players (First Place) awards at the China Digital Entertainment Expo and Conference (ChinaJoy). To leverage the success of TLBB, we licensed the game to third-party operators to operate the game in Vietnam, Taiwan, Hong Kong, Malaysia and Singapore. We also operate a modified version of TLBB in the U.S. through our U.S. subsidiary.

Changyou has five MMORPGs in the pipeline, with different graphic styles, themes and features to appeal to different segments of the online game player community. Games in our pipeline include the Duke of Mount Deer (DMD), Zhong Hua Ying Xiong (ZHYX), Da Hua Shui Hu (DSHH), Immortal Faith (IF), and the Legend of Ancient World (LAW). DMD, which we are developing in-house, is also based on a popular martial arts novel written by Louis Cha. We have licensed ZHYX, DSHH, IF and LAW from third parties.

Changyou operates our current games under the item-based revenue model, meaning game players can play our games for free, but may choose to pay for virtual items, which are non-physical items that game players can purchase and use within an MMORPG, such as gems, pets, fashion items, magic medicine, riding animals, hierograms, skill books and fireworks, to enhance the game-playing experience. Changyou sells prepaid game cards to a range of regional distributors throughout China, who in turn sub-distribute them to numerous retail outlets, including Internet cafés and various Websites, newsstands, software stores, book stores and retail stores. Changyou also directly sells game points to game players through our online sales platform.

Changyou continually collects feedback from game players through multiple channels. Our product development team and game operations team work closely together, allowing us to translate game player feedback into game updates and expansion packs in a timely manner. We typically release expansion packs, which are software packages that contain significant upgrades and improvements to a game within the existing game's framework, every few months or as regularly as necessary based on game players' feedback, market demand and other factors. These upgrades may include new game content such as storylines, characters, tasks, maps and virtual items. We also update our games on a weekly basis with interim enhancements. We believe that such expansion packs and regular updates improve the game-playing experience and help to maintain the interest level of our game players, thereby helping us to extend the lifespan of our games.

Initial Public Offering of Changyou

Our MMORPG business began operations in 2003. In a few years, our online game business has developed from nascency to become one of the top MMORPG operators in China. Its success was further endorsed by the carve-out and initial public offering of our MMORPG subsidiary Changyou (Nasdaq: CYOU) in April 2009. The successful initial public offering has provided Changyou with the platform and resources to become a leading company in the MMORPG industry, and has enabled Changyou to compete head to head with first tier players.

Edgar Filing: SOHU COM INC - Form 10-K

Subsequent to Changyou's initial public offering, as Changyou's controlling shareholder, Sohu continues to consolidate Changyou but recognizes noncontrolling interests reflecting the shares held by the shareholders other than Sohu. During the second quarter through fourth quarter of 2009, treating all existing restricted shares and restricted share units as fully vested, Sohu owned approximately 66% of the economic interest in Changyou, with the remaining 34% of the economic interest in Changyou owned by Changyou's shareholders other than Sohu. We do not expect the percentage of Sohu's economic interest in Changyou to fluctuate significantly, given that Sohu does not have any plan to sell any additional shares in Changyou in the foreseeable future. For detailed information Changyou's initial public offering and shareholding structure, please see Note 2 Changyou Transactions of Notes to Consolidated Financial Statements.

-2-

Table of Contents

Wireless and Others Businesses

Our wireless and others businesses mainly consist of wireless business, which offers value-added services for mobile phone users such as news, weather forecasts, chatting, entertainment information and mobile phone ringtone and logo downloads.

PRODUCTS AND SERVICES

Advertising Business

Web Properties

The Sohu Group has one of the most comprehensive matrices of Web properties. Among these Web properties, Sohu.com is attracting the highest level of Internet traffic in China. On all of our Websites, we offer basic content to our users on a free of charge basis.

Sohu properties consist of sophisticated Chinese language Web navigational capabilities, approximately 40 main content channels, Web-based communication and community services. Each of our interest-specific main channels contains multi-level sub-channels that cover a comprehensive range of topics including news, entertainment, sports, business and finance, information technology, automobile, real estate, and women-focused issues. We also offer free Web-based communication and community, and other Internet services to enhance the users experience. Our portal attracts consumers and merchants alike because it is designed to meet the specific needs and interests of Internet users in China. Key features of our portal include proprietary Web navigational capabilities that reflect particular cultural characteristics and viewing habits of PRC Internet users.

We deliver authorized high-definition video content and original in-house produced video content surrounding nationwide events on channels geared for specific types of content, including v.sohu for entertainment, s.sohu for sports and tv.sohu for TV programs, and attracted a large number of users. These channels provide users free access to extensive and varied video content, including popular domestic and overseas movies and TV dramas, in-house produced online talk shows, exclusive celebrity interviews, live Webcasts, on-demand sports games, and user-generated video clips.

We continue to upgrade our communication and community services so as to increase user experience and stickiness to our portal network. Communication and community services help users to build customized space and personalized page layouts and offer improved information sharing and real-time communication, so that users are able to expand and maintain their social network with Sohu.

Vertical Sites

17173.com

Our game portal 17173.com was launched in 2000 as the first online game portal in China. 17173.com is a leading online destination for game players seeking information on games and feedback from other players on the site's message boards. With over 500 game zones and tens of millions of registered users supported by alliances with many thousands of Internet cafés, 17173.com is one of the largest online game information and community Websites in China, and widely recognized as a market leader among game Websites in China, with strong expertise in running the Website, building a game community and developing relationships with advertisers in the online game industry. As a result, 17173.com is the marketing platform of choice for many online games, including our own. In addition, 17173.com's experienced game editors review and critique Changyou's games prior to launch, thereby improving the game quality.

Focus.cn

Focus.cn is one of the leading real estate Websites in China, providing comprehensive solutions for house seekers, homeowners, potential property or household appliance buyers with high incomes, and real estate professionals. Launched in 1999, Focus.cn has developed into what we believe is one of the most influential Websites serving the Beijing market. The Focus.cn platform serves as a basis for regional expansion in other key urban areas where Internet penetration is among the highest in China. As of December 31, 2009, the Website had been successfully rolled out into 33 cities. Focus has also been enriching its content and has diversified from residential properties to commercial properties, as well as other auxiliary industries, such as home decoration, furniture and fixtures.

Chinaren.com

Edgar Filing: SOHU COM INC - Form 10-K

ChinaRen is the largest online youth community in China, with over ninety million registered users as of December 31, 2009. Schools and universities in China generally do not have alumni offices to cater to the needs of former students to organize their classes into long-term communities. As in other Asian societies, Chinese people hold strong ties of friendship and loyalty with their fellow alumni, which form the basis of their personal and professional relationship networks. ChinaRen has leveraged a critical mass of loyal users to create one of the leading online alumni networks in China.

-3-

Table of Contents

Sogou.com

Sogou, which means Search Dog, is Sohu's proprietary search engine launched in August 2004. Sogou performs interactive searches of billions of Web pages using advanced algorithms. The user is taken through a fast and convenient interactive process to reach the most relevant selection of the integrated Website and page search results upon search query. Sogou provides our users with high updating speeds, short response times and accurate search results, based on a large database capacity of more than twenty billion retrieved pages. We will continue to update Sogou search engine with advanced techniques to enhance user experience and grow search traffic.

Service Offerings to Users

Aggregated Content

As a leading content aggregator, we organize our content around 40 main channels on the Sohu portal. Each main channel contains numerous sub-channels and features news, commentaries and various utilities and solutions relating to a specific topic. Our regional Websites have extensive reach across China. For example, Focus.cn has penetrated 33 first and second tier cities in China. As of December 31, 2009, we had over 1,500 content partners, which enable us to provide a wide range of content offerings. Our content partners include leading Chinese language media and information providers in a variety of fields across China, such as Xinhua News Agency, People's Daily Online, 21 Century Business Herald, and China Central Television (CCTV), as well as prestigious international content providers such as the NBA and Reuters. Our arrangements with content partners are normally short-term and non-exclusive.

Our main channels include *News, Entertainment, Sports, Business and Finance, Information Technology, Automobile, and Women*:

News channel delivers a comprehensive selection of local, national and international news from newspapers, magazines and other information providers throughout China. Full text search is also available on each page.

Entertainment channel contains extensive coverage of entertainment areas that are of interest to Chinese users, including movies, television programs, plays, operas and popular and classical music.

Sports channel provides the latest in national and international sports headlines, results, commentaries and analyses.

Business and Finance channel features business and financial news provided by leading financial information services in China covering both domestic and international markets. Users can retrieve real-time stock quotes, fund prices, exchange rates, annual reports, research reports and other information on selected listed companies in China.

Information Technology channel offers easy access to industry policies and stories, industry forums, and online communications with the management of top Chinese IT companies. It features information technology news, product reviews and software downloads.

Automobile channel provides a massive database of car models that can be sorted or ranked based on key parameters, industry policies and trends, and online communications with the CEOs of the top Chinese automakers. It also provides automobile features, news, and product previews.

Women channel covers a broad range of lifestyle-related topics that are of particular interest to Chinese women, including fashion and trends, beauty, society, relationships and other areas.

In addition to providing traditional text and picture-based content, we have focused on developing new media technologies. Our online TV-like channels, such as v.sohu for entertainment, s.sohu for sports and tv.sohu for TV programs, are specifically geared for Streaming Online Video content. In addition to watching pre-set programs with broadcasting schedules, users can also enjoy certain programs on an on-demand basis.

Communication and Community Tools

We offer a variety of communication and community tools for our Chinese online users that are important in promoting user affinity to our portal network:

Alumni Club, offered through Chinaren.com, is a database service containing information on schools, classes and classmates that allows classmates to communicate and find each other. As of December 31, 2009, Chinaren.com had over ninety million registered users.

Edgar Filing: SOHU COM INC - Form 10-K

Blog is an interactive platform for users to build their personalized space by posting their articles and pictures, uploading videos, and sharing information amongst users. Further, Sohu blogs provide multiple applications for user-customized front page layouts, interactive communication facilities and services integrated with a selection of Sohu products.

-4-

Table of Contents

E-Mail offers free e-mail services with up to two gigabytes of memory and premium mail service with more features.

Message Boards allows users to post and exchange information on message boards covering 20 main topics, ranging from education and travel to fashion, sports and all news Web pages.

Web Messenger enables Sohu registered users to send instant messages to other Sohu users simply by one click.

Social Networking Services (SNS) is a networking Website that allows users to share ideas, music and photos and play games within individual-centered online communities. After our new SNS Website, namely, Bai Society, was launched in July 2009, we kept adding new interactive Web games and features to attract users and increase the community's stickiness to enlarge our user base.

Sogou Pinyin

Sogou Pinyin is our self-developed Chinese Character Input Method software, whose vocabulary database is tied to the search queries database of Sogou search engine and thus can capture the latest trend of words used by Internet users. Since its launch in 2006, Sogou Pinyin has been well received by users. It continues to gain popularity and expand market share through superior product quality and effective marketing campaigns. As of December 31, 2009, Sogou Pinyin had been installed in over 100 million personal computers (PCs) in China, or over 70% of the PCs in China. During 2009 we also launched the mobile version of Sogou Pinyin, and continued to regularly update our existing products to optimize performance.

Service Offerings to Advertisers

In brand advertising, we enjoy a strong competitive position as one of the leading Internet companies in China. We provide brand advertising services across our matrices of Web properties. Our offerings enable advertisers to post their advertisements in different forms, including textual, rich media and video advertisements, and in different locations across the Sohu matrix of Web properties. Our brand advertising products include but are not limited to banners, links, logos, buttons and stream advertisements placed on our Websites and sponsorships that typically focus on a particular event or a particular Website area. We charge advertisers mainly on a time basis. Sponsorship contracts for a particular area of a Website or for a particular event may require fixed payments over the contract period. Our standard advertising charges vary depending on the terms of the contract and the advertisement's location within our Website. Discounts from standard rates are typically provided for higher-volume, longer-term advertising contracts, and may be provided for promotional purposes.

We rely on both direct sales by our internal sales force and sales by advertising agents for advertising on our Websites. During the year ended December 31, 2009, approximately 1,900 companies advertised on our Websites. Our customers include multinational companies that have significant operations in Chinese markets, many of which are Fortune 500 companies, as well as numerous Chinese domestic companies. We continue focusing on multinational and Chinese domestic companies as our key advertisers. In 2009, sales to our five largest advertisers accounted for approximately 15% of total brand advertising revenues. We have entered into agreements with each of these advertisers. Most of these agreements have terms of less than 12 months.

As of December 31, 2009, we had obligations to provide, and advertisers had obligations to purchase, advertising services under existing contracts in the amount of \$0.8 million, which are required to be provided during the year ending December 31, 2010.

Online Game Business

Online Games

We currently operate three MMORPGs, being TLBB, BO and BH2, all of which are operated under the item-based revenue model, where game players play our game for free but can purchase virtual items to enhance the game-playing experience. We generate revenue through the sale and consumption of such virtual items. We also have five MMORPGs in the pipeline, including DMD, which we are developing in-house, and ZHYX, DHSH, IF and LAW, all of which we licensed from third parties. We plan to operate these new MMORPGs based on the item-based revenue model.

The following table summarizes the type, theme, and status of the games we are currently operating and plan to operate:

Edgar Filing: SOHU COM INC - Form 10-K

Games	Game Type	Theme	In-house Developed or Licensed	Status
Our existing games:				
- TLBB	2.5D MMORPG	Martial arts and community building	In-house	Open beta testing in May 2007
- BO	2.5D MMORPG	Martial arts and fighting	Licensed	Open beta testing in July 2004

-5-

Table of Contents

- BH2	2.5D MMORPG	Martial arts and fighting	Licensed	Open beta testing in September 2009
Our pipeline:				
- DMD	MMORPG supporting 2D, 2.5D and 3D graphic modes	Cartoon style martial arts and community building	In-house	Closed beta testing
- ZHYX	3D MMORPG	Martial arts and fighting	Licensed	Technical closed beta testing
- DSHH	2D MMORPG	Cartoon style and community building	Licensed	Closed beta testing
- IF	2D MMORPG	Chinese myth	Licensed	Closed beta testing
- LAW	2.5D MMORPG	Martial arts and fantasy	Licensed	Technical closed beta testing

Online Games in Operation**TLBB**

TLBB is our first in-house developed MMORPG, for which we commenced development in late 2004. It is a 2.5D martial arts and community building game, adapted from the very popular Chinese novel, Tian Long Ba Bu, which means Novel of Eight Demigods. The missions and activities of the game generally follow the storyline of the novel, which we have adapted to add new features and characters.

TLBB features a combination of martial arts-style-fighting and community-building among its game players, which we believe holds strong appeal for game players. Fighting-based games tend to have high game player participation when they are launched due to the excitement level of the content, but the lifespan of such games tends to be shorter than games that are community-based, and participation tends to drop as the initial excitement fades. Conversely, community-based games tend to take longer to build participation in the beginning of their lifespans because it takes time for new game players to build relationships with each other in the virtual world, but they also tend to have longer lifespans as the relationships among game players strengthen over time. In TLBB, game players choose from nine categories of team-based identities with distinct skill sets and missions, and game players can engage in numerous virtual activities, such as making friends, nurturing pets, learning skills or completing other tasks. Game players can communicate with each other in real time through an in-game instant messaging system. These community-based features foster group interaction and relationship-building among game players, which we believe also helps to maintain our game players' interest over time.

The major categories of virtual items we sell to generate revenues are gems, pets, fashion items, magic medicine, riding animals, hierograms, materials, skill books and fireworks. These virtual items help game players to advance to the next level and enhance the game-playing experience.

Virtual items can be purchased at virtual stores within the game using one of two kinds of currencies: either with an in-game virtual currency known as yuanbao, which game players obtain by purchasing prepaid game cards or game points with real money, or with another in-game virtual currency known as gold coins, which game players can obtain for free by completing certain missions and activities within the game. Each virtual item can be purchased with only one of these two types of virtual currencies. We have found that the mutual exclusivity of the virtual items available for purchase under each of these two virtual currencies creates a demand for game players to exchange the currency they hold for the other currency type required to purchase a particular virtual item.

We typically release updates for TLBB once or twice a week and more significant enhancements in the form of expansion packs every few months. We have developed 11 expansion packs since the game began open beta testing in May 2007. Our expansion packs typically include features such as new territories, themes, tasks, characters, virtual items and other enhanced features. We have found that expansion packs effectively increase game players' interest in the game and enhance the game-playing experience by keeping the game-playing experience fresh even for long-time game players. We believe that the expansion packs help us to maintain game player loyalty, and in turn extend the lifespans of our games.

Blade Online series

Edgar Filing: SOHU COM INC - Form 10-K

The Blade Online series consist of two 2.5D MMORPGs, BO, which we licensed from a third party, and BH2, which is a sequel of Blade Online. Both games are martial arts-style fighting games set to the backdrop of a Chinese myth. In BO, game players can set their own rules for in-game fighting and take on various roles, including a human, an evil spirit or an immortal in the game. Each role has different skill sets that can be learned and improved by completing different tasks. BH2 incorporates popular features of BO as well as new features such as new maps, new characters, new fighting techniques and additional team-combat functions to give players a more intense and realistic fighting experience. The game also includes upgrades to some of the community features found in BO, such as an auto-navigation system and an improved mission tracking system. Like TLBB, both BO and BH2 provide a range of virtual items for game players to purchase to enhance the game-playing experience.

Table of Contents

We began operating BO in October 2004 under the time-based revenue model. On December 27, 2006, we launched an upgraded version of the game and changed its revenue model from time-based to item-based. In December 2006, prior to the launch of the upgraded game operated under the item-based revenue model, the number of peak concurrent users of BO was approximately 26,000, which increased to approximately 57,000 in January 2007. We believe this increase resulted from our upgrading of the game and its changed revenue model. In August 2007, we purchased BO's source codes, enabling us to have complete control over the future enhancement of BO. We have developed four expansion packs for BO since we began operations of it. In September 2009, we began operating its sequel, BH2, under the item-based revenue model.

Online Games in Pipeline

We have five MMORPGs in the pipeline, with different graphic styles, themes and features. Games in our pipeline include DMD, which we are developing in-house, and ZHYX, DSHH, IF and LAW, all of which we licensed from third parties. We intend to operate each of these games using the item-based revenue model and expect to begin open beta testing of these games in 2010.

DMD is adapted from the popular novel *Duke of Mount Deer* written by Louis Cha, the same author from whose novel we developed TLBB. DMD will be an MMORPG targeting a broader audience than TLBB by using cartoon-style graphics and other features, including fashionable outfits and variations to game player appearances that may appeal to more female game players. Game players will be able to choose whether they want to play the game in 2D, 2.5D or 3D graphics mode. Game players can engage in adventures and form partnerships with other game players and compete based on martial arts skills. The game is currently in closed beta testing.

ZHYX is a 3D martial-art MMORPG. The game is based on a popular story from a widely read Hong Kong comic book about the challenge of life for a Chinese expatriate outside his home land. This game targets game players who prefer 3D games and enjoy reading comic books. The game is currently in technical closed beta testing.

DSHH is a 2D cartoon-style, turn-based MMORPG. The game is based on a story from one of the four great classical novels of Chinese literature *Outlaws of the Marsh*, about the adventures of 108 heroes in Northern Song dynasty. The game is currently in closed beta testing.

IF is a 2D MMORPG set against a backdrop of a number of ancient Chinese myths and folklore, which are used to create various missions in the game to attract game players. Game players play characters that can travel between heaven and earth, while encountering legendary figures in mythical settings. The game is currently in closed beta testing.

LAW is a 2.5D MMORPG set in ancient China at the beginning of Chinese civilization, approximately 5,000 years ago. Game players can travel from the modern world to the ancient world in the game, and change the world with magic, martial arts, machinery, and technology. This game targets game players in their late teens to late 20s who enjoy reading fantasy literature. The game is currently in technical closed beta testing.

Game Development and Enhancement

As of December 31, 2009, we had 528 product development personnel, which includes a core product development team that is responsible for developing new MMORPGs, and a dedicated product development team that is responsible for developing game enhancements and expansion packs for each of our games in operation. We believe that such enhancements improve our games' appeal and extend our games' lifespan. We intend to expand our product offerings by continuing to develop additional MMORPGs in-house and continuing to license MMORPGs from third parties.

New Game Development

We have in-house capabilities that allow us to develop quality MMORPGs efficiently and in response to constantly changing market demands and trends.

Our game development process generally includes the following key steps:

- Concept generation

Our design department takes the lead in generating game development ideas based on the latest trends in game player preferences. We recruit game players into our design team to ascertain popular trends among our game players and on the Internet. We also encourage all of our employees to suggest creative ideas and concepts for game development.

Edgar Filing: SOHU COM INC - Form 10-K

- Detailed proposal

Upon management's approval of the new game concept, the design department prepares a detailed proposal that sets preliminary storylines, game characters, estimates of costs and target markets.

- Development plan

After the completion of technical review of the proposal, a project team consisting of our software programmers, platform technicians, media specialists, design staff and graphics artists work together to set the technical criteria for development of the game, and then formulate a game development plan with development milestones. The development plan is typically completed within two to three months of concept generation.

-7-

Table of Contents

- Design, style and story concepts

Based on the game development plan, our graphics artists determine the style of the new game and design game characters; our game designers develop the game story and define game environments; and our program developers develop both the server-end software and the user-end software modules.

- Internal reviews

Mid-term management reviews take place upon the completion of each milestone of the development plan. Concurrently, our testing department tests the accuracy and completeness of the development, and our marketing department initiates marketing campaigns according to the development milestones.

- Technical closed beta testing, closed beta testing and open beta testing

We conduct technical closed beta testing to work out technical issues and eliminate technical problems in the game engine and system. Thereafter, we conduct close beta testing to test and work out technical issues in game features and make adjustments to the in-game economic system. Lastly, we conduct open beta testing to test the operation of new games under open market conditions and introduce new games to players. We begin to generate revenue for our item-based games during open beta testing.

Our games are developed through coordination among teams of program developers, game designers and graphic artists. We try to design each of our games to cater to different audiences to grow our overall player base rather than merely shifting players from one game to another. At each stage of a new game's development, we rely on our quality control department to ensure the game's quality and playability.

Existing Game Enhancement

We derive many of our game development and enhancement ideas from our game players by maintaining multiple channels whereby we obtain our game players' ideas and feedback. These include online surveys, online discussion forums, in-game instant messaging, our 24-hour telephone hotline, and a link to a form for feedback within our games. We use this information not only to create new games with the same quality of design, content and programming, but also to enhance existing games that we have either developed in-house or licensed from third parties.

We typically release game updates for our games once or twice a week and more significant enhancements in the form of expansion packs every few months or as regularly as necessary based on game players' feedback, market demand and other factors. Our expansion packs typically include features such as new territories, themes, tasks, characters, virtual items and other enhanced features. After testing, the game updates and expansion packs are typically distributed electronically through our official game Website. We believe that these game updates and expansion packs help extend the lifespan of our games.

Access to our Games

Our game players typically access our games at Internet cafés or on personal computers connected to the Internet. In order to access our games, our game access software must be installed in the computer being used. Game players using personal computers and Internet café operators can typically download our game access software, interim updates and expansion packs directly from our official game Website. We also distribute our game access software in CD form through our distribution network.

Sales and Distribution

We have developed a multi-channel, nationwide sales and distribution system to sell and distribute our prepaid game cards. We also directly sell game points to our game players through our online sales platform.

Third-Party Distributors

We sell prepaid game cards in virtual and physical form to a range of regional third-party distributors, who in turn sub-distribute them to numerous retail outlets across China. Physical cards are available in Internet cafés, newsstands, software stores, book stores and retail stores. Virtual cards are available through various online channels, telecommunications service providers and at Internet cafés. We typically collect payment from our distributors upon delivery of our prepaid game cards. We currently offer sales discounts and rebates to our distributors.

Edgar Filing: SOHU COM INC - Form 10-K

We generally enter into distribution agreements with our distributors of prepaid game cards for one-year terms. Our distribution agreements contain both pre-set sales targets and pre-set penetration targets, whereby each of our distributors is required to sell our prepaid game cards in a minimum number of Internet cafés in its designated sales territory. We also require that each distributor work closely with our marketing team and support its activities. Our distribution agreements are not exclusive, and do not prohibit our distributors from working with our competitors.

Direct Sales

Game players can purchase game points and charge them to their accounts directly. To do this, they log into their accounts from the game. From the account link, game players can choose to either pay from their bank accounts or through other payment methods, including third-party online payment platforms. We provide discounts to game players who charge their accounts directly. Transaction costs also apply to the use of third-party online payment platforms.

Table of Contents

Marketing

Changyou has a three-pronged marketing and promotion strategy, which includes online advertising, off-line promotions and traditional media. Changyou uses different methods to target different demographic groups of game players.

With respect to online advertising, Changyou is able to leverage its affiliation with Sohu, and aggregate Sohu's large user base to Changyou's games by advertising on Sohu's various Websites, which typically provide a direct link to Changyou's games. In addition, Changyou's technology allows it to distinguish which Sohu users are not currently Changyou's game players, so that Changyou can specifically target its advertisements toward them. Changyou also advertises on a variety of Websites, including on Internet café homepages. In addition, Changyou uses in-game promotional events 24 hours a day, seven days a week. Changyou also creates events to rally current and new game players through event-related features, such as offering special holiday edition virtual items to enhance game player participation at holiday time when participation may be lower than usual.

We also use a variety of physical, offline promotional events, including Internet café events, free trial plays, posters, game players' gatherings, freshmen (or new game player) incentives and the giving away of promotional souvenirs. We have found that these promotional events offer good exposure to targeted customers at a lower cost.

With respect to traditional media, we focus our marketing efforts on print advertisements in magazines that target our game player base and outdoor multimedia, including closed circuit television advertisements on buildings and in elevators. These media targets game players who are less likely to have freely-available access to a computer.

Pricing

We use the item-based revenue model for the games that we currently operate and plan to use it for our games currently in development. Under the item-based revenue model, game players can play the basic functions of the game free of charge for as long as they want. We generate revenues through the sale of virtual items such as performance-enhancing items, clothing, accessories and pets that enhance the game-playing experience. We determine the price of virtual items based on the demand or expected demand for such virtual items. We may change the pricing of certain virtual items based on their consumption patterns.

Customer Service

We provide high-quality customer service and are responsive to our game players' needs. Our game players can access our customer service center via in-game chats, phone or e-mail 24 hours a day, seven days a week. In addition, we have a Website for game players to submit feedback and a physical service center in Beijing, which is open to walk-in game players during normal business hours. We currently have over 150 dedicated customer service representatives, many of whom are MMORPG enthusiasts with a deep understanding of game players. We have dedicated supervisors to monitor our calls to ensure quality service.

Feedback collected by our customer service team is important to the integration of our product development and game operations teams. The information collected by our customer service team forms the basis of our feedback database, which helps us design changes, upgrades and expansion packs for our games.

Licensing

Games Licensed from Third Parties

We licensed rights to operate and further develop each of BO, ZHYX, DHSH, IF and LAW from their respective developers, with exclusive rights to operate such games in China.

We licensed BO from a Beijing-based game studio in 2003. Under our existing licensing arrangement, we have the exclusive right to operate and further develop BO in China. We paid a one-time license fee in 2004 and we paid royalties until June 30, 2008 based on the revenues from the game. We are not required to pay any royalties starting from July 1, 2008. In 2007, we obtained the rights to the source codes of BO, and we own all enhancements and developments we make to BO. BH2 was developed based on BO.

We licensed ZHYX from Chinese Gamer International Corporation, a leading game developer in Taiwan, in September 2009. Pursuant to the licensing arrangement, we have an exclusive right to operate ZHYX in China. We paid a one-time licensing fee and we will pay royalties based

Edgar Filing: SOHU COM INC - Form 10-K

on the revenues from the game.

We licensed DSHH from a local independent studio in September 2009. Under the licensing arrangement, we have an exclusive right to operate DSHH in China. We paid a one-time licensing fee and we will pay royalties based on the revenues from the game.

-9-

Table of Contents

We licensed IF from an independent studio in July 2008. Under the licensing arrangement, we have an exclusive and perpetual right to operate IF in China, an exclusive right to license the game overseas and a right of first refusal for new games developed by the same developer for the term of the license. In addition, we have rights to sell ancillary products of the game. The licensor has agreed to transfer the source codes of the game to us by the end of open beta testing, which will allow us to develop enhancements in-house. We paid a one-time licensing fee and we will pay royalties based on the revenues from the game.

We licensed LAW from a local independent studio in December 2007. Under the licensing arrangement, we have an exclusive and perpetual right to operate LAW in China. We also have a right of first refusal for new games developed by the same developer for the term of the license. Two years after we launch the game, the licensor will transfer to us the source codes of the game, which will enable us to develop enhancements to LAW in-house. We paid a one-time licensing fee and we will pay royalties based on the revenues from the game.

Rights from Third Party Book Author

Under the existing license agreements with Louis Cha, the author of the novels *Tian Long Ba Bu* and *Duke of Mount Deer*, we have the exclusive right in China to adapt these two novels into online games and to operate such games, including the right to use the title of the novels and the name of the characters. We also have the non-exclusive license to operate, and the non-exclusive right to license the right to operate, the games adapted from these novels outside of China. If we wish to continue to operate and license these games after the expiration of the terms of these license agreements, we will need to renew these license agreements.

Overseas Licensing of Our Games

We licensed the rights to operate TLBB in overseas markets, including Taiwan, Hong Kong, Vietnam, Malaysia and Singapore. Under our licensing arrangements with the overseas operators, the licensee operators pay us an upfront license fee and we have revenue sharing rights over the duration of the license. The licenses are typically for a term of two to three years. We provide updates and expansion packs to the licensed games, typically after we launch such updates and expansion packs in China. The licensees are responsible for all other operating services and costs, including costs related to customer service and leasing and maintenance of servers. We licensed TLBB to an operator in Vietnam, and launched the game there in August 2007, and we licensed TLBB to an operator in each of Taiwan and Hong Kong, and launched the game there in April 2008. We also licensed TLBB to an operator in Malaysia and Singapore, and launched the game there in April 2009.

Wireless and Others Businesses

Wireless and other businesses mainly consist of wireless valued added services. For these services, we operate as a service provider to China's leading mobile network operators, offering a wide range of wireless products focused on entertainment, information and communications. These products are available to end users via a broad choice of technologies, such as short messaging services (SMS), Ring Back Tone (RBT), Wireless Application Protocol (WAP), multi-media messaging services (MMS) and interactive voice response (IVR). We provide wireless services mainly pursuant to our cooperation arrangements with all of the three Chinese mobile network operators and their provincial subsidiaries. We will continue to build out our wireless capabilities to provide opportunities for our users to capitalize on improved 3G technologies as the service increases its penetration within China, rather than focusing on revenue expansion of our wireless business.

COMPETITION

The Internet and Internet-related markets in China are relatively new and rapidly evolving. There are many companies in the domestic and international markets that distribute online content, online games, and value-added telecommunications services targeting Chinese users. We now are facing more intense competition from both domestic and international competitors for providing content and services over the Internet, including brand advertising, content, community tools, search engines, Web directories, online games and wireless services.

Advertising Business

In the PRC Internet space, competition is intense and is expected to increase significantly in the future. We compete with our peers and competitors in China primarily on the following basis:

technological advancements;

attractiveness of products;

brand recognition;

volume of traffic and users;

quality of Websites and content;

strategic relationships;

quality of services;

Table of Contents

effectiveness of sales and marketing efforts;

talented staff; and

pricing.

Over time, our competitors may gradually build certain competitive advantages over us in terms of:

greater brand recognition among Internet users and clients;

better products and services;

larger user and customer bases;

more extensive and well developed marketing and sales networks; and

substantially greater financial and technical resources.

There are a number of existing or new PRC Internet companies, including those controlled or sponsored by private and PRC government entities. As an Internet portal, we compete with these portals, including but not limited to Sina, Tencent and NetEase, and vertical sites, such as You Ku, Tu Dou, Ku6, PC Online, SouFun and CRIC. Our search engine faces intense competition from other search engines, such as Baidu, Google, Yahoo! China and SoSo. Moreover, we are competing with other technology-driven companies on developing and promoting client-end software. For example, we developed and launched Sogou Pinyin Input method in 2006 and it has been well received by users. However, many companies, such as Google, Tencent and 360, have presented their own methods of pinyin input and competed with us.

In addition, we compete with operators of global leading Websites or Internet service providers, including Yahoo!, Microsoft/MSN and AOL, which are currently offering, and could expand their online products and services targeting China. These sites and companies compete with us for visitor traffic, advertising dollars, Internet services, wireless services and potential partners.

We also compete with traditional forms of media such as newspapers, magazines, radio and television for advertisers, advertising revenues and content. Some of these traditional media, such as CCTV.com and XinHuaNet, have extended their businesses into the Internet market. Accordingly, we will face more intense competition with traditional media companies in both their traditional media, and in the Internet-related markets.

We believe the rapid increase in China's online population will draw more attention from domestic and multinational players to the PRC Internet market. Our existing competitors may in the future achieve greater market acceptance and gain additional market share. It is also possible that new competitors may emerge and acquire significant market share. In addition, our competitors may leverage their existing Internet platforms to cross-sell newly launched products and services. It is also possible that, as a result of deficiencies in legal protections afforded intellectual property in the Internet industry in China, or inadequate enforcement of existing PRC laws protecting such intellectual property, we may not be able to prevent existing or new competitors from accessing and using our in-house developed Web content.

Online Game Business

For our online game business, we compete principally with the following three groups of competitors in China:

Table of Contents

online game developers and operators in China, including Tencent Holdings Limited, Shanda Games Limited, NetEase.com, Inc., Perfect World Co., Ltd., Giant Interactive Group Inc., NetDragon Websoft Inc., Kingsoft Corporation Limited and The9 Limited;

other private companies in China devoted to game development or operation, many of which are backed by venture capital; and

international competitors.

Our MMORPGs currently compete with, among others, the following MMORPGs in China:

Fantasy Westward Journey, developed and operated by NetEase.com, Inc.;

World of Warcraft, developed by Blizzard Entertainment and operated by NetEase.com, Inc. in China;

Asktao, developed and operated by Beijing Guangyu Huaxia Technology Limited

Dungeon and Fighter, developed and operated by Tencent Holdings Limited;

Eudemons Online, developed and operated by NetDragon Websoft Inc.; and

Zhu Xian and Battle of the Immortals, developed and operated by Perfect World Co., Ltd.

Our existing and potential competitors compete with us for talent, game player spending, time spent on game playing, marketing activities, quality of games, and distribution network. Some of our existing and potential competitors have significantly greater financial and marketing resources than we do.

Government Regulation and Legal Uncertainties

The following description of PRC laws and regulations is based upon the opinions of TransAsia Lawyers, our PRC counsel. For a description of legal risks relating to our ownership structure and business, see Risk Factors.

Regulatory Authorities

Certain areas related to the Internet, such as telecommunications, Internet information services, international connections to computer information networks, information security and censorship are covered extensively by a number of existing laws and regulations issued by various PRC governmental authorities, including:

the Ministry of Industry and Information Technology (or MIIT, formerly the Ministry of Information Industry);

the Ministry of Culture (or MOC);

the Ministry of Public Security;

the State Administration of Industry and Commerce (or State AIC);

the General Administration for Press and Publication (or GAPP formerly the State Press and Publications Administration, or SPPA);

the State Administration for Radio, Film and Television (or SARFT);

the State Council Information Office (or SCIO); and

the State Administration of Foreign Exchange, or SAFE.

Our PRC Corporate Structure

We have the following subsidiaries in China (collectively the China-based subsidiaries, or the PRC subsidiaries):

The following are the subsidiaries engaged in the business segments other than online game:

For Advertising Business

Brand Advertising Business

Sohu Software, established in 2003 by Sohu Hong Kong;

Table of Contents

Sohu Media, established in 2006 by Sohu Hong Kong; and

New Software, established in 2008 by Sohu Era.

Sponsored Search Business

Go2Map Software, acquired in 2005 as a result of the acquisition of Go2Map Inc; and

Sogou Technology, established in 2006 by Sogou BVI.

For Wireless and Others Businesses

Sohu Era, established in 2003 by Sohu Hong Kong; and

Beijing Fire Fox, established in 2005 and currently wholly-owned by Sohu Era.

The following is the subsidiary engaged in the online game business segment. This subsidiary is indirectly controlled by Changyou, which is Sohu.com Inc.'s independently-listed majority-owned subsidiary:

AmazGame, established in 2007 by Changyou HK.

The above China-based subsidiaries are structured to engage in the development of Internet technologies, online game and related software. Sohu Era, Sohu Software, Go2Map Software, Sogou Technology, Sohu Media and AmazGame are wholly foreign-owned enterprises (WFOEs), while New Software and Beijing Fire Fox are companies invested by a WFOE. Under current PRC laws, the establishment of WFOE must be approved by the relevant local branch of the Ministry of Commerce. Moreover, all of the China-based subsidiaries may commence operations only upon the issuance of a business license by the relevant local branch of the State AIC, such as the Beijing AIC, and all of our China-based entities have been issued business licenses by Beijing AIC. Sohu Era, Sohu Media, Sogou Technology and AmazGame, have obtained a *New Technology Enterprise Qualification Certificate* issued by Beijing Science and Technology Commission.

In the opinion of TransAsia Lawyers, the above China-based subsidiaries have presently satisfied the business licenses and/or the New Technology Enterprise Qualification Certificates of the aforementioned requirements.

As mentioned above, the telecommunications value-added services business is an area in which foreign investment is restricted. Thus, we have established the following VIEs in China through contractual arrangements with our subsidiaries to perform certain value-added telecommunications services.

The following are the VIEs engaged in the business segments other than online game:

For Advertising Business

Brand Advertising Business

Sohu Entertainment, formerly known as Beijing Hengda Yitong Internet Technology Development Co., Ltd. (or Hengda), a PRC company established in 2002, which is owned by two of our employees. Hengda provides Internet-related services in China. The company's name of Hengda was changed to Sohu Entertainment as of June 9, 2006; and

Edgar Filing: SOHU COM INC - Form 10-K

Feng Yang Tian Lang, a PRC company that we established in December 2005. High Century and Sohu Internet each holds 50% of the equity interests in Feng Yang Tian Lang, which engages in the online advertising business.

Sponsored Search Business

Tu Xing Tian Xia, a PRC company we acquired in 2005. High Century and Sohu Internet own 56.1% and 43.9% interests in Tu Xing Tian Xia, respectively. Tu Xing Tian Xia provides online mapping service in China; and

Sogou Information, a PRC company that we established in December 2005. Sogou Information is owned by two of our employees and provides Internet-related services in China.

For Wireless and Others Businesses

Table of Contents

Sohu Internet, a PRC company established in 2003, that is 75% owned by High Century and 25% owned by Sohu Entertainment. Sohu Internet provides Internet-related services in China;

GoodFeel, a PRC company we acquired in 2004. GoodFeel is owned by two of our employees and has entered into a series of agreements to provide wireless services in China;

High Century, a PRC company established in 2001, and 80% owned by Dr. Zhang, our founder, Chairman and Chief Executive Officer, and 20% owned by one of our employees. High Century operates as an investment management and consulting company in China;

21 East Beijing, a PRC company engaging in entertainment business in China. We acquired 70% interests in 21 East Beijing through High Century in October 2006. The remaining 30% interests in 21 East Beijing is owned by one of our employees; and

New 21 East, a PRC company that we established in December 2007 that engages in entertainment business in China. New 21 East is 70% owned by High Century and 30% owned by one of our employees.

The following is the VIE engaged in the online game business segment. This VIE is indirectly controlled by Changyou, which is Sohu.com Inc.'s independently-listed majority-owned subsidiary:

Gamease, a PRC company that we established in August 2007. Gamease is owned by two of our employees and provides online game services in China.

Sohu has extended interest-free loans to the individual shareholders of the VIEs to fund their capital investment in the VIEs. We have also entered into a series of agreements with the individual shareholders to transfer their shares in the VIEs to us when required to do so. All of our VIEs presently have valid business licenses issued by the relevant local branch of the State AIC. Sogou Information and Sohu Internet have obtained a *New Technology Enterprise Qualification Certificate issued by Beijing Science and Technology Commission*.

In January 2008, we completed the liquidation of one of our former VIEs, Guangzhou Sohu Interactive Network Technology Co., Ltd. (or Guangzhou Interactive), a PRC company that was 50% owned by Sohu Internet and 50% owned by High Century.

The MIIT promulgated on July 13, 2006 a *Notice of the Ministry of Information Industry on Intensifying the Administration of Foreign Investment in Value-added Telecommunications Services*. The notice is designed to strengthen the administration of foreign investment in PRC telecommunication businesses, particularly those involving value-added telecommunications services, which encompass a wide variety of activities related to the provision of service/content via telecommunications networks. As such, the notice requires the following: Telecom companies (or their shareholders) must hold the domain names and trademarks that they use in their provision of value-added telecommunication services, and must hold necessary business premises and facilities (including servers) within the region covered by their ICP licenses and correspond to the ICP services.

In compliance with the *Notice of the Ministry of Information Industry on Intensifying the Administration of Foreign Investment in Value-added Telecommunications Services*, an enterprise holding an ICP license must be the entity that possesses the key intellectual property rights, e.g., domain names and trademarks. In this connection, Sohu Era has transferred some of its domain names and trademarks to Sohu Internet, which will license the same to Sohu Era and Sohu Media.

In the opinion of TransAsia Lawyers, the ownership structures of our PRC subsidiaries and VIEs comply with all existing laws, rules and regulations of the PRC and each of the eighteen companies as described herein has the full legal right, power and authority, and has been duly approved to carry on and engage in the business as described in its business license.

Telecommunications Laws and Regulations

Among all of the applicable laws and regulations, the *Telecommunications Regulations of the People's Republic of China* (or the *Telecom Regulations*), implemented on September 25, 2000, is the primary governing law, and sets out the general framework for the provision of

Edgar Filing: SOHU COM INC - Form 10-K

telecommunication services by domestic PRC companies. Under the *Telecom Regulations*, it is a requirement that telecommunications service providers procure operating licenses prior to their commencement of operations. The *Telecom Regulations* draw a distinction between basic telecommunications services and value-added telecommunications services. Value-added telecommunications services are defined as telecommunications and information services provided through public networks. A *Catalogue of Telecommunications Business* was issued as an attachment to the *Telecom Regulations* to categorize telecommunications services as basic or value-added. In February 2003, the Catalogue

-14-

Table of Contents

was updated, categorizing online data and transaction processing, on-demand voice and image communications, domestic Internet virtual private networks, Internet data centers, message storage and forwarding (including voice mailbox, e-mail and online fax services), call centers, Internet access, and online information and data search as value-added telecommunications services. Accordingly, there are various types of telecommunications services, in which Sohu is engaged that are regulated as value-added telecommunications services.

Foreign direct investment in telecommunications companies in China is regulated by the *Regulations for the Administration of Foreign-Invested Telecommunications Enterprises* (or the *FITE Regulations*), which were issued by the PRC State Council on December 11, 2001, and became effective on January 1, 2002. The *FITE Regulations* stipulate that telecommunications enterprises in the PRC with foreign investors (or FITEs), must be established as Sino-foreign equity joint ventures. FITEs can undertake operations in basic telecommunications services and value-added telecommunications services. Under the *FITE Regulations* and in accordance with WTO-related agreements, the foreign party to an FITE engaging in value-added telecommunications services may hold up to 50% of the equity of the FITE, with no geographic restrictions on its operations. The PRC government has not made any further commitment to liberalize its regulation of FITEs.

On September 10, 2008, the PRC State Council issued the *Amended Regulations for the Administration of Foreign-Invested Telecommunications Enterprises* (or *Amended FITE Regulations*), as Decree No. 534, which came into effect on the same day. Among other things, the minimum registered capital for a FITE offering basic telecommunications services has been reduced by 50%: from RMB2 billion to RMB1 billion for those operating nationwide or trans-provincial services and from RMB200 million to RMB100 million for intra-provincial operators. There has been no change in the capitalization requirements for value-added telecoms service operators. The restriction on the equity ratio of the foreign party in a FITE remains a maximum of 50%.

In view of the restrictions on foreign direct investment in the telecommunications sector, we established several domestic Variable Interest Entities (or VIEs), to engage in value-added telecommunications services. For a detailed discussion of our VIEs, please refer to below *Our PRC Corporate Structure*. In view of the *FITE Regulations* and *Sino-Foreign Equity Joint Venture Law*, we may consider establishing a foreign-invested telecom entity at an appropriate time.

On March 1, 2009, the MIIT promulgated the *Measures on the Administration of Telecommunications Business Operating Permits* (or the *Telecom License Measures*) to supplement the *Telecom Regulations* and replace the previous *Administrative Measures for Telecommunications Business Operating Licenses* (or *2001 Telecom Operating Measures*). The *Telecom License Measures* confirm that there are two types of telecom operating licenses for operators in China (including FITEs), namely, licenses for basic telecommunications services and licenses for value-added telecommunications services. With respect to the latter, a distinction is made as to whether a license is granted for intra-provincial or trans-regional (inter-provincial) activities. An appendix to the license will detail the permitted activities of the enterprise to which it was granted. An approved telecommunication services operator must conduct its business (whether basic or value-added) in accordance with the specifications recorded on its Telecommunications Services Operating License. Compared to the 2001 Telecom Operating Measure, the *Telecom License Measures* lowered the capital requirement for intra-provincial basic telecom services operators from RMB200 million to RMB100 million and for inter-provincial basic telecom services operators from RMB2 billion to RMB1 billion.

On August 19, 2009 and January 21, 2008, the MIIT issued to Sohu Internet and GoodFeel, respectively, a renewed *Value-Added Telecommunications Services Operating License* each of which authorized the provision of value-added telecommunication services nationwide. Both of these licenses have a valid term of five years and are subject to annual inspections. In addition to the *Value-Added Telecommunications Services Operating License*, we require various other licenses and permits so as to provide Internet-related services in China. For a detailed discussion, please refer below to *Classified Regulations*.

Classified Regulations

Laws and Regulations Related to Content Provision

Internet Information Services

On September 25, 2000, the State Council approved the *Measures for the Administration of Internet Information Services* (or the *ICP Measures*). Under the ICP Measures, any entity that provides information to online users on the Internet is obliged to obtain an operating license from the MIIT or its local branch at the provincial or municipal level in accordance with the *Telecom Regulations* described above.

The ICP Measures stipulate further that entities providing online information services regarding news, publishing, education, medicine, health, pharmaceuticals and medical equipment must procure the consent of the national authorities responsible for such areas prior to applying for an operating license from the MIIT or its local branch at the provincial or municipal level. Moreover, ICPs must display their operating license numbers in conspicuous locations on their home pages. ICPs are required to police their Websites and remove certain prohibited content. This

obligation reiterates Internet content restrictions that have been promulgated by other PRC ministries.

Table of Contents

Most importantly for foreign investors, the ICP Measures stipulate that ICPs must obtain the prior consent of the MIIT prior to establishing an equity or cooperative joint venture with a foreign partner.

On June 12, 2009, the Beijing Telecom Administration (or BTA) issued to Sohu Internet a renewed *Telecommunications and Information Services Operating License* (or *ICP license*). On November 24, 2008, the BTA issued to Sogou Information a renewed ICP license. On May 9, 2008, the BTA issued to Gamease an ICP license. All of these ICP licenses have a term of five years and are subject to annual inspections.

Online News Dissemination

On September 25, 2005, the *Administrative Regulations for Internet News Information Services* (or *News Regulations*) were jointly promulgated by the State Council Information Office and MIIT to replace the previous *Provisional Rules for the Administration of the Operation of News Publication Services by Web Sites* (or *Old News Rules*) issued on November 7, 2000. The *News Regulations* stipulate that general Websites established by non-news organizations, such as Sohu, may publish news released by certain official news agencies if such Websites satisfy the requirements set forth in Article 8 of the regulations but may not publish news items produced by themselves or other news sources. The aforementioned requirements include the following:

they must comply with the constitution, laws and regulations of the PRC, uphold and not mislead the society's public opinion, and safeguard national and public interests;

they must have sound administrative rules and regulations concerning Internet news services;

they must have the necessary premises, equipment and legally-raised funds;

they must have ten or more professional news editors, at least five of whom have worked at a news agency for a minimum of three years;

they must be legal persons who have been legally established for at least two years, engaged in the operation of Internet news services and have not had administrative penalties imposed due to violation of laws and regulations on the administration of Internet news services within the last two years;

if the applicant is an enterprise legal person, its registered capital must not be less than RMB10,000,000; and

they must only republish or disseminate news published by State news agencies or news agencies directly subordinate to the respective governments of the provinces, autonomous regions or directly-administered municipalities without distorting the original news information regarding current events and political affairs to the public, and indicate the source of such news information; and shall not publish news gathered and edited by themselves.

The aforementioned rules also require the general Websites of non-news organizations to apply to the SCIO at the national level for approval after securing the consent of the SCIO at the provincial level before they commence providing news dissemination services. Also, general Websites intending to publish news released by the aforementioned news agencies or bureaus must enter into agreements with them and submit copies of those agreements to the relevant administration department.

On May 11, 2004, Sohu Internet obtained a permit to engage in online news dissemination services, which was issued by the Information Office of the Beijing Municipal Government (the local arm of the SCIO) under the *Old News Rules*. On June 6, 2006, such permit was updated by the SCIO in accordance with the *News Regulations*.

Internet Medical, Health and Pharmaceuticals Information Dissemination

Edgar Filing: SOHU COM INC - Form 10-K

On May 1, 2009, the Ministry of Health (or MOH) issued the *Measures for the Administration of Internet Medical and Healthcare Information Services* which replaced the previous *Measures for the Administration of Internet Medical and Health Information Services* issued by the MOH on January 8, 2001. These measures stipulate that the MOH is responsible for reviewing the qualifications of Websites and approving their publication of health-related information. Additionally, in accordance with the *Measures for the Administration of Internet Pharmaceuticals Information Services*, issued by the State Food and Drug Administration (or SFDA), on July 8, 2004, the formal approval of the SFDA or one of its local branches is required before a Website may disseminate information concerning pharmaceuticals.

According to the aforementioned regulations, medical, health and pharmaceutical information provided by Websites must be scientific and accurate and must indicate the sources of such information. Websites that are approved to disseminate such information must also

Table of Contents

publish or reprint health policies, information on epidemics and major health-related incidents, and other health-related information in accordance with law. Furthermore, medical and pharmaceutical advertisements published by such Websites must not exaggerate the efficacy or promote the medical uses of such products.

On December 11, 2009, Sohu Internet received the renewed SFDA approval. In addition, Sohu Internet obtained the aforementioned approvals from the MOH and completed the registration process with the MOH on November 17, 2005.

Online Audiovisual Transmission

On July 6, 2004, the SARFT issued the *Measures for the Administration of the Transmission of Audiovisual Programs over Information Networks such as the Internet*, which came into effect on October 11, 2004. These measures provide that Websites authorized to disseminate news may apply to the SARFT to obtain a Permit for the Network Transmission of Audiovisual Programs allowing the online dissemination of streaming video. In accordance with these measures, we applied to the SARFT for this permit in 2005, but have not yet obtained said Permit.

On December 20, 2007, the SARFT and the MIIT jointly issued the *Rules for the Administration of Internet Audiovisual Program Services* (or *Document 56*), which came into effect as of January 31, 2008. The rules require all online audio and video service providers to be either state-owned or state-controlled. They also encourage state-owned entities to actively invest in online audiovisual services. However, further to this, a press conference on February 3, 2008, the SARFT and the MIIT clarified that online audio-visual service providers that were already lawfully operating prior to the issuance of *Document 56* may re-register and continue to operate without becoming state-owned or controlled, provided that such providers do not engage in any unlawful activities. This exemption will not be granted to service providers set up after *Document 56* was issued. As we were already engaged in online audiovisual transmission prior to the issuance of *Document 56*, we are presumably exempted from the requirement of being state-owned or state-controlled. Sohu Internet obtained an online audiovisual transmission license from SARFT on May 31, 2008.

On March 30, 2009, the SARFT released its *Notice on Strengthening the Administration of Online Audiovisual Content*. This notice requires that only those films or TV programs that have already obtained from the SARFT a Film Public Screening Permit, TV Drama Distribution Permit, TV Animation Distribution Permit, or TV Documentary Film Screening Permit could be allowed to be transmitted via audiovisual Websites. These permits are already mandatory for all films and programs shown on TV and in cinemas in China and shall be obtained before such film or TV or program is allowed to be released. The approval applications for the abovementioned Film Public Screening Permit, Television Drama Distribution Permit, Television Animation Distribution Permit or Television Documentary Film Screening Permit are extremely difficult and time-consuming. However, the SARFT currently does not enforce requirement for these permits very strictly. Most foreign audiovisual programs transmitted via Internet in China therefore do not have such permits. That being said, the SARFT's current approach does not necessarily mean that it will forego enforcing this provision in the future. Moreover, audiovisual Websites are obligated to enhance their copyright protection systems, and to take appropriate measures to protect the legitimate rights and interests of copyright holders. Operators of such sites must hold, or be licensed with, the copyright to all content they transmit.

Internet Publishing

The *Rules for the Administration of the Publications Market*, issued by the GAPP on July 16, 2003, define the online distribution of publications as the offering of online subscriptions for, and the purchase, storage, shipment, and sale of, publications over the Internet. In addition, the *Provisional Rules for the Administration for Internet Publishing* (or *Internet Publishing Rules*) jointly issued by the GAPP and MIIT on June 27, 2002, define Internet publications as works that are either selected or edited to be published on the Internet or transmitted to end-users through the Internet for the purposes of browsing, reading, using or downloading by the general public. Such works primarily include content or articles formally published publicly in other press such as: (a) books, newspapers, periodicals, audio-visual products and electronic publications and (b) literature, art and articles on natural science, social science, engineering and other topics that have been edited. Under the *Internet Publishing Rules*, Web portals such as ours are required to apply to and register with the GAPP before distributing Internet publications.

In this regard, Sohu Internet obtained a renewed approval from the Beijing News and Publications Bureau (the local arm of the GAPP) on April 1, 2009 to distribute Internet publications.

Online Cultural Products

The Online Culture Regulations apply to entities engaging in activities related to online cultural products, including music and video files, network games, animation features and audiovisual products, performed plays and artwork converted for dissemination via the Internet. Pursuant to this legislation, commercial entities are required to apply to the relevant local branch of the MOC for an Online Culture Operating Permit if they engage in any of the following types of activities:

Table of Contents

the production, duplication, importation, wholesale, retail, leasing or broadcasting of online cultural products;

the dissemination of online cultural products on the Internet or transmission thereof to computers, fixed-line or mobile phones, radios, television sets or gaming consoles for the purpose of browsing, reading, using or downloading such products; or

the exhibition or holding of contests related to online cultural products.

On September 3, 2009, the MOC issued its *Notice on Strengthening and Improving the Content Censorship of Online Music Content* (or the *MOC Notice*). The *MOC Notice* provides that direct links to online music shall be defined as engaging in online music business and therefore the Online Culture Operating Permit is required for providing such search services. In addition, the *MOC Notice* also requires any domestic music products shall be filed for record with the MOC within 30 days after being made available online. For imported music products, they shall be approved by the MOC before being made available online.

In September 2003 and December 2007, the MOC issued an Online Culture Operating Permit to Sohu Internet and Gamease, respectively, authorizing us to provide online game services. This permit is subject to annual inspection. Sogou Information filed an application for an Online Culture Operating Permit with the MOC in September 2009.

International Connections for Computer Information Networks

The State Council and the MIIT have promulgated regulations governing international connections for PRC computer networks, including:

Measures for the Administration of International Connections to China's Public Computer Interconnected Networks (1996);

Provisional Regulations of the People's Republic of China for the Administration of International Connections to Computer Information Networks (1997) and their Implementing Measures (1998);

Reply Concerning the Verification and Issuance of Operating Permits for Business Relating to International Connections for Computer Information Networks and for Public Multimedia Telecommunications Business (1998); and

Administrative Measures for International Communications Gateways (2002).

Under the above regulations, any entity wishing to access international connections for their computer information networks in the PRC must comply with the following requirements:

be a PRC legal person;

have the appropriate equipment, facilities and technical and administrative personnel;

have implemented and registered a system of information security and censorship; and

effect all international connections through an international communications gateway established with the approval of the MIIT. We adopted the relevant measures to ensure that we are in proper compliance with all of these requirements.

Information Security and Censorship

The principal pieces of PRC legislation concerning information security and censorship are:

The Law of the People's Republic of China on the Preservation of State Secrets (1988) and its Implementing Rules (1990);

The Law of the People's Republic of China Regarding State Security (1993) and its Implementing Rules (1994);

Rules of the People's Republic of China for Protecting the Security of Computer Information Systems (1994);

Notice Concerning Work Relating to the Filing of Computer Information Systems with International Connections (1996);

Table of Contents

Administrative Regulations for the Protection of Secrecy on Computer Information Systems Connected to International Networks (1999);

Regulations for the Protection of State Secrets for Computer Information Systems on the Internet (2000);

Notice issued by the Ministry of Public Security of the People's Republic of China Regarding Issues Relating to the Implementation of the Administrative Measure for the Security Protection of International Connections to Computer Information Networks (2000);

The Decision of the Standing Committee of the National People's Congress Regarding the Safeguarding of Internet Security (2000); and

Measures for the Administration of Commercial Website Filings for the Record (2002) and their Implementing Rules (2002).

These pieces of legislation specifically prohibit the use of Internet infrastructure where it results in a breach of public security, the provision of socially destabilizing content or the divulgence of State secrets, as follows:

A breach of public security includes breach of national security or disclosure of state secrets; infringement on state, social or collective interests or the legal rights and interests of citizens or illegal or criminal activities.

Socially destabilizing content includes any action that incites defiance or violation of Chinese laws; incites subversion of state power and the overturning of the socialist system; fabricates or distorts the truth, spreads rumors or disrupts social order; advocates cult activities; or spreads feudal superstition, involves obscenities, pornography, gambling, violence, murder, or horrific acts or instigates criminal acts.

State secrets are defined as matters that affect the security and interest of the state. The term covers such broad areas as national defense, diplomatic affairs, policy decisions on state affairs, national economic and social development, political parties and other State secrets that the State Secrecy Bureau has determined should be safeguarded.

According to the aforementioned legislation, it is mandatory for Internet companies in the PRC to complete security filing procedures with the local public security bureau and for them to update regularly with the local public security bureau regarding information security and censorship systems for their Websites. In this regard, on October 1, 2004, the *Administrative Rules on the Filing of Commercial Websites* were promulgated by the Beijing AIC to replace the previous *Detailed Implementing Rules for the Measures for the Administration of Commercial Website Filings for the Record*, promulgated on September 1, 2000, by the Beijing AIC. The *Administrative Rules on the Filing of Commercial Websites* state that Websites must comply with the following requirements:

they must file with the Beijing AIC and obtain electronic registration marks;

they must place the registration marks on their Websites' homepages; and

they must register their Website names with the Beijing AIC.

Sohu Internet successfully registered its Website with the Beijing AIC on September 11, 2003. Accordingly, the electronic registration mark is prominently placed on its homepage.

Edgar Filing: SOHU COM INC - Form 10-K

In addition, the State Security Bureau has issued regulations authorizing the blocking of access to any site it deems to be leaking State secrets or failing to meet the relevant legal legislation regarding the protection of State secrets in the distribution of information online. Specifically, Internet companies in China with message boards, chat rooms or similar services, such as Sohu, must apply for the approval of the State Secrets Bureau prior to operating such services.

Accordingly, we have established an internal security committee and adopted security maintenance measures, employed a full-time supervisor and exchanged information on a regular basis with the local public security bureau with regard to sensitive or censored information and Websites.

Regulation of Internet Content and Anti-Pornography

The PRC government has promulgated measures relating to Internet content through a number of government authorities, including the MIIT, MOC, GAAP and the Ministry of Public Security. These measures specifically prohibit certain Internet activities, including the operation of online games that result in the publication of any content which is found to, among other things, propagate obscenity.

Table of Contents

gambling or violence, instigate crimes, undermine public morality or the cultural traditions of the PRC, or compromise State security or secrets. If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its Websites.

In addition, the PRC government has issued several regulations concerning the installation of filter software to filter out unhealthy and vulgar content from the Internet. In April 1, 2009, the Ministry of Education, the MIIT and other ministries and agencies promulgated a notice requiring that, by the end of May 2009, all computer terminals connected with the Internet at all elementary and secondary schools be able to include and operate the Green Dam-Youth Escort, software aimed at filtering out unhealthy and vulgar content in text and graphics from the Internet, which, according to the official Website of the software, may be used to control the time on Internet, prohibit access to computer games, and filtering out unhealthy Websites. The MIIT further expanded the scope of usage of this filter software by issuing a notice on May 19, 2009 requiring that, effective as of July 1, 2009, all computers manufactured and sold in China have the latest available version of Green Dam-Youth Escort preinstalled when they leave the factories and all imported computers shall have the latest available version of Green Dam-Youth Escort preinstalled before being sold in China. The Green-Dam Youth Escort is to be preinstalled on the hard drive of the computer or in the form of a CD accompanying the computer and is also to be included in the backup partition and system restore CD. However, on June 30, 2009, MIIT postponed the implementation of this requirement regarding pre-installation of Green Dam-Youth Escort.

The Chinese government also has stringent regulations on online pornographic information and has launched several crackdowns on Internet pornography in 2009. On December 4, 2009, the MIIT and other 3 government authorities jointly issued the *Incentives Measures for Report of Pornographic, Obscene and Vulgar Messages on Internet and Mobile Media* (or the *Anti-Pornography Notice*) to further crackdown on online pornography. Pursuant to this *Anti-Pornography Notice*, rewards of up to RMB10,000 will be provided to Internet users who report Websites that feature pornography, and a committee has been established to review such reports to determine an appropriate award. During the Anti-Pornography campaign, many Websites (including mobile Websites) that contained pornography information were closed down. In addition, mobile network operators such as China Mobile Communication Corporation (or CMCC), have announced a temporary of billing of WAP services, as an effort to fight against Websites providing pornographic content.

Encryption Software

In October 1999, the State Encryption Administration Commission promulgated the *Regulations for the Administration of Commercial Encryption*, followed in November 1999 by the *Notice of the General Office of the State Encryption Administration Commission*. Both of these regulations address the use in China of software with encryption functions.

According to these regulations, encryption products purchased for use must be reported. Violation of the encryption regulations may result in the issuance of a warning, levying of a penalty, confiscation of the encryption products and even criminal liabilities. On March 18, 2000, the Office of the State Commission for the Administration of Cryptography issued a public announcement regarding the implementation of those regulations. The announcement clarifies that:

Only specialized hardware and software, the core functions of which are encryption and decoding, fall within the administrative scope of the regulations as encryption products and equipment containing encryption technology. Other products such as wireless telephone, Windows software and browsers do not fall within this scope.

The State Commission for the Administration of Cryptography changed its name to the State Cryptography Administration Bureau (SCAB) in March 2005. The SCAB maintains authority over the importation, research, production, sale and use of cryptographic products in China (products are defined to include any cryptographic technologies and products to be applied in the encryption or secure authentication of information other than state secrets). Legislation was issued to restrict the importation, research, production and sale of encryption products and requiring that the encryption functions of such products be placed in escrow with the SCAB for reasons of national security.

We are in full compliance with current PRC legislation governing encryption software.

Laws and Regulations Related to Online Advertisings Services

Under the *Administrative Regulations for Advertising Licenses* and the *Implementation Rules for the Administrative Regulations for Advertising*, both of which were issued by the State AIC on November 30, 2004 and effective as of January 1, 2005, enterprises (except for broadcast stations, television stations, newspapers and magazines, non-corporate entities and other entities specified in laws or administrative regulations)

Edgar Filing: SOHU COM INC - Form 10-K

are generally exempted from the previous requirement to obtain an advertising license. Exempted enterprises are only required to apply for the inclusion of advertising services in their business license.

We established Sohu Media in 2006, whose business scope has included the provision of advertising services on their business licenses.

-20-

Table of Contents

Laws and Regulations Related to Online Games

Pursuant to the *Internet Publishing Rules*, the GAPP requires every entity wishing to operate online games to hold an Online Publishing Permit, which specifically authorizes the publishing of games on the Internet.

On February 21, 2008, the GAPP issued the *Rules for the Administration of Electronic Publications (Electronic Publication Rules)*, which took effect as of April 15, 2008. The *Electronic Publication Rules* outline a licensing system for business operations involving electronic publications, which are currently interpreted by the GAPP to include online games. Under the *Electronic Publication Rules*, if a PRC company is contractually authorized to publish foreign electronic publications, it must obtain the approval of, and register the copyright license contract with the GAPP.

On September 28, 2009, the GAPP together with National Administration of Copyright (NAC) and Office of the National Campaign on Anti-pornography and Anti-delinquency jointly issued Notice on Further Strengthening Pre-examination and Pre-approval of Online Game and Administration of Imported Online Game Approval (the GAPP Notice). According to the GAPP Notice, GAPP is the only authority responsible for pre-examination and pre-approval of online game, and all the online game operators shall obtain Internet Publishing License to provide online game services.

Sohu Internet was issued an Internet Publishing License by GAPP on April 28, 2007. Gamease is in the process of applying for an Internet Publishing License with GAPP.

Table of Contents

Online Game Content

On May 14, 2004, the MOC issued *the Notice Regarding the Strengthening of Online Game Censorship*. This notice mandates the establishment of a new committee under the MOC that will screen the content of imported online games. In addition, all imported and domestic online games are required to be filed with the MOC. We have submitted the relevant filing documents to the MOC for the filing of all the games in operation.

On July 12, 2005, the MOC and the MIIT promulgated the *Opinions on the Development and Administration of Online Game* reflecting the PRC government's intent to foster and control the development of the online game industry in China. In addition, the MOC will censor online games that threaten state security, disturb the social order, or contain obscenity or violence.

On November 13, 2009, the MOC issued its *Notice Regarding Improving and Strengthening the Administration of Online Game Content (or the Online Game Content Notice)*. This notice calls for online game operators to improve and innovate their game models. Emphasis is placed specifically on the following: (1) mitigating the pre-dominance of the upgrade by monster fighting model, (2) imposing more severe restraints on the player kill model (*i.e.*, where one player's character attempts to kill another player's character), (3) restricting in-game marriages among game players, and (4) improving the enforcement of the legal requirements for the registration of minors and game time-limits.

The Online Game Content Notice also requires online game operators to set up committees to carry out the self-censorship of game content. The person responsible for such self-censorship must receive training from the MOC or its local department/counterpart. The MOC also intends to introduce a training and evaluation system for the persons in charge of research and development and operations at online game companies. This system is expected to be launched in two years' time.

According to the Online Game Content Notice, the MOC intends to formulate technical standards and norms for game development, in order to provide technological support for original domestic games. The development and operation of thoughtful and educational online games is also to be encouraged.

The MOC is planning to expedite the establishment of an online game industry association, to play a role in the self-regulation system.

Online Games Publishing and Cultural Products

On December 30, 1997, GAPP issued *the Rules for the Administration of Electronic Publications*, or *Electronic Publication Rules*, which took effect on January 1, 1998. These rules were replaced by new *Electronic Publication Rules* promulgated on February 21, 2008, which took effect on April 15, 2008. The *Electronic Publication Rules* regulate the production, publishing and importation of electronic publication in the PRC and outline a licensing system for business operations involving electronic publishing. Under the *Electronic Publication Rules* and other regulations issued by GAPP, online games are classified as a kind of electronic production and publishing of online games is required to be done by licensed electronic publishing entities with standard publication codes. Under the *Electronic Publication Rules*, if a PRC company is contractually authorized to publish foreign electronic publications, it must obtain the approval of, and register the copyright license contract with, GAPP. The online games we currently offer are published by third parties who hold electronic publishing licenses. The term of our agreements with the publishers in connection with the publication of our online games, namely, TLBB, BO and BH2, will expire on December 5, 2010, December 20, 2010 and February 22, 2012, respectively. Our existing online games in operation have been filed with GAPP as electronic publications.

GAPP and the MIIT jointly promulgated the *Tentative Measures for Internet Publication Administration*, or *Internet Publication Measures*, on June 27, 2002, which took effect on August 1, 2002 and imposed a license requirement for any company that intends to engage in Internet publishing, defined as any act by an Internet information service provider to select, edit and process content or programs and to make such content or programs publicly available on the Internet. Since the provision of online games is deemed an Internet publication activity, an online game operator needs to obtain an Internet publishing license in order to directly make its online games publicly available in the PRC. We are in the process of applying for such license with GAPP.

On May 10, 2003, the MOC issued the *Provisional Regulations for the Administration of Online Culture*, which took effect on July 1, 2003, as amended on July 1, 2004 (or the Online Culture Regulations). This regulation applies to entities engaging in activities related to online cultural products, including music and video files, network games, animation features and audiovisual products, performed plays and artwork converted for dissemination via the Internet. Pursuant to this legislation, commercial entities are required to apply to the relevant local branch of the MOC for an Online Culture Operating Permit if they engage in any of the following types of activities:

Edgar Filing: SOHU COM INC - Form 10-K

the production, duplication, importation, wholesale, retail, leasing or broadcasting of online cultural products;

the dissemination of online cultural products on the Internet or transmission thereof to computers, fixed-line or mobile phones, radios, television sets or gaming consoles for the purpose of browsing, reading, using or downloading such products; or

-22-

Table of Contents

the exhibition or holding of contests related to online cultural products.

In January 2008, the MOC issued an *Online Culture Operating Permit to Gamease*, authorizing Gamease to operate online games. In addition, according to the *Online Culture Regulations*, domestically developed online games are required to be filed with the MOC within 60 days after release in the PRC. Accordingly, we have filed with MOC application to register our in-house developed online game, TLBB.

On July 1, 2009, GAPP issued the *Notice on Strengthening the Approval and Administration of Imported Online Games*, which took effect on the same date of promulgation. Pursuant to this notice, GAPP is the only competent approval authority authorized by the State Council for imported online games authorized by offshore copyright owners. Any enterprise which engages in online game publication and operation service within China must obtain the examination and approval of GAPP and relevant Internet publication service license. Moreover, the activities which involve the showing, exhibiting, trading and promoting of offshore online game production held in China shall also obtain the examination and approval of GAPP according to this notice.

On September 7, 2009, the State Commission Office for Public Sector Reform has issued the *Notice on Interpretation of the State Commission Office for Public Sector Reform on Several Provisions relating to Animation, Online Game and Comprehensive Law Enforcement in Culture Market in the Three Provisions* jointly promulgated by MOC, SARFT and GAPP, which took effect on the same date of promulgation. According to this notice, GAPP shall be responsible for the examination and approval of the online games to be uploaded on the Internet, and after the upload on the Internet, the online games shall be completely administrated by MOC. The notice further clarifies that GAPP shall be responsible for the examination and approval of the game publications which are authorized by offshore copyright owners to be uploaded on the Internet, and the other imported online games shall be examined and approved by MOC.

On September 28, 2009, GAPP, National Copyright Administration, and National Office of Combating Pornography and Illegal Publications jointly published the *Further Strengthening of the Administration of Pre-examination and Approval of Online Games and the Examination and Approval of Imported Online Games* which took effect on the same date of promulgation. This notice restates that foreign investors are not permitted to invest in online game operating businesses in China via wholly-owned, equity joint venture or cooperative joint venture investments and expressly prohibits foreign investors from gaining control over or participating in domestic online game operators through establishing other joint venture companies, or contractual or technical arrangements. According to this notice, where new versions, expansion packs or new content shall be updated for online games which have been approved by GAPP, the operation entity shall undertake the same procedures for the examination and approval by GAPP of such new versions, expansion packs or new content.

On November 13, 2009, MOC issued the *Circular on Improving and Strengthening the Administration of Content in Online Games*. This circular emphasizes that a correct culture value tendency shall be maintained to enhance the culture implication in online games, and modes of the games which mainly comprise of upgrading by killing the beasts, the PK system and marriage system in the game shall be further restricted, as well as to protect minor game players by guiding them in registration and limiting their gaming time through technical measures.

Software Products Registration

On October 27, 2000, the MIIT issued the Measures Concerning Software Products Administration, or Software Measures, to regulate software products and promote the development of the software industry in the PRC. These Software Measures have been amended and replaced by the new Software Measures issued by the MIIT on March 1, 2009 effective as of April 10, 2009. Pursuant to the new Software Measures, software developers or producers are allowed to sell or license their software products independently or through agents. Software products developed in the PRC can be registered with the local provincial government authorities in charge of the information industry and filed with the MIIT. Upon registration, the software products shall be granted registration certificates. Each registration certificate is valid for five years and may be renewed upon expiration. Software products developed in the PRC which satisfy the requirements of the Software Measures and have been registered and filed in accordance with the Software Measures may enjoy preferential treatments under relevant policy of the State Council. The MIIT and other relevant departments may supervise and inspect the development, production, sale and import and export of software products in the PRC. We have registered all software products which we currently operate.

Import and Export of Online Games

Pursuant to the Online Culture Regulations, an Online Game Import Approval must be obtained from the GAPP before a game is launched in China. The GAPP handles applications for such approval through its provincial branches. The local provincial bureau of the GAPP will review an application and forward it to the GAPP for approval within 20 days of its own decision, together with a preliminary approval document.

The Online Culture Regulations also require that imported online games be subject to a content review and approval by the MOC. On May 14, 2004, the MOC issued the *Notice Regarding the Strengthening of Online Game Censorship* (or the Online Game Notice). This notice mandates the establishment of a new committee named Committee for the Censorship of the Content of Imported Game Products under the MOC, which

Edgar Filing: SOHU COM INC - Form 10-K

will be responsible for the censorship of politically sensitive content in imported online games. The committee will also be responsible for censorship of games that threaten national security , disturb social order , distort historical facts or infringe on third party intellectual property rights .

-23-

Table of Contents

On April 24, 2009, the MOC issued the *Public Announcement on Regulating Applications for the Examination of the Content of Imported Online Games* (or the Announcement). The Announcement emphasizes that enterprises operating imported online games must apply for the content of those games to be examined by the MOC in accordance with the Online Game Notice. The version of an imported online game which is filed for examination must be the same as that which is ultimately operated or publicly tested.

In addition to the industry regulation on import of online games, China imposes controls on the import and export of online game as technology. On December 10, 2001, the State Council promulgated *Regulations on Administration of Import and Export of Technologies*. The term technology import and export is broadly defined in the regulations to include, without limitation, the transfer or license of patents, software and know-how, and the provision of services in relation to technology. Depending on the nature of the relevant technology, the import and export of technology require either approval by, or registration with, the relevant PRC governmental authorities. We have entered into license agreements with third parties outside of China to license our games, which constitute the export of technology under the regulations. As a result, such licenses are required to be registered with applicable PRC governmental authorities. Gamease is currently in process of registering the export of certain of its technologies and its license agreements with the relevant PRC governmental authorities.

Anti-Fatigue System and Real-name Registration System

On April 15, 2007, the MIIT, the GAPP, the Ministry of Education and five other government authorities, jointly issued the *Notice on the Implementation of Online Game Anti-Fatigue System to Protect the Physical and Psychological Health of Minors* (or the Anti-Fatigue Notice). Pursuant to the Anti-Fatigue Notice, online game operators are required to install an anti-fatigue system that discourages game players from playing games for more than five hours per day. Under the anti-fatigue system, three hours or less of continuous play by minors is considered to be healthy, three to five hours to be fatiguing, and five hours or more to be unhealthy. Game operators are required to reduce the value of in-game benefits to a game player by half if the game player has reached fatiguing level, and to zero in the case of unhealthy level.

To identify whether a game player is a minor and thus subject to the anti-fatigue system, a real-name registration system is also adopted, which requires online game players to register their real identity information before they play online games and requires us to submit the identity information of game players to the public security authority for verification. We have developed our own anti-fatigue system and real-name registration system for our games, and have implemented them since 2007. Under our system, game players must use real identification in order to create accounts, and in this way, we are able to tell which of our game players are minors and thus subject to these regulations. For game players who do not register, we assume that they are minors. In order to comply with the anti-fatigue rules, game players under 18 years of age only receive half of the experience time they actually earn after three hours of play. And, after five hours of play, minors receive no experience points. We use this system to dis-incentivize minors from playing in excess of five hours at a time.

Virtual Currency

On February 15, 2007, the MOC, the People's Bank of China and other relevant government authorities jointly issued the *Notice on the Reinforcement of the Administration of Internet Cafés and Online Games* (or the Internet Cafés Notice). Under the Internet Cafés Notice, the People's Bank of China is directed to strengthen the administration of the virtual currency in online games to avoid any adverse impact on the real economic and financial order. This notice provides that the total amount of virtual currency issued by online game operators and the amount purchased by individual users should be strictly limited, with a strict and clear division between virtual transactions and real transactions carried out by way of electronic commerce. This notice also provides that virtual currency should only be used to purchase virtual items.

On June 4, 2009 the MOC and the Ministry of Commerce jointly issued the *Notice on the Strengthening of Administration on Online Game Virtual Currency* (or the Virtual Currency Notice). Virtual Currency is broadly defined in the Notice as follows: A type of virtual exchange instrument issued by Internet game operation enterprises, purchased directly or indirectly by the game user by exchanging legal currency at a certain exchange rate, saved outside the game programs, stored in servers provided by the Internet game operation enterprises in electronic record format and represented by specific numeric units. Virtual currency is used to exchange Internet game services provided by the issuing enterprise for a designated extent and time, and is represented by several forms, such as prepaid game cards, prepaid amounts or Internet game points, and does not include game props obtained from playing online games. Notably, game props (*i.e.*, virtual items or equipment used in a particular game), are explicitly excluded from the above definition. The Virtual Currency Notice specifically states that game props should not be confused with virtual currency and that the MOC, jointly with other authorities, will issue separate rules to govern them.

On July 20, 2009, MOC promulgated the *Filing Guidelines on Online Game Virtual Currency Issuing Enterprise and Online Game Virtual Currency Trading Enterprise*, which specifically defines the meanings of issuing enterprise and trading enterprise and stipulates that the both business may not be operated by the same enterprise.

Table of Contents

Privacy Protection

Chinese law does not prohibit Internet content providers from collecting and analyzing personal information from their users. We require our users to accept a user agreement whereby they agree to provide certain personal information to us. Chinese law prohibits Internet content providers from disclosing to any third parties any information transmitted by users through their networks unless otherwise permitted by law. If an Internet content provider violates these regulations, the MIIT or its local bureaus may impose penalties and the Internet content provider may be liable for damages caused to its users.

Internet Café

Pursuant to the Internet Cafés Notice, Internet cafés are required to obtain an Online Culture Operating Permit from the MOC and register the same with the State AIC. The Internet Cafés Notice also provides restrictions with respect to Internet cafés' location, size, number of computers, business hours and the ages of their customers. For instance, Internet cafés are prohibited from operating during the hours between 12 a.m. and 8 a.m. Although we do not operate any Internet cafés, the restrictive regulations on the operation of Internet cafés may negatively affect our business operations, because many of our MMORPG users access the games through computers at Internet cafés. On February 15, 2007, the MOC and other relevant government authorities jointly issued the *Notice on the Reinforcement of the Administration of Internet Cafés and Online Games*, or the *Internet Cafés Notice*, which suspended nationwide the approval for the establishment of new Internet cafés in 2007 and imposed tougher penalties for Internet cafés admitting minors. In 2008 and 2009, the MOC, SAIC and other relevant government authorities, individually or jointly, have issued several notices which provide various ways to strengthen the regulation of Internet cafés, including investigating and punishing the Internet cafés which accept minors, cracking down on Internet cafés without sufficient and valid licenses, limiting the total number of Internet cafés, screening unlawful games and Websites, and improving the coordination of regulation over Internet cafés and online games.

Laws and Regulations Related to Wireless Services

Sohu Internet and GoodFeel's business activities include the provision of online services related to wireless services, including SMS, RBT, WAP, MMS and IVR.

On April 25, 2004, the MIIT issued a notice stating that mobile network operators can only provide mobile network access to those mobile Internet service providers which have obtained licenses from the relevant local arm of the MIIT before conducting operations, and that such carriers must terminate mobile network access for those providers who have not secured the required licenses within a thirty-day grace period. On the basis of the notice, CMCC has required each of its mobile Internet service providers to first obtain a license for trans-regional value-added telecommunications services in order to gain full access to its mobile network, which is a nationwide policy in line with a similar notice issued by the Beijing branch of CMCC on April 12, 2004.

Sohu Internet and GoodFeel were granted renewed licenses to provide trans-regional value-added telecommunication services on August 19, 2009 and January 21, 2008, respectively.

Laws and Regulations Related to Consumer Protection and E-mail Services

The MIIT has set forth various requirements for consumer protection in a notice issued on April 15, 2004, which addresses certain problems in the telecommunications sector, including ambiguity in billing practices for premium services, poor quality of connections and unsolicited SMS messages, all of which infringe upon the rights of consumers.

This trend was continued with the issuance of the *Notice Regarding the Ratification and Administration of Mobile Information Services Fees and Charges Method* by MIIT on September 8, 2006.

In addition, there has been a movement in China toward industry self-regulation to combat the problem of unsolicited e-mails. Specifically, on March 25, 2003, the China Internet Association issued the *Anti-Spam E-Mail Guidelines*. These guidelines set forth a number of mechanisms that Internet service providers in China may adopt to cut down the use of their systems to send unsolicited e-mail. We have adopted these guidelines in our operations.

On February 20, 2006, the MIIT promulgated the *Measures for the Administration of Internet E-mails Services*, effective as of March 30, 2006. Under these new regulations, the Opt-in System is expected to be introduced into the area of e-mail services, whereby e-mails containing commercial advertisements are not delivered unless specifically requested by users. Furthermore, the subject line of all e-mails containing commercial advertisements will be required to have the label of advertisement or AD. In addition, the IP address of each server that supports

Edgar Filing: SOHU COM INC - Form 10-K

e-mail will be registered in order to facilitate the tracing and identification of spam sources. We have adjusted our e-mail systems and forms to fulfill the relevant requirements.

-25-

Table of Contents

We are aware of the increasingly strict legal environment covering consumer protection in China, and we attempt to adopt all necessary measures to ensure that our business complies with these evolving standards.

Laws and Regulations Related to Foreign Currency Exchange and Dividend Distribution

Foreign Currency Exchange. The principal regulations governing foreign currency exchange in China are the Foreign Exchange Administration Regulations, as amended in August 2008. Under the Regulations, the RMB is freely convertible for current account items, including the distribution of dividends, interest payments, trade and service-related foreign exchange transactions, but not for capital account items, such as direct investments, loans, repatriation of investments and investments in securities outside of China, unless the prior approval of the SAFE is obtained and prior registration with the SAFE is made. On August 29, 2008, SAFE promulgated a notice, *Circular 142*, regulating the conversion by a foreign-invested company of foreign currency into RMB by restricting how the converted RMB may be used. The notice requires that the registered capital of a foreign-invested company settled in RMB converted from foreign currencies may only be used for purposes within the business scope approved by the applicable governmental authority and may not be used for equity investments within the PRC. In addition, SAFE strengthened its oversight of the flow and use of the registered capital of a foreign-invested company settled in RMB converted from foreign currencies. The use of such RMB capital may not be changed without SAFE's approval, and may not in any case be used to repay RMB loans if the proceeds of such loans have not been used. Violations of *Circular 142* will result in severe penalties, such as heavy fines. As a result, *Circular 142* may significantly limit our ability to transfer the net proceeds from Changyou's initial public offering to Gamease through our subsidiary in the PRC, which may adversely affect the business expansion of Gamease, and we may not be able to convert the net proceeds into RMB to invest in or acquire any other PRC companies, or establish other VIEs in the PRC.

The dividends paid by the subsidiary to its overseas shareholder are deemed income of the shareholder and are taxable in China. Pursuant to the Administration Rules of the Settlement, Sale and Payment of Foreign Exchange (1996), foreign-invested enterprises in China may purchase or remit foreign currency, subject to a cap approved by the SAFE, for settlement of current account transactions without the approval of the SAFE. Foreign currency transactions under the capital account are still subject to limitations and require approvals from, or registration with, the SAFE and other relevant PRC governmental authorities.

Dividend Distribution. The principal regulations governing distribution of dividends of foreign holding companies include the Foreign Investment Enterprise Law (1986), as amended, and the Administrative Rules under the Foreign Investment Enterprise Law (2001).

Under these regulations, foreign investment enterprises in China may pay dividends only out of their accumulated profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, foreign investment enterprises in China are required to allocate at least 10% of their respective accumulated profits each year, if any, to fund certain reserve funds unless these reserves have reached 50% of the registered capital of the enterprises. These reserves are not distributable as cash dividends. Furthermore, effective from January 1, 2008, according to the Corporate Income Tax Law, the maximum tax rate for the withholding tax imposed on dividends payment from PRC foreign invested companies to their overseas investors that are not regarded as resident for tax purpose is 20%. The rate has been reduced to 10% under the Implementing Regulations for the PRC Corporate Income Tax Law issued by the State Council. However, a lower withholding tax rate, which is 5%, might be applied if there is a tax treaty arrangement between China and the jurisdiction of the foreign holding companies, such as Hong Kong.

Circular 75. On October 21, 2005, the SAFE issued Circular 75, which became effective as of November 1, 2005. Under Circular 75, prior registration with the local SAFE branch is required for PRC residents to establish or to control an offshore company for the purposes of financing that offshore company with assets or equity interests in an onshore enterprise located in the PRC. An amendment to registration or filing with the local SAFE branch by such PRC resident is also required for the injection of equity interests or assets of an onshore enterprise in the offshore company or overseas funds raised by such offshore company, or any other material change involving a change in the capital of the offshore company.

Moreover, Circular 75 applies retroactively. As a result, PRC residents who have established or acquired control of offshore companies that have made onshore investments in the PRC in the past are required to complete the relevant registration procedures with the local SAFE branch by March 31, 2006. Under the relevant rules, failure to comply with the registration procedures set forth in Circular 75 may result in restrictions being imposed on the foreign exchange activities of the relevant onshore company, including the increase of its registered capital, the payment of dividends and other distributions to its offshore parent or affiliate and the capital inflow from the offshore entity, and may also subject relevant PRC residents to penalties under PRC foreign exchange administration regulations. PRC residents who control our company from time to time are required to register with the SAFE in connection with their investments in us.

Table of Contents

Stock Option Rule. On December 25, 2006, the PBOC issued the *Administration Measures on Individual Foreign Exchange Control*, and its *Implementation Rules* was issued by SAFE on January 5, 2007, both of which became effective on February 1, 2007. Under these regulations, all foreign exchange matters involved in the employee stock ownership plan, stock option plan and etc. participated by onshore individuals shall be transacted upon the approval from the SAFE or its authorized branch. On March 28, 2007, SAFE promulgated the *Application Procedure of Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Holding Plan or Stock Option Plan of Overseas Listed Company*, or the *Stock Option Rule*. Under the Stock Option Rule, PRC citizens who are granted stock options or restricted share units, or issued restricted shares by an overseas publicly listed company are required, through a PRC agent or PRC subsidiary of such overseas publicly listed company, to complete certain other procedures and transactional foreign exchange matters under the Stock Option Plan upon the examination by, and approval of, SAFE. We and our PRC employees who have been granted stock options or restricted share units, or issued restricted shares are subject to the Stock Option Rule. We and our employees, who are PRC citizens and have been granted stock options or restricted share units or issued restricted shares, are subject to the Stock Option Rule. We and our employees intend to make such application and complete all the requisite procedures in accordance with the Stock Option Rule. However, we cannot assure you that we can complete all the procedures in a timely manner. If the relevant PRC regulatory authority determines that our PRC employees who hold such options, restricted share units or restricted shares or their PRC employer fail to comply with these regulations after our initial public offering, such employees and their PRC employer may be subject to fines and other legal sanctions.

New M&A Regulations and Overseas Listings

On August 8, 2006, six PRC regulatory agencies, including the Ministry of Commerce, the State Assets Supervision and Administration Commission, the State Administration for Taxation, the State Administration for Industry and Commerce, the CSRC and the SAFE, jointly issued the *Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors*, or the *New M&A Rule*, which became effective on September 8, 2006. This *New M&A Rule*, among other things, includes provisions that purport to require that an offshore special purpose vehicle formed for purposes of overseas listing of equity interests in PRC companies and controlled directly or indirectly by PRC companies or individuals obtain the approval of the CSRC prior to the listing and trading of such special purpose vehicle's securities on an overseas stock exchange.

On September 21, 2006, the China Securities Regulatory Commission, or CSRC, published on its official Website procedures regarding its approval of overseas listings by special purpose vehicles. The CSRC approval procedures require the filing of a number of documents with the CSRC and it would take several months to complete the approval process. The application of this new PRC regulation remains unclear, with no consensus currently existing among leading PRC law firms regarding the scope of the applicability of the CSRC approval requirement.

Employment Contract

On June 29, 2007, the National People's Congress promulgated the *Employment Contract Law of PRC* (or *Employment Contract Law*), which became effective as of January 1, 2008. The *Employment Contract Law* requires employers to provide written contracts to their employees, restricts the use of temporary workers and aims to give employees long-term job security.

Pursuant to the *Employment Contract Law*, employment contracts lawfully concluded prior to the implementation of the *Employment Contract Law* and continuing as of the date of its implementation shall continue to be performed. Where an employment relationship was established prior to the implementation of the *Employment Contract Law* but no written employment contract was concluded, a contract must be concluded within one month after its implementation.

On September 18, 2008, the State Council promulgated the *Implementing Regulations for the PRC Employment Contract Law* which came into effect immediately. These regulations interpret and supplement the provisions of the *Employment Contract Law*.

We have modified our standard employment contract to comply with the requirements of the *Employment Contract Law* and its implementing regulations. We have entered into written employment contracts with all of our employees.

Conclusion

In the opinion of TransAsia Lawyers, our companies are approved to engage in the specific online services (categorized and addressed in the above sections) as described in the respective scopes indicated in the corresponding licenses and/or permits issued to the respective companies.

INTELLECTUAL PROPERTY AND PROPRIETARY RIGHTS

Edgar Filing: SOHU COM INC - Form 10-K

We regard our patents, copyrights, service marks, trademarks, trade secrets and other intellectual property as critical to our success. We rely on patent, trademark and copyright law, trade secret protection, non-competition and confidentiality and/or license agreements with our employees, customers, partners and others to protect our intellectual property rights. Despite our precautions, it may be possible for third parties to obtain and use our intellectual property without authorization. Furthermore, the validity, enforceability

-27-

Table of Contents

and scope of protection of intellectual property rights in Internet-related industries are uncertain and still evolving. The laws of the PRC and certain other countries do not protect intellectual property to the same extent as do the laws of the United States.

We have registered three service marks with the U.S. Patent and Trademark Office. They are (i) Sohu.com, registered on August 1, 2000; (ii) Sohu.com (stylized), registered on August 1, 2000; and (iii) Sohu, registered on June 13, 2000. We received the registration certificate for the mark Sohu.com issued by the China Trademark Office in October 2000. We have also filed registration applications with the China Trademark Office to register other key marks, including the Sohu Fox logo, 17173.com, Focus.cn, GoodFeel, Sogou, Go2Map, TLBB, Changyou, DMD and their corresponding Chinese version marks. We succeeded in registering certain marks such as 17173, Focus.cn, GoodFeel, Go2Map and Sogou and TLBB in the PRC under certain classes, while the others are still under examination by the China Trademark Office. We also filed registration of trademarks relating to our subsidiary company name and our MMOPRGs in various countries and regions, such as United States, Europe, Malaysia, Turkey and Vietnam. Our rights to these marks could be affected adversely if any of our applications are rejected. In addition, it is possible that our competitors will adopt product or service names similar to ours, thereby impeding our ability to distinguish our brand and possibly leading to customer confusion.

Many parties are actively developing chat, homepage, search and related Web technologies. We expect these parties to continue to take steps to protect these technologies, including seeking patent protection. There may be patents issued or pending that are held by others and cover significant parts of our technology, business methods or services. For example, we are aware that a number of patents have been issued in the areas of e-commerce, Web-based information indexing and retrieval and online direct marketing. Disputes over rights to these technologies may arise in the future. We cannot be certain that our products do not or will not infringe valid patents, copyrights or other intellectual property rights held by third parties. We may be subject to legal proceedings and claims, from time to time, relating to the intellectual property of others in the ordinary course of our business.

We also intend to continue licensing technology from third parties. The market is evolving and we may need to license additional technologies to remain competitive. We may not be able to license these technologies on commercially reasonable terms or at all. In addition, we may fail to successfully integrate any licensed technology into our services. Our inability to obtain any of these licenses could delay product and service development until alternative technologies can be identified, licensed and integrated.

TECHNOLOGY INFRASTRUCTURE

We have built what we believe is a reliable and secure network infrastructure, that will fully support our operations, which include one of the most comprehensive matrices of Chinese language Web properties and one of the most popular online games in China.

To fully support our operation of the Web properties, we have established three main service provision centers in Beijing through China United Network Communication Group Company Limited (or China Unicom), China Telecom Corporation (or China Telecom), and China Education and Research Network (or CERNET), to maintain most of our servers. China Unicom, China Telecom, and CERNET are the three largest Internet connection service providers in China and their nodes in Beijing are one of their core nodes across China. In addition, we have established many branch nodes in different provinces throughout China through different Internet connection operators, such as China Unicom, China Telecom, CERNET, and China Mobile in order to establish national coverage and provide fast and stable access to our Website properties to users across China.

We have developed a close working relationship with China Unicom and its Beijing Subsidiary, China Telecom and CERNET. Our operations depend on the ability of China Unicom and its Beijing Subsidiary, China Telecom and CERNET to protect their systems against damage from fire, power loss, telecommunications failure, break-ins and other events. China Unicom and its Beijing Subsidiary, China Telecom and CERNET provide us with support services twenty-four hours per day, seven days per week. China Unicom and its Beijing Subsidiary, China Telecom and CERNET also provide connectivity for our servers through multiple high-speed connections. All facilities are protected by multiple power supplies.

For reliability, availability, and serviceability, we have created an environment in which each server can function separately. Key components of our server architecture are served by multiple redundant machines. We also use in-house and third-party monitoring software. Our reporting and tracking systems generate daily traffic, demographic and advertising reports. We deploy load balance equipment to avoid single point failure.

Our operations must accommodate a high volume of traffic and deliver frequently updated information. Components or features of our products and services have in the past suffered outages or experienced slower response times because of equipment or software down time. These events have not had a material adverse effect on our business to date, but such events could have a material adverse effect in the future.

Table of Contents

We have also built what we believe is a reliable and secure network infrastructure that will fully support our online game operations. In order to maintain stable operations of our MMORPGs, as of December 31, 2009 we maintained approximately 2,600 servers located in Internet data centers in eight major cities in China, with the capacity to accommodate up to 1.7 million concurrent game players, and a sufficient amount of connectivity bandwidth to maintain such service. In order to enhance our game players' experience and minimize the impact of cross-region connections, we have located our game servers in a number of regions throughout China, enabling our game players to play our games by connecting to the nearest servers located in their region without needing to exchange data across the national backbone network. We have technical support employees to maintain our current technology infrastructure and develop new software features to further enhance the functionality of our management and security system. We monitor the operation of our server network 24 hours a day, seven days a week. Our remote control system allows us to track our concurrent online users in real time, and discover and fix problems in the operation of hardware and software in our server network in a timely fashion. In addition, we frequently update our game servers to ensure the stability of our operation and reduce risks.

EMPLOYEES

As of December 31, 2009, we had 3,997 full-time and part-time employees, including 1,734 employees for our brand advertising business and 1,368 employees for our online game business. We also employ independent contractors to support our research and development, sales, marketing, and editorial departments. None of our personnel are represented under collective bargaining agreements.

We have entered into standard employment agreements with our employees through our subsidiaries and variable interest entities. In addition, all of our full-time employees have entered into confidentiality, non-competition and non-solicitation agreements with us. However, the degree of protection afforded to an employer pursuant to confidentiality and non-competition undertakings governed by PRC law may be more limited when compared to the degree of protection afforded under the laws of other jurisdictions. A number of our employees hold share-based awards granted by Sohu.com Inc. and Changyou.com Limited, which provide additional financial incentives to them. These awards generally vest over a period of four years.

AVAILABLE INFORMATION

Our corporate Website is located at <http://corp.sohu.com>. We make available free of charge on or through our corporate Website our annual report on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission, or SEC. You will find links to copies of these reports, and to copies of Section 16 filings related to Sohu, by clicking on "Investor Relations" on the first full English page. Information contained on our corporate Website is not part of this report or any other report filed with the SEC.

Table of Contents

ITEM 1A RISK FACTORS
Risks Related to Our Business

We are a relatively young company subject to the risks associated with operating in a new and evolving market.

As a relatively young company in the new and rapidly evolving PRC Internet market, we face numerous risks and uncertainties. Some of these risks relate to our ability to:

continue to attract a larger audience to our matrices of Web properties and proprietary search engines by expanding the type and technical sophistication of the content and services we offer;

maintain our current, and develop new, strategic relationships to increase our revenue streams as well as product and service offerings;

increase the revenues derived from our fee-based services and products we offer online;

build our sponsored search, online game, and wireless businesses successfully; and

attract and retain qualified personnel.

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

Our annual and quarterly operating results have varied significantly in the past, and may vary significantly in the future, due to a number of factors which could have an adverse impact on our business, such as our reliance on advertisers in certain industries for brand advertising revenues, our reliance on certain key third party distributors for sponsored search revenues, our reliance on operation of TLBB for online game revenues and our reliance on mobile network operators for our wireless revenues. The Chinese Internet industry is at an early stage of development. We are unsure if it will continue to grow, and if it does, the rate at which it will grow. In addition, we are subject to government regulations that may change at any time with or without notice. Fluctuations in the industries of our key advertisers may affect our brand advertising revenues materially, because they may cut their spending on online marketing if there is any downturn in their industries. We rely on certain third party distributors to sell our sponsored search products. If we lose any of our key distributors, our business may be materially affected. We rely on our operation of TLBB to derive most of our online game revenue. If there were any interruptions of TLBB's operation, our online game revenue could be adversely affected. We rely on mobile network operators for, among other things, billing of and collection of wireless service fees from mobile phone users. If our arrangements with the operators were to be terminated, altered or not renewed, or if the operators did not provide continuous or adequate service, our wireless revenues could be reduced significantly.

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

Changyou's limited operating history makes evaluating our business and prospects difficult.

Changyou was incorporated on August 6, 2007 in the Cayman Islands as an indirect wholly-owned subsidiary of Sohu.com Inc. On December 1, 2007, Sohu transferred all of its MMORPG business to Changyou. Changyou launched three MMORPGs when Changyou was still a business unit of the Sohu Group, including Knight Online (KO) in June 2003, BO in October 2004 and TLBB in May 2007, of which KO and BO are licensed games. In September 2009, Changyou launched BH2, the sequel to BO. Changyou terminated the operation of KO in November 2006 when its license expired. Changyou developed TLBB in-house. TLBB generated a substantial majority of the Sohu Group's online game revenues for the years ended December 31, 2007, 2008 and 2009. Changyou's limited operating history may not provide a meaningful basis for you to evaluate its business and prospects. Furthermore, Changyou was a business unit within the Sohu Group prior to its reorganization and had no experience running its business as a separate, stand-alone company. Changyou's business strategy has not been proven over time and we

Edgar Filing: SOHU COM INC - Form 10-K

cannot be certain that it will be able to successfully expand its MMORPG business.

You should also consider additional risks and uncertainties that may be experienced by early stage companies operating in a rapidly developing and evolving industry. Some of these risks and uncertainties relate to Changyou's ability to:

develop or license new MMORPGs that are appealing to game players and meet Changyou's expected timetable for launches of new games;

Table of Contents

raise Changyou's brand recognition and game player loyalty; and

successfully adapt to an evolving business model.

We may not be successful in addressing the risks listed above, which may materially and adversely affect our online game business prospects.

Changyou is not likely to sustain its recent growth rate.

Changyou's revenues have grown significantly in a relatively short period of time, in particular after its launch of TLBB in May 2007. Primarily due to the commercial success of TLBB, Changyou's revenues grew from \$1.6 million for the three months ended March 31, 2007 before the launch of TLBB to \$58.4 million for the three months ended December 31, 2008 and \$70.7 million for the three months ended December 31, 2009, representing an increase of 35.5 times over seven quarters and 43.2 times over eleven quarters, and its net income grew from a net loss of \$1.4 million for the three months ended March 31, 2007 to net income of \$29.1 million for the three months ended December 31, 2008 and \$38.9 million for the three months ended December 31, 2009. Changyou is not likely to sustain similar growth rate in revenues or net income in future periods due to a number of factors, including, among others, the greater difficulty of growing at sustained rates from a larger revenue base, the uncertain level of popularity of its future games, the potential need to expend greater amounts in order to develop or acquire new games, and the potential increases in its costs and expenses as a separate, stand-alone public company. For example, for the three months ended December 31, 2009, Changyou's revenues grew 2.9% over the three months ended September 30, 2009, which was significantly lower than the revenue growth rate of the previous several quarters, as TLBB has entered into a more mature stage. Accordingly, you should not rely on the results of any prior period as an indication of Changyou's future financial and operating performance.

We rely on a single MMORPG, TLBB, for a significant portion of our revenues and gross profit and a decrease in its popularity could have a material adverse effect on our operating results.

Our in-house developed MMORPG, TLBB, contributes a significant percentage of our total revenues and of our total gross profit. Accordingly, any decrease in TLBB's popularity could materially and adversely affect our business. For the year ended December 31, 2009, revenues generated from TLBB accounted for approximately 94% of our online game revenues and 49% of our total revenues. Our gross profit from online game constituted approximately 64% of our total gross profit. We launched TLBB in May 2007, and we cannot guarantee how long TLBB will continue to sustain its current level of popularity. To prolong TLBB's lifespan, we need to continually improve and update it on a timely basis with new features that appeal to existing game players and attract new game players, and to market these new features. Despite our efforts to improve TLBB, our game players may nevertheless lose interest in the game over time or may be attracted to other games, which are copied from TLBB. In view of our reliance on TLBB, our limited history developing and operating MMORPGs and the uncertainty of our ability to launch and commercialize new games in our pipeline, if we fail to improve and update TLBB on a timely basis, or if our competitors introduce more popular games catering to our game player base, our revenues and profitability could be materially and adversely affected.

Furthermore, if there were any interruptions in TLBB's operation due to unexpected server interruptions, network failures or other factors, game players could be prevented or deterred from making purchases of virtual items, which could result in significant decreases in our online games revenues.

Rapid technological changes may increase our game development costs.

The online game industry is evolving rapidly, so we need to anticipate new technologies and evaluate their possible market acceptance. In addition, government authorities or industry organizations may adopt new standards that apply to game development. Any new technologies and new standards may require increases in expenditures for MMORPG development and operations, and we will need to adapt our business to cope with the changes and support these new services to be successful. If we fall behind in adopting new technologies or standards, our existing games may lose popularity, and our newly developed games may not be well received in the marketplace. As a result, our business prospects and results of operations could be materially and adversely affected.

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

There are many companies that distribute online content and services targeting Chinese Internet users. We compete with distributors of content and services over the Internet, including content sites, Web directories, search engines, online games, Internet service providers and sites maintained by government and educational institutions. These sites compete with us for visitor traffic, advertising dollars, online game players, potential partners and wireless services. The Internet market in China is relatively new and rapidly evolving. Competition is intense and expected to increase significantly in the future, because there are no substantial barriers to entry in our market.

Table of Contents

We have many competitors in the PRC Internet market, including Sina, Tencent, NetEase, You Ku, Tu Dou, Ku6, PC online, SouFun, CRIC, Baidu, Google, Yahoo! China, SoSo, Shanda Interactive Entertainment, Perfect World, Giant Interactive, The9, Netdragon, Kingsoft, Nineyou, Tom Online, KongZhong, Linktone and Hurray!. In addition, there are a number of existing or new PRC Internet portals, including those controlled or sponsored by PRC government entities.

We compete with our peers and competitors in China primarily on the following basis:

technological advancements;

attractiveness of products;

brand recognition;

volume of traffic and users;

quality of Websites and content;

strategic relationships;

quality of services;

effectiveness of sales and marketing efforts;

talented staff; and

pricing.

Over time, our competitors may gradually build certain competitive advantages over us in terms of:

greater brand recognition among Internet users and clients;

better products and services;

larger user and customer bases;

more extensive and well developed marketing and sales networks; and

substantially greater financial and technical resources.

Our existing competitors may in the future achieve greater market acceptance and gain a greater market share through launching of new products, introducing new technologies, or forming alliances among themselves, or through mergers and acquisitions in order to enhance their ability to compete with us. For example, Shanda Interactive Entertainment's online game subsidiary, Shanda Games, completed an initial public offering on NASDAQ in September 2009. The proceeds from the offering will provide Shanda Games with additional financial resources that will enhance its competitiveness. Moreover, China Real Estate Information Corporation, a joint venture established by Sina Corporation and E-House (China) Holdings Limited that provides a new path for Internet companies to cooperate with the real estate industry to gain competitive advantages, completed an initial public offering on NASDAQ in October 2009. It is also possible that new competitors may emerge and acquire significant market share. In addition, operators of leading Websites or Internet service providers, including Yahoo!, Microsoft/MSN and AOL, currently offer, and could expand, their online products and services targeting China. Such entities may cooperate with other organizations, such as telecommunication operators, in China to accelerate their entry into, and to enhance their competitiveness in, the Chinese market.

If we fail to successfully develop and introduce new products and services, our competitive position and ability to generate revenues could be harmed.

We are continuously developing new products and services for our users. The planned timing or introduction of new products and services is subject to risks and uncertainties. Actual timing may differ materially from original plans. Unexpected technical, operational, distribution or other problems could delay or prevent the introduction of one or more of our new products or services. Moreover, we cannot be sure that any of our new products and services will achieve widespread market acceptance or generate incremental revenue.

Table of Contents

We may be adversely affected by the slowdown of the Chinese economy caused in part by the global crisis in the financial services and credit markets, and our brand advertising business in particular could be severely affected by such slowdown.

The Chinese economy has experienced a slowing growth rate and this slowing growth rate may continue for a while. A number of factors have contributed to this slowdown, including appreciation of the RMB, which adversely affected China's exports, and tightened macroeconomic measures and monetary policies adopted by the Chinese government aimed at preventing overheating of the Chinese economy and controlling China's high level of inflation. The slowdown has been exacerbated by the global crisis in the financial services and credit markets, which has resulted in significant volatility and dislocation of the global capital markets. It is uncertain how long the global crisis in the financial services and credit markets will continue and how much of an impact it will have on the global economy in general or the Chinese economy in particular, and whether slowing economic growth in China could result in our customers reducing their spending on Website services, advertising, and online game. Slower growth in the Chinese economy could affect our businesses generally, and could have a significant impact on our brand advertising business in particular, as our brand advertising revenues could decrease as a result of our brand advertising customers reducing their advertising budgets.

Our business depends on a strong brand; thus we will not be able to attract users, customers and clients of our products and offerings if we do not maintain and develop our brands.

It is critical for us to maintain and develop our brands so as to effectively expand our user base and our revenues. We believe that the importance of brand recognition will increase as the number of Internet users in China grows. In order to attract and retain Internet users, advertisers, online game and wireless customers, we may need to substantially increase our expenditures for creating and maintaining brand loyalty. Accordingly, our revenues will need to increase at least proportionately in order for us to maintain our current levels of profitability.

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

Our failure to keep up with rapid technology changes may severely affect our future success.

The Internet industry is undergoing rapid technological changes. Our future success will depend on our ability to respond to rapidly evolving technologies, adapt our services to changing industry standards and improve the performance and reliability of our services. If we fail to adapt to such changes, our business may be adversely affected. For example, with the evolution of Web 2.0, Internet users may shift to new modes of information sharing, such as Social Networking Sites and client-end software. Our competitors may develop their own peer-to-peer streaming technology or update their existing technology to surpass us. With the development of search engine technologies, Internet users may choose to access information, news and content through search engines rather than portals. In addition, the online game industry is evolving rapidly, so we need to anticipate new technologies and games and evaluate their possible market acceptance. We may be unable to recover our game development costs if our new online games are less attractive to users. In addition, with the development of 2.5G and even 3G technology, the focus of wireless applications has been transferred from text message services to multi-media message services, wireless games, wireless downloads and other applications. Accordingly, we will need to adapt our business to cope with the changes and support these new services to be successful. In addition, the MIIT is cooperating with other administrations, including the Ministry of Public Security, the Ministry of Culture and the Ministry of Justice, to draft industry standards or regulations regarding Spyware software. If we cannot adapt to new industry standards, more technical expenses could be required in the future.

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

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

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

Table of Contents

We are required under U.S. GAAP to review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment annually, or more frequently if facts and circumstances warrant a review. Factors that may be considered a change in circumstances indicating that the carrying value of our amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization and slower or declining growth rates in our industry. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined.

We recorded goodwill of \$7.5 million related to our acquisition of Go2map for our sponsored search business. We assess the goodwill related to our sponsored search for impairment annually. In the assessment of goodwill impairment relating to our sponsored search business, both income approach and market approach were applied, in which the assumptions used were based on the information available to us at the time. Further decline in the performance of our sponsored search business and other factors may require us to record a significant impairment charge to earnings.

Any changes in accounting rules for share-based compensation may adversely affect our operating results, our stock price and our competitiveness in the employee marketplace.

Our performance is largely dependent on talented and highly skilled individuals. Our future success depends on our continuing ability to identify, develop, motivate and retain highly skilled personnel for all areas of our organization. We have a history of using employee share options and restricted stock units to align employees' interest with the interests of our shareholders and encourage quality employees to join us and retain our quality employees by providing competitive compensation packages. On January 1, 2006, we adopted revised guidance on accounting for share-based compensation, which requires the measurement and recognition of compensation expense for all share-based compensation based on estimated fair values. As a result, our operating results contain a charge for share-based compensation expense related to employee share options and restricted stock units. The recognition of share-based compensation in our statement of operations would have a negative effect on our reported results and earnings per share, which could in turn negatively affect our stock price. On the other hand, if we alter our employee stock incentive plan to minimize the share-based compensation expenses, it may limit our ability to continue to use share-based awards as a tool to attract and retain our employees, and it may adversely affect our operations. We cannot assure that there will be no changes in the accounting rules for share-based compensation in future; thus our operating results, our stock price and our competitiveness in the employee marketplace may be adversely affected.

Any utilization of U.S. federal net operating losses generated from excess tax deductions related to share-based awards will be recorded in shareholders' equity

Sohu.com Inc. may utilize excess tax benefits from U.S. federal net operating losses (NOL) generated from excess tax deductions related to share-based awards (windfall tax benefit) to offset their U.S. taxable income. However, in accordance with U.S. GAAP, this windfall tax benefit will be charged to the shareholders' equity section in our consolidated balance sheets rather than offsetting current year income tax expenses. Realizing this benefit reduces the amount of taxes payable in the U.S. and does not otherwise involve cash flows. Current year income tax expenses still arise due to having U.S. taxable income. For the year ended December 31, 2009, we realized \$3.9 million of such items and we recorded \$3.9 million income tax expenses for U.S. taxable income.

Our failure to manage growth and diversify our business could harm us.

We have experienced dramatic growth in personnel in the past five years and we expect to continue to hire additional personnel in selected areas. This growth requires significant time and resource commitments from us and our senior management. If we are unable to effectively manage a large and geographically dispersed group of employees or anticipate our future growth, our business could be adversely affected.

Additionally, our business relies on our financial reporting and data systems (including our systems for billing users of our fee-based services), which have grown increasingly complex in the recent past due to acquisitions and the diversification and complexity of our business. Our ability to operate our business efficiently depends on these systems, and if we are unable to adapt to these changes, our business could be adversely affected.

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

We rely on a number of third party relationships to provide high-quality video, audio and text content in order to make our Websites more attractive to users and advertisers. Most of our arrangements with content providers are short-term and may be terminated at the convenience of the other party. Most content providers have increased the fees they charge us for their content. This trend could increase our costs and operating

Edgar Filing: SOHU COM INC - Form 10-K

expenses and could adversely affect our ability to obtain content at an economically acceptable cost. We have also entered into exclusive agreements with some of our video content providers. If we are not able to renew our exclusive deals or video content become exclusive to our competitors, our attractiveness to users will be severely impaired. Except for the exclusive content, much of the third party content provided to our Websites is also available from other sources or may be provided to other Internet companies. If other Internet companies present the same or similar content in a superior manner, it would adversely affect our visitor traffic.

-34-

Table of Contents

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

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

Our future success is heavily dependent upon the continued service of our key executives, particularly Dr. Zhang, who is the founder, Chief Executive Officer, Chairman of the Board, and a major shareholder of our company. We rely on his expertise in our business operations. Our future success in online game business depends substantially on the continued services of Changyou's executive officers and its key development personnel, such as Changyou's Chief Executive Officer, Tao Wang, who has been instrumental in the development of TLBB, its Chief Technology Officer, Xiaojian Hong, and its President and Chief Operating Officer, Dewen Chen. We also rely on other senior executives. If one or more of our key executives and employees are unable or unwilling to continue in their present positions, we may not be able to replace them easily and our business may be severely disrupted. In addition, if any of our key executives or employees joins a competitor or forms a competing company, we may lose know-how, key professionals and staff members as well as customers, suppliers and incur additional expenses to recruit and train personnel. Changyou's executive officers and key employees could develop and operate games that could compete with and take game players away from our existing and future games. Each of our executive officers has entered into an employment agreement and a confidentiality, non-competition and non-solicitation agreement with us. However, the degree of protection afforded to an employer pursuant to confidentiality and non-competition undertakings governed by PRC law may be more limited when compared to the degree of protection afforded under the laws of other jurisdictions. We do not maintain key-man life insurance for any of our key executives.

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

Changyou is rapidly expanding its business and need to hire a significant number of new employees. If Changyou is unable to attract a sufficient number of qualified new employees or retain its existing employees, its business prospects may be materially and adversely affected.

As Changyou is in the early stages of its development and its business is growing rapidly, it has needed, and expects to continue to need, to increase the number of its employees, including senior-level executives, experienced project managers and game development personnel. The number of its employees nearly doubled between the end of 2008 and the end of 2009. Online game industry in China is characterized by high demand and intense competition for talent, particularly for game developers and related technical personnel, and Changyou may not be able to attract a sufficient number of additional qualified new employees or retain existing employees to meet the growth of our business, in which case Changyou's growth strategy and its business prospects could be materially and adversely affected.

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

We have limited operational, administrative and financial resources, which may be inadequate to sustain the growth we want to achieve. As the demands of our audience and the needs of our customers change, as the number of our users and volume of online advertising, and wireless activities increase, and as requirements for maintaining sufficient servers to provide high-definition online video and to provide game players smooth online game experiences increase, we will need to increase our investment in our network infrastructure, facilities and other areas of operations. If we are unable to manage our growth and expansion effectively, the quality of our services could deteriorate and our business may suffer. Our future success will depend on, among other things, our ability to:

adapt our services and maintain and improve the quality of our services;

protect our Website from hackers and unauthorized access

continue training, motivating and retaining our existing employees and attract and integrate new employees; and

develop and improve our operational, financial, accounting and other internal systems and controls.

We face risks related to health epidemics and other outbreaks.

Our business could be adversely affected by the effects of H1N1 flu, avian flu, SARS or other epidemics or outbreaks. China reported a number of cases of SARS in April 2003. In recent years, there have been reports of occurrences of H1N1 flu and avian flu in various parts of China, including a few confirmed human cases and deaths. Any prolonged recurrence of H1N1 flu, avian flu, SARS or other

Table of Contents

adverse public health developments in China may have a material adverse effect on our business operations. These could include illness and loss of our management and key employees, as well as temporary closure of our offices and related business operations, such as server operations, upon which we rely. Such loss of management and key employees or closures would severely disrupt our business operations and adversely affect our results of operations. We have not adopted any written preventive measures or contingency plans to combat any future outbreak of H1N1 flu, avian flu, SARS or any other epidemic. In addition, other major natural disasters may also adversely affect our business by, for example, causing disruptions of the Internet network or otherwise affecting access to our portals and our games. For example, after the Sichuan earthquake in May 2008, we suspended our delivering of online advertisements and our MMORPG operations during a three-day national mourning period.

We do not have business insurance coverage.

The insurance industry in China is still at an early stage of development. Insurance companies in China offer limited business insurance products, or offer them at a high price. As a result, we do not have any business liability, loss of data or disruption insurance coverage for our operations in China. Any business disruption, litigation or natural disaster might result in our incurring substantial costs and the diversion of our resources.

We depend on online advertising for a significant portion of our revenues, but the online advertisement market includes many uncertainties, which could cause our advertising revenues to decline.

We derive a significant portion of our revenues, and expect to derive a significant portion of our revenues for the foreseeable future, from the sale of advertising on our Websites. Advertising revenues represented approximately 36% and 41% of our total revenues for the years ended December 31, 2009 and 2008 respectively. For the years ended December 31, 2009 and 2008, sales to our five largest advertisers accounted for approximately 15% of our total brand advertising revenues. The growth of our advertising revenues relies on increased revenue from the sale of advertising spaces on our Websites, which may be affected by many of the following risk factors:

The online advertising market is new and rapidly evolving, particularly in China. As a result, many of our current and potential advertising clients have limited experience using the Internet for advertising purposes and historically have not devoted a significant portion of their advertising budget to Internet-based advertising.

Changes in government policy could restrict or curtail our online advertising services. For example, during the last several years, the PRC government enacted a series of regulations, administrative instructions and policies to restrict online medical advertising. As a result of these regulations, we may lose some of our existing medical advertising clients.

Advertising clients may adopt the new methods and strategies other than online advertising to promote their brand and therefore our advertising revenue would be negatively affected.

The acceptance of the Internet as a medium for advertising depends on the development of a measurement standard. No standards have been widely accepted for the measurement of the effectiveness of online advertising. Industry-wide standards may not develop sufficiently to support the Internet as an effective advertising medium. If these standards do not develop, advertisers may choose not to advertise on the Internet in general or through our portals or search engines.

In addition, our ability to generate and maintain significant online advertising revenues will also depend upon:

the development of a large base of users possessing demographic characteristics attractive to advertising clients;

the acceptance of online advertisement as an effective way for business marketing by advertising clients;

the effectiveness of our advertising delivery, tracking and reporting systems; and

the resistance pressure on online advertising prices and limitations on inventory.

We rely on advertising agencies to sell our brand advertising services. If current trends of consolidation of advertising agencies in the Chinese market continue, the bargaining power of the large advertising agencies resulting from such consolidation may permit them to require that we pay higher sales rebates, which would adversely affect our gross margin.

Most of our brand advertising services are distributed by advertising agencies. In 2009, for example, approximately 94% of our brand advertising revenues were derived from advertising agencies. In consideration for these agencies' services, we are required to pay certain percentages of revenues as sales rebates. During 2009, the biggest 10 advertising agencies in China contributed approximately 50% of our brand advertising revenue. These advertising agencies currently are seeking consolidation in the market.

Table of Contents

If the online advertising market is consolidated and effectively controlled by a small number of large advertising agencies, such advertising agencies may be in a position to demand higher sales rebates based on increased bargaining power, which could negatively affect our brand advertising growth as we book our brand advertising revenue netted off our sales rebates to advertising agencies.

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

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

Our failure to retain key distributors or attract additional distributors for our sponsored search customers could have an adverse impact on our business.

Sponsored search is at an early stage of development in China and is not as widely accepted by or available to businesses in China as in the United States. As a result, we rely heavily on our nationwide distribution network of third-party distributors for our sales to, and collection of payment from, our sponsored search customers. If our distributors do not provide quality services to our customers or otherwise breach their contracts with them, we may lose our customers. We do not have long-term agreements with any of our distributors, including our key distributors, and cannot assure that we will continue to maintain favorable relationships with them.

We rely on our Website Alliance members for a significant portion of our sponsored search revenues. If we fail to retain existing Website Alliance members or attract additional members, our revenues and growth may be adversely affected.

By posting bid listing links on their Websites, we share the revenues generated from clicks by users with our Website Alliance members. For the year ended December 31, 2009, the total revenues generated from Website Alliance accounted for approximately 50% of our total bid listing revenues. We consider our Website Alliance critical to the future growth of our sponsored search revenues. If our Website Alliance members decide to use a competitor's or their own Internet search services, or if we fail to attract additional Websites to join our Website Alliance, our sponsored search revenues may decline.

Restrictions on online music search may adversely affect our online search business

On September 3, 2009, the MOC issued a Notice on Strengthening and Improving the Content Censorship of Online Music Content (or the *MOC Notice*). The *MOC Notice* provides that providing direct links to online music will constitute engaging in online music business, and that therefore the Online Culture Operating Permit is required for providing such search services. In addition, the *MOC Notice* also requires any domestic music products to be filed for record with the MOC within 30 days after being made available online. Further, the *MOC Notice* provides that imported music products, must be approved by the MOC before being made available online.

To comply with this provision, we have filed an application for an Online Culture Operating Permit with the MOC for our Sogou entity. However, we cannot assure you that our Sogou entity will be approved to receive the license. If we are unable to obtain the license, our search business could be severely adversely affected. We cannot assure you that we have fully complied with the *MOC Notice* approval and filing procedures. In order to comply with the requirements of the *MOC Notice*, it may be necessary for us to change or improve our search model and technology. These restrictions may result in higher costs for our search engine operation, which may have an adverse effect on our profitability.

Our online game business may not succeed in a highly competitive market.

Competition in the online game market in China is becoming increasingly intense. For example, according to data from the *2009 China Online Game Market White Paper* issued by the Ministry of Culture of the People's Republic of China (MOC), there were about 360 new games launched in China in 2009, and the number of new game launches in 2010 is forecasted to reach 400. There were four online game companies, Perfect World Co., Ltd., Giant Interactive Group Inc., Kingsoft Corporation Limited and NetDragon Websoft Inc., that successfully listed their shares on Nasdaq, the New York Stock Exchange or the Hong Kong Stock Exchange in the second half of 2007 alone, adding to the previously listed public companies focusing on the online game market in China, such as NetEase.com, Inc., Tencent Holdings Limited and The9 Limited, most of which focus on MMORPGs. In September 2009, Shanda Games Limited, which engaged in online game business, was carved out from Shanda Interactive Entertainment Limited and listed its shares on Nasdaq. Moreover, there are many venture-backed private companies focusing on online game development, and MMORPG development in particular, further intensifying the competition. Recently, many of our competitors

Table of Contents

have been aggressively hiring talent for game development, increasing spending on marketing for games and bidding for licenses of games. We have also observed that there are some online games operated in China that include similar elements of design and game concepts to those of TLBB, which could have an adverse effect on the potential for increases in the number of players of TLBB. Increased competition in the online game market may make it difficult for us to retain our existing employees and attract new employees, and to sustain our growth rate. Furthermore, we also face intense competition for cost-effective marketing resources for online games, such as online game-related Websites, which could drive up our marketing costs and decrease the effectiveness of our marketing campaigns.

There are uncertainties regarding the future growth of the online game industry in China.

The online game industry, from which we derive a significant percentage of our revenues, is a relatively new and evolving industry. The growth of the online game industry and the level of demand and market acceptance of our online games are subject to a high degree of uncertainty. Our future operating results will depend on numerous factors affecting the online game industry, many of which are beyond our control, including:

the growth of personal computer, Internet and broadband users and penetration in China and other markets in which we offer our games, and the rate of any such growth;

whether the online game industry, particularly in China and the rest of the Asia-Pacific region, continues to grow and the rate of any such growth;

general economic conditions, particularly economic conditions adversely affecting discretionary consumer spending, such as the slowdown in Chinese economy growth between the third quarter of 2007 and the first quarter of 2009;

the availability and popularity of other forms of entertainment, particularly games of console systems, which are already popular in developed countries and may gain popularity in China; and

changes in consumer demographics and public tastes and preferences.

There is no assurance that online games, in particular MMORPGs, will continue to be popular in China or elsewhere. A decline in the popularity of online games in general, or the MMORPGs that we operate, will likely adversely affect our business and prospects.

Further strengthened supervision of the online game industry may adversely affect our online game operation

Under the GAPP Notice, GAPP is the only authority responsible for pre-examination and pre-approval of online games, and all online game operators must obtain an internet publishing license to provide online game services. Moreover, additional approvals from GAPP are required when game operators release new versions or expansion packs, or make any changes to the originally approved online game. In addition, on July 1, 2009, GAPP issued a *Notice on Strengthening the Approval and Administration of Imported Online Games*; pursuant to this notice, GAPP is the only authority authorized by the State Council to approve the importation of online games from offshore copyright owners. In the event of any failure to meet the above-mentioned requirements, an operator may face heavy penalties, such as being ordered to stop operation, or having its business license revoked. Our online game business may be adversely affected by these two GAPP notices. The launch of expansion packs and imported games might be delayed because of the extra approval required. Such delay in releasing expansion packs or imported games may result in higher costs for our online game operation and have an adverse effect on our game revenue.

We do not hold Internet publishing licenses that are required under PRC regulations for the games we currently operate, due to the temporary suspension, effective since our inception, of the issuance of such licenses by GAPP. If GAPP later challenges the commercial operation of our games, or if we fail to obtain or renew necessary licenses to commercially operate our games, we may be subject to various penalties, including restrictions on our operations.

Pursuant to PRC regulations issued by GAPP and MIIT relating to the regulation of online publication, an online game operator needs to obtain an Internet publishing license in order to directly make its online games publicly available in the PRC, as operating online games is deemed to be an online publishing activity. Changyou does not hold such licenses, as GAPP temporarily suspended the issuance of such licenses. Prior to

the transfer of all of the assets and operations relating to Sohu's MMORPG business unit to

Table of Contents

Changyou on December 1, 2007, our MMORPGs TLBB and BO were published in China under an Internet publishing license held by Sohu Internet, a VIE of Sohu, and electronic publication licenses held by third-party publishers. TLBB and BO are currently published in China as electronic publications by the same third-party publishers. The current PRC regulations are not clear as to the consequence of operating without an Internet publishing license. We have made oral inquiries with the officials at GAPP and have been informed that GAPP is aware of and does not object to such practice, so long as the applications for the Internet publishing licenses for such online games have been filed with GAPP. We applied for Internet publishing licenses with respect to our existing games in operation. However, we may not be able to obtain Internet publishing licenses for our games. If our current practice is later challenged by GAPP, we may be subject to various penalties, including fines, confiscation of publishing equipment and the revenues generated from the illegal publishing activities, the revocation of our business license, or the forced discontinuation or restriction on our operations.

There are currently no laws or regulations in the PRC governing property rights of virtual assets and therefore it is not clear what liabilities, if any, we may have relating to the loss of virtual assets by our game players.

In the course of playing our games, TLBB and the BO series including BO and BH2, some virtual assets, such as game player experience, skills and weaponry, are acquired and accumulated. Such virtual assets can be highly valued by game players and in some cases are traded among game players for real money or assets. In practice, virtual assets can be lost for various reasons, such as data loss caused by delay of network service by a network crash, or by hacking activities. There are currently no PRC laws and regulations governing property rights of virtual assets. As a result, it is unclear who the legal owner of virtual assets is and whether the ownership of virtual assets is protected by law. In addition, it is unclear under PRC law whether an operator of online games such as us would have any liability (whether in contract, tort or otherwise) for loss of such virtual assets by game players. Based on several judgments regarding the liabilities of online game operators for loss of virtual assets by game players, the courts have generally required the online game operators to provide well-developed security systems to protect such virtual assets owned by game players. In the event of a loss of virtual assets, we may be sued by game players and may be held liable for damages.

We may fail to maintain a stable and efficient physical distribution network for our prepaid online game cards.

Online payment systems in China are in a developmental stage and are not as widely available to or accepted by consumers in China as they are in the United States. We rely heavily on a physical distribution network composed of third-party distributors to cover a network of retail outlets across China for the sales of our prepaid game cards to our game players. As a result, our revenues could be adversely affected by the under-performance of our distributors, such as the failure to meet minimum sales or penetration targets or the failure to establish an extensive retail network. We generally sign one-year agreements with our distributors. We may not continue to maintain favorable relationships with them. In addition, our distributors may violate our distribution agreements. Such violations may include, among other things, their:

failure to maintain minimum price levels for our prepaid game cards in accordance with our distribution agreements;

failure to properly promote our MMORPGs in local Internet cafés and other important outlets, or cooperate with our sales and marketing team's efforts in their designated territories; and

selling our prepaid game cards outside their designated territories.

In the past, some of our distributors have failed to carry out their obligations in accordance with the distribution agreements, which resulted in our termination of our distribution relationship with them. If we decide to penalize, suspend or terminate our distributors for acting in violation of our distribution agreements, or if the distributors fail to address material violations committed by any of their retail outlets in a timely manner, our ability to effectively sell our prepaid game cards in any given territory could be negatively impacted, which could materially and adversely affect our online game revenues.

We could be liable for breaches of security of our and third-parties' online payment platforms, and sales made through those channels might have a negative impact on our online game revenues.

Currently, we directly sell a substantial portion of virtual prepaid game cards and game points to our game players through third-party online payment platforms. In all these online transactions, secured transmission of confidential information, such as customers' credit card numbers and expiration dates, personal information and billing addresses, over public networks is essential to maintain consumer confidence. In addition, we expect that an increasing amount of our sales will be conducted over the Internet as a result of the growing use of online payment systems. As a result, the associated online crime will likely increase as well. Our current security measures and those of the third parties with whom we

Edgar Filing: SOHU COM INC - Form 10-K

transact business may not be adequate. We must be prepared to increase our security measures and efforts so that our game players have confidence in the reliability of the online payment systems that we use, which will require additional costs and expenses and may still not be completely safe. In addition, we do not have control over the security measures of our third-party online payment vendors. Security breaches of the online payment systems that we use could expose us to litigation and possible liability for failing to secure confidential customer information and could harm our reputation, ability to attract customers and ability to encourage customers to purchase virtual items.

-39-

Table of Contents

If we fail to satisfy the changing demands of game players, our online game revenues may be adversely affected.

We depend on purchase and continual consumption of virtual items by our game players to generate revenues, which in turn depends on the continued attractiveness of our games to the game players and their satisfactory game-playing experience. We provide support for our games and collect game players' feedback on their game-playing experience in order to resolve any programming flaws or other game operational issues in a timely manner. We also use software and systems to monitor game players' preferences in order to develop and improve game features and virtual items in a way that is attractive to our game players. We continue to improve our games through regular updates as well as periodic major enhancements using expansion packs. However, we cannot assure you that our efforts will be effective in eliminating program errors associated with our games, satisfying game player demands, or retaining the continued attractiveness of our games. For example:

we may fail to provide game updates and expansion packs in a timely manner due to technologies, resources or other factors;

our game updates and expansion packs may contain program errors, and their installation may create other unforeseen issues that adversely affect the game-playing experience;

we may fail to timely respond and/or resolve complaints from our game players;

we may fail to eliminate the computer bots which may destroy harmonious game environment and reduce the attractiveness of our games; and

our game updates and expansion packs may change rules or other aspects of our games that our game players do not welcome, resulting in reduction of peak concurrent users and/or average concurrent users of our games.

Our failure to address the above-mentioned issues could adversely affect the game-playing experience of our game players, damage the reputation of our games, shorten the lifespan of our games, and eventually result in the loss of game players and a decrease in our online game revenues.

Furthermore, for the games that we license from third parties, we may not have access to the game source codes during the initial period of the license or at all. Without the source codes, we have to rely on the licensors to provide updates and enhancements during the initial period, giving us less control over the quality and timeliness of updates and enhancements. If our game players are not satisfied with the level of services they receive, they may choose to not play the games, leading to a decrease in our online game revenues.

We may fail to launch new games according to our timetable, and our new games may not be commercially successful, or may attract game players away from our existing games.

We must introduce new games that can generate additional online game revenue and diversify our online game revenue source in order to remain competitive. We have several games in the pipeline, DMD, ZHYX, DSH, IF and LAW. We expect to begin open beta testing of these games in 2010. We are developing DMD in-house and we have licensed ZHYX, DSH, IF and LAW from third-party developers. We will not generate any revenue from a game until it enters open beta testing. However, we cannot assure you that we will be able to meet our timetable for new game launches. A number of factors, including technical difficulties, lack of sufficient game development personnel and other resources, relevant authorities' approvals and adverse developments in our relationship with the licensors of our new licensed games could result in delayed launching of our new games. In addition, we cannot assure you that our new games will be as well received in the market as TLBB, and you should not use TLBB as an indication of the commercial success of our future games. There are many factors that may adversely affect the popularity of our new games. For example, we may fail to anticipate and adapt to future technical trends, new business models and changed game player preferences and requirements, fail to effectively plan and organize marketing and promotion activities, or fail to differentiate our new games from our existing games. If the new games we introduce are not commercially successful, we may not be able to recover our product development costs, which can be significant.

In addition, our new games may attract game players away from our existing games. In particular, DMD is an MMORPG based on a novel written by Louis Cha, the same author of *Tian Long Ba Bu*, based on which we developed TLBB. We cannot assure you that our TLBB game

Edgar Filing: SOHU COM INC - Form 10-K

players will not be attracted to play DMD instead of TLBB after DMD's launch. If this occurred, it would decrease our existing games' player bases, which could in turn make these games less attractive to other game players, resulting in decreased online game revenues from our existing games. Game players of our existing games may also spend less money to purchase virtual items in our new games than they would have spent if they had continued playing our existing games, which could materially and adversely affect our total online game revenues.

-40-

Table of Contents

All of our online game revenues are generated under the item-based revenue model, which has a short history of commercial application and presents risks related to consumer preferences and regulatory restrictions.

When we first launched BO in October 2004, it generated revenue under the time-based revenue model. Currently, we operate our games, TLBB and the BO series, under the item-based revenue model. Under this revenue model, our game players are free to play the games for an unlimited amount of time, but are charged for the purchases of certain virtual items. We currently expect that a substantial majority of our revenues, including revenues from all of our current pipeline games, will continually be generated under the item-based revenue model. The item-based revenue model requires us to design games that not only attract game players to spend more time playing, but also encourage them to purchase virtual items. The sale of virtual items requires us to track closely consumer tastes and preferences, especially as to in-game consumption patterns. If we fail to design virtual items so as to incentivize game player to purchase them, we may not be able to effectively translate our game player base and their playing time into revenues. Although the item-based revenue model is currently a prevalent revenue model for MMORPGs in China, it does not have a long history of proven commercial application. In addition, the item-based revenue model may cause additional concerns with PRC regulators who have been implementing regulations designed to reduce the amount of time that Chinese youths spend on online games and intended to limit the total amount of virtual currency issued by online game operators and the amount of purchase by individual game player. A revenue model that does not charge for time may be viewed by the PRC regulators as inconsistent with this goal. We cannot assure you that the item-based revenue model will continue to be commercially successful, or that we will not in the future need to change our revenue model back to the time-based revenue model or to a new revenue model. Any change in revenue model could result in disruption of our game operations and decrease in the number of our game players.

The PRC government has begun to tighten its regulation of Internet cafés, which are currently one of the primary places where our games are played. Stricter government regulation of Internet cafés could restrict our ability to maintain or increase our revenues and our game player base.

Internet cafés are one of the primary places where our games are played. In April 2001, the PRC government began tightening its regulation and supervision of Internet cafés. In particular, a large number of Internet cafés without requisite government licenses have been closed. In addition, the PRC government has imposed higher capital and facility requirements for the establishment of Internet cafés. The PRC government's policy, which encourages the development of a limited number of national and regional Internet cafe chains and discourages the establishment of independent Internet cafés, may also slow down the growth in the number of new Internet cafés. In February 2007, several central governmental authorities jointly issued a notice suspending the issuance of new Internet cafe licenses, and the total number of Internet Cafes nationwide is restricted and controlled by the relevant authorities. Governmental authorities may from time to time impose stricter requirements, such as the customers' age limit and hours of operation, among others, as a result of the occurrence and perception of, and the media attention on, gang fights, arson and other incidents in or related to Internet cafés. So long as Internet cafés remain as one of the primary places for game players to play our games, any reduction in the number, or any slowdown in the growth, of Internet cafés or restrictions in their operations in China could limit our ability to maintain or increase our revenues and our game player base, thereby adversely affecting our results of operations and business prospects.

Our online game business may be materially harmed if we do not feature our games in a sufficient number of Internet cafés in China.

A substantial number of players access our games through Internet cafés. Due to limited hardware capacity, Internet cafés generally feature a limited number of games on their computers. We thus compete with a growing number of other online game operators to ensure that our games are featured on these computers. This competition may intensify in China due to a nationwide suspension of approval for the establishment of new Internet cafés in 2007, and the restrictions and control on the total number of Internet cafés nationwide by the MOC thereafter. We take steps to ensure that our games are featured in a sufficient number of Internet cafés, including maintaining good relationships with Internet café administrators, requiring our distributors to maintain a sales presence in a wide range of Internet cafés and general sales and marketing efforts. If we fail to maintain good relationships with Internet café administrators, or if we and/or our distributors fail to successfully persuade Internet cafés to feature our online games on their computers, our business, financial condition and operating results may be materially and adversely affected.

Further, pursuant to the Internet Cafés Notice, Internet cafés are required to obtain an Online Culture Operating Permit from the MOC and register the same with the State AIC. The Internet Cafés Notice also provides restrictions with respect to Internet cafés' location, size, number of computers, business hours and the ages of customers. For instance, Internet cafés are prohibited from operating between the hours of 12 a.m. and 8 a.m. These regulatory restrictions on the operation of Internet cafés may negatively affect our online game business operations.

Restrictions on Virtual Currency may adversely affect our online game revenue.

Our online game revenues are collected through the sale of our prepaid cards or online sale of game points. Pursuant to the Internet Cafés Notice, the People's Bank of China has been directed to strengthen the administration of virtual currency in online games to avoid any adverse

Edgar Filing: SOHU COM INC - Form 10-K

impact on the economic and financial order. This notice provides that the total amount of virtual currency issued by online game operators and the amount purchased by individual users should be strictly limited, with a strict and clear division between virtual transactions and real transactions carried out by way of electronic commerce. This notice also provides that virtual currency

Table of Contents

should only be used to purchase virtual items. Pursuant to the Virtual Currency Notice, the authorities for the first time define Virtual Currency as a type of virtual exchange instrument issued by online game operators, purchased directly or indirectly by the game user by exchanging legal currency at a certain exchange rate, saved outside the game programs, stored in servers provided by the online game operators in electronic record format and represented by specific numeric units. In addition, the Virtual Currency Notice categorizes companies involved with virtual currency as either issuers or trading platforms and prohibits companies from simultaneously engaging as both issuer and trading platform. Most importantly, one of the Virtual Currency Notice's stated intended objectives is to limit the circulation of virtual currency and thereby reduce concerns that it may impact real world inflation. Specifically, the Virtual Currency Notice provides that online game operators are required to report the total amount of their issued virtual currencies on a quarterly basis and game operators are prohibited from issuing disproportionate amounts of virtual currencies in order to generate revenues. In addition, the Virtual Currency Notice reiterates that virtual currency can only be provided to users in exchange for an RMB payment and can only be used to pay for virtual goods and services of the issuers. Online game operators are strictly prohibited from providing lucky draws or lotteries which are conducted on the condition that participants contribute cash or virtual currencies in exchange for game props or virtual currencies. The Virtual Currency Notice also places potentially burdensome obligations on online game operators, including a requirement that operators keep transaction data records for no less than 180 days and a prohibition on operators providing virtual currency trading services to minors. In order to comply with the requirements of the Virtual Currency Notice, it may be necessary for us to change our virtual currency distribution channel, and our business model may be affected accordingly and we may put more effort in maintaining our database so as to keep users' information longer. These restrictions may result in higher costs for our online game operation and lower sales of our prepaid cards or game points, which may have an adverse effect on our games revenues.

We rely on data recorded in our online game billing systems for revenue recognition as well as identification of game player consumption patterns of virtual items. If such billing systems fail to operate effectively, it will not only affect the completeness and accuracy of the recognition of our revenues, but also our ability to design and improve virtual items that appeal to game players.

Our online game revenues are collected through the sale of our prepaid cards or online sale of game points. However, we do not recognize revenue when our prepaid card or game points are sold. Rather, our online game revenues are recognized when the virtual items purchased by our game players are consumed. For consumable virtual items, including those with a pre-determined expiration time, revenues are recognized as they are consumed, and for perpetual virtual items, revenues are recognized over their estimated lives. We rely on our online game billing systems to capture the purchase and consumption of virtual items by our game players. If our online game billing systems fail to accurately record the purchase and consumption information of the virtual items, we may not be able to accurately recognize our revenues. In addition, various factors affect the estimated lives of perpetual virtual items, such as the average period that game players typically play our games and other game players behavior patterns, the acceptance and popularity of expansion packs, promotional events launched and market conditions, and we rely on our online game billing systems to capture such historical game players' behavior patterns and other information. If such information is not accurately recorded, or if we do not have sufficient information due to the short operating history of MMORPGs, we will not be able to accurately estimate the lives of the perpetual virtual items, which will also affect our ability to accurately recognize our online game revenues from such perpetual virtual items. Therefore, if our online game billing systems were damaged by system failure, network interruption, or virus infection, or attacked by a hacker, the integrity of data would be compromised, which could have a significant affect on our online game revenue recognition and the accuracy of our recorded online game revenues, resulting in possible restatement of our financial statements and loss of investor confidence in us.

In addition, we rely on our online game billing systems to record game player consumption patterns, based on which we improve our existing virtual items and design new virtual items. For example, we intend to increase development efforts on the number and variety of virtual items that our game players like to purchase, and may also adjust prices accordingly. If our online game billing systems fail to record such data accurately, our ability to improve existing virtual items or design new virtual items that are appealing to our game players may be adversely affected, which could in turn materially and adversely affect our online game revenues.

We incur additional costs and face significant risks when we license our games outside of China and seek to expand our operations to select markets, such as the United States, Europe and Malaysia. If we fail to manage these risks, our growth and business prospects could be materially and adversely affected.

We currently license TLBB to third-party operators to operate the game in Taiwan, Hong Kong, Vietnam, Malaysia and Singapore. Pursuant to our strategy, we plan to continue to license TLBB and other future games in these and other overseas markets. We have also expanded our direct MMORPG operations to select markets, such as the United States, the United Kingdom and Malaysia. Identifying appropriate overseas markets, negotiating with potential third-party licensees and managing our relationships with our licensees all require substantial management effort and skills and the incurrence of additional expenditures. Licensing games, or operating them directly in overseas also requires translation of our games to the local language of the overseas market in which we plan to lic