SOHU COM INC
Form 10-Q
May 08, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2007

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	**98-0204667**
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	**(I.R.S. EMPLOYER IDENTIFICATION NUMBER)**

Level 12, Sohu.com Internet Plaza

No. 1 Unit Zhongguancun East Road, Haidian District

Beijing 100084

People s Republic of China

(011) 8610-6272-6666

(Address, including zip code, of registrant s principal executive offices

and registrant s telephone number, including area code)

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

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

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

Class	Outstanding at April 18, 2007
Common stock, $.001 par value	**36,831,406**

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PART I FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

SOHU.COM INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

	As of March 31, 2007 (unaudited)	December 31, 2006 (audited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 92,573	$ 124,756
Accounts receivable, net (including $68 and $286 from a related party, respectively)	27,465	23,825
Prepaid and other current assets	7,434	5,961
Current portion of long-term investments in marketable debt securities	4,957	4,942
Total current assets	132,429	159,484
Investment in an associate	1,254	1,296
Fixed assets, net	57,590	21,453
Goodwill	55,052	54,986
Intangible assets, net	7,744	8,360
Restricted cash	3,784	4,774
Other assets, net	2,673	3,238
	$ 260,526	$ 253,591
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,614	$ 1,177
Accrued liabilities	33,784	36,618
Zero coupon convertible senior notes	59,780	59,780
Total current liabilities	95,178	97,575
Commitments and contingencies (Note 8)		
Minority interests	41	53
Shareholders equity:		
Common stock: $0.001 par value per share (75,400 authorized; 36,789 and 36,647 shares issued and outstanding, respectively)	41	41

Additional paid-in capital	165,053	161,033
Treasury stock (4,137 shares)	(54,686)	(54,686)
Accumulated other comprehensive income	5,960	5,102
Retained earnings	48,939	44,473
Total shareholders equity	165,307	155,963
	$ 260,526	$ 253,591

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

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SOHU.COM INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

(In thousands, except per share data)

	Three Months Ended March 31, 2007	2006
Revenues:		
Advertising:		
Brand advertising	$ 23,527	$ 16,675
Sponsored search	2,086	3,450
Subtotal of advertising revenues	25,613	20,125
Non-advertising:		
Wireless	5,576	8,009
Others	1,897	2,280
Subtotal of non-advertising revenues	7,473	10,289
Total revenues	33,086	30,414
Cost of revenues:		
Advertising:		
Brand advertising (including share-based compensation expense under SFAS 123(R) of $412 and $339, respectively)	8,144	4,331
Sponsored search (including share-based compensation expense under SFAS 123(R) of $19 and $22, respectively)	1,578	1,092
Subtotal of cost of advertising revenues	9,722	5,423
Non-advertising:		
Wireless	2,610	3,812
Others (including share-based compensation expense under SFAS 123(R) of $4 and $5, respectively)	693	792
Subtotal of cost of non-advertising revenues	3,303	4,604
Total cost of revenues	13,025	10,027
Gross profit	20,061	20,387
Operating expenses:		
Product development (including share-based compensation expense under SFAS 123(R) of $796 and $493, respectively)	4,954	4,243
Sales and marketing (including share-based compensation expense under SFAS 123(R) of $447 and $448, respectively)	7,290	6,374
General and administrative (including share-based compensation expense under SFAS 123(R) of $806 and $424, respectively)	3,358	3,076
Amortization of intangible assets	379	509

Total operating expenses		15,981		14,202
Operating profit		4,080		6,185
Other expenses		(120)		(68)
Interest income		769		529
Income before income tax expense		4,729		6,646
Income tax expense		(282)		(443)
Income from continuing operations		4,447		6,203
Minority interests		12		
Net income from continuing operations		4,459		6,203
Gain (loss) from discontinued e-commerce operations		7		(165)
Net income	$	4,466	$	6,038
Basic net income per share	$	0.12	$	0.16
Shares used in computing basic net income per share		36,722		36,768
Diluted net income per share	$	0.12	$	0.16
Shares used in computing diluted net income per share		38,986		39,384

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

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SOHU.COM INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

(In thousands)

	Three Months Ended March 31, 2007	2006
Cash flows from operating activities:		
Net income	$ 4,466	$ 6,038
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	2,174	1,293
Amortization of intangible assets and other assets	830	1,040
Provision for allowance for doubtful accounts	427	237
Share-based compensation expense	2,484	1,731
Excess tax benefits from share-based payment arrangements	(79)	
Others	232	428
Changes in assets and liabilities:		
Accounts receivable	(3,988)	(5,685)
Prepaid and other current assets	(1,878)	334
Accounts payable	436	519
Accrued liabilities	(1,329)	(1,160)
Net cash provided by operating activities	3,775	4,775
Cash flows from investing activities:		
Purchase of fixed assets	(38,380)	(1,853)
Decrease of restricted cash	990	
Purchase of other assets	(16)	(55)
Acquisitions, net of cash acquired	(637)	
Net cash used in investing activities	(38,043)	(1,908)
Cash flows from financing activities:		
Issuance of common stock	1,429	1,026
Excess tax benefits from share-based payment arrangements	79	
Net cash provided by financing activities	1,508	1,026
Effect of exchange rate change on cash and cash equivalents	577	546
Net (decrease) increase in cash and cash equivalents	(32,183)	4,439
Cash and cash equivalents at beginning of period	124,756	119,091
Cash and cash equivalents at end of period	$ 92,573	$ 123,530

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

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SOHU.COM INC.

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (unaudited)

(In thousands)

	Three Months Ended March 31, 2007	2006
Common stock:		
Balance, beginning of period	$ 41	$ 40
Issuance of common stock		
Balance, end of period	41	40
Additional paid-in capital:		
Balance, beginning of period	161,033	148,780
Issuance of common stock	1,429	1,026
Compensatory share-based awards	2,484	1,731
Tax benefits from share-based awards	107	
Balance, end of period	165,053	151,537
Treasury stock:		
Balance, beginning and end of period	(54,686)	(39,686)
Accumulated other comprehensive income:		
Balance, beginning of period	5,102	2,126
Net unrealized gains (losses) on marketable debt securities	15	(7)
Foreign currency translation adjustment	843	667
Balance, end of period	5,960	2,786
Retained earnings:		
Balance, beginning of period	44,473	18,588
Net income	4,466	6,038
Balance, end of period	48,939	24,626
Total shareholders equity	$ 165,307	$ 139,303
Comprehensive income:		
Net income	$ 4,466	$ 6,038
Other comprehensive income:		
Net unrealized gains (losses) on marketable debt securities	15	(7)
Foreign currency translation adjustment	843	667
Total comprehensive income	$ 5,324	$ 6,698

	Number of Outstanding Shares	
Common stock:		
Balance, beginning of period	36,647	36,680
Issuance of common stock	142	173

Balance, end of period	36,789	36,853

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

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SOHU.COM INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. THE COMPANY AND BASIS OF PRESENTATION

Sohu.com Inc. (the Company or Sohu) is a leading online media, search and mobile value-added services company providing comprehensive online products and services to consumers and businesses in the People s Republic of China (the PRC or China). The Company, a Delaware corporation, commenced operations in 1996.

The Company, its subsidiaries and variable interest entities (or VIEs) primarily offer content, brand advertising, sponsored search, wireless and online game services through the Company s Internet sites, www.sohu.com, www.sogou.com, www.chinaren.com, www.17173.com, www.focus.cn, www.goodfeel.com.cn and www.go2map.com. The Company markets its products and services to consumers primarily in the PRC.

The accompanying unaudited condensed consolidated interim financial statements reflect all normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of the results for the interim periods presented. Results for the three months ended March 31, 2007 are not necessarily indicative of the results expected for the full fiscal year or for any future period.

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

These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

Accounting Policy on Uncertain Tax Positions

The Company adopted the Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes (or FIN 48), on January 1, 2007. FIN 48 prescribes a more likely than not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods, and income tax disclosures. As a result of the implementation of FIN 48, the Company did not have any adjustment to the opening balance of retained earnings as of January 1, 2007.

2. SEGMENT INFORMATION

Based on the criteria established by SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, the Company mainly operates in three principal segments: brand advertising, sponsored search and wireless. In June 2006, the Company terminated its e-commerce business. Accordingly, the results of operations for e-commerce have been reclassified as gains (losses) from discontinued operation for all periods presented.

The Company does not allocate any operating expenses or assets to its brand advertising, sponsored search, wireless and other segments as management does not use this information to measure the performance of the operating segments. Management does not consider share-based compensation for their segment reporting as shown in the tables, as such information does not impact the decisions on resource allocation and segment performance evaluation.

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

	Three Months Ended March 31, 2007				
	Brand Advertising	Sponsored Search	Wireless	Others	Total
Revenues	$ 23,527	$ 2,086	$ 5,576	$ 1,897	$ 33,086
Segment cost of revenues	(7,732)	(1,559)	(2,610)	(689)	(12,590)
Segment gross profit	$ 15,795	$ 527	$ 2,966	$ 1,208	$ 20,496
Share-based compensation expense under SFAS 123(R)					(435)
Gross profit					$ 20,061

	Three Months Ended March 31, 2006				
	Brand Advertising	Sponsored Search	Wireless	Others	Total
Revenues	$ 16,675	$ 3,450	$ 8,009	$ 2,280	$ 30,414
Segment cost of revenues	(3,992)	(1,070)	(3,812)	(787)	(9,661)
Segment gross profit	$ 12,683	$ 2,380	$ 4,197	$ 1,493	$ 20,753
Share-based compensation expense under SFAS 123(R)					(366)
Gross profit					$ 20,387

3. INCOME TAX EXPENSE

The Company is subject to taxes in the United States at 34% or 35%, depending upon taxable income levels. Certain of the Company s subsidiaries are subject to taxes in Hong Kong at 17.5% and certain subsidiaries are subject to taxes in China as disclosed below. The Company s subsidiaries in China are governed by the Income Tax Law of the People s Republic of China concerning Foreign Investment Enterprises and Foreign Enterprises and local income tax laws (the FIE and FE tax law). Pursuant to the FIE and FE tax law, wholly-owned foreign enterprises are subject to tax at a statutory rate of 33% (30% state income tax plus 3% local income tax), or 15% for certain technology enterprises, on PRC taxable income. Furthermore, new technology enterprises are exempted from Chinese state corporate income tax for three years, beginning with their first year of operations, and are entitled to a 50% tax reduction at the rate of 7.5% for the subsequent three years and 15% thereafter.

In March 2007, the Chinese government promulgated the Corporate Income Tax Law, which will be effective from January 1, 2008. The Corporate Income Tax Law will impose a unified income tax rate of 25% for both domestic and foreign invested enterprise. The existing tax laws, which stipulated income tax rates for domestic and foreign invested enterprises at different rates, will be abolished simultaneously. Currently, the Company s China-based subsidiaries and VIEs are subject to the tax rates under the existing tax laws. The Corporate Income Tax Law provides for a 5-year transitional period for those entities that were subject to FIE and FE tax laws in previous years. The reduced income tax rate for new technology enterprises remains at 15% under the Corporate Income Tax Law. However, the qualifying criteria of a new technology enterprise under the new law and detailed implementation rules have not been released. The Company will continue to assess the impact of such new law in the future.

The Company adopted FIN 48 on January 1, 2007. The Company did not have any adjustment to the opening balance of retained

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earnings as of January 1, 2007 as a result of the implementation of FIN 48. The Company s policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of January 1, 2007, the Company did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor recognize any interest expense during the three months ended March 31, 2007.

The Company has not been the subject of income tax audits by any U.S. federal, state or local authorities, or any non-U.S. taxing authorities, for several years.

4. NET INCOME PER SHARE

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

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

	Three Months Ended March 31, 2007	2006
Numerator:		
Net income from continuing operations	$ 4,459	$ 6,203
Gain (loss) from discontinued e-commerce operations	7	(165)
Net income	4,466	6,038
Effect of dilutive securities:		
Amortization of offering costs for the zero coupon convertible senior notes	124	155
Net income adjusted for dilutive securities	$ 4,590	$ 6,193
Denominator:		
Weighted average basic common shares outstanding	36,722	36,768
Effect of dilutive securities:		
Stock options and restricted stock units	928	945
Zero coupon convertible senior notes	1,336	1,671
Weighted average diluted common shares outstanding	38,986	39,384
Basic income per share from continuing operations	$ 0.12	$ 0.17
Basic gain (loss) per share from discontinued e-commerce operations		(0.01)
Basic net income per share	$ 0.12	$ 0.16
Diluted net income per share from continuing operations	$ 0.12	$ 0.16
Diluted loss per share from discontinued e-commerce operations		
Diluted net income per share	$ 0.12	$ 0.16

5. SHARE-BASED COMPENSATION EXPENSE

The Company s 2000 Stock Incentive Plan, including stock options and restricted stock units, provides for the issuance of up to 9,500,000 shares of common stock. The maximum term of any issued stock right is ten years from the grant date.

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The Company has reserved 9,500,000 shares of new common stock for issuance under the Company s 2000 Stock Incentive Plan. As of March 31, 2007, 948,411 shares were available for grant under the plan.

A summary of option activity under the plan as of March 31, 2007, and changes during the period then ended, is presented below:

Options	Number of Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value (in thousands)
Outstanding at January 1, 2007	2,580	$ 15.69	7.15	$ 23,206
Exercised	(135)	10.61		
Forfeited or expired	(37)	17.10		
Outstanding at March 31, 2007	2,408	15.95	6.91	$ 15,795
Vested and expected to vest at March 31, 2007*	2,160	15.83	6.80	$ 14,827
Exercisable at March 31, 2007	1,655	14.83	6.44	$ 13,173

* These are options outstanding as of March 31, 2007 that are already vested and expected to vest in the future.

The aggregate intrinsic value in the preceding table represents the total intrinsic value based on the Company s closing stock price of $21.43 as of March 30, 2007.

The total intrinsic value of options exercised during the three months period ended March 31, 2007 was $2.0 million.

A summary of restricted stock unit activity under the plan as of March 31, 2007, and changes during the period ended, is presented below:

Restricted Stock Units	Number of Units (in thousands)	Weighted-Average Grant-Date Fair Value
Unvested at January 1, 2007	529	$ 24.03
Granted	202	23.60
Vested	(12)	21.77
Forfeited	(29)	24.18
Unvested at March 31, 2007	690	23.94
Expected to vest at March 31, 2007	521	23.91

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The following table summarizes significant ranges of outstanding and exercisable options as of March 31, 2007:

	Options Outstanding as of March 31, 2007			Options Exercisable as of March 31, 2007	
Range of Exercise Price	**Number Outstanding (in thousands)**	**Weighted Average Remaining Contractual Life (Years)**	**Weighted Average Exercise Price**	**Number Exercisable (in thousands)**	**Weighted Average Exercise Price**
$0.86 - $1.18	215	4.29	$ 0.94	215	$ 0.94
$1.37 - $1.81	27	5.30	1.43	27	1.43
$2.27	32	5.56	2.27	32	2.27
$3.85	68	2.68	3.85	68	3.85
$5.88 - $7.64	203	4.84	6.96	202	6.96
$8.39	37	5.78	8.39	37	8.39
$13.00 - $16.84	292	7.18	16.22	184	16.15
$17.00 - $22.86	1,164	8.11	17.95	584	17.96
$23.17 - $34.51	370	6.71	28.36	306	28.72
	2,408			1,655	

The effects of application of SFAS 123(R) on the condensed consolidated statements of operations for the three months ended March 31, 2007 are summarized as follows (in thousands, except per share data):

	Three Months Ended March 31, 2007	2006
Decrease in net income from continuing operations	$ 2,484	$ 1,731
Decrease in income before income tax expense	2,484	1,731
Decrease in net income	2,484	1,731
Decrease in basic net income per share	0.07	0.05
Decrease in diluted net income per share	0.06	0.04

As of March 31, 2007, there was $3.0 million of total unrecognized compensation cost related to options for which services had not been provided, net of forecasted forfeitures. That cost is expected to be recognized over a weighted average period of 0.9 years. The total fair value of options expensed during the three months ended March 31, 2007 and 2006 was $1.0 million and $1.7 million, respectively.

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As of March 31, 2007, there was $9.3 million of total unrecognized compensation cost related to unvested restricted stock units, net of forecasted forfeitures. This amount is expected to be recognized over a weighted average period of 1.2 years. Total fair value of restricted stock units expensed during the three months ended March 31, 2007 and 2006 was $1.5 million and $0, respectively.

To the extent the actual forfeiture rate is different than the Company has anticipated, the number of share-based awards expected to vest would be different from our expectations.

In accordance with SFAS 123(R), effective from January 1, 2006, the Company has recognized income tax benefits related to share-based awards to employees and directors that could be expected to be realized under applicable tax regulations. The tax benefits realized for options exercised during the three months ended March 31, 2007 was $107,000. Gross excess tax benefits from share-based compensation for the three months ended March 31, 2007 was $79,000 as reported on the condensed consolidated statements of cash flows in financing activities.

There were no capitalized share-based compensation costs during the three months ended March 31, 2007 and 2006.

During three months ended March 31, 2007 and 2006, total cash received from the exercise of stock options amounted to $1.4 million and $1.0 million, respectively.

6. VIEs

FIN 46R Consolidation of Variable Interest Entities requires a VIE to be consolidated by a company if that company is the primary beneficiary of that VIE.

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

Under contractual agreements with the Company, Dr. Zhang and other Sohu employees who are shareholders of the VIEs are required to transfer their ownership in these entities to the Company, if permitted by PRC laws and regulations, or, if not so permitted, to designees of the Company at any time to repay the loans outstanding. All voting rights of the VIEs are assigned to the Company, and the Company has the right to designate all directors and senior management personnel of the VIEs. Dr. Zhang and the other Sohu employees who are shareholders of the VIEs have pledged their shares in the VIEs as collateral for the loans. As of March 31, 2007, the aggregated amount of these loans was $9.8 million.

The following is a summary of the VIEs of the Company, which had been consolidated under FIN 46R:

a) Beijing Sohu

Beijing Sohu Online Network Information Services, Ltd (or Beijing Sohu) was incorporated in the PRC in 1998 and engages in Internet information and wireless services in the PRC on behalf of the Company. The registered capital of Beijing Sohu is $242,000. Originally, Dr. Zhang and He Jinmei held 80% and 20% interests in Beijing Sohu, respectively. He Jinmei transferred all of her shares in Beijing Sohu to High Century in June 2005. As a result, Dr. Zhang and High Century hold 80% and 20% interests in Beijing Sohu, respectively. In February 2007, Beijing Sohu was liquidated, and all loans related to Beijing Sohu were repaid.

b) High Century

Beijing Century High Tech Investment Co., Ltd. (or High Century) was incorporated in the PRC in 2001 and engages in investment holding in the PRC on behalf of the Company. The registered capital of High Century is $4,595,000. Dr. Zhang and Li Wei, an employee of the Company, hold 80% and 20% interests in High Century, respectively.

c) Sohu Entertainment

Beijing Sohu Entertainment Culture Media Co., Ltd (or Sohu Entertainment), formerly known as Beijing Hengda Yitong Internet Technology Development Co., Ltd. (or Hengda) was incorporated in the PRC in 2002 and engages in Internet access and wireless services in the PRC on behalf of the Company. The registered capital of Sohu Entertainment is $1,210,000. Originally, High Century and Li Wei held 80% and 20% interests in Sohu Entertainment, respectively. In November 2004, to further satisfy PRC regulations, High Century and Li Wei transferred their interests in Sohu Entertainment to Wang Xin and Wang Jianjun, each of whom is an employee of the Company. As a result, Wang Xin and Wang Jianjun hold 80% and 20% interests in Sohu Entertainment, respectively.

d) Sohu Internet

Beijing Sohu Internet Information Service Co. Ltd. (or Sohu Internet) was incorporated in the PRC in 2003 and engages in Internet information, wireless and advertising services in the PRC on behalf of the Company. The original registered capital was $605,000, and High Century and He Jinmei held 80% and 20% interests in Sohu Internet, respectively. In December 2003, Sohu Entertainment made a $605,000 investment in Sohu Internet. In April 2005, He Jinmei transferred all her interests in Sohu Internet to High Century, and High Century made a $1,208,000 additional investment in Sohu Internet. As a result, the registered capital is now $2,418,000, with High Century and Sohu Entertainment holding 75% and 25% interests, respectively.

e) Goodfeel

Beijing Goodfeel Information Technology Co., Ltd. (or Goodfeel) was incorporated in the PRC in 2001 and engages in value-added telecommunication services in the PRC. The registered capital of Goodfeel is $1,208,000. In May 2004, High Century and Sohu Internet acquired 73% and 27% interests in Goodfeel, respectively. In July 2004, High Century and Sohu Internet invested $613,000 and $473,000 in Goodfeel, respectively, so that High Century owned a 58.1% interest in Goodfeel with the remaining 41.9% interest owned by Sohu Internet. In October 2004, to further satisfy PRC regulations, High Century and Sohu Internet transferred their interests in Goodfeel to Deng Xiufeng and Zhou Jing, each of whom is an employee of the Company. As a result, Deng Xiufeng and Zhou Jing own 58.1% and 41.9% interests in Goodfeel, respectively.

f) Huohu

Beijing Huohu Digital Technology Co., Ltd. (or Huohu) was incorporated in the PRC in 2005. Huohu engages in software and technology development for the games business. The registered capital of Huohu is $121,000. Beijing Sohu New Era Information Technology Co., Ltd. (or Sohu Era), one of the indirect China-based subsidiaries of the Company, and an employee of Huohu, hold 75% and 25% interests in Huohu, respectively. The Company provided the employee with a non-interest bearing loan of $32,000 to finance his capital contribution to Huohu. The loan is repayable upon demand by the Company at any time or upon termination of the employment of the employee and can only be repaid through transfer of the employee s shares in Huohu to Sohu Era. Based on the arrangement between Sohu Era and the employee, Sohu Era is the sole and primary beneficiary of Houhu. Accordingly, Huohu is 100% consolidated into the financial statements of the Company.

g) Tu Xing Tian Xia

Beijing Tu Xing Tian Xia Information Consultancy Co., Ltd. (or Tu Xing Tian Xia) was incorporated in the PRC in 1999 and engages in mapping services in the PRC. The registered capital of Tu Xing Tian Xia is $248,000. In May 2005, in connection with the Company s acquisition of Go2Map, the Company designated High Century and Sohu Internet as its designees to purchase the outstanding registered capital of Tu Xing Tian Xia. As a result, High Century and Sohu Internet own 56.1% and 43.9% interests in Tu Xing Tian Xia, respectively.

h) Feng Yang Tian Lang

Beijing Feng Yang Tian Lang Advertising Co., Ltd. (or Feng Yang Tian Lang) was incorporated in the PRC in 2005 and engages in advertising services in the PRC. The registered capital of Feng Yang Tian Lang is $248,000. Sohu Internet and High Century each holds a 50% interest in Feng Yang Tian Lang.

i) Sogou Information

Beijing Sogou Information Services Co., Ltd. (or Sogou Information) was incorporated in the PRC in 2005 and engages in providing Internet information services in the PRC. The registered capital of Sogou Information is $2,480,000. Zhou Jing and Li Wei, each of whom is an employee of the Company, each owns a 50% interest in Sogou Information.

j) Guangzhou Interactive

Guangzhou Sohu Interactive Network Technology Co., Ltd (or Guangzhou Interactive) was incorporated in the PRC in 2006 and engages in providing Internet information services in Guangdong Province. The registered capital of Guangzhou Interactive is $631,000. Sohu Internet and High Century each holds a 50% interests in Guangzhou Interactive.

Pursuant to FIN 46R, Beijing Sohu, High Century, Sohu Entertainment, Sohu Internet, Goodfeel, Huohu, Tu Xing Tian Xia, Feng Yang Tian Lang, Sogou Information and Guangzhou Interactive are VIEs, of which the Company is the primary beneficiary. Accordingly, the VIEs have been consolidated in the Company s financial statements. As of March 31, 2007, the above VIEs have aggregate accumulated profits of approximately $7.0 million which have been reflected in the consolidated financial statements.

7. RELATED PARTY TRANSACTIONS

The following table summarizes related party transactions during the three months ended March 31, 2007 and 2006, respectively (in thousands):

Name or Description of Related Party	Description of Transactions	Accounting Caption	Three Months Ended March 31, 2007	2006
Qingfan, a company controlled by Dr. Zhang s brother	Delivery service provided by Qingfan	Cost of revenues	$	$ 18
An investee of the Company	Amortization of licensing fee	Product development expenses		26
	Revenue sharing	Cost of revenues	378	446

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8. COMMITMENTS AND CONTINGENCIES

The Company s China-based subsidiaries and VIEs, Sohu Era, Sohu Internet, Sogou Information, Beijing Sogou Technology Development Co., Ltd. (Sogou Technology) and Beijing Sohu New Media Information Technology Co., Ltd. (Sohu Media) enjoy tax benefits which are available to new technology enterprises . The effective income tax rate for new technology enterprises registered and operating in Beijing Zhongguancun Science Park is 15%, while the local income tax will be exempted as long as the enterprise holds the status of a new technology enterprise. New technology enterprises are exempted from Chinese state corporate income tax for three years, beginning with their first year of operations, and are entitled to a 50% tax reduction, at the rate of 7.5%, for the subsequent three years. Sohu Era and Sohu Internet were incorporated in 2003 and, providing there is no change in their status as a new technology enterprise or a change in the relevant regulations, are subject to an income tax rate of 0% in 2003 to 2005, 7.5% in 2006 to 2008 and 15% thereafter. Sogou Information was incorporated in 2005, Sogou Technology and Sohu Media were incorporated in 2006 and, providing there is no change in their status as a new technology enterprise or a change in the relevant regulations, are subject to an income tax rate of 0% in 2006 to 2008, 7.5% in 2009 to 2011 and 15% thereafter. To be considered a new technology enterprise under current PRC law, a company must: (i) operate in the high-tech industry (which includes the information technology industry); (ii) be incorporated and operate in Beijing Zhongguancun Science Park; (iii) receive 60% of its revenue from high-tech products or services; and (iv) have at least 20% of its employees involved in technology development. New technology enterprises are subject to annual inspection to determine whether they continue to meet these requirements. If Sohu Era, Sohu Internet, Sogou Information, Sogou Technology and Sohu Media did not meet the requirements of a new technology enterprise, they could be subject to enterprise income tax in China at rates up to 33%, which could cause a significant reduction in the Company s after-tax income.

In March 2007, the Chinese government promulgated the Corporate Income Tax Law which will be effective from January 1, 2008. The Corporate Income Tax Law will impose a unified income tax rate of 25% for both domestic and foreign invested enterprise. The existing tax laws, which stipulated income tax rates for domestic and foreign invested enterprises at different rates, will be abolished simultaneously. Currently, the Company s China-based subsidiaries and VIEs are subject to the tax rates under the existing tax laws. The Corporate Income Tax Law provides for a 5-year transitional period for those entities that were subject to FIE and FE tax laws in previous years. The reduced income tax rate for new technology enterprises remains at 15% under the Corporate Income Tax Law. However, the qualifying criteria of a new technology enterprise under the new law and detailed implementation rules have not been released. The Company will continue to assess the impact of such new law in the future. If any of Sohu Era, Sohu Internet, Sogou Information, Sogou Technology or Sohu Media does not meet the requirements of a new technology enterprise under the new Corporate Income Tax Law, its tax rate will eventually become 25%.

The Chinese market in which the Company operates poses certain macro-economic and regulatory risks and uncertainties. These uncertainties extend to the ability of the Company to operate an Internet business, and to conduct brand advertising, sponsored search, wireless and online game services in the PRC. Though the PRC has, since 1978, implemented a wide range of market-oriented economic reforms, continued reforms and progress towards a full market-oriented economy are uncertain. In addition, the telecommunication, information, and media industries remain highly regulated. Restrictions are currently in place and are unclear with respect to which segments of these industries foreign owned entities, like the Company, may operate. The Chinese government may issue from time to time new laws or new interpretations of existing laws to regulate areas such as telecommunication, information and media. Regulatory risks also encompass the interpretation by the tax authorities of current tax laws and regulations, including the applicability of certain preferential tax treatments. The Company s legal structure and scope of operations in China could be subjected to restrictions which could result in severe limits to the Company s ability to conduct business in the PRC.

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

From time to time, the Company becomes subject to legal proceedings and claims in the ordinary course of our business, including claims of alleged infringement of trademarks, copyrights and other intellectual property rights in connection with the content published on our Websites. The Company provides for the amount of loss, if there is information available prior to issuance of the Company s financial statements indicating that it is probable that a liability had been incurred at the date of the financial statements and the amount of loss can be reasonably estimated.

The Company has entered in certain sponsorship agreements, under which the Company is obliged to provide advertising services and Website construction, operation and maintenance services to third parties during the contract periods.

As of March 31, 2007, the Company had future minimum content and service purchase commitments of $11.1 million, $4.4 million and $1.0 million for the years ended March 31, 2008, 2009 and 2010, respectively. As of March 31, 2007, the Company had made certain deposits into restricted bank accounts as guarantees to meet the requirements under those contracts.

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

As used in this report, references to us, we, our, our company, Sohu and Sohu.com are to Sohu.com Inc. and, except where the context requires otherwise, our subsidiaries, Sohu.com (Hong Kong) Limited (or Sohu Hong Kong), Sohu.com Limited, Kylie Enterprises Limited, All Honest International Limited, Marvel Hero Limited, Go2Map Inc., Sohu.com (Search) Limited, Sogou Inc., Sogou (BVI) Limited, 21 East Entertainment Limited (or 21 East HK), Sohu ITC Information Technology (Beijing) Co., Ltd. (or Beijing ITC), Beijing Sohu New Era Information Technology Co., Ltd. (or Sohu Era), Beijing Sohu Interactive Software Co., Ltd. (or Sohu Software), Go2Map Software (Beijing) Co., Ltd. (or Go2Map Software), Beijing Sogou Technology Development Co., Ltd. (or Sogou Technology) and Beijing Sohu New Media Information Technology Co., Ltd. (or Sohu Media), and our VIEs Beijing Century High Tech Investment Co., Ltd. (or High Century), Beijing Sohu Entertainment Culture Media Co., Ltd. (or Sohu Entertainment, formerly known as Beijing Hengda Yitong Internet Technology Development Co., Ltd. (or Hengda)), Beijing Sohu Internet Information Service Co., Ltd. (or Sohu Internet), Beijing Goodfeel Information Technology Co., Ltd. (or Goodfeel), Beijing Huohu Digital Technology Co., Ltd. (or Huohu), Beijing Tu Xing Tian Xia Information Consultancy Co., Ltd. (or Tu Xing Tian Xia), Beijing Feng Yang Tian Lang Advertising Co., Ltd (or Feng Yang Tian Lang), Beijing Sogou Information Services Co., Ltd. (or Sogou Information), Guangzhou Sohu Interactive Network Technology Co., Ltd. (or Guangzhou Interactive) and Beijing 21 East Culture Development Co., Ltd (or 21 East Beijing), 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

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available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Our business and financial performance are subject to substantial risks and uncertainties. Actual results could differ materially from those projected in the forward-looking statements. In evaluating our business, you should carefully consider the information set forth below under the caption Risk Factors. Readers are cautioned not to place undue reliance on these forward-looking statements.

OVERVIEW

We are a leading online media, search and mobile value-added services company providing comprehensive online products and services to consumers and businesses in China, through our comprehensive matrices of web properties, consisting of the mass portal and leading online media destination www.sohu.com; interactive search engine www.sogou.com; the leading online alumni club www.chinaren.com; the leading games information portal www.17173.com; one of the top real estate Websites www.focus.cn; the wireless value-added services provider www.goodfeel.com.cn; and a leading online mapping service Website www.go2map.com. We offer our user community very broad choices regarding information, entertainment, communication and wireless services. We derive revenue primarily through the sale of brand advertising, sponsored search, wireless and online games services. We also sponsor major events to further enhance our viewership and create a positive branding impact.

We were incorporated in the state of Delaware in August 1996 as Internet Technologies China Incorporated, and launched our original Website, itc.com.cn, in January 1997. During 1997, we developed the Sohu online directory, search engine and related technology infrastructure, and also focused on recruiting personnel, raising capital and aggregating content to attract and retain users. In February 1998, we re-launched our Website under the domain name sohu.com. In September 1999, we re-named our company Sohu.com Inc. Our business operations are conducted primarily through our indirect wholly owned subsidiaries, Sohu Era, Sohu Software, Go2Map Software, Sogou Technology and Sohu Media and our VIEs, High Century, Sohu Entertainment, Sohu Internet, Goodfeel, Huohu, Tu Xing Tian Xia, Feng Yang Tian Lang, Sogou Information, Guangzhou Interactive and 21 East Beijing.

CRITICAL ACCOUNTING POLICIES AND MANAGEMENT ESTIMATES

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

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Revenue Recognition

Advertising Revenues

Advertising revenues include revenues from brand advertising and sponsored search services, after deducting agent rebates and applicable business tax. No revenues from advertising-for-advertising barter transactions were recognized.

Brand advertising contracts establish the fixed price and advertising services to be provided. Pursuant to brand advertising contracts, we provide advertisement placements on various Website channels and in different formats, including but not limited to banners, links, logos, buttons, rich media and content integration. Revenue is recognized ratably over the period the advertising is provided and, as such, we consider the services to have been delivered. We treat all elements of advertising contracts as a single unit of accounting for revenue recognition purposes. Based upon our credit assessments of our customers prior to entering into contracts, we determine if collectibility is reasonably assured. In situations where collectibility is not deemed to be reasonably assured, we recognize revenue upon payment from the customer.

Sponsorship contracts may include services similar to those in our brand advertising contracts, are generally for larger dollar amounts and for a longer period of time, may allow advertisers to sponsor a particular area on our Websites, may include brand affiliation services and/or a larger volume of services, and may require some exclusivity or premier placements. Sponsorship advertisement revenues are normally recognized on a straight-line basis over the contract period, provided we are meeting our obligations under the contract.

Pursuant to sponsored search contracts, which are normally for relatively small dollar amounts and are with small and medium sized enterprises, sponsored search services mainly include priority placements in our search directory, listing in our classified advertisements section and pay-for-click services consisting of displaying the text-based links of our advertisers on our Websites and our Website Alliance network. We normally provide priority placements services and listing in our classified advertisements section for a fixed fee over the service period of the contracts. Revenues on priority placements and listing in our classified advertisements section are normally recognized on a straight-line basis over the contract period provided we are meeting our obligation under the contract. Pay-for-click services of displaying the text-based links to our advertisers Websites are charged on a cost per click basis, so that an advertiser pays us only when a user clicks on the displayed link. The priority of the display of text-based links is based on the bidding price of different advertisers. Revenues from the pay-for-click services are recognized as the users click on the links.

Material differences could result in the amount and timing of our advertising revenue for any period if management made different judgments or utilized different estimates.

Non-Advertising Revenues

Non-advertising revenues include revenues principally from wireless and online game services.

Wireless revenues are derived from providing short messaging services (or SMS), Wireless Application Protocol (or WAP), Ring Back Tone (or RBT), multimedia messaging services (or MMS) and interactive voice response (or IVR), mainly consisting of news, weather forecast, chatting, entertainment information, music, ring tone, picture and logo downloads and various other mobile related products provided to mobile phone users. Wireless service fees are charged on a monthly or per message/download basis. Wireless revenues and cost of revenues are recognized in the month in which the service is performed, provided no significant obligations from Sohu remain. We rely on mobile network operators in China to bill mobile phone users for wireless service fees. In order to meet ownership requirements under PRC law which restrict or prohibit wholly foreign owned enterprises from providing Internet information and value-added telecommunication services such as wireless, we rely on Sohu Internet and Goodfeel to contract with the mobile network operators. Generally, (i) within 15 to 90 days after the end of each month, Sohu Internet or Goodfeel receives statements from each of the operators confirming the amount of wireless service charges billed to that operator s mobile phone users and (ii) within 30 to 180 days after delivering monthly statements, each operator remits the wireless service fees, net of its service

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fees, for the month to Sohu Internet or Goodfeel. In order to recognize revenue and be paid for services provided, we rely on billing confirmations from the mobile network operators as to the actual amount of services they have billed to their mobile customers. We are unable to collect certain wireless services fees from an operator in certain circumstances due to technical issues with the operator s network. This is referred to as the failure rate , which can vary from operator to operator. At the end of each reporting period, where an operator has not provided Sohu Internet or Goodfeel with the monthly statements for any month confirming the amount of wireless service charges billed to that operator s mobile phone users for the month, Sohu, using information generated from its own internal system and historical data, makes estimates of the failure rate and collectable wireless service fees and accrues revenue accordingly. The quarterly historical differences in our estimated revenue which was recorded in the financial statements compared to the actual revenue have ranged from an underestimation of $535,000 (gross margin underestimate of $326,000) to an overestimation of $340,000 (gross margin overestimate of $171,000) since 2002 when wireless revenues began representing a significant portion of our total revenues. We believe we have the ability to make a reasonable estimate. However, differences between the actual failure rate per an operator s statement and our internal records could result in material differences in the amount and timing of our revenue and cost of non-advertising revenue for any period. For the three months ended March 31, 2007, 73% of our estimated wireless revenues were confirmed by the monthly statements received from the mobile network operators.

Our management must determine whether to record our wireless revenues using the gross or net method of reporting. Determining whether revenue should be reported gross or net is based on an assessment of various factors, principally whether Sohu is acting as the principal in offering services to the customer or whether Sohu is acting as an agent in the transaction. To the extent Sohu is acting as a principal in a transaction, Sohu reports as revenue the payments received on a gross basis, and reports as costs of revenue the amounts attributable to services provided by mobile network operators and other vendors. To the extent Sohu is acting as an agent in a transaction, Sohu reports on a net basis reporting as revenue the payments received less commission and other payments to third parties. The determination of whether Sohu is serving as principal or agent in a transaction is judgmental in nature and based on an evaluation of the terms of an arrangement.

Based on our assessment, the majority of our wireless revenues are recorded on a gross basis. We have primary responsibility for fulfillment and acceptability of the wireless services. The content and nature of the wireless services are designed and developed by us (either independently or with third parties) and originate from our Websites, our links located on third parties Websites, or one of our dedicated phone numbers. The mobile network operators that we contract with to deliver these services to the end customers are not involved in the design or development of the services that are provided by us. The end customer purchases the wireless content, community access or value-added services, such as news, weather forecast, chatting, entertainment information, music, ring tone, picture and logo downloads that Sohu provides. The end customer receives identical services from us regardless of which mobile network operator is used to deliver the message. In addition, we provide customer services to the end customers directly and we could be requested by the mobile network operators to assume the credit risk if the operators are not able to collect fees from the end customers. Sohu has determined that in addition to the indicators of gross reporting, there are also certain indicators of net reporting, including the fact that the mobile network operators set maximum prices that Sohu can charge and that the mobile network operators also have the right to set requirements and procedures associated with using their platform. However, Sohu has determined that the gross revenue reporting indicators are stronger, because Sohu is the primary obligor, adds value to the products, has inventory risk related to content and products, and has reasonable pricing latitude.

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

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Functional Currency

Our functional currency is the US Dollar. The functional currency of our subsidiaries and VIEs in China is RMB. An entity s functional currency is the currency of the primary economic environment in which it operates; normally, that is the currency of the environment in which it primarily generates and expends cash. Management s judgment is essential in determination of the functional currency by assessing various indicators, such as cash flows, sales price and market, expenses, financing and inter-company transactions and arrangements. Assets and liabilities of the China subsidiaries and VIEs are translated into US Dollar, our reporting currency, at the exchange rate in effect at the balance sheet date. Foreign currency translation adjustments are not included in determining net income for the period but are accumulated in a separate component of consolidated equity on the balance sheet. The accumulated foreign currency translation adjustment as of March 31, 2007 and December 31, 2006 was a gain of $6.0 million and $5.2 million, respectively.

Allowance for Doubtful Accounts Receivables

Our management must make estimates of the collectibility of our accounts receivables. Management specifically analyzes accounts receivables, historical bad debts, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. Our accounts receivable balance was $29.1 million, net of allowance for doubtful accounts of $1.6 million as of March 31, 2007. If the financial condition of Sohu s customers or mobile network operators were to deteriorate, resulting in their inability to make payments, or the mobile network operators requested that we assume additional bad debts as a result of the operators inability to collect fees from end customers, additional allowance might be required.

Impairment on Long-Lived Assets

Our long-lived assets include goodwill, intangible assets, fixed assets and other assets. We test goodwill for impairment at the reporting unit level (operating segment) on an annual basis, and between annual tests when an event occurs or circumstances change that could more likely than not reduce the fair value of goodwill below its carrying value. Application of a goodwill impairment test requires judgment, including the identification of reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units, and determining the fair value of each reporting unit. Significant judgments required to estimate the fair value of reporting units include estimating future cash flows, determining appropriate discount rates and making other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value for each reporting unit. Any impairment losses recorded in the future could have a material adverse impact on our financial condition and results of operations. As of March 31, 2007, we did not believe that any event or change of circumstances had occurred that would result in material impairment losses in goodwill.

In respect of our intangible assets, which mainly comprise domain names, trademarks, customer lists and computer software purchased from unrelated third parties, we amortize the costs over their expected future economic lives. Fixed assets comprise office building, computer equipment, office furniture and equipment, vehicles and leasehold improvement, and are depreciated over the estimated useful lives of the assets on a straight-line basis. Other assets mainly include long-term prepayment for content purchases and rental deposits. Management judgment is required in the assessment of the economic lives of intangible assets and useful lives of the fixed assets and other assets. Based on the existence of one or more indicators of impairment, we measure any impairment of intangible assets, fixed assets and other assets based on a projected discounted cash flow method using a discount rate determined by our management to commensurate with the risk inherent in our business model. An impairment charge would be recorded if we determined that the carrying value of intangible assets, fixed assets or other assets may not be recoverable. Our estimates of future cash flows require significant judgment based on our historical results and anticipated results and are subject to many factors. As of March 31, 2007, we were not aware of any indication of impairment of our intangible assets, fixed assets and other assets.

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Share-Based Compensation

Effective from January 1, 2006, we adopted SFAS 123(R), which requires all share-based payments to employees and directors, including grants of employee stock options and restricted stock units, to be recognized in the financial statements based on their grant date fair values. The valuation provisions of SFAS 123(R) apply to new awards, to awards granted to employees and directors before the adoption of SFAS 123(R) whose related requisite services had not been provided, and to awards which were subsequently modified or cancelled. In March 2005, the SEC issued Staff Accounting Bulletin No. 107, Share-Based Payment (or SAB 107) regarding the SEC s interpretation of SFAS 123(R) and the valuation of share-based payments for public companies. We have applied the provisions of SAB 107 in its adoption of SFAS 123(R). Prior to SFAS 123(R), we accounted for share-based payments in accordance with Accounting Principles Board Opinions No. 25, Accounting for Stock Issued to Employees (or APB 25), and complied with the disclosure provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (or SFAS 123). In general, compensation cost under APB 25 was recognized based on the difference, if any, between the estimated fair value of our common stock and the amount an employee must pay to acquire the stock, as determined on the date the option is granted.

As of January 1, 2006, we adopted SFAS 123(R) using the modified prospective method. The fair value of the options granted before January 1, 2006 is determined based on the Black-Scholes valuation model, which is consistent with the valuation techniques utilized when we prepared pro forma information under SFAS 123. Restricted stock units are measured based on the fair market values of the underlying stock on the dates of grant. Fair value of the share-based awards is recognized as share-based compensation cost over the requisite service period, net of estimated forfeitures on an accelerated basis under SFAS 123(R).

The determination of the fair value of share-based awards and related share-based compensation expense requires input of subjective assumptions, including but not limited to the valuation model adopted, risk-free interest rate, expected life of the share-based awards, stock price volatility, and expected forfeiture rate. The selection of an appropriate valuation technique or model depends on the substantive characteristics of the instrument being valued. Risk free interest rates are decided based on the yield to maturity of US government bonds as at respective dates of grant of options. Expected life is the number of years that we estimate, based primarily on the history, using plain-vanilla method, that options will be outstanding prior to settlement. Volatility is measured using historical daily price changes of our stock over the respective expected life of the option. Forfeiture rate is estimated based on historical forfeiture pattern and adjusted in accordance with our expectation for the future.

Our input assumptions were based on historical experience, with consideration to developing expectations about the future. The assumptions used in calculating the fair value of share-based awards and related share-based compensation represent management s best estimations, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change or we utilize different assumptions, our share-based compensation expense could be materially different for any period.

Current Income Tax Position and Valuation Allowance against Deferred Tax Assets

We estimate income tax expense in each of the jurisdictions in which we operate for each period presented, including estimating our current tax exposure as well as assessing realizable deferred tax assets and deferred tax liabilities.

As of March 31, 2007, the majority of our deferred tax assets are related to net operating losses that would apply to United States income taxes. As substantially all of our income is earned in China, and we do not intend in the foreseeable future to repatriate this income to the United States where it would be taxable, it is more likely than not that deferred tax assets resulting from net operating losses will not be realized. The remaining deferred tax assets are related to China-based subsidiaries and VIEs, resulting from net

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operating losses and temporary differences between accounting and tax base. We believe that it is more likely than not that the balance will not be realized. We have recorded a valuation allowance against our gross deferred tax assets in order to reduce our deferred tax assets to the amount that is more likely than not to be realized. If events were to occur in the future that would allow us to realize more of our deferred tax assets than the presently recorded net amount, an adjustment would be made to the deferred tax assets that would increase income for the period when those events occurred. If events were to occur in the future that would require us to realize less of our deferred tax assets than the presently recorded net amount, an adjustment would be made to the valuation allowance against deferred tax assets that would decrease income for the period when those events occurred.

Significant management judgment is required in determining income tax expense, and deferred tax assets and liabilities.

RESULTS OF OPERATIONS

FOR THE THREE MONTHS ENDED MARCH 31, 2007 AND 2006

In order to focus on our core revenue source of online advertising, on June 20, 2006 we discontinued our unprofitable e-commerce business. As a result of the discontinuation of this business, the e-commerce business is accounted for as a discontinued operation. Accordingly, our statements of operations separate the discontinued operation for all periods presented.

REVENUES

Total revenues were $33.1 million and $30.4 million for the three months ended March 31, 2007 and 2006, respectively.

Advertising Revenues

Advertising revenues are derived principally from brand advertising and sponsored search.

Advertising revenues were $25.6 million and $20.1 million, or 77% and 66% of total revenues for the three months ended March 31, 2007 and 2006, respectively. For the three months ended March 31, 2007, advertising revenues consisted of revenues from brand advertising of $23.5 million, and revenues from sponsored search of $2.1 million. For the three months ended March 31, 2006, advertising revenues consisted of revenues from brand advertising of $16.7 million, and revenues from sponsored search of $3.4 million.

Brand advertising. Brand advertising revenues increased by $6.8 million to $23.5 million for the three months ended March 31, 2007 as compared to $16.7 million for the three months ended March 31, 2006. The increase of $6.8 million from 2006 to 2007 consisted of: (i) a $6.9 million increase from advertisers who advertised with us during the three months ended March 31, 2007 but did not advertise on our Website channels during the three months ended March 31, 2006; (ii) a $4.8 million increase in revenues from the advertisers who advertised with us in the three months ended March 31, 2006 and continued to do so in the three months ended March 31, 2007; and (iii) a $4.9 million decrease in revenues as some of the advertisers who advertised with us during the three months ended March 31, 2006 did not advertise on our Website channels during the three months ended March 31, 2007. No single customer accounted for more than 10% of total brand advertising revenues for each of the three months ended March 31, 2007 and 2006. As of March 31, 2007 and 2006, we had $1.9 million and $1.1 million of receipt in advance from advertisers, respectively. We have not recorded any revenue from advertising-for-advertising barter transactions.

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For the three months ended March 31, 2007 and 2006, we recorded brand advertising revenues of approximately $267,000 and $40,000, respectively, from Fujian Tian Qing Digital Co., Ltd. (or Fujian Tian Qing), formerly known as NetDragon Websoft Inc., in connection with its advertisements on our 17173.com Website. Those advertising services are provided pursuant to a three-year advertising framework agreement expiring in November 2006. In December 2006, the advertising framework agreement had been extended to November 2009. Fujian Tian Qing was the previous owner of 17173.com Website prior to our acquisition of 17173.com.

We expect brand advertising revenues to increase in the second quarter of 2007 as compared to the first quarter of 2007.

Sponsored search. Sponsored search revenues decreased by $1.3 million to $2.1 million for the three months ended March 31, 2007 as compared to $3.4 million for the three months ended March 31, 2006. Sponsored search services primarily include priority placements in our search directory and listing in our classified advertisement section, in addition to pay-for-click services of displaying the text-based links of our advertisers on our Websites and our Website Alliance network. We normally provide priority placement services and listings in our classified advertisement section for a fixed fee over a period. Pay-for-click services displaying the text-based links to our advertiser s Websites charged on a cost-per-click basis, so that an advertiser pays us only when a user clicks on the displayed link on our Websites or on our Website Alliance network. The priority of the display of text-based links is based on the bidding price of different advertisers. For the three months ended March 31, 2007, revenues from priority placement services and our classified advertisement section amounted to $1.5 million, a 38% decrease from the three months ended March 31, 2006. The decrease in revenue from priority placement services was mainly due to the gradual market migration from preference for fixed fee listings to pay-for-click listings. For the three months ended March 31, 2007, revenues from pay-for-click services amounted to $0.6 million, a 43% decrease from the three months ended March 31, 2006. Revenues from pay-for-click services accounted for approximately 28% of the total sponsored search revenues in the first quarter of 2007 as compared to 30% in the first quarter of 2006. The decrease in revenues from pay-for-click services mainly resulted from our efforts to further strengthen our anti-fraudulent click-through technology in the second half of 2006 which resulted in a decrease in average click-through rates. We believe the improved anti-fraudulent click-through technology will provide benefits to our sponsored search business in the long run. In addition, the late 2007 Chinese New Year further reduced advertising spending by small and medium-sized enterprises as compared with 2006.

Non-advertising Revenues

Non-advertising revenues are derived principally from wireless and other services.

Non-advertising revenues were $7.5 million and $10.3 million, or 23% and 34% of total revenues for the three months ended March 31, 2007 and 2006, respectively.

For the three months ended March 31, 2007, non-advertising revenues consisted of revenues from wireless of $5.6 million and from other services of $1.9 million. For the three months ended March 31, 2006, non-advertising revenues consisted of revenues from wireless of $8.0 million and from other services of $2.3 million.

Wireless. Our wireless revenues include SMS, WAP, RBT, MMS and IVR services. Our wireless services include news, weather forecast, chatting, entertainment information, music, ring tone, picture and logo downloads and various other related products provided to mobile phone users. Most of our services are charged on a monthly or per message/download basis. For the three months ended March 31, 2007, we normally charged monthly fees ranging from $0.065 to $3.876 and per message/download fee ranging from approximately $0.006 to $0.517.

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For the three months ended March 31, 2007, our wireless revenues decreased by $2.4 million to $5.6 million as compared to $8.0 million for the three months ended March 31, 2006, primarily due to a decrease of $2.0 million in SMS revenues and a decrease of $1.1 million in WAP, MMS and IVR revenues. This decrease was partially offset by an increase of $0.7 million in RBT revenues. The decrease in SMS revenues was primarily due to ongoing negative impact of policies such as double confirmation, billing reminders and details of promotion adopted by SPs issued by mobile network operators in July 2006. In January 2007, CMCC launched its own WAP channel, WAP Premier Select, which is placed in more prominent positions, and distracted traffic from us. Accordingly, our WAP revenue was decreased.

Assuming that there are no further regulatory changes, we expect wireless revenues to increase in the second quarter of 2007.

Others. Other services mainly consist of online game services and sales of software to third parties. For the three months ended March 31, 2007, online game revenues were $1.6 million, and revenues from the sales of software and applications service provider (or ASP) services was $87,000. Our online game revenue decreased by $0.5 million as compared with $2.1 million for the three months ended March 31, 2006 was mainly attributed to the termination of services related to Knight Online game in November 2006.

COSTS AND EXPENSES

Cost of Revenues

Total cost of revenues was $13.0 million and $10.0 million for the three months ended March 31, 2007 and 2006, respectively.

Cost of Advertising Revenues

Cost of advertising revenues increased by $4.3 million to $9.7 million for the three months ended March 31, 2007 as compared to $5.4 million for the three months ended March 31, 2006.

Brand advertising. Cost of brand advertising revenues includes personnel costs and overheads relating to our editorial center, content purchases, payments to our business partners, relevant depreciation of servers and computer equipment and bandwidth leasing costs. Cost of brand advertising revenues was $8.1 million and $4.3 million for the three months ended March 31, 2007 and 2006, respectively. The increase of $3.8 million consisted of a $1.4 million increase in content purchases, a $0.9 million increase in personnel expense, a $0.6 increase in bandwidth leasing costs due to increased traffic of our Websites, a $0.4 increase in payments to our business partners, a $0.4 million increase in servers depreciation expense, and a $0.1 million increase in other costs. Our brand advertising gross margin for the three months ended March 31, 2007 and 2006 was 65% and 74%, respectively. The decrease was mainly because of increased spending on content purchases to obtain premier, differentiated and exclusive content, including video content, partnerships or sponsorships.

Sponsored search. Cost of sponsored search revenues consisted primarily of payments to our Website Alliance, relevant depreciation of servers and computer equipment, bandwidth leasing costs, personnel cost and data collection cost. Cost of sponsored search revenues was $1.6 million for the three months ended March 31, 2007 as compared to $1.1 million for the three months ended March 31, 2006. The increase in cost of sponsored search revenues resulted from an increase of $452,000 in relevant depreciation and bandwidth leasing costs, and a $48,000 increase in personnel expense and payment to Website Alliances.

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Cost of Non-advertising Revenues

Cost of non-advertising revenues decreased by $1.3 million to $3.3 million for the three months ended March 31, 2007 as compared to $4.6 million for the three months ended March 31, 2006.

Wireless. Cost of wireless revenues mainly consists of collection and wireless transmission charges paid to mobile network operators, expenses related to complaints based on allegations of breaches of certain provisions of our agreements with mobile network operators, fees or royalties paid to third party content providers for services and content associated with our wireless services, payments to third party wireless service alliances, relevant depreciation of servers and computer equipment and bandwidth leasing costs. Cost of wireless revenues decreased by $1.2 million to $2.6 million for the three months ended March 31, 2007 as compared to $3.8 million for the three months ended March 31, 2006. The decrease in cost of wireless revenues resulted from a decrease of $1.6 million in collection charges, transmission charges and expenses related to penalties paid to mobile network operators, which were offset by a $0.4 million increase in amounts paid to third party wireless service alliances and content providers. The collection and transmission charges vary between mobile network operators and include a gateway fee of $0.003 to $0.026 per message, depending on the volume of the monthly total wireless messages, and a collection fee of 15% to 55% of total fees collected by mobile network operators from mobile phone users and paid to us in the first quarter of 2007. Our wireless gross margins were 53% and 52% for the three months ended March 31, 2007 and 2006, respectively.

Others. Cost of revenues for other services, was $693,000 and $792,000 for the three months ended March 31, 2007 and 2006, respectively, consisting mainly of payments to game developers, personnel and other expenses in connection with sale of software business and provision of ASP services.

Product Development Expenses

Product development expenses increased by $0.7 million to $4.9 million for the three months ended March 31, 2007, as compared to $4.2 million for the three months ended March 31, 2006. The increase was primarily due to a $525,000 increase in personnel expenses resulting from increases in headcount and salaries and a $303,000 increase in share-based compensation expense under SFAS 123(R), offset by a $128,000 decrease in other expenses.

Sales and Marketing Expenses

Sales and marketing expenses increased by $0.9 million to $7.3 million for the three months ended March 31, 2007 as compared to $6.4 million for the three months ended March 31, 2006. The increase primarily consists of a $656,000 increase in advertising and promotion expense, which included the relevant expenses associated with our exclusive Olympic sponsorship in the Internet Content Services category, a $198,000 increase in traveling and entertainment expenses, and a $46,000 increase in other expenses.

General and Administrative Expenses

General and administrative expenses increased by $0.3 million to $3.4 million for the three months ended March 31, 2007 as compared to $3.1 million for the three months ended March 31, 2006. The increase was primarily due to the increase of share-based compensation expense under SFAS 123(R) of $382,000, and was offset by a $82,000 decrease in other expenses.

Amortization of Intangible Assets

Amortization of intangible assets was $379,000 and $509,000 for the three months ended March 31, 2007 and 2006, respectively, which were mainly related to the acquisitions of the 17173.com, Focus.cn, Goodfeel and Go2Map.

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Operating Profit

As a result of the foregoing, our operating profit decreased by $2.1 million to $4.1 million for the three months ended March 31, 2007, as compared to $6.2 million for the three months ended March 31, 2006. The operating profit for the three months ended March 31, 2007 included $2.5 million of share-based compensation expense, as compared to $1.7 million of share-based compensation expense for the three months ended March 31, 2006.

Other Expenses

For the three months ended March 31, 2007, other expenses of $120,000 mainly consisted of $124,000 amortization of the offering costs of our zero coupon convertible senior notes issued in July 2003. For the three months ended March 31, 2006, other expenses of $68,000 mainly consisted of $155,000 amortization of the offering costs of our zero coupon convertible senior notes issued in July 2003, which was offset by our share of profits of $38,000 from our investment in Pixel, an associate and $49,000 of miscellaneous other income.

Interest Income

For the three months ended March 31, 2007, interest income was $769,000, as compared to $529,000 for the three months ended March 31, 2006. The increase was mainly due to an increase in market interest rates and RMB appreciation.

Income Tax Expense

For the three months ended March 31, 2007, income tax expense was $282,000 as compared with $443,000 for the same period in 2006. The decrease of income tax expense was mainly attributed to the decrease of taxable income.

Most of our income is earned by our China-based subsidiaries and VIEs. Our China-based subsidiaries and VIEs, Sohu Era, Sohu Internet, Sogou Information, Sogou Technology and Sohu Media enjoy tax benefits which are available to new technology enterprises . Furthermore, they are exempted from Chinese state corporate income tax for three years, beginning with their first year of operations, and are entitled to a 50% tax reduction at the rate of 7.5% for the subsequent three years and 15% thereafter.

Income earned in the United States, where Sohu.com Inc. is incorporated, is subject to taxation at 34% or 35%. For the foreseeable future, we anticipate the major source of income earned in the United States and subject to United States taxation to be interest income. If dividends are paid by our China or other non-U.S. subsidiaries to Sohu.com Inc., the dividends would be taxed at Sohu.com Inc. s rate of taxation which is 34% or 35% (as reduced by any applicable deemed-paid foreign tax credits for foreign income taxes paid by such subsidiaries). For the foreseeable future, we do not intend for the China or other non-U.S. subsidiaries to pay dividends to Sohu.com Inc.

Minority Interests

On October 31, 2006, we completed the acquisition of a 70% interest in 21 East HK and 21 East Beijing (collectively 21 East), an entertainment company. The acquisition was accounted for as a purchase business combination and the results of operations from the acquisition date have been included in our consolidated financial statements, resulting in minority interests of $12,000 for the three months ended March 31, 2007.

Net Income from Continuing Operations

For the three months ended March 31, 2007, income from continuing operations was $4.4 million, as compared to $6.2 million for the three months ended March 31, 2006.

Gain (loss) from Discontinued E-commerce Operations

On June 20, 2006, we discontinued our e-commerce business. For the three months ended March 31, 2007, gain from discontinued e-commerce operations of $7,000 was mainly from collection of receivables that had been provided bad debt for. For the three months ended March 31, 2006, loss from discontinued e-commerce operations was $165,000.

Net Income

As a result of the foregoing, we had net income of $4.5 million for the three months ended March 31, 2007, as compared to net income of $6.0 million for the three months ended March 31, 2006. The net profit for the three months ended March 31, 2007 included $2.5 million of share-based compensation expense under SFAS 123(R), as compared to $1.7 million of share-based compensation expense for the three months ended March 31, 2006.

LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations and capital expenditures principally through private sales of equity securities, the initial public offering of our common stock, a private placement of zero coupon convertible senior notes, and cash provided by operations. From inception through March 31, 2007, we have raised net proceeds of $39.2 million through the sale of preferred stock in private placements, $52.4 million from the sale of common stock in our initial public offering and $87.4 million through the sale of zero coupon convertible senior notes.

We completed a private placement on July 14, 2003 of $90.0 million principal amount of zero coupon convertible senior notes due July 2023, which resulted in net proceeds to Sohu of approximately $87.4 million after deduction of the initial purchaser s discount and our offering expenses. The notes do not pay any interest, have a zero yield to maturity, and are convertible into Sohu s common stock at a conversion price of $44.76 per share, subject to adjustment for dividends, distributions, and upon the occurrence of certain other events. Each $1,000 principal of the notes is initially convertible into 22.3414 shares of Sohu s common stock. Each holder of the notes will have the right, at the holder s option, to require Sohu to repurchase all or any portion of the principal amount of the holder s notes on July 14 in 2007, 2013 and 2018 at a price equal to 100% of the outstanding principal amount. Sohu may also redeem all or a portion of the notes for cash at any time on or after July 14, 2008 at 100% of the principal amount of the notes if the closing price of Sohu s common stock for each of the 30 consecutive trading days prior to such time was at least 130% of the conversion price or at such time at least 90% of the initial aggregate principal amount of the notes has been converted, repurchased or redeemed. In addition, upon a change of control event, each holder of the notes may require Sohu to repurchase some or all of its notes at a repurchase price equal to 100% of the principal amount of the notes. In 2005 and 2006, we early redeemed our zero coupon convertible senior notes with a face value of $30,220,000 at a discount. As of March 31, 2007, the outstanding balance of our zero coupon convertible senior notes was $59.8 million.

In summary, our cash flows were (in thousands):

	Three months ended March 31, 2007	Three months ended March 31, 2006
Net cash provided by operating activities	$ 3,775	$ 4,775
Net cash used in investing activities	(38,043)	(1,908)
Net cash provided by financing activities	1,508	1,026
Effect of exchange rate change on cash and cash equivalents	577	546
Net (decrease) increase in cash and cash equivalents	(32,183)	4,439
Cash and cash equivalents at beginning of period	124,756	119,091
Cash and cash equivalents at end of period	$ 92,573	$ 123,530

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For the three months ended March 31, 2007, net cash provided by operating activities was $3.8 million, and was primarily attributable to our net income of $4.5 million, depreciation and amortization of $3.0 million, share-based compensation of $2.5 million, provision for allowance for doubtful accounts of $427,000, which were offset by a $6.6 million decrease in working capital. For the three months ended March 31, 2006, net cash provided by operating activities was $4.8 million, and was primarily attributable to our net income of $6.0 million, depreciation and amortization of $2.3 million, share-based compensation of $1.7 million, provision for allowance for doubtful accounts of $237,000, which were offset by a $5.4 million decrease in working capital.

For the three months ended March 31, 2007, net cash used in investing activities was $38.0 million, and was primarily attributable to $38.4 million used in acquiring fixed assets, $0.6 million used in other acquisitions, and was offset by a $1.0 million decrease in restricted cash. For the three months ended March 31, 2006, net cash used in investing activities was $1.9 million, and was primarily attributable to $1.9 million used in acquiring fixed assets.

For the three months ended March 31, 2007, $1.5 million net cash provided by financing activities was primarily attributable to issuance of common stock upon the exercise of options granted under our stock incentive plan. For the three months ended March 31, 2006, $1.0 million net cash provided by financing activities was from issuance of common stock upon the exercise of options granted under our stock incentive plan.

As of March 31, 2007, we had cash and cash equivalents of $92.6 million, and investments in marketable debt securities of $4.9 million, totaling approximately $97.5 million as compared to $129.7 million as of December 31, 2006.

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

RISK FACTORS

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;

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- build our sponsored search, wireless, and online games 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 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 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.

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 users. We compete with distributors of content and services over the Internet, including Web directories, search engines, content sites, Internet service providers and sites maintained by government and educational institutions. These sites compete with us for visitor traffic, advertising dollars, wireless services, online game users and potential partners. 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.

We have many competitors in the PRC Internet market, including Sina, Netease, Tencent, Baidu, Tom Online, KongZhong, Linktone, Shanda, The9, Google and Yahoo! China. In addition, there are a number of existing or new PRC Internet portals, including those controlled or sponsored by PRC government entities. These private and government sponsored competitors may have certain competitive advantages over us in terms of:

- substantially greater financial and technical resources;

- more extensive and well developed marketing and sales networks;

- better access to original content and information;

- greater global brand recognition among consumers; and

- larger customer bases.

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We compete with other portals in China primarily on the following bases:

- attractiveness of products;
- brand recognition;
- volume of traffic and users;
- quality of our Websites and content;
- strategic relationships;
- quality of our services;
- effectiveness of sales and marketing efforts;
- talented staff; and
- price.

Our existing competitors may in the future achieve greater market acceptance and gain a greater market share through the launching of new products and introducing new technologies. It is also possible that new competitors may emerge and acquire significant market share. In particular, our search engine faces intense competition from software and other Internet products and services incorporating search and retrieval capabilities, such as Baidu, Google and Yahoo! China. In addition, operators of leading Websites or Internet service providers, including Yahoo!, Microsoft/MSN and America Online, 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. For example, on September 19, 2006, China Telecom Corporation (or China Telecom) and Microsoft announced an agreement pursuant to which Microsoft will provide Windows Live search service to 25 million users of China Telecom. We believe the rapid increase in China s online population will draw more attention from these multinational players to the PRC Internet market. We also compete with traditional forms of media, such as newspapers, magazines, radio and television, for advertisers and advertising revenues.

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.

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.

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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, wireless, and online games 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 customers.

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 blogs. Moreover, we have used peer-to-peer streaming technology on video content to promote our online video. 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, 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 online games 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, the MII 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.

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 spaces on our Websites. Advertising revenues represented approximately 77% and 66% of our total revenues for the three months ended March 31, 2007 and 2006. For the three months ended March 31, 2007 and 2006, our five largest advertisers accounted for approximately 20% and 18% of our total brand advertising revenues, respectively. 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, since July 2006, the PRC government has 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 or potential medical advertising clients.

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- Advertising clients that have invested substantial resources in other methods of conducting business may be reluctant to adopt a new strategy that may limit or compete with their existing efforts.

- The 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.

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 quarter ended March 31, 2007, the total revenues generated from Website Alliance accounted for approximately 72% 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.

We rely on wireless services for a significant portion of our revenues. Wireless revenues have decreased in prior periods and may decrease further in the future.

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We derive a significant portion of our revenues from wireless services. We have derived our wireless revenues in prior periods from providing SMS, WAP, RBT, MMS and IVR, mainly consisting of news, weather forecast, chatting, entertainment information, music, ring tone, picture and logo downloads and various other mobile related products to mobile phone users and Personal Handy-phone System (or PHS) users. For the quarters ended March 31, 2007 and March 31, 2006, wireless revenues represented approximately 17% and 26%, respectively, of our total revenues.

Wireless revenues decreased in certain prior periods. Wireless revenues may decrease in the future due to the possibilities that:

- Our consumers may not understand our services or the fees they are being charged, may not be satisfied with our services and/or may not use our services on a regular basis;

- Consumers may cancel their services at any time without notice;

- Revenues from new wireless services such as WAP, RBT, MMS and IVR may not continue to grow significantly and become a significant portion of our total wireless revenues;

- Competitors, including mobile network operators, may launch competing or better products than ours at any time;

- There are limited barriers to entry to the wireless services sector;

- Changes in the billing practices or operational rules and procedures of any of the four mobile network operators on whom we rely for service delivery and fee collection namely, CMCC, Unicom Corporation Limited (or Unicom), CNC and China Telecom could have a material impact on our wireless revenues. For instance, in July 2006, two major mobile network operators, CMCC and Unicom, introduced new policies on wireless value-added service, including extension of the trial period, double reminders for new monthly subscriptions, billing reminders to existing monthly subscribers and conversion of per message-based SMS subscriptions. In October 2006, the MII issued a guideline to regulate wireless value-added services, which reiterated policies carried on by major mobile network operators, including double confirmation, billing reminders, etc. On January 1, 2007, a notice of the MII, which focuses on the protection of mobile phone users right to select services and the strengthening of regulation on billing procedure, came into effect. Accordingly, these regulations and policies may cause the mobile network operators to change their billing procedures. We believe that our wireless revenues might be negatively affected by the implementation of these regulations and policies;

- Changes in government policy could restrict or curtail the services which we provide. The MII has proposed requiring all handset users (including pre-paid mobile phone users) to register using their real names. If this requirement is implemented, it may cause the decrease of new customers, and in turn, reducing our wireless revenues;

- Mobile network operators may impose penalties on wireless service providers, or SPs, for violating certain operating policies relating to the provision of wireless services. We have received several penalty notices from mobile network operators, claiming a breach of cooperation contracts and imposing both service suspension sanctions for a period of not more than a year and/or monetary penalties. There is no guarantee that we will not be subject to similar, or more severe, penalties from mobile network operators in the future, which could significantly impair our wireless business;

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- We may enter into cooperation agreements with mobile network operators on terms that are not favorable to us since we have limited bargaining power to negotiate contract terms. In addition, mobile network operators may unilaterally revise their agreement at any time. As a result of such contract terms, we could easily be found in breach of our agreement with an operator and may be subject to penalties; and

- Mobile network operators may not enter new agreements or renew existing agreements with SPs with respect to wireless services. However, those mobile network operators will continue work with us to provide services and monthly statements. New or renewed agreements with mobile network operators could change in a way that would be unfavorable to us, or such agreements may not be entered into at all.

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

Our wireless services depend mainly on the cooperation of mobile network operators such as CMCC, Unicom, CNC, China Telecom and their respective subsidiaries. We rely on mobile network operators in the following ways:

- we use mobile network operators networks and gateways to provide wireless services;

- we use and rely on mobile network operators billing systems to charge our subscribers through the subscribers mobile phone bills;

- we rely on mobile network operators collection proxy services to collect payments from subscribers; and

- we rely on mobile network operators infrastructure to further develop our wireless services.

We face significant risks with respect to our arrangements with mobile network operators which could adversely affect our wireless revenues. Such risks include the following:

- Mobile network operators have changed their operating rules and may make further changes at any time. Such previous or any future changes could result in our being required to pay penalties for breaching or being alleged to have breached certain provisions of our agreements with the mobile network operators under new or revised operation rules, or having our service discontinued with or without notice. Changes in these operating rules could also have a material impact on our wireless revenues;

- We provide wireless services through our Website and record the delivery of the service in our internal systems. However, in order to recognize revenues and receive payment for services provided, we rely on billing confirmations from mobile network operators as to the actual amount of services they have billed to their mobile customers. We are unable to collect wireless service fees from an operator in certain circumstances due to technical issues with the operator s network. We refer to these failures as an operator s failure rate, which can vary from operator to operator. An operator s failure rate can vary from month to month, ranging from 0% to 98% and may change at any time without notice. If an operator encounters technical problems, increases in the failure rate for that operator could occur;

- The service fees we pay for using an operator s infrastructure are set on the basis of negotiation of annual contracts. Our negotiation leverage is limited and if an operator increases its service fees or does not comply with the terms of our contract, our gross margin and profitability could be materially reduced. It is possible that some subsidiaries of the mobile network operators may consider increasing their service fees;

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We are required to follow the operators guidance in setting up wireless service fees. We also rely on the mobile network operators to collect the fees on our behalf which they have billed to our mobile customers. If an operator requires us to reduce the wireless service fees charged to mobile customers, disallows us from billing of certain inactive customers, refuses to pay us, requires us to share bad debts expenses, or, limits the amount of wireless service fees which can be billed or requires us to comply with any new billing rules, our wireless revenues could be adversely affected;

An operator s refusal to allow us to supply certain services could disrupt our wireless services. For example, during the period from September 1, 2004 to July 31, 2005, our MMS services were temporarily suspended by CMCC, based on allegations that Beijing Sohu, which was one of our VIEs at the time, breached certain provisions of its agreement with a CMCC subsidiary;

An operator could launch competing services at any time and could work with content providers directly so that SPs abilities to diversify their products might be limited. For example, in July 2006, CMCC introduced M.Music, an integrated music service platform which CMCC works directly with music record companies to provide downloads of various songs and music. In December 2006, CMCC introduced its own WAP channel, WAP Premier Select , which is placed in more prominent positions on Monternet and directly competes with SPs. If mobile network operators were unwilling to work with us, we would not be able to find substitute partners; and

CMCC set up rules for ranking of WAP service providers on its Monternet browser, which has a significant impact on WAP revenues. CMCC may change the rules at any time to affect the rank of the top five listings. As a result, the growth of our WAP revenues was lower than expected and we may lose our existing ranking because of lower visit rates.

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

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

Our investment in the online games business may not be successful.

We have invested and may invest further in our online games business. The offering of online games is currently one of the fastest growing online services in the PRC. Sohu had operated two online games, namely Knight Online and Blade Online, which we licensed from third party game companies. We discontinued the operation of Knight Online in March 2007 when the license expired. Our license of Blade Online will expire in September 2008. In the event that a license expires and we wish to renew such license, the licensor may only agree to renew such license upon an increase in the license fee that we pay to such licensor. Our new in-house developed online game Tian Long Ba Bu (or TLBB) will begin its open beta testing in May 2007. If the operation of TLBB is not as successful as we have expected, our online games business may be negatively impacted. In addition, our business might be significantly affected if there are any changes in the PRC laws or regulations in relation to these businesses. For example, the PRC government has issued a new law to implement restrictions and further regulation on the online games industry. Based on

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these rules, online games companies are required to install an anti-fatigue system , which discourages game participants from playing games for more than five hours per day. In addition, the PRC government is planning to make a compulsory requirement for online game players to register their real names and provide ID numbers when playing games. Also, with the requirement of the real name registration for online game players, the government will implement a rating system for online games. For those online games rated as not suitable for children under the age of 18, children under the age of 18 will be unable to access such game if a real name registration is in place. As a result, our revenues from online games may be adversely affected. We may not succeed in these markets despite our investment of time and funds. If we fail to achieve a significant market position, we will fail to realize our anticipated returns on these investments.

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 portal business. Our acquisitions could result in the use of substantial amounts of cash, potentially dilutive issuances of equity securities, significant impairment losses related to goodwill or amortization expenses related to intangible assets and exposure to undisclosed or potential liabilities of acquired companies. Moreover, the resources expended in identifying and consummating acquisitions may be significant. Furthermore, any 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.

The acquisition and integration of Go2Map create certain risks and uncertainties.

We completed the acquisitions of all of the outstanding capital stock of Go2Map Inc., and all of the registered share capital of Tu Xing Tian Xia, a company incorporated in the PRC which was an affiliate of Go2Map Inc (collectively Go2Map) in May 2005. As a result of these acquisitions, we continue to spend considerable time and effort integrating into our company the employees, organization, customers and operations of Go2Map. Also, there can be no assurance that we will succeed in realizing the anticipated economic benefits of the acquisitions, including increased sponsored search revenues. During the three months ended March 31, 2007, Go2Map was operating at a loss. In addition, we might be required to obtain additional licenses or approvals from relevant government authorities based on the application laws and regulations and might incur additional costs and expenses in obtaining any such licenses and approvals.

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

We are required under generally accepted accounting principles to review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization and slower growth rates in our industry. We may be required to record a charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined. As of March 31, 2007, our goodwill and amortizable intangible assets arising from acquisitions were approximately $61.0 million.

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

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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 stock 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 Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, (or SFAS 123(R)), 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 stock 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.

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

We have experienced dramatic growth in personnel since our inception 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 and technology providers and infrastructure providers, we may not be able to attract and retain users.

Although we believe we have attractive content, we need to rely on a number of third party relationships to attract traffic and provide content in order to make our Websites 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. Some content providers have increased the fees they charge us for their content. This trend could increase our costs and operating 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 premier content providers. If we are not able to renew our exclusive deals or premier 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.

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. For example, there are uncertainties in the wireless industry, such as the delayed issuance of 3G licenses and rumors concerning the possible restructuring of state-owned telecommunication companies, that increase our risk in maintaining co-operation relationship with mobile network operators.

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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 and a direct and indirect major shareholder of High Century, Sohu Internet, Tu Xing Tian Xia and Feng Yang Tian Lang. We rely on his expertise in our business operations, and on his personal relationships with the relevant regulatory authorities, our customers and suppliers. 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 customers and suppliers and incur additional expenses to recruit and train personnel. Each of our executive officers has entered into an employment agreement and a confidentiality, non-competition and non-solicitation agreement with us. However, the degree of protection afforded to an employer pursuant to confidentiality and non-competition undertakings governed by PRC law may be more limited when compared to the degree of protection afforded under the laws of other jurisdictions. We do not maintain key-man life insurance for any of our key executives.

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

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

We have limited operational, administrative and financial resources, which may be inadequate to sustain the growth we want to achieve. As the demands of our audience and the needs of our customers change, and as the number of our users and volume of online advertising and online games activities 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.

Risks Related to China s Telecommunications Infrastructure

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

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

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

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

We have signed Bandwidth Provision and Server Hosting Agreements with CNC and China Telecom. Under these agreements, we established two main service provision centers to maintain most of our servers in Beijing. However, as there are limited telecommunication infrastructure service providers, we may not be able to lease additional bandwidth on acceptable terms, on a timely basis, or at all. If we are not able to lease additional bandwidth, the development of our business can be affected.

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

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

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

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

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

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

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

We have limited backup systems and have experienced system failures and electrical outages from time to time in the past, which have disrupted our operations. Most of our servers and routers are currently hosted in a single location within the premises of Beijing Telecom Administration (or BTA). Our disaster recovery plan cannot fully ensure safety in the event of damage from fire, floods, typhoons, earthquakes, power loss, telecommunications failures, break-ins and similar events. If any of the foregoing occurs, we may experience a complete system shutdown. We do not carry any business interruption insurance. To improve the performance and to prevent disruption of our services, we may have to make substantial investments to deploy additional servers or one or more copies of our Websites to mirror our online resources.

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Although we carry property insurance with low coverage limits, our coverage may not be adequate to compensate us for all losses, particularly with respect to loss of business and reputation, that may occur.

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

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

Risks Related to China s Regulation Environment

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

We conduct our Internet and value-added telecommunication operations solely in the PRC through our indirect wholly owned subsidiaries, Beijing ITC, Sohu Era, Sohu Software, Go2Map Software, Sogou Technology and Sohu Media (or collectively PRC subsidiaries), and VIEs, High Century, Sohu Entertainment, Sohu Internet, Goodfeel, Huohu, Tu Xing Tian Xia, Feng Yang Tian Lang, Sogou Information, Guangzhou Interactive and 21 East Beijing. We are a Delaware corporation, while Sohu Hong Kong, our indirect wholly owned subsidiary and the parent company of Beijing ITC, Sohu Era, Sohu Software and Sohu Media, is a Hong Kong corporation and a foreign person under PRC law. In order to meet ownership requirements under PRC law which restrict or prohibit wholly foreign owned enterprises, or WFOEs, from operating in certain industries such as Internet information, wireless, Internet access, and certain other industries, our VIEs are companies incorporated in the PRC and owned by Dr. Zhang and certain other employees of Sohu, rather than by Sohu.

The PRC began several years ago to regulate its Internet sector by making pronouncements or enacting regulations regarding the legality of foreign investment in the PRC Internet sector and the existence and enforcement of content restrictions on the Internet. We believe that our current ownership structure complies with all existing PRC laws, rules and regulations. There are, however, substantial uncertainties regarding the interpretation of current PRC Internet laws and regulations. The PRC government may issue new interpretations of the regulations regarding supervision of the Information industry from time to time. In July 2006, the MII issued a notice to strengthen management of foreign investment in and operation of value-added telecommunication services. The notice emphasizes that foreign investors who wish to engage in value-added telecommunication services must strictly follow the relevant rules and regulations on foreign investment in telecommunication sectors. The notice also prohibits domestic telecommunication services providers from leasing, transferring or selling telecommunications business operating licenses to any foreign investor in any form, or providing any resources, sites or facilities to any foreign investor for their illegal operation of a telecommunications business in China. According to the notice, either the holder of a value-added telecommunication service license or its shareholders must directly own the domain names and trademarks used by such license holders in their provision of Value-added Telecommunication Services. The notice further requires each license holder to have the necessary facilities, including servers, for its approved business operations and to maintain such facilities in the regions covered by its license. Value-added services

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license holders are required to evaluate the compliance with the requirements set forth in the notice. We are in the process of transferring several of our domain names and trademarks to Sohu Internet, which licensed the same to Sohu Era and Sohu Media, and we may modify other certain aspects of our business structure in order to further comply with these requirements. In addition, new PRC Internet and foreign exchange laws and regulations were recently adopted. Accordingly, it is possible that the PRC government may ultimately take a view contrary to ours.

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

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

If we or any of our PRC subsidiaries and VIEs were found to be in violation of any existing or future PRC laws or regulations, the relevant PRC authorities would have broad discretion in dealing with such violations, including, without limitation, the following:

levying fines;

confiscating our income;

revoking our licenses;

shutting down our servers and/or blocking our Websites;

requiring us to restructure our ownership structure or operations; and

requiring us to discontinue any portion or all of its Internet and value-added telecommunication businesses.

We may rely on dividends and other distributions on equity paid by Sohu.com Limited, our wholly owned subsidiary, to fund any cash requirements we may have. We may not be able to obtain cash from distributions to the extent such distributions are restricted by PRC law or future debt covenants. For any dividend received by Sohu.com Inc., it may be subject to US tax at 34% to 35%.

We are a holding company with no operating assets other than investments in Chinese operating entities, including Beijing ITC, Sohu Era, Sohu Software, Go2Map Software, Sogou Technology and Sohu Media, through an intermediate holding company, Sohu.com Limited, our wholly-owned subsidiary in the Cayman Islands, and our VIEs, High Century, Sohu Entertainment, Sohu Internet, Goodfeel, Huohu, Tu Xing Tian Xia, Feng Yang Tian Lang, Sogou Information, Guangzhou Interactive and 21 East Beijing. We may need to rely on dividends and other distributions on equity paid by Sohu.com Limited for our cash requirements in excess of any cash raised from investors and retained by us. If Beijing ITC, Sohu Era, Sohu Software, Go2Map Software, Sogou Technology and Sohu

Media incur debt on their own behalf in the future, the instruments governing the debt may restrict Beijing ITC s, Sohu Era s, Sohu Software s, Go2Map Software s, Sogou Technology s and Sohu Media s ability to pay dividends or make other distributions to us. In addition, PRC legal restrictions permit payment of dividends by Beijing ITC, Sohu Era, Sohu Software, Go2Map Software, Sogou Technology and Sohu Media only out of their net income, if any, determined in accordance with PRC accounting standards and regulations. Under PRC law, Beijing ITC, Sohu Era, Sohu Software, Go2Map Software, Sogou Technology and Sohu Media are also required to set aside 10% of their net income each year to fund certain reserve funds until these reserves equal to 50% of the amount of paid-in capital. These reserves are not distributable as cash dividends. Furthermore, subject to possible reduction to the extent that our PRC subsidiaries pay a tax in China and would therefore be entitled to a foreign tax credit, dividends received by Sohu.com Inc. would be subject to taxation at United States tax rates of 34% or 35%. We do not expect any dividends or other distributions on equity from Sohu.com Limited in the foreseeable future.

We may be unable to collect long-term loans to officers and employees or exercise management influence associated with High Century, Sohu Entertainment, Goodfeel, Huohu, Sogou Information and Guangzhou Interactive.

As of March 31, 2007, Sohu had outstanding long-term loans of $9.8 million to Dr. Zhang, Sohu s Chief Executive Officer and a major Sohu shareholder, and certain of our employees. The long-term loans are used to finance investments in High Century; High Century, which is owned 80% by Dr. Zhang and 20% by an employee; Sohu Entertainment, which is owned by two of our employees; Goodfeel, which is owned by two of our employees; Huohu, which is owned 75% by Sohu Era and 25% by an employee; Sogou Information, which is owned by two of our employees, and Guangzhou Interactive, which is owned 50% by Sohu Internet and 50% by High Century. High Century, Sohu Entertainment, Goodfeel, Huohu, Sogou Information and Guangzhou Interactive are used to facilitate our participation in telecommunications, Internet content and certain other businesses in China where foreign ownership is either prohibited or restricted.

The loan agreements contain provisions that, subject to PRC law, (i) the loans can only be repaid to us by transferring the shares of High Century, Sohu Entertainment, Goodfeel, Huohu, Sogou Information or Guangzhou Interactive to us; (ii) the shares of High Century, Sohu Entertainment, Goodfeel, Huohu, Sogou Information or Guangzhou Interactive cannot be transferred without our approval; and (iii) we have the right to appoint all directors and senior management personnel of High Century, Sohu Entertainment, Goodfeel, Huohu, Sogou Information and Guangzhou Interactive. Dr. Zhang and the other employee borrowers have pledged all of their shares in High Century, Sohu Entertainment, Goodfeel, Huohu, Sogou Information and Guangzhou Interactive as collateral for the loans and the loans bear no interest and are due on demand after November 2003 in the case of High Century; after November 2005 in the case of Huohu; after August 2006 in the case of Sogou Information; after October 2006 in the case of Goodfeel; after November 2006 in the case of Sohu Entertainment and the earlier of a demand or, in any case, at such time as Dr. Zhang or the other employee borrowers, as the case may be, is not an employee of Sohu. Sohu does not intend to request repayment of the loans as long as PRC regulations prohibit it from directly investing in businesses being undertaken by the VIEs.

Because these loans can only be repaid by the borrowers transferring the shares of the various entities, our ability to ultimately realize the effective return of the amounts advanced under these loans will depend on the profitability of High Century, Sohu Entertainment, Goodfeel, Huohu, Sogou Information and Guangzhou Interactive is uncertain.

Furthermore, because of uncertainties associated with the PRC law, ultimate enforcement of the loan agreements is uncertain. Accordingly, we may never be able to collect these loans or exercise influence over High Century, Sohu Entertainment, Goodfeel, Huohu, Sogou Information and Guangzhou Interactive.

We depend upon contractual arrangements with High Century, Sohu Entertainment, Sohu Internet, Goodfeel, Huohu, Tu Xing Tian Xia, Feng Yang Tian Lang, Sogou Information and Guangzhou Interactive for the success of our business and these arrangements may not be as effective in providing operational control as direct ownership of these businesses and may be difficult to enforce.

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

Dr. Zhang, our Chief Executive Officer and a major shareholder of our company, is also the direct and indirect majority shareholder of High Century, Sohu Internet, Tu Xing Tian Xia, Feng Yang Tian Lang and Guangzhou Interactive. As a result, our contractual relationships with those companies could be viewed as entrenching his management position or transferring certain value to him, especially if any conflict with him arises.

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

The PRC has enacted regulations that apply to Internet-related services and telecom-related activities. While many aspects of these regulations remain unclear, they purport to limit and require licensing of various aspects of the provision of Internet information and content, online advertising and value-added telecommunication services. In addition, the PRC may promulgate new laws, rules or regulations at any time. If these current or future laws, rules or regulations regarding Internet-related activities, are interpreted to be inconsistent with our ownership structure and/or our business operations, our business will be severely impaired and we could be subject to severe penalties. In addition, we may be required to apply for a new license or new qualification or transfer from an old type of license to a new type of license at any time as a result of the requirements of newly promulgated laws or new regulations. From the promulgation of such requirements to the final issuance of the license or qualification, there might be a long pending period. Although the issuance of the new license will finally trace back to the date of filing of the application, we may be held liable for operating without a proper license and may be fined for the operation during the application period.

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

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

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

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

We are also subject to potential liabilities for content on our Websites that is deemed inappropriate and for any unlawful actions of our subscribers and other users of our systems under regulations promulgated by the MII, such potential liabilities including, but not limited to, the imposition of fines or even the shutting down of the Website.

Furthermore, we are required to delete content that clearly violates the laws of the PRC and report content that we suspect may violate PRC law. We may have difficulty determining the type of content that may result in liability for us and, if we are wrong, we may be prevented from operating our Websites.

We may not have exclusive rights over the marks that are crucial to our business, including but not limited to Sohu.com , Sogou , 17173 , Focus.cn , Goodfeel and Go2Map .

We have applied for the registration of our key marks in the PRC, including but not limited to Sohu.com, Sogou, 17173, Focus.cn, Goodfeel and Go2Map, so as to establish and protect our exclusive rights to the marks. We have succeeded in registering the marks Sohu.com , 17173 , Focus.cn , GoodFeel and Go2Map in the PRC under certain classes. The applications for the registration of the other marks or some marks under other classes are still under examination by the Trademark Office of PRC. Completion of the registrations is subject to the Trademark Office of PRC s determination that there are no prior rights in the PRC. Any rejection of these applications could adversely affect our rights to these marks.

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

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

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

We cannot be certain that our products, services and intellectual property used in our normal course of business do not or will not infringe valid patents, copyrights or other intellectual property rights held by third parties. We have in the past been, are currently, and may in the future be, subject to claims and legal proceedings relating to the intellectual property of others in the ordinary course of our business. In particular, if we are found to have violated the intellectual property rights of others, we may be enjoined from using such intellectual property, may be ordered to pay a fine and may incur licensing fees or be forced to develop alternatives. We may incur substantial expenses in defending against these third party infringement claims, regardless of their merit. Successful infringement claims against us may result in substantial monetary liability or may materially disrupt the conduct of our business by restricting or prohibiting our use of the intellectual property in question. For example, during 2006 five United States movie companies commenced a lawsuit against us in the PRC alleging that a movie download service we had been providing infringed their copyrights in the movies. In December 2006, the PRC court decided the case against us, and ordered us to pay damages of approximately $138,000 to the U.S. movie companies. In addition, we provide search engine facilities capable of locating and accessing links to download MP3 music, movies, images and other multimedia files and/or other content hosted on third party Websites, which may be protected by law. Although, in a recent judgment in China, the court deemed that one of the industry participants was not infringed the rights of copyright owners for its MP3 search services, we still may face risks of increasing amounts of claims or lawsuits relating to our MP3 services in the future.

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

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

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

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

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

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

The MII has stated that the activities of Internet content providers are subject to regulation by various PRC government authorities, depending on the specific activities conducted by the Internet content provider. Various government authorities have stated publicly that they are in the process of preparing new laws and regulations that will govern these activities. The areas of regulation currently include online advertising, online news reporting, online publishing, online or wireless music providing, online securities trading, the provision of industry-specific (e.g., drug-related) information over the Internet and foreign investment in value-added telecommunication services. For instance, the MOC issued Several Opinions of Development and Supervision of Online Music in November 2006. In accordance with requirement of the MOC, we submitted most of online music, which we distributed in the PRC through online or wireless ways, to the MOC for censoring and recording in March 2007. We may be held liable for supervising nonprofit users distribution of online music on our portal in the future. If we fail to comply with these requirements, we may be fined. Other aspects of our online operations may be subject to regulations in the future.

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

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

China has enacted regulations governing Internet access and the distribution of news and other information. Furthermore, the Propaganda Department of the Chinese Communist Party has been given the responsibility to censor news published in China to ensure, supervise and control a particular political ideology. In addition, the MII has published implementing regulations that subject online information providers to potential liability for contents included in their portals and the actions of subscribers and others using their systems, including liability for violation of PRC laws prohibiting the distribution of content deemed to be socially destabilizing. Furthermore, the MII may implement a requirement that users of blogs register under their real names. If such a regulation is implemented, our business may be negatively affected due to a decrease in the number of blog users. Furthermore, because many PRC laws, regulations and legal requirements with regard to the Internet are relatively new and untested, their interpretation and enforcement may involve significant uncertainty. In addition, the PRC legal system is a civil law system in which decided legal cases have limited binding force as legal precedents. As a result, in many cases a Website operator may have difficulties determining the type of content that may subject it to liability.

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

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

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

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

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

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

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

The PRC legal system embodies uncertainties which could limit the legal protections available to us and you, or could lead to penalties on us.

The PRC legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases have little precedential value. In 1979, the PRC government began to promulgate a comprehensive system of laws and regulations governing economic matters in general. Our PRC operating subsidiaries, Beijing ITC, Sohu Era, Sohu Software, Go2Map Software, Sogou Technology and Sohu Media are wholly-foreign owned enterprises, or WFOEs, which are enterprises incorporated in mainland China and wholly-owned by our indirect subsidiary, Sohu Hong Kong. Beijing ITC, Sohu Era, Sohu Software, Go2Map Software, Sogou Technology and Sohu Media are subject to laws and regulations applicable to foreign investment in mainland China. In addition, all of our subsidiaries and VIEs are incorporated in China and subject to all applicable Chinese laws and regulation. Because of the relatively short period for enacting such a comprehensive legal system, it is possible that the laws, regulations and legal requirements are relatively recent, and their interpretation and enforcement involve uncertainties. These uncertainties could limit the legal protections available to us and other foreign investors, including you, and may lead to penalties imposed on us because of the different understanding between the relevant authority and us. For example, according to current tax laws and regulation, we are

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responsible to pay business tax on a Self-examination and Self-application basis. However, since there is no clear guidance as to the applicability of those preferential treatments, we may be found in violation of the interpretation of local tax authorities with regard to the scope of taxable services and the percentage of tax rate and therefore might be subject to penalties, including but not limited to monetary penalties. In addition, we cannot predict the effect of future developments in the PRC legal system, particularly with regard to the Internet, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the preemption of local regulations by national laws.

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

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

If tax benefits presently available to certain of our subsidiaries and VIEs located in China were not available, the income tax rate on most of our profits in China could be significantly increased.

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

Subject to the approval of the relevant tax authorities, the effective income tax rate for new technology enterprises registered and operating in Beijing Zhongguancun Science Park is 15%, while the local income tax will be exempted as long as the enterprise holds the new technology enterprise status. New technology enterprises are exempted from Chinese state corporate income tax for three years, beginning with their first year of operations, and are entitled to a 50% tax reduction at the rate of 7.5%, for the subsequent three years and 15% thereafter. Currently, our China-based subsidiaries and VIEs, Sohu Era, Sohu Internet, Sogou Information, Sogou Technology and Sohu Media enjoy tax benefits which are available to new technology enterprises beginning with their first year of operations. Providing there is no change in the new technology enterprise status or change in relevant regulations, Sohu Era and Sohu Internet are exempted from income tax for the years ended December 31, 2003, 2004 and 2005, are subject to a 7.5% tax rate for the year ended December 31, 2006 and the years ending December 31, 2007 and 2008, and are subject to a 15% tax rate for each year thereafter. Sogou Information, Sogou Technology and Sohu Media are exempted from income tax for the year ended December 31, 2006 and the years ending December 31, 2007 and 2008, are subject to a 7.5% tax rate for the years ending December 31, 2009, 2010 and 2011, and are subject to a 15% tax rate for each year thereafter.

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If there is any change in governmental policy or the governmental regulations concerning the qualifying criteria of a new technology enterprise, or we are unable to meet the existing new technology enterprise requirements, the above tax benefits would no longer be available. If we did not meet the requirements of a new technology enterprise, we may be subject to enterprise income tax in China at rates up to 33%, which could cause a significant reduction in our after-tax income.

In March 2007, the Chinese government promulgated the Corporate Income Tax Law which will be effective from January 1, 2008. The Corporate Income Tax Law will impose a unified income tax rate of 25% for both domestic and foreign invested enterprise. The existing Tax Law of the People s Republic of China for Enterprises with Foreign Investment and Foreign Enterprises (the FIE and FE tax laws) and Provisional Regulations of the People s Republic of China on Enterprise Income Tax (collectively referred to as the existing tax laws), which stipulated income tax rates for domestic and foreign invested enterprises at different rates, will be abolished simultaneously. Currently, our China-based subsidiaries and VIEs are subject to the tax rates under the existing tax laws. The Corporate Income Tax Law provides for a 5-year transitional period for those entities that were subject to FIE and FE tax laws in previous years. The reduced income tax rate for new technology enterprises remains at 15% under the Corporate Income Tax Law. However, the qualifying criteria of a new technology enterprise under the new law and detailed implementation rules have not been released. We will continue to assess the impact of such new law in the future. If any of Sohu Era, Sohu Internet, Sogou Information, Sogou Technology or Sohu Media does not meet the requirements for being considered a new technology enterprise under the new Corporate Income Tax Law, its tax rate will eventually become 25%. Although the new Corporate Income Tax Law has provided a five-year transitional period for such enterprises, the increased income tax rates may result a significant reduction in our after-tax income.

Our subsidiaries and VIEs in China are subject to restrictions on paying dividends or making other payments to our overseas entities.

We are a holding company and do not have any assets or conduct any business operations in China other than our investments in our Chinese subsidiaries and VIEs. As a result, we depend on dividend payments from our subsidiaries in China after they receive payments from our VIEs under various services and other arrangements. It is possible that our Chinese subsidiaries will not continue to receive the payments in accordance with our contracts with our VIEs. To the extent that the VIEs have undistributed after tax net income, we must pay tax on behalf of our employees who hold interests in the VIEs when the VIEs distribute dividends in the future. The current dividend tax rate is 20%. In addition, under PRC law, our subsidiaries are only allowed to pay dividends to us out of their accumulated profits, if any, as determined in accordance with PRC accounting standards and regulations. Moreover, our Chinese subsidiaries are required to set aside at least 10% of their respective accumulated profits, if any, up to 50% of their registered capital to fund certain mandated reserve funds that are not payable or distributable as cash dividends.

The PRC government also imposes controls on the convertibility of RMB into foreign currencies and, in certain cases, the remittance of currencies out of China. We may experience difficulties in completing the administrative procedures necessary to obtain and remit foreign currencies. If we or any of our subsidiaries are unable to receive all of the revenues from our operations through these contractual or dividend arrangements, we may be unable to effectively finance our operations or pay dividends on our shares.

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

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

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

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

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

We may suffer currency exchange losses if the RMB depreciates relative to the US Dollar.

Our reporting currency is the US Dollar. However, substantially all of our revenues are denominated in RMB. In July 2005, China reformed its exchange rate regime by establishing a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. The RMB is no longer pegged to the US dollar and the exchange rate will have some flexibility. Hence, considering the floating exchange rate regime, if the RMB depreciates relative to the US Dollar, our revenues as expressed in our US Dollar financial statements will decline in value. In addition, there are very limited hedging transactions available in China to reduce our exposure to exchange rate fluctuations. While we may decide to enter into hedging transactions in the future, the availability and effectiveness of these hedges may be limited and we may not be able to successfully hedge our exposure, if at all. In addition, our currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert RMB into US Dollars.

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

The market price of our common stock has been volatile and is likely to continue to be so. The initial public offering price of our common stock in July 2000 was $13.00 per share. The trading price of our common stock subsequently dropped to a low of $0.52 per share on April 9, 2001. During 2006, the trading price of our common stock ranged from a low of $18.20 per share to a high of $29.43 per share and during three months ended March 31, 2007, the trading price of our common stock ranged from a low of $21.26 per share to a high of $27.58 per share. On May 7, 2007, the closing price of our common stock was $24.11 per share.

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

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

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

In July 2003, we issued $90 million aggregate principal amount of zero coupon convertible senior notes due July 2023. The notes are convertible into our common stock at a conversion price of $44.76 per share, subject to adjustment upon the occurrence of specified events, which would result in the issuance of an aggregate of approximately two million shares. Therefore, each $1,000 principal amount of the notes will initially be convertible into 22.3414 shares of our common stock. Each holder of the notes will have the right, at the holder s option, to require Sohu to repurchase all or any portion of the principal amount of the holder s notes on July 14 in 2007, 2013 and 2018 at a price equal to 100% of the outstanding principal amount. We had early redeemed our zero coupon convertible senior notes with face value of $30,220,000 at a discount from the market in 2005 and 2006. We may also be required to repurchase all of the outstanding notes following a fundamental change of Sohu, such as a change of control, prior to maturity. As of March 31, 2007, the face value of outstanding zero coupon convertible senior notes was $59.8 million. All of the outstanding notes were classified as current liability as of March 31, 2007. We will continue to repurchase the outstanding notes on an ongoing and opportunistic basis. However, we may not have enough cash on hand or the ability to access cash to pay the notes if presented for redemption on a fundamental change, on a redemption date referred to above or at maturity. In addition, the redemption or purchase of our notes with shares of our common stock or the conversion of the notes into our common stock could result in a reduction of our earnings per share.

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

Our Chief Executive Officer, Dr. Zhang, beneficially owns approximately 23.2% of the outstanding shares of our common stock and is our largest stockholder. Our Chief Executive Officer, together with our other executive officers and members of our Board of Directors, beneficially own approximately 26.2% of the outstanding shares of our common stock. Accordingly these stockholders acting together will have significant influence in determining the outcome of any corporate transaction or other matter submitted to the stockholders for approval, including mergers, consolidations, the sale of all or substantially all of our assets, election of directors and other significant corporate actions. They will also have significant influence in preventing or causing a change in control. In addition, without the consent of these stockholders, we may be prevented from entering into transactions that could be beneficial to us. The interests of these stockholders may differ from the interests of the other stockholders.

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

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

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

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

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISKS
FOREIGN CURRENCY EXCHANGE RATE RISK

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

The RMB is currently freely convertible under the current account , which includes dividends, trade and service-related foreign exchange transactions, but not under the capital account , which includes foreign direct investment. In addition, commencing on July 21, 2005, China reformed its exchange rate regime by changing to a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. Under the managed floating exchange rate regime, the RMB is no longer pegged to the US Dollar. The People s Bank of China will announce the closing prices of foreign currencies such as the US Dollar traded against the RMB in the inter-bank foreign exchange market after the closing of the market on each business day, and will make such prices the central parity for trading against the RMB on the following business day. To date, we have not entered into any hedging transactions in an effort to reduce our exposure to foreign currency exchange risk. While we may decide to enter into hedging transactions in the future, the effectiveness of these hedges may be limited and we may not be able to successfully hedge our exposure. Accordingly, we may incur economic losses in the future due to foreign exchange rate fluctuations, which could have a negative impact on our financial condition and results of operations.

The following table provides information, by maturity date, regarding our foreign currency sensitive financial instruments, which consist of cash and cash equivalents, receivables, payables and zero coupon convertible senior notes as of March 31, 2007:

	Expected Maturity Date							
			Before March 31,				Total Recorded	
	2008	2009	2010	2011	2012	Thereafter	Value	Fair Value
On-balance sheet financial instruments (in US$ 000)								
Cash and cash equivalents:								
in US$	39,863						39,863	39,863
in RMB	51,819						51,819	51,819
in HK$	891						891	891
Sub-total	92,573						92,573	92,573

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Restricted cash					
in US$	1,250	1,500		2,750	2,750
in RMB			1,034	1,034	1,034
Sub-total	1,250	1,500	1,034	3,784	3,784
Receivables					
in US$	635			635	635
in RMB	34,210			34,210	34,210
in HK$	54			54	54
Sub-total	34,899			34,899	34,899
Investments in marketable debt securities					
in US$	4,957			4,957	4,957
Payables					
in US$	4,223			4,223	4,223
in RMB	31,134			31,134	31,134
in HK$	41			41	41
Sub-total	35,398			35,398	35,398
Zero coupon convertible senior notes					
in US$	59,780			59,780	58,771

INVESTMENT RISK

Sohu invests in marketable debt securities to preserve principal while at the same time maximizing yields without significantly increasing risk. These marketable debt securities are classified as available-for-sale because we may dispose of the securities prior to maturity and they are thus reported at the market value as of the end of the period. As of March 31, 2007, an unrealized loss of $43,000 was recorded as accumulated other comprehensive income in shareholders equity.

INTEREST RATE RISK

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

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

The following table provides information, by maturity date, regarding our interest rate sensitive financial instruments, which consist of marketable debt securities and zero coupon convertible senior notes as of March 31, 2007.

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(US$ 000)	Expected Maturity Date						Total Recorded	
			Before March 31,				Value	Fair Value
	2008	2009	2010	2011	2012	Thereafter		
Investments in marketable securities	4,957						4,957	4,957
Average interest rate	4.40%							
Zero coupon convertible senior notes	59,780						59,780	58,771
Average interest rate	0.00%							

ITEM 4. CONTROLS AND PROCEDURES

Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this quarterly report (the Evaluation Date), have concluded that as of the Evaluation Date our disclosure controls and procedures were effective and designed to ensure that all material information relating to Sohu required to be included in our reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and to ensure that information required to be disclosed is accumulated and communicated to our management, including our principal executive and financial officers, as appropriate to allow timely decisions regarding required disclosure.

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

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

There are no material legal proceedings pending or, to our knowledge, threatened against us. From time to time we become subject to legal proceedings and claims in the ordinary course of our business, including claims of alleged infringement of trademarks, copyrights and other intellectual property rights, and a variety of claims arising in connection with our email, message boards, auction sites, shopping services, and other communications and community features, such as claims alleging defamation or invasion of privacy. However, such legal proceedings or claims, even if not meritorious, could result in the expenditure of significant financial and management resources.

ITEM 1A. RISK FACTORS

The disclosures under the heading Risk Factors in Part I of this report, which update and supplement the Risk Factors included in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2006 filed with the SEC on March 8, 2007, are incorporated by reference into this Part II, Item 1A.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Use of Proceeds

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

During the three months ended March 31, 2007, we did not use any proceeds from the offering. The remaining net proceeds from the offering have been invested in cash, cash equivalents, and marketable debt securities. The use of the proceeds from the offering does not represent a material change in the use of proceeds described in the prospectus contained in the Registration Statement on Form S-1 described above.

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ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Please see the Exhibit Index attached hereto.

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SIGNATURES

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

Dated: May 8, 2007

SOHU.COM INC.

By: /s/ Carol Yu
Co-President and Chief Financial Officer

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Sohu.com Inc.

Quarterly Report on Form 10-Q For Quarter Ended March 31, 2007

EXHIBITS INDEX

10.1	Employment Agreement between Sohu.com Inc and Carol Yu
10.2	Purchasing Agreement of Real Property Between Sohu New Era and Vision Hua Qing[(1)]
31.1	Rule 13a-14(a)/15d-14(a) Certification of Charles Zhang
31.2	Rule 13a-14(a)/15d-14(a) Certification of Carol Yu
32.1	Section 1350 Certification of Charles Zhang
32.2	Section 1350 Certification of Carol Yu

(1) The Company s subsidiaries entered into eight other purchasing agreements with Vision Hua Qing, which were substantially identical in all material respects to the agreement included as Exhibit 10.2, covering different portions of the same building.