

SOHU COM INC  
Form 10-Q  
November 08, 2013  
Table of Contents

**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 SEPTEMBER 30, 2013**

**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)**

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**Delaware**  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)  
**Level 18, SOHU.com Media Plaza**  
**Block 3, No. 2 Kexueyuan South Road, Haidian District**  
**Beijing 100190**  
**People's Republic of China**  
**(011) 8610-6272-6666**

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

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

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

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

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

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

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

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

Class	Outstanding at June 30, 2013
Common stock, \$.001 par value	38,292,919

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

	<b>PAGE</b>
<b>PART I</b>	
<b><u>FINANCIAL INFORMATION</u></b>	
Item 1	3
	3
	5
	7
	9
	11
Item 2	45
Item 3	72
Item 4	73
<b>PART II</b>	
<b><u>OTHER INFORMATION</u></b>	
Item 1	73
Item 1A	74
Item 2	74
Item 3	74
Item 4	74
Item 5	74
Item 6	74
	75
	76

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

	As of	
	September 30, 2013	December 31, 2012 (Revised)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,240,842	\$ 833,535
Restricted time deposits	314,836	116,140
Short-term investments	24,369	54,901
Investments in debt securities	81,327	79,548
Accounts receivable, net	153,284	98,398
Prepaid and other current assets	95,501	55,761
<b>Total current assets</b>	<b>1,910,159</b>	<b>1,238,283</b>
Fixed assets, net	546,228	178,951
Goodwill	164,461	159,215
Intangible assets, net	81,255	70,054
Restricted time deposits	60,151	130,699
Prepaid non-current assets	9,844	291,643
Other assets	16,249	13,792
<b>Total assets</b>	<b>\$ 2,788,347</b>	<b>\$ 2,082,637</b>
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable (including accounts payable of consolidated variable interest entities ( VIEs ) without recourse to the Company of \$11,067 and \$6,958, respectively, as of September 30, 2013 and December 31, 2012)	\$ 96,171	\$ 67,934
Accrued liabilities (including accrued liabilities of consolidated VIEs without recourse to the Company of \$51,937 and \$53,034, respectively, as of September 30, 2013 and December 31, 2012)	209,463	117,029
Receipts in advance and deferred revenue (including receipts in advance and deferred revenue of consolidated VIEs without recourse to the Company of \$64,765 and \$54,150, respectively, as of September 30, 2013 and December 31, 2012)	112,805	89,687
	76,108	61,722

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Accrued salary and benefits (including accrued salary and benefits of consolidated VIEs without recourse to the Company of \$2,985 and \$4,940, respectively, as of September 30, 2013 and December 31, 2012)

Taxes payable (including taxes payable of consolidated VIEs without recourse to the Company of \$14,091 and \$14,191, respectively, as of September 30, 2013 and December 31, 2012)

56,672

33,897

Deferred tax liabilities (including deferred tax liabilities of consolidated VIEs without recourse to the Company of \$3 and \$83, respectively, as of September 30, 2013 and December 31, 2012)

16,806

11,878

Short-term bank loans (including short-term bank loans of consolidated VIEs without recourse to the Company of nil as of both September 30, 2013 and December 31, 2012)

354,002

113,000

-3-

**Table of Contents**

Other short-term liabilities (including other short-term liabilities of consolidated VIEs without recourse to the Company of \$132,111 and \$33,074, respectively, as of September 30, 2013 and December 31, 2012)	63,298	63,352
Contingent consideration (including contingent consideration of consolidated VIEs without recourse to the Company of nil as of both September 30, 2013 and December 31, 2012)	0	76
<b>Total current liabilities</b>	<b>985,325</b>	<b>558,575</b>
Long-term accounts payable (including long-term accounts payable of consolidated VIEs without recourse to the Company of \$1,294 and nil, respectively, as of September 30, 2013 and December 31, 2012)	7,333	12,684
Long-term bank loans (including long-term bank loans of consolidated VIEs without recourse to the Company of nil as of both September 30, 2013 and December 31, 2012)	0	126,353
Deferred tax liabilities (including deferred tax liabilities of consolidated VIEs without recourse to the Company of \$3,310 and \$3,846, respectively, as of September 30, 2013 and December 31, 2012)	7,350	7,998
<b>Total long-term liabilities</b>	<b>14,683</b>	<b>147,035</b>
<b>Total liabilities</b>	<b>1,000,008</b>	<b>705,610</b>
<b>Commitments and contingencies</b>		
<b>MEZZANINE EQUITY</b>	0	61,810
<b>SHAREHOLDERS EQUITY</b>		
Sohu.com Inc. shareholders equity:		
Common stock: \$0.001 par value per share (75,400 shares authorized; 38,293 shares and 38,089 shares, respectively, issued and outstanding as of September 30, 2013 and December 31, 2012)	44	44
Additional paid-in capital	594,812	378,311
Treasury stock (5,889 shares as of September 30, 2013 and December 31, 2012)	(143,858)	(143,858)
Accumulated other comprehensive income	105,768	79,542
Retained earnings	749,748	770,184
<b>Total Sohu.com Inc. shareholders equity</b>	<b>1,306,514</b>	<b>1,084,223</b>
<b>Noncontrolling interest</b>	<b>481,825</b>	<b>230,994</b>
<b>Total shareholders equity</b>	<b>1,788,339</b>	<b>1,315,217</b>
<b>Total liabilities, mezzanine equity and shareholders equity</b>	<b>\$ 2,788,347</b>	<b>\$ 2,082,637</b>

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

Table of Contents

## SOHU.COM INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (unaudited)

(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30, 2012	
	2013	2012	2013	(Revised)
Revenues:				
Online advertising:				
Brand advertising	\$ 124,780	\$ 77,874	\$ 305,208	\$ 208,154
Search and others	52,305	35,284	134,528	85,684
Subtotal of online advertising revenues	177,085	113,158	439,736	293,838
Online games	161,494	150,263	497,210	412,187
Mobile	14,524	14,312	43,610	43,261
Others	15,220	7,645	34,267	18,423
Total revenues	368,323	285,378	1,014,823	767,709
Cost of revenues:				
Online advertising:				
Brand advertising	63,780	37,476	160,214	125,331
Search and others	26,785	19,736	72,075	49,056
Subtotal of cost of online advertising revenues	90,565	57,212	232,289	174,387
Online games	21,750	20,753	67,381	54,475
Mobile	8,108	9,474	26,342	28,535
Others	5,067	9,310	16,652	18,718
Total cost of revenues	125,490	96,749	342,664	276,115
Gross profit	242,833	188,629	672,159	491,594
Operating expenses:				
Product development	70,551	46,994	185,731	128,927
Sales and marketing	90,728	58,250	221,129	145,903
General and administrative	29,365	19,666	77,726	54,968
Impairment of intangible assets via acquisition of businesses	0	0	0	2,906
Total operating expenses	190,644	124,910	484,586	332,704

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Operating profit	52,189	63,719	187,573	158,890
Other income /(expense)	1,533	(111)	5,596	3,320
Interest income	7,595	5,974	19,794	19,692
Exchange difference	(1,305)	667	(5,274)	69
Income before income tax expense	60,012	70,249	207,689	181,971
Income tax expense	18,923	18,727	55,192	55,881
Net income	41,089	51,522	152,497	126,090
Less: Net income attributable to the mezzanine-classified noncontrolling interest shareholders	0	4,495	17,780	6,701
Net income attributable to the noncontrolling interest shareholders	22,855	21,146	70,426	57,618
Dividend or deemed dividend to noncontrolling Sogou series A preferred shareholders	82,423	0	82,423	14,219
Net income /(loss) attributable to Sohu.com Inc.	\$ (64,189)	\$ 25,881	\$ (18,132)	\$ 47,552

-5-



**Table of Contents**

Net income	41,089	51,522	152,497	126,090
Other comprehensive income /(loss): Foreign currency translation adjustment, net of tax	8,249	(3,447)	33,481	(7,115)
Comprehensive income	49,338	48,075	185,978	118,975
Less: Comprehensive income attributable to the mezzanine-classified noncontrolling interest shareholders	0	4,495	17,780	6,701
Comprehensive income attributable to noncontrolling interest shareholders	24,749	20,540	77,681	56,510
Dividend or deemed dividend to noncontrolling Sogou series A preferred shareholders	82,423	0	82,423	14,219
Comprehensive income /(loss) attributable to Sohu.com Inc.	\$ (57,834)	\$ 23,040	\$ 8,094	\$ 41,545
Basic net income /(loss) per share attributable to Sohu.com Inc.	\$ (1.68)	\$ 0.68	\$ (0.47)	\$ 1.25
Shares used in computing basic net income /(loss) per share attributable to Sohu.com Inc.	38,288	38,022	38,239	38,036
Diluted net income /(loss) per share attributable to Sohu.com Inc.	\$ (1.69)	\$ 0.63	\$ (0.53)	\$ 1.06
Shares used in computing diluted net income /(loss) per share attributable to Sohu.com Inc.	38,522	38,344	38,481	38,392

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

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

	<b>Nine Months Ended September 30,</b>	
	<b>2013</b>	<b>2012</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 152,497	\$ 126,090
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Depreciation	37,997	28,137
Share-based compensation expense	5,523	10,202
Amortization of intangible assets and purchased video content in prepaid expense	53,378	48,541
Impairment of purchased video content	0	15,101
Impairment of other intangible assets	1,504	7,522
Provision /(Reversal) for allowance for doubtful accounts	(134)	3,538
Excess tax benefits from share-based payment arrangements	0	(3,492)
Investment income from investments in debt securities	(4,143)	(4,098)
Others	(1,722)	89
<b>Changes in assets and liabilities, net of acquisition:</b>		
Accounts receivable	(49,920)	(15,025)
Prepaid and other assets	(25,135)	(4,042)
Deferred tax	6,928	7,595
Accounts payable	11,921	22,487
Taxes payable	870	(5,010)
Accrued liabilities	58,493	19,165
Receipts in advance and deferred revenue	12,578	4,809
Other short-term liabilities	14,751	18,172
<b>Net cash provided by operating activities</b>	<b>275,386</b>	<b>279,781</b>
<b>Cash flows from investing activities:</b>		
Purchase of noncontrolling interest in 7Road	(76,010)	0
Purchase of fixed assets	(84,201)	(50,840)
Purchase of intangible and other assets	(61,738)	(44,048)
Cash paid related to restricted time deposits	(121,705)	(225,757)
Proceeds /purchase of short-term investments, net	32,856	(24,436)
Other acquisitions, net of cash acquired	0	(683)
Other cash proceeds /(payments) related to investing activities	1,783	(979)
<b>Net cash used in investing activities</b>	<b>(309,015)</b>	<b>(346,743)</b>
<b>Cash flows from financing activities:</b>		
Issuance of common stock	964	240
Issuance of Sogou series B preferred shares and Class B ordinary shares	475,472	0

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Sohu's purchase of Sogou Series A Preferred Shares from Alibaba	0	(25,800)
Repurchase of common stock	0	(12,566)
Repurchase of Changyou American depositary shares ( ADSs )	(9,048)	0
Portion of Changyou dividend distributed to noncontrolling interest shareholders	0	(64,551)
Portion of Sogou special dividend distributed to holders of Series A Preferred Shares other than Sohu	(139,700)	0
Proceeds of loans from offshore banks	111,530	222,353

-7-

**Table of Contents**

Payment of contingent consideration	(19,736)	(13,806)
Excess tax benefits from share-based payment arrangements	0	3,492
Exercise of share-based awards in subsidiary	1,794	1,352
Proceeds received from early exercise of share-based awards in subsidiary	5,278	0
Other cash payments related to financing activities	(447)	(281)
Net cash provided by financing activities	426,107	110,433
Effect of exchange rate changes on cash and cash equivalents	14,829	(2,609)
Net increase in cash and cash equivalents	407,307	40,862
Cash and cash equivalents at beginning of period	833,535	732,607
Cash and cash equivalents at end of period	\$ 1,240,842	\$ 773,469
Supplemental cash flow disclosures:		
Barter transactions	\$ 380	\$ 451
Supplemental schedule of non-cash investing activity:		
Consideration payable for acquisition of Shi Ji Guang Su	24,398	0
Consideration payable for the purchase of noncontrolling interest in 7Road	2,000	0
Changes in government grant in prepaid and other current assets	1,066	794
Supplemental schedule of non-cash financing activity:		
Transaction expenses payable for issuance of Sogou Series B Preferred Shares and Class B Ordinary Shares	5,898	0

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

Table of Contents

## SOHU.COM INC.

## CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)

Nine Months Ended September 30, 2013

(In thousands)

	Sohu.com Inc. Shareholders' Equity						
	Total	Common Stock	Additional Paid-in Capital	Treasury Stock	Accumulated Other Comprehensive Income	Retained Earnings	Noncontrolling Interest
Beginning balance	\$ 1,315,217	\$ 44	\$ 378,311	\$(143,858)	\$ 79,542	\$ 770,184	\$ 230,994
Issuance of common stock	964	0	964	0	0	0	0
Repurchase of Changyou ADSs	(9,048)	0	(6,116)	0	0	0	(2,932)
Share-based compensation expense	5,464	0	(836)	0	0	0	6,300
Purchase of noncontrolling interest in 7Road	2,257	0	1,517	0	0	0	740
Consideration received for the issuance of Sogou shares to Tencent, net of transaction expenses	470,662	0	146,798	0	0	0	323,864
Direct tax impact of Sogou-Tencent Transactions	(21,420)	0	(21,420)	0	0	0	0
Special dividend paid to noncontrolling Sogou Series A Preferred Shareholders	(139,700)	0	86,335	0	0	(82,423)	(143,612)
Repurchase /put options for Sogou Series A preferred shares	(6,048)	0	(3,744)	0	0	(2,304)	0
Settlement of share-based awards in subsidiary	1,793	0	13,003	0	0	0	(11,210)
Net income attributable to Sohu.com Inc. and noncontrolling interest shareholders	134,717	0	0	0	0	64,291	70,426
Foreign currency translation adjustment, net of tax	33,481	0	0	0	26,226	0	7,255
Ending balance	\$ 1,788,339	\$ 44	\$ 594,812	\$(143,858)	\$ 105,768	\$ 749,748	\$ 481,825

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



**Table of Contents****SOHU.COM INC.****CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited and revised)****Nine Months Ended September 30, 2012**

(In thousands)

	<b>Sohu.com Inc. Shareholders' Equity</b>						
	<b>Total</b>	<b>Common Stock</b>	<b>Additional Paid-in Capital</b>	<b>Treasury Stock</b>	<b>Accumulated Other Comprehensive Income</b>	<b>Retained Earnings</b>	<b>Noncontrolling Interest</b>
Beginning balance	\$ 1,219,071	\$ 44	\$ 366,210	\$ (131,292)	\$ 76,219	\$ 697,244	\$ 210,646
Issuance of common stock	240	0	240	0	0	0	0
Repurchase of common stock	(12,566)	0	0	(12,566)	0	0	0
Share-based compensation expense	10,202	0	4,555	0	0	0	5,647
Settlement of share-based awards in subsidiary	1,353	0	(7,477)	0	0	0	8,830
Portion of Changyou dividend attributable to noncontrolling interest shareholders	(64,551)	0	0	0	0	0	(64,551)
Sohu's purchase of Sogou Series A Preferred Shares from Alibaba	(25,800)	0	0	0	0	(14,219)	(11,581)
Changes in mezzanine equity of Changyou	6,836	0	6,836	0	0	0	0
Transaction cost for Sohu's sale of the 17173 Business to Changyou	118	0	118	0	0	0	0
Deemed contribution from noncontrolling shareholders (related to Sohu's sale of the 17173 Business to Changyou)	0	0	171	0	0	0	(171)
Excess tax benefits from share-based awards	3,492	0	3,492	0	0	0	0
Net income attributable to Sohu.com Inc. and noncontrolling interest shareholders	119,389	0	0	0	0	61,771	57,618
Foreign currency translation adjustment, net of tax	(7,115)	0	0	0	(6,007)	0	(1,108)
Ending balance	\$ 1,250,669	\$ 44	\$ 374,145	\$ (143,858)	\$ 70,212	\$ 744,796	\$ 205,330

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



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**Table of Contents**

**SOHU.COM INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. The Company and Basis of Presentation**

*Nature of Operations*

Sohu.com Inc. (Sohu or the Company), a Delaware corporation organized in 1996, is a leading online media, search, gaming, community and mobile service group providing comprehensive online products and services in the People's Republic of China (the PRC or China). The Company, together with its wholly-owned and majority-owned subsidiaries and variable interest entities (collectively the Sohu Group or the Group), mainly offers online advertising services, online game services and mobile services.

Online advertising and online games are the core businesses of the Sohu Group.

*Online Advertising*

The online advertising business consists of the brand advertising business as well as the search and others business.

*Brand Advertising Business*

The brand advertising business offers advertisements on the Sohu Group's Web properties to companies seeking to increase their brand awareness online.

*Search and Others Business*

The search and others business, provided by Sohu's search subsidiary Sogou Inc. (Sogou), primarily offers customers pay-for-click services, as well as online marketing services on the Sogou Web Directory.

On September 16, 2013, pursuant to a Subscription Agreement entered into on that date by and among Sogou, THL A21 Limited, a British Virgin Islands company which is a wholly-owned subsidiary of Tencent Holdings Limited, a Cayman Islands company (Tencent Holdings Limited together with its subsidiaries, Tencent); Sohu's wholly-owned subsidiary Sohu.com (Search) Limited, a Cayman Islands company (Sohu Search); and Photon Group Limited (Photon), the investment vehicle of the Sohu Group's Chairman and Chief Executive Officer Dr. Charles Zhang, and a series of other contracts also entered into on that date between Sogou and Tencent, Tencent invested a net amount of \$448 million in cash in Sogou and transferred its Soso search-related businesses and certain other assets to Sogou (collectively, the Sogou-Tencent Transactions, or the Transactions).

On September 16, 2013, Sogou entered into (i) a Repurchase Option Agreement with Sohu Search, exercisable commencing March 16, 2014, granting to Sogou the right to purchase 24 million Series A Preferred Shares of Sogou held by Sohu Search for an aggregate purchase price of \$78.8 million; (ii) a Repurchase Option Agreement with Photon, also exercisable commencing March 16, 2014, granting to Sogou the right to purchase 6.4 million Series A Preferred Shares of Sogou held by Photon for an aggregate purchase price of \$21 million; and (iii) a Repurchase/Put Option Agreement with China Web Search (HK) Limited (China Web), an investment vehicle of Yunfeng Capital, granting to Sogou the right to purchase at any time from March 16, 2014 to July 31, 2014, and granting to China Web

the right to put to Sogou at any time prior to July 31, 2014, 14.4 million Series A Preferred Shares of Sogou held by China Web for an aggregate purchase price of \$47.3 million. Sogou expects to exercise its rights under each of these agreements when they first become exercisable.

On September 16, 2013, Sogou, Sohu Search, Photon, Mr. Xiaochuan Wang, four other members of Sogou's management (collectively, the "Sohu Parties") and Tencent entered into a Shareholders Agreement (the "Shareholders Agreement"). Under the Shareholders Agreement, the parties have agreed to vote their Sogou voting shares in all elections of directors to elect three designees of Sohu Search and two designees of Tencent.

On September 17, 2013, Sogou paid a special dividend to the three holders of Series A Preferred Shares of Sogou in an aggregate amount of \$301 million, of which Sohu received \$161 million, Photon received \$43 million, and China Web received \$97 million.

Pursuant to the Shareholders Agreement, Sohu will hold approximately 53.6% of the total voting power for the election of the Board of Directors of Sogou, assuming that the repurchase options and the repurchase/put option are exercised, Tencent's non-voting Class B Ordinary Shares are converted to voting shares, and all share options under the Sogou 2010 Share Incentive Plan and all share options under an arrangement providing for Sogou share-based awards to Sohu management and key employees (the "Management Share Option Arrangement") are granted and exercised. As Sohu is the controlling shareholder of Sogou, Sohu consolidates Sogou in the Sohu Group's consolidated financial statements, and recognizes noncontrolling interest reflecting economic interests in Sogou held by shareholders other than Sohu.

## **Table of Contents**

### *Online Games*

The online game business is conducted by Sohu's majority-owned subsidiary Changyou.com Limited ( Changyou ). Changyou completed its initial public offering ( IPO ) on the NASDAQ Global Select Market under the symbol CYOU in 2009. As of September 30, 2013, Sohu held approximately 68% of the combined total of Changyou's outstanding ordinary shares and controlled approximately 83% of the total voting power in Changyou. As Changyou's controlling shareholder, Sohu consolidates Changyou in the Sohu Group's consolidated financial statements but recognizes noncontrolling interest reflecting the economic interest in Changyou held by shareholders other than Sohu.

The online game business consists of the development, operation and licensing of massively multiplayer online games ( MMOGs ), which are interactive online games that may be played simultaneously by hundreds of thousands of game players, Web games, which are played over the Internet using a Web browser, and mobile games. Changyou currently operates several MMOGs in China, including the in-house developed Tian Long Ba Bu ( TLBB ), and developed, and primarily jointly operates with third-party joint operators, DDTank and Wartune (also known as Shen Qu ), which are two popular Web games in China.

### *Basis of Consolidation*

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

### *VIE Consolidation*

The Sohu Group adopted the guidance of accounting for VIEs, which requires VIEs to be consolidated by the primary beneficiary of the entity. For consolidated VIEs, management made evaluations of the relationships between the Sohu Group and the VIEs and the economic benefit flow of contractual arrangements with the VIEs. In connection with such evaluation, management also took into account the fact that, as a result of such contractual arrangements, the Group controls the shareholders' voting interests in these VIEs. As a result of such evaluation, management concluded that the Sohu Group is the primary beneficiary of its consolidated VIEs. The Sohu Group has one VIE that is not consolidated since the Group is not the primary beneficiary.

### *Noncontrolling Interest Recognition*

Noncontrolling interests are recognized to reflect the portion of the equity of majority-owned subsidiaries and VIEs which is not attributable, directly or indirectly, to the controlling shareholders.

### *Basis of Presentation*

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements and related footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

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 nine months ended September 30, 2013 are not necessarily indicative of the results

expected for the full fiscal year or for any future period. Certain comparative figures have been reclassified to conform to the current presentation.

*Historical accounting error regarding net income attributable to Sohu.com Inc. and basic and diluted net income per share attributable to Sohu.com Inc.*

In the third quarter of 2013, as previously reported in an Amendment No. 1 to Current Report on Form 8-K/A that the Company filed with the SEC on September 20, 2013, management noted an accounting error in the Company's Quarterly Report on Form 10-Q for the three months ended June 30, 2012 regarding net income attributable to Sohu.com Inc. and the calculation of basic and diluted net income per share attributable to Sohu.com Inc. In June 2012, Sohu had purchased from Alibaba Investments Limited ( Alibaba ), a private investment subsidiary of Alibaba Group Holding Limited, 24.0 million Series A Preferred Shares of Sogou for cash consideration of \$25.8 million. Under ASC 260-10-S99-2, this transaction gave rise to a deemed dividend in the amount of \$14.2 million, which was the difference between the consideration Sohu paid to Alibaba and the carrying amount of these 24.0 million Series A Preferred Shares in the Group's consolidated financial statements. Accordingly, this amount of \$14.2 million should have been subtracted from net income to arrive at net income available to common shareholders in the Group's calculation of net income

**Table of Contents**

per share. This deemed dividend was inappropriately accounted for when calculating the net income attributable to the Group, resulting in an error in the calculation of basic and diluted net income per share attributable to Sohu.com Inc. There was a carry-forward effect of this accounting error to the net income attributable to Sohu.com Inc. and the net income per share calculation as reported for the nine months ended September 30, 2012 in the Company's Quarterly Report on Form 10-Q for the three months then ended (the 3rd Quarter 2012 10-Q), and as reported for the year ended December 31, 2012 in the Company's Annual Report on Form 10-K for the year then ended. In addition, there was a carry-forward effect of the error to the classification of retained earnings and additional paid-in capital in the Company's Quarterly Report on Form 10-Q for the three months ended June 30, 2012, September 30, 2012, March 31, 2013 and June 30, 2013, and the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

Management performed an assessment of the impact of this accounting error from both a quantitative and a qualitative perspective in accordance with the guidance contained in SAB 99, and concluded that the error was not material to the Group's relevant historical financial statements taken as a whole. Therefore, management concluded that the relevant affected historical financial statements could continue to be relied upon but would be revised to correct the error.

Correction of the error in the Group's consolidated statements of comprehensive income for the nine months ended September 30, 2012 included in this report resulted in a reduction of \$14.2 million in the amount reported for net income attributable to Sohu.com Inc. (from \$61.8 million to \$47.6 million) and a reduction of \$0.38 in the amounts reported for both basic net income per share and diluted net income per share attributable to Sohu.com Inc. (from \$1.63 to \$1.25 for basic net income per share, and from \$1.44 to \$1.06 for diluted net income per share), as compared to the corresponding amounts reported in the 3rd Quarter 2012 10-Q. Correction of the error in the Group's consolidated balance sheets as of December 31, 2012 included in this report resulted in an increase of \$14.2 million in additional paid-in capital (from \$364.1 million to \$378.3 million) and a reduction of \$14.2 million in retained earnings (from \$784.4 million to \$770.2 million), as compared to the corresponding amounts reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

*Reclassification of revenues and costs related to Changyou Internet value-added services ( IVAS )*

Commencing January 1, 2013, in order to provide a better foundation for understanding Changyou's performance, both revenues and costs generated from the operation of third-party Web games by the 17173 business were reclassified from the online game business to IVAS in the others business. To conform to current period presentations, the relevant amounts for prior periods have been reclassified accordingly. Such reclassifications amounted to \$0.8 million and \$3.5 million, respectively, for revenues and \$0.3 million and \$1.3 million for costs, respectively, for the three and nine months ended September 30, 2012.

**2. Segment Information**

The Sohu Group's segments are business units that offer different services and are reviewed separately by the chief operating decision maker (the CODM), or the decision making group, in deciding how to allocate resources and in assessing performance. The Group's CODM is Sohu.com Inc.'s Chief Executive Officer. There are five segments in the Group, consisting of brand advertising, Sogou (which mainly consists of the search and others business), Changyou (which mainly consists of the online game business), mobile and others.

Some items, such as share-based compensation expense, operating expenses, other income and expense, and income tax expense, are not reviewed by the CODM. These items are disclosed in the segment information for reconciliation purposes only.

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

**Three Months Ended September 30, 2013**  
**Brand Advertising, Mobile and**  
**Others**

	<b>Brand Advertising</b>	<b>Mobile</b>	<b>Others</b>	<b>Brand Advertising, Mobile and Others</b>	<b>Sogou</b>	<b>Changyou</b>	<b>Eliminations</b>	<b>Consolidated</b>
Revenues (1)	\$ 110,008	\$ 14,524	\$ 7,036	\$ 131,568	\$ 56,940	\$ 183,068	\$ (3,253)	\$ 368,323
Segment cost of revenues	(60,512)	(8,108)	(71)	(68,691)	(26,687)	(30,093)	109	(125,362)
Segment gross profit /(loss)	\$ 49,496	\$ 6,416	\$ 6,965	62,877	30,253	152,975	(3,144)	242,961
SBC (2) in cost of revenues				(59)	(24)	(45)	0	(128)
Gross profit				62,818	30,229	152,930	(3,144)	242,833