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

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**FORM 10-K**

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(MARK ONE)

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

For the fiscal year ended December 31, 2016

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

COMMISSION FILE NUMBER 0-30961

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**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)

**98-0204667**  
(I.R.S. Employer  
Identification No.)

**Level 18, Sohu.com Media Plaza  
Block 3, No. 2 Kexueyuan South Road, Haidian District  
Beijing 100190  
People's Republic of China**  
(Address of principal executive offices)

**(011) 8610-6272-6666**  
(Registrant's Telephone Number, Including Area Code)

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**SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:  
Common Stock, \$0.001 Par Value**

**SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:  
None**

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

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

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

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

The aggregate market value of common stock held by non-affiliates of the registrant, based upon the last sale price on June 30, 2016 as reported on the NASDAQ Global Select Market, was approximately \$917 million.

As of January 31, 2017, there were 38,813,288 shares of the registrant’s common stock outstanding.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for Sohu’s 2016 Annual Meeting of Stockholders to be filed on or about April 28, 2017 are incorporated into Part III of this report.

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SOHU.COM INC.

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**PART I**

As used in this report, references to “us,” “we,” “our,” “our company,” “our Group,” the “Sohu Group,” the “Group,” and “Sohu.com” are to Sohu.com Inc. and, except where the context requires otherwise, our subsidiaries and variable interest entities (“VIEs”) Sohu.com Limited, Sohu.com (Hong Kong) Limited (“Sohu Hong Kong”), All Honest International Limited (“All Honest”), Sohu.com (Game) Limited (“Sohu Game”), Go2Map Inc., Sohu.com (Search) Limited (“Sohu Search”), Sogou Inc. (“Sogou”), Sogou (BVI) Limited (“Sogou BVI”), Sogou Hong Kong Limited (“Sogou HK”), Vast Creation Advertising Media Services Limited (“Vast Creation”), Sogou Technology Hong Kong Limited, Fox Video Investment Holding Limited (“Video Investment”), Fox Video Limited (“Sohu Video”), Fox Video (HK) Limited (“Video HK”), Focus Investment Holding Limited, Sohu Focus Limited, Sohu Focus (HK) Limited, Beijing Sohu New Era Information Technology Co., Ltd. (“Sohu Era”), Beijing Sohu Software Technology Co., Ltd., Beijing Sogou Technology Development Co., Ltd. (“Sogou Technology”), Beijing Sogou Network Technology Co., Ltd (“Sogou Network”), Fox Information Technology (Tianjin) Limited (“Video Tianjin”), Beijing Sohu New Media Information Technology Co., Ltd. (“Sohu Media”), Beijing Sohu New Momentum Information Technology Co., Ltd. (“Sohu New Momentum”), Beijing Century High Tech Investment Co., Ltd. (“High Century”), Beijing Heng Da Yi Tong Information Technology Co., Ltd. (“Heng Da Yi Tong”, formerly known as Beijing Sohu Entertainment Culture Media Co., Ltd.), Beijing Sohu Internet Information Service Co., Ltd. (“Sohu Internet”), Beijing GoodFeel Technology Co., Ltd., Beijing Sogou Information Service Co., Ltd. (“Sogou Information”), Beijing 21 East Culture Development Co., Ltd., Beijing Sohu Donglin Advertising Co., Ltd. (“Donglin”), Beijing Pilot New Era Advertising Co., Ltd. (“Pilot New Era”), Beijing Focus Yiju Network Information Technology Co., Ltd., SohuPay Science and Technology Co., Ltd., Beijing Sohu Dianjin Information Technology Co., Ltd., Beijing Yi He Jia Xun Information Technology Co., Ltd., Tianjin Jinhu Culture Development Co., Ltd. (“Tianjin Jinhu”), Guangzhou Qianjun Network Technology Co., Ltd. (“Guangzhou Qianjun”), Shenzhen Shi Ji Guang Su Information Technology Co., Ltd., Chengdu Sogou Easypay Technology Co., Ltd., Beijing Shi Ji Si Su Technology Co., Ltd., Chongqing Qogir Enterprise Management Consulting Co., Ltd., SendCloud Technology Co., Ltd., Beijing Hua Yang Lian Zhong Advertising Co., Ltd, Beijing Focus Interactive Information Service Co., Ltd., Beijing Focus Xin Gan Xian Information Technology Co., Ltd., Beijing Focus Real Estate Agency Co., Ltd. and our independently-listed majority-owned subsidiary Changyou.com Limited (“Changyou,” formerly known as TL Age Limited) as well as the following direct and indirect subsidiaries and VIEs of Changyou: Changyou.com HK Limited (“Changyou HK”) formerly known as TL Age Hong Kong Limited), Changyou.com Webgames (HK) Limited (“Changyou HK Webgames”), Changyou.com Gamepower (HK) Limited, ICE Entertainment (HK) Limited (“ICE HK”), Changyou.com Gamestar (HK) Limited, Changyou.com Korea Limited, Changyou.com India Private Limited, Changyou BILISIM HIZMETLERI TICARET LIMITED SIRKETI, Kylie Enterprises Limited, Mobogarden Enterprises Limited, Heroic Vision Holdings Limited, TalkTalk Limited, RaidCall (HK) Limited, 7Road.com Limited (“7Road”), 7Road.com HK Limited (“7Road HK”), Changyou.com (TH) Limited, Changyou.com Rus Limited, PT. CHANGYOU TECHNOLOGY INDONESIA, Changyou Middle East FZ-LLC, Changyou.com Technology Brazil Desenvolvimento De Programas LTDA, Greative Entertainment Limited (formerly known as Greative Digital Limited), Glory Loop Limited (“Glory Loop”), MoboTap Inc. (“MoboTap”, a Cayman Islands company), MoboTap Inc. Limited (“MoboTap HK”), MoboTap Inc. (a Delaware corporation), Dolphin Browser Inc., TMobi Limited (formerly known as Muse Entertainment Limited), Dstore Technology Limited, Mobo Information Technology Pte. Ltd., Changyou Mobo Glint Limited, Global Cool Limited, Beijing AmazGame Age Internet Technology Co., Ltd. (“AmazGame”), Beijing Changyou Skyline Property Management Co. Ltd, Beijing Cruise stars Technology Co., Ltd., Beijing Changyou Chuangxiang Software Technology Co., Ltd., Beijing Changyou Gamespace Software Technology Co., Ltd. (“Gamespace”), ICE Information Technology (Shanghai) Co., Ltd. (“ICE Information”), Beijing Changyou RaidCall Internet Technology Co., Ltd. (“RaidCall”), Beijing Yang Fan Jing He Information Consulting Co., Ltd. (“Yang Fan Jing He”), Shanghai Jingmao Culture Communication Co., Ltd. (“Shanghai Jingmao”), Shanghai Hejin Data Consulting Co., Ltd., Beijing Changyou Jingmao Film & Culture Communication Co., Ltd. (“Beijing Jingmao”), Beijing Gamease Age Digital Technology Co., Ltd. (“Gamease”), Beijing Guanyou Gamespace Digital Technology Co., Ltd. (“Guanyou Gamespace”), Beijing Zhi Hui You Information Technology Co., Ltd., Shanghai ICE Information Technology Co., Ltd. (“Shanghai ICE”), Shenzhen 7Road Network Technologies Co., Ltd. (“7Road Technology”), Beijing Changyou Star Digital Technology Co., Ltd (“Changyou Star”), Beijing Changyou Creation Information Technology Co., Ltd. (formerly known as Beijing Changyou e-pay Co. Ltd.), Shenzhen Brilliant Imagination Technologies Co., Ltd. (“Brilliant Imagination”), Beijing Baina Information Technology Co., Ltd., Baina Zhiyuan (Beijing) Technology Co., Ltd. (“Beijing Baina Technology”), Baina Zhiyuan (Chengdu) Technology Co., Ltd., Chengdu Xingyu Technology Co., Ltd., Baina (Wuhan) Information Technology Co., Ltd. (“Wuhan Baina Information”), Wuhan Xingyu Technology Co., Ltd., Wuhan Hualian Chuangke Technology Co., Ltd., Beijing Global Cool Technology Co., Ltd., Beijing Changyou Creative Technology Co., Ltd., and HongKong New Xinlang Electron Group Limited, and these references should be interpreted accordingly. Unless otherwise specified, references to “China” or “PRC” refer to the People’s Republic of China and do not include the Hong Kong Special Administrative Region, the Macau Special Administrative Region or Taiwan. This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding our expectations, beliefs, intentions or future strategies that are signified by the words “expect,” “anticipate,” “intend,” “believe,” or similar language. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Our business and financial performance are subject to substantial risks and uncertainties. Actual results could differ materially from those projected in the forward-looking statements. In evaluating our business, you should carefully consider the information set forth under the heading “Risk Factors.” Readers are cautioned not to place undue reliance on these forward-looking statements.

## ITEM 1. BUSINESS

### OUR COMPANY

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

In August 1996, we were incorporated in Delaware as Internet Technologies China Incorporated, and in January 1997 we launched our original Website, itc.com.cn. In February 1998, we re-launched our Website under the domain name Sohu.com and, in September 1999, we renamed our company Sohu.com Inc. On July 17, 2000, we completed our initial public offering on NASDAQ.

### OUR BUSINESS

Through the operation of Sohu, Sogou and Changyou, we generate online advertising revenues (including brand advertising revenues and search and search-related revenues), online games revenues and other revenues. Online advertising and online games are our core businesses. In the year ended December 31, 2016, total revenues generated by Sohu, Sogou and Changyou were approximately \$1.65 billion, including:

#### Sohu:

- \$408.6 million in brand advertising revenues, of which \$181.8 million was from Sohu Media Portal, \$123.1 million was from Sohu Video, and \$103.7 million was from Focus; and
- \$56.0 million in other revenues, mainly attributable to revenues from paid subscription services, interactive broadcasting services, sub-licensing of purchased video content to third parties, content provided through the platforms of the three main telecommunications operators in China, and the filming business.

Total revenues generated by Sohu were \$464.6 million.

#### Sogou:

- \$597.1 million in search and search-related revenues; and
- \$63.3 million in other revenues, primarily attributable to Sogou's offering of Internet value-added services (or "IVAS") with respect to the operation of Web games and mobile games developed by third parties, as well as other services and products provided to users.

Total revenues generated by Sogou were \$660.4 million.

#### Changyou:

- \$395.7 million in online game revenues;
- \$39.4 million in brand advertising revenues, mainly attributable to Changyou's 17173.com Website; and
- \$90.3 million in other revenues attributable to Changyou's cinema advertising business and IVAS business.

Total revenues generated by Changyou were \$525.4 million.

For the year ended December 31, 2016, our total brand advertising revenues were \$448.0 million, total search and search-related revenues were \$597.1 million, total online game revenues were \$395.7 million, and total other revenues were \$209.6 million.

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### **Sohu's Business**

#### *Brand Advertising Business*

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

- **Sohu Media Portal.** Sohu Media Portal is a leading online news and information provider in China. Sohu Media Portal provides users comprehensive content through [www.sohu.com](http://www.sohu.com) for PCs, the mobile phone application Sohu News APP and the mobile portal [m.sohu.com](http://m.sohu.com);
- **Sohu Video.** Sohu Video is a leading online video content and service provider in China through [tv.sohu.com](http://tv.sohu.com) for PCs and the mobile phone application Sohu Video APP; and
- **Focus.** Focus ([www.focus.cn](http://www.focus.cn)) is a leading online real estate information and services provider in China.

Revenues generated by the brand advertising business are classified as brand advertising revenues in our consolidated statements of comprehensive income.

#### *Other Business*

Sohu also engages in the other business, which consists primarily of paid subscription services, interactive broadcasting services, sub-licensing of purchased video content to third parties, providing content through the platforms of the three main telecommunications operators in China, and the filming business. Revenues generated by Sohu from the other business are classified as other revenues in our consolidated statements of comprehensive income.

### **Sogou's Business**

#### *Search and Search-related Business*

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

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

#### *Other Business*

Sogou also engages in the other business, primarily by offering IVAS with respect to the operation of Web games and mobile games developed by third parties, as well as other services and products provided to users. Revenues generated by Sogou from the other business are classified as other revenues in our consolidated statements of comprehensive income.

### **Changyou's Business**

Changyou's business lines consist of the online game business; the platform channel business, which consists primarily of online advertising and also includes IVAS; and the cinema advertising business.

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### *Online Game Business*

Changyou's online game business offers to game players (a) PC games, which are interactive online games that are accessed and played simultaneously by hundreds of thousands of game players through personal computers and require that local client-end game access software be installed on the computers used and (b) mobile games, which are played on mobile devices and require an Internet connection. Prior to the sale of Shenzhen 7Road Technology Co., Ltd., or Shenzhen 7Road, in August 2015, Changyou's online games also included Web games, which became an insignificant part of its online games business following the sale. All of Changyou's games are operated under the item-based revenue model, meaning that game players can play the games for free, but can choose to pay for virtual items, which are non-physical items that game players can purchase and use within a game, such as gems, pets, fashion items, magic medicine, riding animals, hieroglyphs, skill books and fireworks. Revenues derived from the operation of online games are classified as online game revenues in our consolidated statements of comprehensive income.

### *Platform Channel Business*

Changyou's platform channel business consists primarily of the operation of the 17173.com Website, one of the leading information portals in China, which provides news, electronic forums, online videos and other information services on online games to game players. Changyou's platform channel business also offers a number of software applications for PCs and mobile devices through RaidCall and the Dolphin Browser. RaidCall provides online music and entertainment services, primarily in Taiwan. The Dolphin Browser, which is operated by MoboTap, is a gateway to a host of user activities on mobile devices, with the majority of its users based in Europe, Russia and Japan. As Changyou management had determined that the Dolphin Browser was unable to provide expected synergies with Changyou's platform channel business, in 2016, Changyou's Board of Directors approved the disposal of Changyou's 51% equity interest in MoboTap Inc. (collectively with its subsidiaries and VIEs "MoboTap"), which is the mobile technology developer behind the Dolphin Browser. As of December 31, 2016, Changyou has been negotiating with a potential buyer on the terms of disposal. Accordingly, the assets and liabilities attributable to MoboTap are classified as assets and liabilities held for sale and measured at the lower of their carrying amounts or their fair value, less cost to sell, in our consolidated balance sheet as of December 31, 2016. All revenues generated by the 17173.com Website are classified as brand advertising revenues, IVAS revenues generated by the Dolphin Browser and by RaidCall are classified as other revenues and a relatively small amount of online game revenues generated by the Dolphin Browser are included in online game revenues in our consolidated statements of comprehensive income.

### *Cinema Advertising Business*

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

## **PRODUCTS AND SERVICES**

### **Sohu's Business**

#### ***Brand Advertising Business***

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

### *Sources*

#### *Sohu Media Portal*

Sohu Media Portal is a leading online news and information provider in China. Sohu Media Portal provides users comprehensive content through www.sohu.com for PCs, the mobile phone application Sohu News APP and the mobile portal m.sohu.com. We provide content by aggregating content from other media organizations and partnering with independent contributors, and also use content generated by our in-house editorial teams. We use algorithms to recommend to users personalized content that may interest them.

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### Sohu Video

Sohu Video (tv.sohu.com) is a leading online video content and service provider in China. We deliver premium purchased video content, self-developed video content, and user-generated content (“UGC”). Professional generated content (“PGC”) is a sub-category of UGC where the content is made by a large group of professional or semi-professional content studios. We provide users free access to the majority of our extensive and comprehensive video content library, which includes popular domestic and overseas television dramas, variety shows, movies, animations, PGC, documentaries, interactive broadcasting, and self-developed video content. We also offer selected fee-based content, which includes overseas television dramas, self-developed video content, and movies. Users can access our video content via PCs through tv.sohu.com, or via mobile devices by visiting our mobile video site or installing Sohu Video APP, our mobile video application.

### Focus

Focus (www.focus.cn) is a leading online real estate information and services provider in China. Focus provides diversified online content consisting of new homes for sale, properties for re-sale and home furnishing services, and other comprehensive services and solutions for house seekers, homeowners and buyers. Focus membership cards allow potential home buyers to purchase specified properties from real estate developers at a discount greater than the price that Focus charges for the card. Focus has also developed a transaction platform to offer online and offline services that facilitate the purchase of new homes by buyers.

### Business Model

In the brand advertising business, we enjoy a strong competitive position as one of the leading Internet companies in China. Through the platforms described above, we have built a sizeable user base through good user experiences provided by our products and services. This user base is appealing to advertisers. Through PCs and mobile devices, we provide advertisement placements to our advertisers on different Internet platforms and in different formats, which include banners, links, logos, buttons, full screen, pre-roll, mid-roll, post-roll video screens, pause video screens, loading page ads, news feed ads and in-feed video infomercial ads. We rely on both direct sales by our internal sales force and sales by advertising agents for advertising on our Internet platforms. Our advertisers include multinational companies and Chinese domestic medium-sized and small companies.

Currently we have four main types of pricing models, consisting of the Fixed Price model, the Cost Per Impression (“CPM”) model, the E-commerce model, and the Cost Per click (“CPC”) model.

#### Fixed Price model

Under the Fixed Price model, a contract is signed to establish a fixed price for the advertising services to be provided.

#### CPM model

Under the CPM model, the unit price for each qualifying display is fixed, but there is no overall fixed price for the advertising services stated in the contract with the advertiser. A qualifying display is defined as the appearance of an advertisement, where the advertisement meets criteria specified in the contract. Advertising fees are charged to the advertisers based on the unit prices and the number of qualifying displays.

#### E-commerce model

Under the e-commerce model, revenues are mainly generated from sales of membership cards which allow potential home buyers to purchase specified properties from real estate developers at a discount greater than the price that Focus charges for the card. Membership fees are refundable until the potential home buyers use the discounts to purchase properties. Focus recognizes such revenues upon obtaining confirmation that a membership card has been redeemed to purchase a property.

#### CPC model

Under the CPC model, there is no overall fixed price for advertising services stated in the contract with the advertiser. We charge advertisers on a per-click basis when the users click on the advertisements. The unit price for each click is auction-based.



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### **Other Business**

Sohu also engages in the other business, which consists primarily of paid subscription services, interactive broadcasting services, sub-licensing of purchased video content to third parties, providing content through the platforms of the three main telecommunications operators in China, and the filming business. Revenues generated by Sohu from the other business are classified as other revenues in the Sohu Group's consolidated statements of comprehensive income.

### **Sogou's Business**

#### ***Search and search-related Business***

##### *Products and Services for Users*

Sogou's main business is the search and search-related business. Sogou is a leading online search, client software and mobile Internet product provider in China. Sogou offers extensive products and services, including Sogou Search, Sogou Input Method, Sogou Browser and Sogou Web Directory to China's online users.

##### Sogou Search

Sogou Search is Sogou's proprietary search engine and is conducted through Sogou.com on both PCs and mobile devices. Upon a search query, users are taken through an interactive process to reach the most relevant selection of integrated Websites and search results pages based on advanced algorithms. Sogou Search provides users with high updating speed, short response time and accurate search results. We also provide direct answers to search queries that integrate relevant information from massive data. To better serve mobile users, Sogou mobile search supports voice and image search, intuitive display of search results and personalized features. In addition, we have made solid progress in artificial intelligence (AI) technologies, including natural language processing, and voice and image recognition. Such technologies have been applied to optimize our general search results ranking and voice and image search to improve search quality.

Sogou Search is dedicated to providing users with high quality and unique search results. Through our partnership with Tencent, one of Sogou's major shareholders, Sogou Search allows users to access content on many of Tencent's social platforms, including content published on Weixin/WeChat accounts, and also empowers users with enhanced vertical search capabilities. As the exclusive search partner of Zhihu Technology Limited ("Zhihu"), which operates an online question and answer-based knowledge and information-sharing platform, we are able to give our users easy access to the content available on Zhihu's platform. We partner with Microsoft to allow our users to conduct English and academic searches on Microsoft's Bing search engine. We also collaborate with credible online healthcare information platforms to improve the quality of healthcare search results for our users.

##### Sogou Input Method

Sogou Input Method is in-house developed software for the input of Chinese characters on PCs and mobile devices. It is among the most popular Internet products in China and has a dominant market share. Sogou Input Method uses search engine technology to capture and generate vocabularies and language models and can present the latest trends in words used by Internet users. In December 2016, Sogou Input Method's monthly active users on PCs reached 514 million, with a penetration rate over 95% in China, according to iResearch. Sogou Mobile Keyboard, the mobile version of Sogou Input Method, provides tailored features for smart phones, such as multimedia (voice and image) input, handwriting recognition, and vocabulary sync between mobile devices and PCs. In December 2016, Sogou Mobile Keyboard remained the third largest mobile application in China in terms of daily active users, according to iResearch.

##### Sogou Browser

Sogou Browser is our self-developed browser that is designed with technologies to make Web-navigation faster, safer, and easier for PCs and mobile devices. Sogou Browser for PCs has an original dual-core network-layer system and a seven-stage acceleration mechanism, which can accelerate browsing speed for users accessing the Internet. Sogou mobile browser has mobile-specific features, including file transfer from PC to mobile and news feed flow.

##### Sogou Web Directory

Sogou Web Directory is a popular Chinese Web directory navigation site for both PCs and mobile devices which serves as a key access point to popular and preferred Websites.

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### *Products and Services for Advertisers*

Search and search-related services include primarily pay-for-click services, as well as online marketing services on Web directories operated by Sogou.

#### *Pay-for-click Services*

Pay-for-click services are services that enable our advertisers' promotional links to be displayed on Sogou search result pages and on Sogou Website Alliance members' Internet properties where the links are relevant to the subject and content of such members' properties. For pay-for-click services, we introduce Internet users to our advertisers through our auction-based pay-for-click systems and charge advertisers on a per-click basis when the users click on the displayed links. Revenue for pay-for-click services is recognized on a per-click basis when the users click on the displayed links.

#### *Online Marketing Services on Web Directories Operated by Sogou*

Online marketing services on Web directories operated by Sogou mainly consist of displaying advertisers' promotional links on the Web pages of Web directories. Revenue for online marketing services on Web directories operated by Sogou is normally recognized on a straight-line basis over the contract period, provided our obligations under the contract and all revenue recognition criteria have been met.

Both pay-for-click services and online marketing services on Web directories operated by Sogou expand the distribution of advertisers' promotional links or advertisements by leveraging traffic on Sogou Website Alliance members' Internet properties, including Web content, software and mobile applications. We recognize gross revenue for the amount of fees we receive from advertisers, as we have the primary responsibility for fulfillment and acceptability. Payments made to Sogou Website Alliance members are included in cost of search and search-related revenues as traffic acquisition costs. We pay Sogou Website Alliance members based on either revenue-sharing arrangements, under which we pay a percentage of pay-for-click revenues generated from clicks by users of their properties, or on a pre-agreed unit price.

### **Other Business**

Sogou also engages in the other business, primarily by offering IVAS with respect to the operation of Web games and mobile games developed by third parties, as well as other services and products provided to users. Revenues generated by Sogou from the other business are classified as other revenues in our consolidated statements of comprehensive income.

### **Changyou's Business**

#### **Online Game Business**

##### *Business Model*

Changyou's game players typically access Changyou's games through personal computers and mobile devices, such as mobile phones and tablets, connected to the Internet. In order to access Changyou's PC games, game access software must be installed in the computer being used. Game players using PCs can typically download Changyou's game access software, interim updates and expansion packs directly from its official game Website. Game players access Changyou's mobile games by downloading its mobile game applications, primarily from third-party mobile application stores or, to a lesser extent, from Changyou's game Website. Prior to the sale of Shenzhen 7Road in August 2015, Changyou's online games also included Web games, which became a relatively insignificant part of its online games business following the sale.

Changyou's online games include a variety of game genres, including massively multiplayer online role-playing games ("MMORPGs"), CCGs, TPSs and other genres. Changyou is also developing, and plans to expand its game portfolio with, new genres such as S-RPGs, MOBAs, SLGs and advanced casual games. MMORPGs are massive multiplayer online role playing games that allow a large number of players to take on the role of a character and interact with one another within a virtual world. CCGs are collectible card games in which players collect cards and compete to win by using card sets with different functions. TPSs are third person shooter games that are structured around shooting, where a player can see and control an avatar on-screen in a third-person view. S-RPGs are a new innovative subset of role playing games that place emphasis on their storylines. MOBAs are multiplayer online battle arena games, which allow a player to join a team and work with his or her teammates to compete in a mapped field in order to achieve a common goal. SLGs are simulation games, which allow players to control, manage and use game characters and items and to design and implement their own strategies to win the games.

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Changyou's games are operated under the item-based revenue model, meaning game players can play Changyou's games for free, but may choose to pay for virtual items, which are non-physical items that game players can purchase and use within a game, such as gems, pets, fashion items, magic medicine, riding animals, hierograms, skill books and fireworks. Through virtual items, players are able to enhance or personalize their game environments or game characters, accelerate their progress in Changyou's games and share and trade with friends.

For players who choose to purchase virtual goods, Changyou delivers enhanced gameplay experiences and benefits, such as:

*Accelerated Progress.* Many of Changyou's games offer players the option to purchase items that can accelerate their progress in the game and increase their capabilities, so that they level up more quickly and compete more effectively against others in the game. While Changyou sells many items that accelerate progress in its games, Changyou monitors and carefully balances the disparity in capabilities between paying and non-paying game players to avoid discouraging non-paying game players and to keep the game challenging and interesting for paying game players.

*Enhanced Social Interaction.* Changyou uses a variety of virtual items to promote interaction and to facilitate relationship-building among game players in its games.

*Personalized and Customized Appearance.* Many of Changyou's games offer players the option to purchase decorative and functional items to customize the appearance of their characters, pets, vehicles, houses and other in-game possessions to express their individuality.

*Gifts.* Many of Changyou's games offer players the option to purchase gift items to send to their friends. Examples of gift items include decorative items and time-limited items for special holiday events and festivals, such as Valentine's Day, Spring Festival (Chinese New Year) and Christmas.

Changyou's online game business includes games that it self-operates and games that it licenses out to third-party operators.

### Self-Operated Games

For self-operated games, Changyou determines the price of virtual items based on the demand or expected demand for such virtual items. Changyou may change the pricing of certain virtual items based on its consumption patterns. Changyou hosts the games on its own servers and is responsible for sales and marketing of the games as well as customer service. Changyou's self-operated games include PC games and mobile games developed in house as well as PC games and mobile games that Changyou licenses from or jointly develops with third party developers.

### Licensed Out Games

Changyou also authorizes third parties to operate its online games. Changyou currently licenses TLBB to third-party operators, including operators in Hong Kong, Malaysia, Vietnam, and Taiwan. Changyou licenses its mobile games TLBB 3D, Fengyun, Legend of Sword and Fairy 5 to third-party operators, including operators in Hong Kong, Korea, Macau, Malaysia, Vietnam, Singapore, Taiwan, and Thailand. Changyou also licenses some of its games, including Feng Yun, to third-party operators in China.

The licensed-out games include PC games and mobile games developed in house as well as mobile games licensed from and jointly developed with third-party developers. Under Changyou's licensing arrangements with third-party operators, the operators pay Changyou upfront license fees and Changyou has revenue sharing rights over the terms of the licenses. The licenses are typically for a term of one to three years. Changyou provide updates and expansion packs for the licensed games, typically after it launches the updates and expansion packs in China.

For licensed-out games, the third-party operators are responsible for all operations and costs, including marketing and customer service, as well as the leasing and maintenance of servers.

### ***Platform Channel Business***

Changyou's platform channel business consists primarily of the operation of the 17173.com Website. The 17173.com Website, which is one of the leading game information portals in China, provides news, electronic forums, online videos and other information services on online games to game players. Changyou's platform channel business also offers a number of software applications for PCs and mobile devices through RaidCall and the Dolphin Browser. RaidCall provides online music and entertainment services, primarily in Taiwan. The Dolphin Browser is a gateway to a host of user activities on mobile devices, with the majority of its users based in Europe, Russia and Japan. As Changyou management had determined that the Dolphin Browser was unable to provide expected synergies with Changyou's platform channel business, in 2016, Changyou's Board of Directors approved the disposal of Changyou's 51% equity interest in MoboTap, which is the mobile technology developer behind the Dolphin Browser. As of December 31, 2016, Changyou has been negotiating with a potential buyer on the terms of disposal. Accordingly, the assets and liabilities attributable to MoboTap are classified as assets and liabilities held for sale and measured at the lower of their carrying amounts or their fair value, less cost to sell, in our consolidated balance sheet as of December 31, 2016. All revenues generated by the 17173.com Website are classified as brand advertising revenues and IVAS revenues generated by the Dolphin Browser and by RaidCall are classified as other revenues in our consolidated statements of comprehensive income. A relatively small amount of online game revenues generated by the Dolphin Browser are included in our online game revenues.

### ***Cinema Advertising Business***

Changyou also operates a cinema advertising business, which consists primarily of the acquisition, from operators of movie theaters, and the sale, to advertisers, of pre-film advertising slots, which are advertisements shown before the screening of a movie in a cinema theatre. Revenues generated by Changyou's cinema advertising business are classified as other revenues in our consolidated statements of comprehensive income.

## **COMPETITION**

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

In recent years there have emerged three large conglomerates, Tencent, Alibaba Group Holding Limited ("Alibaba") and Baidu, Inc. ("Baidu"), that have a wide reach in the Internet industry in China, and between them tend to dominate key aspects of the industry through their own operations or through strategic investments in other companies. Each of these companies is in a position to compete very effectively against us. For example, Alibaba alone competes with us in almost every key aspect of our business, competing with us in media through its investment in Sina Corporation ("Sina"); in online video through its subsidiary Youku Tudou Inc. ("Youku Tudou"); and in online search through its subsidiary UCWeb Inc. ("UCWeb").

During July 2016, Qihoo 360 Technology Co., Ltd. ("Qihoo"), with which we compete in our search and search-related business, has completed a "going private" transaction resulting in the delisting of its shares from the New York Stock Exchange, which could enhance Qihoo's competitive position relative to ours by giving Qihoo greater flexibility in its business operations and an opportunity to seek high valuations on alternative share exchanges, such as PRC exchanges, which could in turn provide Qihoo with increased capital resources, the ability to offer more valuable equity incentives for purposes of personnel recruiting, and valuable equity to use as consideration for strategic acquisitions.

### ***Sohu's Business***

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

- access to financial resources;
- gateway to host of Internet users activities;
- technological advancements;
- attractiveness of products;

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- brand recognition;
- volume of traffic and users;
- quality of Internet platforms and content;
- quality and quantity of purchased video content, self-developed video content, and user-generated content;
- strategic relationships;
- quality of services;
- effectiveness of sales and marketing efforts;
- talent of staff; and
- pricing.

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

- greater brand recognition among Internet users and clients;
- better products and services;
- larger user and advertiser bases;
- more extensive and well developed marketing and sales networks; and
- substantially greater financial and technical resources.

There are a number of existing or new PRC Internet companies, including those controlled or sponsored by private entities and by PRC government entities. As an Internet portal, we compete with various portals, including Tencent, Sina, NetEase.com, Inc. (“NetEase”), TouTiao.com and Phoenix New Media Limited (“Phoenix”), and vertical sites, such as Autohome Inc. (“Autohome”), Bitauto Holdings Limited (“BitAuto”), Youku Tudou, Beijing Xin Lian Xin De Advertising Media Co., Ltd. (“iQIYI”), SouFun Holdings Limited (“SouFun”), Leju Holdings Limited (“Leju”), and YY Inc. (“YY”).

We also compete with traditional forms of media, such as newspapers, magazines, radio and television, for advertisers, advertising revenues and content. Some of these traditional media, such as CCTV, Xinhua News Agency and People’s Daily, have extended their businesses into the Internet market. As a result, we expect to face more intense competition with traditional media companies in both their traditional media and in the Internet-related markets.

### ***Sogou’s Business***

Our search and search-related business mainly consists of pay-for-click services, as well as online marketing services on the Web directories operated by Sogou. Pay-for-click services face intense competition from other search engines, powered by Baidu, Qihoo, UCWeb and Google Inc. (“Google”). Online marketing services on Web directories operated by Sogou also face intense competition from other Chinese Web directories, such as the 360 Personal Start-up Page of Qihoo and Hao123.com of Baidu.

Moreover, we compete with other technology-driven companies on developing and promoting client-end software and mobile Internet products. For example, for the Sogou Input Method, we face competition from Baidu, IFLYTEK Co., Ltd. Microsoft and Google. For the Sogou Browser, we compete with Baidu, Alibaba, Qihoo, Cheetah, Microsoft and Google.

Our existing and potential competitors compete with us for users and advertisers on the basis of the quality and quantity of search results, the features, availability and ease of use of products and services, and the number of marketing and distribution channels. They also compete with us for talent with technological expertise, which is critical to the sustained development of our products and services. We also face competition from traditional forms of media.

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### **Changyou's Business**

#### *Online Game Business*

In the online game industry, Changyou competes principally with the following three groups of competitors in China:

- online game developers and/or operators in China that are publicly traded in the United States and in Hong Kong, including Tencent Holdings Limited, NetEase.com, Inc., Kingsoft Corporation Limited, IGG Inc. and NetDragon Websoft Inc;
- other companies in China devoted to game development and/or operation that are publicly traded in China, such as Kalends Inc., Perfect World Co., Ltd. and Century Cruises (formerly known as Giant Interactive Group Inc.), or privately-held companies, usually backed by venture capital or private equity, including Shulong Technologies (formerly known as Shanda Games Limited); and
- international competitors.

#### *Platform Channel Business*

In the platform channel business, Changyou's game information portal operated through the 17173.com Website currently competes in China with, among others, the following game information portals:

- Duowan.com, operated by YY Inc; and
- game.sina.com.cn, operated by Sina Corporation.

#### *Cinema Advertising Business*

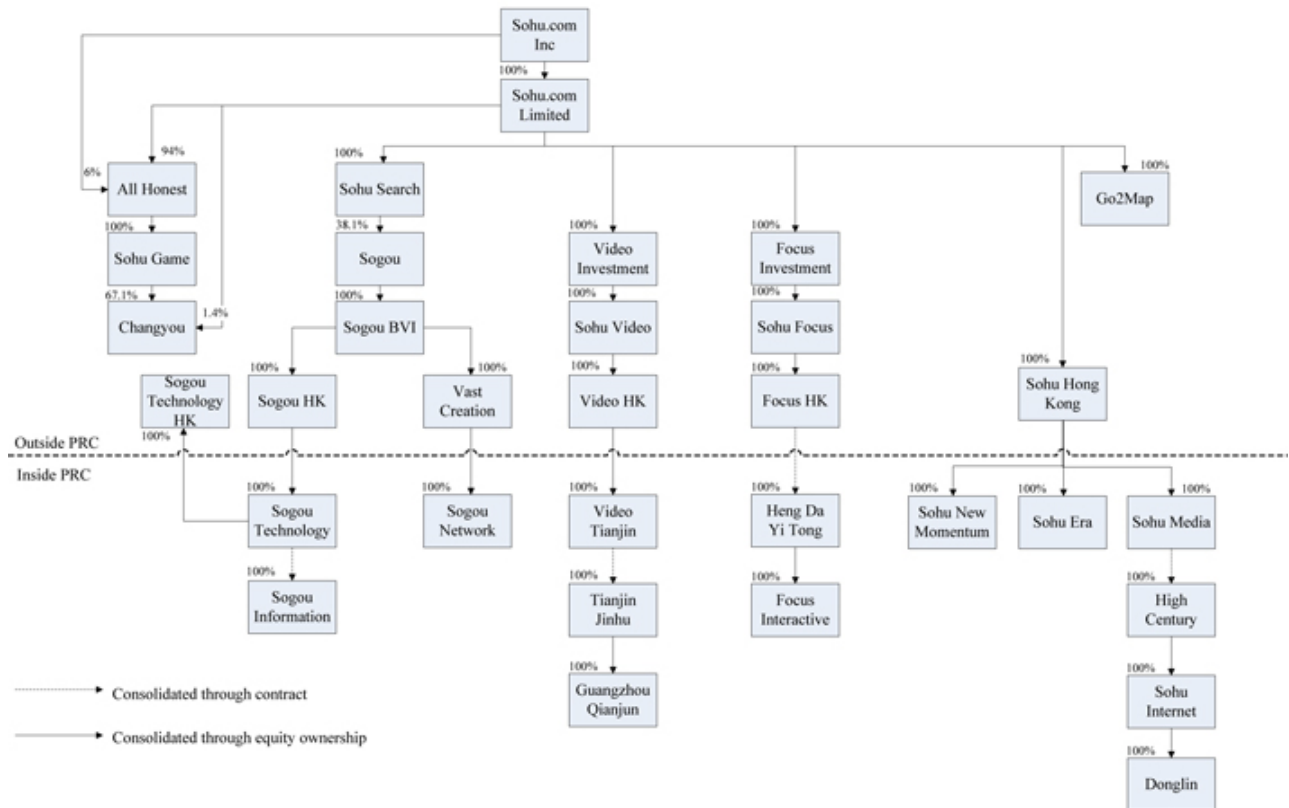
- Focus Film, operated by Focus Media Group; and
- China Movie Media Group, operated by Wanda Cinema Line, a Wanda Group company.

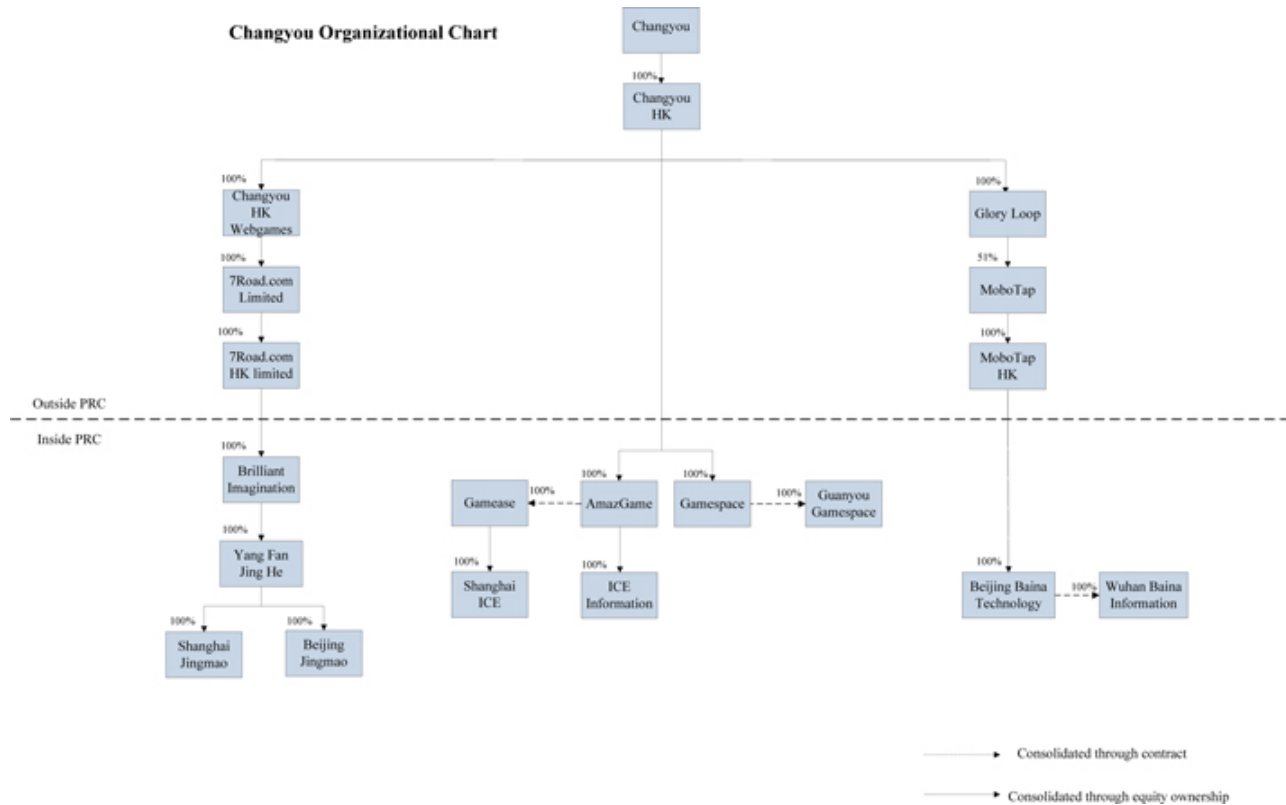
The existing and potential competitors in the online games industry compete with Changyou for talent, game player spending, time spent on game playing, marketing activities, quality of games, and distribution network. The existing and potential competitors in the online advertising industry compete with Changyou for talent, advertiser spending, number of unique visitors, number of page views, visitors' time spent on Websites, and quality of service. The existing and potential competitors in the cinema advertising industry compete with Changyou for cooperative relationships with operators of movie theaters that are popular among movie-goers, market share of quality pre-film advertisement slots, advertiser spending, and experienced sales and marketing personnel.

### **OUR CORPORATE STRUCTURE**

The charts below present the principal consolidated entities of Sohu.com Inc. not including our consolidated Changyou entities, and our principal consolidated Changyou entities.

**Sohu Organizational Chart**





**Principal Subsidiaries**

The following are our China-based principal direct or indirect operating subsidiaries, all of which were established as wholly foreign-owned enterprises (or “WFOEs”) under PRC law (collectively the “China-Based Subsidiaries,” or the “PRC Subsidiaries”):

*For Sohu’s Business*

- Sohu Era, established in 2003;
- Sohu Media, established in 2006;
- Sohu New Momentum, established in 2010; and
- Video Tianjin, established in 2011.

*For Sogou’s Business*

- Sogou Technology, established in 2006; and
- Sogou Network, established in 2012.

*For Changyou’s Business*

- AmazGame, established in 2007;
- ICE Information, established in 2007 and acquired by Changyou in 2010;
- Gamespace, established in 2009;



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- Yang Fan Jing He, established in 2010;
- Shanghai Jingmao, established in 2009 and acquired by Changyou in 2011;
- Beijing Jingmao, established in 2010 and acquired by Changyou in 2011;
- Brilliant Imagination, established in 2014; and
- Beijing Baina Technology, acquired by Changyou in 2014.

### ***Principal Variable Interest Entities***

The following are our principal VIEs, which we established or acquired in China to perform value-added telecommunications services because of PRC restrictions on direct foreign investment in and operation of value-added telecommunications businesses, which restrictions are discussed further below under the heading “Government Regulation and Legal Uncertainties-Specific Statutes and Regulations-Regulation of Foreign Direct Investment in Value-Added Telecommunications Companies.” We entered into contractual arrangements between our VIEs and our PRC Subsidiaries that govern a substantial portion of our operations, including those of the brand advertising business, the search and search-related business, the online game business and the others business. These entities are consolidated in Sohu’s consolidated financial statements, and noncontrolling interest is recognized when applicable.

#### *For Sohu’s Business*

- High Century, a PRC company that was incorporated in 2001. As of December 31, 2016, Dr. Charles Zhang, our Chairman of the Board and Chief Executive Officer, and Wei Li, one of our employees, held 80% and 20% interests, respectively, in this entity;
- Heng Da Yi Tong, a PRC company that was incorporated in 2002. As of December 31, 2016, Dr. Charles Zhang and Wei Li held 80% and 20% interests, respectively, in this entity;
- Sohu Internet, a PRC company that was incorporated in 2003. As of December 31, 2016, High Century held a 100% interest in this entity;
- Donglin, a PRC company that was incorporated in 2010. As of December 31, 2016, Sohu Internet held a 100% interest in this entity;
- Tianjin Jinhu, a PRC company that was incorporated in 2011. As of December 31, 2016, Xiufeng Deng and Xuemei Zhang, both of whom are our employees, each held a 50% interest in this entity;
- Guangzhou Qianjun, a PRC company that we acquired in November 2014. As of December 31, 2016, Tianjin Jinhu held a 100% interest in this entity; and
- Focus Interactive, a PRC company that was incorporated in July 2014. As of December 31, 2016, Heng Da Yi Tong held a 100% interest in this entity.

#### *For Sogou’s Business*

- Sogou Information, a PRC company that was incorporated in 2005. As of December 31, 2016, Xiaochuan Wang, Sogou’s Chief Executive Officer, High Century and Tencent held 10%, 45% and 45% interests, respectively, in this entity.

#### *For Changyou’s Business*

- Gamease, a PRC company that was incorporated in 2007. As of December 31, 2016, High Century held a 100% interest in this entity;
- Guanyou Gamespace, a PRC company that was incorporated in 2010. As of December 31, 2016, Beijing Changyou Star Digital Technology Co., Ltd (“Changyou Star”) held a 100% interest in this entity;
- Shanghai ICE, a PRC company that was acquired by Changyou in 2010. As of December 31, 2016, Gamease held a 100% interest in this entity;
- Wuhan Baina Information, a PRC company that Gamease acquired in July 2014. As of December 31, 2016, Changyou Star and Yongzhi Yang, the former chief executive officer of MoboTap, held 60% and 40% interests, respectively, in this entity.

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We have extended interest-free loans to the individual shareholders of the VIEs to fund their capital investment in the VIEs. The loans are secured by pledges of the shareholders' equity interests in the VIEs, and can only be repaid by the shareholders by surrender of those equity interests to us. We have also entered into a series of agreements with the individual shareholders to transfer their equity interests in the VIEs to us when required to do so.

## GOVERNMENT REGULATION AND LEGAL UNCERTAINTIES

*The following description of PRC laws and regulations is based upon the opinion of Haiwen & Partners, or Haiwen, our PRC legal counsel. The laws and regulations affecting China's Internet industry and other aspects of our business are at an early stage of development and are evolving. There are substantial uncertainties regarding the interpretation and enforcement of PRC laws and regulations. We cannot assure you that the PRC regulatory authorities would find that our corporate structure and business operations strictly comply with PRC laws and regulations. If we are found to be in violation of PRC laws and regulations by the PRC government, we may be required to pay fines, obtain additional or different licenses or permits, and/or change, suspend or discontinue our business operations until we are found to comply with applicable laws. For a description of legal risks relating to our ownership structure and business, see "Risk Factors."*

### Overview

The Chinese government has enacted an extensive regulatory scheme governing Internet-related areas, such as telecommunications, Internet information services, international connections to computer information networks, online game services, information security and censorship.

Various aspects of the PRC Internet industry are regulated by various PRC governmental authorities, including:

- the Ministry of Industry and Information Technology ("MIIT");
- the Ministry of Culture ("MOC");
- the Ministry of Public Security ("MPS");
- the Ministry of Commerce ("MOFCOM");
- the State Administration of Industry and Commerce ("SAIC");
- the State Administration of Press, Publication, Radio, Film and Television ("SAPPRFT"), which resulted from the merger of the former General Administration of Press and Publication, or ("GAPP"), with the former State Administration of Radio, Film and Television ("SARFT"), in March 2013. The "SAPPRFT" as used in this report refers to the governmental authority that resulted from the merger, as well as to the GAPP and the SARFT separately for periods prior to the merger;
- the PRC State Council Information Office ("SCIO");
- the Cyberspace Administration of China ("CAOC"); and
- the State Administration of Foreign Exchange ("SAFE").

### Specific Statutes and Regulations

#### *Requirements for Establishment of WFOEs*

Under the Law of the People's Republic of China on Foreign Investment Enterprises (the "Foreign Investment Enterprises Law"), promulgated on April 12, 1986 and amended on October 31, 2000, the establishment of a WFOE was required to be approved by MOFCOM or one of its local branches. On September 3, 2016, the Foreign Investment Enterprises Law was further amended by the Decision of the Standing Committee of the National People's Congress on Amending Four Laws including the Law of the People's Republic of China on Wholly Foreign-Owned Enterprises, issued by the Standing Committee of the National People's Congress, and on October 8, 2016 MOFCOM issued the Interim Measures for the Administration of Filing for Establishment and Change of the Foreign Investment Enterprises (the "Interim Filing Measures"). The Foreign Investment Enterprises Law, as amended, and the Interim Filing Measures provide that, with certain exceptions, the establishment of foreign-invested enterprises is only subject to certain filing requirements with, and no longer requires prior approval by, MOFCOM or its local branches.

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Each of our WFOEs established before September 3, 2016 was established with proper approval, and we have not established any WFOEs since September 3, 2016.

### **Requirements for Obtaining Business Licenses**

All China-based companies may commence operations only upon the issuance of a business license by the relevant local branch of the SAIC. All of our China-Based Subsidiaries and VIEs have been issued business licenses by the relevant local branches of the SAIC.

In the opinion of Haiwen, our principal China-Based Subsidiaries and principal VIEs have satisfied the requirements for business licenses.

### **Regulation of Value-added Telecommunications Services**

The *Telecommunications Regulations of the People's Republic of China* ("Telecom Regulations"), implemented on September 25, 2000 and amended on July 29, 2014, are the primary PRC law governing telecommunication services, and set out the general framework for the provision of telecommunication services by domestic PRC companies. The Telecom Regulations require that telecommunications service providers procure operating licenses prior to commencing operations. The Telecom Regulations draw a distinction between "basic telecommunications services," which we generally do not provide, and "value-added telecommunications services." The Telecom Regulations define value-added telecommunications services as telecommunications and information services provided through public networks. The *Catalogue of Telecommunications Business* ("Catalogue"), which was issued as an attachment to the Telecom Regulations and updated in February 2003, identifies online data and transaction processing, on-demand voice and image communications, domestic Internet virtual private networks, Internet data centers, message storage and forwarding (including voice mailbox, e-mail and online fax services), call centers, Internet access, and online information and data search as value-added telecommunications services. We engage in various types of business activities that are value-added telecommunications services as defined and described by the Telecom Regulations and the Catalogue.

On March 1, 2009, the MIIT issued the *Measures on the Administration of Telecommunications Business Operating Permits* (the "Telecom License Measures"), which became effective on April 10, 2009, to supplement the Telecom Regulations and replace the previous *Administrative Measures for Telecommunications Business Operating Licenses*. The Telecom License Measures confirm that there are two types of telecom operating licenses for operators in China, one for basic telecommunications services and one for value-added telecommunications services. A distinction is also made as to whether a license is granted for "intra-provincial" or "trans-regional" (inter-provincial) activities. An appendix to each license granted will detail the permitted activities of the enterprise to which it was granted. An approved telecommunication services operator must conduct its business (whether basic or value-added) in accordance with the specifications recorded in its Telecommunications Services Operating License.

The business activities of Sohu Internet include providing content to mobile phone users through the platforms of China's main three telecommunications operators. An insignificant portion of our mobile revenues are currently derived through products such as SMS, RBT and IVR. On April 25, 2004, the MIIT issued a notice stating that China mobile network operators may only provide mobile network access to those mobile Internet service providers which have obtained licenses from the relevant local arm of the MIIT before conducting operations. On the basis of the notice, China Mobile Communication Corporation ("China Mobile") has required each of its mobile Internet service providers to first obtain a license for trans-regional value-added telecommunications services in order to gain full access to its mobile network, which is a nationwide policy in line with a similar notice issued by the Beijing branch of China Mobile on April 12, 2004.

On August 8, 2014, January 30, 2015, and June 2, 2016, respectively, the MIIT issued to Sohu Internet, Guangzhou Qianjun, and Sogou Information renewed Value-Added Telecommunications Services Operating Licenses, which authorize the provision of trans-regional mobile services classified as value-added telecommunication services. The licenses are subject to annual inspection.

### **Regulation of Foreign Direct Investment in Value-Added Telecommunications Companies**

Various PRC regulations currently restrict foreign-invested entities from engaging in value-added telecommunication services, including providing Internet information services and operating online games. Foreign direct investment in telecommunications companies in China is regulated by the *Regulations for the Administration of Foreign-Invested Telecommunications Enterprises* (“FITE Regulations”), which were issued by the PRC State Council, or State Council, on December 11, 2001, became effective on January 1, 2002 and were amended on September 10, 2008 and February 6, 2016. The FITE Regulations stipulate that foreign invested telecommunications enterprises in the PRC (“FITEs”) must be established as Sino-foreign equity joint ventures. Under the FITE Regulations and in accordance with WTO-related agreements, the foreign party to a FITE engaging in value-added telecommunications services may hold up to 50% of the equity of the FITE, with no geographic restrictions on the FITE’s operations. On June 30, 2016, the MIIT issued an *Announcement of the Ministry of Industry and Information Technology on Issues concerning the Provision of Telecommunication Services in the Mainland by Service Providers from Hong Kong and Macao* (the “MIIT Announcement”), which provides that investors from Hong Kong and Macau may hold more than 50% of the equity in FITEs engaging in certain specified categories of value-added telecommunications services.

For a FITE to acquire any equity interest in a value-added telecommunications business in China, it must satisfy a number of stringent performance and operational experience requirements, including demonstrating a track record and experience in operating a value-added telecommunications business overseas. FITEs that meet these requirements must obtain approvals from the MIIT and the MOFCOM or their authorized local counterparts, which retain considerable discretion in granting approvals.

On July 13, 2006, the MIIT issued the *Notice of the Ministry of Information Industry on Intensifying the Administration of Foreign Investment in Value-added Telecommunications Services* (the “MIIT Notice”), which reiterates certain provisions of the FITE Regulations. Under the MIIT Notice, if a FITE intends to invest in a PRC value-added telecommunications business, the FITE must be established and must apply for a telecommunications business license applicable to the business. Under the MIIT Notice, a domestic company that holds a license for the provision of Internet content services, or an ICP license, is considered to be a type of value-added telecommunications business in China, and is prohibited from leasing, transferring or selling the license to foreign investors in any form, and from providing any assistance, including providing resources, sites or facilities, to foreign investors to conduct value-added telecommunications businesses illegally in China. Trademarks and domain names that are used in the provision of Internet content services must be owned by the ICP license holder. The MIIT Notice requires each ICP license holder to have appropriate facilities for its approved business operations and to maintain such facilities in the regions covered by its license. In addition, all value-added telecommunications service providers are required to maintain network and information security in accordance with standards set forth in relevant PRC regulations. Our VIEs, rather than our subsidiaries, hold ICP licenses, own our domain names, and hold or have applied for registration in the PRC of trademarks related to our business and own and maintain facilities that we believe are appropriate for our business operations.

In view of these restrictions on foreign direct investment in the value-added telecommunications sector, we established or acquired several domestic VIEs to engage in value-added telecommunications services. For a detailed discussion of our VIEs, please refer to “Our Corporate Structure” above. Due to a lack of interpretative materials from the relevant PRC authorities, there are uncertainties regarding whether PRC authorities would consider our corporate structure and contractual arrangements to constitute foreign ownership of a value-added telecommunications business. See “Risks Related to Our Corporate Structure.” In order to comply with PRC regulatory requirements, we operate our main business through companies with which we have contractual relationships but in which we do not have an actual ownership interest. 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.

In the opinion of Haiwen, subject to the uncertainties and risks disclosed elsewhere in this report under the heading “Risk Factors” and “Government Regulation and Legal Uncertainties”, the ownership structures of our principal PRC Subsidiaries and our principal VIEs comply with all existing laws, rules and regulations of the PRC and each of such companies has the full legal right, power and authority, and has been duly approved, to carry on and engage in the business described in its business license.

### **Regulation of the Provision of Internet Content**

#### *Internet Information Services*

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

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The ICP Measures further stipulate that entities providing online information services regarding news, publishing, education, medicine, health, pharmaceuticals and medical equipment must procure the consent of the national authorities responsible for such areas prior to applying for an operating license from the MIIT or its local branch at the provincial or municipal level. Moreover, ICPs must display their operating license numbers in conspicuous locations on their home pages. ICPs are required to police their Internet platforms and remove certain prohibited content. Many of these requirements mirror Internet content restrictions that have been announced previously by PRC ministries, such as the MIIT, the MOC, and the SAPPRFT, that derive their authority from the State Council.

Sogou Information, Sohu Internet, Focus Interactive, Guangzhou Qianjun, Shanghai ICE, Guanyou Gamespace, Gamease and Wuhan Baina Information hold Telecommunications and Information Services Operating Licenses (each an “ICP license”), each of which is subject to annual inspection.

In 2000, the MIIT promulgated the *Internet Electronic Bulletin Service Administrative Measures* (“BBS Measures”). The BBS Measures required ICPs to obtain specific approvals before they provided BBS services, which included electronic bulletin boards, electronic forums, message boards and chat rooms. On September 23, 2014, the MIIT abolished the BBS Measures in a *Decision on Abolishment and Amendment Certain Regulations and Rules*. However, in practice certain local authorities still require operating companies to obtain approvals or make filings for the operation of BBS services. The ICP licenses held by Sohu Internet, Sogou Information, Focus Interactive, Gamease and Guanyou Gamespace include such specific approval of the BBS services that they provide.

On December 29, 2011, the MIIT issued *Several Provisions for Standardizing the Market Order of Internet Information Services* (the “Several Provisions”) which took effect on March 15, 2012. With the aim of promoting the healthy development of the Internet information services market in China, the Several Provisions strengthen the regulation of the operations of Internet information service providers, including prohibiting Internet information service providers from infringing the rights and interests of other Internet information service providers, regulating evaluations provided by Internet information service providers regarding the services and products of other Internet information service providers, and regulating the installation and running of software by Internet information service providers. The Several Provisions also provide various rules to protect the interests of Internet information users, such as requesting Internet information service providers to take measures to protect the privacy information of their users and prohibiting Internet information service providers from cheating and misleading their users.

### *Online News Dissemination*

On September 25, 2005, the *Administrative Regulations for Internet News Information Services* (“News Regulations”) were jointly promulgated by the SCIO and the MIIT to replace the previous *Provisional Rules for the Administration of the Operation of News Publication Services by Web Sites* (“Old News Rules”) issued on November 7, 2000. The News Regulations stipulate that general Websites established by non-news organizations, such as Sohu, may publish news released by certain official news agencies if such Websites satisfy the requirements set forth in Article 8 of the News Regulations but may not publish news items produced by themselves or other news sources. The News Regulations also require the general Websites of non-news organizations to apply to the SCIO at the national level for approval after securing the consent of the SCIO at the provincial level before they commence providing news dissemination services.

Requirements specified in the News Regulations include the following:

- non-news organizations’ Websites must comply with the constitution, laws and regulations of the PRC, uphold and not mislead the society’s public opinion, and safeguard national and public interests;
- non-news organizations must have sound administrative rules and regulations concerning Internet news services;
- non-news organizations must have the necessary premises, equipment and legally-raised funds;
- non-news organizations must have ten or more professional news editors, at least five of whom have worked at a news agency for a minimum of three years;
- non-news organizations must be legal persons who have been legally established for at least two years, engaged in the operation of Internet news services and have not had administrative penalties imposed due to violation of laws and regulations on the administration of Internet news services within the last two years;

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- if the applicant for the SCIO approval is an entity, its registered capital must not be less than RMB10,000,000 (or approximately \$1.5 million); and
- non-news organizations must only republish or disseminate to the public news regarding current events and political affairs that has been published by State news agencies or news agencies directly subordinate to the respective governments of the provinces, autonomous regions or directly-administered municipalities, without distorting the news as reported by those agencies, and indicate the source of such news information; and shall not publish news gathered and edited by themselves.

In addition, general Websites intending to publish news released by approved agencies must enter into agreements with those agencies and submit copies of those agreements to the relevant administration department.

On July 3, 2016, the CAOC issued a Notice on Further Strengthening the Management and Prevention of Fake News (the “Fake News Notice”). The Fake News Notice requires all providers of online news services, including news applications, Weibo and WeChat, to establish and maintain rigorous internal supervision and management systems and to not provide any news without identifying the sources of the news, invent news, report news based on hearsay or distort facts.

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

### *Internet Publishing*

On February 4, 2016, the SAPPRFT and MIIT jointly issued the Rules for the Administration for Internet Publishing Services (the “Internet Publishing Rules”) to replace the Provisional Rules for the Administration for Internet Publishing that had been jointly issued by the SAPPRFT and the MIIT on June 27, 2002. The Internet Publishing Rules define “Internet publications” as digital works that are edited, produced or processed to be published and provided to the public through the Internet, including (a) original digital works, such as pictures, maps, games, and comics; (b) digital works with content that is consistent with the type of content that, prior to the Internet age, typically was published in media such as books, newspapers, periodicals, audio-visual products, and electronic publications; (c) digital works in the form of online databases compiled by selecting, arranging and compiling other types of digital works; and (d) other types of digital works identified by the SAPPRFT. Under the Internet Publishing Rules, Web portals such as ours are required to apply to and register with the SAPPRFT before distributing Internet publications.

On December 22, 2010, Sohu Internet obtained an Internet publishing license issued by the SAPPRFT, and has recently applied to the SAPPRFT to have the license renewed. For the details of the Internet publishing licenses held by Changyou’s VIEs, see “Specific Statutes and Regulations - Regulation of Online Game Services –Online Games and Cultural Products.”

### *Online Audiovisual Transmission Through the Public Internet*

On December 20, 2007, the SAPPRFT and the MIIT jointly issued *Rules for the Administration of Internet Audiovisual Program Services* (“Document 56”), which came into effect as of January 31, 2008. Document 56 requires all online audio and video service providers to be either state-owned or state-controlled and to obtain a permit for the Network Transmission of Audiovisual Programs. However, at a press conference held on February 3, 2008 the SAPPRFT and the MIIT clarified that online audio-visual service providers that were already lawfully operating prior to the issuance of Document 56 may re-register and continue to operate without becoming state-owned or controlled, provided that such providers do not engage in any unlawful activities. This exemption will not be granted to service providers set up after Document 56 was issued. As we were already engaged in online audiovisual transmission prior to the issuance of Document 56, we are presumably exempted from the requirement of being state-owned or state-controlled. Sohu Internet and Guangzhou Qianju currently hold permits, both for PC and for Mobile Apps, for the Network Transmission of Audiovisual Programs.



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On March 30, 2009, the SAPPRFT released a *Notice on Strengthening the Administration of Online Audiovisual Content* (the “March 2009 SAPPRFT notice”). March 2009 SAPPRFT notice requires the operators of audiovisual Websites to enhance their processes for protecting copyrights, and to take appropriate measures to protect the rights and interests of copyright holders. Operators of such sites must hold, or have a license to, the copyright to all content that they transmit. In addition, the March 2009 SAPPRFT notice stipulates that only those films or TV programs that have already obtained from the SAPPRFT a Film Public Screening Permit, TV Drama Distribution Permit, TV Animation Distribution Permit, or TV Documentary Film Screening Permit are allowed to be transmitted via audiovisual Websites. These permits are mandatory for all films and programs shown on TV and in cinemas in China and must be obtained before such film or TV or program is allowed to be released. The approval applications for the Film Public Screening Permit, Television Drama Distribution Permit, Television Animation Distribution Permit or Television Documentary Film Screening Permit are extremely difficult and time-consuming, and the SAPPRFT previously did not enforce very strictly the requirements regarding these permits. However, on September 2, 2014, the SAPPRFT issued a *Notice on Further Strengthening the Administration of Online Foreign Audiovisual Content* (“September 2014 SAPPRFT Notice”), which requires that operators of audiovisual Websites to obtain from the SAPPRFT a Film Public Screening Permit, TV Drama Distribution Permit, or TV Animation Distribution Permit for all foreign films and TV dramas before they are transmitted via the Internet in China. The September 2014 SAPPRFT Notice further stipulates that before any foreign films or TV dramas for transmission exclusively via the Internet are purchased after the promulgation of the September 2014 SAPPRFT Notice, operators of audiovisual Websites must declare their annual purchasing plans with the SAPPRFT before the end of the year preceding the year of the intended broadcast and obtain the SAPPRFT’s approval. The September 2014 SAPPRFT Notice also states that the number of foreign films and TV dramas to be purchased by an operator and transmitted via its Website in a single year may not exceed 30% of the total amount of the Chinese films and TV dramas purchased and transmitted by the same Website in the previous year.

On April 1, 2010, SAPPRFT issued a *Catalogue of Classification of Internet Audio-Video Program Services (Trial)* (the “Internet Audio-Video Program Catalogue”). The Internet Audio-Video Program Catalogue classifies Internet audio-video program services (excluding IPTV, Internet TV and mobile TV services) into four categories, consisting of (i) Internet audio-video programs sponsored and broadcast through Internet radio and television stations, including political news, political talk shows, self-produced news programs and live programs of vital political, military, economic, social and sports activities; (ii) reprints of political news, Internet hosting, interviews, report and commentary services in entertainment, technology, financial, sports and educational audio-video programs, production and broadcasting of Internet dramas, compilation and broadcasting of entertainment, technology, financial, sports and education audio-video programs, and live broadcasting of cultural and sports activities; (iii) aggregation and broadcasting of Internet audio-video programs and user-uploaded audio-video programs; and (iv) retransmission of Internet audio-video programs. A permit for the Network Transmission of Audiovisual Programs specifies the scope of the services under one or more of these categories that the holder of the permit is allowed to provide. Our permit for the Network Transmission of Audiovisual Programs allows us to provide services mostly under the categories described in clauses (ii), (iii), and (iv) above.

On July 6, 2012, the SAPPRFT issued a *Notice on Further Strengthening the Administration of Internet Dramas, Micro Movies and Other Internet Audiovisual programs* (the “2012 SAPPRFT Notice 53”), which reiterates that online audio-visual service providers must obtain a Permit for the Network Transmission of Audiovisual Programs from the SAPPRFT. The 2012 SAPPRFT Notice 53 further stipulates that online audio-visual service providers must review the content of Internet audiovisual programs prior to their transmission and must file certain information, such as the names of the Internet audiovisual programs, summaries of their content and names of the persons conducting the reviews, with the appropriate provincial office of the SAPPRFT.

On January 2, 2014, the SAPPRFT issued a *Supplemental Notice on 2012 SAPPRFT Notice 53*, which stipulates that producers of Internet dramas, micro movies and other Internet audiovisual programs must obtain a Permit for Radio and Television Program Production and Operation. Online audio-visual service providers may only retransmit dramas and micro movies produced and uploaded by individuals whose identities have been verified and the content of which complies with relevant regulations. Online audio-visual service providers must file with the provincial SAPPRFT the content of Internet audiovisual programs proposed for transmission prior to transmitting the programs.

On November 4, 2016, the SAPPRFT issued a *Notice on Further Strengthening the Planning, Development and Administration of Original Internet Audiovisual Programs* (“Document 198”). Document 198 stipulates that if online service providers plan to produce and disseminate audiovisual programs that are considered to be key audiovisual programs under Document 198, the service providers must, during the early planning and development stage, file a summary of the programs and their titles, producer names, themes, and duration with the SAPPRFT and, for audiovisual programs with sensitive themes such as politics, military, diplomacy, national security, national sovereignty, religion, the PRC justice system and public security, consult with designated PRC governmental authorities before production of the programs.

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### *Private Network and Targeted Communication Audiovisual Program Services*

On April 25, 2016, the SAPPRFT issued the *Provisions on the Administration of Private Network and Targeted Communication Audiovisual Program Services* (the “Private Network Audiovisual Programs Administration Provisions”), effective on June 1, 2016, to replace the *Measures for the Administration of the Transmission of Audiovisual Programs over Internet and other Information Networks* that had been issued by the SAPPRFT on July 6, 2004. The Private Network Audiovisual Programs Administration Provisions stipulate that private network and targeted communication audiovisual program services include the provision, integrated control, transmission and distribution of audiovisual content through IPTV, targeted mobile television, television network and other targeted channels. The Private Network Audiovisual Programs Administration Provisions provide that operators engaging in private network and targeted communication audiovisual program services must obtain a permit for the Network Transmission of Audiovisual Programs from the SAPPRFT. The Private Network Audiovisual Programs Administration Provisions provide that only PRC state-owned or state-controlled entities may engage in private network and targeted communication audiovisual program services. We provide a small amount of audiovisual program services through private network and/or targeted communication channels, such as IPTVs and television networks. In order to comply with the Private Network Audiovisual Programs Administration Provisions, we partner with PRC state-owned entities for the provision of such services through private network and targeted communication channels. According to a press conference of SAPPRFT regarding the Private Network Audiovisual Programs Administration Provisions, Internet audiovisual program services provided through the public Internet, which include our main online video services, other than private network and targeted communication channels should comply with Document 56. See “Government Regulation and Legal Uncertainties - Specific Statutes and Regulations - Regulation of the Provision of Internet Content –Online Audiovisual Transmission through Public Internet” for a description of regulations affecting Internet Audio-video program services provided through the public Internet.

### *Online Cultural Products*

On May 10, 2003, the MOC issued the *Provisional Regulations for the Administration of Online Culture* (“Online Culture Regulations”), which took effect on July 1, 2003 and were amended on July 1, 2004. On February 17, 2011, the MOC issued the new *Provisional Regulations for the Administration of Online Culture* (“New Online Culture Regulations”), which took effect on April 1, 2011, to replace the previous regulations. The New Online Culture Regulations apply to entities engaging in activities related to “Internet cultural products,” which include those cultural products that are produced specially for Internet use, such as online music and entertainment, online games, online plays, online performances, online works of art and Web animations, and those cultural products that, through technical means, produce or reproduce music, entertainment, games, plays and other art works for Internet dissemination. Pursuant to the New Online Culture Regulations, commercial entities are required to apply to the relevant local branch of the MOC for an Online Culture Operating Permit if they engage in any of the following types of activities:

- the production, duplication, importation, release or broadcasting of Internet cultural products;
- the dissemination of online cultural products on the Internet or transmission thereof via Internet or mobile phone networks to user terminals such as computers, fixed-line or mobile phones, television sets ,gaming consoles and Internet surfing service sites such as Internet cafés for the purpose of browsing, using or downloading such products; or
- the exhibition or holding of contests related to Internet cultural products.

On January 6, 2017, the MOC issued Trial Measures of Administration of Cultural Market Blacklist (the “Blacklist Measures”), which stipulate that cultural products containing prohibited content, including content so specified by the New Online Culture Regulations, that has a material adverse effect on society will be listed in a “cultural product blacklist” published by the MOC or its local branches. Any future application made to the MOC or its local branches by an online cultural operator that has engaged in the distribution of cultural products included in the blacklist will be subject to heightened scrutiny.

On July 1, 2016, the MOC issued a *Notice on Strengthening the Administration of Online Performance* (the “Online Performance Notice”) and on December 2, 2016, issued the *Measures of Administration of Online Performance Operating Activities* (the “Online Performance Measures”), which became effective on January 1, 2017. The Online Performance Notice and the Online Performance Measures both stipulate that online performance service providers must obtain an Online Culture Operating Permit and that online performances must not contain any content that is horrific, cruel, violent, vulgar or humiliating in nature, mocks persons with disabilities, includes photographs or video clips that infringe third parties’ privacy or other rights, features animal abuse, or presents characters and other features of online games that have not been registered and approved for publication by applicable PRC governmental authorities.



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On September 2, 2016, the SAPPRFT issued the *Notice on Strengthening the Management of Live Online Social Video Services* (the “Live Online Notice”), which requires interactive broadcasting service providers to procure a permit for the Network Transmission of Audiovisual Programs. Sohu Internet and Guangzhou Qianju currently hold permits for the Network Transmission of Audiovisual Programs. The Live Online Notice also stipulates that a service provider must make a filing with the local SAPPRFT branch at least five days before making any live broadcast of any significant political, military, economic, social, cultural or sports activities and at least 48 hours before making any live broadcast of other cultural or sports activities. On November 4, 2016, the CAOC issued the Provisions on the Administration of Online Live Social Video Services (the “Live Social Video Provisions”) effective December 1, 2016. The Live Social Video Provisions provide that business entities such as us that offer interactive broadcasting services on their Internet platforms have the primary responsibility for monitoring content disseminated by interactive broadcasting hosts and viewers through such services, and must allocate sufficient staff in line with the scale of such services and establish and maintain adequate internal policies and procedures for, among other things, content review, information security management, emergency management and technical support. The Live Social Video Provisions also require that Internet providers verify the real-name identity of interactive broadcasting hosts and viewers before allowing them to establish user accounts with the Internet providers and take appropriate remedial actions, such as issuing warnings, removing posted content, or terminating the user’s account, with respect to interactive broadcasting content or activity that is prohibited by the Live Social Video Provisions. Internet providers are subject to administrative penalties and other sanctions for noncompliance with the Live Social Video Provisions.

Sohu Internet, Guangzhou Qianjun, Focus Interactive, Sogou Information, Gamease, Guanyou Gamespace, Shanghai ICE and Wuhan Baina information currently hold Online Culture Operating Permits, each of which is subject to annual inspection.

### *Mobile Internet Applications Information Services*

On June 28, 2016, the CAOC issued the *Provisions on the Administration of Mobile Internet Applications Information Services* (the “APP Provisions”), which became effective on August 1, 2016. Under the APP Provisions, mobile application providers and application store service providers are prohibited from engaging in any activity that may endanger national security, disturb the social order, or infringe the legal rights of third parties, and may not produce, copy, issue or disseminate through mobile applications any content prohibited by laws and regulations. The APP Provisions also require application providers to procure relevant approval to provide services through such applications and require application store service providers to register with local branch offices of the CAOC within 30 days after they start providing application store services. We have procured the required approvals for services that we provide through our mobile applications. Sogou has filed an application for registration with the applicable local branch of the CAOC with respect to Sogou’s provision of application store services.

### *Internet Map Services*

Under the *Opinions on Strengthening the Supervision of Internet Map and Geographic Information Services* and the *Notices on Further Strengthening the Management of Internet Map Services Permit* issued on February 25, 2008 and December 23, 2011, respectively, by the State Administration of Surveying, Mapping and Geo-information (the “SASMG,” formerly known as the State Bureau of Surveying and Mapping) and the *Administrative Regulations on Maps* issued by the State Council on November 26, 2015, effective on January 1, 2016, any provider of Internet map services that is not a professional surveying and mapping enterprise must obtain the approval of the SASMG or its local branches and a Surveying and Mapping Qualification Certificate in order to provide such services. In addition, providers of Internet map services must use maps obtained through government-approved channels and display the SASMG approval number, the Surveying and Mapping Qualification Certificate number and the Telecommunications Services Operating License number in conspicuous locations on their Websites.

On January 1, 2014, the SASMG issued new *Administrative Regulations on Surveying and Mapping Qualification Certificate and Classification Standard on Surveying and Mapping Qualification Certificate* (the “SASMG Regulations and Standards”) to replace previous regulations issued on June 1, 2004 and April 12, 2010. Under the SASMG Regulations and Standards, there are two types of Surveying and Mapping Qualification certificates that may be issued to providers of Internet map services. A Class A certificate allows a holder to provide (i) map-location services, (ii) geo-information uploading and dimension services, and (iii) geo-information database development services, while a holder of a Class B certificate may only provide the first two types of services.

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On July 26, 2016, the State Bureau of Surveying and Mapping (the “SBSM”) and the Office of the Central Leading Group for Cyberspace Affairs (the “OCLGCA”) jointly issued a *Notice on Standardizing the Usage of Maps by Internet Services Providers* (the “Maps Usage Notice”), which stipulates that all the Internet service providers must review and use maps in accordance with the PRC *Surveying and Mapping Law* and *Administrative Regulations on Maps*. The Maps Usage Notice requires that maps displayed by Internet service providers be obtained through government-approved channels and identify their sources and censor numbers. Internet service providers are prohibited from using maps obtained from unaccredited sources, including foreign Websites. All maps, other than scenic maps, block maps, subway maps and other specified maps, must be reviewed by PRC governmental authorities before they are published, and must not contain any information or content specified as prohibited in the Maps Usage Notice.

### *Internet Medical, Health and Pharmaceuticals Information Dissemination*

Under the *Measures for the Administration of Internet Pharmaceuticals Information Services* (the “Pharmaceuticals Information Services Measures”) issued by the State Food and Drug Administration (“SFDA”) on July 8, 2004, the formal approval of the SFDA or one of its local branches is required before a Website may disseminate information concerning pharmaceuticals.

Under the Pharmaceuticals Information Services Measures, medical, health and pharmaceutical information provided by Websites must be scientific and accurate and must indicate the sources of such information. Websites that have received approval to disseminate such information must also publish or reprint health policies, information on epidemics and major health-related incidents, and other health-related information in accordance with law. Furthermore, medical and pharmaceutical advertisements published by such Websites must not exaggerate the efficacy or promote the medical uses of such products.

Sohu Internet, Guangzhou Qianjun, and Sogou Information received renewed SFDA approval on November 26, 2014, April 30, 2014 and November 10, 2016, respectively.

### **Regulation of Online Advertising Services**

#### *Brand Advertising Services*

On April 24, 2015, the Standing Committee of the National People’s Congress enacted the *Advertising Law of the People’s Republic of China* (“New Advertising Law”). The New Advertising Law, which was a major overhaul of an advertising law enacted in 1994, increases the potential legal liability of providers of advertising services, and includes provisions intended to strengthen identification of false advertising and the power of regulatory authorities. On July 4, 2016, the SAIC issued the *Interim Measures of the Administration of Online Advertising* (the “SAIC Interim Measures”), effective on September 1, 2016. The New Advertising Law and the SAIC Interim Measures both provide that advertisements posted or published through the Internet may not affect users’ normal usage of a network, and advertisements published in the form of pop-up windows on the Internet must display a “close” sign prominently and ensure one-key closing of the pop-up windows. The SAIC Interim Measures provide that all online advertisements must be marked “Advertisement” so that viewers can easily identify them as such. Moreover, the SAIC Interim Measures treat pay-for-click search results as advertisements that are subject to PRC advertisement laws, and require that pay-for-click search results be conspicuously identified on search result pages as advertisements. The New Advertising Law and SAIC Interim Measures will require us to conduct more stringent examination and monitoring of our advertisers and the content of their advertisements.

On April 13, 2016, the SAIC and sixteen other PRC government agencies jointly issued a *Notice of Campaign to Crack Down on Illegal Internet Finance Advertisements and Other Financial Activities in the Name of Investment Management* (the “Campaign Notice”), pursuant to which a campaign was conducted between April 2016 and January 2017 targeting, among other things, online advertisements for Internet finance and other financial activities posted on Internet search portals and other portal, financial, real estate, P2P and investment product sales services Websites.

#### *Search and search-related Services*

On August 18, 2009, the MOC issued a *Notice on Strengthening and Improving the Content Censorship of Online Music Content* (“MOC Notice”). The MOC Notice provides that providing direct links to online music will constitute engaging in the online music business, and that therefore an Online Culture Operating Permit is required for providing such search services. Sogou Information applied for an Online Culture Operating Permit and received it on November 9, 2010. The permit was renewed on December 2, 2016.

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On June 25, 2016, the CAOC issued *Measures for the Administration of Online Information Search Services* (the “CAOC Interim Measures”), which came into effect on August 1, 2016. The CAOC Interim Measures, like the SAIC Interim Measures, require that providers of online search services verify the credentials of pay-for-click advertisers, specify a maximum percentage that pay-for-click search results may represent of results on a search page, and require that providers of search services conspicuously identify pay-for-click search results as such.

### **Regulation of Online Game Services**

#### *Online Games and Cultural Products*

In September 2009, the SAPPRFT, together with the National Copyright Administration and the National Office of Combating Pornography and Illegal Publications, jointly issued a *Notice on Further Strengthening on the Administration of Pre-examination and Approval of Online Game and the Examination and Approval of Imported Online Game* (the “SAPPRFT Online Game Notice”). The SAPPRFT Online Game Notice states that foreign investors are not permitted to invest in online game operating businesses in China via wholly foreign-owned entities, China-foreign equity joint ventures or cooperative joint ventures or to exercise control over or participate in the operation of domestic online game businesses through indirect means, such as other joint venture companies or contractual or technical arrangements. If the VIE structure of Changyou was deemed under the SAPPRFT Online Game Notice to be an “indirect means” for foreign investors to exercise control over or participate in the operation of a domestic online game business, the VIE structure of Changyou might be challenged by the SAPPRFT. We are not aware of any online game companies which use the same or similar VIE contractual arrangements as those Changyou uses having been challenged by the SAPPRFT as using those VIE arrangements as an “indirect means” for foreign investors to exercise control over or participate in the operation of a domestic online game business or having been penalized or ordered to terminate operations since the SAPPRFT Online Game Notice first became effective. However, it is unclear whether and how the SAPPRFT Online Game Notice might be interpreted or implemented in the future.

On February 21, 2008, the SAPPRFT issued Rules for the Administration of Electronic Publications (the “Electronic Publication Rules”), which were amended on August 28, 2015. The Electronic Publication Rules regulate the production, publishing and importation of electronic publications in the PRC and outline a licensing system for business operations involving electronic publishing. Under the Electronic Publication Rules and other related regulations issued by the SAPPRFT, online games are classified as a type of electronic publication or Internet publication that may only be provided by a licensed electronic publishing entity with a standard publication code, and the establishment of an electronic publishing entity must be approved by the SAPPRFT. Electronic publishing entities are responsible for assuring that the content of electronic publications comply with relevant PRC law and regulations, and must obtain the approval of the SAPPRFT before publishing foreign electronic publications. The Measures of Internet Publication Service Administration issued by the SAPPRFT and the MIIT (the “New Internet Publication Measures”), which became effective on March 10, 2016 and replaced the Temporary Measures for Internet Publication Administration that had become effective in 2002, require that entities in the Internet publishing business apply for an online publication license and obtain approval from the SAPPRFT prior to the publication of new online games. In addition, under the New Internet Publication Measures, Sino-foreign joint ventures and foreign-invested entities are not permitted to engage in Internet publication services, and the legal representative of an entity providing Internet publication services may not be a foreigner.

Gamease, which is the operator of TLBB, BO, BH2 and certain other licensed PC games, and Guanyou Gamespace, which provides online game services, obtained Internet publishing licenses on December 10, 2010 and October 13, 2011, respectively. TLBB, BO, BH2 and some of Changyou’s other games were historically published through third parties that were licensed electronic publishing entities, because Gamease had not obtained an Internet publishing license at the time those online games were made publicly available. TLBB, BO and BH2 and certain of Changyou’s other existing games are currently published under an Internet publishing license held by Gamease. Current PRC regulations are not clear as to the consequences of obtaining authorization codes through third-party electronic publishing entities. While we believe that arrangements like Changyou’s are acknowledged by the SAPPRFT, in view of the lack of formal interpretation regarding this issue, the SAPPRFT might challenge Changyou’s current and past practices and could subject Changyou to various penalties, including fines, confiscation of publishing equipment and the revenues generated from the publishing activities, the revocation of Changyou’s business license, or the forced discontinuation of or restrictions on its operations.

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On May 24, 2016, the SAPPRFT issued the Mobile Game Notice, which became effective on July 1, 2016 and sets forth requirements for the publication and operation of mobile games online, including requiring that mobile game publishers and operators, including joint operators, review the content of the games that they publish and operate, and apply for publication and authorization codes at least 20 business days before first publishing and operating domestic recreational and educational mobile games through open beta testing. The Mobile Game Notice, as updated by a subsequent notice, specified that game publishers and game operators were required to review the content of mobile games that were published and operated online before July 1, 2016, and to complete approval procedures for those games before December 31, 2016, or to cease operating the games. Changyou completed prior to December 31, 2016 all of the approval procedures required by the SAPPRFT for its mobile games that were in operation before July 1, 2016.

The MOC issued the *New Provisional Regulations for the Administration of Online Culture*, or the Online Culture Regulations, which took effect on April 1, 2011 and replaced the *Provisional Regulations for the Administration of Online Culture*. The Online Culture Regulations apply to entities engaging in activities related to “Internet cultural products,” which include cultural products that are produced specifically for Internet use, such as online music and entertainment, online games, online plays, online performances, online works of art and Web animation, and other online cultural products that through technical means, produce or reproduce music, entertainment, games, plays and other art works for Internet dissemination. Under the New Online Culture Regulations, commercial entities are required to apply to the relevant local branch of the MOC for an Online Culture Operating Permit if they engage in the production, duplication, importation, release or broadcasting of Internet cultural products; the dissemination of online cultural products on the Internet or the transmission of such products via Internet or mobile phone networks to user terminals, such as computers, phones, television sets and gaming consoles, or Internet surfing service sites such as Internet cafés; or the holding or exhibition of contests related to Internet cultural products. In January 2008 Gamease obtained an Online Culture Operating Permit, which was re-certified in October 2015; in June 2011 Guanyou Gamespace obtained an Online Culture Operating Permit, which was re-certified in October 2015; and in December 2010 Shanghai ICE obtained an Online Culture Operating Permit, which was re-certified in January 2014.

The Interim Measures for the Administration of Online Games (“Online Game Measures”), issued by the MOC, which took effect on August 1, 2010, regulate a broad range of activities related to the online games business, including the development, production and operation of online games, the issuance of virtual currencies used for online games, and the provision of virtual currency trading services. The Online Game Measures provide that any entity that is engaged in online game operations must obtain an Online Culture Operating Permit, and require the content of an imported online game to be examined and approved by the MOC prior to the game’s launch and a domestic online game to be filed with the MOC within 30 days after its launch. The *Notice of the Ministry of Culture on the Implementation of the Interim Measures for the Administration of Online Games*, which was issued by the MOC on July 29, 2010 to implement the Online Game Measures (i) requires online game operators to protect the interests of online game users and specifies certain terms that must be included in service agreements between online game operators and the users of their online games, (ii) specifies content review of imported online games and filing procedures for domestic online games, (iii) emphasizes the importance of the protection of minors playing online games, and (iv) requests online game operators to promote real-name registration by their game users. On December 1, 2016, the MOC issued the Online Game Operation Notice, which will become effective on May 1, 2017. The Online Game Operation Notice includes clarification of products and services that will be considered to be within the scope of the operation of online games, provides enhanced standards for the issuance of and payment for virtual items used in online games and enhanced protection of online games users, and announces more stringent supervision of the operation of online games and penalties for violations by online game operators of regulations with respect to the operation of online games. The Online Game Operation Notice stipulates that game operators are prohibited from providing lucky draws or lotteries that are conducted on the condition that participants contribute cash or virtual currency in exchange for virtual items and services; must timely publish the name, properties, description, amount, and probability of winning for such lucky draws or lotteries on either the Website of the game or the Web page on which such lucky draws or lotteries are provided; must require real-name registration of game players who wish to enter such lucky draws or lotteries; and must publish the results of such lucky draws or lotteries on the Website of or other conspicuous location in the game; and must maintain all relevant records for at least 90 days. The Online Game Operation Notice also stipulates that online game operators must require real-name registration of online game players and may sell game points and virtual items only to real-name registered game players, must set limits on the maximum amount of game points for a particular game that game players may purchase in a single transaction, must require confirmation of transaction information by game players placing orders and must maintain all relevant records for at least 180 days. Changyou filed its games TLBB, BO, BH2, and certain of its other existing games with the MOC. If Changyou fails to maintain any of its permits, approvals or registrations, to make any necessary filings, or to apply for and obtain any required new permits, approvals or registrations or make any new filings on a timely basis, it may be subject to various penalties, including fines and a requirement that it discontinue or limit its operations.

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The *Notice on Strengthening the Approval and Administration of Imported Online Games* (the “SAPPRFT Imported Online Game Notice”), which was issued by the SAPPRFT and took effect in July 2009, states that the SAPPRFT is the only governmental department authorized by the State Council to approve the importation of online games from offshore copyright owners, and that any enterprise which engages in online game publication and operation services within China must have the game examined and approved by the SAPPRFT and receive from the SAPPRFT an Internet publishing license. Changyou’s VIEs Gamease and Guanyou Gamespace have obtained Internet publishing licenses from the SAPPRFT. In addition, the Imported Online Game Notice states that activities which involve the showing, exhibition, trading and promotion of offshore online games in China must be examined and approved by the SAPPRFT.

The *Notice Regarding Improving and Strengthening the Administration of Online Game Content* (the “Online Game Content Notice”), issued by the MOC in November 2009, calls for online game operators to improve and adapt their game models by (i) mitigating the predominance of the “upgrade by monster fighting” model, (ii) limiting the use of the “player kill” model (where one player’s character attempts to kill another player’s character), (iii) limiting in-game marriages among game players, and (iv) improving their compliance with legal requirements for the registration of minors and game time-limits.

The *Administrative Measures for Content Self-Review by Internet Culture Business Entities*, which took effect in December 2013, require Internet culture business entities to review the content of products and services to be provided prior to providing such content and services to the public. The content management system of an Internet culture business entity is required to specify the responsibilities, standards and processes for content review as well as accountability measures, and is required be filed with the local provincial branch of the MOC.

In January 2014, the SAIC promulgated the *Administrative Measures for Online Trading* (the “Online Trading Measures”), which took effect on March 15, 2014, and replaced the Interim Measures for the *Administration of Online Commodities Trading and Relevant Services*, issued by the SAIC, which had taken effect on July 1, 2010. The Online Trading Measures regulate online commodity trading and related activities. The Online Trading Measures require that online transactions in commodities or services comply with the provisions of all applicable laws, regulations and rules. When selling commodities or providing services to consumers, online operators must comply with all applicable laws with respect to the protection of consumer rights and interests, the protection of intellectual property rights of others and the prevention of unfair competition. Information provided with respect to commodities and services provided by online commodity operators or related service operators must be authentic and accurate. If Changyou fails to comply with all requirements of the Online Trading Measures, the local branch of the SAIC or another governmental authority with jurisdiction might impose penalties, such as fines.

### *Registration of Software Products*

The *Measures Concerning Software Products Administration* (the “Software Measures”) issued by the MIIT, which became effective in April 2009 and replaced measures which had been in effect since 2000, permit software developers and producers to sell or license their software products independently or through agents, and software products developed in the PRC can be registered with the local provincial government authorities in charge of the information industry and filed with the MIIT. Upon registration, the software products are granted registration certificates which are valid for five years and may be renewed upon expiration. Under policies promulgated by the State Council, software products developed in the PRC which satisfy the requirements of the Software Measures and have been registered and filed in accordance with the Software Measures may enjoy certain types of preferential treatment. State Council policies provide that the MIIT and other relevant departments may supervise and inspect the development, production, sale, import and export of software products in the PRC. Changyou has registered software copyrights covering all of its significant copyrightable products and enhancements.

### *Regulation of Internet Content*

The PRC government has promulgated measures relating to Internet content through a number of government authorities, including the MIIT, the MOC, the SAPPRFT and the MPS. These measures prohibit certain specified Internet activities, including the operation of online games that result in the publication of any content which is found to, among other things, propagate obscenity, gambling or violence, instigate crimes, undermine public morality or the cultural traditions of the PRC, or compromise State security or secrets. If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its Websites.

*Protection of Minors*

On April 15, 2007, the SAPPRFT and several other governmental authorities issued a circular requiring the implementation of an “anti-fatigue system” and a real-name registration system by all PRC online game operators, in an effort to curb addictive online game play behaviors of minors. Under the anti-fatigue system, three hours or less of continuous play by minors is considered to be “healthy,” three to five hours to be “fatiguing,” and five hours or more to be “unhealthy.” Game operators are required to reduce the value of in-game benefits to a game player by half if the game player has reached “fatiguing” level, and to zero in the case of “unhealthy” level.

To identify whether a game player is a minor and thus subject to the anti-fatigue system, there was adopted a real-name registration system, which requires online game players to register their real identity information before they play online games and requires an online game operator such as Changyou to submit the identity information of game players to the public security authorities for verification. On July 1, 2011, the SAPPRFT, the MIIT, the Ministry of Education and five other governmental authorities issued a *Notice on Initializing the verification of Real-name Registration for Anti-Fatigue System on Internet Games* (the “Real-Name Registration Notice”), which took effect on October 1, 2011, to strengthen the implementation of the anti-fatigue system and real-name registration. The Real-name Registration Notice’s main focus is to prevent minors from using an adult’s ID to play Internet games and, accordingly, the notice imposes stringent punishments on online game operators that do not implement the required anti-fatigue and real-name registration measures properly and effectively. The most severe punishment contemplated by the Real-name Registration Notice is to require termination of the operation of the online game if it is found to be in violation of the Anti-Fatigue Notice, the Monitor System Circular or the Real-Name Registration Notice. Changyou developed its own anti-fatigue and real-name registration systems for its games, and implemented them beginning in 2007. Under Changyou’s system, game players must use real identification in order to create accounts, and in this way Changyou generally is able to tell which of its game players are minors and thus subject to these regulations. For game players who do not register, Changyou assumes that they are minors. As required by the anti-fatigue rules, Changyou reduces the value of in-game benefits of game players under 18 years based on the amount of their continuous play.

On January 15, 2011, the MOC, the MIIT and six other central government authorities jointly issued a circular entitled *Implementation of Online Game Monitor System of the Guardians of Minors* (the “Monitor System Circular”), aiming to provide protection measures to monitor the online game activities of minors and curb addictive online game playing behaviors of minors. Under the Monitor System Circular, online game operators are required to adopt various measures to maintain a system to communicate with the parents or other guardians of minors playing online games and online game operators are required to monitor the online game activities of minors, and must suspend the account of a minor if so requested by the minor’s parents or guardians. The monitor system was formally implemented commencing March 1, 2011.

In February 2013, 15 PRC government authorities, including the SAPPRFT, the Ministry of Education, the MOC and the MIIT, jointly issued *the Work Plan for the Integrated Prevention of Minors Online Game Addiction* (the “Work Plan”), integrating measures issued by various different authorities to prevent minors from being addicted to online games. Under the Work Plan, the current relevant regulations regarding online games will be further clarified and additional implementation rules will be issued; and as a result, online game operators will be required to implement additional measures to protect minors.

On July 25, 2014, the SAPPRFT promulgated a *Notice on Further Carrying out the Verification of Real-name Registration for Anti-Fatigue System on Internet Games* (the “Verification of Real-Name Registration Notice”), which took effect on October 1, 2014. The Verification of Real-Name Registration Notice requires local press and publication administrative departments to strengthen their administration over enterprises engaged in online game publication and operations, and requires such enterprises to abide by anti-fatigue and real-name registration requirements when developing and promoting online games, but excluding, at present, mobile games.



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### *Information Security and Censorship*

Internet content in China is also regulated and restricted from a State security standpoint. The Standing Committee of the National People's Congress enacted the *Decision on Internet Security Protection* in 2000, and amended it in August, 2009. The decision makes it unlawful to: (i) gain improper entry into a computer or system of strategic importance; (ii) disseminate politically disruptive information; (iii) leak State secrets; (iv) spread false commercial information; or (v) infringe intellectual property rights. The MPS has promulgated measures that prohibit the use of the Internet in ways which, among other things, result in a leakage of State secrets or distribution of socially destabilizing content. The MPS has supervision and inspection rights in this regard, and Changyou may be subject to the jurisdiction of local security bureaus. If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its Websites. On November 7, 2016, the Standing Committee of the National People's Congress issued the Internet Security Law, which will take effect on June 1, 2017. The Internet Security Law will require providers of services over Internet networks to keep user information that they have collected in strict confidence and to establish improved systems for the protection of user information. Such service providers must provide notice of the purpose, methods and scope of their collection and use of user information, and obtain the consent of each person whose personal information will be collected. Service providers may not collect any personal information that is not related to the services they provide, or disclose or tamper with personal information that they have collected, unless such information is encoded to prevent identification of individuals whose information is so disclosed or tampered with. Service providers who do not comply with the Internet Security Law may be subject to fines, suspension of their businesses, shutdown of their websites, and revocation of their business licenses.

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

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

In April, 2009, the MOC issued a *Public Announcement on Regulating Applications for the Examination of the Content of Imported Online Games* (the "Announcement"). The Announcement emphasizes that enterprises operating imported online games must have the content of those games examined and approved by the MOC.

### *Virtual Currency*

On February 15, 2007, the MOC, the PBOC and other relevant government authorities jointly issued the Internet Cafés Notice. Under the Internet Cafés Notice, the PBOC is directed to strengthen the administration of virtual currency in online games to avoid any adverse impact on the economy and financial system. The Internet Cafés Notice limits the total amount of virtual currency that may be issued by online game operators and the amount that may be purchased by individual game players, and includes a clear division between virtual transactions and real transactions carried out by way of electronic commerce. The Internet Cafés Notice also provides that virtual currency may only be used to purchase virtual items.

On June 4, 2009, the MOC and the MOFCOM jointly issued the Virtual Currency Notice, to regulate the trading of online game virtual currencies. The Virtual Currency Notice defines the meaning of virtual currency and places a set of restrictions on the trading and issuance of virtual currency. The Virtual Currency Notice also states that online game operators are not allowed to give out virtual items or virtual currency through lottery-based activities, such as lucky draws, betting or random computer sampling, in exchange for user's cash or virtual money. The Virtual Currency Notice is mainly targeted at lottery-based activities relating to the "treasure boxes" found in some online games.

On July 20, 2009, the MOC promulgated *Filing Guidelines on Online Game Virtual Currency Issuing Enterprise and Online Game Virtual Currency Trading Enterprise*, which define the terms "issuing enterprise" and "trading enterprise" and stipulate that the same enterprise may not be both an issuing enterprise and a trading enterprise.

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On December 1, 2016, the MOC issued the Online Game Operation Notice, which will become effective on May 1, 2017. The Online Game Operation Notice standardizes rules regarding the issuance of virtual items used for online games. The Online Game Operation Notice provides that the issuance and exchange of virtual items issued by online game operators must be administered in accordance with the regulations applicable to virtual currency; that online game operators generally may not allow online game virtual currency to be exchanged for real currency or physical items; requires that, when online game operators allow users to exchange small-value physical items for virtual items, the content and value of such physical items must comply with applicable laws and regulations; and stipulates that online game operators are prohibited from providing lucky draws or lotteries that are conducted on the condition that participants contribute cash or virtual currencies in exchange for virtual items and services, must publish the results of such lucky draws or lotteries on the Website of or other conspicuous location in the game and must maintain all relevant records for at least 90 days.

### *Import and Export of Software Technology*

China imposes controls on the import and export of technology and software products. Under the *Regulations on Administration of Import and Export of Technologies* promulgated by the State Council, the term “technology import and export” is defined to include, among other things, the transfer or licensing of patents and know-how, and the provision of services related to technology. Depending on the nature of the relevant technology, the import and export of technology require either approval by or registration with the relevant PRC governmental authorities. Under the *Software Export Management and Statistics Measures* promulgated in October 2001, if a company is classified as a software enterprise and has a minimum of RMB1 million (or approximately \$145,000) in registered capital, it may engage in an export business after being registered with the relevant PRC governmental authorities. All contracts which relate to the export of software products, transfer of technology or provision of related services must be filed with the relevant PRC governmental authorities. The *Measures for the Administration of Registration of Technology Import and Export Contracts*, issued by the MOFCOM in February 2009, specify registration requirements related to the import and export of technology.

Changyou has entered into license agreements with third parties outside of China to license its games, which may be deemed to constitute the export of technology under the regulations. As a result, such licenses are required to be registered with applicable PRC governmental authorities. Although there are no explicit penalties set forth in these regulations for lack of such registration, failure to register an agreement where such registration is required may result in restrictions concerning foreign exchange, banking and taxation matters relating to such agreements. Changyou has not registered all of the game license agreements under which it authorizes overseas third-party online game operators to operate its online games, and so far Changyou has not encountered any problems with respect to foreign exchange, banking or taxation matters relating to its license agreements, nor has Changyou received any notice from any governmental authority requiring it to complete the registration of its game license agreements.

### **Regulation of Other Services**

#### *Real Estate Services*

On March 10, 2015, the National Development and Reform Commission (the “NDRC”) and the MOFCOM issued a new Foreign Investment Industrial Guidance Catalogue (the “New Catalogue”), which became effective on April 10, 2015. The New Catalogue removed from the category of industries where foreign investment is restricted real estate agency and brokerage services, which had been included in the restricted category in the previous Foreign Investment Industrial Guidance Catalogue issued in 2011. The New Catalogue loosened existing restrictions on foreign ownership of real estate agency and brokerage services in China, and as a result we may conduct real estate agency and brokerage services directly.

On April 4, 2001, the Ministry of Housing and Urban-Rural Development promulgated the *Regulatory Measures on the Sale of Commercial Houses*, pursuant to which a real estate developer may engage a real estate services organization as a broker to pre-sell or sell primary residential housing. The regulatory measures provide that a real estate broker must not make any false statements regarding a property to clients and must present clients with relevant title certificates or sale permits for the properties and a related letter of authorization.

On December 29, 2006, the Ministry of Construction and the PBOC jointly issued the *Circular Concerning Strengthening the Management of Real Estate Services and Regulating the Trade Settlement Capital Account*, which provides a number of directives regulating the real estate services industry. Under the circular, a real estate services company is not permitted to receive cash purchase payments on behalf of clients in secondary real estate transactions and is required to establish separate security deposit accounts for clients.



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On January 20, 2011, the Ministry of Housing and Urban-Rural Development (“MHURD”), the NDRC, and the Ministry of Human Resources and Social Security jointly issued the *Measures for Administration on Real Estate Brokerage* (the “Brokerage Measures”), which became effective on April 1, 2011 and were amended on April 1, 2016, and govern the activities of real estate brokerages and real estate brokerage personnel in providing intermediary, agency and related services and charging commissions. Furthermore, pursuant to the Brokerage Measures, a real estate brokerage company and its branches must have a sufficient number of licensed real estate brokers. The Brokerage Measures also require real estate brokerage companies to file with real estate regulatory authorities at the county level or above within 30 days after their business registration with the relevant local counterparts of the SAIC. Focus Interactive has made the required filings.

On July 29, 2016, the MHURD issued the *Opinions on Strengthening the Administration of Sound Development of Real Estate Brokerage* (the “MHURD Opinions”), to further regulate real estate brokerage services. The MHURD Opinions stipulate that real estate brokers are obligated to censor specified real estate-related information, including ownership, price, area, and location, and may not provide, directly or through agencies, loans for down payments and other similar financial services.

On September 30, 2016, Beijing MHURD and five other governmental authorities jointly issued the *Measures for the Promotion of Stable and Healthy Development of the Local Real Estate Market* (the “Beijing Measures”), with the goal of tempering rampant increases in housing prices by balancing land supply in favor of residential use and owner-occupied apartments, providing guidance for real estate developers and brokers as to the setting of prices and the conduct of advertising, selling and financing activities, and providing for enhanced enforcement measures with respect to false and misleading advertisements and pricing information and other illegal selling and financing activities in the local real estate market. Certain other cities, including Tianjin, Suzhou, Zhengzhou, Chengdu, Hefei, and Wuhan, adopted similar measures. One effect of these regulations has been to make real estate developers more cautious with respect to advertising housing on Internet platforms and cooperating on real estate-related e-commerce programs with Internet service providers such as us. In some cases, our real estate developer clients have suspended or discontinued their collaboration with us on our program that allows our users to purchase Focus membership cards and later purchase real estate properties from the real estate developers at a discount greater than the price of the membership cards, and as a result users have asked us to reimburse them for the fees for their cards.

### *Online Payment Services*

On June 14, 2010, the PBOC issued the *Measures for the Administration of Payment Services Provided by Non-financial Institutions* (the “Payment Services Measures”), which took effect on September 1, 2010 and were amended on February 3, 2016. On December 1, 2010, the PBOC promulgated the *Implementing Rules for the Payment Services Measures*. The Payment Services Measures and their implementing rules require any non-financial institution engaging in payment services, such as online payments, issuance and acceptance of prepaid cards, and bill collection via bank cards, to obtain a Payment Service License. Applications for Payment Service Licenses are examined by the local branches of the PBOC and then submitted to the PBOC for approval. To further regulate the operation of online payment services, the PBOC issued the *Administration of Online Payment Services Provided by Non-Bank Payment Institutions* (the “Online Payment Services Measures”), which took effect on July 1, 2016. The Online Payment Services Measures classify personal payment accounts at entities that already hold a Payment Service License into three categories based on the extent to which the holders of the accounts have completed identity verification procedures, and provide that those account holders who have completed more of the identity verification process are entitled to a broader range of payment options through their accounts. The Online Payment Services Measures prohibit non-bank payment institutions from engaging in securities, insurance, financing, trusts and other unauthorized financial business. Non-bank payment institutions are also required to develop risk control systems, including a risk rating system for users, a dispute resolution system, and a risk reserve.

In addition, on January 20, 2015, the SAFE issued the Notice of the State Administration of Foreign Exchange on the Pilot Scheme of Cross-border Foreign Exchange Payment Services Provided by Payment Institutions (the “Pilot Notice”), replacing the Guiding Opinions on the Pilot Services of Cross-Border E-commerce Foreign Exchange Payment by Payment Institutions issued by the SAFE on February 1, 2013, pursuant to which a payment institution is required to obtain approval from the SAFE and to be registered in the Enterprise Directory for Foreign Exchange Receipts and Payments in Trade in order to provide pilot foreign exchange payment services for cross-border e-commerce transactions. Any institution applying for such registration and approval must first obtain a Payment Services License that authorizes it to engage in the online payments business.

*Lottery Sales*

On May 4, 2009, the State Council issued the *Regulation on Administration of Lottery* stating that “lottery issuance agencies” and “lottery sales agencies” may authorize other entities to conduct lottery sales. On September 26, 2010, the Ministry of Finance (the “MOF”) issued the *Interim Measures on the Administration of Internet Lottery Sale* (the “Lottery Measures”), which set forth detailed requirements for the administration of online lottery sales as well as requirements for qualified online lottery service providers. Pursuant to the Lottery Measures, the MOF is the supervisory and regulatory department for online lottery sales. Lottery issuance agencies may collaborate with other entities or authorize lottery sales agencies to conduct online lottery sales, or appoint qualified entities as their online lottery sales agents. The Lottery Measures require qualified online lottery service providers to meet certain criteria, including having obtained an Internet content provider license. Lottery issuance agencies are required to apply to the MOF for approval of online lottery service providers that the lottery service agencies propose to engage to conduct an online lottery business.

On January 18, 2012, the MOF, the Ministry of Civil Affairs and the General Administration of Sports jointly issued the *Implementing Rules of the Regulation on Administration of Lottery* (the “Lottery Implementing Rules”), which became effective on March 1, 2012 and stipulate that lotteries sold without the MOF’s approval and a lottery issuing agency’s or a lottery sales agency’s authorization may be categorized as illegal lotteries.

On February 28, 2012, the General Administration of Sports issued the *Urgent Notice on the Strengthening Execution of the Lottery Implementing Rules*, reiterating that lotteries sold via the Internet without the approval of the MOF will be deemed to be illegal lotteries. In December 2012, the MOF issued the *Lottery Distribution and Sale Administration Measures*, which became effective on January 1, 2013 and expressly permit Internet lottery sales.

On March 27, 2014, the MOF issued the *Interim Measures on the Administration of the Sale of Lotteries via Telephone* (the “Telephone Lottery Measures”) to replace the MOF’s former version promulgated on September 26, 2010. Under the Telephone Lottery Measures, “sale of lotteries via telephone” refers to the use of fixed-line telephones and mobile telephones to sell lotteries through short messages, voice calls and applications. Properly qualified lottery sales agencies may authorize other entities (“Telephone Sales Agents”) to carry out the business of sale of lotteries via telephone. The lottery sales agencies and the Telephone Sales Agent must enter into a commission agreement. A qualified Telephone Sales Agent is required to meet certain criteria, including having obtained a Value-Added Telecommunications Services Operating License. The Telephone Lottery Measures further provide that a Telephone Sales Agent must conduct business in accordance with parameters approved by the MOF and an pursuant to a commission agreement.

On January 15, 2015, the MOF, the Ministry of Civil Affairs and the General Administration of Sports jointly promulgated the Notice related to Self-inspection and Self-Remedy of Unauthorized Online Lottery Sales (the “Self-inspection Notice”), which requires provincial and municipal government branches, including financial, civil affairs and sports bureaus, to conduct inspections and take remedial measures for unauthorized online lottery sales within their respective jurisdictions. The scope of inspection includes, among other things, commission contracts, online lottery products, exchange of lottery sales data, online lottery sales channels, and sales commission fees in connection with unauthorized engagements of online sales agents by lottery sales agencies. The Notice further requires that a formal report on the result of the inspections and the remedial measures be submitted by each provincial or municipal government to the MOF, the Ministry of Civil Affairs and the General Administration of Sports by March 1, 2015.

On April 3, 2015, eight governmental authorities consisting of the MOF, the MPS, the SAIC, the MIIT, the Ministry of Civil Affairs, the People’s Bank of China (“PBOC”), the General Administration of Sports and the China Banking Regulatory Commission jointly released a public announcement with regard to unauthorized online lottery sales (the “Public Announcement”). The Public Announcement provides, among other things, that (i) all lottery institutions, internet companies, and other institutions or individuals provide unauthorized online lottery sales services, either directly or through agents, must immediately cease such services; (ii) the local governmental authorities for finance, civil affairs and sports must investigate and sanction unauthorized online lottery sales in their respective jurisdictions in accordance with applicable laws and regulations; (iii) the local governmental authorities for public security and industry and commerce must investigate any issuances or sales of illegal lotteries within their respective jurisdictions, with necessary assistance from local governmental authorities for finance, communication, banking regulation, civil affairs and sports, and local branches of the PBOC, and report any criminal activities to judicial authorities for prosecution; (iv) the lottery issuance authorities that plan to sell lottery products online must obtain approval from the Ministry of Civil Affairs or the General Administration of Sports by submitting an application to the MOF for written approval, and (v) no entity may provide online lottery sales services without the approval of the MOF. On April 28, 2016, the MOF, the MPS and the SAIC, and on May 5, 2015 the SAIC, issued notices regarding unauthorized online lottery sales and further emphasized the requirements specified in the Public Announcement. Online lottery sales are an insignificant business for us.

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### *Production of Radio and Telecommunications Equipment*

On September 11, 1993, the State Council and Central Military Commission jointly issued the *Regulations on the Management of Radio Operations*, which were amended on November 11, 2016, under which the working frequencies, bands, and related technical indices of radio transmission equipment must conform to relevant regulations regarding radio and are required to be submitted to the state radio administration authority or its local branches. Pursuant to the *Regulation on the Penalties of Radio Management* issued by State Radio Regulatory Commission on October 28, 1995, failure to submit such information will result in the imposition of a fine.

On October 7, 1997, the State Radio Regulatory Bureau (formerly the State Radio Regulatory Commission), together with the General Administration of Quality Supervision, Inspection and Quarantine (formerly the State Bureau of Quality) promulgated *Regulations on the Production of Radio Transmitting Equipment* (the “Radio Transmitting Equipment Regulations”), which took effect on January 1, 1999. Pursuant to the Radio Transmitting Equipment Regulations, each type of radio transmission equipment is subject to approval from State Radio Regulatory Bureau (“SRRC Certificate”) prior to production.

On May 10, 2001, MIIT promulgated the *Administration Measures of the Network Entry of Telecommunication Equipment* (the “Telecommunication Equipment Measures”), which was amended on September 23, 2014. Pursuant to the Telecommunication Equipment Measures, the State requires all telecommunications terminal equipment to be connected to a public telecommunications network to obtain network connection permits. A Permit of Network Connection, or China Type Approval Certificate (“CTA Certificate”), issued by the MIIT must be obtained for such telecommunications equipment. When a producer of such telecommunications terminal equipment applies for a CTA Certificate, it must submit a test report or product quality certificate (namely SRRC Certificate). If a CTA Certificate has not been obtained for such equipment, it may not be connected to a public telecommunications network and may not be used or sold domestically.

### *Miscellaneous*

#### *Laws and Regulations Related to International Connections for Computer Information Networks*

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

- *Provisional Regulations of the People’s Republic of China for the Administration of International Connections to Computer Information Networks (1997) and related Implementing Measures (1998); and*
- *Administrative Measures for International Communications Gateways (2002).*

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

- be a PRC legal person;
- have the appropriate equipment, facilities and technical and administrative personnel;
- have implemented and registered a system of information security and censorship; and
- effect all international connections through an international communications gateway established with the approval of the MIIT.

We have adopted measures necessary to ensure that we are in compliance with all of these requirements.

#### *Laws and Regulations Related to Intellectual Property Protection*

China has adopted comprehensive legislation governing intellectual property rights, including copyrights, patents and trademarks.

#### Copyright

On September 7, 1990, The National People’s Congress promulgated the *Copyright Law*, which took effect on June 1, 1991 and was amended in 2001 and in 2010. The amended Copyright Law extends copyright protection to Internet activities, products disseminated over the Internet and software products. In addition, there is a voluntary registration system administered by the China Copyright Protection Center. The amended Copyright Law also requires registration of the pledge of a copyright.

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In order to further implement the *Computer Software Protection Regulations*, promulgated by the State Council on December 20, 2001 and amended on January 30, 2013, the National Copyright Administration (the “NCA”) issued *Computer Software Copyright Registration Procedures* on February 20, 2002, which specify detailed procedures and requirements with respect to the registration of software copyrights.

To address the problem of copyright infringement related to content posted or transmitted over the Internet, on April 29, 2005 the NCA and the MIIT jointly promulgated the *Measures for Administrative Protection of Copyright Related to Internet*, which became effective on May 30, 2005. These measures apply to situations where an ICP operator (i) allows another person to post or store any works, recordings, audio or video programs on the Websites operated by such ICP operator, or (ii) provides links to, or search results for, the works, recordings, audio or video programs posted or transmitted by such person, without editing, revising or selecting the content of such material. Upon receipt of an infringement notice from a legitimate copyright holder, an ICP operator must take remedial actions immediately by removing or disabling access to the infringing content. If an ICP operator knowingly transmits infringing content or fails to take remedial actions after receipt of a notice of infringement harming public interest, the ICP operator could be subject to administrative penalties, including an order to cease infringing activities; confiscation by the authorities of all income derived from the infringement activities; or payment of fines.

On May 18, 2006, the State Council promulgated the *Regulations on the Protection of the Right to Network Dissemination of Information* (as amended in 2013). Under these regulations, an owner of the network dissemination rights with respect to written works or audio or video recordings who believes that information storage, search or link services provided by an Internet service provider infringe his or her rights may require that the Internet service provider delete, or disconnect the links to, such works or recordings.

Since 2005, the NCA, together with certain other PRC governmental authorities, have jointly launched annual campaigns, which normally last for three to four months every year, specifically aiming to crack down on Internet copyright infringement and piracy in China. According to the *Notice of 2010 Campaign to Crack Down on Internet Infringement and Piracy* promulgated by the NCA, the MPS and the MIIT on July 19, 2010, one of the main targets, among others, of the 2010 campaign was Internet audio and video programs. From the time the 2010 campaign commenced in late July, the local branches of the NCA focused on popular movies and television series, newly published books, online games and animation, music and software and illegal uploading or transmission of a third party’s works without proper license or permission, sales of pirated audio/video and software through e-commerce platforms, providing search links, information storage, Web hosting or Internet access services for third parties engaging in copyright infringement or piracy and infringement by the use of mobile media. In serious cases, the operating permits of the Websites engaging in illegal activities may be revoked, and such Websites may be ordered to shut down. On July 12, 2016, the NCA, the State Internet Information Office, the MIIT and the MPS jointly announced the 2016 Campaign to Crack Down on Internet Infringement and Piracy (the “Jian Wang 2016 Campaign”), targeting the infringement of rights to, and piracy of, online literary works and infringement activities using mobile application programs, and strengthening the supervision and regulation of the Website Alliance, to enhance copyright protection.

On April 17, 2015, the NCA issued the *Circular on Regulating the Order of Internet Reproduction of Copyrighted Works* (“Internet Reproduction Circular”). Under the Internet Reproduction Circular, in order to reproduce the work of others, Internet media companies must comply with relevant provisions of the copyright laws and regulations, and, unless provided otherwise by law or regulation, must obtain permission from and pay remuneration to the owner of the copyright to the work, and must indicate the name of the author, as well as the title and the source of the work, and may not infringe any other rights or interests of the copyright owner. Moreover, when reproducing the work of others, Internet media companies may not make material alterations to the content; and may not make editorial modifications or abridgments of the work that change the work’s title or its original intent. When reproducing the work of others, we will need to comply with these strict requirements of the Internet Reproduction Circular.

We have adopted measures to mitigate copyright infringement risks, such as real-time monitoring and mechanisms for fast removal upon receipt of notices of infringement.

On December 26, 2009, the Standing Committee of the National People’s Congress adopted the *Torts Liability Law*, which became effective on July 1, 2010. Under this new law, both Internet users and Internet service providers may be liable for the wrongful acts of users who infringe the lawful rights of other parties. If an Internet user utilizes Internet services to commit a tortious act, the party whose rights are infringed may request the Internet service provider to take measures, such as removing or blocking the content, or disabling the links thereto, to prevent or stop the infringement. If the Internet service provider does not take necessary measures after receiving such a notice, it will be jointly liable for any further damages suffered by the rights holder. Furthermore, if an Internet service provider fails to take necessary measures when it knows that an Internet user utilizes its Internet services to infringe the lawful rights and interests of other parties, it will be jointly liable with the Internet user for damages resulting from the infringement.

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On December 17, 2012, PRC Supreme People's Court promulgated the *Provisions on Several Issues Concerning the Application of Law for Trial of Civil Dispute Cases Involving Infringement of the Right to Network Dissemination of Information* ("Network Dissemination of Information Provision"). The Network Dissemination of Information Provisions stipulate that the dissemination by network users or network service providers of written works, performance or audio or video recordings without the permission of the holder of the rights to such dissemination will constitute infringement of such rights, and that network service providers that aid or abet any network user's infringement of the rights of another to network dissemination of any works or recordings may be liable for such network user's infringing activities.

### Patent Law

On March 12, 1984, the Standing Committee of the National People's Congress promulgated the *Patent Law*, which was amended in 1992, 2000 and 2008. On June 15, 2001, the State Council promulgated the *Implementation Regulation for the Patent Law*, which was amended in January 9, 2010. According to these laws and regulations, the State Intellectual Property Office is responsible for administering patents in the PRC. The Chinese patent system adopts a "first to file" principle, which means that where more than one person files a patent application for the same invention, a patent will be granted to the person who filed the application first. To be patentable, invention or utility models must meet three conditions: novelty, inventiveness and practical applicability. A patent is valid for 20 years in the case of an invention and 10 years in the case of utility models and designs. A third-party user must obtain consent or a proper license from the patent owner to use the patent. Otherwise, third-party use constitutes an infringement of patent rights.

### Trademark Law

On August 23, 1982, the Standing Committee of the National People's Congress promulgated the *Trademark Law* (the "Trademark Law"), which was amended in 1993, 2001 and 2013. On September 15, 2002, the State Council promulgated the *Implementation Regulation for the Trademark Law*, which was amended in April 29, 2014. Under the Trademark Law and the implementing regulation, the Trademark Office of the Administration for Industry and Commerce is responsible for the registration and administration of trademarks. The Administration for Industry and Commerce under the State Council has established a Trademark Review and Adjudication Board for resolving trademark disputes. As with patents, China has adopted a "first-to-file" principle for trademark registration. If two or more applicants apply for registration of identical or similar trademarks for the same or similar commodities, the application that was filed first will receive preliminary approval and will be publicly announced. For applications filed on the same day, the trademark that was first used will receive preliminary approval and will be publicly announced. Registered trademarks are valid for ten years from the date the registration is approved. A registrant may apply to renew a registration within twelve months before the expiration date of the registration. If the registrant fails to apply in a timely manner, a grace period of six additional months may be granted. If the registrant fails to apply before the grace period expires, the registered trademark shall be deregistered. Renewed registrations are valid for ten years.

### Laws and Regulations Related to Encryption Software

In October 1999, the State Encryption Administration Commission promulgated the *Regulations for the Administration of Commercial Encryption*, amended on February 3, 2016, followed in November 1999 by the *Notice of the General Office of the State Encryption Administration Commission*. Both of these regulations address the use in China of software with encryption functions.

These regulations require that encryption products purchased for use be reported. Violation of the encryption regulations may result in the issuance of a warning, levying of a penalty, confiscation of the encryption products and even criminal liabilities. On March 18, 2000, the Office of the State Commission for the Administration of Cryptography issued a public announcement regarding the implementation of the regulations. The announcement states that only specialized hardware and software, the core functions of which are encryption and decoding, fall within the administrative scope of the regulations as "encryption products and equipment containing encryption technology." Other products, such as wireless telephone, Windows software and browsers do not fall within this scope.

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

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

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### *Laws and Regulations Related to Consumer Protection and Privacy Protection*

#### Consumer Protection

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

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

On January 26, 2014, the SAIC issued the *Administrative Measures on Online Transactions* (the “Online Transaction Measures”), which took effect on March 15, 2014, to regulate online commodity trading and related online services and replace the previous *Interim Measures for the Administration of Online Commodities Trading and Relevant Services* issued on May 31, 2010. The Online Transaction Measures stipulate various obligations of online service providers, including the obligation to protect the interests of customers. Under the Online Transaction Measures, commodities or relevant services transacted online must comply with relevant laws, regulations and rules. When selling commodities or providing services to consumers, online commodity operators must comply with all applicable laws with respect to the protection of consumer rights/interests, intellectual property rights of others and the prevention of unfair competition. Information on commodities or services provided by online commodity operators or related service operators must be authentic and accurate.

On May 26, 2016, the MIIT issued the *Measures on the Complaint Settlement of the Telecommunication Services Users* (the “Complaint Settlement Measures”), which took effect on July 30, 2016. The Complaint Settlement Measures require telecommunication services providers to respond to their users within fifteen days upon the receipt of any complaint delivered by such users, the failure of which will give the complaining users the right to file a complaint against the service providers with the provincial branch offices of the MIIT.

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

#### Privacy Protection

The PRC Constitution states that PRC law protects the freedom and privacy of the communications of citizens and prohibits infringement of such rights. In recent years, PRC government authorities have issued various regulations on the use of the Internet that are designed to protect personal information from unauthorized disclosure. For example, the ICP Measures prohibit an Internet information services provider from insulting or slandering a third party or infringing upon the lawful rights and interests of a third party. In addition, PRC regulations authorize PRC telecommunication authorities to demand rectification of unauthorized disclosure by ICPs.

Chinese law does not prohibit ICPs from collecting and analyzing personal information from their users. The PRC government, however, has the power and authority to order ICPs to submit personal information of an Internet user if such user posts any prohibited content or engages in illegal activities on the Internet. In addition, the Several Provisions stipulate that ICPs must not, without the users’ consent, collect information on users that can be used, alone or in combination with other information, to identify the user, or User Personal Information, and may not provide any User Personal Information to third parties without prior user consent. ICPs may only collect User Personal Information necessary to provide their services and must expressly inform the users of the method, content and purpose of the collection and processing of such User Personal Information. In addition, an ICP may use User Personal Information only for the stated purposes under the ICP’s scope of services. ICPs are also required to ensure the proper security of User Personal Information, and take immediate remedial measures if User Personal Information is suspected to have been disclosed. If the consequences of any such disclosure are expected to be serious, the ICP must immediately report the incident to the telecommunications regulatory authorities and cooperate with the authorities in their investigations. We require our users to accept a user agreement whereby they agree to provide certain personal information to us. If we violate these regulations, the MIIT or its local bureaus may impose penalties and we may be liable for damage caused to our users.



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On December 28, 2012, the Standing Committee of the National People's Congress enacted the *Decision to Enhance the Protection of Network Information* ("Information Protection Decision"), to further enhance the protection of User Personal Information in electronic form. The Information Protection Decision provides that ICPs must expressly inform their users of the purpose, manner and scope of the ICPs' collection and use of User Personal Information, publish the ICPs' standards for their collection and use of User Personal Information, and collect and use User Personal Information only with the consent of the users and only within the scope of such consent. The Information Protection Decision also mandates that ICPs and their employees must keep strictly confidential User Personal Information that they collect, and that ICPs must take such technical and other measures as are necessary to safeguard the information against disclosure.

On July 16, 2013, the MIIT issued the *Order for the Protection of Telecommunication and Internet User Personal Information* (the "Order"). Most of the requirements under the Order that are relevant to ICP operators are consistent with the requirements already established under the MIIT provisions discussed above, except that under the Order the requirements are often more strict and have a wider scope. If an ICP operator wishes to collect or use personal information, it may do so only if such collection is necessary for the services it provides. Further, it must disclose to its users the purpose, method and scope of any such collection or use, and must obtain consent from the users whose information is being collected or used. ICP operators are also required to establish and publish their protocols relating to personal information collection or use, keep any collected information strictly confidential, and take technological and other measures to maintain the security of such information. ICP operators are required to cease any collection or use of the user personal information, and de-register the relevant user account, when a given user stops using the relevant Internet service. ICP operators are further prohibited from divulging, distorting or destroying any such personal information, or selling or providing such information unlawfully to other parties. In addition, if an ICP operator appoints an agent to undertake any marketing or technical services that involve the collection or use of personal information, the ICP operator is still required to supervise and manage the protection of the information. The Order states, in broad terms, that violators may face warnings, fines, and disclosure to the public and, in the most severe cases, criminal liability.

On August 21, 2014, the supreme people's court promulgated the *Provisions of the Supreme People's Court on Application of Laws to Cases Involving Civil Disputes over Infringement upon Personal Rights and Interests by Using Information Networks*, pursuant to which if an ICP operator discloses genetic information, medical records, health examination data, criminal record, home address, private events and or other personal information of a natural person online, causing damage to the person, the People's Court should support a claim by the infringed party for recovery of damages from the infringing ICP operator.

On January 5, 2015, the SAIC promulgated the Measures on Punishment for Infringement of Consumer Rights, pursuant to which business operators collecting and using personal information of consumers must comply with the principles of legitimacy, propriety and necessity, specify the purpose, method and scope of collection and use of the information, and obtain the consent of the consumers whose personal information is to be collected. Business operators may not: (i) collect or use personal information of consumers without their consent; (ii) unlawfully divulge, sell or provide personal information of consumers to others; (iii) send commercial information to consumers without their consent or request, or when a consumer has explicitly declined to receive such information.

On August 29, 2015, the Standing Committee of the National People's Congress issued Amendment (IX) to the Criminal Law of the People's Republic of China ("Amendment (IX)"), which strengthens the protection of individual information and Internet security. Pursuant to Amendment (IX), network service providers who do not comply with laws and regulations regarding the safe management of information on their networks, and who do not correct their conduct after they receive notice of such non-compliance from the relevant regulatory authorities, may be sentenced to prison for up to three years, and may also be subject to public surveillance and fines.

Our current security measures and those of the third parties with whom we transact business may not be adequate for the protection of user personal information. In addition, we do not have control over the security measures of our third-party online payment vendors. Security breaches of our system and the online payment systems that we use could expose us to litigation and liability for failing to secure confidential customer information and could harm our reputation, ability to attract customers and ability to encourage customers to purchase virtual items.

### *Laws and Regulations Related to Security and Censorship*

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

- *The Law of the People's Republic of China on the Preservation of State Secrets (1988, as amended in 2010) and related Implementing Rules (2014);*
- *The Law of the People's Republic of China Regarding Anti-spy (2014);*

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- *Rules of the People’s Republic of China for Protecting the Security of Computer Information Systems (1994, as amended in 2011);*
- *Administrative Regulations for the Protection of Secrecy on Railway Computer Information Systems Connected to International Networks (1999);*
- *Regulations for the Protection of State Secrets for Computer Information Systems on the Internet (2000);*
- *Notice issued by the Ministry of Public Security of the People’s Republic of China Regarding Issues Relating to the Implementation of the Administrative Measure for the Security Protection of International Connections to Computer Information Networks (2000); and*
- *The Decision of the Standing Committee of the National People’s Congress Regarding the Safeguarding of Internet Security (2000) which has been amended in 2009.*

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

- “A breach of public security” includes a breach of national security or disclosure of state secrets; infringement on state, social or collective interests or the legal rights and interests of citizens or illegal or criminal activities.
- “Socially destabilizing content” includes any action that incites defiance or violation of Chinese laws; incites subversion of state power and the overturning of the socialist system; fabricates or distorts the truth, spreads rumors or disrupts social order; advocates cult activities; spreads feudal superstition; involves obscenities, pornography, gambling, violence, murder, or horrific acts; or instigates criminal acts.
- “State secrets” are defined as “matters that affect the security and interest of the state.” The term covers such broad areas as national defense, diplomatic affairs, policy decisions on state affairs, national economic and social development, political parties and “other State secrets that the State Secrecy Bureau has determined should be safeguarded.”

Under the aforementioned legislation, it is mandatory for Internet companies in the PRC to complete security filing procedures with the local public security bureau and for them provide regular updates to the local public security bureau regarding information security and censorship systems for their Websites. In this regard, on October 1, 2004, the *Administrative Rules on the Filing of Commercial Websites* (“Commercial Websites Filing Rules”) were promulgated by the Beijing Administration of Industry and Commerce (Beijing AIC), to replace the *Detailed Implementing Rules for the Administration of Commercial Website Filings for the Record* promulgated by the Beijing AIC on September 1, 2000. The Commercial Websites Filing Rules state that operators of commercial Websites must comply with the following requirements:

- filing with the Beijing AIC and obtain electronic registration marks for the Websites;
- placing the registration marks on the Websites’ homepages; and
- registering the Website names with the Beijing AIC.

On November 7, 2016, the Standing Committee of the National People’s Congress issued the *Internet Security Law* (the “Internet Security Law”), which will take effect on June 1, 2017. The Internet Security Law will require providers of services over Internet networks to keep user information that they have collected in strict confidence and to establish improved systems for the protection of user information. Such service providers must provide notice of the purpose, methods and scope of their collection and use of user information, and obtain the consent of each person whose personal information will be collected. Providers of services over Internet networks may not collect any personal information that is not related to the services they provide, or disclose or tamper with personal information that they have collected, unless such information is encoded to prevent identification of individuals whose information is so disclosed or tampered with. Service providers who do not comply with the Internet Security Law may be subject to fines, suspension of their businesses, shutdown of their websites, and revocation of their business licenses.

Sohu Internet and Changyou have successfully registered the Sohu.com Website, the Changyou.com Website and the cy.com Website with the Beijing AIC and the electronic registration marks for the Websites are prominently placed on the homepages of the Sohu.com Website and the Changyou.com Website and the cy.com Website.

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



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

### Internet Content and Anti-Pornography

The PRC government has promulgated measures relating to Internet content through a number of government authorities, including the MIIT, the MOC, the SAPPRFT and the MPS. These measures specifically prohibit certain Internet activities, including the operation of online games, which results in the publication of any content which is found to, among other things, propagate obscenity, gambling or violence, instigate crimes, undermine public morality or the cultural traditions of the PRC, or compromise State security or secrets. If an ICP license holder violates these measures, the PRC government may revoke its ICP license and shut down its Websites.

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

On December 4, 2009, the MIIT and three other PRC government authorities jointly issued the *Incentives Measures for Report of Pornographic, Obscene and Vulgar Messages on Internet and Mobile Media* (“Anti-Pornography Notice”), to crack down on online pornography. Pursuant to the Anti-Pornography Notice, rewards of up to RMB10,000 will be provided to Internet users who report Websites that feature pornography, and a committee has been established to review such reports to determine an appropriate award. During a PRC anti-pornography campaign, which continued during 2014, many Websites (including mobile Websites) that contained pornography were closed down. In addition, China Mobile announced a temporary suspension of billing for Wireless Application Protocol (“WAP”) services, as a means of fighting against Websites providing pornographic content.

On April 13, 2014, the National Working Group on Anti-Pornography and three other PRC government authorities jointly issued the *Proclamation of Special Action Regarding Crackdown on Online Pornographic Content* (the “Anti-Pornography Proclamation”). Under the Anti-Pornography Proclamation, Internet service providers must immediately remove texts, images, video, advertisements and other information that contain pornographic content. The relevant government authority may order enterprises or individuals who flagrantly produce or disseminate pornographic content to stop conducting business, and may revoke relevant administrative permits. Moreover, an enterprise or individual who provides telecom operation services, network access services, advertising services or payment services to facilitate dissemination of pornographic content may have criminal or civil penalties imposed under the PRC Criminal Law and other relevant laws and regulations.

### *Laws and Regulations Related to Unfair Competition*

Pursuant to the *Anti-Unfair Competition Law*, which took effect in 1993, a business operator is prohibited from any of the following unfair activities:

- copying and using the registered trademarks of others;
- using the same or similar names, packages or decorations of well-known brand name products so as to mislead buyers;
- using the names of other enterprises without authorization so as to mislead buyers; and
- forging identification marks, marks indicating good quality and other marks on commodities or falsifying the place of origin or using other false indicators to mislead people with regard to quality.

In addition, the Supreme People’s Court has promulgated an *Interpretation on Several Issues Relating to the Application of the Law in Civil Trials for Unfair Competition Cases*, effective as of February 1, 2007. This interpretation provides guidance on how to conduct trials involving unfair competition, protect the legal rights and interests of business operators and maintain orderly market competition.

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### *Regulation of M&A and Overseas Listings*

On August 8, 2006, six PRC regulatory agencies, including the MOC, the State Assets Supervision and Administration Commission, the State Administration of Taxation (“SAT”), the SAIC, the China Securities Regulatory Commission (the “CSRC”), and the SAFE, jointly issued the *Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (“M&A Rule”), which became effective on September 8, 2006 and amended on June 22, 2009. The M&A Rule includes provisions that purport to require that an offshore special purpose vehicle formed for purposes of the overseas listing of equity interests in PRC companies and controlled directly or indirectly by PRC companies or individuals obtain the approval of the CSRC prior to the listing and trading of such special purpose vehicle’s securities on an overseas stock exchange.

On September 21, 2006, the CSRC published on its official Website procedures regarding its approval of overseas listings by special purpose vehicles. The CSRC approval procedures require the filing of a number of documents with the CSRC. The application of this new PRC regulation remains unclear, with no consensus currently existing among leading PRC law firms regarding the scope of the applicability of the CSRC approval requirement.

The M&A Rules also establish procedures and requirements that could make some acquisitions of Chinese companies by foreign investors more time-consuming and complex, including requirements in some instances that the MOFCOM be notified in advance of any change-of-control transaction in which a foreign investor takes control of a Chinese domestic enterprise.

In February 2011, the General Office of the State Council promulgated a *Notice on Establishing the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (“Circular 6”), which established a security review system for mergers and acquisitions of domestic enterprises by foreign investors. Under Circular 6, a security review is required for mergers and acquisitions by foreign investors having “national defense and security” concerns and mergers and acquisitions by which foreign investors may acquire “de facto control” of domestic enterprises with “national security” concerns. In August 2011, the MOFCOM promulgated the *Rules on Implementation of Security Review System* (“MOFCOM Security Review Rules”), to replace the *Interim Provisions of the Ministry of Commerce on Matters Relating to the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* promulgated by the MOFCOM in March 2011. The MOFCOM Security Review Rules, which came into effect on September 1, 2011, provide that the MOFCOM will look into the substance and actual impact of a transaction and prohibit foreign investors from bypassing the security review requirement by structuring transactions through proxies, trusts, indirect investments, leases, loans, control through contractual arrangements or offshore transactions.

### *Laws and Regulations Related to Antitrust*

On August 30, 2007, the Standing Committee of the National People’s Congress of the PRC adopted the PRC Anti-Monopoly Law (“AML”), which took effect on August 1, 2008. Pursuant to the AML, monopolistic conduct, including entering into monopoly agreements, abuse of dominant market position and concentration of undertakings that have the effect of eliminating or restricting competition, is prohibited. To further implement the Antitrust Law and clarify certain issues, the State Council, MOFCOM, NDRC and SAIC, issued several regulations and rules, including *the Provisions on Thresholds for Prior Notification of Concentrations of Undertakings* issued by the State Council on August 3, 2008, *the Regulation on the Prohibition of Acts Involving Monopolistic Agreements* issued by the SAIC on December 31, 2010, *the Regulation on the Prohibition of Conduct Constituting an Abuse of a Dominant Market Position* issued by the SAIC on December 31, 2010, *the Regulation on the Prevention of Conduct Constituting an Abuse of Administrative Powers to Eliminate or Restrict Competition* issued by the SAIC on December 31, 2010, *the Anti-Price Monopoly Regulation* issued by the NDRC on 29 December 2010, *the Declaration Rules for Concentrations of Undertakings* issued by the MOFCOM on November 21, 2009, and amended on June 6, 2014, *the Assessment Rules for Concentration of Undertakings* issued by the MOFCOM on November 24, 2009, and *the Provisional Measures on the Investigation and Handling of Concentrations between Business Operators which Were Not Notified in Accordance with the Law* issued by the MOFCOM on December 30, 2011.

Taken together these various laws and regulations provide for the following:

**Monopoly Agreement:** competing business operators may not enter into monopoly agreements that eliminate or restrict competition, such as by boycotting transactions, fixing or changing the price of commodities, limiting the output of commodities, fixing the price of commodities for resale to third parties, unless such agreements satisfy the exemptions under the Antitrust Law, such as improving technologies or increasing the efficiency and competitiveness of small and medium-sized enterprises. Sanctions for violations include an order to cease the relevant activities, confiscation of illegal gains and fines (from 1% to 10% of sales revenue from the previous year, or RMB 500,000 if the intended monopoly agreement has not been performed).

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*Abuse of Dominant Market Position:* a business operator with a dominant market position may not abuse its dominant market position to conduct acts such as selling commodities at unfairly high prices or buying commodities at unfairly low prices, selling products at prices below cost without any justifiable cause, and refusing to trade with a trading party without any justifiable cause. Dominant market position refers to a market position held by a business operator having the capacity to control the price, quantity or other trading conditions of commodities in the relevant market, or to hinder or affect any other business operator to enter the relevant market, which will be determined based on the market share of the relevant business operator, capacity of a business operator to control the sales market, the degree of dependence of other business operators upon the business operator in question in transactions, and the degree of difficulty for other business operators to enter into the relevant market. Sanctions for violation of the prohibition on the abuse of dominant market position include an order to cease the relevant activities, confiscation of illegal gains and fines (from 1% to 10% of sales revenue from the previous year).

*Concentration of Enterprises:* pursuant to the AML, where a concentration of enterprises reaches the declaration threshold stipulated by the State Council, a declaration must be lodged in advance with the antitrust authority under the State Council. Otherwise, the concentration cannot be effected. Concentration refers to (1) a merger of enterprises; (2) acquiring control over other enterprises by an enterprise through acquiring equities or assets; or (3) acquiring control over, or the possibility of exercising decisive influence on, an enterprise by contract or by any other means. Under the Provisions on Thresholds for Prior Notification of Concentrations of Undertakings, the thresholds for prior notification of concentration of enterprises are the following:

- the combined worldwide turnover of all of the subject enterprises in the preceding financial year is more than RMB10.00 billion, and the nationwide turnover within China of each of at least two of the subject enterprises in the preceding financial year is more than RMB400.0 million; or
- the combined nationwide turnover within China of all the subject enterprises in the preceding financial year is more than RMB2.00 billion, and the nationwide turnover within China of each of at least two of the subject enterprises in the preceding financial year is more than RMB400.0 million.

If business operators fail to comply with these mandatory declaration provisions, the antitrust authority is empowered to terminate and/or unwind the transaction, dispose of relevant assets, shares or businesses and impose fines up to RMB500,000.

### *Regulation of Foreign Currency Exchange and Dividend Distribution*

The principal regulations governing foreign currency exchange in China are the *Foreign Exchange Administration Regulations* (“FX Regulations”), which were last amended in August 2008. Under the FX Regulations, the RMB is freely convertible for current account items, including the distribution of dividends, interest payments, trade and service-related foreign exchange transactions, but not for capital account items, such as direct investments, loans, repatriation of investments and investments in securities outside of China, unless the prior approval of the SAFE is obtained and prior registration with the SAFE is made. Dividends paid by a PRC subsidiary to its overseas shareholder are deemed income of the shareholder and are taxable in the PRC. Pursuant to *the Administration Rules of the Settlement, Sale and Payment of Foreign Exchange* (1996), foreign-invested enterprises in the PRC may purchase or remit foreign currency, subject to a cap approved by the SAFE, for settlement of current account transactions without the approval of the SAFE. Foreign currency transactions under the capital account are still subject to limitations and require approvals from, or registration with, the SAFE and other relevant PRC governmental authorities.

In July 2014, the SAFE promulgated *the Circular on Issues Concerning Foreign Exchange Administration Over the Overseas Investment and Financing and Roundtrip Investment by Domestic Residents Via Special Purpose Vehicles* (“Circular 37”) which replaced *Relevant Issues Concerning Foreign Exchange Control on Domestic Residents’ Corporate Financing and Roundtrip Investment through Offshore Special Purpose Vehicles* (“Circular 75”). Circular 37 requires PRC residents, including PRC institutions and individuals, to register with the local SAFE branch in connection with their direct establishment or indirect control of an offshore entity, referred to in Circular 37 as a “special purpose vehicle,” for the purpose of holding domestic or offshore assets or interests. PRC residents must also file amendments to their registrations in the event of any significant changes with respect to the special purpose vehicle, such as increase or decrease of capital contributed by PRC individuals, share transfer or exchange, merger, division or other material event. Under these regulations, PRC residents’ failure to comply with specified registration procedures may result in restrictions being imposed on the foreign exchange activities of the relevant PRC entity, including the payment of dividends and other distributions to its offshore parent, as well as restrictions on capital inflows from the offshore entity to the PRC entity, including restrictions on the ability to contribute additional capital to the PRC entity. Further, failure to comply with the various SAFE registration requirements could result in liability under PRC law for evasion of foreign exchange regulations.

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Under Circular 37, if a non-listed special purpose vehicle uses its own equity to grant equity incentives to any directors, supervisors, senior management or any other employees directly employed by a domestic enterprise which is directly or indirectly controlled by such special purpose vehicle, or with which such an employee has established an employment relationship, related PRC residents and individuals may, prior to exercising their rights, apply to the SAFE for foreign exchange registration formalities for such special purpose vehicle. However, in practice, different local SAFE branches may have different views and procedures on the interpretation and implementation of the SAFE regulations, and since Circular 37 was the first regulation to regulate the foreign exchange registration of a non-listed special purpose vehicle's equity incentives granted to PRC residents, there remains uncertainty with respect to its implementation.

On December 25, 2006, the PBOC issued the *Administration Measures on Individual Foreign Exchange Control* and related *Implementation Rules* were issued by the SAFE on January 5, 2007. Both became effective on February 1, 2007. Under these regulations, all foreign exchange transactions involving an employee share incentive plan, share option plan, or similar plan participated in by onshore individuals may be conducted only with approval from the SAFE or its authorized branch. Under the *Notice of Issues Related to the Foreign Exchange Administration for Domestic Individuals Participating in Stock Incentive Plan of Overseas Listed Company* ("Offshore Share Incentives Rules"), which was issued by the SAFE on February 15, 2012, PRC citizens who are granted share options, restricted share units or restricted shares by an overseas publicly listed company are required to register with the SAFE or its authorized branch and to comply with a series of other requirements. In November 2011, the SAFE approved our application to designate our PRC subsidiary Sohu Media to handle the registrations and other procedures required by the Offshore Share Incentives Rules. In February 2012, the SAFE approved Changyou's application to designate its PRC subsidiary AmazGame to handle the registrations and other procedures required by the Offshore Share Incentive Rules. If we, Changyou or the PRC employees of Changyou and us who hold options, restricted share units or restricted shares fail to comply with these registration or other procedural requirements, we, Changyou and/or such employees may be subject to fines and other legal sanctions.

The principal regulations governing distribution of dividends of foreign holding companies include the *Foreign Investment Enterprise Law* (1986), which was amended in October 2000 and October, 2016, and the *Administrative Rules under the Foreign Investment Enterprise Law* (2001), which was amended in February, 2014.

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

### *Laws and Regulations Related to Employment and Labor Protection*

On June 29, 2007, the National People's Congress promulgated the *Employment Contract Law of PRC* ("Employment Contract Law"), which became effective as of January 1, 2008 and amended on December 28, 2012. The Employment Contract Law requires employers to provide written contracts to their employees, restricts the use of temporary workers and aims to give employees long-term job security.

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

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

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

## **Conclusion**

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

## **INTELLECTUAL PROPERTY AND PROPRIETARY RIGHTS**

We regard our patents, copyrights, service marks, trademarks, trade secrets and other intellectual property as critical to our success. We rely on patent, trademark and copyright law, trade secret protection, non-competition and confidentiality and/or license agreements with our employees, customers, partners and others to protect our intellectual property rights. Despite our precautions, it may be possible for third parties to obtain and use our intellectual property without authorization. Furthermore, the validity, enforceability and scope of protection of intellectual property rights in Internet-related industries are uncertain and still evolving. The laws of the PRC and certain other countries do not protect intellectual property to the same extent as do the laws of the United States.

We have registered three service marks with the U.S. Patent and Trademark Office. They are (i) Sohu.com, registered on August 1, 2000; (ii) Sohu.com (stylized), registered on August 1, 2000; and (iii) Sohu, registered on June 13, 2000. We received the registration certificate for the mark “SOHU.com” issued by the China Trademark Office in September 2000. We have also filed registration applications with the China Trademark Office to register other key marks, including Sohu.com logos, Sohu Fox logos, GoodFeel logos, Go2Map, Sogou logos, Sohu Focus, TLBB, ChangYou.com, cyou.com, TL logos, Blade Online, 17173 and their corresponding Chinese version marks. We succeeded in registering certain marks such as Sohu.com logos, Sohu Fox logos, www.focus.com.cn, GoodFeel logos, Go2Map, Sogou logos, Sohu Focus, Sohu Auto, TLBB, ChangYou.com, cyou.com, TL Logos, 17173 and Dolphin Browser in the PRC under certain classes, while the others are still under examination by the China Trademark Office. We also filed registration of trademarks relating to our subsidiary companies’ names and Changyou’s online games and other businesses in various countries and regions, such as the United States, European Union, Turkey, Japan, South Korea, Malaysia, Indonesia, Vietnam, Thailand, Brazil, Taiwan and Hong Kong. Our rights to these marks could be affected adversely if any of our applications are rejected. In addition, it is possible that our competitors will adopt product or service names similar to ours, thereby impeding our ability to distinguish our brand and possibly leading to customer confusion.

Many parties are actively developing chat, search, Web directory and related Web technologies. We expect these parties to continue to take steps to protect these technologies, including seeking patent protection. There may be patents issued or pending that are held by others and cover significant parts of our technology, business methods or services. For example, we are aware that a number of patents have been issued in the areas of e-commerce, Web-based information indexing and retrieval and online direct marketing. Disputes over rights to these technologies may arise in the future. We cannot be certain that our products do not or will not infringe valid patents, copyrights or other intellectual property rights held by third parties. We may be subject to legal proceedings and claims, from time to time, relating to the intellectual property of others in the ordinary course of our business. See “Item 3. Legal Proceedings”.

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

## **TECHNOLOGY INFRASTRUCTURE**

We have built what we believe is a reliable and secure network infrastructure, that will fully support our operations, which include one of the most comprehensive matrices of content and services, provided by Sohu and Sogou, and one of the most popular online games in China, provided by Changyou.

### **Content and Services provided by Sohu and Sogou**

As of December 31, 2016 we maintained approximately 40,000 servers in China. To fully support the operation of our content and services, we established these data centers primarily through China Mobile, China United Network Communication Group Company Limited (“China Unicom”), and China Telecom Corporation (“China Telecom”), which are the three largest Internet connection service providers in China, to support most of our core services. In addition, we have established branch nodes in different provinces throughout China through different telecommunication operators in order to establish national coverage and provide fast and stable access to our Internet platforms properties to users across China. In addition, we have developed cooperation with several smaller private Internet service providers.

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

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

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

### **Online Games, provided by Changyou**

Changyou supports its operations with a network of reliable and secure physical and cloud-based servers that have fully supported its operations for many years. As of December 31, 2016, Changyou maintained for its online game business approximately 6,000 physical servers that are located in Internet data centers in 16 major cities in China, and 2,000 cloud-based servers that are spread across mainland China, Hong Kong and North America. In order to enhance Changyou's game players' experience and to improve connectivity, Changyou has located its physical game servers in a number of regions throughout China. This allows its players to connect to the nearest servers that are located in their region without exchanging data across the national backbone network. Furthermore, to ensure high quality services for its game players, Changyou works with leading domestic cloud technology firms to provide efficient and stable game services using cloud-based resources. Changyou has a professional technical support team that specializes in maintaining its quality technology infrastructure and online operating platform. Changyou monitors the operation of its server network 24 hours a day, seven days a week. Changyou's remote control system allows it to track its concurrent online users in real time, and discover and fix hardware or software problems on its server network in a timely fashion.

### **EMPLOYEES**

As of December 31, 2016, we had approximately 10,000 employees. We also employ independent contractors to support our research and development, sales, marketing, and editorial departments. None of our personnel are represented under collective bargaining agreements.

We have entered into standard employment agreements with our employees through our subsidiaries and VIEs. All of our employees have entered into confidentiality, non-competition and non-solicitation agreements with us. However, the degree of protection afforded to an employer pursuant to confidentiality and non-competition undertakings governed by PRC law may be more limited when compared to the degree of protection afforded under the laws of other jurisdictions. A number of our employees hold share-based awards granted by Sohu, Sogou, Changyou, and Sohu Video, which provide additional financial incentives to them. Most of these awards vest over a period of four years.

### **AVAILABLE INFORMATION**

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



## ITEM 1A RISK FACTORS

### Risks Related to Our Business

***We are subject to the risks associated with operating in an evolving market.***

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

- continue to attract users to remain with us and use our products and services as one of the primary means of surfing the Internet switches from traditional PCs to mobile phones or other portable devices;
- continue to attract a large audience to our matrices of Chinese language content and services by expanding the type and technical sophistication of the content and services we offer;
- develop a sufficiently large advertiser base for our brand advertising and search and search-related businesses;
- maintain and attract online game users by periodically updating our existing online games and developing and launching new online games;
- increase the revenues derived from our fee-based services and products we offer online;
- build our Sohu Media Portal, Sohu Video, Focus, search and search-related, online game and other businesses successfully;
- attract and retain qualified personnel; and
- effectively control our increased costs and expenses as we expand our business.

***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. Our online advertising revenue often fluctuates as our advertisers adjust their online marketing spending as their industries go through business and economic cycles. We rely on third-party providers for high-quality news, video, audio and text content in order to make our Internet platforms, which include our Websites and our applications optimized for mobile devices, or Mobile Apps, more attractive to users and advertisers. In recent years, video content costs escalated sharply and adversely affected our operating results. Sogou incurred substantial traffic acquisition costs for leveraging traffic from Sogou Website Alliance members' Internet properties to expand distribution of our advertisers' promotional links or advertisements. If traffic acquisition costs increase sharply, Sogou's operating results may be adversely affected. A significant portion of our online game revenue is attributable to Changyou's PC game TLBB; however, the popularity of PC games continues to decline as game players increasingly switch to mobile devices to access online games. Despite Changyou's efforts to improve TLBB, our game players have nevertheless lost interest in it over time and TLBB's popularity, revenues and profitability have continued to decline. If Changyou fails to improve and update TLBB on a timely basis, or if Changyou's competitors introduce more popular games, including mobile games, catering to Changyou's game-player base, the decline in TLBB's popularity can be expected to accelerate, which could cause a significant decrease in our revenues. Changyou made significantly increased expenditures for sales and marketing during 2013 and 2014, mainly for the promotion of its platform channel business. However, Changyou determined that its efforts were not successful, and it is unlikely that Changyou will be able to recoup those expenses.

***We depend on Changyou's online games, and on Changyou's PC game TLBB and mobile game TLBB 3D in particular, for a significant portion of our revenues, net income, and operating cash flow, and TLBB's popularity has been declining recently.***

We rely on Changyou's online games, and on Changyou's PC Game TLBB and mobile game TLBB 3D in particular, for a significant portion of our revenues, net income and operating cash flows. For the year ended December 31, 2016, 13% of our total revenues and 56% of our online game revenues were derived from TLBB and TLBB 3D. If Changyou's online game revenues from games other than TLBB and TLBB 3D do not grow, or if they decrease, our revenues, net income and cash flows will be adversely affected. Furthermore, if there are any interruptions in TLBB's and TLBB 3D's operations due to unexpected server interruptions, network failures or other factors, game players may be prevented or deterred from making purchases of virtual items, which could also cause significant decreases in our revenues, net income and cash flow.

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

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



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We have many competitors in the PRC Internet market, including among others Tencent, Alibaba, Baidu, Sina, NetEase, TouTiao.com, Phoenix, Autohome, BitAuto, Youku Tudou, iQIYI, SouFun, Leju, YY, Qihoo, UCWeb, Google, Microsoft, Kingsoft, IGG Inc. NetDragon, Kalends Inc., Ourpalm Corporate limited, Century Cruises (formerly known as Giant Interactive Group Inc.), Da Xing (formerly known as Perfect World Co., Ltd.) and Shulong Technologies (formerly known as Shanda Games Limited). We compete with our peers and competitors in China primarily on the following basis:

- access to financial resources;
- gateway to a host of Internet user activities;
- technological advancements;
- attractiveness of products;
- brand recognition;
- volume of traffic and users;
- quality of Internet platforms and content;
- strategic relationships;
- quality of services;
- effectiveness of sales and marketing efforts;
- talented staff; and
- pricing;

Our competitors may have certain competitive advantages over us including:

- greater brand recognition among Internet users and clients;
- better products and services;
- larger user and advertiser bases;
- more extensive and well developed marketing and sales networks; and
- substantially greater financial and technical resources.

Our existing competitors may in the future achieve greater market acceptance and gain a greater market share through launching of new products, introducing new technologies, or forming alliances among themselves, or may enhance their ability to compete with us through mergers and acquisitions or financing activities. For example, during the past few years, many of our competitors have successfully raised significant amounts of capital through IPOs, follow-on public equity offerings, and convertible bond offerings. Several of our competitors have also conducted private placements of equity or debt that included alliances with larger partners who are able to bring them strategic advantages in addition to financing. By enhancing their capital bases and forming strategic alliances, our competitors have strengthened their competitiveness and gained greater brand recognition. Recently some of our major competitors have engaged in or initiated transactions that could make it more difficult for us to compete against them effectively. For example, Alibaba's recent acquisition of Youku Tudou has provided Youku Tudou with considerably greater financial and other resources than were previously available to it for developing and expanding its online video business, which resources we are unlikely to be able to match. In addition, Qihoo, with which we compete in our search and search-related business, has delisted its shares from the New York Stock Exchange. These transactions could enhance Youku Tudou's and Qihoo's competitive positions relative to ours by giving them greater flexibility in their business operations and an opportunity to seek high valuations on alternative share exchanges, such as PRC exchanges, which could in turn provide them with increased capital resources, the ability to offer more valuable equity incentives for purposes of personnel recruiting, and valuable equity to use as consideration for strategic acquisitions.

It is also possible that new competitors may emerge and acquire significant market share. In addition, operators of leading Websites or Internet service providers, including Tencent, Alibaba, Baidu, Google and Microsoft, currently offer, and could expand, their online products and services targeting China. Such entities may cooperate with other organizations in China to accelerate their entry into, and to enhance their competitiveness in, the key Chinese markets in which we operate.

As a result, we are likely to need additional financial and additional strategic resources in order to compete effectively in the primary markets in which we operate. If our competitors are more successful than we are in developing products or in attracting and retaining users and advertisers, our revenues and growth rates could decline.

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***If we fail to successfully develop and introduce new products, features and services, our ability to attract and retain users and generate revenues could be harmed.***

We are continually developing new products, features and services for our users. The planned timing or introduction of new products, features 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. Emerging start-ups may be able to innovate and provide new products, features and services faster than we can. Moreover, we cannot be sure that any of our new products, features and services will achieve widespread market acceptance or generate incremental revenue.

In addition, we may experience difficulties in promoting our new products, features and services as a result of the significant market power of our competitors or any anti-competitive practices they might engage in. As a result, despite considerable efforts in this regard, we may fail to attract and retain users.

***As our products and services are currently accessed primarily through mobile phones, tablets and other internet-enabled mobile devices, we believe that we must develop products and applications for such devices if we are to maintain or increase our market share and revenues, and we may not be successful in doing so.***

Devices other than personal computers, such as mobile phones, tablets, wearable devices and other internet-enabled mobile devices, are used increasingly in China and in overseas markets, and have surpassed personal computers as the primary means to access the Internet in the key Chinese markets in which we operate. We believe that, for our business to be successful, we will need to design, develop, promote and operate new products and applications that will be popular with such devices. The design and development of new products and applications may not be successful. We may encounter difficulties with the installation of such new products and applications for mobile devices, and such products and applications may not function smoothly. As new devices are released or updated, we may encounter problems in developing and upgrading our products or applications for use on mobile devices and we may need to devote significant resources to the creation, support, and maintenance of such products or applications for mobile devices.

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

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

***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 emergence of cloud computing technology, the primary Internet technology platform has been transformed from a traditional platform to a cloud computing platform. If we fail to adapt to the transformation, our products and services upgrade process will fall behind our competitors, and accordingly weaken our capacity to adapt our technology to the market. Furthermore, cloud computing itself is a significant business opportunity. If we fail to seize the opportunity, we will lose our ability to capture a share of that market. In addition, as mobile devices other than personal computers are increasingly used to access the Internet, we must develop products and services for such devices. To meet advertisers' needs in targeting potential advertisers accurately, we need to develop and operate a more effective system for our advertising delivery, tracking and recording. Otherwise, we will not be able to maintain or increase our revenues and market share. In the meantime, the MIIT and other PRC governmental authorities can be expected to regularly promulgate standards and other regulations regarding Internet software and other Internet-based technologies. Adapting to any such standards and regulations could require us to make significant expenditures in the future.

***Our strategy of acquiring complementary assets, technologies and businesses may fail and result in impairment losses.***

As a component of our growth strategy, we have acquired and intend to actively identify and acquire assets, technologies and businesses that are complementary to our existing businesses. Our acquisitions could result in the use of substantial amounts of cash, issuance of potentially dilutive 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. For example, in 2014 Changyou recognized a \$33.8 million impairment loss for goodwill and a \$15.3 million impairment loss for acquired intangible assets related to RaidCall, as a result of Changyou's management's assessment that the impairments existed based on its conclusion that RaidCall was unable to provide expected synergies with Changyou's online games business. In 2015 Changyou recognized a \$29.6 million impairment loss for good will and an \$8.9 million impairment loss for acquired intangible assets relating to the Dolphin Browser operated by MoboTap, which was acquired by Changyou in 2014, as a result of Changyou's management's conclusion that expected synergies with Changyou's platform channel business would not materialize.

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

We are required under U.S. GAAP to test for goodwill impairment annually or more frequently if facts and circumstances warrant a review. Currently our brand advertising business is losing money, and goodwill under the brand advertising reporting unit will be impaired if the losses continue. We are also required to review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Factors that may be considered a change in circumstances indicating that the carrying value of our amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization and slower or declining growth rates in our industry. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined. For example, Sohu recognized an impairment loss of \$18.8 million in 2016, due to the fact that a recent restructuring of the sales team of Sohu Video had an adverse impact on Sohu Video's performance for 2016, which caused management to lower their estimate of the potential value of Sohu Video's purchased video content.

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

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

***Our failure to manage growth and adapt to evolving industry trends and business models could harm us.***

We have experienced dramatic growth in personnel in the past and we expect to continue to hire additional personnel. 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. As we have approximately 10,000 employees, it can be difficult for us to fully monitor each employee's behavior. In addition, as we are expanding our business into many cities throughout China to provide localized products and services, it is harder for us to monitor and regulate the overall behavior of our branch offices or of individual employees at such branch offices, to effectively implement our strategy to local offices and to manage the growth of these local operations. We cannot assure you that we will be able to maintain policies and procedures that are rigorous enough or that we will be able to cause all of our employees or all of our branch offices to behave in conformity with those policies and procedures, or to ensure that our employees will not engage in conduct that could expose us to third-party liability or governmental sanctions, which may limit our future growth and hamper our business strategy. 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.

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Moreover, to keep pace with the rapidly developing and evolving Internet industry, we must explore new products, services or revenue models for our business. For example, in addition to using traditional advertising forms, we have begun to embed product placements in our self-developed content; and for our real estate business, we sell paid memberships through which potential home buyers can purchase properties from our partner developers at discounts. Since we have limited experience in these business areas, we may fail to manage growth and adapt to industry trends and business models.

In addition, the Internet industry has seen a significant shift from traditional personal computers to mobile devices and accordingly we must develop new products and services that are adaptable to mobile devices so as to attract users and cause our existing users to remain with us. If we are unable to successfully adapt to new business models by developing and investing in new business strategies, products, services and technologies, our ability to maintain and expand our business in the future may be impeded.

***If we fail to establish and maintain relationships with content, technology and infrastructure providers and with reputable and popular hosts for our online interactive broadcasting platforms, we may not be able to attract and retain users.***

We rely on third party providers for high-quality news, video, audio and text content in order to make our Internet platforms more attractive to users and advertisers. Most of our content providers have increased the fees they charge us for their content. This trend has increased our costs and operating expenses and has affected our ability to obtain content at an economically acceptable cost. Video content costs have escalated sharply in recent years. If we are not able to purchase as much video content as we did before, the size of our video library will be reduced and our attractiveness to users will be severely impaired and advertisers may choose not to advertise through our Internet platforms, including our Internet platforms for video. Except for exclusive content that we obtain from certain of our video content providers, much of the third party content provided to our Internet platforms 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 user traffic.

We have made efforts to create a culture for UGC and PGC that will allow and encourage Internet users to play an active role in the process of collecting, reporting, analyzing and disseminating content, and to encourage our users and other content providers to establish and disseminate their content through our Internet platforms. As the number of UGC and PGC writers on our Internet platforms continues to grow, we increasingly rely on high-quality news, video, audio and text content provided by UGC and PGC writers to generate user traffic, retain our existing users and attract new users. If we are not able to continue to attract users or other content providers to establish quality content on our Internet platforms, or if the UGC and PGC writers on our Internet platform are not able to provide quality content that is appealing to Internet users in general, the volume of our user traffic may decrease and our business and prospects may be adversely affected. Also see “We may be subject to intellectual property infringement claims, which may force us to incur substantial legal expenses and, if determined adversely to us, materially disrupt our business.”

As online interactive broadcasting has surged in popularity in China, we increasingly rely on our own online interactive broadcasting platforms to attract and retain users. We believe that, in order for our interactive broadcasting services to be successful, we will need to establish and maintain relationships with a number of hosts who are both reputable and widely popular among our existing and potential users. If we are not successful in identifying such hosts and establishing and maintaining relationships with them, or if we lose any of our existing hosts to our competitors, our ability to attract and retain users may be adversely affected.

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

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

Our future success is heavily dependent upon the services of our key executives, particularly Dr. Charles Zhang, who is the founder, Chief Executive Officer, Chairman of the Board, and a major shareholder of our company. We rely on his expertise in our business operations. For Sogou, we rely heavily on the services of Xiaochuan Wang, Sogou’s Chief Executive Officer. For Changyou, we rely heavily on the services of Dewen Chen, Changyou’s Chief Executive Officer. If one or more of our key executives and employees are unable or unwilling to continue in their present positions, we may not be able to replace them easily and our business may be severely disrupted. In addition, if any of our key executives or employees joins a competitor or forms a competing company, we may lose know-how, key professionals and staff members as well as customers, suppliers and incur additional expenses to recruit and train personnel. 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.

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We also rely on a number of key technology staff for our business. Given the competitive nature of the industry, and in particular our competitors' increasingly aggressive efforts to provide competitive compensation packages to attract talent in the key Chinese markets where we operate, the risk of key technology staff leaving Sohu is high and could have a disruptive impact on our operations.

### ***Our growth may cause significant pressures upon our financial, operational, and administrative resources.***

Our financial, operational, and administrative resources may be inadequate to sustain the growth we want to achieve. As the demands of our users and the needs of our customers change, the number of our users and volume of online advertising increase, requirements for maintaining sufficient servers to provide high-definition online video and to provide game players smooth online game experiences increase, requirements for search traffic and users' requirements as to the quality of search services increase, and mobile 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:

- access financial resources;
- adapt our services and maintain and improve the quality of our services;
- protect our Internet platforms from hackers and unauthorized access;
- continue training, motivating and retaining our existing employees and attract and integrate new employees; and
- maintain and improve our operational, financial, accounting and other internal systems and controls.

### ***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, 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. For example, a third-party Internet platform operator might provide its users access to video content on our Internet platforms while blocking Internet advertisements embedded in our video content, which could adversely affect our online advertising revenues and our reputation with our current and potential advertising clients. 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. For example, some of our self-developed Web series video productions were disseminated by third parties without our authorization. Furthermore, under the *Patent Law*, the State Council's Patent Administration Department may grant a compulsory license to individuals or entities to use one or more of our patents if our exploitation of the patents has been determined to violate the antitrust laws. 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. We cannot be certain that judgments from the lawsuits will be issued in our favor, or that any resulting damages will cover our business losses and litigation expenses. If our campaigns and lawsuits against piracy do not achieve their intended effect, our business and operation may be adversely affected.

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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 to us, materially disrupt our business.***

We cannot be certain that the 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, 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 and have in the past been, and may in the future be, required to pay damages or to agree to restrict our activities. 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 damages or fines, and may incur licensing fees or be forced to develop alternatives. We may incur substantial expense in defending against 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. In March 2008, we were sued by four major record companies, Sony BMG, Warner, Universal and Gold Label, which alleged that we had provided music search links and download services that violated copyrights they owned. Although the lawsuits were settled in 2013 without any payment of damages by us, we may be subject to similar lawsuits in the future. In addition, it is possible that content on our Websites and Sohu News App, which not only includes content developed by us but also provides a platform for a significant amount of content generated by others, may violate the intellectual property rights of third parties. As we produce more self-developed content for our Internet platforms as part of our new content strategy, we, as the primary provider of such content, may incur relatively higher monetary liability if such content is found to have infringed the intellectual property rights of third parties. Also, as we increasingly rely on content provided by third-party UGC and PGC writers on our Internet platforms, either developed by the outlets themselves or adapted from content of parties separate from such outlets, it will become increasingly difficult for us to fully monitor such content, which could make us more vulnerable to potential infringement claims. Furthermore, PRC governmental authorities have recently been drawing attention to issues regarding the infringement of online intellectual property rights. For example, the Jian Wang 2016 campaign, which targets three primary types of Internet infringement and piracy, was launched on July 12, 2016.

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

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 based on the nature and content of such information. Furthermore, we could be subject to claims for the online activities of our users and incur significant costs in our defense. In the past, claims based on the nature and content of information that was posted online by users 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 Internet platforms or through content and materials that our users may post in classifieds, message boards, micro blog, chat rooms or other interactive services. If any information provided through our services contains errors, third parties may make claims against us for losses incurred in reliance on the information. We also offer Web-based e-mail and subscription services, which expose us to potential liabilities or claims resulting from:

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

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

***We may not have exclusive rights to trademarks, designs and technologies that are crucial to our business.***

We have applied for initial registrations in the PRC and overseas, and/or changes in registrations relating to transfers of our key trademarks in the PRC, including Sohu.com logos, Sohu Fox logos, www.focus.com.cn, GoodFeel logos, Go2Map, Sogou logos, Sohu Focus, ChangYou.com, cyou.com, TLBB, TL logos, New Blade Online, 17173, TLBB 3D and the corresponding Chinese versions of the marks, so as to establish and protect our exclusive rights to these trademarks. We have also applied for patents relating to our business. While we have succeeded in registering the trademarks for most of these marks in the PRC under certain classes, the applications for initial registration, and/or changes in registrations relating to transfers, of some marks and/or of some of marks under other classes are still under examination by the Trademark Office of the SAIC, and relevant authorities overseas. While we have succeeded in obtaining some patents, some of our patent applications are still under examination by the State Intellectual Property Office of the PRC. Approvals of our initial trademark registration applications, and/or of changes in registrations relating to such transfers, or of our patent applications, are subject to determinations by the Trademark Office of the SAIC, the State Intellectual Property Office of the PRC and relevant authorities overseas that there are no prior rights in the applicable territory. We cannot assure that these applications will be approved. Any rejection of these applications could adversely affect our rights to the affected marks, designs and technologies. In addition, even if these applications are approved, we cannot assure you that any registered trademark or issued patent will be sufficient in scope to provide adequate protection of our rights.

***We may be subject to claims for invasion of personal privacy, which may force us to incur legal expenses and, if determined adversely to us, materially disrupt our business.***

We allow users to upload written materials, images, pictures and other content on our platform and download, share, link to audio, video and other content either on our platform or from other Websites through our platform. Procedures that we have designed to reduce the likelihood that content will be used without proper licenses or third-party consents may not be effective in preventing the unauthorized posting or sharing of content. We cannot be certain that content uploaded or shared by our users is legal and will not violate the privacy of others. In August 2014, the supreme people's court promulgated the *Provisions of the Supreme People's Court on Application of Laws to Cases Involving Civil Disputes over Infringement upon Personal Rights and Interests by Using Information Networks*, which provide that if an ICP operator discloses genetic information, medical records, health examination data, criminal record, home address, private events and or other personal information of a natural person online, causing damage to the person, the People's Court should support a claim by the infringed party for recovery of damages from the infringing ICP operator. Defending invasion of privacy litigation is costly and can impose a significant burden on management and employees, and we may not obtain favorable outcomes in such cases. Such claims, even if they do not result in liability, may harm our reputation.

***We face risks related to health epidemics and other outbreaks.***

Our business could be adversely affected by the effects of H1N1 influenza, H7N9 influenza, avian influenza, SARS or other epidemics or outbreaks. China reported a number of cases of SARS in April 2003. In recent years, there have been reports of occurrences of H1N1 influenza, H7N9 influenza and of avian influenza in various parts of China, including a few confirmed human cases and deaths. Any prolonged recurrence of H1N1 influenza, H7N9 influenza, avian influenza, SARS or other adverse public health developments in China may have a material adverse effect on our business operations. These could include illness and loss of our management and key employees, as well as temporary closure of our offices and related business operations, such as server operations, upon which we rely. Such loss of management and key employees or closures would severely disrupt our business operations and adversely affect our results of operations. We have not adopted any written preventive measures or contingency plans to combat any future outbreak of H1N1 influenza, H7N9 influenza, avian influenza, SARS or any other epidemic. In addition, other major natural disasters may also adversely affect our business by, for example, causing disruptions of the Internet network or otherwise affecting access to our portals and our games. For example, after the Sichuan earthquake in May 2008, we suspended our delivering of online advertisements and our MMOG operations during a three-day national mourning period.

***We do not have business insurance coverage.***

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



***We depend on brand advertising for a significant portion of our revenues, but the brand advertisement market includes many uncertainties, which could cause our brand 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 for posting on our Internet platforms. Brand advertising revenues represented approximately 27% and 30% of our total revenues for the years ended December 31, 2016 and 2015, respectively. For the years ended December 31, 2016 and 2015, sales to our five largest advertisers accounted for approximately 11% and 10%, respectively, of our total brand advertising revenues. The growth of our brand advertising revenues relies on increased revenue from the sale of advertising for posting our Internet platforms, which may be affected by many of the following risk factors:

- The brand advertising market is still evolving in China. Some of our current and potential advertising clients historically have not devoted a significant portion of their advertising budget to Internet-based advertising;
- Changes in government policy could restrict or curtail our brand advertising services. For example, during the last several years, the PRC government enacted a series of regulations, administrative instructions and policies to restrict online medical advertising. As a result of these regulations, we may lose some of our existing medical advertising clients. For another example, see “Government Regulation and Legal Uncertainties - Specific Statutes and Regulations - Regulation of Other Services - Real Estate Services” for a description of the Beijing Measures and other regulations affecting Focus’s business.
- Advertising clients may adopt new methods and strategies other than brand advertising to promote their brand and therefore our advertising revenue would be negatively affected;
- The acceptance of the Internet as a medium for advertising depends on the development of standards for measuring the effectiveness of advertisements disseminated over the Internet, and no standards have been widely accepted for the measurement of the effectiveness of brand advertising over the Internet. Industry-wide standards may not develop that are sufficient 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;
- Historically we have charged our advertisers on a CPC basis, where we charge when users click on our advertisers’ promotional links displayed on our Internet platforms. However, increasing numbers of advertisers are indicating that in the future they will only enter into contracts with us pursuant to which we would charge on a Cost Per Action (“CPA”) basis, where users must not only click on the links but must also download and install the advertisers’ promotional software or applications and run the installed software or applications at least once. If this migration from a CPC to a CPA payment model continues on a large scale, or if CPA advertisements cannot generate enough user actions that can be tracked as delivered advertisements, our advertising revenues will be adversely affected; and
- We may not have systems that are sufficiently well-developed to support the CPM pricing models, and as a result, we may suffer system bugs that cause bad user experiences errors or omission in publishing our client’s advertisements, which could have a negative impact on our brand advertising business.

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

- the development of a large base of users possessing demographic characteristics attractive to advertising clients;
- the acceptance of brand advertisement as an effective way for business marketing by advertising clients;
- the effectiveness of our advertising delivery, tracking and reporting systems;
- the resistance pressure on brand advertising prices and limitations on inventory; and
- the establishment of a successful business model to make our new products adaptable to portable devices, which has required, and will continue to require us, to make significant expenditures for research, development, promotion and operations.

Many advertisers have shifted their PC online advertising budgets to advertising on mobile devices. Hence we must successfully optimize, adapt and make attractive our various product and service offerings for access on mobile devices and must effectively deliver advertising content in a manner that attracts and retains users’ interest and attention or our online advertising business will suffer.

***Our costs for brand advertising have increased significantly as a result of our investment in online video services. If we are unable to manage the growth of our online video business successfully and control its operating costs effectively, our business may be adversely affected.***

In 2007 we launched our video service, and its operation requires significant upfront capital expenditures as well as continuous, substantial investment in content, technology, infrastructure and brand promotion for both PCs and mobile devices. Although we have attempted to control our costs relating to content, bandwidth, marketing, and other items for online video services, our operating expenses have increased significantly and may continue to escalate. As the acquisition costs for quality TV series and other online video content have increased dramatically in recent years, we have had to invest increasingly significant financial, operational, strategic, technological, personnel and other resources in order to compete with vertical online video sites, such as those operated by Tencent, Alibaba's online video subsidiary Youku Tudou, and iQiyi, that have substantially greater financial resources or have raised significant capital through financing activities, which may significantly strain our resources and negatively affect our operating results. If we are unable to continue to acquire and provide on our video platforms quality video content, we may not be able to grow or maintain the level of our user traffic, which could make our video platforms less attractive to advertisers and have a negative impact on our ability to generate advertising revenues from our video platforms.

We are increasingly required to pay license fees upfront for video content prior to its production. There often are delays of several months, or sometimes up to two or three years, between our payment of such up-front fees and the time when we are able to offer fully-developed content online and begin to receive advertising dollars. These delays have often placed, and can be expected to continue to place, significant strains on our cash flow. Our up-front payments also subject us to a certain level of credit risk, as content producers to which we make such payments may fall into financial difficulties and be unable to deliver the content we have purchased. We are also subjected to the risk that the quality of content will not be up to our expectations. In addition, when we purchase rights to the online versions of TV series, we generally rely on the expectation that the series will be broadcast on nationwide TV channels according to a specified schedule. If there are delays in such TV broadcasts, we will have to delay, perhaps indefinitely, our presentation of the online version of the series. We are also subject to the risk that TV content we purchase will be broadcast on less popular TV channels than expected, which will cause our online viewership to be correspondingly lower than we expected.

We have spent, and expect to continue to spend, significant resources to develop our own TV series and other video content. We have also invested, and will likely invest in the future, in the production of movies by selected independent third-party movie studios, where we have exclusive rights to distribute the online versions of such movies on our Internet platforms for video. If our self-developed TV series or other video content, or movies in which we invest, are not well received by viewers and/or fail to attract sufficient advertising placements from advertisers, or if the development of such video content or movies is not completed as a result of financial, regulatory or other restraints, we may not be able to recoup our production costs or investments in movie production.

***We may not be able to maintain or increase the revenues from our online video business. If we fail to do so, Sohu Video may not be able to become profitable, in which case we would be unable to recoup our substantial expenditures for the development of our online video business.***

Although China's online video industry has experienced substantial growth in recent years in terms of both users and content, we cannot assure you that the online video industry will continue to grow as rapidly as it has in the past, if at all. With the development of technology, new forms of media may emerge and render online video Websites or Mobile Apps less attractive to users. Growth of the online video industry is affected by numerous factors, such as users' general online video experience, technological innovations, development of Internet and Internet-based services, regulatory changes in general, and regulations affecting copyright in particular, and the macroeconomic environment. If the online video industry in China does not grow as quickly as expected or if we fail to benefit from such growth by successfully implementing our business strategies, our user traffic may decrease and our business and prospects may be adversely affected. For Sohu Video to become profitable, it will be necessary for us to both maintain or increase our revenues from Sohu Video and control or reduce our expenditures for video content and other costs. If Sohu Video fails to become profitable, we will be unable to recoup our substantial expenditures for the development of our online video business.

***We rely on advertising agencies to sell our brand advertising services. As the brand advertising market in China is effectively controlled by a small number of large advertising agencies, such advertising agencies may be in a position to demand higher sales rebates, which would adversely affect our gross margin.***

Most of our brand advertising services are distributed by advertising agencies. In 2016, for example, approximately 70% of our brand advertising revenues were derived from advertising agencies. In consideration for these agencies' services, we are required to pay certain percentages of revenues as sales rebates. As the brand advertising market is effectively controlled by a small number of large advertising agencies, such advertising agencies may be in a position to demand higher sales rebates based on increased bargaining power, which could negatively affect our brand advertising growth. During 2016 the biggest 10 advertising agencies in China contributed approximately 28% of our brand advertising revenues.

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As an attempt to strengthen our bargaining power in the real estate market, we carried out direct sales of our advertising services instead of relying on agencies. If our direct sales fail to attract advertisers, we could lose our sale channels where we had previously relied on agencies.

### ***The expansion of Internet advertisement blocking measures 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. For example, some Rich Site Summary, or RSS, Internet platforms allow their users to access video content from our Internet platforms, while completely blocking our advertisements from being viewed by their users. Since our advertising revenues are generally based on user views, the expansion of advertisement blocking on the Internet may decrease our advertising revenues because, when an advertisement is blocked, it is not downloaded from the server, which means such advertisements will not be tracked as a delivered advertisement. In addition, advertisers may choose not to advertise on the Internet or on our Internet platforms because of the use by third parties of Internet advertisement blocking measures. In addition, increasing numbers of browsers include technical barriers designed to prevent Internet information service providers such as us to trail the browsing history of the Internet users, which is also like to adversely affect the growth of online advertising.

### ***If our video content fails to attract and retain users and advertisers, we may not be able to generate sufficient user traffic to allow us to maintain or increase our video revenues.***

The success of our online video business largely depends on our ability to generate sufficient user traffic, through provision of attractive products, to in turn attract advertisers to place advertisements on our Internet platforms for video. In order to attract and retain users, we have needed, and will continue to need, to expend significant resources to develop our own or acquire from third parties' high-quality video content. In 2015 and 2016, we purchased significant amounts of exclusive video content, through which we generated user traffic and revenues by bartering for other video content from other parties or distributing to other third parties, and in 2016 we developed several TV series. We cannot assure you that we will continue to be able to acquire exclusive content rights or develop premium content in the future and our user traffic and revenues generated from such exclusive content rights and self-developed content could be reduced. Moreover, if we fail to produce by ourselves or acquire from third parties high-quality video content, or if video content we develop by ourselves or acquire proves to be less attractive to users than we anticipated, our user traffic and our market share could be adversely effected, which could result in our being unable to maintain or increase our video revenues.

### ***Videos and other types of content and materials displayed on our Internet platforms may be found objectionable by PRC regulatory authorities, may subject us to penalties and other administrative actions, and may be subject us to liabilities for infringement of third-party intellectual property rights or other allegations.***

The PRC government has adopted regulations governing Internet access and the distribution of videos over the Internet. In addition to professionally produced content, we allow our users to upload videos to our Internet platforms. Our users can upload all types of content, including user-created and professionally produced content, and can upload graphic files for limited purposes, such as updating user biographies. Although we have adopted internal procedures to monitor the content displayed on our Internet platforms, due to the significant amount of content uploaded by our users, we may not be able to identify all videos or other content that may violate relevant laws and regulations, and the risk may be greater as we increasingly rely on content provided by UGC and PGC writers through our Internet platforms, as we do not have an opportunity to fully review such content prior to its publication. Failure to identify and prevent illegal or inappropriate content, such as content that is defamatory, is racially or religiously discriminatory, compromises national security, or infringes the intellectual property rights of third parties, from being displayed on our Internet platforms may subject us to liability.

To the extent that PRC regulatory authorities find any content displayed on our Internet platforms objectionable, they may require us to limit or eliminate the dissemination of such content on our Internet platforms, with take-down orders or otherwise. The SAPPRFT publishes from time to time lists of content that it considers objectionable, and we must dedicate teams of employees to continually monitor user-uploaded content and remove content that is deemed objectionable. In addition, regulatory authorities may impose penalties on us based on content displayed on or linked to our Internet platforms in cases of significant violations, including a revocation of our operating licenses or a suspension or shutdown of our online operations. In the event that PRC regulatory authorities find the video content on our Internet platforms objectionable and impose penalties on us or take other administrative actions against us in the future, our business and reputation may be adversely affected. Moreover, the costs of compliance with these regulations may continue to increase as more content is uploaded by our users.

In addition, under PRC laws and regulations governing online advertising, online publishers, such as us, are required to monitor advertising content displayed on their Internet platforms for accuracy, and for compliance with PRC law governing the dissemination of content over the Internet that is deemed to be unlawful or inappropriate. If we were found to have failed to fulfill our obligation to monitor the advertisements of an advertising customer, we could be subject to various penalties, including being prohibited from providing advertising services for advertisers in the entire industry of the customer.

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We have been involved in litigation based on allegations of infringement of third-party copyright and other rights, such as privacy and image rights, due to the videos displayed on our Internet platforms. See “Risks Related to Our Business - 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.” While we have implemented internal procedures to review videos uploaded by our users and remove promptly from our Internet platforms any infringing videos after we receive infringement notifications from rights owners, due to the significant number of videos uploaded by users, we may not be able to identify all content that may infringe on third-party rights. Moreover, some rights owners may not send us a notice before bringing a lawsuit against us. Thus, our failure to identify unauthorized videos posted on our Internet platforms has subjected us to, and may in the future subject us to, claims of infringement of third-party intellectual property rights or other rights. In addition, we may be subject to administrative actions brought by the NCA or its local branches for alleged copyright infringement.

We may also face litigation or administrative actions for defamation, negligence, or other purported injuries resulting from videos and advertisements that we display on our Internet platforms. Such litigation and administrative actions, with or without merit, may be expensive and time-consuming and may result in significant diversion of resources and management attention from our business operations. Furthermore, such litigation or administrative actions may adversely affect our brand image and reputation.

### ***Our search and search-related revenues may not sustain their growth or may decrease in the future.***

The growth of our search and search-related revenue is subject to the following risks:

- As increasing numbers of users are using mobile devices to access the Internet, if we are unable to attract and retain mobile users to our products and services, we may fail to capture market share for mobile search;
- We may not be able to achieve greater market acceptance or gain additional market share from our existing competitors or new competitors;
- Many of our current and potential advertisers have limited experience with the Internet as a marketing channel, and historically have not devoted a significant portion of their marketing budgets to online marketing and promotion. As a result, they may not consider the Internet to be an effective channel to promote their products and services as compared to traditional print and broadcast media;
- Although devices other than personal computers, such as mobile phones, tablets and other internet-enabled mobile devices, are increasingly used to access the Internet, many of our current and potential advertisers have limited experience using the Internet as a marketing channel with advertising content delivered by Mobile Apps to such mobile devices, and may not be ready to devote a significant portion of their Internet marketing budgets to mobile Internet marketing and promotion;
- Our success depends on providing products and services to attract users and enable users to have a high-quality Internet experience. A loss of users could weaken our brand and result in a loss of advertisers, which would have a material adverse effect on revenues;
- We may be unable to retain our existing advertisers or attract new advertisers;
- We rely heavily on our nationwide agency network of third-party agencies for our sales to, and collection of payment from, our advertisers. We cannot assure that we will continue to maintain favorable relationships with those agencies; and
- We rely on our Website Alliance members for a significant portion of our search revenues. If we fail to retain existing Website Alliance members or attract additional members, our revenues and growth may be adversely affected.

### ***If Sogou’s collaboration with Tencent is terminated or curtailed, Sogou’s business would likely be adversely affected.***

A substantial amount of our search and search-related traffic is generated from users of Tencent products and services. Sogou increasingly relies on Tencent for the promotion of Sogou products and services on both PCs and internet-enabled mobile devices, such as mobile phones and tablets. In addition, Sogou collaborates with Tencent to provide differentiated products and services. For example, Sogou launched a unique Weixin search function for both PCs and mobile devices that allows users to search the large amount of content that is published on Weixin accounts. If Sogou’s collaborative relationship with Tencent is terminated or curtailed, or if Tencent does not continue to deliver an adequate level of access to its platforms or adequately promote Sogou products and services, Sogou business would likely be adversely affected.

***If we fail to retain key agencies or attract additional agencies for sales to our search advertisers, our search business may be adversely affected.***

We rely heavily on our nationwide distribution network of third-party agencies for our sales to, and collection of payment from, our search (including pay-for-click services) advertisers. If our agencies do not provide quality services to our advertisers or otherwise breach their contracts with them, we may lose our advertisers. We do not have long-term agreements with any of our agencies, including our key agencies, 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 search revenues. If we fail to retain existing Website Alliance members or attract additional members, our revenues and growth may be adversely affected.***

We enhance the distribution of advertisers' promotional links or advertisements by leveraging traffic on Sogou's Website Alliance members' Internet properties, and revenues generated from the Website Alliance account for a significant portion of our total pay-for-click revenues. If the Website Alliance members decide to use a competitor's or their own Internet search services, or if we fail to attract additional members to join Sogou's Website Alliance, our pay-for-click revenues will be adversely affected.

***If we fail to detect significant fraudulent click-through, we could lose the confidence of our search advertisers and our search revenues could decline.***

Our search business is exposed to the risk of click-through fraud on our paid search results. Click-through fraud occurs when a person clicks paid search results for a reason other than to view the underlying content of search results. If we fail to detect significant fraudulent clicks or otherwise are unable to prevent significant fraudulent activity, the affected search advertisers may experience a reduced return on their investment in our pay-for-click services and lose confidence in the integrity of our pay-for-click service systems, and we may have to issue refunds to our advertisers. If this happens, we may be unable to retain existing advertisers and attract new advertisers for our pay-for-click services, and our search revenues could decline. In addition, affected advertisers may also file legal actions against us claiming that we have over-charged or failed to refund them. Any such claims or similar claims, regardless of their merits, could be time-consuming and costly for us to defend against and could also adversely affect our search brand and our search advertisers' confidence in the integrity of our pay-for-click service systems.

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

***We depend on China Mobile, China Unicom, 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 China Mobile, China Unicom and China Telecom under the administrative control and regulatory supervision of the MIIT. We rely on this infrastructure and China Mobile, China Unicom, 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 China Mobile, China Unicom, and China Telecom. Under these agreements, we maintained servers in China to support most of our core services. 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.

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***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 Internet 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. Even if we scale our systems proportionately, any unforeseen increase in traffic may disrupt our operations and make it difficult for our users to visit our Internet platforms, or even cause users to be unable to access our Internet platforms at all, which could result in a loss of users.

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

Our Internet platforms operations are dependent upon Web browsers, Internet service providers, content providers and other Internet platforms 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. For example, on February 14, 2009, our blog services were disconnected because of a power loss affecting China Unicom. Although such disconnection did not have any material adverse effect on our business, we cannot assure that our business would not be affected negatively by any future similar events.

***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 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 Internet platforms to mirror our online resources.

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

***Our network operations may be vulnerable to hacking, viruses and other disruptions, which may make our products and services less attractive and reliable, and third-party online payment platforms that we partner with may be susceptible to security breaches, which may damage our reputation and adversely affect our business.***

Internet use can 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 Internet platforms against hackers, and measures we may take may not be effective. In addition, the inadvertent transmission of computer viruses could expose us to a risk of loss or litigation and possible liability, as well as damage our reputation and decrease our user traffic.

Furthermore, we could be liable for security breaches of our users' confidential information, such as credit card numbers and expiration dates, personal information and billing addresses, stored by the third-party online payment platforms that we partner with. Since our revenues are derived in part from such payment platforms, any security breach resulting from Internet payment transactions could damage our reputation and deter current and potential users from using our online services.



## Risks Related to Our Corporate Structure

***Although the Sohu Group holds substantial amounts of cash and cash equivalents, a significant portion of such cash and cash equivalents is held by Changyou and Sogou, and it can be difficult for Sohu to have access to the portion held by Changyou and Sogou.***

Sohu has made significant expenditures in recent years, and expects to continue to do so through the current fiscal year, particularly for the development of Sohu Video's business. Although we hold a significant amount of cash and cash equivalents in the Sohu Group, the amount of cash directly available to Sohu, without including cash and cash equivalents of our subsidiaries Changyou and Sogou, is limited. Of approximately \$1.245 billion in cash and cash equivalents that we held in the Sohu Group on a consolidated basis as of December 31, 2015, approximately \$431 million was held by Sohu, approximately \$244 million was held by Sogou, and approximately \$570 million was held by Changyou. Of approximately \$1.051 billion in cash and cash equivalents that we held in the Sohu Group on a consolidated basis as of December 31, 2016, the amount held by Sohu had been reduced to approximately \$168 million, approximately \$286 million was held by Sogou, and approximately \$597 million was held by Changyou.

Sohu can obtain access, for use in its business, to cash held or generated by Sogou and Changyou only through dividends paid by Sogou or Changyou, as applicable, to shareholders, or through loans made by Sogou or Changyou to Sohu. Payment of dividends by Sogou or Changyou is subject to approval of the board of directors of Sogou or Changyou, as applicable and, in the case of Sogou, approval of Tencent. In addition, cash held by Mainland China-based subsidiaries and VIEs of Sogou and China can only be available for distribution by Sogou or Changyou as dividends to shareholders after compliance with restrictions and requirements imposed by PRC law, including PRC profit appropriation and PRC withholding tax, that will reduce the amount available for such subsidiaries and VIEs to distribute to Sogou Inc. and Changyou.com Limited for payment of dividends to their shareholders. Further, payments of such dividends by Sogou or Changyou would reduce the cash and cash equivalents of the Sohu Group as a whole, as non-controlling shareholders of each of those entities would be entitled to a pro rata share of such dividends. See "Risks Related to China's Regulatory Environment -Our offshore entities may need to rely on dividends and other distributions on equity paid by the China-based subsidiaries of our subsidiaries Sohu.com Limited, Sogou and Changyou to fund any cash requirements those offshore entities may have. Our offshore entities may not be able to obtain cash from distributions because our subsidiaries and VIEs in China are subject to restrictions imposed by PRC law on paying such dividends or making other payments," and "- Dividends we receive from our operating subsidiaries located in the PRC are subject to PRC profit appropriation and PRC withholding tax."

Sohu's ability to obtain loans from Changyou or Sogou for use by Sohu in its business is subject to determination by the respective boards of directors of Changyou or Sogou that making any such loans is in the best interests of Changyou or Sogou, as applicable, separate from Sohu.

As a result of the foregoing, it could be difficult for Sohu to have sufficient cash available to fund its future expenditures without obtaining debt or equity financing from sources other than within the Sohu Group, which might not be available on acceptable terms, if at all.

***Our interests in our two primary controlled subsidiaries could be significant diluted.***

Our percentage and economic interests in our two primary controlled subsidiaries, Sogou and Changyou, could be diluted by the implementation and operation of existing or future equity incentive plans or any equity issued by them as consideration for acquisitions. The occurrence of any of these dilutive events would cause our share of the revenues and earnings of the affected subsidiaries to be reduced.

***In order to comply with PRC regulatory requirements, we operate our main businesses through companies with which we have contractual relationships but in which we do not have an actual ownership interest. 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.***

Various regulations in the PRC restrict or prohibit WFOEs from operating in specified industries such as Internet information, online game, mobile, Internet access, and certain other industries. We are a Delaware corporation, and Sohu Hong Kong, our indirect wholly-owned subsidiary and the parent company of Sohu New Momentum, Sohu Era and Sohu Media; Sogou HK, our indirect controlled subsidiary and the parent company of Sogou Technology; Vast Creation, our indirect controlled subsidiary and the parent company of Sogou Network; Video HK, our indirect wholly-owned subsidiary and the parent company of Video Tianjin; and Changyou HK, our indirect subsidiary and the parent company of AmazGame, Gamespace, Beijing Baina Technology, are foreign persons under PRC law. In order to comply with PRC regulatory requirements, we conduct our Internet and value-added telecommunication operations in the PRC through our VIEs that are incorporated in the PRC and owned by certain of our employees. Through a series of contractual arrangements, our VIEs, for which Sohu is their primary beneficiary, are effectively controlled by our indirect wholly-owned and majority-owned PRC Subsidiaries.



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The MIIT issued a circular in 2006 that emphasizes restrictions on foreign investment in value-added telecommunications businesses. In addition, a notice issued in 2009 by the SAPPRFT, the National Copyright Administration, and the National Office of Combating Pornography and Illegal Publications states that foreign investors are not permitted to invest in online game operating businesses in China or to exercise control over or participate in the operation of such businesses through indirect means. While we are not aware of any internet company which uses the same or similar contractual arrangements as we do having been penalized or ordered to terminate operations by PRC authorities claiming that the arrangements constituted foreign investment in value-added telecommunication services or a kind of control over or participation in the operation of online game operating businesses through indirect means, it is unclear whether and how the various regulations of the PRC authorities might be interpreted or implemented in the future. For a detailed discussion of PRC regulations, notices and circulars with respect to such restrictions, see “Specific Regulations - Regulation of Foreign Direct Investment in Value-Added Telecommunications Companies” and “Specific Regulations - Regulation of the Online Game Services - Online Games and Cultural Products.”

Further, on January 19, 2015, MOFCOM, released on its Website for public comment a proposed PRC law, the Draft FIE Law, that appears to include VIEs within the scope of entities that could be considered to be foreign invested enterprises, or FIEs, that would be subject to restrictions under existing PRC law on foreign investment in certain categories of industry. Specifically, the Draft FIE Law introduces the concept of “actual control” for determining whether an entity is considered to be an FIE. In addition to control through direct or indirect ownership or equity, the Draft FIE Law includes control through contractual arrangements within the definition of “actual control.” If the Draft FIE Law is passed by the People’s Congress of the PRC and goes into effect in its current form, these provisions regarding control through contractual arrangements could be construed to reach our VIE arrangements, and as a result our VIEs could become explicitly subject to the current restrictions on foreign investment in certain categories of industry. The Draft FIE Law includes provisions that would exempt from the definition of foreign invested enterprises entities where the ultimate controlling shareholders are either entities organized under PRC law or individuals who are PRC citizens. The Draft FIE Law is silent as to what type of enforcement action might be taken against existing VIEs, such as ours, that operate in restricted or prohibited industries and are not controlled by entities organized under PRC law or individuals who are PRC citizens. If the restrictions and prohibitions on foreign invested enterprises included in the Draft FIE Law are enacted and enforced in their current form, our ability to use our VIE arrangements and our ability to conduct business through them could be severely limited.

In addition, pursuant to Circular 6 and the MOFCOM Security Review Rules, a security review is required for mergers and acquisitions by foreign investors having “national defense and security” concerns and mergers and acquisitions by which foreign investors may acquire “de facto control” of domestic enterprises with “national security” concerns and prohibit foreign investors from bypassing the security review requirement by structuring transactions through proxies, trusts, indirect investments, leases, loans, control through contractual arrangements or offshore transactions. These national security review-related regulations are relatively new and there is a lack of clear statutory interpretation regarding the implementation of the rules, and PRC authorities may interpret these regulations to mean that the transactions implementing our VIE structures should have been submitted for review. For a discussion of these PRC national security review requirements, see “Specific Regulations - Miscellaneous - Regulation of M&A and Overseas Listings”

If we were found to be in violation of any existing or future PRC law or regulations relating to foreign ownership of value-added telecommunications businesses, including the Draft FIE Law if it becomes effective, and security reviews of foreign investments in such businesses, including online games businesses, regulatory authorities with jurisdiction over the operation of our business would have broad discretion in dealing with such a violation, including levying fines, confiscating our income, revoking the business or operating licenses of PRC subsidiaries and/or VIEs, requiring us to restructure our ownership structure or operations, requiring us to discontinue or divest ourselves of all or any portion of our operations or assets, restricting our right to collect revenues, blocking our Internet platforms, or imposing additional conditions or requirements with which we may not be able to comply. Any of these actions could cause significant disruption to our business operations and have an adverse impact on our business, financial condition and results of operations. Further, if changes were required to be made to our ownership structure, our ability to consolidate our VIEs could be adversely affected.

***We may be unable to collect long-term loans to officers and employees or exercise management influence associated with High Century, Heng Da Yi Tong, Tianjin Jinhu, Sogou Information, Gamease and Guanyou Gamespace.***

As of December 31, 2016, Sohu had outstanding long-term loans of \$9.4 million to Dr. Charles Zhang and certain other employees. These long-term loans were used to finance investments in our VIEs High Century, Heng Da Yi Tong, Tianjin Jinhu, Sogou Information, Gamease and Guanyou Gamespace, which are used to facilitate our participation in telecommunications, Internet content, online games and certain other businesses in China where foreign ownership is either prohibited or restricted.

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The loan agreements contain provisions that, subject to PRC laws, (i) the loans can only be repaid to us by transferring the shares of High Century, Heng Da Yi Tong, Tianjin Jinhui, Sogou Information, Gamease and Guanyou Gamespace to us; (ii) the shares of High Century, Heng Da Yi Tong, Tianjin Jinhui, Sogou Information, Gamease and Guanyou Gamespace cannot be transferred by the borrowers without our approval; and (iii) we have the right to appoint all directors and senior management personnel of High Century, Heng Da Yi Tong, Tianjin Jinhui, Sogou Information, Gamease and Guanyou Gamespace. Under the loan agreements the borrowers have pledged all of their shares in High Century, Heng Da Yi Tong, Tianjin Jinhui, Sogou Information, Gamease and Guanyou Gamespace collateral for the loans, and the loans bear no interest and are due on the earlier of a demand or such time as Dr. Charles Zhang or one of 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 engaged in 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, Heng Da Yi Tong, Tianjin Jinhui, Sogou Information, Gamease and Guanyou Gamespace and is therefore uncertain.

Furthermore, because of uncertainties associated with PRC law, ultimate enforcement of the loan agreements is uncertain. Accordingly, we may never be able to collect these loans and we may not be able to continue to exercise influence over High Century, Heng Da Yi Tong, Tianjin Jinhui, Sogou Information, Gamease and Guanyou Gamespace.

***We depend upon contractual arrangements with our VIEs for the success of our business and these arrangements may not be as effective in providing operational control as direct ownership of these businesses and may be difficult to enforce.***

Because we conduct our Internet operations mainly in the PRC, and are restricted or prohibited by the PRC government from owning Internet content, telecommunication, online games operations and certain other operations in the PRC, we are dependent on our VIEs in which we have no direct ownership interest, to provide those services through contractual agreements among the parties and to hold some of our assets, including some of the domain names and trademarks relating to our business. These arrangements may not be as effective in providing control over our Internet content, telecommunications operations, online games operations and certain other as direct ownership of these businesses. For example, if we had direct ownership of our VIEs, we would be able to exercise our rights as a shareholder to effect changes in their boards of directors, which in turn could effect changes at the management level. Due to our VIE structure, we have to rely on contractual rights to effect control and management of our VIEs, which exposes us to the risk of potential breach of contract by the VIEs or their shareholders, such as their failing to use the domain names and trademarks held by them, or failing to maintain our Internet platforms, in an acceptable manner or taking other actions that are detrimental to our interests. In addition, as each of our VIEs is jointly owned by its shareholders, it may be difficult for us to change our corporate structure if such shareholders refuse to cooperate with us. In addition, 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 permits for the content servers. Furthermore, if the shareholders of any of our VIEs were involved in proceedings that had an adverse impact on their shareholder interests in such VIE or on our ability to enforce relevant contracts related to the VIE structure, our business would be adversely affected.

The shareholders of the VIEs may breach, or cause the VIEs to breach, the VIE contracts for a number of reasons. For example, their interests as shareholders of the VIEs and the interests of our subsidiaries may conflict and we may fail to resolve such conflicts; the shareholders may believe that breaching the contracts will lead to greater economic benefit for them; or the shareholders may otherwise act in bad faith. If any of the foregoing were to happen, we might have to rely on legal or arbitral proceedings to enforce our contractual rights. In addition, disputes may arise among the shareholders of any of our VIEs with respect to their ownership of such VIE, which could lead them to breach their agreements with us. Such arbitral and legal proceedings and disputes may cost us substantial financial and other resources, and result in disruption of our business, and the outcome might not be in our favor. For example, a PRC court or arbitration panel could conclude that our VIE contracts violate PRC law or are otherwise unenforceable. If the contractual arrangements with any of our VIEs were found by PRC authorities with appropriate jurisdiction to be unenforceable, we could lose control over the assets owned by such VIE and lose our ability to consolidate such VIE's results of operations, assets and liabilities in our consolidated financial statements and/or to transfer the revenues of such VIE to our corresponding PRC subsidiary.

***A failure by our VIEs or their shareholders to perform their obligations under our contractual arrangements with them could have an adverse effect on our business and financial condition.***

As all of these contractual arrangements are governed by PRC law and provide for the resolution of disputes through either arbitration or litigation in the PRC, they would be interpreted in accordance with PRC law and any disputes would be resolved in accordance with PRC legal procedures. We would have to rely for enforcement on legal remedies under PRC law, including specific performance, injunctive relief or damages, which might not be effective. For example, if we sought to enforce the equity interest purchase right agreements for the transfer of equity interests in any of our VIEs, if the transferee was a foreign company the transfer would be subject to approval by PRC governmental authorities such as the MIIT and the MOFCOM, and the transferee would be required to comply with various requirements, including qualification and maximum foreign shareholding percentage requirements. As these PRC governmental authorities have wide discretion in granting such approvals, we could fail to obtain such approval. In addition, our VIE contracts might not be enforceable in China if PRC governmental authorities, courts or arbitral tribunals took the view that such contracts contravened PRC law or were otherwise not enforceable for public policy reasons.

Furthermore, the legal environment in the PRC is not as developed as in other jurisdictions, such as the United States. As a result, uncertainties in the PRC legal system could further limit our ability to enforce these contractual arrangements. In the event we were unable to enforce these contractual arrangements, we would not be able to exert effective control over our VIEs, and our ability to conduct our business, and our financial condition and results of operations, would be severely adversely affected.

***The contractual arrangements between our subsidiaries and our VIEs may result in adverse tax consequences.***

PRC laws and regulations emphasize the requirement of an arm's length basis for transfer pricing arrangements between related parties. The laws and regulations also require enterprises with related party transactions to prepare transfer pricing documentation to demonstrate the basis for determining pricing, the computation methodology and detailed explanations. Related party arrangements and transactions may be subject to challenge or tax inspection by PRC tax authorities.

Under a tax inspection, if our transfer pricing arrangements between the China-Based Subsidiaries and VIEs are judged as tax avoidance, or related documentation does not meet the requirements, our China-based subsidiaries and VIEs may be subject to material adverse tax consequences, such as transfer pricing adjustment. A transfer pricing adjustment could result in a reduction, for PRC tax purposes, of adjustments recorded by VIEs, which could adversely affect us by (i) increasing VIE's tax liabilities without reducing our subsidiaries' tax liabilities, which could further result in interest and penalties being levied on us for unpaid taxes; or (ii) limiting the ability of our PRC companies to maintain preferential tax treatment and other financial incentives. In addition, if for any reason we needed to cause the transfer of any of the shareholders' equity interest in any of our VIEs to a different nominee shareholder (such as if, for example, one of such shareholders was no longer employed by us), we might be required to pay individual income tax, on behalf of the transferring shareholder, on any gain deemed to have been realized by such shareholder on such transfer.

***We may lose the ability to use and enjoy assets held by any of our VIEs that are important to the operation of our business if such VIE declares bankruptcy or becomes subject to a dissolution or liquidation proceeding.***

Each of our VIEs holds assets, such as our core intellectual property, licenses and permits, that are critical to our business operations. Although the equity interest purchase right agreements among our WFOEs, our VIEs and the shareholders of our VIEs contain terms that specifically obligate the shareholders of our VIEs to ensure the valid existence of our VIEs, in the event the shareholders breached these obligations and voluntarily liquidated our VIEs, or if any of our VIEs declared bankruptcy and all or part of its assets became subject to liens or rights of third-party creditors, we might be unable to continue some or all of our business operations. Furthermore, if any of our VIEs were to undergo a voluntary or involuntary liquidation proceeding, its shareholders or unrelated third-party creditors might claim rights to some or all of such VIE's assets and their rights could be senior to our rights under the VIE contracts, thereby hindering our ability to operate our business.

***Frequent press reports in the United States questioning the VIE structure used by us and other Chinese companies publicly-traded in the United States appear to have created concern among investors, and may cause such an effect in the future.***

In recent years various prominent Western news outlets have questioned the use by Chinese companies that are publicly-traded in the United States of VIE structures as a means of complying with Chinese laws prohibiting or restricting foreign ownership of certain businesses in China, including businesses we are engaged in such as Internet information and content, online advertising, online game, sponsored search, and value-added telecommunication services. Some of such news reports have also sought to draw a connection between recent widely reported accounting issues at certain Chinese companies and the use of VIE structures. Such news reports appear to have had the effect of causing concern among investors in several Chinese companies, including us, that are publicly-traded in the United States. While we are not aware of any causal connection between the recently reported accounting scandals and the use of VIE structures, it is possible that investors in our common stock will believe that such a connection exists. Any of such circumstances could lead to further loss of investor confidence in Chinese companies such as ours and cause fluctuations in the market prices of our common stock and, if such prices were to drop sharply, could subject us to shareholder litigation, which could cause the price for our shares to drop further.

### **Risks Related to China's Regulatory Environment**

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

Substantially all of our business, operating assets, fixed assets and operations are located in China, and substantially 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. Furthermore, the PRC government began to focus more attention on social issues in recent years and has promulgated or may promulgate additional laws or regulations in this area, which could affect our business in China.

***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 Sohu New Momentum, Sohu Era, Sohu Media, Video Tianjin, Sogou Technology, Sogou Network, AmazGame, Gamespace and Beijing Baina Technology are WFOEs, which are enterprises incorporated in China and wholly-owned by our indirect off-shore subsidiaries. Those WFOEs are subject to laws and regulations applicable to foreign investment in China. In addition, all of our subsidiaries and VIEs are incorporated in China and subject to all applicable Chinese laws and regulations. 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. Such uncertainties may also make it easier for others to infringe our intellectual property without significant cost, and new entrants to the market may tend to use gray areas to compete with us. In addition, uncertainties in the PRC legal system may lead to penalties imposed on us because of a difference in interpretation of the applicable law between the relevant governmental authority and us. For example, under current tax laws and regulations, we are responsible for paying business tax on a “Self-examination and Self-application” basis. However, since there is no clear guidance as to the applicability of certain areas of preferential tax treatment, we may be found to be in violation of the tax laws and regulations based on the interpretation of local tax authorities with regard to the scope of taxable services and the applicable tax rates, and therefore might be subject to penalties, including 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.

***The enforcement of the PRC Labor Contract Law and other labor-related regulations in the PRC may adversely affect our business and results of operations.***

The Standing Committee of the National People’s Congress enacted the *Labor Contract Law* in 2008, and amended it on December 28, 2012. The Labor Contract Law introduced specific provisions related to fixed-term employment contracts, part-time employment, probationary periods, consultation with labor unions and employee assemblies, employment without a written contract, dismissal of employees, severance, and collective bargaining to enhance previous PRC labor laws. Under the Labor Contract Law, an employer is obligated to sign an unlimited-term labor contract with any employee who has worked for the employer for ten consecutive years. Further, if an employee requests or agrees to renew a fixed-term labor contract that has already been entered into twice consecutively, the resulting contract, with certain exceptions, must have an unlimited term, subject to certain exceptions. With certain exceptions, an employer must pay severance to an employee where a labor contract is terminated or expires. In addition, the PRC governmental authorities have continued to introduce various new labor-related regulations since the effectiveness of the Labor Contract Law. For example, there are regulations which require that annual leave ranging from five to 15 days be made available to employees and that employees be compensated for any unused annual leave days at a rate of three times their daily salary, subject to certain exceptions.

Under the *PRC Social Insurance Law* and the *Administrative Measures on Housing Fund*, employees are required to participate in pension insurance, work-related injury insurance, medical insurance, unemployment insurance, maternity insurance and housing funds and employers are required, together with their employees or separately, to pay the social insurance premiums and housing funds for their employees.

These laws designed to enhance labor protection tend to increase our labor costs. In addition, as the interpretation and implementation of these regulations are still evolving, our employment practices may not be at all times be deemed in compliance with the regulations. As a result, we could be subject to penalties or incur significant liabilities in connection with labor disputes or investigations.

***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, online game, and mobile services.

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SAPPRFT issued the *Catalogue of Classification of Internet Audio-Video Program Services (Trial)* on April 1, 2010, pursuant to which the business of providing public program searching and watching services through the Internet to the public is classified as an Internet audio-video program service for which a Permit for the Network Transmission of Audiovisual Programs is required. On May 31, 2008, Sohu Internet received a Permit for the Network Transmission of Audiovisual Programs, issued by the SAPPRFT, and received a renewal on June 20, 2014. However, Sogou Information has not yet been granted such a license. If Sogou's provision of video search services is later challenged by the SAPPRFT, we may be subject to severe penalties, including fines, or the suspension of our video search services or even our operations. In addition, Sohu's online video businesses are operated under various Internet platforms, such as sohu.com, Focus.cn and sogou.com, but current PRC laws and regulations are lack of clear provisions indicating whether it is permissible to provide video services over several Internet platforms that are owned by a single company under one permit and the SAPPRFT might claim that such operation under one permit is not allowed under the SAPPRFT Measures. If the SAPPRFT were to make such a claim, we could face penalties from the SAPPRFT, such as fines, cancellation of our existing permit, or the forced discontinuation or restriction on our video services or even our operations. If we are ordered to suspend our services, our user traffic will be reduced and therefore our revenues will be negatively affected.

We cannot assure you that we have fully complied with or will in the future always comply with PRC rules and regulations regarding Internet-related services and telecom-related activities. In addition, the PRC government may promulgate new laws, rules or regulations at any time. If 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 could be severely impaired and we could be subject to severe penalties.

### ***PRC laws and regulations mandate complex procedures for some acquisitions of Chinese companies by foreign investors, which could make it more difficult for us to make acquisitions in China.***

PRC laws and regulations, such as the M&A Rules, which were jointly issued by six PRC regulatory agencies on August 8, 2006 and were amended on June 22, 2009, the Anti-Monopoly Law, Circular 6 and the MOFCOM Security Review Rules, established additional procedures and requirements that are expected to make merger and acquisition activities in China by foreign investors more time-consuming and complex, including requirements in some instances that the MOFCOM be notified in advance of any change-of-control transaction in which a foreign investor takes control of a PRC domestic enterprise, or that the approval from the MOFCOM be obtained in circumstances where overseas companies established or controlled by PRC enterprises or residents acquire affiliated domestic companies. PRC laws and regulations also require certain merger and acquisition transactions to be subject to a merger control security review. The MOFCOM Security Review Rules, effective from September 1, 2011, further provide that, when deciding whether a specific merger or acquisition of a domestic enterprise by foreign investors is subject to a security review by the MOFCOM, the principle of substance over form should be applied and foreign investors are prohibited from bypassing the security review requirement by structuring transactions through proxies, trusts, indirect investments, leases, loans, control through contractual arrangements of offshore transaction. Factors that the MOFCOM considers in its review are whether (i) an important industry is involved, (ii) such transaction involves factors that have had or may have an impact on national economic security and (iii) such transaction will lead to a change in control of a domestic enterprise that holds a well-known PRC trademark or a time-honored PRC brand. If a business of any target company that we plan to acquire falls into the ambit of security review, we may not be able to successfully acquire such company. Complying with the requirements of the relevant regulation to complete any such transaction could be time-consuming, and any required approval process, including approval from the MOFCOM, may delay or inhibit our ability to complete such transactions, which could affect our ability to expand our business.

In addition, under the PRC AML, which took effect in 2008, an antitrust notification must be filed with the MOFCOM prior to the closing of a business combination that reaches certain notification thresholds. Although we believe that the Sogou-Tencent Transactions were not subject to the AML and we were not required to file an antitrust notification with respect to them, it is possible that MOFCOM will consider the Sogou-Tencent Transactions to have constituted a joint venture that would require an antitrust notification under the AML. If the MOFCOM were to conclude that such a notification was required, and prevail in such conclusion, MOFCOM might instruct us to discontinue the Sogou-Tencent Transactions, and within a specified time limit, dispose of the shares or assets, transfer the business and adopt other necessary measures to return to the state prior to Sogou-Tencent Transactions, and impose a fine of up to RMB500,000 on us, which could disrupt Sogou's operations and business.

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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 Internet platforms that is deemed inappropriate and for any unlawful actions of our subscribers and other users of our systems under regulations promulgated by the MIIT, such potential liabilities including the imposition of fines or even the shutting down of the Internet platforms.

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 Internet platforms.

***Dividends we receive from our operating subsidiaries located in the PRC are subject to PRC profit appropriation and PRC withholding tax.***

PRC legal restrictions permit payment of dividends by our China-based WFOEs only out of their accumulated profits, if any, determined in accordance with PRC accounting standards and regulations. Under PRC law, our China-based WFOEs are also required to set aside 10% of their net income each year to fund certain reserve funds until these reserves equal 50% of the amount of registered capital. These reserves are not distributable as cash dividends.

Furthermore, the PRC Corporate Income Tax Law (the "CIT Law") provides that a withholding tax at a rate of up to 20% may be applicable to dividends payable to non-PRC investors that are "non-resident enterprises," to the extent that such dividends are derived from sources within the PRC. Under the Arrangement Between the PRC and the Hong Kong Special Administrative Region on the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital ("China-HK Tax Arrangement"), which became effective on January 1, 2007, the dividend withholding tax rate may be reduced to 5% if a Hong Kong resident enterprise is considered a non-PRC resident enterprise and holds at least 25% of the equity interests in the PRC enterprise distributing the dividends, subject to approval of the PRC local tax authority. However, if the Hong Kong resident enterprise is not considered to be the beneficial owner of such dividends under applicable PRC tax regulations, such dividends may remain subject to withholding tax at a rate of 10%. On October 27, 2009, the SAT issued a Notice on How to Understand and Determine the Beneficial Owners in Tax Agreement ("Circular 601"), which provides guidance on determining whether an enterprise is a "beneficial owner" under China's tax treaties and tax arrangements. Circular 601 provides that, in order to be a beneficial owner, an entity generally must be engaged in substantive business activities. A company that is set up for the purpose of avoiding or reducing taxes or transferring or accumulating profits will not be regarded as a beneficial owner and will not qualify for treaty benefits such as preferential dividend withholding tax rates. If any of our Hong Kong subsidiaries is, in the light of Circular 601, considered to be a non-beneficial owner for purpose of the China-HK Tax Arrangement, any dividends paid to it by any of our PRC Subsidiaries would not qualify for the preferential dividend withholding tax rate of 5%, but rather would be subject to the usual rate of 10%. All of our foreign-invested enterprises are subject to withholding tax, generally at a 10% rate.

Furthermore, to the extent that the VIEs have undistributed after-tax profits, 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 individual income tax rate is 20%.

***The non-U.S. activities of our non-U.S. subsidiaries and VIEs may be subject to U.S. taxation.***

Sohu.com Inc. is a Delaware corporation and is subject to income taxes in the United States. The majority of our subsidiaries and VIEs are based in China and are subject to income taxes in the PRC. These China-based subsidiaries and VIEs conduct substantially all of our operations, and generate most of our income in China.



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In accordance with U.S. generally accepted accounting principles (“U.S. GAAP”), we do not provide for U.S. federal income taxes or tax benefits on the undistributed earnings or losses of our non-U.S. subsidiaries or consolidated VIEs because, for the foreseeable future, we do not have the intention to repatriate those undistributed earnings or losses to the U.S. However, our practice of not repatriating undistributed earnings to Sohu.com Inc. limits that amount of cash that would otherwise be available to us to pay dividends or repurchase shares of our common stock from the market. In addition, certain activities conducted in the PRC may give rise to U.S. corporate income tax, even if there are no distributions to Sohu.com Inc. These taxes would be imposed on Sohu.com Inc. when its subsidiaries that are controlled foreign corporations (“CFCs”) generate income that is subject to Subpart F of the U.S. Internal Revenue Code, or Subpart F. Passive income, such as rents, royalties, interest, dividends, and gain from disposal of our investments is among the types of income subject to taxation under Subpart F. Any income taxable under Subpart F is taxable in the U.S. at federal corporate income tax rates of up to 35%. Subpart F income that is taxable to Sohu.com Inc., even if it is not distributed to Sohu.com, may also include income from intercompany transactions between Sohu.com Inc.’s non-U.S. subsidiaries and Changyou’s non-U.S. subsidiaries, or where Sohu.com Inc.’s non-U.S. subsidiaries make an “investment in U.S. property,” within the meaning of Subpart F, such as holding the stock in, or making a loan to, a U.S. corporation.

In prior years, Sohu.com Inc. has not been required to treat dividends received by its Cayman Islands subsidiary, Sohu.com Limited, from Changyou as Subpart F income, which would be includible in Sohu.com Inc.’s taxable income in the U.S., by relying on what is commonly referred to as the CFC look-through rule. Under this rule, distributions from a lower-tier CFC to a higher-tier CFC are generally not Subpart F income if the activities that gave rise to the distribution arose from an active business. The CFC look-through rule is a temporary provision of the U.S. tax code that has been extended several times by the U.S. Congress. The provision is currently scheduled to expire for taxable years beginning after December 31, 2019. Unless further extended, the CFC look-through rule will be available for Sohu.com Inc.’s and Changyou.com Limited’s non-U.S. subsidiaries only through their taxable years ending November 30, 2020. Sohu.com Inc. would also be subject to U.S. corporate income tax under Subpart F to the extent that Sohu.com Inc.’s non-U.S. subsidiary sells Changyou ADSs at a price higher than the adjusted tax basis of such ADSs for U.S. federal income tax purposes. Any such resulting U.S. corporate income tax imposed on Sohu.com Inc. would reduce our consolidated net income.

***Our offshore entities may need to rely on dividends and other distributions on equity paid by the Mainland China-based subsidiaries of our subsidiaries Sohu.com Limited, Sogou and Changyou to fund any cash requirements those offshore entities may have. Our offshore entities may not be able to obtain cash from distributions because our subsidiaries and VIEs in Mainland China are subject to restrictions imposed by PRC law on paying such dividends and making other payments.***

Sohu.com Inc. is a holding company with no operating assets other than investments in Chinese operating entities through our intermediate holding companies, our subsidiaries in the Cayman Islands, and our VIEs. Our offshore entities may need to rely on dividends and other distributions on equity paid by Mainland China-based subsidiaries of Sohu.com Limited, Sogou and Changyou for the cash requirements in excess of any cash raised from investors and retained by Sohu.com Inc. or our other offshore entities. In addition, for subsidiaries engaging in Sohu’s business in Mainland China to be able to use the proceeds of cash dividends from Sogou or Changyou, the dividends would have to be paid through the Sohu Cayman Islands entities (Sohu Search and Sohu Game) that hold Sohu’s shares in Sogou and Changyou. The primary source of any dividend payments to our offshore entities would need to be our subsidiaries in Mainland China after they receive payments from our VIEs under various service agreements and other arrangements. It is possible that our Mainland China-based subsidiaries will not continue to receive payments in accordance with our contracts with our VIEs that such payments will become subject to restrictions imposed PRC law. If our subsidiaries and VIEs incur debt on their own behalf in the future, the instruments governing the debt may restrict their ability to pay dividends or make other distributions to us through the intermediate companies. In addition, amounts available for dividends are further reduced because transfers of funds out of Mainland China generally are subject to a withholding tax of 5%, if transfers are made to Hong Kong and subject to Mainland China – Hong Kong tax treaty, and of 10% in other cases, and any further transfers to Sohu.com Inc. in the U.S. would generally be subject to U.S. corporate income tax at a rate of up to 35%.

The PRC government also imposes controls on the convertibility of the RMB into foreign currencies and, in certain cases, the remittance of currencies out of Mainland 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 the revenues from our operations through these service agreements and other arrangements, we may be unable to effectively fund any cash requirements we may have.

***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 MIIT 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, provision of online or mobile music, online securities trading, the provision of industry-specific (e.g., drug-related) information over the Internet and foreign investment in value-added telecommunication services. Other aspects of our online operations may be subject to additional regulations in the future. For example, our online interactive broadcasting video platform enables users to perform real time musical acts, exchange information, interact with others and engage in various other online activities. Although we have obtained a permit to engage in the online interactive broadcasting video platform services, we cannot assure you that the PRC regulatory authorities will not issue new laws or regulations specifically regulating the operation of an online interactive broadcasting video platform. Our operations might not be consistent with current laws and regulations or any such new regulations and, as a result, we could be subject to penalties.

***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 takes the responsibility to censor news published in China to ensure, supervise and control a particular political ideology. In addition, the MIIT 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, 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 an Internet platform 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. Meanwhile, the Ministry of Public Security also 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 or exercise its authority 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.

***We may be subject to the PRC government's ongoing crackdown on Internet pornographic content.***

The Chinese government has stringent prohibitions on online pornographic information and has launched several crackdowns on Internet pornography recently. On December 4, 2009, the MIIT and other three PRC government authorities jointly issued the *Incentives Measures for Report of Pornographic, Obscene and Vulgar Messages on Internet and Mobile Media* (the "Anti-Pornography Notice") to further crackdown on online pornography. Pursuant to this Anti-Pornography Notice, rewards of up to RMB10,000 will be provided to Internet users who report Websites that feature pornography, and a committee has been established to review such reports to determine an appropriate award. On April 13, 2014, the National Working Group on Anti-Pornography and three other PRC government authorities jointly issued the Anti-Pornography Proclamation, under which Internet service providers must immediately remove texts, images, video, advertisements and other information that contain pornographic content. The relevant government authority may order enterprises or individuals who flagrantly produce or disseminate pornographic content to stop conducting business, and may revoke relevant administrative permits. Although we require all users upon account registration to agree to our terms of service, which specify the types of content that are prohibited on our platform, and we have deleted from our relevant channels and communities all Web pages with material that we believe could reasonably be considered to be vulgar and have strengthened our internal censorship and supervision of links and content uploaded by users, it is possible that our users may engage in obscene conversations or activities on our platform that may be deemed illegal under PRC laws and regulations. For example, we provide an online interactive broadcasting video platform for users, and because the video and audio communication on this platform is conducted in real time, we are unable to examine the content generated by our hosts and users on air before the content is streamed on the platform. There is no assurance that content considered vulgar by PRC government agencies will not appear in the future. We may be subject to fines or other disciplinary actions, including in serious cases suspension or revocation of the licenses necessary to operate our platform, if we are deemed to have facilitated the appearance of inappropriate content placed by third parties on our platform under PRC laws and regulations. In addition, if we are accused by the government of hosting vulgar content, our reputation could be adversely affected.

***Regulations relating to the online transmission of foreign films and TV dramas may adversely affect our online video business.***

On September 2, 2014, the SAPPRFT issued a *Notice on Further Strengthening the Administration of Online Foreign Audiovisual Content* (the "September 2014 SAPPRFT Notice"), which requires that operators of audiovisual Websites obtain from the SAPPRFT a Film Public Screening Permit, TV Drama Distribution Permit, or TV Animation Distribution Permit for all foreign films and TV dramas before they are transmitted via the Internet in China. The September 2014 SAPPRFT Notice further stipulates that before any foreign films or TV dramas for transmission exclusively via the Internet are purchased after the promulgation of the September 2014 SAPPRFT Notice, operators of audiovisual Websites must declare their annual purchasing plans with the SAPPRFT before the end of the year preceding the year of the intended broadcast and obtain the SAPPRFT's approval. The September 2014 SAPPRFT Notice also states that the number of foreign films and TV dramas to be purchased by an operator and transmitted via its Website in a single year may not exceed 30% of the total amount of the Chinese films and TV dramas purchased and transmitted by the same Website in the previous year.

We rely heavily on foreign films and TV dramas to attract users and advertisers to our online video Internet platforms and, accordingly, the promulgation of the September 2014 SAPPRFT Notice could have an adverse impact on our online video business. If we are not able to obtain the required SAPPRFT approval in time, there will be a delay in our ability to broadcast such foreign films and TV dramas on our Internet platforms and in our generation of advertising revenues from such films and TV dramas. We are also subject to the risk that users might access pirated versions of such films and TV dramas during any such delay, and become less likely to view them on our Internet platforms when they become available, which would cause our online traffic and advertising revenues to be lower than we expected. If we fail to obtain the required approval by the SAPPRFT, we may not be able to recoup the costs we spent in acquiring the broadcasting rights of, and marketing, those films and TV dramas. In addition, it could be necessary for us to recognize impairment charges related to foreign films and TV dramas we have purchased. The requirement of a minimum ratio of domestic video content to foreign-sourced content in the September 2014 SAPPRFT Notice may require us to purchase more domestic video content in order for us to be permitted to maintain a sufficient portfolio of online foreign films and TV dramas. If, on the other hand, we respond to the minimum ratio requirement of the September 2014 SAPPRFT Notice by reducing our purchases of foreign films and TV dramas, our attraction to users, traffic or advertisers on our online video Internet platforms could be reduced, resulting in a decrease in our advertising revenues.

***Regulation and censorship of online interactive broadcasting services in China may adversely affect our business.***

As online interactive broadcasting has surged in popularity in China, PRC governmental authorities have increased their efforts to regulate it. The MOC issued an *Online Performance Notice* on July 1, 2016 and issued *Online Performance Measures* on December 2, 2016, both effective January 1, 2017, and the CAOC issued *Live Social Video Provisions* on November 4, 2016, providing for the administration and censorship of online interactive broadcasting. The Live Social Video Provisions require us to implement procedures to detect and block illegal, fraudulent, politically-sensitive and inappropriate content and activities conducted through our online interactive broadcasting platform. Although we have implemented procedures for our online interactive broadcasting platform designed to detect and prevent material and activity that we believe could reasonably be considered to be prohibited, it is possible that hosts and users of our platform may distribute content and engage in activities that may be deemed illegal, but that we do not detect and identify as such. Furthermore, we may not be able to immediately block all such content uploads or activities generated by our hosts and users, because there is often a lag between the time our hosts and users upload and stream content on our platform and the time we are able to examine such content. If PRC authorities believe that illegal or inappropriate activities have been conducted through our online interactive broadcasting platform, or if there is negative media coverage concerning our platform, PRC government authorities may hold us liable for non-compliance and subject us to administrative penalties or other sanctions, which could cause our business to suffer or have an adverse effect on our user base. See “Government Regulation and Legal Uncertainties - Specific Statutes and Regulations - Regulation of the Provision of Internet Content – Online Cultural Products.”

***Regulations relating to sponsored search may adversely affected our search and search-related revenues and may continue to have an adverse effect on such revenues.***

On April 13, 2016, the SAIC and sixteen other PRC government agencies jointly issued a *Notice of Campaign to Crack Down on Illegal Internet Finance Advertisements and Other Financial Activities in the Name of Investment Management* (the “Campaign Notice”), pursuant to which a campaign was conducted between April 2016 and January 2017 targeting, among other things, online advertisements for internet finance and other financial activities posted on internet search portals such as Sogou’s. On June 25, 2016, the CAOC issued the Interim Measures for the Administration of Online Search (the “CAOC Interim Measures”), which became effective on August 1, 2016 and require that providers of online search services verify the credentials of pay-for-click advertisers, specify a maximum percentage that pay-for-click search results may represent of results on a search page, and require that providers of search services conspicuously identify pay-for-click search results as such. Also, on July 4, 2016, the SAIC issued the *Interim Measures for the Administration of Online Advertising* (the “SAIC Interim Measures”), which became effective on September 1, 2016 and treat pay-for-click search results as advertisements subject to PRC advertisement laws and require that pay-for-click search results be conspicuously identified on search result pages as advertisements and cause revenues from such advertisements to be subject to the 3% PRC tax on advertising revenues. In order to comply with these regulations, we have established more stringent standards for selecting advertisers for our pay-for-click services and have turned down certain existing advertisers, and have lowered the percentage that pay-for-click search results represent of results on our search pages, which have had an adverse impact on our search and search-related revenues for 2016 and, along with the tax on advertising, are likely to continue to have such an impact. Also, we cannot assure you that the PRC regulatory authorities will not issue new laws or regulations specifically regulating sponsored search services, which could further impact our revenues.

***Regulations relating to offshore investment activities by PRC residents may limit our ability to acquire PRC companies and could adversely affect our business.***

In July 2014, SAFE promulgated Circular 37, which replaced Circular 75, promulgated by SAFE in October 2005. Circular 37 requires PRC residents, including PRC institutions and individuals, to register with the local SAFE branch in connection with their direct establishment or indirect control of an offshore entity, referred to in Circular 37 as a “special purpose vehicle,” for the purpose of holding domestic or offshore assets or interests. PRC residents must also file amendments to their registrations in the event of any significant changes with respect to the special purpose vehicle, such as increase or decrease of capital contributed by PRC individuals, share transfer or exchange, merger, division or other material event. Under these regulations, PRC residents’ failure to comply with specified registration procedures may result in restrictions being imposed on the foreign exchange activities of the relevant PRC entity, including the payment of dividends and other distributions to its offshore parent, as well as restrictions on capital inflows from the offshore entity to the PRC entity, including restrictions on the ability to contribute additional capital to the PRC entity. It is unclear how these regulations will be interpreted and implemented as Circular 37 is newly issued and it is possible that some or all of our and Changyou’s shareholders who are PRC residents will not comply with all the requirements required by Circular 37 or related rules. Any future failure by any of our, or Changyou’s shareholders who is a PRC resident, or controlled by a PRC resident, to comply with relevant requirements under these regulations could subject us and Changyou to fines or sanctions imposed by the PRC government, including restrictions on our subsidiaries’ ability to pay dividends or make distributions to us and our ability to increase our investment in these subsidiaries.

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### ***We may be subject to fines and legal sanctions if we or our employees who are PRC citizens fail to comply with PRC regulations relating to employee share options.***

Under the *Administration Measures on Individual Foreign Exchange Control* issued by the PBOC and the related Implementation Rules issued by the SAFE, all foreign exchange transactions involving an employee share incentive plan, share option plan or similar plan participated in by PRC citizens may be conducted only with the approval of the SAFE. Under the *Notice of Issues Related to the Foreign Exchange Administration for Domestic Individuals Participating in Stock Incentive Plan of Overseas Listed Company* (“Offshore Share Incentives Rule”), issued by the SAFE on February 15, 2012, PRC citizens who are granted share options, restricted share units or restricted shares by an overseas publicly listed company are required to register with the SAFE or its authorized branch and comply with a series of other requirements. The Offshore Share Incentives Rule also provides procedures for registration of incentive plans, the opening and use of special accounts for the purpose of participation in incentive plans, and the remittance of funds for exercising options and gains realized from such exercises and sales of such options or the underlying shares, both outside and inside the PRC. We, and any of our PRC employees or members of our board of directors who have been granted share options, restricted share units or restricted shares, are subject to the *Administration Measures on Individual Foreign Exchange Control*, the related Implementation Rules, and the Offshore Share Incentives Rule. Circular 37 was the first regulation to regulate the foreign exchange registration of a non-listed special purpose vehicle’s equity incentives granted to PRC residents, there remains uncertainty with respect to its implementation. If we, or any of our PRC employees or members of our board of directors who receive or hold options, restricted share units or restricted shares in us or any of our subsidiaries, fail to comply with these registration and other procedural requirements, we may be subject to fines and other legal or administrative sanctions.

### ***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 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 the status of certain of our PRC subsidiaries and VIEs as “High and New Technology Enterprises,” “Key National Software Enterprises” or “Software Enterprises” is revoked or expires, we may have to pay additional taxes or make up any previously unpaid tax and may be subject to a higher tax rate, which would adversely affect our results of operations.***

The CIT Law generally imposes a uniform income tax rate of 25% on all enterprises, but grants preferential treatment to High and New Technology Enterprises (“HNTEs”), pursuant to which HNTEs are instead subject to an income tax rate of 15%, subject to a requirement that they re-apply for HNTE status every three years. During this three-year period, an HNTE must conduct a qualification self-review each year to ensure it meets the HNTE criteria, and will be subject to the regular 25% income tax rate for any year in which it does not meet the criteria. The CIT Law and its implementing regulations provide that a “Software Enterprise” can enjoy an income tax exemption for two years beginning with its first profitable year and a 50% reduction to a rate of 12.5% for the subsequent three years. An entity that qualifies as a “Key National Software Enterprise” (“KNSE”) can enjoy a further reduced preferential income tax rate of 10%. Enterprises wishing to enjoy the status of Software Enterprises or KNSEs must perform a self-assessment each year to ensure they meet the relevant criteria for qualification. If at any time during the preferential tax treatment years an enterprise uses the preferential CIT rates but the relevant authorities determine that it failed to meet applicable criteria for qualification, the authorities may revoke the enterprise’s Software Enterprise or KNSE status, as applicable.

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There are uncertainties regarding future interpretation and implementation of the CIT Law and its implementing regulations. It is possible that the HNTE, Software Enterprise, and KNSE qualifications of our operating entities currently qualified as such, or their entitlement to an income tax exemption or refund of their VAT, will be challenged by higher level tax authorities and be repealed, or that there will be future implementing regulations that are inconsistent with current interpretation of the CIT Law. For example, in 2016 the SAT issued a circular with new criteria for certifying a Software Enterprise. Therefore, it is possible that the qualification of one or more of our PRC Subsidiaries or VIEs as a Software Enterprise will be challenged in the future or that such companies will not be able to take any further actions, such as re-application for Software Enterprise qualification, to enjoy such preferential tax treatment. If those operating entities cannot qualify for such preferential income tax status, our effective income tax rate will be increased significantly and we may have to pay additional income tax to make up the previously unpaid tax, which would reduce our net income.

### ***We may be deemed a PRC resident enterprise under the CIT Law and be subject to PRC taxation on our worldwide income.***

The CIT Law provides that enterprises established outside of China whose “de facto management bodies” are located within China are considered “resident enterprises” and are generally subject to the uniform 25% enterprise income tax rate on their worldwide income (including dividend income received from subsidiaries). Under the *Implementing Regulations for the Corporate Income Tax Law*, “de facto management body” is defined as a body that has material and overall management and control over the manufacturing and business operations, personnel and human resources, finances and treasury, and acquisition and disposition of properties and other assets of an enterprise. Since substantially all of our operational management is currently based in the PRC, it is unclear whether PRC tax authorities would require (or permit) us to be treated as a PRC-resident enterprise. If we are treated as a resident enterprise for PRC tax purposes, we will be subject to PRC tax on our worldwide income at the 25% uniform tax rate, which could have an impact on our effective tax rate and an adverse effect on our net income and the results of operations, although dividends distributed from our PRC Subsidiaries to us could be exempted from Chinese dividend withholding tax, since such income is exempted under the CIT Law for PRC-resident recipients.

### ***Dividends payable by us to our foreign investors and profits on the sale of our shares may be subject to tax under PRC tax laws.***

Under the *Implementing Regulations for the Corporate Income Tax Law*, PRC income tax at the rate of 10% is applicable to dividends payable to investors that are “non-resident enterprises,” not having an establishment or place of business in the PRC, or which do have such establishment or place of business but the relevant income is not effectively connected with the establishment or place of business, to the extent that such dividends have their sources within the PRC. Similarly, any profits realized through the transfer of shares by such investors are also subject to 10% PRC income tax if such profits are regarded as income derived from sources within the PRC. It is unclear whether dividends we pay with respect to our share, or the profits you may realize from the transfer of our shares, would be treated as income derived from sources within the PRC and be subject to PRC tax. If we are required under the *Implementing Regulations for the Corporate Income Tax Law* to withhold PRC income tax on dividends payable to our non-PRC investors that are “non-resident enterprises,” or if you are required to pay PRC income tax on the transfer of our shares, the value of your investment in our shares may be materially and adversely affected.

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

Substantially all of our revenues and operating expenses are denominated in RMB. The RMB is not freely tradable in “capital account” transactions, which include foreign direct investment. Foreign exchange transactions classified as capital account transactions are subject to limitations and require approval 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.

Further, although the RMB is at present freely convertible in “current account” transactions, which include dividends, and trade and service-related foreign exchange transactions, and our China-Based Subsidiaries may purchase and retain foreign exchange for settlement of such transactions, including payment of dividends, without the approval of the SAFE, 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 are likely to be in the form of RMB, these existing restrictions, and any future restrictions, on currency exchange may limit our ability to use revenues generated in RMB to fund our business activities outside of China, or to make expenditures denominated in foreign currencies.



***We may suffer currency exchange losses if the RMB depreciates relative to the U.S. dollar.***

Our reporting currency is the U.S. 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 U.S. dollar and the exchange rate will have some flexibility. Hence, considering the floating exchange rate regime, if the RMB depreciates relative to the U.S. dollar, our revenues as expressed in our U.S. dollar financial statements will decline in value. Also, we currently have outstanding loans from overseas banks that are denominated in U.S. dollars. To repay these loans, we will need to first convert our cash denominated in RMB into U.S. dollars. If the RMB depreciates relative to the U.S. dollar, we will have to use a larger amount of cash in RMB for any such loan repayment.

On May 19, 2007, the PBOC announced a policy to expand the maximum daily floating range of RMB trading prices against the U.S. dollar in the inter-bank spot foreign exchange market from 0.3% to 0.5%. While the international reactions to the RMB revaluation and widening of the RMB's daily trading band have generally been positive, with the increased floating range of the RMB's value against foreign currencies, the RMB may appreciate or depreciate significantly in value against the U.S. dollar or other foreign currencies in the long term, depending on the fluctuation of the basket of currencies against which it is currently valued. On June 19, 2010, the PBOC announced that it has decided to proceed further with the reform of the RMB exchange rate regime to enhance the flexibility of the RMB exchange rate and that emphasis would be placed on reflecting market supply and demand with reference to a basket of currencies. While so indicating its intention to make the RMB's exchange rate more flexible, the PBOC ruled out any sharp fluctuations in the currency or a one-off adjustment. On April 16, 2012, the PBOC enlarged the floating band of RMB's trading prices against the U.S. dollar in the inter-bank spot foreign exchange market from 0.5% to 1% around the middle rate released by the China Foreign Exchange Trade System each day. In February 2014, the center point of the currency's official trading band hit 6.1146, representing appreciation of more than 11.7% since June 19, 2010. On March 17, 2014, the PBOC announced a policy to further expand the maximum daily floating range of RMB trading prices against the U.S. dollar in the inter-bank spot foreign exchange market to 2%. Through 2016 the RMB continued its significant depreciation. The center point of the currency's official trading band was 6.5486 in January 2016, and was 6.9189 in December 2016, which contributed to a decline in our revenues reported in U.S. dollars. 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 U.S. dollars.

**Risks Related to Our Common Stock**

***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 2014 the trading price of our common stock ranged from a low of \$42.03 per share to a high of \$87.68 per share, during 2015 the trading price of our common stock ranged from a low of \$40.2 per share to a high of \$71.78 per share, and during 2016 the trading price of our common stock ranged from a low of \$32.6 per share to a high of \$55.21 per share. On February 22, 2017, the closing price of our common stock was \$42.16 per share.

In addition, the NASDAQ Global Select 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 share options or other stock awards.



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

Dr. Charles Zhang beneficially owns approximately 20% 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 21% 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 matters 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 and our certificate of incorporation 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 our 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.

### ***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.

### ***If we do not appoint a third member of our Audit Committee before the earlier of our 2017 annual meeting or August 4, 2017, our common stock will be subject to delisting from NASDAQ.***

As a result of the resignation of Charles Huang from the Audit Committee of our Board of Directors on August 4, 2016, as of the date of this report we do not comply with NASDAQ Listing Rule 5605(c)(2), which requires companies with securities listed on NASDAQ to have an audit committee composed of at least three directors, but we are relying on the cure period provided by NASDAQ Listing Rule 5605(c)(4), which will allow the vacancy to continue until the earlier of our 2017 annual meeting of stockholders or August 4, 2017. If our Board of Directors were to fail to identify and appoint a qualified replacement to fill the vacancy before the expiration of the cure period, our common stock would be subject to delisting from NASDAQ, which would substantially reduce or effectively terminate the trading of our common stock in the United States.

### ***Registered public accounting firms in China, including our independent registered public accounting firm, are not inspected by the U.S. Public Company Accounting Oversight Board, which deprives us and our investors of the benefits of such inspection.***

Auditors of companies whose shares are registered with the U.S. Securities and Exchange Commission and traded publicly in the United States, including our independent registered public accounting firm, must be registered with the U.S. Public Company Accounting Oversight Board (the "PCAOB") and are required by the laws of the United States to undergo regular inspections by the PCAOB to assess their compliance with the laws of the United States and professional standards applicable to auditors. Our independent registered public accounting firm is located in, and organized under the laws of, the PRC, which is a jurisdiction where the PCAOB, notwithstanding the requirements of U.S. law, is currently unable to conduct inspections without the approval of the Chinese authorities. In May 2013, PCAOB announced that it had entered into a Memorandum of Understanding on Enforcement Cooperation with the CSRC and the PRC Ministry of Finance, which establishes a cooperative framework between the parties for the production and exchange of audit documents relevant to investigations undertaken by PCAOB, the CSRC or the PRC Ministry of Finance in the United States and the PRC, respectively. PCAOB continues to be in discussions with the CSRC and the PRC Ministry of Finance to permit joint inspections in the PRC of audit firms that are registered with PCAOB and audit Chinese companies that trade on U.S. exchanges.

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This lack of PCAOB inspections in China prevents the PCAOB from fully evaluating audits and quality control procedures of our independent registered public accounting firm. As a result, we and investors in our common stock are deprived of the benefits of such PCAOB inspections. The inability of the PCAOB to conduct inspections of auditors in China makes it more difficult to evaluate the effectiveness of our independent registered public accounting firm's audit procedures or quality control procedures as compared to auditors outside of China that are subject to PCAOB inspections, which could cause investors and potential investors in our stock to lose confidence in our audit procedures and reported financial information and the quality of our financial statements.

***If additional remedial measures are imposed on the Big Four PRC-based accounting firms, including our independent registered public accounting firm, in administrative proceedings brought by the SEC alleging the firms' failure to meet specific criteria set by the SEC, we could be unable to timely file future financial statements in compliance with the requirements of the Exchange Act.***

In December 2012, the SEC instituted administrative proceedings against the Big Four PRC-based accounting firms, including our independent registered public accounting firm, alleging that these firms had violated U.S. securities laws and the SEC's rules and regulations thereunder by failing to provide to the SEC the firms' audit work papers with respect to certain PRC-based companies that are publicly traded in the United States. On January 22, 2014, the ALJ presiding over the matter rendered an initial decision that each of the firms had violated the SEC's rules of practice by failing to produce audit workpapers to the SEC. The initial decision censured each of the firms and barred them from practicing before the SEC for a period of six months. The Big Four PRC-based accounting firms appealed the ALJ's initial decision to the SEC. The ALJ's decision does not take effect unless and until it is endorsed by the SEC. On February 6, 2015, the four China-based accounting firms each agreed to a censure and to pay a fine to the SEC to settle the dispute and avoid suspension of their ability to practice before the SEC and audit U.S.-listed companies. The settlement required the firms to follow detailed procedures and to seek to provide the SEC with access to Chinese firms' audit documents via the China Securities Regulatory Commission, or the CSRC. If future document productions fail to meet specified criteria, the SEC retains authority to impose a variety of additional remedial measures on the firms depending on the nature of the failure. While we cannot predict if the SEC will further review the four China-based accounting firms' compliance with specified criteria or if the results of such a review would result in the SEC imposing penalties such as suspensions or restarting the administrative proceedings, if the accounting firms are subject to additional remedial measures, our ability to file our financial statements in compliance with SEC requirements could be impacted. A determination that we have not timely filed financial statements in compliance with SEC requirements could ultimately lead to the delisting of our common stock from NASDAQ or the termination of the registration of our common stock under the Exchange Act, or both, which would substantially reduce or effectively terminate the trading of our common stock in the United States.

### **Risks Related to Our Financing Activities**

***Sogou's status as a controlled, but less than wholly-owned, subsidiary of us could have an adverse effect on us.***

Given that Sogou is not a wholly-owned subsidiary of us, it is possible that our and Sogou's interests could diverge in the future as we may need to consider the interests of other shareholders of Sogou. If Sogou's interests differ from, or are contrary to, our interests, our business operations may be adversely affected. Furthermore, if our search business does not break even or achieve profitability and we are unable to raise additional capital, we could be forced to suspend the operation of our search business, and even if we were able to raise additional capital, our interest in Sogou would be further diluted.

Moreover, since Sohu does not hold 100% of Sogou, certain transactions between Sohu and Sogou, as well as between their subsidiaries and VIEs, might expose Sohu.com Inc. to up to 35% U.S. corporate income tax. In addition, certain transactions entered into by Sogou and its subsidiaries and VIEs, such as investing in U.S. properties, might expose Sohu.com Inc. to the risk that these will be treated as transactions subject to U.S. tax. If Sogou were to pay a dividend to its shareholders, we, as one of the shareholders of Sogou, could be subject to U.S. corporate income tax at up to 35% on the portion of the dividend it received.

***Changyou's status as a public company could have an adverse impact on Sohu.***

Changyou's American depositary shares, or ADSs, are listed and traded on the NASDAQ Global Select Market. As a separate publicly-listed company, Changyou may have interests that differ from, or may even be contrary to, those of Sohu, and we may have disagreements on certain matters. Our business might be adversely affected by any such disagreements.

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Changyou's status as a publicly-listed company may have adverse U.S. tax consequences for us. As the Sohu Group has two listed companies, Sohu.com Inc. and Changyou.com Limited, which are regarded as separate legal entities for U.S. tax purposes, certain transactions between these two companies, as well as between their subsidiaries and VIEs, might expose Sohu.com Inc. to U.S. corporate income tax at a rate of 34%. Moreover, certain types of transactions by Changyou and its subsidiaries and VIEs - investing in U.S. properties, for example - might expose Sohu.com Inc. to the risk that the transactions will be subject to U.S. tax. If Changyou pays dividends, Sohu.com Inc., as one of the shareholders of Changyou, might be subject to U.S. corporate income tax at a rate of up to 35% for the dividends received. Under certain circumstances, when we sell Changyou ordinary shares originally held by us at a price higher than our U.S. tax basis, a portion of the proceeds will be subject to U.S. corporate income tax at a rate of up to 35%.

### **Risks Related to Changyou.com Limited**

#### **Risks Relating to Changyou's Business and Industry**

##### Overall Risks

***The markets for Changyou's products and services are evolving rapidly and significantly, which makes evaluating its business and prospects difficult.***

Changyou's three primary businesses are the online game business; the platform channel business, which consists primarily of online advertising; and the cinema advertising business. Changyou's businesses and the industries in which it operates are evolving rapidly. Changyou was incorporated on August 6, 2007 in the Cayman Islands and began its online game business as an indirect wholly-owned subsidiary of Sohu.com Inc. In 2007 Sohu transferred all of its PC game business to Changyou. In 2011 Changyou acquired 7Road and began generating Web game revenues. In 2012, Changyou began to develop and operate mobile games, but did not begin to generate any significant revenues from mobile games until late in 2014 when Changyou launched TLBB 3D. In August 2015, as revenues from Changyou's Web games Wartune and DDTank had begun to decline, Changyou sold 7Road's operating company Shenzhen 7Road Technology Co., Ltd., or Shenzhen 7Road, and as a result Changyou has no remaining significant Web games in operation or development. In 2011, Changyou began to expand into the platform channel business with its acquisition from Sohu of the 17173.com Website, which operates Changyou's online advertising business. In December 2013, Changyou acquired RaidCall, which operates free social communication software; and in July 2014 Changyou acquired a majority interest in MoboTap Inc., or MoboTap, a Cayman Islands company that operates the Dolphin Browser. However, Changyou's acquisitions of RaidCall and MoboTap were not successful, as expected synergies did not materialize. In 2011, Changyou acquired the entities that operate its cinema advertising business. Changyou's cinema advertising business experienced strong growth in 2016 and has become a significant part of Changyou's overall business, but Changyou may not be able to sustain that growth.

Changyou's past successes in its online games business with PC games may not provide a meaningful basis for you to evaluate its current business and prospects, as game players increasingly migrate from personal computers to mobile devices to access online games and the relative popularity of PC games continues to decline. In response to such rapid migration, Changyou has devoted and Changyou expects to continue to devote substantial resources to the development of its mobile games as a critical component of its business strategy. However, Changyou's mobile games strategy has not been proven, and presents very different challenges from those presented in the past by its operation of PC games and Web games. We cannot be certain that Changyou will be successful in its efforts to continue to expand into mobile games. Despite the early success of Changyou's mobile game TLBB 3D after Changyou introduced it, the popularity of, and the revenues generated from, the game declined through 2016, and Changyou has not been able to generate comparable revenues from new mobile games to sustain or grow its mobile game business.

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

- raise Changyou's brand recognition and game player loyalty;
- develop, license or operate new games that are appealing to game players; adapt to new trends and game player tastes; meet Changyou's expected timetables for their launch; and, if they are successful, have acceptably long lifespans and result in an acceptable level of profit for Changyou;
- successfully adapt to evolving business models, industry trends and market environments by developing and investing in new business strategies, products, services and technologies, including, in particular, virtual reality, or VR, technology, and new games;

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- arrange for its mobile games to be distributed through popular mobile application stores with commercial terms, including revenue-sharing arrangements, that are favorable enough to Changyou and allow it to achieve an acceptable level of profit from the games;
- integrate new technologies, businesses and personnel of acquired entities, and generate sufficient revenues to offset the costs and expenses of such acquisitions;
- maintain or expand Changyou's marketing efforts to attract more game players to its games and to the game information portal of the 17173.com Website in a rapidly changing and increasingly competitive business environment, and generate sufficient revenues to offset the costs and expenses of such marketing efforts; and reverse the recent decline in Changyou's revenues from the 17173.com Website, particularly in view of the rapid emergence of mobile games and the decline in the relative popularity of PC games and Web games as users increasingly switch to mobile devices; and
- successfully expand Changyou's marketing efforts to attract advertisers to place advertisements in pre-film advertising slots that it purchases from operators of movie theaters, which are critical to Changyou's ability to recoup its significant upfront payments and committed payments under Changyou's contracts with the operators of movie theaters.

If Changyou does not adapt its business to address these risks and uncertainties, its ability to continue its past success or to expand its business in the future is likely to be impeded.

### ***Changyou's business may not succeed in a highly competitive market.***

Competition in the online game market in China is becoming increasingly intense. Changyou competes primarily with other online game developers in China, including Tencent Holdings Limited and NetEase.com, Inc. Many of Changyou's competitors have, or may over time be able to gain, competitive advantages over Changyou in terms of:

- greater financial and technical resources;
- more aggressive and effective strategies for hiring talent for game development, which may make it difficult for Changyou to retain its existing employees and attract new employees, which are necessary for Changyou to be able to grow its business;
- substantially greater financial resources and more effective methods for acquiring exclusive license rights to the titles, characters, themes and story lines of popular works in order to adapt online games from such works (which has become increasingly important for new online games to be successful);
- more aggressive and effective marketing strategies for promoting their online games and penetrating the mobile game market; and
- more capability for developing and releasing new software for mobile devices to attract a growing number of game players that access Internet products and services through mobile devices.

The 17173.com Website derives revenue primarily from providing online advertising services to advertisers that develop, operate and distribute PC games. As the market demand for PC games continues to decline, the 17173.com Website faces intense competition, particularly from mobile application stores and other Internet platforms through which game players access mobile games, for advertising business targeting online players of mobile games. Changyou competes with other game information portals, such as duowan.com, operated by YY Inc., and game.qq.com, operated by Tencent Holdings Limited, and other Internet portals which have, or may over time be able to build, competitive advantages over Changyou in terms of:

- greater brand recognition among game players and advertising clients;
- larger user and customer bases;
- more extensive and well developed marketing and sales networks;
- more attractive mobile versions of their game information portals and more extensive mobile game-related products and services, such as mobile game discussion forums, in response to the rapid migration of users of Internet services from PCs to mobile devices such as tablets and mobile phones, and the unique preferences and demands of mobile users and mobile game players; and
- substantially greater financial and technical resources.

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Changyou's cinema advertising business generates revenues through contracts that Changyou enters into with advertisers to place their advertisements in pre-film advertising slots that Changyou purchases from operators of movie theaters. Changyou competes with Focus Media Group, Wanda Group and other companies selling pre-film advertisement slots to advertisers. These competitors in general, and Wanda Group in particular, have, and may be able to build further, competitive advantages over Changyou arising from their having significantly greater financial resources, greater brand recognition among operators of movie theaters and advertisers and more capable and effective sales and marketing forces and strategies than Changyou does. Wanda Group has a particular competitive advantage over Changyou as Wanda itself is one of the largest operators of movie theaters in China. Therefore, it is cost-effective for Wanda Group to expand its own cinema advertising business together with its expansion of movie theaters. In addition, Wanda Group is competing with Changyou for advertising slots in other movie theaters that Wanda does not own or operate, which may force Changyou to increase the price for such advertising slots, which may impair Changyou's ability to compete effectively in those markets.

In order to compete effectively in the PRC, as well as in the worldwide market, Changyou must continue to invest in research and development, to enhance its technology and its existing games, advertising and other services, and to introduce new game products and services in order for it to adapt to industry trends and shifting demands of game players and advertising clients and to remain competitive. If Changyou's products and services are not responsive to the needs of its game players and advertisers, are not appropriately timed with market opportunities, or are not effectively brought to market, or if its competitors are more successful than Changyou is in developing compelling products or in attracting and retaining game players and advertisers, Changyou may not be able to compete effectively.

***Changyou's business could suffer if Changyou does not successfully manage any future growth.***

Changyou experienced a period of rapid growth and expansion through 2013 that placed strain on its management personnel, systems and resources. In addition, to accommodate any future growth, Changyou anticipates that it will need to implement a variety of new and upgraded operational and financial systems, including procedures and controls, improvement of its accounting and other internal management systems and security systems related to the foregoing, all of which require substantial management efforts and financial resources. Changyou will also need to continue to train, manage and motivate its workforce, and manage its relationships with its third-party operators, distributors and service providers and its game player base. All of these endeavors will require substantial management effort and skills and the incurrence of additional expenditures. Changyou may not be able to efficiently or effectively implement its growth strategies and manage the growth of its operations, and any failure to do so may limit its future growth and hamper its business strategy.

***Changyou may not be able to avoid slowing growth or declines in its revenues, or future losses.***

Changyou's revenues grew significantly in a relatively short period of time prior to 2014, but its revenue growth stalled in 2014 and 2015, and revenues decreased in 2016. Primarily due to the commercial success of TLBB, Changyou's revenues grew from \$623.4 million for the year ended December 31, 2012 to \$737.9 million for the year ended December 31, 2013. However, Changyou's revenues increased only slightly to \$755.3 million and to \$761.6 million, respectively, for the years ended December 31, 2014 and 2015, and Changyou's revenues decreased to \$525.4 million for the year ended December 31, 2016. Even if Changyou's revenues increase in future years, Changyou is not likely to experience rates of revenue growth in the future similar to those that it experienced prior to 2014. Changyou suffered a net loss attributable to Changyou.com Limited of \$3.4 million for the year ended December 31, 2014. Changyou's net income attributable to Changyou.com Limited was \$212.8 million for the year ended December 31, 2015, but decreased to \$144.9 million for the year ended December 31, 2016. Changyou also may experience declines in its revenues or suffer net losses in the future due to a number of factors, including, among other things, the continued decline in TLBB's and TLBB 3D's revenues and profitability, the uncertain level of popularity of Changyou's future games (particularly its future mobile games as users increasingly switch to mobile devices), uncertainty as to Changyou's ability to develop and launch high-quality mobile games that are commercially successful and the relatively higher game development and distribution costs generally associated with such games; the need to expend greater amounts in order to develop or acquire new games, technologies, assets, and businesses; and uncertainty as to Changyou's ability to integrate such newly acquired games, technologies, assets and businesses. Accordingly, you should not rely on the results of any prior period as an indication of Changyou's future financial and operating performance.

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***Changyou's previous and any future acquisitions and/or strategic alliances may have an adverse effect on its ability to manage its business and may also result in impairment charges.***

Changyou has made acquisitions of, and may potentially acquire in the future, technologies, businesses or assets that are complementary to its business and/or enter into strategic alliances in order to leverage its position in the Chinese online game market and expand its business domestically and internationally. Such acquisitions or strategic alliances may expose Changyou to potential risks, including risks associated with the integration of new technologies, businesses and personnel including its continued reliance on the management teams of the acquisition targets to operate the acquired businesses, unforeseen or hidden liabilities, the diversion of management attention and resources from its existing business, and the inability to generate sufficient revenues to offset the costs and expenses of acquisitions or strategic alliances. Any difficulties encountered in the acquisition and strategic alliance process may have an adverse effect on Changyou's ability to manage its business. In addition, acquired businesses may not perform to Changyou's expectations for various reasons, including the loss of key personnel or key clients, and Changyou's strategic focus may change. As a result, Changyou may not realize the benefits it anticipated. If Changyou fails to integrate acquired technologies, businesses and assets or realize the expected benefits, Changyou may not receive a return on its investment and its transaction costs for such acquisitions. The benefits of an acquisition or investment may also take considerable time to develop, and we cannot be certain that any particular acquisition or investment will produce the intended benefits, which could adversely affect its business and operating results. Acquisitions could result in contingent liabilities or amortization expenses related to intangible assets or write-offs of goodwill and/or intangible assets, which could adversely affect Changyou's results of operations. For example, in December 2013, Changyou acquired RaidCall with the expectation of generating benefits from synergies with Changyou's online game business; in November 2013 Changyou acquired Beijing Doyo Internet Technology Co., Ltd., or Doyo, with the expectation of generating benefits from synergies with Changyou's online advertising business, and in July 2014 Changyou acquired MoboTap, which operates the Dolphin Browser, with the expectation of generating benefits from synergies with Changyou's platform channel business. In 2014 Changyou recognized a \$33.8 million impairment loss for goodwill and a \$15.3 million impairment loss for acquired intangible assets related to RaidCall, in 2015 Changyou recognized a \$29.6 million impairment loss for goodwill and an \$8.9 million impairment loss for acquired intangible assets relating to the Dolphin Browser, and in 2015 Changyou sold Doyo and recognized a \$1.9 million impairment loss for goodwill, as a result of Changyou's management's conclusion that the expected synergies would not materialize.

***Changyou is dependent upon its management and upon its key development and technical personnel; and Changyou's business may be disrupted if it loses the services of any of them.***

Changyou's future success depends substantially on the services of the members of its management and its key development and technical personnel, such as Changyou's Chief Executive Officer Dewen Chen. If one or more of the members of Changyou's management or key development or technical personnel were unable or unwilling to continue in their present positions, Changyou might not be able to replace them easily, or at all. If any of the members of Changyou's management or its key employees joins a competitor or forms a competing company, not only would Changyou lose know-how, key professionals, staff members and suppliers, but such members of Changyou's management and key employees could develop and operate games and other services that could compete with and take game players and users away from its existing and future business. Although each of these members of Changyou's management and key personnel has entered into an employment agreement with non-competition provisions, these non-competition provisions may not be enforceable in China.

***Changyou's prospects for growth may be adversely affected if Changyou cannot successfully manage and make timely adjustments to its hiring needs to support its business strategies.***

The Internet industry in China is characterized by high demand and intense competition for talent, particularly for game developers and related technical personnel, and Changyou's success in the implementation of its growth strategies depends on Changyou's ability to successfully manage, and make timely adjustments to, its hiring needs. The number of Changyou's employees decreased by 11.0% in 2014, by 41.9% in 2015, and by 13.0% in 2016, as Changyou emphasized the development of mobile games and laid off a number of employees who had been focused primarily on international markets and the platform channel business. These layoffs could have an adverse effect on Changyou's remaining employees' morale and their loyalty to Changyou, and cause Changyou to lose employees whose talent and experience are important for its business, and could also have a negative impact on its reputation as an employer and its ability to attract qualified employees in the future. Laid-off employees could also make claims against Changyou for additional compensation, causing Changyou to incur additional expense.



***Changyou may not have exclusive rights to trademarks, designs and technologies that are crucial to its business.***

Changyou has applied for initial registrations in the PRC and overseas, and/or changes in registrations relating to transfers of its key trademarks in the PRC, including ChangYou.com, cyou.com, TLBB, TL logos, New Blade Online, 17173, TLBB 3D and the corresponding Chinese versions of the marks, so as to establish and protect its exclusive rights to these trademarks. Changyou has succeeded in registering the trademarks ChangYou.com, cyou.com, TLBB, TL logos, 17173 and Dolphin Browser in the PRC under certain classes. The applications for initial registration, and/or changes in registrations relating to transfers, of other marks and/or of some of these marks under other classes are still under examination by the Trademark Office of the State Administration for Industry & Commerce of the PRC (the “SAIC”) and relevant authorities overseas. Changyou has applied for patents relating to the design of its games and to technology intended to enhance the functionalities of its games. Changyou has various patent applications under examination by the State Intellectual Property Office of the PRC. Approvals of Changyou’s initial trademark registration applications, and/or of changes in registrations relating to such transfers, and approvals of Changyou’s patent applications are subject to determinations by the Trademark Office of the SAIC, the State Intellectual Property Office of the PRC and relevant authorities overseas that there are no prior rights in the applicable territories. Changyou cannot be certain that these applications will be approved. Any rejection of these applications could adversely affect Changyou’s rights to the affected marks, designs and technologies. In addition, even if these applications are approved, Changyou cannot assure you that any registered trademark or issued patent will be sufficient in scope to provide adequate protection of its rights.

***Changyou may need to incur significant expenses to enforce its proprietary rights, and if it is unable to protect such rights, its competitive position and financial performance could be harmed.***

Changyou regards its intellectual property and proprietary rights as critical to its success. In particular, Changyou has spent a significant amount of time and resources in developing its current games and possible future games. Changyou’s ability to protect its proprietary rights in connection with its games is critical for their success and Changyou’s overall financial performance. While Changyou has registered software in China for copyright protection and has taken various measures to protect its source codes, such measures may not be sufficient to protect its proprietary information and intellectual property. Intellectual property rights and confidentiality protection in China may not be as effective as they are in the United States and other developed countries. Policing unauthorized use of proprietary technology is difficult and expensive. In addition, while Changyou has registered some trademarks relating to its games in the PRC and other jurisdictions, and has applied for additional registrations of trademarks, in some instances Changyou may not succeed in obtaining registration of trademarks that it has applied for in different languages, such as English. We cannot assure that these pending or future trademark applications will be approved. Any failure to register trademarks in any country or region may limit Changyou’s ability to protect its rights in such country or region under relevant trademark laws, and Changyou may need to change the name of the relevant trademark in certain cases, which may adversely affect Changyou’s branding and marketing efforts.

Despite Changyou’s efforts to protect its intellectual property, online game developers may copy Changyou’s ideas and designs, and other third parties may infringe Changyou’s intellectual property rights. For example, certain third parties have misappropriated the source codes of previous versions of TLBB and have set up unauthorized servers in China and elsewhere to operate TLBB to compete with Changyou. The existence of unauthorized servers may attract game players away from Changyou’s games and may result in decreases in Changyou’s revenues. Any measures Changyou takes in response may not be successful in eliminating these unauthorized servers. Litigation relating to intellectual property rights may result in substantial costs to Changyou and diversion of resources and management attention away from its business, and may not be successful. In addition, Changyou’s ideas and certain of its designs, if not fixed in a tangible form of expression or registered with the appropriate PRC authorities, may not be protected by patents or other intellectual property rights. As a result, Changyou may be limited in its ability to assert intellectual property rights against online game developers who independently develop ideas and designs that compete with Changyou.



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***Changyou may be exposed to infringement or misappropriation claims by third parties, which, if determined adversely to it, could subject it to significant liabilities and other costs.***

Changyou's success depends largely on its ability to use and develop its technology and know-how without infringing the intellectual property rights of third parties. We cannot assure you that third parties will not assert intellectual property claims against Changyou. Changyou is subject to additional risks if entities licensing to it intellectual property, including, for example, game source codes, do not have adequate rights in any such licensed materials. The validity and scope of claims relating to the intellectual property of game development and technology involve complex scientific, legal and factual questions and analyses and, therefore, tend to be uncertain. If third parties assert copyright or patent infringement or violation of other intellectual property rights against it, Changyou will have to defend itself in litigation or administrative proceedings, which can be both costly and time consuming and may significantly divert the efforts and resources of Changyou's technical and management personnel. An adverse determination or settlement in any such litigation or proceedings to which Changyou may become a party could subject it to significant liability to third parties, or require it to seek licenses from third parties, pay ongoing royalties, or redesign its games or subject it to injunctions prohibiting the development and operation of its games.

### **Risk Related to Online Games**

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

The online game industry, from which Changyou derives most of its revenues, is a rapidly evolving industry. The growth of the online game industry and the level of demand and market acceptance of Changyou's games are subject to a high degree of uncertainty. Changyou's future operating results will depend on numerous factors affecting the online game industry, many of which are beyond Changyou's control, including:

- whether the online game industry, particularly in China and the rest of the Asia-Pacific region, continues to grow and the rate of any such growth;
- the availability and popularity of other forms of entertainment, particularly games on console systems, which are already popular in developed countries and may gain popularity in China;
- growth in users of the Internet and broadband and penetration in China and other markets in which Changyou offers its games, and the rate of any such growth;
- whether recent declines in the use of personal computers and growth in users of mobile devices (such as smart phones and tablets) in general, and for purposes of accessing online games in particular, continue or accelerate in China and other markets in which Changyou offers its games;
- changes in consumer demographics and public tastes and preferences; and
- general economic conditions in China, particularly economic conditions adversely affecting discretionary consumer spending, such as the slowdown in China's economic growth that occurred between the first quarter of 2010 and the third quarter of 2012 and from 2014 through 2015.

There is no assurance that online games in general will continue to be popular in China or elsewhere. If the current decline in the popularity of PC games continues or accelerates as users increasingly switch to mobile devices, Changyou's revenues from its PC games may decrease significantly; and if the PC games that Changyou has launched, or expects to launch in the future, are not successful, Changyou may not be able to recoup the investments in its development and marketing of those games.

***Changyou currently depends on TLBB for a substantial portion of its revenues, and any continued decrease in the popularity of TLBB or interruption in its operation would adversely affect Changyou's results of operations.***

Changyou currently relies on TLBB for a substantial portion of its revenues. Changyou launched TLBB in May 2007 and TLBB is unlikely to sustain its current level of popularity over time. Despite Changyou's efforts to improve TLBB, its game players have nevertheless lost interest in it over time as the relative popularity of PC games (which are accessed through personal computers) continues to decline and its popularity, revenues and profitability have continued to decline. See "*Changyou may not be successful in operating and improving its games to satisfy the changing demands of game players.*"

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To prolong TLBB's lifespan and slow down the pace of its decline, Changyou needs to continually improve and update it on a timely basis with new features, including enhanced social interaction features, that appeal to existing game players and attract new game players (including those who played earlier versions of TLBB), and improve player stickiness to the game. If Changyou fails to improve and update TLBB on a timely basis, or if its competitors introduce more popular games, including mobile games, catering to its game player base, the decline in TLBB's popularity can be expected to accelerate, which would cause Changyou's revenues to decrease at a faster pace. Furthermore, if there are any interruptions in TLBB's operation due to unexpected server interruptions, network failures or other factors, game players may be prevented or deterred from making purchases of virtual items, which could also cause significant decreases in Changyou's revenues.

***If the market demand for PC games in general, and for the PC games that Changyou operates in particular, continues to decline and the number of game players of PC games continues to decrease, Changyou's online game business and prospects may be adversely affected.***

A substantial portion of Changyou's online game revenues are generated from its PC games, and from TLBB in particular. However, the popularity of PC games continues to decline and an increasing number of online game developers are delaying or suspending their plans to develop and launch new PC games, as game players increasingly switch to mobile devices to access online games. It has become increasingly difficult for PC game developers and operators to retain existing players of their games and the number of game players who are willing to spend time and money to play new PC games continues to decrease. If this downward trend continues or accelerates, it may make it increasingly difficult for Changyou's existing PC games in general, and TLBB in particular, to maintain their popularity and for its new PC games to ever become commercially successful; the game player base of Changyou's PC games in general, and of TLBB in particular, may continue to shrink, which would increase its costs to acquire and retain players of its PC games and would have a negative impact on its online game revenues. In addition, Changyou's PC games generally produce relatively higher profit margins for it than do its mobile games, because Changyou must distribute its mobile games through third-party mobile application stores and enter into revenue-sharing arrangements with such mobile application stores. Accordingly, any decrease in Changyou's revenues from its PC games may have a relatively larger negative impact on its overall profits.

***As mobile devices such as tablets, mobile phones and other devices other than personal computers are increasingly used to access online games, Changyou must continue to acquire or develop increasing numbers of mobile games that work on such devices.***

Devices other than personal computers, such as mobile phones and tablets, are used increasingly in China and in overseas markets. We believe that, for its business to be successful, Changyou will need to continue to develop versions of its existing games and any future games that work well with such devices. The games that Changyou develops for such devices may not function as smoothly as its existing games, and may not be attractive to game players in other ways. In addition, manufacturers of such devices may establish restrictive conditions for developers of applications to be used on such devices, and as a result Changyou's games may not work well, or at all, on such devices. As new devices are released or updated, Changyou may encounter problems in developing versions of its games for use on such devices and may need to devote significant resources to the development, support, and maintenance of games for such devices. Since 2014 Changyou has been investing, and it expects to continue to invest, significant amounts in the acquisition, development, promotion and operation of games for mobile devices. If Changyou is unable to successfully expand the types of devices on which its existing and future games are available, or if mobile versions of games that Changyou develops for such devices do not function well or are not attractive to users and game players, or if the mobile games that Changyou has launched, or expects to launch in the future, are not successful, Changyou may not be able to maintain or increase its revenues and recoup its investments in the mobile market.

***Changyou's business will suffer if it is unable to develop successful high-quality games, for mobile devices, successfully monetize mobile games Changyou develops or acquires and maintain for a reasonable period the popularity and revenue levels of any mobile games that are successful.***

Developing high-quality games for mobile devices is an important component of Changyou's online game strategy. China's mobile games market recently has been dominated by a small number of high quality games, which collectively generate a substantial majority of the total revenues and profits of all mobile games in the market. Changyou has devoted and Changyou expects to continue to devote substantial resources to the development of its mobile games, focusing on those that Changyou believes have the potential to become high-quality games. We cannot guarantee that Changyou will be able to develop high-quality games that appeal to players or, even if Changyou is able to develop high-quality games that are successful, that such games will have lifespans that are long enough to generate an acceptable level of revenues, as mobile games tend to have relatively shorter lifespans than PC games. In addition, Changyou may encounter difficulty in integrating features on games developed for mobile devices that a sufficient number of players will pay for, or in otherwise sufficiently monetizing mobile games. If Changyou is unable to develop successful high-quality games, or implement successful monetization strategies for its mobile games in general, its ability to grow revenue and its financial performance will be negatively affected.

Changyou's ability to successfully develop and monetize games for mobile devices will depend on its ability to:

- expand the portfolio of mobile games, and particularly high quality games, that Changyou develops in-house and licenses from third-party developers;
- effectively develop new mobile games for multiple mobile operating systems and mobile devices;
- anticipate and effectively respond to the growing number of players switching to mobile games, the changing mobile landscape and the interests of players;
- attract, retain and motivate talented game designers, product managers and engineers with experience in developing games for mobile devices;
- minimize launch delays and cost overruns on the development of new games;
- effectively monetize mobile games without degrading the social game experience for its players;
- develop games that provide for a compelling and optimal user experience through existing and developing third-party technologies, including third-party software and middleware utilized by its players; and
- acquire and successfully integrate high- quality mobile game assets, personnel or companies.

Further, even if Changyou develops or acquires license rights to a mobile game that is successful, the game's lifespan may be short, as even successful mobile games tend to have less sustained user loyalty than do successful PC games. For example, the revenues generated from Changyou's mobile game, TLBB 3D, which was launched in October 2014, declined sequentially through 2015 and 2016, which is typical for a mobile game. In addition, although a relatively large number of the mobile games available at any given time may be low-quality games that attract fewer game players than do high-quality games, such games may on an aggregate level have the effect of attracting away a significant number of game players who would otherwise play high-quality mobile games. In view of the uncertain lifespans of mobile games and the large quantity of mobile games competing for game players, it is necessary for Changyou to make considerable investments in order to have a number of mobile games, and particularly mobile games that have the potential to become high-quality hit games, in its pipeline.

If Changyou is unable to succeed in developing or acquiring new mobile games in general, and high quality games in particular, that are successful and in maintaining for a reasonable period the popularity and revenue levels of any mobile games that Changyou develops or acquires that are successful, Changyou may not be able to recoup its development and acquisition costs and its ability to expand its business in the future is likely to be impeded.

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***We believe that the chance of success for online games is improved if they are adapted from the titles, characters, themes and story lines of popular works. However, there are many risks and uncertainties for obtaining the rights to adapt such works for online games, and Changyou's games adapted from such works may not be successful.***

We believe that, in order for many of the new online games that Changyou develops to be successful in China, it is important for it to obtain license rights, and preferably exclusive license rights, to adapt the titles, characters, themes and story lines of popular works for use in the games. For example, Changyou developed and it operates its PC game TLBB and its mobile game TLBB 3D with various features that are included in reliance on rights under its existing license agreements with the Chinese martial arts author Louis Cha with respect to his popular novel Tian Long Ba Bu. We believe that these features have had a critical role in attracting and retaining many of the players of TLBB and TLBB 3D. However, it can be difficult to identify a sufficient number of such works that are suitable for adaptation for use in online games, and Changyou faces significant competition for the rights to such works from other online game companies that also adapt their online games from popular works. Obtaining license rights, and particularly exclusive license rights, to adapt suitable works for use in online games can involve significant expense. Even if Changyou obtains license rights for works, we cannot assure you that games that Changyou adapts from such works will be popular and commercial successes and that Changyou will be able to recoup the amounts it pays for the license rights. Obtaining such rights and adapting such works for mobile games present additional risks, because of the relatively short lifespans of mobile games. Moreover, after the expiration of the terms of Changyou's existing license agreements with Mr. Cha and other holders of copyrights, Changyou may not be able to renew the agreements with commercial terms that are favorable to it, if at all. Changyou's inability to renew such agreements could force it to discontinue the related online games, and have a significant adverse impact on its online game operations and revenues.

***Changyou may not be able to distribute its mobile games through its desired Internet platforms, its profits from any successful mobile games can be expected to be relatively lower than the profits Changyou has enjoyed historically from PC games and its mobile game revenues are subject to additional risks as Changyou relies on mobile application stores to collect payments from players of its mobile games.***

Changyou may not be able to arrange for its mobile games to be distributed through its desired popular third-party mobile application stores with commercial terms, including revenue-sharing arrangements that are favorable enough to it and allow it to achieve an acceptable level of profit from the games. Changyou's profits from mobile games, even if the games are successful, are likely to be relatively lower than the profits it generates from PC games, because, in order to gain access for its games on mobile application stores, Changyou must enter into revenue-sharing arrangements that generally result in lower profit margins than those generated from its PC games. Changyou relies on mobile application stores to collect payments from game players for their purchases of its virtual items and to pay to Changyou pre-agreed revenue-sharing amounts. If mobile application stores cease to offer Changyou's games over their platforms, change their user payment policies, such as return policies, or fail to make revenue-sharing payments that are due to Changyou, Changyou's revenues will be adversely affected. When Changyou distributes its games through smaller, less well-known application stores, Changyou may not receive revenue-sharing payments when they are due to it. In addition, the iOS-based mobile application store allows game players to use foreign currency to purchase virtual items or game points in Changyou's games, and the store pays to Changyou pre-agreed revenue-sharing amounts after converting the foreign-currency denominated revenues from such purchases into RMB using an exchange rate effective at the time of the payment. Since there is usually a delay between the time of a game player's purchase and the time when the store pays Changyou, if the foreign currency used has depreciated against the RMB during the delay Changyou will receive lower share-sharing amounts at the time of the payment than Changyou would have received if the payment had been made at the time of the game player's purchase.

***Changyou's new mobile games will be less likely to be successful if Changyou cannot adopt and implement innovative and effective marketing strategies to attract attention to its games from game players in its targeted demographic groups.***

A relatively large number of mobile games are typically available at any given time in the markets in which Changyou launches and operates its mobile games, and such games compete for attention from the same game player population that it targets. Changyou's ability to successfully promote and monetize its mobile games will depend on its ability to adopt and effectively implement innovative marketing strategies, and particularly precision marketing through new media, such as Weibo, WeChat, bilibili.com Website and other online game forums, targeting potential mobile game players in general, and game players in specific demographic groups for certain games in particular, and Changyou's ability to cross-market mobile games to players of its current PC games and mobile games. If Changyou fails to adopt and implement such marketing and cross-marketing strategies, or if the marketing strategies of Changyou's competitors are more innovative and effective than Changyou's, its mobile games will be less likely to be successful and as a result Changyou may not be able to achieve an acceptable level of revenues from those games.

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***Changyou's development and operation of mobile games may be adversely affected by the promulgation of new, and the implementation and interpretation of existing, PRC laws and regulations affecting mobile games.***

As mobile games are a relatively new type of online game in China, developers and operators of mobile games, including Changyou, have been facing increasingly intense regulatory scrutiny from PRC regulatory authorities regarding the development and operation of mobile games. Substantial uncertainties exist regarding the timing of the promulgation of, and any changes to, current and future PRC laws and regulations and the effect of the interpretation and implementation thereof, which may, among other things:

- have an adverse impact on the way Changyou designs its games and game features, which may make the games less attractive to game players;
- have an adverse impact on Changyou's ability to achieve an acceptable level of revenues and profit from its mobile games;
- make it harder to access Changyou's mobile games and cause a decrease in its player base;
- increase the cost of the development and operation of Changyou's mobile games; and
- require substantial management attention and effort in monitoring the development of, and ensuring Changyou's compliance with, existing and future PRC laws and regulations affecting the mobile games business.

For a discussion of the risks associated with PRC laws and regulations affecting online games in general and mobile games in particular, see "Risks Related to Doing Business in China" in this Item 3 of this annual report.

***Changyou's new games may attract game players away from its existing games.***

With Changyou's increasingly diversified game portfolio, we cannot assure you that players of Changyou's existing games will not be attracted to play other newly launched games, including its new mobile games. If this occurs, it will decrease Changyou's existing games' player bases, which could in turn make these games less attractive to other game players, resulting in decreased revenues from its existing games. Game players who switch from playing Changyou's existing games to its new games may also spend less money to purchase virtual items in its new games than they would have spent if they had continued playing Changyou's existing games, resulting in an adverse effect on its overall revenues. In addition, game players' switching from playing Changyou's existing PC games to its new mobile games, as well as from its in-house developed games to its licensed games, could cause Changyou's overall online game profits to be relatively lower, as its profits from mobile games and licensed games tend to be relatively lower as a result of revenue-sharing arrangements.

***Changyou relies on recorded data for game revenue recognition and tracking of game players' consumption patterns of virtual items. If its data systems fail to operate effectively, such failure will affect the completeness and accuracy of its revenue recognition, and also its ability to design and improve virtual items that appeal to game players.***

Changyou's game operation revenues are generated through the direct online sale of game points and sale of its prepaid game cards, and its recognition of those revenues depends on such factors as whether the virtual items purchased by game players are considered consumable or perpetual. Changyou's revenue recognition policy with respect to perpetual virtual items is based on its best estimate of the lives of the items. Changyou considers the average period that paying players typically play its games and other player behavior patterns to arrive at its best estimate of the lives of these perpetual items. However, given the fast-evolving nature of the game industry and the various types of online games that Changyou offers to players with different tastes and preferences, its estimate of the period that players typically play its games may not accurately reflect the actual lives of these perpetual virtual items. Changyou revises its estimates as it gain operating data, and it attempts to refine its estimation process accordingly. Any future revisions to these estimates could adversely affect the time period during which Changyou recognizes revenues from these items. For example, an increase in the estimated lives of these perpetual virtual items would increase the period over which revenues from these items are recognized.

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Changyou relies on its data systems to record and monitor the purchase and consumption of virtual items by its game players and the types of virtual items purchased. If its data systems fail to accurately record the purchase and consumption information of the virtual items, Changyou may not be able to accurately recognize its revenues. In addition, Changyou relies on its billing systems to capture such historical game player behavior patterns and other information. If such information is not accurately recorded, or if Changyou does not have sufficient information due to the short operating history of any of its games, Changyou will not be able to accurately estimate the lives of, or the estimated average period the game players play its games with respect to, the perpetual virtual items, which will also affect its ability to accurately recognize its revenues from such perpetual virtual items. If Changyou's data systems were damaged by system failure, network interruption, or virus infection, or attacked by a hacker, the integrity of data would be compromised, which could adversely affect its revenue recognition and the completeness and accuracy of its recognized revenues.

In addition, Changyou relies on its data systems to record game player purchase and consumption patterns, based on which Changyou improves its existing virtual items and designs new virtual items. For example, Changyou intends to increase development efforts on the number and variety of virtual items that its game players like to purchase, and Changyou may also adjust prices accordingly. If its data systems fail to record data accurately, its ability to improve existing virtual items or design new virtual items that are appealing to its game players may be adversely affected, which could in turn adversely affect its revenues.

***Changyou could be liable for breaches in the security of the online payment platforms of third parties with whom Changyou transacts business, and any such breaches could cause its customers to lose confidence in the integrity of the payment systems that Changyou uses.***

Currently, Changyou sells a substantial portion of its virtual game points and prepaid game cards to its game players through third-party online payment platforms. In these online transactions, secure transmission of confidential information, such as customers' credit card numbers and expiration dates, personal information and billing addresses, over public networks is essential if Changyou is to maintain its consumers' confidence in it. In addition, Changyou expects that an increasing amount of its sales will be conducted over the Internet as a result of the growing use of online payment systems. As a result, the risk of associated online crime will increase. Changyou's current security measures and those of the third-party online payment platforms with whom Changyou transacts business may not be adequate. Changyou must be prepared to increase its security measures and efforts so that its game players have confidence in the reliability of the online payment systems that it uses, which will require Changyou to incur additional expense. Such increased security measures may still not make its online payment systems completely safe. In addition, Changyou does not have control over the security measures of its third-party online payment service vendors. Breaches in the security of online payment systems that Changyou uses could expose it to litigation and liability for failing to secure confidential customer information, and could harm its reputation, ability to attract customers and ability to encourage customers to purchase virtual items.

***Any failure of third-party developers of online games that Changyou licenses from or jointly develops with them to fulfill their obligations under Changyou's license or joint operation agreements with them could have an adverse effect on Changyou's operation of and revenues from those games.***

Changyou derives an increasing portion of its revenues from PC games and mobile games that Changyou licenses from, or jointly develops with, third-party developers. Under its license and joint development agreements for these games, Changyou relies on the third-party developers to provide game updates, enhancements and new versions, provide materials and other assistance in promoting the games and resolving game programming errors and issues with "bots" and other intrusions. Any failure of third-party developers to provide game updates, enhancements and new versions in a timely manner and that are appealing to game players, and provide assistance that enables Changyou to effectively promote the games, or otherwise fulfill their obligations under Changyou's license and joint development agreements could adversely affect the game-playing experience of Changyou's game players, damage its reputation, or shorten the life-spans of those games, any of which could result in the loss of game players, acceleration of Changyou's amortization of the license fees it has paid for those games, or a decrease in or elimination of its revenues from those games.

Furthermore, for games that Changyou licenses from or jointly develops with third parties, Changyou may not have access to the game source codes during the initial period of the license, or at all. Without the source codes, Changyou has to rely on the licensors to provide updates and enhancements, giving it less control over the quality and timeliness of updates and enhancements. If Changyou's game players are not satisfied with the level of services they receive, they may choose to not play the games.

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There are additional risks associated with Changyou's licensing from overseas developers of online games that are successful only in particular overseas markets, because such games may not be successful in the China market and other markets if Changyou is not able to successfully customize the games to adapt to differences in culture and user preferences in the China market and other markets.

***Changyou receives relatively lower profits from the operation of online games that it licenses from or jointly develops with third-party developers.***

Changyou's revenue-sharing arrangements for games that Changyou licenses from or jointly develops with third-party developers provide Changyou with relatively less profit than games that Changyou develops in-house, and in some cases Changyou may not be able to recoup its investments in such games. Moreover, to secure the rights to games from third-party developers, Changyou often must pay up-front fees and also commit to pay additional fees in the future. Similarly, Changyou also has invested in mobile game development studios in order to assure access to an extensive pipeline of mobile games. Changyou often must make such commitments and investments without knowing whether the games Changyou is licensing or jointly developing will be successful and generate sufficient revenues to enable Changyou to recoup its costs or for the games to be profitable.

***Changyou faces significant risks and incurs substantial costs when it licenses its games to, or jointly operates them with, third-party operators, and Changyou faces additional risks and costs when it directly operates its games or licenses its games to, or jointly operates its games with, third-party operators in overseas markets.***

Changyou currently, and expects to continue to, exclusively license to, or jointly operate with, third-party operators some of its games, including an increasing number of its mobile games, in markets that Changyou selects, including overseas markets. Changyou faces significant risks associated with the licensing or joint operation of Changyou's games, including:

- difficulties in identifying appropriate markets;
- difficulties in identifying, negotiating and maintaining good relationships with licensees or joint operators who are knowledgeable about, and can effectively operate Changyou's games in, particular markets;
- difficulties in maintaining Changyou's reputation and the reputation of its games when its games are operated by licensees or joint operators pursuant to their own standards; and
- difficulties in protecting Changyou's intellectual property.

Changyou currently licenses and operates, and expects to continue to expand the licensing and operation of, some of its existing and future games, either directly or jointly with third-party operators, in selected overseas markets. Additional risks associated with the licensing or direct or joint operation of Changyou's games overseas include:

- difficulties and significant costs in protecting Changyou's intellectual property in overseas markets;
- difficulties in retaining and maintaining local management and key development and technical personnel who are experienced and knowledgeable about, and can effectively operate Changyou's games in, particular markets;
- uncertainties relating to Changyou's ability to develop its games and/or expansion packs catering to particular overseas markets;
- uncertainties relating to Changyou's ability to renew its license and joint operation agreements with licensees and joint operators upon their expiration;
- for Changyou's direct operation of its games overseas, interruptions in the operation of the games due to cross-border Internet connections or other system failures;
- significant costs for translation of its games into the local languages of, or customization of its games for, the overseas markets in which Changyou plans to license or jointly operate its games;
- limited choices of third-party Internet platforms to distribute Changyou's mobile games in certain overseas markets;
- significant marketing costs to promote Changyou's games in certain overseas markets where third-party Internet platforms do not include marketing services as part of the revenue-sharing arrangements;
- different game player preferences in certain overseas markets;



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- difficulties and significant costs relating to compliance with the different legal requirements and commercial terms, such as game export regulatory procedures, taxes and other restrictions and expenses, in the overseas markets in which Changyou licenses or directly or jointly operates its games;
- exposure to different regulatory systems governing the protection of intellectual property and the regulation of online games, the Internet and the export of technology;
- costs for compliance with different legal requirements and commercial terms in overseas markets;
- difficulties in verifying revenues generated from Changyou's games by its licensees for purposes of determining royalties payable to Changyou;
- difficulties and delays in contract enforcement and collection of receivables through the use of foreign legal systems;
- changes in the political, regulatory or economic conditions, or public policy, affecting online games in particular foreign countries or regions;
- the risk that regulatory authorities in foreign countries or administrative regions may impose withholding taxes, or place restrictions on repatriation of Changyou's profits; and
- fluctuations in currency exchange rates.

If Changyou is unable to manage these risks and control these costs effectively, its ability to license or operate its games in China or in regions and countries outside of Mainland China, either directly or jointly with third-party joint operators, may be impaired.

### ***Changyou may not be successful in operating and improving its games to satisfy the changing demands of game players.***

Changyou depends on purchases and continual consumption of virtual items by its game players to generate revenues, which in turn depend on the continued attractiveness of its games to the game players and their satisfactory game-playing experience. Various issues could arise that would cause its games to be less attractive to its game players or could limit the continued attractiveness of its games. For example:

- Changyou may fail to provide game updates, expansion packs and other enhancements in a timely manner due to technological or resource limitations, resources or other factors;
- Changyou's game updates, expansion packs and new versions may contain programming errors, and their installation may create other unforeseen issues that adversely affect the game-playing experience;
- Changyou may fail to timely respond and/or resolve complaints from its game players;
- Changyou may fail to eliminate computer "bots" which can disrupt its games' smooth operation and reduce the attractiveness of its games; and
- Changyou's game updates, expansion packs and other enhancements may change rules or other aspects of its games that its game players do not welcome, resulting in a reduction in the active accounts or active paying accounts of its online games.

Changyou's failure to address these issues could adversely affect the game-playing experience of its game players, damage the reputation of its games, shorten the lifespans of its games, and result in the loss of game players and a decrease in its revenues.

### ***Changyou may fail to launch new games according to its timetable, and its new games may not be commercially successful.***

All online games have limited lifespans. Changyou must launch new games that can generate additional revenue and diversify its revenue sources in order to remain competitive. Changyou will not generate any meaningful revenue from a game in development until it is commercially launched after open beta testing, and we cannot assure you that Changyou will be able to meet its timetable for new game launches or that its new games will be successful. A number of factors, including technical difficulties, lack of sufficient game development personnel and other resources, failure to obtain or delays in obtaining relevant governmental authorities' approvals and adverse developments in Changyou's relationships with the licensors or third-party operators of its new games could result in delayed launching of its new games. In addition, we cannot assure you that Changyou's new games will be as well received in the market as TLBB and TLBB 3D have been, and you should not view Changyou's historical game revenues or the success of TLBB and TLBB 3D as indications of the commercial success of any of its new or future games. Changyou may fail to anticipate and adapt to future technical trends, new business models and changed game player preferences and requirements, fail to effectively plan and organize marketing and promotion activities, or fail to differentiate its new games from its existing games. If the new games Changyou introduces are not commercially successful, Changyou may not be able to generate sufficient revenues from new games to sustain or grow its revenues or to recover its product development costs and sales and marketing expenses, which can be significant.

***Changyou generates all of its game revenues under the item-based revenue model, which presents risks related to consumer preferences and regulatory restrictions.***

All of Changyou's games, including PC games and mobile games, are operated under the item-based revenue model. Under this revenue model, Changyou's game players are able to play the games for free, but are charged for the purchase of virtual items in the games. The item-based revenue model requires Changyou to design games that not only attract game players to spend more time playing, but also encourage them to purchase virtual items. The sale of virtual items requires Changyou to track closely consumer tastes and preferences, especially as to in-game consumption patterns. If Changyou fails to design and price virtual items so as to incentivize game players to purchase them, Changyou may not be able to effectively translate its game player base and their playing time into revenues. In addition, the item-based revenue model may cause additional concerns with PRC regulators who have been implementing regulations designed to reduce the amount of time that Chinese youths spend on online games and intended to limit the total amount of virtual currency issued by online game operators and the amount purchased by individual game players. A revenue model that does not charge for time played may be viewed by the PRC regulators as inconsistent with these goals. The item-based revenue model may not continue to be commercially successful and in the future Changyou may need to change its revenue model to a time-based or other revenue model. Any change in revenue model could result in disruption of Changyou's game operations, a decrease in the number of its game players and a decline in its revenues.

***Undetected programming errors or defects in Changyou's games could harm its reputation and adversely affect its results of operations; and breaches in the security of Changyou's server network could cause disruptions in its service, facilitate piracy of its intellectual property, or compromise confidential information of its game players.***

Changyou's games are subject to frequent improvement and updates, and may contain bugs or flaws that may become apparent only after the updated applications are accessed by users, particularly as Changyou launches new updates under tight time constraints. If for any reason programming bugs or flaws are not resolved in a timely fashion, Changyou may lose some of its users and its revenues will be affected negatively, and its reputation and the market acceptance of its games may also be harmed.

Changyou stores on its servers and transmits over the Internet considerable and continually increasing amounts of data, much of which is essential to the operation of its business or is highly confidential information concerning its business and its game players. In addition, the expansion of Changyou's business to include mobile games and its need to comply with PRC regulations requiring real-name registration of its game players are likely to cause the amount of personal data concerning its game players that is transmitted over its networks to increase over time. Any breaches of Changyou's network by hackers could cause severe disruptions in its service, allow piracy of the source code used in the operation of its games and allow pirated versions of its games to enter the marketplace, or result in the release of confidential personal or financial information of its game players, any of which could have an adverse impact on Changyou's business, its revenues, and its reputation among game players. In order to minimize the likelihood of such breaches as Changyou's business expands and the amount of confidential and sensitive data increases, we expect that Changyou will need to expend considerable resources to maintain and enhance the effectiveness of its security systems.

***Rapid technological changes may increase Changyou's game development costs.***

Technological development in online game industry is evolving rapidly, so Changyou needs to anticipate new technologies and evaluate their possible market acceptance. For example, the use of VR technology has become prevalent in the industry, and an increasing number of game players hope to have VR included in online games that they access. Changyou has begun investing, and expects to continue to invest in the future, resources to develop VR technology and online games using VR technology. However, Changyou is not aware of any proven business or monetization model for online games using VR technology, and playing online games with VR technology generally requires devices with particularly high-level technical specifications, which may limit the number of players. If online games using VR technology that Changyou develops and launches are not well received by game players, Changyou may not be able to recoup its related development costs. In addition, government authorities or industry organizations may adopt new technical standards that apply to game development. Any new technologies and new standards may require increases in expenditures for PC game and mobile game development and operations and continuing professional training of Changyou's development and technical personnel, and Changyou will need to adapt its business and prepare its workforce to cope with the changes and support these new services to be successful. If Changyou falls behind in adopting new technologies or standards, its existing games may lose popularity, and its newly developed games may not be well received in the marketplace.

***The proliferation of “cheating” programs and scam offers that seek to exploit Changyou’s games and players harms the game-playing experience and may lead players to stop playing its games.***

Third parties have developed, and may continue to develop, “cheating” programs that enable players to exploit Changyou’s games, play the games in an automated way or obtain unfair advantages over other players who play fairly. These programs harm the experience of players who play fairly and may disrupt the economics of Changyou’s games. In addition, unrelated third parties may attempt to scam Changyou’s players with fake offers for virtual items. Changyou needs to devote significant resources to discover, disable and prevent such programs and activities, and if Changyou is unable to do so quickly its operations may be disrupted, its reputation may be damaged and players may stop playing its games. This may lead to lost revenue and increased costs for Changyou to develop technological measures to combat such programs and activities.

***Game players’ spending on Changyou’s games may be adversely affected by slower growth in the Chinese economy and adverse conditions in the global economy.***

Changyou relies on the spending of its game players, which in turn depends on the players’ level of disposable income, perceived future earnings capabilities and willingness to spend. The real estate market in the PRC and the level of exports from the PRC have both experienced significant declines recently and, according to the National Bureau of Statistics of China, the growth rate of China’s gross domestic product, compared to that of the previous year, went from 7.5% in 2012, to 7.7% in 2013, to 7.4% in 2014, to 6.9% in 2015, and to 6.7% in 2016. Such growth may also slow in the future, which could in turn result in a reduction in spending by Changyou’s game players.

In addition, the global economy has experienced significant instability and there has been volatility in global financial and credit markets in recent years, recent growth in the United States economy may not be sustainable and some analysts are concerned that the European Community may experience a sustained downturn. It is unclear how long such instability and volatility will continue, whether it will increase, whether it will lead to a renewed worldwide economic downturn such as the one that began in 2008, and how much adverse impact such instability and volatility or any such downturn might have on the economies of China and other jurisdictions where Changyou operates its games. Any such instability, volatility or adverse impact in China or in overseas markets could cause Changyou’s game players to reduce their spending on its games in China or overseas and reduce its revenues.

#### ***Risks Related to the Platform Channel Business***

***Notwithstanding Changyou’s significant investment in its platform channel business, Changyou was unable to successfully monetize it beyond the operation of the 17173.com Website, and Changyou was not able to recoup all of its investment. Changyou may have similar adverse experiences with future investments.***

During 2013 and 2014 Changyou made significant investments in acquiring assets and marketing, including both domestic and overseas marketing, and spent considerable sums to increase its staffing levels, with the goal of expanding and promoting its platform channel business beyond the operation of the 17173.com Website. However, Changyou did not generate meaningful revenues from such additions to its platform channel business as its efforts to monetize those products and services were not successful, and does not expect to be able to make its platform channel business apart from the 17173.com Website profitable or to recoup the investments it made in assets, marketing and staffing for the platform channel business. For example, after Changyou’s acquisition of a majority interest in MoboTap, Changyou’s management concluded that the Dolphin Browser operated by MoboTap would not be able to provide expected synergies with Changyou’s platform channel business, and Changyou recognized substantial impairment charges as a result. Also see “Changyou’s previous and any future acquisitions and/or strategic alliances may have an adverse effect on its ability to manage its business and may also result in impairment charges.”

***Online advertising revenues from the 17173.com Website could fail to grow, or could decline further, as a result of the shift from PC games to mobile games in the online game market and uncertainties in the online advertising market.***

Changyou’s online advertising revenues of \$39.4 million for the year ended December 31, 2016, which were mainly derived from the operation of the 17173.com Website, represented 7.6% of Changyou’s total revenues for the year, and represented a decline of \$18.4 million, or 32%, from its online advertising revenues for the year ended December 31, 2015. Changyou’s ability to avoid further declines in, or grow, its online advertising revenues may be adversely affected by any of the following risk factors:

- Changes in government policy could restrict or curtail Changyou’s online advertising services;
- The decline in the demand for online advertising services from developers and operators of PC games, as the relative popularity of such games continues to decline;

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- Advertising clients may adopt new methods and strategies other than online advertising to promote their brands, which would have an adverse impact on Changyou's advertising revenues; and
- The acceptance of the Internet as a medium for advertising depends on the development of a measurement standard. No standards for the measurement of the effectiveness of online advertising have been widely accepted. 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 Changyou's Websites.

In addition, Changyou's 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 development of successful mobile versions of the 17173.com Website and the provision of extensive mobile game-related products and services in response to the rapid migration of users of Internet services from PCs to mobile devices, such as tablets and mobile phones;
- the acceptance of online advertisements, either through PCs or mobile devices, as an effective method of business marketing;
- the effectiveness of Changyou's advertising delivery, tracking and reporting systems;
- the extent of resistance from existing or potential customers to online advertising prices; and
- the development of new formats for online advertising, such as streaming video.

### ***The expansion of Internet advertisement blocking software may result in a decrease in 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 Changyou's revenues from the 17173.com Website because, when an advertisement is blocked, it is not downloaded from the server, which means that it will not be tracked as a delivered advertisement. In addition, advertisers may choose not to advertise on the Internet or on the 17173.com Website because of the use by third parties of Internet advertisement blocking software.

***Changyou relies on advertising agencies to sell online advertising services on the 17173.com Website. If current trends of consolidation of advertising agencies in the Chinese market continue, the bargaining power of the large advertising agencies resulting from such consolidation may permit them to require that Changyou pay higher sales rebates, which would adversely affect Changyou's online advertising revenues.***

Most of the online advertising services of the 17173.com Website are distributed by, and most of the online advertising revenues of the 17173.com Website are derived from, advertising agencies. For example, in 2016 Changyou engaged six advertising agencies, which contributed approximately 98% of the online advertising revenues of the 17173.com Website. In consideration for these agencies' services, Changyou is required to pay certain percentages of revenues as sales rebates. If the online advertising market is consolidated and effectively controlled by a small number of large advertising agencies, such advertising agencies may be in a position to demand higher sales rebates based on increased bargaining power, which could negatively affect Changyou's online advertising growth, as Changyou books its online advertising revenue net of its sales rebates to advertising agencies.

### **Risks Related to the Cinema Advertising Business**

***There are uncertainties regarding the future growth of the cinema advertising industry in China.***

Changyou's cinema advertising business experienced strong growth in 2016 and has benefited from robust growth in China's cinema and movie industry in recent years. If the recent growth in China's cinema and movie industry slows or the industry declines in the future, pre-film advertising slots are likely to become less attractive to advertisers, which would have an adverse effect on Changyou's cinema advertising business. In addition, advertisers are increasingly turning to new advertising formats, such as video streaming, as Internet technology develops. If pre-film advertising becomes less attractive to advertisers than such new formats, Changyou's cinema business will be adversely affected. Moreover, the growth of Changyou's cinema advertising business in recent years placed strain on its management personnel, systems and resources. Changyou may not be able to efficiently or effectively implement its growth strategies and manage the growth of its cinema advertising business, and any failure to do so may limit its future growth and hamper its overall business strategy.

***Changyou may not be able to successfully manage its growth in the highly competitive cinema advertising market.***

Changyou faces intense competition for the acquisition of the rights to and placement of pre-film advertising slots. See “Changyou’s business may not succeed in a highly competitive market.” Changyou may not be able to effectively compete with its competitors in developing, maintaining or expanding the types of cooperative relationships with operators of movie theaters that will permit it to maintain its existing rights or to obtain additional rights to pre-film advertisement slots at reasonable prices, on the one hand, and in attracting advertisers that will place their advertisements in the pre-film advertisement slots that it offers, on the other hand, as Changyou’s competitors may have greater financial resources, greater brand recognition among operators of movie theaters and advertisers and more capable and effective management, sales and marketing forces and strategies than it does, which would have an adverse impact on the prospect for growth of its cinema advertising business.

***Changyou faces risks related to its purchase of pre-film advertising slots.***

In order for Changyou to compete effectively in its desired markets, Changyou must continue to build and maintain a competitive reserve of pre-film advertisement slots in those markets and has incurred, and expects to continue to incur, significant upfront costs to acquire the pre-film advertising rights for such pre-film advertising slots under long-term contracts, typically with one to three year terms, with operators of various movie theaters, which has placed, and will continue to place, constraints on its cash flow. There is a risk that Changyou will lose those upfront acquisition costs, because Changyou is not able to generate corresponding revenues and begin to recoup the costs until it has both entered into contracts with advertisers for the pre-film advertising slots that it has acquired and displayed the advertiser’s advertisements in those slots. Such delay in generating corresponding revenues may also place constraints on the cash flow available to Changyou for maintaining and expanding its cinema advertising business. Moreover, Changyou may be forced to make additional payments to operators of popular movie theaters in certain regional markets that are particularly competitive if the average market prices for pre-film advertisement slots in such markets increase significantly during the contract period and the operators threaten to terminate their contracts with Changyou in order to enter into more profitable contracts with its competitors.

***Changyou may not be able to maintain or expand the revenues that it receives from cinema advertising services.***

Changyou’s cinema advertising business generates revenues through contracts that it enters into with advertisers to place their advertisements in the pre-film advertising slots that Changyou has purchased from operators of movie theaters. If Changyou is unable to sell to advertisers a large enough portion of the pre-film advertising slots, it may not be able to recoup its upfront payments and additional committed payments under the contracts with the operators of the movie theaters. Any failure by Changyou to develop, maintain or expand cooperative relationships with advertisers could cause its cinema advertising revenues to decrease.

***Risks Related to Changyou’s Corporate Structure and Corporate Governance.***

***If the PRC government determines that the VIE structure for operating Changyou’s business does not comply with applicable PRC government restrictions on foreign investment in telecommunication industry, it could face severe penalties.***

Various regulations in China currently restrict foreign-invested entities from engaging in value-added telecommunication services, which are defined by PRC authorities to include operating online games and providing platform channel services. Because of these restrictions, Changyou operates certain aspects of its game business and platform channel business in the PRC through its principal VIEs, which are not owned of record by it and include Beijing Gamease Age Digital Technology Co., Ltd., or Gamease; Beijing Guanyou Gamespace Digital Technology Co., Ltd., or Guanyou Gamespace; Baina (Wuhan) Information Technology Co., Ltd., or Wuhan Baina Information; and Shanghai ICE Information Technology Co., Ltd., or Shanghai ICE, which is a wholly-owned subsidiary of Gamease. Each of the nominee shareholders of Gamease, Guanyou Gamespace and Wuhan Baina Information is either a PRC citizen or a PRC company. Through a series of contractual arrangements, Changyou’s VIEs are effectively controlled by its wholly-owned subsidiaries in China.

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The Ministry of Industry and Information Technology, or MIIT, issued a circular in 2006 that emphasizes restrictions on foreign investment in value-added telecommunications businesses. In addition, a notice jointly issued in 2009 by the State Administration of Press, Publication, Radio, Film and Television, or the SAPPRFT, the National Copyright Administration, and the National Office of Combating Pornography and Illegal Publications states that foreign investors are not permitted to invest in online game operating businesses in China or to exercise control over or participate in the operation of such businesses through indirect means. Due to a lack of interpretative materials from the relevant PRC authorities, there are uncertainties regarding whether PRC authorities would consider Changyou's corporate structure and contractual arrangements to be a kind of foreign investment in value-added telecommunications services or online game operation businesses. While Changyou is not aware of any online game companies that use the same or similar contractual arrangements as Changyou's having been penalized or ordered to terminate operations by PRC authorities claiming that the arrangements constituted foreign investment in value-added telecommunication services or a kind of control over or participation in the operation of online game operating businesses through indirect means, it is unclear whether and how the various regulations of the PRC authorities might be interpreted or implemented in the future.

Further, on January 19, 2015, the Ministry of Commerce, or the MOFCOM, released on its Website for public comment a draft foreign investment law of the PRC, or the Draft FIL, that appears to include VIEs within the scope of entities that could be considered to be foreign invested enterprises, or FIEs, that would be subject to restrictions under existing PRC law on foreign investment in certain categories of industry. Specifically, the Draft FIL introduces the concept of "actual control" for determining whether an entity is considered to be an FIE. In addition to control through direct or indirect ownership or equity, the Draft FIL includes control through contractual arrangements within the definition of "actual control." If the Draft FIL is passed by the People's Congress of the PRC and goes into effect in its current form, these provisions regarding control through contractual arrangements could be construed to reach Changyou's VIE arrangements, and as a result Changyou's VIEs could become explicitly subject to the current restrictions on foreign investment in certain categories of industry. The Draft FIL includes provisions that would exempt from the definition of foreign invested enterprises entities where the ultimate controlling shareholders are either entities organized under PRC law or individuals who are PRC citizens. The Draft FIL does not make clear how "control" would be determined for such purpose, and is silent as to what type of enforcement action might be taken against existing VIEs, such as Changyou's, that operate in restricted industries and are not controlled by entities organized under PRC law or individuals who are PRC citizens.

In addition, under the *Notice of the General Office of the State Council on Establishing the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors*, or Circular No. 6, promulgated by the State Council of the PRC, or the State Council, on February 3, 2011 and the *Rules of Ministry of Commerce on Implementation of Security Review System of Mergers and Acquisitions of Domestic Enterprises by Foreign Investors*, or the MOFCOM Security Review Rules, promulgated by the MOFCOM in August, 2011 to implement Circular No. 6, a security review is required for mergers and acquisitions by foreign investors having "national defense and security" concerns and mergers and acquisitions by which foreign investors may acquire "de facto control" of domestic enterprises with "national security" concerns and prohibit foreign investors from bypassing the security review requirement by structuring transactions through proxies, trusts, indirect investments, leases, loans, control through contractual arrangements or offshore transactions. As there is no explicit provision or official interpretation stating that the business of MoboTap falls into the scope subject to security review, Changyou did not submit for security review its acquisition of a majority interest in MoboTap. However, these national security review-related regulations are relatively new and there is a lack of clear statutory interpretation regarding the implementation of the rules, and PRC authorities may interpret these regulations to mean that the transaction should have been submitted for review. For a discussion of these PRC national security review requirements and media reports, see "Specific Regulations - Miscellaneous - Regulation of M&A and Overseas Listings".

If Changyou was found to be in violation of any existing or future PRC law or regulations relating to foreign ownership of value-added telecommunications businesses, including the Draft FIL if it becomes effective, and security reviews of foreign investments in such businesses, including online games businesses, regulatory authorities with jurisdiction over the operation of Changyou's business would have broad discretion in dealing with such a violation, including levying fines, confiscating Changyou's income, revoking the business or operating licenses of PRC subsidiaries and/or VIEs, requiring it to restructure its ownership structure or operations, requiring it to discontinue or divest ourselves of all or any portion of its operations or assets, restricting its right to collect revenues, blocking its Websites, or imposing additional conditions or requirements with which it may not be able to comply. Any of these actions could cause significant disruption to Changyou's business operations and have an adverse impact on its business, financial condition and results of operations. Further, if changes were required to be made to its ownership structure, Changyou's ability to consolidate its VIEs could be adversely affected.



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For a detailed discussion of PRC regulations, notices and circulars with respect to such restrictions, see “PRC Regulation—Regulation of Value-Added Telecommunication Services,” “PRC Regulation—Regulation of Foreign Direct Investment in Value-Added Telecommunications Companies,” and “PRC Regulation—Regulation of Online Games Services” and “PRC Regulation—Regulation of the Provision of Internet Content— Online Cultural Products”.

***Changyou’s contractual arrangements with its VIEs and their shareholders may not be as effective in providing control over Changyou’s VIEs as direct ownership of the VIEs and the shareholders of its VIEs may have conflicts of interest with it or with each other.***

Changyou has no ownership interest in its principal VIEs Gamease, Guanyou Gamespace, Shanghai ICE, and Wuhan Baina Information and it conducts most of its operations and generates substantially all of its revenues through contractual arrangements that its indirect subsidiaries Beijing AmazGame Age Internet Technology Co., Ltd., or AmazGame, Beijing Changyou Gamespace Software Technology Co., Ltd., or Gamespace, and Baina Zhiyuan (Beijing) Technology Co., Ltd., or Beijing Baina Technology, entered into with Gamease, Guanyou Gamespace, and Wuhan Baina Information, respectively, and their shareholders. Such contractual arrangements are designed to provide Changyou with effective control over Gamease, Guanyou Gamespace, Shanghai ICE and Wuhan Baina Information. Changyou depends on Gamease, Guanyou Gamespace, Shanghai ICE and Wuhan Baina Information, directly or through their subsidiaries, to hold and maintain certain licenses and permits necessary and material for its online game business and for its operation of the 17173.com Website and the Dolphin Browser. Gamease, Guanyou Gamespace, Shanghai ICE, and Wuhan Baina Information, directly or through their subsidiaries, collectively own all of the key necessary intellectual property, facilities and other assets relating to the operation of Changyou’s online games, the 17173.com Website and the Dolphin Browser that are not owned directly by its subsidiaries, and employ personnel for the operation and distribution of its online games, the 17173.com Website and the Dolphin Browser that are not employed directly by its subsidiaries.

These contractual arrangements may not be as effective in providing Changyou with control over Gamease, Guanyou Gamespace, Shanghai ICE and Wuhan Baina Information as direct ownership. For example, if Changyou had direct ownership of Gamease, Guanyou Gamespace, Shanghai ICE and Wuhan Baina Information, it would be able to exercise its rights as a shareholder to effect changes in their boards of directors, which in turn could effect changes at the management level. Due to Changyou’s VIE structure, it has to rely on contractual rights to effect control and management of Gamease, Guanyou Gamespace, Shanghai ICE and Wuhan Baina Information, which exposes it to the risk of potential breach of contract by the shareholders of Gamease, Guanyou Gamespace and Wuhan Baina Information. In addition, as each of Gamease, Guanyou Gamespace and Wuhan Baina Information is owned by its respective shareholders, it may be difficult for Changyou to change its corporate structure if such shareholders refuse to cooperate with it. Furthermore, if the shareholders of any of Changyou’s principal VIEs were involved in proceedings that had an adverse impact on their shareholder interests in such VIE or on Changyou’s ability to enforce relevant contracts related to the VIE structure, its business would be adversely affected.

The shareholders of Gamease, Guanyou Gamespace and Wuhan Baina Information may breach, or cause Gamease, Guanyou Gamespace or Wuhan Baina Information to breach, the VIE contracts for a number of reasons. For example, their interests as shareholders of these companies and the interests of Changyou may conflict and it may fail to resolve such conflicts; the shareholders may believe that breaching the contracts will lead to greater economic benefit for them; or the shareholders may otherwise act in bad faith. If any of the foregoing were to happen, Changyou might have to rely on legal or arbitral proceedings to enforce its contractual rights. In addition, disputes may arise among the shareholders of any of Changyou’s principal VIEs with respect to their ownership of such VIE which could lead them to breach their agreements with it. Such arbitral and legal proceedings and disputes may cost Changyou substantial financial and other resources, and result in disruption of its business, and the outcome might not be in Changyou’s favor. For example, a PRC court or arbitration panel could conclude that Changyou’s VIE contracts violate PRC law or are otherwise unenforceable. If the contractual arrangements with any of Changyou’s principal VIEs were found by PRC authorities with appropriate jurisdiction to be unenforceable, Changyou could lose its ability to consolidate such VIE’s results of operations, assets and liabilities in its consolidated financial statements and/or to transfer the revenues of such VIE to its corresponding PRC subsidiary. In addition, such a finding of unenforceability by PRC authorities could cause more than 75% of its gross income or more than 50% of its assets to be passive in the year that this finding was made or in subsequent years, which, in a given year during which Changyou otherwise did not expect to be classified as a passive foreign investment company, or PFIC, for United States federal income tax purposes, could cause Changyou to be classified as a PFIC.



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Under the contractual arrangements with Changyou's principal VIEs and their shareholders, no shareholder or group of shareholders of any of its principal VIEs has the ability to unilaterally terminate any of the agreements between the VIEs in which they hold shares and its corresponding PRC subsidiary. However, (i) the shareholders of Gamease and Guanyou Gamespace have a termination right under the loan agreements if Changyou's corresponding PRC subsidiary engages in gross negligence, fraud or other material illegal actions or if its corresponding PRC subsidiary's existence is terminated as a result of bankruptcy, dissolution, or legal process by government authorities and (ii) the shareholders of Changyou's principal VIEs, other than Wuhan Baina Information, have a termination right under the equity purchase right agreements if the corresponding VIE's existence is terminated as a result of bankruptcy, dissolution, or legal process by government authorities.

In addition, as all of these contractual arrangements are governed by PRC law and provide for the resolution of disputes through either arbitration or litigation in the PRC, they would be interpreted in accordance with PRC law and any disputes would be resolved in accordance with PRC legal procedures. Changyou would have to rely for enforcement on legal remedies under PRC law, including specific performance, injunctive relief or damages, which might not be effective. For example, if Changyou sought to enforce the equity interest purchase right agreements for the transfer of equity interests in any of its principal VIEs, if the transferee was a foreign company the transfer would be subject to approval by governmental authorities such as the MIIT and the MOFCOM, and the transferee would be required to comply with various requirements, including qualification and maximum foreign shareholding percentage requirements. As these governmental authorities have wide discretion in granting such approvals, Changyou could fail to obtain such approval. In addition, Changyou's VIE contracts might not be enforceable in China if PRC governmental authorities or courts or arbitral tribunals took the view that such contracts contravened PRC law or were otherwise not enforceable for public policy reasons.

Furthermore, the legal environment in the PRC is not as developed as in other jurisdictions, such as the United States. As a result, uncertainties in the PRC legal system could further limit Changyou's ability to enforce these contractual arrangements. In the event Changyou was unable to enforce these contractual arrangements, it would not be able to exert effective control over Gamease, Guanyou Gamespace, Shanghai ICE and Wuhan Baina Information, and its ability to conduct its business, and its financial condition and results of operations, would be severely adversely affected.

### ***Changyou's contractual arrangements with its principal VIEs may result in adverse tax consequences to it.***

Under PRC law and regulations, arrangements and transactions among related parties may be subject to audit or challenge by PRC tax authorities. Changyou could face adverse tax consequences if PRC tax authorities determined that its contractual arrangements with any of Gamease, Guanyou Gamespace or Wuhan Baina Information were not made on an arm's length basis and such PRC tax authorities adjusted Changyou's income and expenses for PRC tax purposes in the form of a transfer pricing adjustment. A transfer pricing adjustment could result in a reduction, for PRC tax purposes, of adjustments recorded by any of its principal VIEs, which could adversely affect Changyou by (i) increasing the tax liability of such VIE without reducing the tax liability of Changyou's corresponding PRC subsidiary, which could further result in interest and penalties being levied on Changyou for underpaid taxes or (ii) limiting such VIE's ability to maintain preferential tax treatments and other financial incentives. In addition, if for any reason Changyou needed to cause the transfer of any of the shareholders' shares in any of its VIEs to a different nominee shareholder (such as if, for example, one of such shareholders is no longer employed by it), Changyou might be required to pay individual income tax, on behalf of the transferring shareholder, on any gain deemed to have been realized by such shareholder on such transfer.

### ***Changyou may lose the ability to use and enjoy assets held by any of its principal VIEs that are important to the operation of its business if such VIE declares bankruptcy or becomes subject to a dissolution or liquidation proceeding.***

Each of Changyou's VIEs holds assets that are critical to Changyou's business operations, such as its core intellectual property, licenses and permits, and/or joint operation agreements relating to its games and game operations. Although the equity interest purchase right agreements among Changyou's wholly foreign-owned entities, or WFOEs, its VIEs and the shareholders of its VIEs contain terms that specifically obligate the shareholders of its VIEs to ensure the valid existence of its VIEs, in the event the shareholders breached this obligation and voluntarily liquidated Changyou's VIEs, or if any of Changyou's VIEs declared bankruptcy and all or part of such VIE's assets became subject to liens or rights of third-party creditors, Changyou might be unable to continue some or all of its business operations. Furthermore, if any of Changyou's VIEs were to undergo a voluntary or involuntary liquidation proceeding, such VIE's shareholders or unrelated third-party creditors might claim rights to some or all of such VIE's assets and their rights could be senior to Changyou's rights under the VIE contracts, thereby hindering Changyou's ability to operate its business.

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***Nearly all of Changyou's revenues are generated through its principal VIEs Gamease, Guanyou Gamespace, Shanghai ICE and Wuhan Baina Information, and Changyou relies on payments made by these entities to its subsidiaries AmazGame, Gamespace and Beijing Baina Technology, respectively, pursuant to contractual arrangements requiring the transfer of any such revenues to these subsidiaries. Any restriction on such payments and any increase in the amount of PRC taxes applicable to such payments may adversely affect Changyou's business and its ability to pay dividends to its shareholders, including us.***

Changyou conducts nearly all of its operations through its principal VIEs Gamease, Guanyou Gamespace, Shanghai ICE and Wuhan Baina Information, which generate nearly all of its revenues. As Changyou's VIEs are not owned by its subsidiaries, they are not able to make dividend payments to Changyou's subsidiaries. Instead, Changyou's China subsidiaries AmazGame, Gamespace and Beijing Baina Technology are parties to a number of contracts with their corresponding VIEs, pursuant to which the VIE pays the PRC subsidiary for certain services that the PRC subsidiary provides to the VIE. However, depending on the nature of services provided, certain of these payments are subject to PRC taxes, including value-added tax, or VAT, which effectively reduce the amount that Changyou receives from the VIEs. The PRC government might impose restrictions on such payments or change the tax rates applicable to such payments. Any such restrictions on such payment or increases in the applicable tax rates could limit Changyou's ability to receive payments from the VIEs or limit the amount of such payments, and could in turn adversely affect its business, its net income and its ability to pay dividends to its shareholders, including us.

### ***Risks Related to Doing Business in China***

***Adverse changes in political and economic policies of the PRC government could have a material and adverse effect on the overall economic growth of China, which could reduce the demand for Changyou's products.***

Most of Changyou's business operations are conducted in China and most of its revenues are generated in China. Accordingly, its business, financial condition, results of operations and prospects are affected significantly by economic, political and legal developments in China. The Chinese economy differs from the economies of most developed countries in many respects, including the amount of government involvement, the level of development, the growth rate, the control of foreign exchange, and the allocation of resources.

While the Chinese economy has grown significantly in the past 35 years, the growth has been uneven geographically among various sectors of the economy, and during different periods. The Chinese economy may not continue to grow, and if there is growth, such growth may not be steady and uniform; if there is a slowdown, such a slowdown may have a negative effect on Changyou's business. The Chinese economy experienced high inflation in 2010 and 2011, and to curb the accelerating inflation the PBOC, China's central bank, raised benchmark interest rates three times in 2011. Partly as a result of these measures, the real estate market in the PRC experienced significant declines in those years. The level of exports from the PRC also declined significantly recently. According to the National Bureau of Statistics of China, the growth rate of China's gross domestic product, compared to that of the same period in the previous year, slowed from 7.5% in 2012, to 7.7% in 2013, to 7.4% in 2014, to 6.9% in 2015, and to 6.7% in 2016. Various macroeconomic measures and monetary policies adopted by the PRC government to guide economic growth and manage inflation and the allocation of resources may not be effective in sustaining the growth rate of the Chinese economy. In addition, such measures, even if they benefit the overall Chinese economy in the long run, may have an adverse effect on Changyou if they reduce the disposable income of its game players or if they cause its advertising clients to reduce their spending for Changyou's online advertising services on the 17173.com Website.

***Uncertainties with respect to the Chinese legal system could have a material adverse effect on it.***

Changyou conducts most of its operations in China through its principal PRC WFOEs AmazGame, Gamespace and Beijing Baina Technology, and its principal VIEs Gamease, Guanyou Gamespace, Shanghai ICE and Wuhan Baina Information. Changyou's PRC subsidiaries are generally subject to laws and regulations applicable to foreign investment in China and, in particular, laws applicable to WFOEs. Changyou's VIEs are generally subject to laws applicable to domestic companies in China. The PRC legal system is based on written statutes and regulations. Prior court decisions may be cited for reference but have limited precedential value. The PRC legal system continues to rapidly evolve, the interpretations of laws and regulations are not always uniform and enforcement of laws and regulations involves uncertainties. We cannot predict the effect of future developments in the PRC legal system, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, the preemption of local regulations by national laws, or the overturning of a local government's decisions by a higher level of government. These uncertainties may limit legal protections available to it. In addition, any litigation in China may be protracted and result in substantial costs and diversion of resources and management attention. For example, on December 1, 2016, the MOC issued a Notice of Ministry of Culture on Regulating Online Game Operation Strengthening Interim and Ex-post Supervision, or the Online Game Operation Notice, effective on May 1, 2017, which stipulates that game operators are prohibited from providing lucky draws or lotteries that are conducted on the condition that participants contribute cash or virtual currencies in exchange for virtual items and services; must timely publish the name, properties, description, amount and probability of winning for such lucky draws or lotteries on either the Website of the game or the Web page on which such lucky draws or lotteries are provided; and must require online game users to register their accounts using their real names, supported by valid identification. In order to comply with these requirements of the Online Game Operation Notice, Changyou will be required to spend more financial and human resources in designing new game content for lucky draws or lotteries and developing real-name registration and verification and data tracking, recording and publishing systems. These requirements in general, and the real-name registration requirement in particular, may cause a decrease in Changyou's game players.

***If Changyou is found to be in violation of current or future PRC law and regulations regarding Internet-related services and telecom-related activities, it could be subject to severe penalties.***

The PRC government has enacted regulations that apply to Internet-related services and telecom-related activities, and purport to limit and require licensing of various aspects of the provision of Internet information and content, online games, and online advertising services.

Under regulations issued by the Ministry of Culture, or MOC, commercial entities are required to apply to a local branch of the MOC for an Online Culture Operating Permit if they engage in the production, duplication, importation, release or broadcasting of Internet cultural products; the dissemination of online cultural products on the Internet or the transmission of such products via Internet or mobile phone networks to user terminals such as computers, phones, television sets and gaming consoles; the provision of Internet surfing service sites such as Internet cafés; or the holding or exhibition of contests related to Internet cultural products.

Many aspects of the existing regulations remain unclear. In addition, the PRC government may promulgate new laws or regulations at any time. If current or future laws or regulations regarding Internet-related activities are interpreted to be inconsistent with its ownership structure and/or its business operations, Changyou's business could be severely impaired and it could be subject to severe penalties.

***The SAPPRFT's, the MOC's, and other PRC authorities' regulatory supervision of the online game industry may adversely affect Changyou's online game operations.***

The SAPPRFT has issued a series of regulations affecting the online game industry and providing guidance regarding online game operations. The SAPPRFT issued a notice in September 2009 stating that the SAPPRFT would be the only governmental agency with the authority to review and approve online games, including reviewing and approving the importation of online games from offshore copyright owners, and that all online game operators must obtain an Internet publishing license in order to operate online games and related services and obtain additional pre-approval from the SAPPRFT to make any changes to, or any new versions or expansion packs of, the originally approved online games. On May 24, 2016, the SAPPRFT issued a *Notice of the SAPPRFT on Administration of Mobile Game Publishing Services*, or the Mobile Game Notice, which became effective on July 1, 2016. The Mobile Game Notice provides that the content of mobile games is subject to review, and that mobile game publishers and operators must apply for publishing and authorization codes for the games. Under the Mobile Game Notice, significant upgrades and expansion packs for mobile games that have previously been approved for publishing may be regarded as new works, and the operators will be required to obtain approval for such upgrades and expansion packs before they are released. In the event of any failure to meet these license and approval requirements, an operator may face heavy penalties, such as being ordered to stop operation, or having its business license revoked. Changyou's online game business may be adversely affected by these SAPPRFT notices, as the launch of online games, new versions, expansion packs and imported games might be delayed because of the approval required. Such delays may result in higher costs for Changyou's online game operation and have an adverse effect on its game revenue.

The MOC also has issued regulations affecting the online game industry. For example, on June 3, 2010, the MOC issued the Interim Measures for Online Games Administration, or the Online Game Measures, which became effective on August 1, 2010. The Online Game Measures stipulate that the MOC has the power to review the content of all online games except online game publications that have been pre-approved by the SAPPRFT. However, the Online Game Measures do not clearly specify what constitutes "online game publication." Furthermore, the Online Game Measures provide that all domestic online games must be filed with the MOC, while all imported online games are subject to a content review prior to their launch. If a substantial change (for example, any significant modification to a game's storyline, language, tasks, or trading system) is made to an existing imported or domestic online game, it will be subject to a new content review. Changyou's online game business may be adversely affected by the Online Game Measures. The Online Game Measures do not set forth any specific procedure for the required filing and content review procedures for online games and therefore may cause delay when Changyou tries to file or apply for content review with the MOC. For Changyou's imported licensed games, the requirement for pre-approval by the MOC of any substantial change in Changyou's games may cause delay in releasing its expansion packs of the games, which may result in higher costs for its online game operations and have an adverse effect on its game revenues. In addition, the Online Game Measures do not resolve certain inconsistencies and ambiguities resulting from pronouncements included in previous notices issued by the SAPPRFT and the MOC.

Because there is ambiguity in the scope of the authority and the roles and responsibilities of governmental departments, such as the SAPPRFT and the MOC, with oversight of the online game industry, Changyou may face stricter scrutiny of the day-to-day operations of its online game business. If any of its online game operating entities cannot comply with any of the stipulations of any PRC governmental department regarding the online game industry, Changyou may be subject to various penalties and its online game business may be adversely affected.

***PRC law and regulations governing the online game industry in China are evolving and subject to future changes. Changyou may fail to obtain or maintain all applicable permits, approvals, registrations and filings.***

The online game industry in China is highly regulated by the PRC government. Various regulatory authorities of the PRC central government, such as the State Council, the MIIT, the SAPPRFT, the MOC and the Ministry of Public Security, or the MPS, have the power to issue and implement regulations governing various aspects of the online game industry.

Changyou is required to obtain applicable permits, approvals and registrations from, and make necessary filings with, different regulatory authorities in order to operate its online games. For example, as an online game operator in China, Changyou must obtain an ICP license from the MIIT, an Online Cultural Operating Permit from the MOC and an Internet publishing license from the SAPPRFT in order to distribute games through the Internet. Any online game Changyou operates needs to be approved by the SAPPRFT prior to its launch and filed with the MOC within 30 days after its launch. Once a new online game or any upgrade, expansion pack or new version of any existing game is launched, such new game or such upgrade, expansion pack or new version must be filed with the MOC and approval must be obtained from the SAPPRFT for online publication. If Changyou fails to maintain any of its permits, approvals or registrations, to make any necessary filings, or to apply for and obtain any new permits, approvals or registrations or make any new filings on a timely basis, Changyou may be subject to various penalties, including fines and a requirement that it discontinues or limits its operations.

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As the online game industry is at an early stage of development in China, new law and regulations may be adopted from time to time to require additional licenses and permits other than those Changyou currently has, and address new issues that arise. In addition, substantial uncertainties exist regarding the interpretation and implementation of current and any future PRC law and regulations applicable to the online game industry. Furthermore, as mobile games are a relatively new type of online game, there are uncertainties relating to whether a game developer, such as Changyou, which provides mobile games to mobile device users, needs to obtain a separate operating license in addition to the ICP license that it has already obtained. For any mobile games Changyou launches, Changyou may be required to apply for a separate operating license for the mobile applications. Therefore, it may not be able to obtain timely, or at all, required licenses or any other new license required in the future, and it may be found to be in violation of current or future PRC law and regulations, which could impede its ability to conduct business.

***Changyou operates some of its existing games, and plans to operate certain of its future games, with Internet authorization codes that it obtained through third-party electronic publishing entities. If the SAPPRFT challenges the commercial operation of any of Changyou's games that are operated with Internet authorization codes obtained through third-party publishing entities, Changyou may be subject to various penalties, including restrictions on its operations.***

Under regulations issued by the SAPPRFT and the MIIT, online game operators are required to have an Internet publishing license, and an authorization code obtained under such a license is required for each game in operation and publicly available in the PRC. Changyou publishes certain of its existing games with authorization codes obtained under Internet publishing licenses held by third parties. See “PRC Regulation—Regulation of Online Games Services” and “PRC Regulation—Regulation of the Provision of Internet Content— Online Cultural Products.” Current PRC regulations are not clear as to the consequence of obtaining authorization codes through the licenses of third-party entities. Changyou's past and expected future practices might be challenged by the SAPPRFT, which could subject Changyou to various penalties, including fines, confiscation of publishing equipment and the revenues generated from the publishing activities, the revocation of its business license, or the forced discontinuation of or restrictions on its operations.

***Restrictions on virtual currency may adversely affect Changyou's online game revenues.***

Changyou's online game revenues are collected through the online sale of game points and sale of its prepaid cards, which are considered to be “virtual currency” as such term is defined in the *Notice on Strengthening the Administration of Online Game Virtual Currency*, or the Virtual Currency Notice, which was jointly issued by the MOC and the MOFCOM in 2009. PRC laws and regulations, including the Virtual Currency Notice, provide various restrictions on virtual currency and impose various requirements and obligations on online game operators with respect to the virtual currency used in their games, including that (i) the total amount of virtual currency issued by online game operators and the amount purchased by individual users in the PRC is subject to limits, and online game operators are required to report the total amount of their issued virtual currency on a quarterly basis and are prohibited from issuing disproportionate amounts of virtual currency in order to generate revenues; (ii) virtual currency may only be provided to users in exchange for payment in RMB and may only be used to pay for virtual goods and services of the issuer of the currency, and online game operators are required to keep transaction data records for no less than 180 days; (iii) online game operators are prohibited from providing lucky draws or lotteries that are conducted on the condition that participants contribute cash or virtual currency in exchange for game props or virtual currencies; (iv) online game operators are prohibited from providing virtual currency trading services to minors; and (v) companies involved with virtual currency in the PRC must be either issuers or trading platforms, and may not operate simultaneously as issuers and as trading platforms. On December 1, 2016, the MOC issued the Online Game Operation Notice, which will become effective on May 1, 2017. The Online Game Operation Notice stipulates that online game operators generally may not allow online game virtual currency to be exchanged for real currency or physical items. Changyou must tailor its business model carefully, including designing and operating its databases to maintain users' information for the minimum required period, in order to comply with the requirements of current PRC laws and regulations, including the Virtual Currency Notice and the Online Game Operation Notice, in a manner that in many cases can be expected to result in relatively lower sales of its game coins and an adverse impact on its online game revenues.

***Changyou's business may be adversely affected by public opinion and governmental policies in China as well as in other jurisdictions where it operates its online games or licenses its online games to third parties.***

Currently, most of Changyou's game players in China are young males, many of whom are students. Due to relatively easy access to personal computers and Internet cafés, the increasing use and popularity of mobile devices such as smart phones and tablets connected to the Internet, and the lack of other appealing forms of entertainment in China, many teenagers in China frequently play online games. This may result in these teenagers spending less time on or refraining from other activities, including education, vocational training, sports, and resting, which could result in adverse public reaction and stricter government regulation. For example, the PRC government has promulgated anti-fatigue-related regulations to limit the amount of time minors can play online games.

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Adverse public opinion could discourage game players from playing Changyou's games, and could result in government regulations that impose additional limitations on the operations of online games as well as game players' access to online games. For example, under the Monitor System Circular online game operators are required to adopt various measures to maintain a system to communicate with the parents of minors playing online games and are required to monitor the activities of minors and suspend the accounts of minors if so requested by their parents. We believe that stricter government regulations, such as regulations imposing stricter age and hour limits, limiting the issuance of virtual currency by online game operators or the amount of virtual currency that can be purchased by an individual game player, and extending anti-fatigue-related regulations to adults, could be implemented in the future. Any such adverse public opinion or tightened government regulations could adversely affect Changyou's ability to maintain or increase its revenues.

In addition, the PRC State Administration of Taxation, or the SAT, has announced that it will tax game players on the income derived from the trading of virtual currencies at the rate of 20%. It is currently unclear how the tax will be collected or if there will be any effect on Changyou's game players or its business, but collection of such a tax might discourage players who are interested in trading virtual currencies from playing its games, which could reduce its revenues.

Moreover, similar adverse public reaction may arise, and similar government policies may be adopted, in other jurisdictions where Changyou licenses or operates its games, which could similarly adversely affect its revenues.

### ***Regulation and censorship of information disseminated over the Internet in China may adversely affect Changyou's business, and Changyou may be liable for information displayed on, retrieved from or linked to its Websites.***

The PRC government has adopted regulations governing Internet access and the distribution of news and other information over the Internet. Under these regulations, Internet content providers and Internet publishers are prohibited from posting or displaying over the Internet any content that, among other things, violates PRC law and regulations, impairs the national dignity of China, or is obscene, superstitious, fraudulent or defamatory. When Internet content providers and Internet publishers, including online game operators, find that information falling within the above scope is transmitted on their Websites or is stored in their electronic bulletin service systems, they are required to terminate the transmission of such information or delete such information immediately, keep records, and report to relevant authorities. Failure to comply with these requirements could result in the revocation of Changyou's ICP license and other required licenses and the closure of its Websites. Internet content providers may also be held liable for prohibited information displayed on, retrieved from or linked to their Websites.

In addition, the MIIT has published regulations that subject Internet content providers to potential liability for the actions of game players and others using their Websites, including liability for violations of PRC law prohibiting the dissemination of content deemed to be socially destabilizing. As these regulations are subject to interpretation by the relevant authorities, it is not possible for Changyou to determine in all cases the type of content that could result in liability for it as a developer and operator of online games, and as an operator of the 17173.com Website and the Dolphin Browser. In addition, Changyou may not be able to control or restrict the content of other Internet content providers linked to or accessible through its Websites, or content generated or placed on its Websites by its game players, despite its attempt to monitor such content. To the extent that regulatory authorities find any portion of its content objectionable, they may require Changyou to curtail its games, which may reduce its game player base, the amount of time its games are played or the purchases of virtual items.

### ***Changyou may be subject to the PRC government's ongoing crackdown on Internet pornographic content.***

The PRC government has stringent restrictions on online pornographic information and has launched several crackdowns on Internet pornography. Regulations jointly issued by the MIIT and three other government authorities jointly provide for rewards of up to RMB10,000 to Internet users who report Websites that feature pornography, and the MIIT established a committee to review such reports to determine an appropriate award. Changyou has not, to date, received any penalty from the PRC government in this regard. However, it is possible that content considered pornographic or vulgar by PRC government agencies will appear in the future on Websites or games that it operates. In the event that Changyou is accused by the PRC government of hosting pornographic or vulgar content, its business and reputation could be adversely affected.



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

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

***Changyou's online game operations may be adversely affected by implementation of anti-fatigue-related regulations.***

The PRC government may decide to adopt more stringent policies to monitor the online game industry as a result of adverse public reaction to perceived addiction to online games, particularly by minors. Eight PRC government authorities, including the SAPPRFT, the Ministry of Education and the MIIT, jointly issued regulations, or the Anti-Fatigue Notice, requiring all Chinese online game operators to adopt an "anti-fatigue system" in an effort to curb addiction to online games by minors. Under the anti-fatigue system, three hours or less of continuous play is defined to be "healthy," three to five hours is defined to be "fatiguing," and five hours or more is defined to be "unhealthy." Game operators are required to reduce the value of game benefits for minor game players by half when those game players reach the "fatiguing" level, and to zero when they reach the "unhealthy" level. In addition, online game players in China are now required to register their identity card numbers before they can play an online game. This system allows game operators to identify which game players are minors. These restrictions could limit Changyou's ability to increase its business among minors. If these restrictions were expanded to apply to adult game players in the future, Changyou's revenues could be adversely affected.

These eight PRC government authorities subsequently promulgated additional regulations, including a *Notice on Initializing the verification of Real-name Registration for Anti-Fatigue System on Internet Games*, or the Real-name Registration Notice, to strengthen the implementation of the anti-fatigue system and real-name registration. The Real-name Registration Notice's main focus is to prevent minors from using an adult's identity to play Internet games and, accordingly, provides stringent punishment for online game operators for not implementing the anti-fatigue and real name registration measures properly and effectively. The most severe punishment contemplated by the Real-name Registration Notice is termination of the operation of the online game if it is found to be in violation of the Anti-Fatigue Notice, the Real-name Registration Notice or the circular entitled *Implementation of Online Game Monitor System of the Guardians of Minors*, or the Monitor System Circular. The Real-name Registration Notice increases Changyou's operating risks, as it will be required to spend more resources on the real-name verification and anti-fatigue system, which will lead to an increase in its operating costs. In addition, the amount of time that minors will be able to spend playing online games such as Changyou's will be further limited, which can be expected to lead to a reduction in its revenues. Furthermore, if it is found to be violating these regulations, Changyou may be required to suspend or discontinue its online game operations.

In February 2013, 15 PRC government authorities, including the SAPPRFT, the Ministry of Education, the MOC and the MIIT, jointly issued the *Work Plan for the Integrated Prevention of Minors Online Game Addiction*, or the Work Plan, implementing integrated measures by different authorities to prevent minors from being addicted to online games. Under the Work Plan, the current relevant regulations will be further clarified and additional implementation rules will be issued by relevant authorities. As a result, Changyou may have to impose more stringent limits for minor game players, which may lead to an increase in its operating expenses and a reduction in its revenues from minor game players.

In July 2014, the SAPPRFT issued the *Notice on Further Launch Verification of Real-name Registration for Anti-Fatigue System on Internet Games*, stating that, in view of some of the hardware and functionality limitations inherent in mobile devices, anti-fatigue system requirements applicable to Internet games do not currently apply to mobile games. If the SAPPRFT in the future decides to expand the anti-fatigue system requirements to mobile games, Changyou's operating expenses would be likely to increase.



***Contract drafting, interpretation and enforcement in China involve significant uncertainty.***

Changyou has entered into numerous contracts governed by PRC law, many of which are material to its business. As compared with contracts in the United States, contracts governed by PRC law tend to contain less detail and are not as comprehensive in defining contracting parties' rights and obligations. As a result, contracts in China are more vulnerable to disputes and legal challenges. In addition, contract interpretation and enforcement in China are not as developed as in the United States, and the result of any contract dispute is subject to significant uncertainties. Therefore, Changyou may be subject to disputes under its contracts, and if such disputes arise, it may not prevail. Due to the materiality of certain contracts to Changyou's business, such as its license agreements with Louis Cha regarding its rights to develop and operate TLBB, any dispute involving such contracts, even if without merit, may adversely affect Changyou's reputation and its business operations.

***SAFE Rules and regulations may limit Changyou's ability to transfer funds it holds overseas to its subsidiaries and VIEs in the PRC, which may adversely affect its business.***

On March 30, 2015, SAFE promulgated the *Notice of the State Administration of Foreign Exchange on Reforming the Administration of Foreign Exchange Settlement of Registered Capital of Foreign-invested Enterprises*, or Circular 19, which allows foreign-invested enterprises generally to decide when to exchange into RMB their foreign exchange denominated paid-in capital, but only up to a maximum percentage specified by SAFE. The maximum percentage specified by SAFE is currently 100%, but SAFE may choose to adjust the permitted level at any time. The use of any such RMB funds by foreign-invested enterprises is also subject to review and approval by SAFE or local SAFE branches or designated banks. Circular 19 further provides that any such RMB funds of a foreign-invested enterprise may not be used for any purpose outside of the entity's business scope or if such use would violate the laws and regulations of the PRC. For example, such RMB funds may not be used for the making of RMB-denominated entrusted loans that are not within the enterprise's business scope, for the repayment of inter-enterprise loans (including third party advances), or for the purpose of relending to third parties RMB-denominated bank loans made to the enterprise. Circular 19 may limit Changyou's ability to transfer foreign exchange-denominated funds that it holds overseas to its subsidiaries and VIEs in the PRC, which may adversely affect its business.

***PRC law establishes complex procedures for some acquisitions of Chinese companies by foreign investors, which could make it more difficult for Changyou to make acquisitions in China.***

Applicable PRC law and regulations, such as the *Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (the "M&A Rules"), which became effective on September 8, 2006 and were amended on June 22, 2009, the Anti-Monopoly Law, which became effective on August 1, 2008, the *Notice on Establishing the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors*, or Circular 6, promulgated by the General Office of the State Council and the MOFCOM Security Review Rules, mandate procedures and requirements, including requirements in some instances that the MOFCOM be notified in advance of any change-of-control transaction in which a foreign investor takes control of a PRC domestic enterprise, or that approval from the MOFCOM be obtained in circumstances where overseas companies established or controlled by PRC enterprises or residents acquire affiliated domestic companies, that can be expected to make merger and acquisition activities in China by foreign investors time-consuming and complex. PRC law also requires certain merger and acquisition transactions to be subject to a security review. The MOFCOM Security Review Rules, which became effective September 1, 2011, provide that, when deciding whether a specific merger or acquisition of a domestic enterprise by foreign investors is subject to a security review by the MOFCOM, the principle of substance over form should be applied, and foreign investors are prohibited from bypassing the security review requirement by structuring transactions through proxies, trusts, indirect investments, leases, loans, or control through contractual arrangements. Factors that the MOFCOM considers in its review are whether (i) an important industry is concerned, (ii) such transaction involves factors that have had or may have an impact on national economic security and (iii) such transaction will lead to a change in control of a domestic enterprise that holds a well-known PRC trademark or a time-honored PRC brand. If the business of any target company that it plans to acquire falls into the ambit of security review, Changyou may not be able to successfully acquire such company. Complying with the requirements of the relevant regulations to complete such transactions could be time-consuming, and any required approval process, including approval from the MOFCOM, may delay or inhibit Changyou's ability to complete such transactions, which could affect its ability to expand its business.

***Regulations relating to offshore investment activities by PRC residents may limit Changyou's ability to acquire PRC companies and could adversely affect its business.***

In July 2014, SAFE promulgated the *Circular on Issues Concerning Foreign Exchange Administration Over Overseas Investment and Financing and Roundtrip Investment by Domestic Residents Via Special Purpose Vehicles*, or Circular 37, which replaced *Issues Concerning Foreign Exchange Control on Domestic Residents' Corporate Financing and Roundtrip Investment through Offshore Special Purpose Vehicles*, or Circular 75. Circular 37 requires PRC residents to register with local branches of SAFE in connection with their direct establishment or indirect control of an offshore entity, referred to in Circular 37 as a "special purpose vehicle," for the purpose of holding domestic or offshore assets or interests. Circular 37 further requires amendment to a PRC resident's registration in the event of any significant changes with respect to the special purpose vehicle, such as an increase or decrease in the capital contributed by PRC individuals, share transfer or exchange, merger, division or other material event. Under these regulations, PRC residents' failure to comply with specified registration procedures may result in restrictions being imposed on the foreign exchange activities of the relevant PRC entity, including the payment of dividends and other distributions to its offshore parent, as well as restrictions on capital inflows from the offshore entity to the PRC entity, including restrictions on its ability to contribute additional capital to its PRC subsidiaries. Further, failure to comply with the SAFE registration requirements could result in penalties under PRC law for evasion of foreign exchange regulations.

Different local SAFE branches may have different views and procedures as to the interpretation and implementation of the SAFE regulations, and it may be difficult for Changyou's ultimate shareholders or beneficial owners who are PRC residents to provide sufficient supporting documents required by the SAFE or to complete the required registration with the SAFE in a timely manner, or at all. Any failure by any of Changyou's shareholders who is a PRC resident, or is controlled by a PRC resident, to comply with relevant requirements under these regulations could subject Changyou to fines or sanctions imposed by the PRC government, including restrictions on the ability of AmazGame and Gamespace to pay dividends or make distributions to Changyou and on its ability to increase its investment in AmazGame, Gamespace, or its VIEs.

Under Circular 37, if a non-listed special purpose vehicle uses its own equity or share options to grant equity incentive awards to directors, supervisors, members of senior management or employees directly employed by a domestic enterprise that is directly or indirectly controlled by such special purpose vehicle, or with which such employees have established employment relationships, any of such directors, supervisors, members of senior management or employees who is a PRC resident must, prior to exercising their rights, file an application with the SAFE for foreign exchange registration with respect to such special purpose vehicle. However, in practice, different local SAFE branches may have different views and procedures as to the interpretation and implementation of the SAFE regulations and, since Circular 37 was the first regulation to regulate the foreign exchange registration of a non-listed special purpose vehicle's equity incentives granted to PRC residents, there remains uncertainty with respect to its implementation.

***To fund any cash requirements it may have, Changyou may need to rely on dividends, loans or advances made by its principal PRC subsidiaries AmazGame, Gamespace and Beijing Baina Technology, which are subject to limitations and possible taxation under applicable PRC law.***

Changyou may need to rely on dividends and other distributions on equity, or loans and advances, made by its PRC subsidiaries AmazGame, Gamespace and Beijing Baina Technology to fund any cash requirements Changyou may have, including the funds necessary to pay dividends and other cash distributions, if any, to its shareholders, including us, and to service any debt it may incur. The distribution of dividends and the making of loans and advances by entities organized in China are subject to limitations. Regulations in the PRC currently permit payment of dividends only out of accumulated profits as determined in accordance with accounting standards and regulations in China. AmazGame, Gamespace and Beijing Baina Technology are also required to set aside at least 10% of their after-tax profit based on PRC accounting standards each year to their general reserves until the cumulative amount of such reserves reaches 50% of the entities' registered capital. These reserves are not distributable as cash dividends, loans or advances. AmazGame, Gamespace and Beijing Baina Technology may also allocate a portion of their after-tax profits, as determined by their boards of directors, to their staff welfare and bonus funds, which may not be distributed to it. In addition, if AmazGame, Gamespace or Beijing Baina Technology incurs debt on its own behalf in the future, the instruments governing the debt may restrict its ability to pay dividends or make other distributions to it. Furthermore, under regulations of the State Administration of Foreign Exchange, or the SAFE, the RMB is not convertible into foreign currencies for capital account items, such as loans, repatriation of investments and investments outside of China, unless prior approval of the SAFE is obtained and prior registration with the SAFE is made, which could delay or prevent any transfers of funds from Changyou's PRC subsidiaries to it.

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In addition, there are uncertainties under the CIT Law with regard to the PRC withholding tax on dividends paid by AmazGame, Gamespace and Beijing Baina Technology to Changyou's Hong Kong subsidiaries. See "Risk Factors—Risks related to Doing Business in China—There are significant uncertainties under the Corporate Income Tax Law of the PRC, or the CIT Law, regarding its PRC enterprise income tax liabilities, such as tax on dividends paid to it by its PRC subsidiaries. The CIT Law also contains uncertainties regarding possible PRC withholding tax on any dividends it pays to its overseas corporate shareholders and gains realized from the transfer of its shares by its overseas corporate shareholders." Should such dividends be subject to PRC withholding tax or be subject to the usual CIT Law withholding tax rate of 10% rather than the preferential dividend withholding tax rate of 5% provided under the China-HK Tax Arrangement, the amount of cash available to Changyou for its cash needs, including for the payment of dividends to its shareholders, including us, would be reduced.

Furthermore, Changyou controls its principal VIEs Gamease, Guanyou Gamespace and Wuhan Baina Information through contractual arrangements rather than equity ownership. To the extent that there is any distributable profit in Gamease, Guanyou Gamespace or Wuhan Baina Information, it may be difficult for these entities to distribute such profit to AmazGame, Gamespace or Beijing Baina Technology, which may further limit the amount that these PRC subsidiaries can distribute to it.

***As the special tax qualifications of certain of Changyou's PRC subsidiaries and VIEs as "High and New Technology Enterprises," "Software Enterprises" or "Key National Software Enterprises" expire, or if they are revoked, Changyou will have to pay additional taxes to make up any previously unpaid tax and will be subject to a higher tax rate.***

The CIT Law generally imposes a uniform income tax rate of 25% on all enterprises, but grants preferential treatment to High and New Technology Enterprises ("HNTEs"), pursuant to which HNTEs are instead subject to an income tax rate of 15%, subject to a requirement that they re-apply for HNTE status every three years. During this three-year period, an HNTE must conduct a qualification self-review each year to ensure it meets the HNTE criteria, and will be subject to the regular 25% income tax rate for any year in which it does not meet the criteria. The CIT Law and its implementing regulations provide that a "Software Enterprise" is entitled to an income tax exemption for two years beginning with its first profitable year and a 50% reduction to a rate of 12.5% for the subsequent three years. An entity that qualifies as a "Key National Software Enterprise" (a "KNSE") is entitled to a further reduced preferential income tax rate of 10%. An enterprise wishing to enjoy the status of a Software Enterprise or a KNSE must perform a self-assessment each year to ensure that it meets the relevant criteria for qualification. If at any time during the preferential tax treatment years an enterprise uses the preferential CIT rates but the relevant authorities determine that it failed to meet applicable criteria for qualification, the authorities may revoke the enterprise's Software Enterprise or KNSE status, as applicable.

In addition, the CIT Law and its implementing regulations provide that "Software Enterprises" can enjoy an income tax exemption for two years beginning with their first profitable year and a 50% reduction to a rate of 12.5% for the subsequent three years. A number of Changyou's PRC Subsidiaries and VIEs qualified for exemptions or rate reductions in 2014, 2015 and 2016.

There are uncertainties regarding future interpretation and implementation of the CIT Law and its implementing regulations. It is possible that the HNTE, Software Enterprise, and KNSE qualifications of Changyou's operating entities currently qualified as such, or their entitlement to an income tax exemption, will be challenged by higher level tax authorities and be repealed, or that there will be future implementing regulations that are inconsistent with current interpretation of the CIT Law. Therefore, it is possible that the qualifications of one or more of Changyou's PRC Subsidiaries or VIEs will be challenged in the future or that such companies will not be able to take any further actions, such as re-application for qualification, to enjoy such preferential tax treatments. If those operating entities cannot qualify for such income tax reductions, Changyou's effective income tax rate will be increased significantly and it may have to pay additional income tax to make up the previously unpaid tax, which would reduce its net income.

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***There are significant uncertainties under the Corporate Income Tax Law of the PRC, or the CIT Law, regarding Changyou's PRC enterprise income tax liabilities, such as tax on dividends paid to it by its PRC subsidiaries. The CIT Law also contains uncertainties regarding possible PRC withholding tax on any dividends Changyou pays to its overseas corporate shareholders and gains realized from the transfer of its shares by its overseas corporate shareholders.***

Changyou is a holding company incorporated in the Cayman Islands which indirectly holds, through its Hong Kong subsidiaries, its equity interests in its subsidiaries in the PRC. Changyou's business operations are principally conducted by its principal PRC subsidiaries and its principal VIEs. The CIT Law and its implementation rules provide that China-sourced income of foreign enterprises, such as dividends paid by a PRC subsidiary to its overseas parent, will normally be subject to PRC withholding tax at a rate of 10%, unless there are applicable tax treaties that reduce such rate. Under the *Arrangement Between the PRC and the Hong Kong Special Administrative Region on the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital*, or the China-HK Tax Arrangement, the dividend withholding tax rate may be reduced to 5%, if a Hong Kong resident enterprise is considered a non-PRC tax resident enterprise and holds at least 25% of the equity interests in the PRC enterprise distributing the dividends, subject to approval of the PRC local tax authority. However, if the Hong Kong resident enterprise is not considered to be the beneficial owner of such dividends under applicable PRC tax regulations, such dividends may remain subject to withholding tax at a rate of 10%. On October 27, 2009, the SAT, issued a *Notice on How to Understand and Determine the Beneficial Owners in Tax Agreement*, or Circular 601, which provides guidance on determining whether an enterprise is a "beneficial owner" under China's tax treaties and tax arrangements. Circular 601 provides that, in order to be a beneficial owner, an entity generally must be engaged in substantive business activities, and that a company that is set up for the purpose of avoiding or reducing taxes or transferring or accumulating profits will not be regarded as a beneficial owner and will not qualify for treaty benefits such as preferential dividend withholding tax rates. If any of Changyou's Hong Kong subsidiaries is, in the light of Circular 601, determined by the SAT to be a non-beneficial owner for purposes of the China-HK Tax Arrangement, any dividends paid to it by any of Changyou's PRC subsidiaries would not qualify for the preferential dividend withholding tax rate of 5%, but rather would be subject to the usual CIT Law rate of 10%.

We believe Changyou is not a PRC tax resident enterprise, but it is not clear whether Changyou or any of its Hong Kong subsidiaries will be deemed to be PRC tax residents under the CIT Law. The tax resident status of an enterprise is subject to determination by the PRC tax authorities and uncertainties remain with respect to the interpretation of the term "de facto management body". Under the CIT Law and its implementation rules, an enterprise established outside of the PRC with a "de facto management body" within the PRC is considered a resident enterprise and will be subject to the enterprise income tax on its global income at the rate of 25%. The implementation rules define the term "de facto management body" as a body that exercises full and substantial control and overall management over the business, productions, personnel, accounts and properties of an enterprise. On April 22, 2009, the SAT issued a circular, known as Circular 82, which provides certain specific criteria for determining whether the "de facto management body" of a PRC-controlled enterprise that is incorporated offshore is located in China. Although this circular only applies to offshore enterprises controlled by PRC enterprises or PRC enterprise groups, not those controlled by PRC individuals or foreigners, the criteria set forth in the circular may reflect the SAT's general position on how the "de facto management body" text should be applied in determining the tax resident status of all offshore enterprises. Under Circular 82, an offshore incorporated enterprise controlled by a PRC enterprise or a PRC enterprise group will be regarded as a PRC tax resident by virtue of having its "de facto management body" in China and will be subject to PRC enterprise income tax on its global income only if all of the following conditions are met: (i) the primary location of the day-to-day operational management is in the PRC; (ii) decisions relating to the enterprise's financial and human resource matters are made or are subject to approval by organizations or personnel in the PRC; (iii) the enterprise's primary assets, accounting books and records, company seals, and board and shareholder resolutions, are located or maintained in the PRC; and (iv) at least 50% of voting board members or senior executives habitually reside in the PRC. If Changyou is considered as a PRC tax resident under the CIT law by the PRC tax authorities, Changyou's global income will be subject to corporate income tax at a rate of 25%.

Although Changyou intends to take the position that any dividends it pays to its overseas corporate shareholders or shareholders or ADS holders of Changyou.com Limited will not be subject to a withholding tax in the PRC, if Changyou or any of its Hong Kong subsidiaries are considered to be PRC tax resident enterprises for tax purposes, any dividends Changyou pays to its overseas corporate shareholders or shareholders or ADS holders of Changyou.com Limited as well as gains realized by such shareholders or ADS holders from the transfer of shares or ADSs may be regarded as China-sourced income and as a result be subject to PRC withholding tax at a rate up to 10%. The implementation rules of the CIT Law provide that, if an enterprise that distributes dividends is domiciled in the PRC or if gains are realized from transferring equity interests of an enterprise domiciled in the PRC, then such dividends or gains are treated as "China-sourced income." However, it is not clear how "domicile" might be interpreted under the CIT Law, and it is possible that domicile could be interpreted to mean the jurisdiction where the enterprise is a tax resident.

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Due to the lack of interpretation of the CIT Law, it is difficult to ascertain how it will be implemented by the relevant PRC tax authorities. If dividend payments from Changyou's wholly-owned subsidiary Changyou.com (HK) Limited, or Changyou HK, or other overseas subsidiaries of Changyou are subject to PRC withholding tax, Changyou's financial condition, results of operations and the amount of dividends available to pay its shareholders may be adversely affected. If dividends Changyou pays to Changyou's overseas shareholders, including us, or gains realized by such shareholders from the transfer of their shares are subject to PRC withholding tax, the withholding tax will generally be at a rate of 10% and reduce their investment return and the value of their investments in Changyou.

### ***Heightened scrutiny of acquisition transactions by PRC tax authorities may have a negative impact on Changyou's business operations and its acquisition strategy.***

Pursuant to the Notice on Strengthening Administration of Enterprise Income Tax for Share Transfers by Non-PRC Resident Enterprises, or SAT Circular 698, effective on January 1, 2008, and the Announcement on Several Issues Related to Enterprise Income Tax for Indirect Asset Transfer by Non-PRC Resident Enterprises, or SAT Announcement 7, effective on February 3, 2015, issued by the SAT, if a non-resident enterprise transfers the equity interests of or similar rights or interests in overseas companies which directly or indirectly own PRC taxable assets through an arrangement without a reasonable commercial purpose, but rather to avoid PRC corporate income tax, the transaction will be re-characterized and treated as a direct transfer of PRC taxable assets subject to PRC corporate income tax. SAT Announcement 7 specifies certain factors that should be considered in determining whether an indirect transfer has a reasonable commercial purpose. However, as SAT Announcement 7 was issued relatively recently, there is uncertainty as to the application of SAT Announcement 7 and the interpretation of the term "reasonable commercial purpose."

Under SAT Announcement 7, the entity which has the obligation to pay the consideration for the transfer to the transferring shareholders has the obligation to withhold any PRC corporate income tax that is due. If the transferring shareholders do not pay corporate income tax that is due for a transfer and the entity which has the obligation to pay the consideration does not withhold the tax due, the PRC tax authorities may impose a penalty on the entity that so fails to withhold, which may be relieved or exempted from the withholding obligation and any resulting penalty under certain circumstances if it reports such transfer to the PRC tax authorities.

Although SAT Announcement 7 became generally effective as of February 3, 2015, it also applies to cases where the PRC tax treatment of a transaction that took place prior to SAT Announcement 7's effectiveness had not yet been finally settled as of the time SAT Announcement 7 became effective. As a result, SAT Announcement 7 could be determined by PRC tax authorities to be applicable to the historical reorganization of 7Road and Changyou's acquisitions of the equity interests of 7Road and MoboTap, and it is possible that these transactions could be determined by PRC tax authorities to lack a reasonable commercial purpose. As a result, the transfer of 7Road's or MoboTap's shares to other parties could be subject to corporate income tax of up to 10% on capital gains generated from such transfers, and PRC tax authorities could impose tax obligations on the transferring shareholders or subject Changyou to penalties if the transferring shareholders do not pay such obligations and it does not withhold such tax.

SAT Announcement 7 and its interpretation by relevant PRC authorities clarify that an exemption provided by SAT Circular 698 for transfers of shares in a publicly-traded entity that is listed overseas is available if the purchase of the shares and the sale of the shares both take place in open-market transactions. However, if a shareholder of an entity that is listed overseas purchases shares in the open market and sells them in a private transaction, or vice-versa, PRC tax authorities might deem such a transfer to be subject to SAT Circular 698 and SAT Announcement 7, which could subject such shareholder to additional reporting obligations or tax burdens. Accordingly, if a holder of Changyou's ADSs or ordinary shares purchases its ADSs or ordinary shares in the open market and sells them in a private transaction, or vice-versa, and fails to comply with SAT Circular 698 or SAT Announcement 7, the PRC tax authorities may take actions, including requesting Changyou to provide assistance for their investigation or impose a penalty on it, which could have a negative impact on Changyou's business operations. In addition, since Changyou may pursue acquisitions as one of its growth strategies, and may conduct acquisitions involving complex corporate structures, PRC tax authorities might impose taxes on capital gains or request that it submit additional documentation for their review in connection with any potential acquisitions, which may cause it to incur additional acquisition costs or delay its acquisition timetable.

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***Changyou may be subject to fines and legal sanctions if it or its employees who are PRC citizens fail to comply with PRC regulations relating to employee share incentives granted by overseas listed companies to PRC citizens.***

Under the *Administration Measures on Individual Foreign Exchange Control* issued by the PBOC and related implementation rules issued by the SAFE, all foreign exchange transactions involving an employee share incentive plan, share option plan or similar plan participated in by PRC citizens may be conducted only with the approval of the SAFE. Under the *Notice of Issues Related to the Foreign Exchange Administration for Domestic Individuals Participating in Stock Incentive Plan of Overseas Listed Company*, or the *Offshore Share Incentives Rules*, issued by the SAFE on February 15, 2012, PRC citizens who are granted share options, restricted share units or restricted shares by an overseas publicly listed company are required to register with the SAFE or its authorized branch and to comply with a series of other requirements. The *Offshore Share Incentives Rule* also provides procedures for registration of incentive plans, the opening and use of special accounts for the purpose of participation in incentive plans, and the remittance of funds for exercising share options and gains realized from such exercises and sales of such options or the underlying shares, both outside and inside the PRC. Changyou, and any of its PRC employees or members of its Board of Directors who have been granted share options, restricted share units or restricted shares, are subject to the *Administration Measures on Individual Foreign Exchange Control*, the related implementation rules issued by the SAFE, and the *Offshore Share Incentives Rule*. If Changyou, or any of its PRC employees or members of its Board of Directors who receive or hold share options, restricted share units or restricted shares, fail to comply with these registration and other procedural requirements, Changyou may be subject to fines and other legal or administrative sanctions.

***The enforcement of the PRC Labor Contract Law and other labor-related regulations in the PRC may adversely affect Changyou's business.***

The Standing Committee of the National People's Congress of the PRC enacted the *Labor Contract Law*, or the *Labor Contract Law* in 2008. The *Labor Contract Law* introduced specific provisions related to fixed-term employment contracts, part-time employment, probationary periods, consultation with labor unions and employee assemblies, employment without a written contract, dismissal of employees, severance, and collective bargaining to enhance previous PRC labor law. Under the *Labor Contract Law*, an employer is obligated to sign an unlimited-term labor contract with any employee who has worked for the employer for ten consecutive years. Further, if an employee requests or agrees to renew a fixed-term labor contract that has already been entered into twice consecutively, the resulting contract, with certain exceptions, must have an unlimited term, subject to certain exceptions. With certain exceptions, an employer must pay severance to an employee where a labor contract is terminated or expires. In addition, PRC governmental authorities have continued to introduce various new labor-related regulations since the effectiveness of the *Labor Contract Law*. For example, there are regulations which require that annual leave ranging from five to 15 days be made available to employees and that employees be compensated for any unused annual leave days at a rate of three times their daily salary, subject to certain exceptions.

Under the *PRC Social Insurance Law* and the *Administrative Measures on Housing Funds*, employees are required to participate in pension insurance, work-related injury insurance, medical insurance, unemployment insurance, maternity insurance and housing funds and employers are required, together with their employees or separately, to pay the social insurance premiums and housing funds for their employees.

These laws designed to enhance labor protection tend to increase Changyou's labor costs. In addition, as the interpretation and implementation of these regulations are still evolving, Changyou's employment practices may not at all times be deemed in compliance with the regulations. As a result, Changyou could be subject to penalties or incur significant liabilities in connection with labor disputes or investigations.

***Changyou has suffered currency exchange losses, and Changyou may continue to suffer currency exchange losses if the RMB continues to depreciate relative to the U.S. dollar, and fluctuations in the value of the RMB may have an adverse effect on Changyou's shareholders', including our, investment in Changyou.***

Changyou's reporting currency through the year ended December 31, 2016 had been the U.S. dollar. However, substantially all of its 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 U.S. dollar and the exchange rate will have some flexibility. If the RMB depreciates relative to the U.S. dollar, Changyou's revenues as expressed in its U.S. dollar financial statements will decline in value. Changyou's currency exchange losses may be magnified by PRC exchange control regulations that restrict its ability to convert RMB into U.S. dollars. On the other hand, Changyou's proceeds from overseas financings and from overseas game operations will decrease in value if Changyou chooses not to or is unable to convert the proceeds into RMB and the RMB appreciates against the U.S. dollar, which may reduce the value of a shareholder's, including our, investment in Changyou.



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On March 17, 2014, the PBOC announced a policy to expand the maximum daily floating range of RMB trading prices against the U.S. dollar in the inter-bank spot foreign exchange market to 2%. The RMB may appreciate or depreciate significantly in value against the U.S. dollar or other foreign currencies in the long term, depending on the fluctuation of the basket of currencies against which it is valued.

***The successful operation of Changyou's business and implementation of its growth strategies, including its ability to accommodate additional game players and advertising clients in the future, depend upon the performance and reliability of the Internet infrastructure and fixed telecommunications networks in China.***

Almost all access to the Internet in China is maintained through state-owned telecommunications operators under the administrative control and regulatory supervision of the MIIT. Changyou relies on this national information infrastructure to provide data communications capacity, primarily through local telecommunications lines. Although the PRC government has announced plans to further develop this infrastructure, it may not be further developed as planned. In addition, Changyou 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. The Internet infrastructure in China may not support the demands necessary for continued growth in Internet usage.

***Changyou may be subject to, and may expend significant resources in defending against, claims regarding the content and services it provides over its Websites.***

As Changyou's services may be used to download and distribute information to others, there is a risk that claims may be made against Changyou for defamation, negligence, copyright or trademark infringement or based on the nature and content of such information. Furthermore, Changyou could be subject to claims related to the online activities of its visitors and incur significant costs in its defense. In the past, claims regarding 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. Changyou could be exposed to liability for the selection of listings that may be accessible through its Websites or through content and materials that its visitors may post in classifieds, message boards, chat rooms or other interactive services. If any information provided through Changyou's services contains errors, third parties may make claims against Changyou for losses incurred in reliance on the information.

Changyou does not carry any liability insurance against of the foregoing risks.

***Changyou does not have business insurance coverage.***

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

***The limited use of personal computers in China and the relatively high cost of Internet access in relation to per capita gross domestic product may limit the development of the Internet in China and impede Changyou's growth.***

The penetration rate for personal computers in China is significantly lower than it is in the United States and other developed countries. Furthermore, the cost of Internet access in China is still relatively high as compared to other developed countries. The limited use of personal computers in China and the relatively high cost of Internet access may limit the growth of Changyou's business. In addition, there may be increases in Internet access fees or telecommunication fees in China. If that happens, the number of Changyou's game players may decrease or the growth of Changyou's game player base may be adversely impacted. Slow growth of, or a decrease in, the traffic on the 17173.com Website may also cause Changyou's advertising clients to reduce their use of Changyou's online advertising services, reducing its online advertising revenues.



***Changyou may not be able to generate sufficient cash flow in U.S. dollars in the future to service its debt obligations, which would cause it to default under its matching loans to Sohu and SoEasy.***

During 2016, certain of Changyou's subsidiaries entered into a series of matching-loans arrangements with certain subsidiaries of Sohu and certain subsidiaries of SoEasy Internet Finance Group Limited ("SoEasy"), pursuant to which Changyou's subsidiaries are entitled to draw down U.S. dollar-denominated loans from the Sohu subsidiaries and the SoEasy subsidiaries. Since Changyou conducts most of its business operations in Mainland China and generates most of its revenues in RMB, and its existing loans owed to the Sohu subsidiaries and the SoEasy subsidiaries are denominated in U.S. dollars and are repayable in U.S. dollars, in order for it to make scheduled payments on those loans, Changyou may need to rely on dividends or loans from its PRC subsidiaries, which would be subject to restrictions under PRC laws and regulations, including those regarding foreign exchange controls, and may be time-consuming. Also see "- To fund any cash requirements it may have, Changyou may need to rely on dividends, loans or advances made by its principal PRC subsidiaries AmazGame, Gamespace and Beijing Baina Technology, which are subject to limitations and possible taxation under applicable PRC law." If Changyou fails to timely receive U.S. dollar-denominated cash from its PRC subsidiaries, it may default on its payment obligations with respect to those loans.

***Changyou faces risks related to health epidemics and other natural disasters.***

Changyou's business could be adversely affected by the effects of H1N1 influenza, H7N9 influenza, avian influenza or other epidemics or outbreaks. In recent years, there have been reports of occurrences of H1N1 influenza, H7N9 influenza and of avian influenza in various parts of China, including a few confirmed human cases and deaths. Any prolonged recurrence of H1N1 influenza, H7N9 influenza, avian influenza or other adverse public health developments in China may have an adverse effect on Changyou's business operations. Adverse effects could include illness and loss of Changyou's management and key employees, as well as temporary closure of its offices and related other businesses, such as server operations, upon which it relies, and a decrease in the number of its game players. Such loss of management and key employees or closures would severely disrupt Changyou's business operations. Changyou has not adopted any written preventive measures or contingency plans to combat any future outbreak of H1N1 influenza, H7N9 influenza, avian influenza, or any other epidemics. In addition, other major natural disasters may also adversely affect Changyou's business by, for example, causing disruptions of the Internet network or otherwise affecting access to its games.

#### ***Risks Related to Changyou's Shares***

***Changyou's operating results for a particular period could fall below its expectations or the expectations of investors or research analysts, resulting in a decrease in the price of its ADSs and the value of our interest in Changyou.***

Changyou's operating results may vary significantly from period to period as a result of factors beyond its control, such as the slowdown in China's economic growth that occurred between the first quarter of 2010 and third quarter of 2012 and continued from 2014 through 2016, caused in part by measures adopted by the Chinese government intended to slow such growth and to temper real estate prices and inflation, and the significant instability recently experienced in the worldwide economy, and the European Community facing disruptions as a result of crises in the economies of Greece and Spain, among other countries, and such factors may be difficult to predict for any given period. Other factors also could cause significant fluctuations in Changyou's operating results, including the timing and success of its new game launches, its costs of developing and launching new games, and the level of user activity of its games in China during particular fiscal quarters. If its operating results for any period fall below its expectations or the expectations of investors or research analysts, the price of Changyou's ADSs is likely to decrease, which would reduce the value or our interest in Changyou.

***As a holder of Changyou's Class B ordinary shares, we will experience dilution when additional Class A ordinary shares are issued in settlement of restricted share units or upon exercise of options.***

As a holder of Changyou's Class B ordinary shares, we will experience dilution to the extent that additional Class A ordinary shares are issued upon settlement of restricted share units or exercise of outstanding options that it may grant from time to time. As of the date of this report, there were outstanding 9,986 Class A restricted share units, with each such restricted share unit settleable upon vesting by the issuance of its Class A ordinary share, and outstanding options for the purchase of 2,800,090 Class A ordinary shares at a nominal price.

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***Changyou may need additional capital and may sell additional ADSs or other equity securities or incur indebtedness, which could result in additional dilution to its shareholders, including us, or increase its debt service obligations.***

Changyou may require additional cash resources due to changed business conditions or other future developments, including any investments or acquisitions it may decide to pursue. If its cash resources are insufficient to satisfy its cash requirements, Changyou may seek to sell additional equity or debt securities or obtain a credit facility. The sale of additional equity securities or equity-linked debt securities could result in additional dilution to its shareholders, including us. The incurrence of indebtedness would result in debt service obligations and could result in operating and financing covenants that would restrict Changyou's operations. We cannot assure you that financing will be available in amounts or on terms acceptable to Changyou, if at all.

### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

There are no comments that we received from the staff of the SEC 180 days or more before the end of the year ended December 31, 2016 regarding our periodic or current reports under the Exchange Act that remain unresolved.

### **ITEM 2. PROPERTIES**

#### **Sohu**

In February 2007, we purchased an office building of approximately 18,265 square meters in Beijing, for consideration of approximately \$35.3 million, of which 17,188 square meters have been leased to Sogou since November 2013.

In November 2009, we entered into a contract for the purchase and development of an office building of approximately 41,283 square meters in Beijing to serve as our headquarters, for consideration of approximately \$162 million. The office building was placed in service in May 2013.

As of December 31, 2016, we leased office space in Beijing of approximately 7,644 square meters. We also leased office space of approximately 25,589 square meters in other cities in the PRC.

#### **Sogou**

As of December 31, 2016, Sogou leased 4,423 square meters of office space in Beijing, in addition to office space that Sogou leased from Sohu. Sogou also leases a total of approximately 2,913 square meters of office space in Chengdu, the provincial capital of Sichuan province in the PRC.

#### **Changyou**

In August 2009, Changyou purchased an office building of approximately 14,950 square meters in Beijing, for consideration of approximately \$33.4 million. Since January 1, 2016, Changyou has leased out this building to third-party business tenants.

In August 2010, Changyou entered into a contract for the purchase and development of an office building of approximately 56,549 square meters in Beijing to serve as its headquarters, for consideration of approximately \$171 million. The office building was placed in service in December 2013.

As of December 31, 2016, Changyou leased additional office space in Beijing of approximately 1,143 square meters. Changyou also leased office space of approximately 15,043 square meters in other cities in the PRC and in other countries.

### **ITEM 3. LEGAL PROCEEDINGS**

From time to time we become subject to legal proceedings and claims in the ordinary course of our business. Such legal proceedings or claims, even if not meritorious, could result in the expenditure of significant financial and management resources.

### **ITEM 4. MINE SAFETY DISCLOSURES**

None.

**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Market Information**

Our common stock is traded on the NASDAQ Global Select Market, under the symbol "SOHU." Public trading in our common stock commenced on July 12, 2000. The following table sets forth the high and low sale prices of our common stock as reported by the NASDAQ Stock Market for the quarters indicated.

	2015		2016	
	High	Low	High	Low
First quarter	\$58.25	\$48.82	\$55.21	\$41.47
Second quarter	71.78	52.94	49.85	35.65
Third quarter	59.23	40.20	45.84	36.43
Fourth quarter	59.50	41.05	45.00	32.60

The closing price of our common stock on February 22, 2017 as reported by the NASDAQ Global Select Market was \$42.16.

**Holdings**

As of February 13, 2017, there were 13 holders of record of our common stock. Because many of our shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the exact number of beneficial holders represented by these record holders. As of February 13, 2017, there were approximately 10,700 beneficial holders of our common stock.

**Dividends**

We do not expect Sohu.com Inc. to pay any dividends to its shareholders in the foreseeable future.

**Securities Authorized for Issuance under Equity Compensation Plans**

The information in Item 12 of this report is incorporated herein by reference.

**Recent Sales of Unregistered Securities**

None.

**Issuer Purchases of Equity Securities**

For the years ended December 31, 2016 and 2015 we did not have a program for the repurchase of outstanding shares of common stock of Sohu.com Inc. or of outstanding ADSs of Changyou.com Limited.

**Report of Offering of Securities and Use of Proceeds Therefrom****Initial Public Offering of our Common Stock**

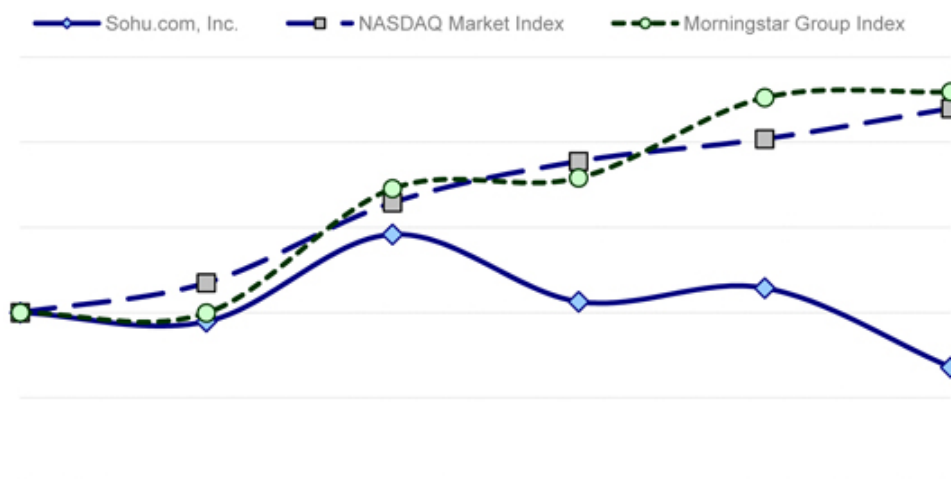
On July 17, 2000, we completed an underwritten initial public offering of our common stock pursuant to a Registration Statement on Form S-1 (SEC file No. 333-96137), which became effective on July 10, 2000. Our net proceeds, after deduction of the underwriting discount of \$4.2 million and offering expenses of \$3.2 million, were approximately \$52.4 million. None of the expense payments were made to the underwriters, to any of our directors, officers or affiliates or to any persons owning 10% or more of any class of our equity securities.

Through December 31, 2016, we had used \$8.2 million of the net proceeds from the offering for operating activities, purchases of fixed assets, funding for certain equity investments and strategic acquisitions of complementary businesses. The remaining net proceeds from the offering have been invested in cash and cash equivalents. 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.

**PERFORMANCE GRAPH**

The following graph compares the cumulative total stockholder return for Sohu, the NASDAQ Stock Market (U.S. companies) Index (or the NASDAQ Market Index) and the Morningstar Group Index. The graph covers the period from December 31, 2011 to December 31, 2016. The graph assumes that \$100 was invested on December 31, 2011 in our common stock, the NASDAQ Market Index and the Morningstar Group index, and the reinvestment of any dividends. The stock price performance on the following graph is not necessarily indicative of future stock price performance.

**Comparison of Cumulative Total Return**



ASSUMES \$100 INVESTED ON DEC. 31, 2011  
 ASSUMES DIVIDEND REINVESTED  
 FISCAL YEAR ENDING DEC. 31, 2016

	<u>Sohu.com Inc.</u>	<u>Morningstar Group</u>	<u>NASDAQ Market Index</u>
12/31/2011	91.71	91.54	102.27
12/31/2012	86.83	89.25	120.40
12/31/2013	154.06	355.07	281.18
12/31/2014	92.84	192.93	221.02
12/31/2015	90.08	228.60	200.31
12/31/2016	67.78	229.67	219.89

The Stock Performance Graph is not “soliciting material,” is not deemed filed with the Securities and Exchange Commission and is not deemed to be incorporated by reference by any general statement incorporating by reference this annual report on Form 10-K into any filing of the Company under the Securities Act of 1933, or any filing under the Exchange Act, except to the extent that we specifically request that the information be treated as soliciting material or specifically incorporate this information by reference into any such filing, and will not otherwise be deemed incorporated by reference into any other filing under the Securities Act or the Securities Exchange Act, except to the extent that we specifically incorporate it by reference.

Information used on the graphs was obtained from Morningstar, Inc., a source believed to be reliable.

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**ITEM 6. SELECTED FINANCIAL DATA**

The selected consolidated financial data below should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, the consolidated financial statements and notes thereto and the other information contained in this Form 10-K.

	<b>Year Ended December 31,</b>				
	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
<b>(In thousands, except per share data)</b>					
<b>Statements of Comprehensive Income Data:</b>					
Revenues:					
Online advertising:					
Brand advertising	\$ 290,205	\$ 428,526	\$ 541,158	\$ 577,114	\$ 447,956
Search and search-related	124,389	198,915	357,839	539,521	597,133
Subtotal of online advertising revenues	414,594	627,441	898,997	1,116,635	1,045,089
Online games	570,346	669,168	652,008	636,846	395,709
Others	82,261	103,665	122,072	183,610	209,633
Total revenues	<u>1,067,201</u>	<u>1,400,274</u>	<u>1,673,077</u>	<u>1,937,091</u>	<u>1,650,431</u>
Cost of revenues:					
Online advertising:					
Brand advertising	161,195	221,659	307,708	383,187	371,085
Search and search-related	70,628	109,139	163,918	238,944	290,158
Subtotal of cost of online advertising revenues	231,823	330,798	471,626	622,131	661,243
Online games	76,350	93,307	142,552	156,315	96,168
Others	61,485	55,945	71,456	80,618	102,389
Total cost of revenues	<u>369,658</u>	<u>480,050</u>	<u>685,634</u>	<u>859,064</u>	<u>859,800</u>
Gross profit	<u>697,543</u>	<u>920,224</u>	<u>987,443</u>	<u>1,078,027</u>	<u>790,631</u>
Operating expenses:					
Product development	181,359	276,120	409,285	398,143	353,144
Sales and marketing	214,736	351,653	526,514	383,931	434,780
General and administrative	75,243	108,970	204,325	173,160	119,841
Goodwill impairment and impairment of intangible assets acquired as part of business acquisitions	2,906	0	52,282	40,324	0
Total operating expenses	<u>474,244</u>	<u>736,743</u>	<u>1,192,406</u>	<u>995,558</u>	<u>907,765</u>
Operating profit /(loss)	<u>223,299</u>	<u>183,481</u>	<u>(204,963)</u>	<u>82,469</u>	<u>(117,134)</u>
Other income /(expense), net	5,422	12,721	9,959	74,526	(10,713)
Net interest income	25,277	27,829	30,977	23,459	21,143
Exchange difference	(635)	(6,660)	(1,142)	5,337	12,803
Income /(loss) before income tax expense	253,363	217,371	(165,169)	185,791	(93,901)
Income tax expense	76,171	50,422	6,050	76,936	21,072
Net income /(loss)	177,192	166,949	(171,219)	108,855	(114,973)
Less: Net income attributable to the mezzanine-classified noncontrolling interest shareholders	11,196	17,780	0	0	0
Net income /(loss) attributable to the noncontrolling interest shareholders	78,837	82,044	(32,309)	146,542	109,048
Dividend or deemed dividend to noncontrolling Sogou Series A Preferred shareholders	14,219	82,432	27,747	11,911	0
Net income/(loss) attributable to Sohu.com Inc.	<u>\$ 72,940</u>	<u>\$ (15,307)</u>	<u>\$ (166,657)</u>	<u>\$ (49,598)</u>	<u>\$ (224,021)</u>
Net income /(loss)	\$ 177,192	\$ 166,949	\$ (171,219)	\$ 108,855	\$ (114,973)
Other comprehensive income /(loss)	4,413	47,125	(8,390)	(87,655)	(77,155)
Comprehensive income /(loss)	<u>181,605</u>	<u>214,074</u>	<u>(179,609)</u>	<u>21,200</u>	<u>(192,128)</u>
Less: Comprehensive income attributable to the mezzanine-classified noncontrolling interest shareholders	11,196	17,780	0	0	0
Comprehensive income /(loss) attributable to noncontrolling interest shareholders	79,927	92,407	(33,797)	118,138	78,824
Dividend or deemed dividend to noncontrolling Sogou Series A Preferred shareholders	14,219	82,423	27,747	11,911	0
Comprehensive income /(loss) attributable to Sohu.com Inc.	<u>76,263</u>	<u>21,464</u>	<u>(173,559)</u>	<u>(108,849)</u>	<u>(270,952)</u>
Basic net income/(loss) per share attributable to Sohu.com Inc.	<u>\$ 1.92</u>	<u>\$ (0.40)</u>	<u>\$ (4.33)</u>	<u>\$ (1.28)</u>	<u>\$ (5.79)</u>
Shares used in computing basic net income/(loss) per share attributable to Sohu.com Inc.	<u>38,038</u>	<u>38,255</u>	<u>38,468</u>	<u>38,598</u>	<u>38,706</u>
Diluted net income/(loss) per share attributable to Sohu.com Inc.	<u>\$ 1.66</u>	<u>\$ (0.47)</u>	<u>\$ (4.43)</u>	<u>\$ (1.32)</u>	<u>\$ (5.83)</u>
Shares used in computing diluted net income/(loss) per share attributable to Sohu.com Inc.	<u>38,392</u>	<u>38,502</u>	<u>38,468</u>	<u>38,598</u>	<u>38,706</u>

	As of December 31,				
	2012	2013	2014	2015	2016
	(In thousands)				
<b>Balance Sheets Data:</b>					
Cash and cash equivalents	\$ 833,535	\$ 1,287,288	\$ 876,340	\$ 1,245,205	\$ 1,050,957
Restricted time deposits	246,839	434,048	426,748	227,285	0
Investments in debt securities	79,548	82,009	0	0	0
Working capital	681,490	937,146	902,923	814,933	918,520
Total assets	2,082,637	2,998,715	2,867,009	3,042,194	2,563,690
Short-term bank loans	113,000	410,331	25,500	344,500	0
Long-term bank loans	126,353	0	344,500	0	0
Total liabilities	705,610	1,161,995	1,178,103	1,311,442	1,005,895
Mezzanine equity– Noncontrolling interest	61,810	0	0	0	0
Noncontrolling interest	230,994	510,015	487,245	489,730	564,215
Total shareholders' equity	1,315,217	1,836,720	1,688,906	1,730,752	1,557,795

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### OVERVIEW

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

Through the operation of Sohu, Sogou and Changyou, we generate online advertising revenues (including brand advertising revenues and search and search-related revenues), online games revenues and other revenues. For the year ended December 31, 2016, our total revenues were approximately \$1.65 billion, representing an decrease of 15% compared to 2015, and our gross margin decreased from 56% to 48%. Our online advertising business generated revenues of \$1.05 billion, with a 6% annual decline, representing 63% of total revenues. Our online game business generated revenues of \$395.7 million, with a 38% annual decline, representing 24% of total revenues. In 2016, our net loss before deducting the noncontrolling interest was \$119.3 million, compared to net profit of \$108.9 million in 2015. In 2016, our net loss after deducting the noncontrolling interest was \$224.0 million, compared to a net loss of \$49.6 million in 2015. Diluted net loss per share attributable to Sohu.com Inc. was \$5.83 in 2016, compared to a diluted net loss per share attributable to Sohu.com Inc. of \$1.32 in 2015.

### Factors and Trends Affecting our Business

With the accelerated shift in user activities from PCs to mobile devices and an increase in the number of Internet users, the use of various kinds of mobile Internet services continued to increase. As of the end of December 2016, according to China Internet Network Information Center ("CNNIC"), mobile internet users had reached 695 million, an increase of 12% from the end of 2015. At Sohu, we focused our efforts on developing a portfolio of leading mobile products across our business lines that we believed our users would like.

For Sohu Media Portal, we concentrated our focus on content and product design to accelerate the usage of our core mobile products - the Sohu News APP and the Web-based HTML5 Portal m.sohu.com. During 2016, we continued to optimize Sohu News App's design and introduce new features to meet users' appetites. At the same time, we ramped up marketing and promotion activities to accelerate the product's penetration. Daily active users of Sohu News APP continued to gain traction. On the sales front, in 2016 we experienced a modest decline in revenue for Sohu Media Portal as advertising revenues from large brand advertisers were soft due to the sluggish Chinese economy, while solid growth from small and medium enterprise ("SME") customers partially offset the negative impact.

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Online video services remained one of the most popular Internet applications, and continued to gain viewers from television stations. The video industry continued to be deeply competitive as major online platforms aggressively competed for popular content. The competition led to an escalation in the price of content. During 2016, Sohu Video began to shift our focus to the self-developed content category, which, in our view, will create long-lasting value to our platform and offer better financial returns compared to TV station content. Leveraging our exclusive original content, we also actively explored opportunities with subscription services that we believe will become an important revenue source in addition to traditional advertising revenues. Financially, Sohu Video's revenues for 2016 were affected by the weak economy and a turnover of the video sales team in the middle of the year, and its loss-making widened from 2015.

For our search and search-related business, Sogou is one of the top players in the online search sector in China. We have reinforced our competitive position through cooperation with Tencent, which has helped us build exclusive access to Tencent's social platforms and bring in unique and high-quality content. In 2016, we launched and upgraded a series of vertical channels, including English, Academic and Healthcare. These new services helped us stand out from competing products. By the end of December 2016, Sogou's mobile search traffic grew 70% from the same period in 2015, contributing 75% of aggregate traffic. Mobile search revenues accounted for two-thirds of total search revenues. During 2016, we also made solid progress in artificial intelligence, in particular with voice technology. The daily use of voice input through Sogou Mobile Keyboard more than doubled from a year ago. Due to newly-imposed regulations for online advertising that tightened the scrutiny of advertiser qualifications, Sogou's revenue growth for 2016 decelerated from previous years'.

For Changyou's PC game business, the PC game TLBB experienced a relatively large drop in revenue at the beginning of 2016, and Changyou immediately adjusted its operational strategy to focus on user stabilization by cutting down on the number of in-game promotions, improving in-game content and strengthening social functionality. The revenues of TLBB remained stable throughout the year, with slight increases in the third and fourth quarters on a sequential basis. For Changyou's mobile game business, revenues from TLBB 3D declined sequentially mainly due to its natural declining life cycle. In order to extend the game's life span, Changyou will explore new social interactive features that can be added to the game. Overall, Changyou started at the beginning of 2016 to focus on producing high-quality games. This approach and higher testing standards have set the bar high for new games in the pipeline, which had an impact on 2016 revenues. Nevertheless, after a year of hard work, Changyou now has a solid pipeline with a focus on MMORPG games, and supplemented by a number of advanced casual games in 2017. For the three months ended December 31, 2016, the PC games and mobile games that Changyou operates had approximately 4.1 million total average monthly active accounts and approximately 1.4 million total active paying accounts.

## **CRITICAL ACCOUNTING POLICIES AND MANAGEMENT ESTIMATES**

Our discussion and analysis of our financial condition and results of operations relates to our consolidated financial statements, which have been prepared in accordance with United States of America generally accepted accounting principles ("U.S. GAAP"). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, costs and expenses, and related disclosures. 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. Identified below are the accounting policies that reflect our most significant estimates and judgments, and those that we believe are the most critical to fully understanding and evaluating our consolidated financial statements.

### **Basis of Consolidation**

Our consolidated financial statements include the accounts of Sohu.com Inc. and its subsidiaries and consolidated VIEs. All intercompany transactions are eliminated.

### ***VIE Consolidation***

Our VIEs are wholly or partially owned by certain of our employees as nominee shareholders. For our consolidated VIEs, management made evaluations of the relationships between us and our 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, we control the shareholders' voting interests in these VIEs. As a result of such evaluation, management concluded that we are the primary beneficiary of our consolidated VIEs.



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### ***Noncontrolling Interest Recognition***

Noncontrolling interests are recognized to reflect the portion of the equity of subsidiaries and VIEs which is not attributable, directly or indirectly, to the controlling shareholder. Currently, the noncontrolling interests in our consolidated financial statements primarily consist of noncontrolling interests for Sogou and Changyou.

#### *Noncontrolling Interest for Sogou*

##### Sogou's Share Structure

As of December 31, 2016, Sogou had outstanding a combined total of 334,746,495 ordinary shares and preferred shares held as follows:

- (i) Sohu.com Inc.: 131,697,750 Class A Ordinary Shares, of which 4,484,500 shares may be purchased by Sohu management and key employees under an option arrangement;
- (ii) Photon Group Limited, an investment vehicle of the Sohu Group's Chairman and Chief Executive Officer Charles Zhang ("Photon"): 32,000,000 Series A Preferred Shares;
- (iii) Tencent: 6,757,875 Class A Ordinary Shares, 65,431,579 Series B Preferred Shares and 79,368,421 non-voting Class B Ordinary Shares; and
- (iv) Various employees of Sogou and Sohu: 19,490,870 Class A Ordinary Shares.

##### Sohu's Shareholding in and Control of Sogou

As of December 31, 2016, we held approximately 36% of the outstanding equity capital of Sogou on a fully-diluted basis, assuming for such purpose that all share options under the Sogou 2010 Share Incentive Plan and all share options under the Sohu Management Sogou Share Option Arrangement are granted and exercised, and that all of the Sogou Class A Ordinary Shares that Sogou has repurchased are re-issued to shareholders other than us. Also as of December 31, 2016, we held over 50% of the total voting power of Sogou on a fully-diluted basis and controlled the election of a majority of the Board of Directors of Sogou, assuming that Tencent's non-voting Class B Ordinary Shares are converted to voting shares, that all of the Sogou Class A Ordinary Shares that Sogou has repurchased are re-issued to shareholders other than us, and that all Sogou share options under the Sogou 2010 Share Incentive Plan and all Sogou share options under the Sohu Management Sogou Share Option Arrangement are granted and exercised.

As Sogou's controlling shareholder, we consolidate Sogou in our consolidated financial statements, and recognize noncontrolling interest reflecting economic interests in Sogou held by shareholders other than us (the "Sogou noncontrolling shareholders"). Sogou's net income/(loss) attributable to the Sogou noncontrolling shareholders is recorded as noncontrolling interest in our consolidated statements of comprehensive income. Sogou's cumulative results of operations attributable to the Sogou noncontrolling shareholders, along with changes in shareholders' equity/(deficit) and adjustment for share-based compensation expense in relation to those share-based awards which are unvested and vested but not yet settled and the Sogou noncontrolling shareholders' investments in Sogou's Series A Preferred Shares and Series B Preferred Shares (collectively, the "Sogou Preferred Shares") and Ordinary Shares are accounted for as a noncontrolling interest classified as permanent equity in our consolidated balance sheets, as we have the right to reject a redemption requested by the noncontrolling shareholders. These treatments are based on the terms governing investment, and on the terms of the classes of Sogou shares held, by the noncontrolling shareholders in Sogou.

##### Principles of Allocation of Sogou's Profit and Loss

By virtue of the terms of Sogou Preferred Shares and Class A Ordinary Shares and Class B Ordinary Shares, Sogou's losses are allocated in the following order:

- (i) net losses are allocated to holders of Sogou Class A Ordinary Shares and the holder of Sogou Class B Ordinary Shares until their basis in Sogou decreased to zero;
- (ii) additional net losses are allocated to holders of Sogou Series A Preferred Shares until their basis in Sogou decreased to zero;
- (iii) additional net losses are allocated to the holder of Sogou Series B Preferred Shares until its basis in Sogou decreases to zero; and
- (iv) further net losses are allocated between Sohu and noncontrolling shareholders based on their shareholding percentage in Sogou.

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Net income from Sogou is allocated in the following order:

- (i) net income is allocated between Sohu and noncontrolling shareholders based on their shareholding percentage in Sogou until their basis in Sogou increases to zero;
- (ii) additional net income is allocated to the holder of Sogou Series B Preferred Shares to bring its basis back;
- (iii) additional net income is allocated to holders of Sogou Series A Preferred Shares to bring their basis back;
- (iv) further net income is allocated to holders of Sogou Class A Ordinary Shares and the holder of Sogou Class B Ordinary Shares to bring their basis back; and
- (v) further net income is allocated between Sohu and noncontrolling shareholders based on their shareholding percentage in Sogou.

### Key Terms of Sogou Preferred Shares

The following is a summary of some of the key terms of the Sogou Preferred Shares under Sogou's Memorandum and Articles of Association as currently in effect.

#### Dividend Rights

Sogou may not declare or pay dividends on its Class A Ordinary Shares or Class B Ordinary Shares (collectively, "Ordinary Shares") unless the holders of the Sogou Preferred Shares then outstanding first receive a dividend on each outstanding Preferred Share in an amount at least equal to the sum of (i) the dividends that would have been payable to the holder of such Preferred Share if such share had been converted into Ordinary Shares, at the then-applicable conversion rate, immediately prior to the record date for such dividend, and (ii) all accrued and unpaid Accruing Dividends. "Accruing Dividends" are calculated from the date of issuance of the Series A Preferred Shares at the rate per annum of \$0.0375 per Series A Preferred Share and from the date of issuance of the Series B Preferred Shares at the rate per annum of \$0.411 per Series B Preferred Share.

#### Liquidation Rights

In the event of any "Liquidation Event," such as the liquidation, dissolution or winding up of Sogou, a merger or consolidation of Sogou resulting in a change of control, the sale of substantially all of Sogou's assets or similar events, the holders of Series B Preferred Shares are entitled to receive an amount per share equal to the greater of (i) \$6.847 plus any unpaid Accruing Dividends or (ii) such amount per share as would have been payable if the Series B Preferred Shares had been converted into Ordinary Shares prior the Liquidation Event, and holders of Series A Preferred Shares are entitled to receive, after payment to the holders of the Series B Preferred Shares but before any payment to holders of Ordinary Shares, an amount equal to the greater of (i) 1.3 times their original investment in the Series A Preferred Shares plus all accrued but unpaid Accruing Dividends or (ii) such amount per share as would be payable if the Series A Preferred Shares had been converted into Ordinary Shares immediately prior to the Liquidation Event.

#### Redemption Rights

The Sogou Preferred Shares are not redeemable at the option of the holders.

#### Conversion Rights

Each Sogou Preferred Share is convertible, at the option of the holder, at any time, and without the payment of additional consideration by the holder. Each Sogou Preferred Share is convertible into such number of Class A Ordinary Shares as is determined, in the case of Series A Preferred Shares, by dividing \$0.625 by the then-effective conversion price for Series A Preferred Shares, which is initially \$0.625, and, in the case of Series B Preferred Shares, by dividing \$7.267 by the then-effective conversion price for Series B Preferred Shares, which is initially \$7.267. The conversion prices of the Sogou Preferred Shares are subject to adjustment on a weighted average basis upon the issuance of additional equity shares, or securities convertible into equity shares, at a price per share less than \$0.625, in the case of Series A Preferred Shares, or less than \$7.267, in the case of Series B Preferred Shares, subject to certain customary exceptions, such as shares issued pursuant to the Sogou 2010 Share Incentive Plan. Each Sogou Preferred Share will be automatically converted into Class A Ordinary Shares of Sogou upon the closing of a qualified IPO of Sogou based on the then-effective conversion ratio of such Sogou Preferred Share, which is currently one-for-one for both Series A Preferred Shares and Series B Preferred Shares.

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### Voting Rights

Each holder of Sogou Preferred Shares is entitled to cast the number of votes equal to the number of Class A Ordinary Shares into which the Sogou Preferred Shares held by such holder are then convertible.

### Other Rights

The holders of Sogou Preferred Shares have various other rights typical of preferred share investments.

### Key Terms of Sogou Class A Ordinary Shares and Class B Ordinary Shares

The Class A Ordinary Shares and Class B Ordinary Shares have identical rights, except that Class B Ordinary Shares do not have voting rights unless the holders of at least a majority of the then outstanding Class B Ordinary Shares elect, by written notice to Sogou, to convert them into shares with voting rights.

### *Noncontrolling Interest for Changyou*

Changyou is a public company listed on the NASDAQ Global Select Market. As of December 31, 2016, we held approximately 69% of the combined total of Changyou's outstanding ordinary shares, and controlled approximately 96% of the total voting power in Changyou.

As Changyou's controlling shareholder, we consolidate Changyou in our consolidated financial statements, and recognize noncontrolling interest reflecting the economic interest in Changyou held by shareholders other than us (the "Changyou noncontrolling shareholders"). Changyou's net income/(loss) attributable to the Changyou noncontrolling shareholders is recorded as noncontrolling interest in our consolidated statements of comprehensive income, based on their share of the economic interest in Changyou. Changyou's cumulative results of operations attributable to the Changyou noncontrolling shareholders, along with changes in shareholders' equity, adjustment for share-based compensation expense in relation to those share-based awards which are unvested and vested but not yet settled and adjustment for changes in our ownership in Changyou, are recorded as noncontrolling interest in our consolidated balance sheets.

### *Segment Reporting*

Our 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 CODM is Sohu.com Inc.'s Chief Executive Officer.

### **Revenue Recognition**

We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. The recognition of revenues involves certain management judgments. The amount and timing of our revenues could be materially different for any period if management made different judgments or utilized different estimates.

Barter trade transactions in which physical goods or services (other than advertising services) are received in exchange for advertising services are recorded based on the fair values of the goods and services received. For online advertising-for-online advertising barter transactions, no revenue or expense is recognized because the fair value of neither the advertising surrendered nor the advertising received is determinable.

### *Online Advertising Revenues*

Online advertising revenues include revenues from brand advertising services as well as search and search-related services. We recognize revenue for the amount of fees we receive from our advertisers, after deducting agent rebates and net of value-added tax ("VAT") and related surcharges.

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### *Brand Advertising Revenues*

#### *Business Model*

Through PCs and mobile devices, we provide advertisement placements to our advertisers on different Internet platforms and in different formats, which include banners, links, logos, buttons, full screen, pre-roll, mid-roll, post-roll video screens, pause video screens, loading page ads, news feed ads and in-feed video infomercial ads.

Currently we have four main types of pricing models, consisting of the Fixed Price model, the Cost Per Impression (“CPM”) model, the E-commerce model, and the Cost Per click (“CPC”) model.

#### Fixed Price model

Under the Fixed Price model, a contract is signed to establish a fixed price for the advertising services to be provided. We recognize revenue based on the contract price and the period of display.

#### CPM model

Under the CPM model, the unit price for each qualifying display is fixed, but there is no overall fixed price for the advertising services stated in the contract with the advertiser. A qualifying display is defined as the appearance of an advertisement, where the advertisement meets criteria specified in the contract. We recognize revenue based on the fees we charge the advertisers, which are based on the unit prices and the number of qualifying displays.

#### E-commerce model

Under the e-commerce model, revenues were mainly generated from sales of membership cards which allow potential home buyers to purchase specified properties from real estate developers at a discount greater than the price that Focus charges for the card. Membership fees are refundable until the potential home buyer uses the discounts to purchase properties. Focus recognizes such revenues upon obtaining confirmation that the membership card has been redeemed to purchase a property.

#### CPC model

Under the CPC model, there is no overall fixed price for advertising services stated in the contract with the advertiser. We charge advertisers on a per-click basis when the users click on the advertisements. The unit price for each click is auction-based. We recognize revenue based on qualifying clicks and the unit price.

#### *Revenue Recognition*

For brand advertising revenue recognition, prior to entering into contracts, we make a credit assessment of the advertiser. For contracts for which collectability is determined to be reasonably assured, we recognize revenue when all revenue recognition criteria are met. In other cases, we only recognize revenue when the cash is received and all other revenue recognition criteria are met.

We treat advertising contracts with multiple deliverable elements as separate units of accounting for revenue recognition purposes and recognizes revenue on a periodic basis during the contract period when each deliverable service is provided. Since the contract price is for all deliverables under one advertising contract, we allocate the contract price among all the deliverables at the inception of the arrangement on the basis of their relative selling prices according to the selling price hierarchy established by *ASU No. 2009-13*. We first use vendor-specific objective evidence of selling price, if it exists. If vendor-specific objective evidence of selling price does not exist, we use third-party evidence of selling price. If neither vendor-specific objective evidence of selling price nor third-party evidence of selling price exists, we use management’s best estimate of selling price for the deliverables.

### *Search and Search-related Revenues*

Search and search-related services primarily include pay-for-click services, as well as online marketing services on Web directories operated by Sogou.

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### *Pay-for-click Services*

Pay-for-click services are services that enable our advertisers' promotional links to be displayed on Sogou search result pages and Sogou Website Alliance members' Internet properties where the links are relevant to the subject and content of such properties. For pay-for-click services, we introduce Internet users to our advertisers through our auction-based pay-for-click systems and charge advertisers on a per-click basis when the users click on the displayed links. Revenue for pay-for-click services is recognized on a per-click basis when the users click on the displayed links.

### *Online Marketing Services on Web Directories Operated by Sogou*

Online marketing services on Web directories operated by Sogou mainly consist of displaying advertisers' promotional links on the Web pages of Web directories. Revenue for online marketing services on Web directories operated by Sogou is normally recognized on a straight-line basis over the contract period, provided our obligations under the contract have been met and all revenue recognition criteria have been met.

Both pay-for-click services and online marketing services on Web directories operated by Sogou expand distribution of advertisers' promotional links or advertisements by leveraging traffic on Sogou Website Alliance members' Internet properties including Web content, software and mobile applications. We recognize gross revenue for the amount of fees we receive from advertisers, as we have the primary responsibility for fulfillment and acceptability. Payments made to Sogou Website Alliance members are included in cost of search and search-related revenues as traffic acquisition costs. We pay Sogou Website Alliance members based on either revenue-sharing arrangements, under which we pay a percentage of pay-for-click revenues generated from clicks by users of their properties, or on a pre-agreed unit price.

### ***Online Game Revenues***

Changyou's online game revenues are generated primarily from its self-operated and licensed-out PC games and mobile games. Prior to the sale of the 7Road business in 2015, Changyou generated online game revenues from Web games, which have been an insignificant part of Changyou's business since the sale. Changyou's online game revenues also include a small amount of revenues generated from online card and board games offered by MoboTap on the Dolphin Browser. All of Changyou's games are operated under the item-based revenue model, where the basic game play functions are free of charge and players are charged for purchases of in-game virtual items, including those with a predetermined expiration time and perpetual virtual items.

### *Self-Operated Games*

Changyou is the primary obligor of its self-operated games. Changyou hosts the games on its own servers and is responsible for the sale and marketing of the games as well as customer service. Accordingly, revenues are recorded gross of revenue sharing-payments to third-party developers and/or mobile APP stores, but are net of business tax/VAT and discounts to game card distributors where applicable. Changyou obtains revenues from the sale of in-game virtual items. Revenues are recognized over the estimated lives of the virtual items purchased by game players or as the virtual items are consumed. If different assumptions were used in deriving the estimated lives of the virtual items, the timing of the recording of the revenues would be impacted.

### *PC Games*

Proceeds from the self-operation of PC games are collected from players and third-party game card distributors through sales of Changyou's game points on its online payment platform and prepaid game cards.

Self-operated PC games are either developed in house or licensed from third-party developers. For licensed PC games, Changyou remits a pre-agreed percentage of the proceeds to the third-party developers, and keeps the balance pursuant to revenue-sharing agreements. Such revenue-sharing amounts paid to third-party developers are recorded in Changyou's cost of revenues.

### *Mobile Games*

For self-operated mobile games, Changyou sells game points to its game players via third-party mobile APP stores. The mobile APP stores in turn pay Changyou proceeds after deducting their share of pre-agreed revenue-sharing amounts.

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Self-operated mobile games are either developed in house or licensed from or jointly developed with third-party developers. For licensed and jointly developed mobile games, Changyou remits a pre-agreed percentage of the proceeds to the third-party developers, and keeps the balance pursuant to revenue-sharing agreements. Such revenue-sharing amounts paid to mobile application stores and third-party developers are recorded in Changyou's cost of revenues.

### Web Games

Changyou continued to operate a small portfolio of self-operated Web games after its sale of the 7Road business in 2015. Proceeds from those Web games are collected from players through the sale of game points.

### *Licensed-Out Games*

Changyou also authorizes third parties to operate its online games. Licensed out games include PC games and mobile games developed in house and mobile games jointly developed with third-party developers. Changyou receives monthly revenue-based royalty payments from all the third-party licensee operators. Changyou receives additional up-front license fees from certain third-party licensee operators who are entitled to an exclusive right to operate Changyou's games in specified geographic areas. Since Changyou is obligated to provide post-sale services, the initial license fees are recognized as revenue ratably over the license period, and the monthly revenue-based royalty payments are recognized when relevant services are delivered, provided that collectability is reasonably assured. Changyou views the third-party licensee operators as Changyou's customers and recognizes revenues on a net basis, as Changyou does not have the primary responsibility for fulfillment and acceptability of the game services. Changyou remits to the third-party developers a pre-agreed percentage of revenues from jointly developed and licensed out mobile games, and recognizes revenues on a net basis.

### **Other Revenues**

#### *Sohu*

Other revenues attributable to Sohu consist primarily of revenues from paid subscription services, interactive broadcasting services, sub-licensing of purchased video content to third parties, content provided through the platforms of the three main telecommunications operators in China, and the filming business.

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### *Sogou*

Other revenues attributable to Sogou are primarily IVAS revenues derived from the operation of Web games and mobile games of third-party developers as well as other services and products that Sogou provides to users.

### *Changyou*

Other revenues attributable to Changyou are primarily from its cinema advertising business and from IVAS.

In its cinema advertising business, Changyou provides clients advertising placements in slots that are shown in theaters before the screening of movies. The rights to place advertisements in such advertising slots are granted under contracts Changyou signs with different theaters. When all the recognition criteria are met, revenues from cinema advertising are recognized based on a percentage of the advertising slots actually delivered or on a straight-line basis over the contract period.

Changyou provides IVAS primarily through software applications for PCs and mobile devices offered by MoboTap on the Dolphin Browser and by RaidCall. Revenues from IVAS are recognized during the period the service rendered or items consumed under the gross method, as Changyou is the principal obligor for provision of the services.

## **Cost of Revenues**

### ***Cost of Online Advertising Revenues***

Cost of online advertising revenues includes cost of revenues from brand advertising services as well as cost of revenues from search and search-related services.

### *Cost of Brand Advertising Revenues*

Cost of brand advertising revenues mainly consists of content and license costs, bandwidth leasing costs, and salary and benefits expense.

### *Cost of Search and Search-related Revenues*

Cost of search and search-related revenues mainly consists of traffic acquisition costs, bandwidth leasing costs, depreciation expenses, as well as salary and benefits expenses. Traffic acquisition costs represent payments made to Sogou Website Alliance members. We pay Sogou Website Alliance members based either on revenue-sharing arrangements or on a pre-agreed unit price. Under the revenue-sharing arrangements, we pay a percentage of pay-for-click revenues generated from clicks by users of the Website Alliance members' properties.

### ***Cost of Online Game Revenues***

Cost of online game revenues mainly consists of revenue-sharing payments, salary and benefits expense, bandwidth leasing costs, content and license costs, amortization and depreciation expenses, and other direct costs.

### ***Cost of Other Revenues***

Cost of other revenues mainly consists of payments to theaters and film production companies for pre-film screening advertising slots, content and license costs related to paid subscription services, revenue-sharing payments related to the IVAS business, and revenue-sharing payments related to interactive broadcasting services.

## **Product Development Expenses**

Product development expenses mainly consist of salary and benefits expenses, content and license expenses, technical service fees, depreciation and amortization expenses, share-based compensation, and facilities expenses. These expenses are incurred for the enhancement and maintenance of our Internet platforms as well as for our products and services, including the development costs of online games prior to the establishment of technological feasibility and maintenance costs after the online games are available for marketing.



### **Sales and Marketing Expenses**

Sales and marketing expenses mainly consist of advertising and promotional expenses, salary and benefits expenses, travel expenses, and facility expenses. Advertising and promotional expenses generally represent the expenses of promotions to create or stimulate a positive image of us or a desire to subscribe for our products and services. Advertising and promotional expenses are expensed as incurred.

### **General and Administrative Expenses**

General and administrative expenses mainly consist of salary and benefits expenses, professional service fees, facility expenses, travel expenses, share-based compensation expense, and depreciation and amortization expenses.

### **Share-based Compensation Expense**

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

For share-based awards for which a grant date has occurred, share-based compensation expense is recognized as costs and expenses in the consolidated statements of comprehensive income based on the fair value of the related share-based awards on their grant dates. For share-based awards for which the service inception date precedes the grant date, share-based compensation expense is recognized as costs and expenses in the consolidated statements of comprehensive income beginning on the service inception date and is re-measured on each subsequent reporting date before the grant date, based on the estimated fair value of the related share-based awards. Share-based compensation expense is charged to the shareholders’ equity or noncontrolling interest section in the consolidated balance sheets. The assumptions used in share-based compensation expense recognition represent management’s best estimates, but these estimates involve inherent uncertainties and the application of management judgment. If factors change or different assumptions are used, our share-based compensation expense could be materially different for any period. Moreover, the estimates of fair value are not intended to predict actual future events or the value that ultimately will be realized by employees who receive equity awards, and subsequent events are not indicative of the reasonableness of the original estimates of fair value made by us for accounting purposes.

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

##### ***Sohu (excluding Sohu Video) Share-based Awards***

In determining the fair value of stock options granted by Sohu (excluding Sohu Video) as share-based awards before 2006, the Black-Scholes valuation model was applied. In determining the fair value of restricted share units granted, the public market price of the underlying shares on the grant dates was applied.

Options for the purchase of Sohu common stock contractually granted under the Sohu 2010 Stock Incentive Plan are subject to vesting in four equal installments over a period of four years, with each installment vesting upon satisfaction of a service period requirement and certain subjective performance targets. Under ASC 718-10-25, no grant date can be established until a mutual understanding is reached between Sohu and the recipients clarifying the subjective performance requirements. In accordance with ASC 718-10-55, as the service inception date preceded the grant date, compensation expense was accrued beginning on the service inception date and will be re-measured on each subsequent reporting date before the grant date is established, based on the then-current fair value of the awards. The estimate of the awards’ fair values will be fixed in the period in which the grant date occurs, and cumulative compensation expense will be adjusted based on the fair value at the grant date. In determining the fair values of the stock options granted, the public market price of the underlying shares at each reporting date was used, and a binomial valuation model was applied.

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### *Sogou Share-based Awards*

In determining the fair value of share options granted by Sogou as share-based awards, the income approach /discounted cash flow method with a discount for lack of marketability was applied, given that the shares underlying the awards were not publicly traded at the time of grant. Certain persons who became Sogou employees when Tencent's Soso search-related businesses were transferred to Sogou on September 16, 2013 had been granted restricted share units under Tencent's share award arrangements prior to the transfer of the businesses to Sogou. These Tencent restricted share units will continue to vest under the original Tencent share award arrangements provided the transferred employees continue to be employed by Sogou during the requisite service period. After the transfer of the Soso search-related businesses to Sogou, Sogou applied the guidance in ASC 505-50 to measure the related compensation expense, based on the then-current fair value at each reporting date, as the expense is deemed to have been incurred by Tencent as an investor on Sogou's behalf. To determine the then-current fair value of the Tencent restricted share units granted to these employees, the public market price of the underlying shares at each reporting date was applied. Because Sogou is not required to reimburse Tencent for such share-based compensation expense, the related amount was recorded by Sogou as a capital contribution from Tencent.

### *Changyou Share-based Awards*

In determining the fair value of ordinary shares and restricted share units granted by Changyou as share-based awards in 2008, the income approach /discounted cash flow method with a discount for lack of marketability was applied, given that the shares underlying the awards were not publicly traded at the time of grant. In determining the fair value of restricted share units granted in 2009 shortly before Changyou's initial public offering, the fair value of the underlying shares was determined based on Changyou's offering price for its initial public offering. In determining the fair value of restricted share units granted after Changyou's initial public offering, the public market price of the underlying shares on the grant dates was applied.

Options for the purchase of Changyou Class A ordinary shares contractually granted under the Changyou 2014 Share Incentive Plan are subject to vesting in four equal installments over a period of four years, with each installment vesting upon satisfaction of a service period requirement and certain subjective performance targets. Under ASC 718-10-25, no grant date can be established until a mutual understanding is reached between Changyou and the recipients clarifying the subjective performance requirements. In accordance with ASC 718-10-55, as the service inception date preceded the grant date, compensation expense was accrued beginning on the service inception date and will be re-measured on each subsequent reporting date before the grant date is established, based on the then-current fair value of the awards. The estimate of the awards' fair values will be fixed in the period in which the grant date occurs, and cumulative compensation expense will be adjusted based on the fair values at the grant date. In determining the fair values of Changyou share options granted, the public market price of the underlying shares at each reporting date was used, and a binomial valuation model was applied.

### *Compensation Expense Recognition*

For options and restricted share units granted with respect to Sohu (excluding Sohu Video) shares and Changyou shares, compensation expense is recognized on an accelerated basis over the requisite service period. For share options granted with respect to Sogou shares, compensation expense is recognized on a straight-line basis over the estimated period during which the service period requirement and performance target will be met. For Tencent restricted share units that Tencent had granted to employees who transferred to Sogou with the Soso search-related businesses, compensation expense is recognized by Sogou on an accelerated basis over the requisite service period, and the fair value of the share-based compensation is re-measured at each reporting date until vesting occurs. The number of share-based awards for which the service is not expected to be rendered over the requisite period is estimated, and no compensation expense is recorded for the number of awards so estimated.

### *Sohu Video Share-based Awards*

On January 4, 2012, Sohu Video, the holding entity of Sohu's video division, adopted a 2011 Share Incentive Plan (the "Video 2011 Share Incentive Plan") which provides for the issuance of up to 25,000,000 ordinary shares of Sohu Video (representing approximately 10% of the outstanding Sohu Video shares on a fully-diluted basis) to management and key employees of the video division and to Sohu management. As of December 31, 2016, grants of options for the purchase of 16,368,200 ordinary shares of Sohu Video had been contractually made, of which options for the purchase of 4,972,800 ordinary shares were vested.

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For purposes of ASC 718-10-25, as of December 31, 2016, no grant date had occurred, because the broader terms and conditions of the option awards had neither been finalized nor mutually agreed upon with the recipients. Therefore the fair value of the awards was not determinable and could not be accounted for. In accordance with ASC 718-10-55, our management determined that the service inception date with respect to vested option awards for the purchase of 4,972,800 shares had preceded the grant date. Therefore, we recognized compensation expense for these vested Sohu Video share-based awards and re-measured, and will re-measure, the compensation expense on each subsequent reporting date based on the then-current fair values of these vested awards until the grant date is established.

### **Taxation**

#### ***Income Taxes***

##### *Recognition*

Income taxes are accounted for using an asset and liability approach which requires the recognition of income taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in our financial statements or tax returns. Deferred income taxes are determined based on the differences between the accounting basis and the tax basis of assets and liabilities and are measured using the currently enacted tax rates and laws. Deferred tax assets are reduced by a valuation allowance, if based on available evidence, it is considered that it is more likely than not that some portion of or all of the deferred tax assets will not be realized. In making such determination, we consider factors including future reversals of existing taxable temporary differences, future profitability, and tax planning strategies. 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.

Our deferred tax assets relate to net operating losses and temporary differences between accounting basis and tax basis for our China-Based Subsidiaries and VIEs, which are subject to corporate income tax in the PRC under the CIT law.

In November 2015, the FASB issued Accounting Standards Update 2015-17, Balance Sheet Classification of Deferred Taxes, which requires deferred income tax liabilities and assets to be classified as non-current in a classified balance sheet, and eliminates the prior guidance, which required an entity to separate deferred tax liabilities and assets into a current amount and a non-current amount in a classified balance sheet. This new guidance is effective for annual reporting periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted. Additionally, the new guidance may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented.

We have changed the manner in which we classify our deferred tax assets and liabilities retrospectively from the fourth quarter of 2016 due to our early adoption of Accounting Standards Update 2015-17, Balance Sheet Classification of Deferred Taxes. As a result of our adoption of this guidance, we reclassified our deferred tax assets and deferred tax liabilities as of December 31, 2016 and 2015 from current assets and liabilities to long-term assets and liabilities.

##### *Applicable Income Tax Rate*

##### *Principal Entities Qualified as HNTEs*

The CIT Law generally applies an income tax rate of 25% to all enterprises but grants preferential tax treatment to HNTEs. Under this preferential tax treatment, HNTEs can enjoy an income tax rate of 15%, but need to re-apply every three years. During this three-year period, an HNTE must conduct a qualification self-review each year to ensure it meets the HNTE criteria and is eligible for the 15% preferential tax rate for that year. If an HNTE fails to meet the criteria for qualification as an HNTE in any year, the enterprise cannot enjoy the 15% preferential tax rate in that year, and must instead use the regular 25% CIT rate.

As of December 31, 2016, the following principal entities were qualified as HNTEs and were entitled to an income tax rate of 15%.

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### For Sohu's Business

- Sohu New Momentum. Sohu New Momentum qualified as an HNTE for 2016 to 2018, and will need to re-apply for HNTE qualification in 2019.
- Sohu Internet. Sohu Internet qualified as an HNTE for 2015 to 2017, and will need to re-apply for HNTE qualification in 2018.
- Sohu Era, Sohu Media and Guangzhou Qianjun. Sohu Era, Sohu Media and Guangzhou Qianjun each qualified as HNTEs for 2014 to 2016, and will need to re-apply for HNTE qualification in 2017.

### For Sogou's Business

- Sogou Information. Sogou Information qualified as an HNTE for 2015 to 2017, and will need to re-apply for HNTE qualification in 2018.
- Sogou Technology. Sogou Technology qualified as an HNTE for 2014 to 2016, and will need to re-apply for HNTE qualification in 2017.
- Sogou Network. Sogou Network qualified as an HNTE for 2016 to 2018, and will need to re-apply for HNTE qualification in 2019.

### For Changyou's Business

- AmazGame and Gamease. AmazGame and Gamease each qualified as HNTEs for 2014 to 2016, and will need to re-apply for HNTE qualification in 2017.

### Principal Entities Qualified as Software Enterprises and KNSE

The CIT Law and its implementing regulations provide that a "Software Enterprise" is entitled to an income tax exemption for two years beginning with its first profitable year and a 50% reduction to a rate of 12.5% for the subsequent three years. An entity that qualifies as a "Key National Software Enterprise" (a "KNSE") is entitled to a further reduced preferential income tax rate of 10%. Enterprises wishing to enjoy the status of a Software Enterprise or KNSE must perform a self-assessment each year to ensure they meet the criteria for qualification and file required supporting documents with the tax authorities before using the preferential CIT rates. These enterprises will be subject to the tax authorities' assessment each year as to whether they are entitled to use the relevant preferential CIT treatments. If at any time during the preferential tax treatment years an enterprise uses the preferential CIT rates but the relevant authorities determine that it fails to meet applicable criteria for qualification, the relevant authorities may revoke the enterprise's Software Enterprise/KNSE status.

### For Sohu's Business

- Sohu New Momentum. In 2016, Sohu New Momentum was in the first of three years in which it is entitled to a 50% reduction to a rate of 12.5% as a Software Enterprise, subject to a requirement that it file documents in 2017 in order for the qualification to apply to 2016 and the following two years.

### For Sogou's Business

- Sogou Technology. Sogou Technology performed the self-assessment and filed required supporting documents in 2016 for KNSE status for 2015. Sogou Technology was qualified as a KNSE after the relevant government authorities' assessment and was entitled to a preferential income tax rate of 10% for 2015. As a result, a reversal of income tax of \$3.8 million for the preferential income tax rate was recorded in the consolidated statements of comprehensive income for the year ended December 31, 2016. Same process will be followed in 2017 by Sogou Technology for its preferential income tax treatment as a KNSE for 2016.
- Sogou Network. Sogou Network performed the self-assessment and filed required supporting documents in 2016 for Software Enterprise status for 2015. Sogou Network was qualified as a Software Enterprise after the relevant government authorities' assessment and was entitled to a preferential income tax rate of 12.5% for 2015.

For Changyou's Business

- **AmazGame.** AmazGame qualified as a KNSE and enjoyed a preferential income tax rate of 10% for each of 2013 and 2014. AmazGame performed the self-assessment and filed required supporting documents in 2016 for KNSE status for 2015. AmazGame was qualified as a KNSE after the relevant government authorities' assessment and was entitled to a preferential income tax rate of 10% for 2015. As a result, a reversal of income tax of \$10.6 million for the preferential income tax rate was recorded in the consolidated statements of comprehensive income for the year ended December 31, 2016. Same process will be followed in 2017 by AmazGame for its preferential income tax treatment as a KNSE for 2016.
- **Gamespace.** In 2016, Gamespace was in the third of three years in which it was entitled to a 50% reduction to a rate of 12.5% as a Software Enterprise. Gamespace will need to re-apply in 2017 for qualification as a Software Enterprise for 2016.
- **Wuhan Baina Information.** In 2016, Wuhan Baina Information was in the first of two years in which it is entitled to income tax exemption as a Software Enterprise. Wuhan Baina Information will need to apply in 2017 for qualification as a Software Enterprise for 2016.

**PRC Withholding Tax on Dividends**

The CIT Law imposes a 10% withholding income tax on dividends distributed by foreign invested enterprises in the PRC to their immediate holding companies outside Mainland China. A lower withholding tax rate may be applied if there is a tax treaty between Mainland China and the jurisdiction of the foreign holding company. A holding company in Hong Kong, for example, will be subject to a 5% withholding tax rate under an arrangement between the PRC and the Hong Kong Special Administrative Region on the "Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital," if such holding company is considered a non-PRC resident enterprise and holds at least 25% of the equity interests in the PRC foreign invested enterprise distributing the dividends, subject to approval of the PRC local tax authority. However, if the Hong Kong holding company is not considered to be the beneficial owner of such dividends under applicable PRC tax regulations, such dividend will remain subject to a withholding tax rate of 10%.

**PRC Value Added Tax**

Effective September 1, 2012, a pilot program (the "Pilot Program") for transition from the imposition of PRC business tax ("Business Tax") to the imposition of VAT for revenues from certain industries was implemented in certain cities and provinces in China, including Beijing and Tianjin. Prior to the Pilot Program, the Group was mainly subject to a 5% PRC business tax and related surcharges on revenues in the PRC. PRC business tax and the related surcharges were recognized when the revenue was earned.

On May 1, 2016, the transition from the imposition of Business Tax to the imposition of VAT was expanded to all industries in China, and all of our revenues have been subject to VAT since that date. To record VAT payable, we adopted the net presentation method, which presents the difference between the output VAT (at a rate of 6%) and the available input VAT amount (at the rate applicable to the supplier).

**U.S. Corporate Income Tax**

Sohu.com Inc. is a Delaware corporation that is subject to U.S. corporate income tax on its taxable income at a rate of up to 35%. To the extent that portions of its U.S. taxable income, such as Subpart F income or a dividend, are determined to be from sources outside of the U.S., subject to certain limitations, Sohu.com Inc. may be able to claim foreign tax credits to offset its U.S. income tax liabilities. Any remaining liabilities are accrued in our consolidated statements of comprehensive income and estimated tax payments are made when required by U.S. law.

**Uncertain Tax Positions**

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

## Net Income/(Loss) per Share

Basic net income / (loss) per share is computed using the weighted average number of common shares outstanding during the period. Diluted net income / (loss) 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 comprise shares issuable upon the exercise or settlement of share-based awards using the treasury stock method. The dilutive effect of share-based awards with performance requirements is not considered before the performance targets are actually met. The computation of diluted net income / (loss) per share does not assume conversion, exercise, or contingent issuance of securities that would have an anti-dilutive effect (i.e. an increase in earnings per share amounts or a decrease in loss per share amounts) on net income / (loss) per share. Additionally, for purposes of calculating the numerator of diluted net income / (loss) per share, the net income / (loss) attributable to the Sohu Group is adjusted as follows. The adjustment will not be made if there is an anti-dilutive effect.

- (1) Sogou's net income/(loss) attributable to Sohu.com Inc. is determined using the percentage that the weighted average number of Sogou shares held by Sohu.com Inc. represents of the weighted average number of Sogou Preferred Shares and Ordinary Shares, shares issuable upon the conversion of convertible preferred shares under the if-converted method, and shares issuable upon the exercise or settlement of share-based awards under the treasury stock method, and is not determined by allocating Sogou's net income/(loss) to Sohu.com Inc. using the methodology for the calculation of net income/(loss) attributable to the Sogou noncontrolling shareholders.

In the calculation of Sohu.com Inc.'s diluted net income / (loss) per share, assuming a dilutive effect, the percentage of Sohu.com Inc.'s shareholding in Sogou was calculated by treating convertible preferred shares issued by Sogou as having been converted at the beginning of the period and unvested Sogou share options with the performance targets achieved as well as vested but unexercised Sogou share options as having been exercised during the period. The dilutive effect of share-based awards with a performance requirement was not considered before the performance targets were actually met. Assuming an anti-dilutive effect, all of these Sogou shares and share options are excluded from the calculation of Sohu.com Inc.'s diluted income/(loss) per share. As a result, Sogou's net income/(loss) attributable to Sohu.com Inc. on a diluted basis equals the number used for the calculation of Sohu.com Inc.'s basic net income/(loss) per share.

- (2) Changyou's net income/(loss) attributable to Sohu.com Inc. is determined using the percentage that the weighted average number of Changyou shares held by Sohu.com Inc. represents of the weighted average number of Changyou ordinary shares and shares issuable upon the exercise or settlement of share-based awards under the treasury stock method, and not by using the percentage held by Sohu.com Inc. of the total economic interest in Changyou, which is used for the calculation of basic net income per share.

In the calculation of Sohu.com Inc.'s diluted net income/(loss) per share, assuming a dilutive effect, all of Changyou's existing unvested restricted share units and share options, and vested restricted share units and share options that have not yet been settled, are treated as vested and settled by Changyou under the treasury stock method, causing the percentage of the weighted average number of shares held by Sohu.com Inc. in Changyou to decrease. As a result, Changyou's net income / (loss) attributable to Sohu.com Inc. on a diluted basis decreased accordingly. Assuming an anti-dilutive effect, all of these Changyou restricted share units and share options are excluded from the calculation of Sohu.com Inc.'s diluted net income/(loss) per share. As a result, Changyou's net income/(loss) attributable to Sohu.com Inc. on a diluted basis equals the number used for the calculation of Sohu.com Inc.'s basic net income/(loss) per share.

## Fair Value of Financial Instruments

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

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

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

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

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

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### **Cash Equivalents**

Our cash equivalents mainly consist of time deposits with original maturities of three months or less, and highly liquid investments that are readily convertible to known amounts of cash.

### **Short-term Investments**

For investments in financial instruments with a variable interest rate indexed to the performance of underlying assets, we elected the fair value method at the date of initial recognition and carried these investments subsequently at fair value. Changes in fair values are reflected in the consolidated statements of comprehensive income.

### **Accounts Receivable, Net**

The carrying value of accounts receivable is reduced by an allowance that reflects our best estimate of the amounts that will not be collected. We make estimations of the collectability of accounts receivable. Many factors are considered in estimating the general allowance, including reviewing delinquent accounts receivable, performing an aging analysis and a customer credit analysis, and analyzing historical bad debt records and current economic trends.

### **Available-for-Sale Securities**

Investments in debt securities and equity securities that have readily determinable fair values not classified as trading securities or as held-to-maturity securities are classified as available-for-sale securities, and are included in long-term investments. Available-for-sale securities are reported at fair value, with unrealized gains or losses recorded in other comprehensive income or losses in the consolidated balance sheets. Realized gains or losses are included in the consolidated statements of comprehensive income during the period in which the gain or loss is realized. An impairment loss on the available-for-sale securities is recognized in the consolidated statements of comprehensive income when the decline in value is determined to be other-than-temporary.

### **Restricted Time Deposits**

Restricted time deposits are valued based on the prevailing interest rates in the market using the discounted cash flow method.

### ***Collateral related to Sogou Incentive Shares Trust Arrangements***

In February 2013, we deposited \$9.0 million in cash into restricted time deposit accounts at a bank as collateral for credit facilities provided by the bank to certain Sogou employees. The facilities were intended to fund the employees' early exercise of Sogou share options and related PRC individual income tax. In the fourth quarter of 2016, all of these credit facilities were repaid to the bank and the \$9.0 million restricted time deposit that secured these facilities was released.

### ***Changyou Loans from Offshore Banks, Secured by Time Deposits***

Commencing in 2012, we had, through Changyou, loans from offshore banks secured by RMB deposits in onshore branches of those banks. The loans from the offshore branches of the lending banks are classified as short-term bank loans or long-term bank loans based on their repayment period. The rates of interest under the loan agreements with the lending banks were determined based on the prevailing interest rates in the market. The RMB onshore deposits securing the offshore loans are treated as restricted time deposits on our consolidated balance sheets. In the first quarter of 2016, Changyou repaid all of the remaining bank loans, and restricted time deposits that secured these loans were released.

### **Foreign exchange forward contracts**

Foreign exchange forward contracts are initially recognized on the date a foreign exchange forward contract is entered into and are subsequently measured at fair value. Changyou entered into such foreign exchange forward contracts in compliance with its risk management policy for the purpose of eliminating the negative impact on earnings and equity resulting from fluctuations in the exchange rate between the U.S. dollar and the RMB. The instruments are marked-to-market at each period-end with the associated changes in fair value recognized in the line item "Other income /(expense), net" in the consolidated statements of comprehensive income and "Other short-term liabilities" or "Prepaid and other current assets" in the consolidated balance sheets.



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### **Equity Investments**

Investments in entities are recorded as equity investments under long-term investments. For entities over which we do not have significant influence, the cost method is applied, as there is no readily determinable fair value; for entities over which we can exercise significant influence but do not own a majority equity interest or control, the equity method is applied. For cost method investments, we carry the investment at historical cost after the date of investment. For equity method investments, we adjust the carrying amount of an investment and recognize investment income or loss for our share of the earnings or loss of the investee after the date of investment.

### **Long-Lived Assets**

Long-lived assets include fixed assets and intangible assets.

#### ***Fixed Assets***

Fixed assets mainly comprise office buildings, computer equipment and hardware, leasehold improvements, office furniture, and vehicles. Fixed assets are recorded at cost less accumulated depreciation with no residual value. Depreciation is computed using the straight-line method over the estimated useful lives of the assets.

<b>Fixed Assets</b>	<b>Estimated Useful Lives (years)</b>
Office buildings	36-47
Leasehold improvements	Lesser of term of the lease or the estimated useful lives of the assets
Vehicles	4-10
Office furniture	5
Computer equipment and hardware	2-5

Expenditure for maintenance and repairs is expensed as incurred.

The gain or loss on the disposal of fixed assets is the difference between the net sales proceeds and the lower of the carrying value or fair value less cost to sell the relevant assets and is recognized in operating expenses in the consolidated statements of comprehensive income.

#### ***Intangible Assets***

Intangible assets mainly comprise purchased video content, operating rights for licensed games, domain names and trademarks, computer software, developed technologies, and cinema advertising slot rights. Intangible assets are recorded at cost less accumulated amortization with no residual value. Amortization of intangible assets other than purchased video content is computed using the straight-line method over their estimated useful lives.

The estimated useful lives of our intangible assets are listed below:

<b>Intangible Assets</b>	<b>Estimated Useful Lives (years)</b>
Domain names and trademarks	4-30
Developed technologies	3-10
Computer software	1-5
Purchased video content	4 months to 2 years, or over the applicable licensing period
Cinema advertising slot rights	over the contract terms
Operating rights for licensed games	over the contract terms

#### ***Impairment of Long-lived Assets***

In accordance with ASC 360-10-35, we review the carrying values of long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Based on the existence of one or more indicators of impairment, we measure any impairment of long-lived assets using the projected discounted cash flow method at the asset group level. The estimation of future cash flows requires significant management judgment based on our historical results and anticipated results and is subject to many factors. The discount rate that is commensurate with the risk inherent in our business model is determined by our management. An impairment loss would be recorded if we determined that the carrying value of long-lived assets may not be recoverable. The impairment to be recognized is measured by the amount by which the carrying values of the assets exceed the fair value of the assets.

## **Video Content**

Video content consists primarily of purchased video content and self-developed video content. Purchased video content is recognized as intangible assets. Amortization of purchased video content is computed based on the trend in viewership accumulation. For self-developed video content, production costs incurred in excess of the amount of revenue contracted for are expensed as incurred, instead of being recorded as intangible assets.

Sohu Video enters into nonmonetary transactions to exchange online broadcasting rights for purchased video content with other online video broadcasting companies. Under *ASC 845*, the cost of a nonmonetary asset acquired in exchange for another nonmonetary asset is the fair value of the asset surrendered to obtain the acquired nonmonetary asset, and a gain or loss should be recognized on the exchange. The fair value of the asset received should be used to measure the cost if the fair value of the asset received is more reliable than the fair value of the asset surrendered. We record these nonmonetary exchanges at the fair values of the online broadcasting rights for purchased video content and recognize any net gain or loss from such exchange transactions.

### ***Impairment of Video Content***

Purchased video content is stated at the lower of cost less accumulated amortization, or net realizable value (“NRV”).

In accordance with *ASC 920-350-35*, if management’s expectations of the programming usefulness of a program, series, package, or program segment are revised downward, it may be necessary to write down unamortized cost to estimated NRV. A write-down from unamortized cost to a lower estimated NRV establishes a new cost basis. Accordingly, we measure the video content’s impairment loss by comparing its carrying value to its NRV. An impairment loss would be recorded if the carrying value of video content was lower than its NRV. The impairment to be recognized is measured by the amount by which the NRV of video content exceeds its carrying value.

## **Goodwill**

Goodwill represents the excess of the purchase price over the fair value of the identifiable assets and liabilities acquired as a result of our acquisitions of interests in our subsidiaries and consolidated VIEs. If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, we report in our financial statements provisional amounts for the items for which the accounting is incomplete. If a measurement period adjustment is identified, we recognize the adjustment as part of the acquisition accounting. We increase or decrease the provisional amounts of identifiable assets or liabilities by means of increases or decreases in goodwill for measurement period adjustments.

In accordance with *ASC 350*, we do not amortize goodwill, but test it for impairment. We test goodwill for impairment at the reporting unit level on an annual basis as of October 1, and between annual tests when an event occurs or circumstances change that could indicate that the asset might be impaired. Under *ASC 350-20-35*, we have the option to choose whether we will apply a qualitative assessment first and then a quantitative assessment, if necessary, or to apply a quantitative assessment directly. For reporting units applying a qualitative assessment first, we start the goodwill impairment test by assessing qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is mandatory. Otherwise, no further testing is required. The quantitative impairment test consists of a comparison of the fair value of goodwill with its carrying value. For reporting units directly applying the quantitative assessment, we perform the goodwill impairment test by quantitatively comparing the fair values of those reporting units to their carrying amounts. After performing the assessment, if the carrying amounts of the reporting units were higher than their fair value, we perform the second step of the two-step quantitative goodwill impairment test.

Application of a goodwill impairment test requires significant management 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. We estimate fair value using the income approach or market approach. The judgment in estimating the fair value of reporting units includes estimating future cash flows, determining appropriate discount rates, control premium, comparable companies’ multipliers, and making other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value for each reporting unit.

## Comprehensive Income

Comprehensive income is defined as the change in equity of a company during a period from transactions and other events and circumstances excluding transactions resulting from investments from owners and distributions to owners. Accumulated other comprehensive income, as presented on our consolidated balance sheets, includes a cumulative foreign currency translation adjustment and an unrealized gain/(loss) on available-for-sale securities.

## Functional Currency and Foreign Currency Translation

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 the entity primarily generates and expends cash. Management's judgment is essential to determine the functional currency by assessing various indicators, such as cash flows, sales price and market, expenses, financing and inter-company transactions and arrangements. The functional currency of Sohu.com Inc. is the U.S. dollar. The functional currency of our subsidiaries in the U.S., the Cayman Islands, the British Virgin Islands and Hong Kong is the U.S. dollar. The functional currencies of our subsidiaries and VIEs in other countries are the national currencies of those countries, rather than the U.S. dollar.

Foreign currency transactions denominated in currencies other than the functional currency are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are re-measured at the applicable rates of exchange in effect at that date. Gains and losses resulting from foreign currency re-measurement are included in the consolidated statements of comprehensive income.

Financial statements of entities with a functional currency other than the U.S. dollar are translated into U.S. dollars, which is the reporting currency. Assets and liabilities are translated at the current exchange rate in effect at the balance sheet date, and revenues and expenses are translated at the average of the exchange rates in effect during the reporting period. Shareholders' equity accounts are translated using the historical exchange rates at the date the entry to shareholders' equity was recorded, except for the change in retained earnings during the year, which is translated using the historical exchange rates used to translate each period's income statement. Differences resulting from translating a foreign currency to the reporting currency are recorded in accumulated other comprehensive income in the consolidated balance sheets.

## RESULTS OF OPERATIONS

### Revenues

The following table presents our revenues by revenue source and by proportion for the periods indicated (in thousands, except percentages):

	2014		2015		Year ended December 31, 2016		2015 VS 2014		2016 VS 2015	
	Amount	Percentage of the total revenue	Amount	Percentage of the total revenue	Amount	Percentage of the total revenue	Amount	Incremental ratio	Amount	Incremental ratio
Revenues:										
Online advertising:										
Brand advertising	\$ 541,158	33%	\$ 577,114	30%	\$ 447,956	27%	\$ 35,956	7%	\$ (129,158)	(22)%
Search and search-related	357,839	21%	539,521	28%	597,133	36%	181,682	51%	57,612	11%
Subtotal of online advertising revenues	898,997	54%	1,116,635	58%	1,045,089	63%	217,638	24%	(71,546)	(6)%
Online game	652,008	39%	636,846	33%	395,709	24%	(15,162)	(2)%	(241,137)	(38)%
Others	122,072	7%	183,610	9%	209,633	13%	61,538	50%	26,023	14%
Total revenues	<u>\$1,673,077</u>	100%	<u>\$1,937,091</u>	100%	<u>\$1,650,431</u>	100%	<u>\$264,014</u>	<u>16%</u>	<u>\$(286,660)</u>	<u>(15)%</u>

### **Online Advertising Revenues**

Online advertising revenues were \$1.05 billion for 2016, compared to \$1.12 billion and \$899.0 million, respectively, for 2015 and 2014. The year-on-year decrease for 2016 was \$71.5 million and the year-on-year increase for 2015 was \$217.6 million, representing a year-on-year decrease rate of 6% for 2016 and a year-on-year growth rate of 24% for 2015.

#### *Brand Advertising Revenues, Generated by Sohu and Changyou*

Brand advertising revenues were \$448.0 million for 2016, compared to \$577.1 million and \$541.2 million, respectively, for 2015 and 2014. The year-on-year decrease for 2016 was \$129.1 million and the year-on-year increase for 2015 was \$35.9 million, representing a year-on-year decrease of 22% for 2016 and a year-on-year increase of 7% for 2015. The year-on-year fluctuations in brand advertising revenues for 2016 and 2015 were both mainly from Sohu Video.

#### Sohu

- *Sohu Media Portal*

Revenues from Sohu Media Portal were \$181.8 million for 2016, compared to \$197.6 million for both 2015 and 2014. The year-on-year decrease for 2016 was \$15.8 million, representing a year-on-year decrease of 8% compared to 2015, while revenues for 2015 were flat compared to 2014. In 2016, while the slowdown in the growth of the economy in China shrank the budgets of brand advertisers, rapid growth in the number of small and medium enterprise (“SME”) customers advertising on Sohu Media Portal helped offset the impact to some extent. The number of advertisers for Sohu Media Portal was 4,259 for 2016, compared to 3,471 and 2,673, respectively, for 2015 and 2014. The average amount spent per advertiser was approximately \$43,000 for 2016, compared to \$57,000 and \$74,000, respectively, for 2015 and 2014.

- *Sohu Video*

Revenues from Sohu Video were \$123.1 million for 2016, compared to \$212.8 million and \$175.8 million, respectively, for 2015 and 2014. Revenues for 2016 decreased by \$89.7 million, representing a year-on-year decrease of 42% compared to 2015. Revenues for 2015 increased by \$37.0 million, representing year-on-year growth of 21% compared to 2014. The changes were mainly attributable to fluctuations both in the number of advertisers and in the average amount spent per advertiser. The number of advertisers on Sohu Video was 455, 587 and 596, respectively, for 2016, 2015 and 2014. The average amount spent per advertiser was approximately \$271,000, \$363,000 and \$295,000, respectively, for 2016, 2015 and 2014.

- *Focus*

Revenues from Focus were \$103.7 million for 2016, compared to \$109.6 million and \$108.8 million, respectively, for 2015 and 2014. The revenues for 2016 decreased by \$5.9 million, representing a year-on-year decrease of 5% compared to 2015. Revenues for 2015 were generally stable compared to 2014.

Revenues from Focus were generated through the Fixed Price model and the E-commerce model.

For the Fixed Price model, revenues were \$49.0 million for 2016, compared to \$55.4 million and \$67.6 million, respectively, for 2015 and 2014. The year-on-year decreases were \$6.4 million and \$12.2 million, respectively, for 2016 and 2015, representing a decrease of 12% and 18%, respectively. In the currently soft Chinese macro economy, advertisers from the real estate business are less willing to adopt the Fixed Price model, which caused our revenues from this model to decrease.

For the E-commerce model, revenues were \$54.7 million for 2016, compared to \$54.2 million and \$41.2 million, respectively, for 2015 and 2014. Revenues for 2016 were flat compared to 2015, while year-on-year growth from 2014 to 2015 was 32%. The number of developers with which we had cooperation arrangements was 1,490, 1,015 and 808, respectively, for 2016, 2015 and 2014. The number of paying subscribers for the membership services was 95,613, 94,149 and 73,232, respectively, for 2016, 2015 and 2014.

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### Changyou

#### • *17173.com Website*

Revenues from the 17173.com Website were \$39.4 million for 2016, compared to \$57.1 million and \$59.0 million, respectively, for 2015 and 2014. The year-on-year decreases were \$17.7 million and \$1.9 million, respectively, for 2016 and 2015. The decreases were primarily a result of fewer PC games being marketed on the 17173.com Website. The number of advertisers on the 17173.com Website was 193, 194 and 168, respectively, for 2016, 2015 and 2014. The average amount spent per advertiser was approximately \$204,000, \$294,000 and \$351,000, respectively, for 2016, 2015 and 2014.

### Other information

Sales to our five largest advertisers comprised approximately 11% of total brand advertising revenues for 2016, compared to 10% and 8%, respectively, for 2015 and 2014. As of December 31, 2016, 2015 and 2014, we recorded \$12.3 million, \$21.4 million and \$24.5 million, respectively, of receipts in advance from advertisers. As of December 31, 2016, we had obligations to provide, and advertisers had obligations to purchase, advertising services under existing contracts in the amount of \$10.1 million, which are required to be provided during the year ending December 31, 2017.

### *Search and Search-related Revenues, Generated by Sogou*

Revenues from search and search-related services were \$597.1 million for 2016, compared to \$539.5 million and \$357.8 million, respectively, for 2015 and 2014, representing a year-on-year growth rate of 11% and 51%, respectively, for 2016 and 2015.

The increase in revenues from search and search-related services was mainly attributable to an increase in revenues from pay-for-click services.

Revenues from pay-for-click services accounted for approximately 82% of the total search and search-related revenues for 2016, compared to 82% and 80%, respectively, for 2015 and 2014. The growth in revenues from pay-for-click services was principally attributable to an increase in the number of paid clicks, offset by depreciation of the RMB against the U.S. dollar. Paid clicks increased by approximately 21% and 39%, respectively, driven by growth in mobile search traffic, for 2016 and 2015, compared to the prior year.

### *Online Game Revenues Generated by Changyou*

Revenues from the online game business were \$395.7 million for 2016, compared to \$636.8 million and \$652.0 million, respectively, for 2015 and 2014. The decrease was mainly due to the natural decline in revenues of Changyou's older games, and a decrease in Web game revenues upon the completion of the sale of the 7Road business during the third quarter of 2015.

### *PC games and Mobile Games*

Revenues from PC games were \$274.6 million for 2016, compared to \$387.6 million and \$485.1 million, respectively, for 2015 and 2014, representing 69%, 61% and 74%, respectively, of Changyou's online game revenues for the corresponding years. The dominant PC game operated by Changyou is TLBB. The year-on-year decreases in PC game revenues were \$113.0 million and \$97.5 million, respectively, for 2016 and 2015, representing a year-on-year decrease of 29% and 20%. The year-on-year decrease in revenues from PC games was mainly due to the natural decline in revenues of TLBB, which is an older PC game. In 2016, the PC game TLBB generated \$219.7 million in revenues, accounting for approximately 56% of Changyou's online game revenues, approximately 42% of Changyou's total revenues and approximately 13% of the Sohu Group's total revenues.

Revenues from mobile games were \$116.8 million for 2016, compared to \$203.3 million and \$66.2 million, respectively, for 2015 and 2014. The dominant mobile game operated by Changyou was TLBB 3D. The year-on-year decrease in mobile game revenues for 2016 was \$86.5 million, mainly due to the natural decline in revenues of TLBB 3D, which is an older mobile game. The year-on-year increase in mobile game revenues for 2015 was \$137.1 million, mainly due to revenues from Changyou's primary mobile game TLBB 3D, which was launched in October, 2014.

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The following table sets forth certain operating data for Changyou's PC games and mobile games for the periods indicated:

Average Monthly Active Accounts (1) (in millions)	Three Months Ended March 31		Three Months Ended June 30		Three Months Ended September 30		Three Months Ended December 31	
	PC games	Mobile games	PC games	Mobile games	PC games	Mobile games	PC games	Mobile games
2014	6.5	2.6	6.9	1.3	10.7	1.5	6.9	7.0
2015	4.9	4.4	4.4	5.7	4.1	2.4	3.6	3.7
2016	3.0	3.2	2.9	2.4	2.7	2.8	2.5	1.6

Quarterly Aggregate Active Paying Accounts (2) (in millions)	Three Months Ended March 31		Three Months Ended June 30		Three Months Ended September 30		Three Months Ended December 31	
	PC games	Mobile games	PC games	Mobile games	PC games	Mobile games	PC games	Mobile games
2014	1.5	0.0	1.4	0.1	1.5	0.1	1.3	1.4
2015	1.1	0.9	1.1	1.4	1.3	0.6	1.2	0.9
2016	1.1	0.8	1.0	0.6	1.0	0.7	1.0	0.4

- (1) Average Monthly Active Accounts for a given period refers to the number of registered accounts that were logged in to these games at least once during the period.
- (2) Quarterly Aggregate Active Paying Accounts for a given quarter refers to the number of accounts from which game points are used at least once during the quarter.

### Web Games

Revenues from Web games were \$4.3 million for 2016, compared to \$45.9 million and \$100.7 million, respectively, for 2015 and 2014. Revenues from Web games decreased \$41.6 million and \$54.8 million, respectively, for 2016 and 2015. The decrease in Web games revenues was mainly due to a decrease in Web game revenues upon the completion of the sale of the 7Road business during the third quarter of 2015.

### Other Revenues

Revenues from other services were \$209.6 million for 2016, compared to \$183.6 million and \$122.1 million, respectively, for 2015 and 2014. The year-on-year increase in 2016 was mainly attributable to a \$26.0 million increase in revenues from the cinema advertisement business and from interactive broadcasting services. The year-on-year increase for 2015 was mainly due to revenue of \$28.7 million from the film "Jian Bing Man" that was produced by Sohu Video and released in 2015, and a \$20.7 million increase in revenues from Changyou's cinema advertising business compared to 2014.

## Costs and Expenses

### Cost of Revenues

The following table presents our cost of revenues by source and by proportion for the periods indicated (in thousands, except percentages):

	Year ended December 31,									
	2014		2015		2016		2015 VS 2014		2016 VS 2015	
	Amount	Percentage of the total cost	Amount	Percentage of the total cost	Amount	Percentage of the total cost	Amount	Incremental ratio	Amount	Incremental ratio
Cost of revenues:										
Online advertising:										
Brand advertising	\$307,708	45%	\$383,187	45%	\$371,085	43%	\$ 75,479	25%	\$(12,102)	(3)%
Search and search-related	163,918	24%	238,944	28%	290,158	34%	75,026	46%	51,214	21%
Subtotal of cost of online advertising revenues	471,626	69%	622,131	73%	661,243	77%	150,505	32%	39,112	6%
Online game	142,549	21%	156,315	18%	96,168	11%	13,766	10%	(60,147)	(38)%
Others	71,459	10%	80,618	9%	102,389	12%	9,159	13%	21,771	27%
Total cost of revenues	<u>\$685,634</u>	100%	<u>\$859,064</u>	100%	<u>\$859,800</u>	100%	<u>\$173,430</u>	<u>25%</u>	<u>\$ 736</u>	<u>0%</u>

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### *Cost of Online Advertising Revenues*

Cost of online advertising revenues was \$661.2 million for 2016, compared to \$622.1 million and \$471.6 million, respectively, for 2015 and 2014. The year-on-year increase for 2016 and 2015 was \$39.1 million and \$150.5 million, respectively, representing year-on-year growth of 6% and 32%.

### *Cost of Brand Advertising Revenues*

Cost of brand advertising revenues was \$371.1 million for 2016, compared to \$383.2 million and \$307.7 million, respectively, for 2015 and 2014.

The year-on-year decrease for 2016 was \$12.1 million, representing a year-on-year decrease of 3%. The decrease mainly consisted of a \$22.3 million decrease in bandwidth leasing costs, a \$4.1 million decrease in salary and benefits expenses, a \$1.7 million decrease in depreciation and amortization expenses and a \$1.2 million decrease in share-based compensation expense, offset by a \$18.8 million increase in content and license costs, and an impairment of purchased video content.

The year-on-year increase for 2015 was \$75.5 million, representing a year-on-year growth rate of 25%. This increase mainly consisted of a \$56.7 million increase in content and license costs, a \$8.9 million increase in salary and benefits expenses and a \$3.3 million increase in bandwidth leasing costs.

Our brand advertising gross margin was 17% for 2016, compared to 34% and 43%, respectively, for 2015 and 2014. The year-over-year decrease in our brand advertising gross margin for 2016 was mainly attributable to a decrease in advertising revenues and an increase in video content cost.

### *Cost of Search and Search-related Revenues*

Cost of search and search-related revenues was \$290.2 million for 2016, compared to \$238.9 million and \$163.9 million, respectively, for 2015 and 2014.

The year-on-year increase for 2016 was \$51.3 million, representing year-on-year growth of 21%. The increase mainly consisted of a \$40.8 million increase in traffic acquisition costs and a \$7.0 million increase in bandwidth leasing costs.

The year-on-year increase for 2015 was \$75.0 million, representing a year-on-year growth rate of 46%. The increase mainly consisted of a \$58.1 million increase in traffic acquisition costs, a \$13.5 million increase in bandwidth leasing costs, and a \$3.0 million increase in depreciation and amortization expense.

Our search and search-related gross margin was 51% for 2016, compared to 56% and 54%, respectively, for 2015 and 2014. The decrease in our search and search-related gross margin for 2016 was mainly due to higher traffic acquisition costs as a percentage of search and search-related revenues.

### *Cost of Online Game Revenues*

Cost of online game revenues was \$96.2 million for 2016, compared to \$156.3 million and \$142.5 million, respectively, for 2015 and 2014.

The year-on-year decrease in cost of online game revenues for 2016 was \$60.1 million. The decrease included a \$35.4 million decrease in revenue-sharing payments to mobile APP stores, a \$6.4 million decrease in salary and benefits expenses, a \$3.4 million decrease in bandwidth leasing costs, a \$2.4 million decrease in content and license costs, and a \$2.2 million decrease in depreciation and amortization expenses.

The year-on-year increase in cost of online game revenues for 2015 was \$13.8 million, representing year-on-year growth of 10%. The increase mainly consisted of a \$53.8 million increase in revenue-sharing payments to mobile application stores, offset by a \$19.0 million decrease in salary and benefits expense, a \$6.1 million decrease in PRC business tax and value-added tax, a \$5.8 million decrease in bandwidth leasing costs, a \$3.8 million decrease in depreciation expenses and a \$2.7 million decrease in revenue-sharing payments to third-party developers.

Our online game gross margin was 76%, 75% and 78%, respectively, for 2016, 2015 and 2014. Gross margin for 2016 was stable compared to 2015, while it decreased by 3% from 2014 to 2015.



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### *Cost of Other Revenues*

Cost of other revenues was \$102.4 million for 2016, compared to \$80.6 million and \$71.5 million, respectively, for 2015 and 2014. The year-on-year increase for 2016 was \$21.8 million compared to 2015, which was mainly due to a \$16.7 million increase in cinema advertising cost. The year-on-year increase for 2015 was \$9.1 million compared to 2014, which was mainly due to \$5.7 million in film production costs for “Jian Bing Man” that were recognized in 2015.

### *Operating Expenses*

The following table presents our operating expenses by nature and by proportion for the periods indicated (in thousands, except percentages):

	Year ended December 31,									
	2014		2015		2016		2015 VS 2014		2016 VS 2015	
	Amount	Percentage of the total revenue	Amount	Percentage of the total revenue	Amount	Percentage of the total revenue	Amount	Incremental ratio	Amount	Incremental ratio
Operating expenses:										
Product development	\$ 409,285	36%	\$398,143	40%	\$353,144	39%	\$ (11,142)	(3)%	\$(44,999)	(11)%
Sales and marketing	526,514	44%	383,931	39%	434,780	48%	(142,583)	(27)%	50,849	13%
General and administrative	204,325	17%	173,160	17%	119,841	13%	(31,165)	(15)%	(53,319)	(31)%
Goodwill impairment and impairment of intangible assets acquired as part of business acquisitions	52,282	3%	40,324	4%	0	0%	(11,958)	(23)%	(40,324)	(100)%
Total operating expenses	<u>\$1,192,406</u>	100%	<u>\$995,558</u>	100%	<u>\$907,765</u>	100%	<u>\$ (196,848)</u>	<u>(17)%</u>	<u>\$(87,793)</u>	<u>(9)%</u>

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### *Product Development Expenses*

Product development expenses were \$353.1 million for 2016, compared to \$398.1 million and \$409.3 million, respectively, for 2015 and 2014.

The year-on-year decrease for 2016 was \$45.0 million, representing a year-on-year decrease of 11%. The decrease mainly consisted of a \$25.6 million decrease in salary and benefits expense, a \$10.2 million decrease in share-based compensation expense, a \$7.8 million decrease in impairment provision for operating rights for licensed games with technological feasibility, and a \$5.2 million decrease in depreciation and amortization expense, offset by a \$4.8 million increase in technical service fees.

The year-on-year decrease for 2015 was \$11.1 million, representing a year-on-year decrease of 3%. The decrease mainly consisted of a \$6.8 million decrease in content and license expense, a \$6.8 million decrease in salary and benefits expense, a \$5.6 million decrease in share-based compensation expense, a \$2.9 million decrease in facility expenses, and a \$0.7 million decrease in travelling and entertainment expenses, offset by a \$8.4 million increase in impairment charges related to game copyrights of Changyou recognized in 2015 and a \$3.3 million increase in depreciation and amortization expense.

### *Sales and Marketing Expenses*

Sales and marketing expenses were \$434.8 million for 2016, compared to \$383.9 million and \$526.5 million, respectively, for 2015 and 2014.

The year-on-year increase for 2016 was \$50.8 million, representing year-on-year growth of 13%. The increase mainly consisted of a \$73.3 million increase in advertising and promotional expenditures, offset by a \$18.0 million decrease in salary and benefits expenses, and a \$1.5 million decrease in depreciation and amortization expense.

The year-on-year decrease for 2015 was \$142.6 million, representing a year-on-year decrease of 27%. The decrease mainly consisted of a \$113.1 million decrease in advertising and promotional expenditures, which was mainly due to Changyou's reduction in marketing and promotional spending for Changyou's platform channel business, a \$18.1 million decrease in salary and benefits expenses, and a \$5.6 million decrease in facility expenses.

### *General and Administrative Expenses*

General and administrative expenses were \$119.8 million for 2016, compared to \$173.2 million and \$204.3 million, respectively, for 2015 and 2014.

The year-on-year decrease for 2016 was \$53.3 million, representing a year-on-year decrease of 31%. The decrease mainly consisted of a \$22.1 million decrease in share-based compensation expense, a \$14.6 million decrease in salary and benefits expenses, a \$7.4 million decrease in facilities expenses, a \$6.2 million decrease in professional fees, and a \$3.3 million decrease in depreciation and amortization expenses.

The year-on-year decrease for 2015 was \$31.2 million, representing a year-on-year decrease of 15%. The decrease mainly consisted of a \$23.7 million decrease in salary and benefits expenses, which primarily resulted from a reduction in Changyou's workforce, a \$12.4 million decrease in share-based compensation expense, and a \$3.1 million decrease in travelling and entertainment expenses, offset by a \$3.5 million increase in facility expenses, a \$2.5 million increase in professional service fees, and a \$2.1 million increase in depreciation and amortization expenses.

### *Goodwill Impairment and Impairment of Intangibles Acquired as Part of Business Acquisition*

In 2016, there was no goodwill impairment or impairment of intangibles via acquisitions of businesses.

In 2015, we recognized \$40.3 million of goodwill impairment and impairment of intangibles acquired as part of business acquisition. This \$40.3 million impairment loss consisted primarily of a \$29.6 million goodwill impairment loss and a \$8.9 million intangible assets impairment loss related to MoboTap. As the financial performance of the Dolphin Browser operated by MoboTap was below original expectations, Changyou's management concluded that the Dolphin Browser was unable to provide expected synergies with Changyou's platform channel business.

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In 2014, we recognized \$52.3 million of goodwill impairment and impairment of intangibles acquired as part of business acquisitions. This \$52.3 million impairment loss consisted primarily of a \$33.8 million impairment loss for goodwill and a \$15.3 million impairment loss for intangible assets related to RaidCall, which was acquired by Changyou in 2013, as Changyou management determined that RaidCall's audio communication technology was not a good fit for Changyou's online games business.

### **Share-based Compensation Expense**

Share-based compensation expense was recognized in costs and expenses for the years ended December 31, 2014, 2015 and 2016, respectively, as follows (in thousands):

Share-based compensation expense	Year Ended December 31,		
	2014	2015	2016
Cost of revenues	\$ 1,973	\$ 1,748	\$ 366
Product development expenses	24,982	19,344	9,184
Sales and marketing expenses	5,645	3,054	2,394
General and administrative expenses	41,843	29,297	7,176
	<u>\$74,443</u>	<u>\$53,443</u>	<u>\$19,120</u>

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

Share-based compensation expense	Year Ended December 31,		
	2014	2015	2016
For Sohu (excluding Sohu Video) share-based awards	\$ 4,410	\$27,811	\$ 2,761
For Sogou share-based awards (1)	61,918	10,310	8,802
For Changyou share-based awards	4,087	15,024	8,402
For Sohu Video share-based awards (2)	4,028	298	(845)
	<u>\$74,443</u>	<u>\$53,443</u>	<u>\$19,120</u>

Note (1): Compensation expense for Sogou share-based awards includes compensation expense for Tencent restricted share units that Tencent had granted to employees who transferred to Sogou with the Soso search-related businesses.

Note (2): The negative amount resulted from re-measured compensation expense based on the then-current fair value of the awards on each reporting date.

There was no capitalized share-based compensation expense for 2014, 2015 and 2016.

As of December 31, 2016, unrecognized share-based compensation expense for Sohu (excluding Sohu Video), Sogou and Changyou share-based awards was as follows (in thousands):

Unrecognized share-based compensation expense	As of December 31, 2016
For Sohu (excluding Sohu Video) share-based awards	\$ 322
For Sogou share-based awards (3)	992
For Changyou share-based awards	56
	<u>\$ 1,370</u>

Note (3): Includes the unrecognized compensation expense for employees who transferred from Tencent with Soso search-related businesses.

### **Operating (Loss) / Profit**

We had an operating loss of \$117.1 million for 2016, compared to an operating profit of \$82.5 million for 2015 and an operating loss of \$205.0 million for 2014.

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### ***Other (Expense)/Income***

Other expense was \$10.7 million for 2016, compared to other income of \$74.5 million and \$10.0 million, respectively, for 2015 and 2014. The changes were mainly due to a disposal gain of \$55.1 million recognized by Changyou for its sale of the 7Road business and certain Changyou subsidiaries during the third quarter of 2015, and a \$27.8 million one-time expense recognized in the second quarter of 2016 related to a donation by Sogou to Tsinghua University related to setting up a joint research institute focusing on artificial intelligence technology.

### ***Interest Income***

Interest income was \$22.5 million for 2016, compared to \$30.6 million and \$37.6 million, respectively, for 2015 and 2014.

### ***Interest Expense***

Interest expense was \$1.4 million for 2016, compared to \$7.2 million and \$6.6 million, respectively, for 2015 and 2014. The decrease in 2016 was primarily due to the repayment of bank loans. The increase in 2015 was primarily due to an increase in the average balances of our bank loans.

### ***Income Tax Expense***

Income tax expense was \$21.1 million for 2016, compared to \$76.9 million and \$6.1 million, respectively, for 2015 and 2014. The decrease mainly resulted from a reversal of PRC income tax expenses of \$10.6 million and \$6.4 million by Changyou and Sogou, respectively, for the preferential tax rate that Changyou's and Sogou's subsidiaries received in 2016 as KNEs or Software Enterprises for 2015, as well as a reversal by Sohu of U.S. income tax expense of \$5.0 million for the disposal of an equity investment that occurred in 2015 and was determined in 2016 to be nontaxable. The decrease was also attributable to a decline in profit before tax of our tax-paying entities.

### ***Net (Loss) / Income***

As a result of the foregoing, we had a net loss of \$115.0 million for 2016, compared to net income of \$108.9 million and a net loss of \$171.2 million, respectively, for 2015 and 2014.

### ***Net Income Attributable to Noncontrolling Interest***

Our net income attributable to noncontrolling interest was \$109.0 million for 2016, compared to net income attributable to noncontrolling interest of \$146.5 million for 2015, and a net loss attributable to noncontrolling interest of \$32.3 million for 2014.

### ***Dividend or deemed dividend to noncontrolling Sogou Series A Preferred shareholders***

Dividend or deemed dividend to noncontrolling Sogou Series A Preferred shareholders was nil for 2016, compared to \$11.9 million and \$27.7 million, for 2015 and 2014.

The \$11.9 million deemed dividend for 2015 resulted from Sogou's repurchase of 6.4 million Sogou Series A Preferred Shares from noncontrolling shareholders in September 2015. The deemed dividend was deemed to have been contributed by Sohu.com Inc., as a holder of ordinary shares of Sogou, representing a portion of the differences between the prices Sogou paid to Photon for the Series A Preferred Shares and the carrying amounts of these Series A Preferred Shares in our consolidated financial statements.

The \$27.7 million deemed dividend for 2014 resulted from Sogou's repurchase of 14.4 million Sogou Series A Preferred Shares from China Web, and was deemed to have been contributed by Sohu, as a holder of ordinary shares of Sogou, in an amount equal to the proportionate difference between the price Sogou paid to China Web for the Series A Preferred Shares and the carrying amount of these 14.4 million Series A Preferred Shares in our consolidated financial statements.

### ***Net Loss attributable to Sohu.com Inc.***

As a result of the foregoing, we had a net loss of \$224.0 million attributable to Sohu.com Inc. for 2016, compared to a net loss of \$49.6 million and \$166.7 million attributable to Sohu.com Inc., respectively, for 2015 and 2014.

## QUARTERLY RESULTS OF OPERATIONS

The following table sets forth, for the periods presented, our unaudited quarterly results of operations for the eight quarters ended December 31, 2016. The data have been derived from our consolidated financial statements and, in our management's opinion, they have been prepared on substantially the same basis as the audited consolidated financial statements and include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the financial results for the periods presented. This information should be read in conjunction with the annual consolidated financial statements included elsewhere in this Form 10-K. The operating results in any quarter are not necessarily indicative of the results that may be expected for any future period.

For a discussion of changes in the basis of presentation for the periods presented below, see Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Results of Operations."

	Three Months Ended							
	Mar. 31, 2015	Jun. 30, 2015	Sep. 30, 2015	Dec. 31, 2015	Mar. 31, 2016	Jun. 30, 2016	Sep. 30, 2016	Dec. 31, 2016
(Unaudited, in thousands, except per share data)								
<b>Revenues:</b>								
Online advertising:								
Brand advertising	\$ 133,821	\$ 150,849	\$ 151,517	\$ 140,927	\$ 125,503	\$ 112,887	\$ 110,871	\$ 98,695
Search and search-related	105,126	135,206	147,938	151,251	133,814	160,152	150,667	152,500
Subtotal of online advertising revenues	<u>238,947</u>	<u>286,055</u>	<u>299,455</u>	<u>292,178</u>	<u>259,317</u>	<u>273,039</u>	<u>261,538</u>	<u>251,195</u>
Online games	184,994	172,350	152,501	127,001	102,529	99,227	98,553	95,400
Others	31,391	35,161	70,134	46,924	46,106	47,872	50,491	65,164
Total revenues	<u>455,332</u>	<u>493,566</u>	<u>522,090</u>	<u>466,103</u>	<u>407,952</u>	<u>420,138</u>	<u>410,582</u>	<u>411,759</u>
<b>Cost of revenues:</b>								
Online advertising:								
Brand advertising	104,552	99,847	91,163	87,625	85,636	93,654	102,137	89,658
Search and search-related	49,919	58,552	62,365	68,108	62,092	71,998	76,457	79,611
Subtotal of cost of online advertising revenues	<u>154,471</u>	<u>158,399</u>	<u>153,528</u>	<u>155,733</u>	<u>147,728</u>	<u>165,652</u>	<u>178,594</u>	<u>169,269</u>
Online games	49,485	43,929	34,635	28,266	26,133	25,380	23,719	20,936
Others	18,198	18,872	25,996	17,552	18,986	21,226	20,571	41,606
Total cost of revenues	<u>222,154</u>	<u>221,200</u>	<u>214,159</u>	<u>201,551</u>	<u>192,847</u>	<u>212,258</u>	<u>222,884</u>	<u>231,811</u>
Gross profit	233,178	272,366	307,931	264,552	215,105	207,880	187,698	179,948
<b>Operating expenses:</b>								
Product development	102,191	100,771	92,779	102,402	82,679	88,959	90,007	91,499
Sales and marketing	83,128	103,977	98,596	98,230	90,047	117,966	110,584	116,183
General and administrative	45,164	49,720	33,330	44,946	27,607	29,650	38,670	23,914
Goodwill impairment and impairment of intangible assets acquired as part of business acquisitions	0	0	40,324	0	0	0	0	0
Total operating expenses	<u>230,483</u>	<u>254,468</u>	<u>265,029</u>	<u>245,578</u>	<u>200,333</u>	<u>236,575</u>	<u>239,261</u>	<u>231,596</u>
Operating profit /(loss)	<u>2,695</u>	<u>17,898</u>	<u>42,902</u>	<u>18,974</u>	<u>14,772</u>	<u>(28,695)</u>	<u>(51,563)</u>	<u>(51,648)</u>
Other income /(loss)	3,154	(437)	70,219	1,590	3,924	(24,573)	3,678	6,258
Interest income	7,810	8,054	7,031	7,748	5,837	5,284	6,327	5,051
Interest expense	(1,775)	(1,826)	(1,839)	(1,744)	(698)	(244)	(209)	(205)
Exchange difference	(183)	(687)	4,322	1,885	(1,022)	3,866	702	9,257
Income /(loss) before income tax expense	11,701	23,002	122,635	28,453	22,813	(44,362)	(41,065)	(31,287)
Income tax expense	16,300	11,519	29,461	19,656	11,868	2,430	974	5,800
Net income /(loss)	(4,599)	11,483	93,174	8,797	10,945	(46,792)	(42,039)	(37,087)
Less: Net income /(loss) attributable to the noncontrolling interest shareholders	26,521	38,682	42,142	39,197	31,231	16,232	32,775	28,810
Dividend or deemed dividend to noncontrolling Sogou Series A Preferred shareholders	0	0	11,911	0	0	0	0	0
Net income /(loss) attributable to Sohu.com Inc.	<u>\$ (31,120)</u>	<u>\$ (27,199)</u>	<u>\$ 39,121</u>	<u>\$ (30,400)</u>	<u>\$ (20,286)</u>	<u>\$ (63,024)</u>	<u>\$ (74,814)</u>	<u>\$ (65,897)</u>
Basic net income/(loss) per share attributable to Sohu.com Inc.	<u>\$ (0.81)</u>	<u>\$ (0.70)</u>	<u>\$ 1.01</u>	<u>\$ (0.79)</u>	<u>\$ (0.52)</u>	<u>\$ (1.63)</u>	<u>\$ (1.93)</u>	<u>\$ (1.70)</u>
Shares used in computing basic net income/(loss) per share attributable to Sohu.com Inc.	<u>38,525</u>	<u>38,587</u>	<u>38,633</u>	<u>38,646</u>	<u>38,666</u>	<u>38,691</u>	<u>38,728</u>	<u>38,739</u>
Diluted net income/(loss) per share attributable to Sohu.com Inc.	<u>\$ (0.81)</u>	<u>\$ (0.71)</u>	<u>\$ 1.00</u>	<u>\$ (0.80)</u>	<u>\$ (0.53)</u>	<u>\$ (1.64)</u>	<u>\$ (1.94)</u>	<u>\$ (1.71)</u>
Shares used in computing diluted net income/(loss) per share attributable to Sohu.com Inc.	<u>38,525</u>	<u>38,587</u>	<u>38,665</u>	<u>38,646</u>	<u>38,666</u>	<u>38,691</u>	<u>38,728</u>	<u>38,739</u>

**LIQUIDITY AND CAPITAL RESOURCES****Resources Analysis****Liquidity Sources and Balances**

Our principal sources of liquidity are cash and cash equivalents, short-term investments, and cash flows generated from our operations. Cash equivalents mainly consist of time deposits with original maturities of three months or less, and highly liquid investments that are readily convertible to known amounts of cash. Short-term investments comprise investment instruments issued by commercial banks in China, with a variable interest rate indexed to performance of underlying assets and maturity dates within one year.

As of December 31, 2016, we had cash and cash equivalents of approximately \$1.05 billion, and short-term investments of \$247.9 million. Of our cash and cash equivalents, \$393.9 million was held in financial institutions inside Mainland China and \$657.1 million was held in financial institutions outside of Mainland China. Our VIEs held \$94.9 million of our cash and cash equivalents and \$956.1 million was held outside of our VIEs.

We believe our current liquidity and capital resources are sufficient to meet anticipated working capital needs (net cash used in operating activities), commitments, capital expenditures, and investment activities over the next twelve months. We may, however, require additional cash resources due to changes in business conditions and other future developments, or changes in general economic conditions.

See Item 1A “Risk Factors - Risks Related to China’s Regulation Environment - Restrictions on currency exchange may limit our ability to use our revenues effectively,” “-Our offshore entities may need to rely on dividends and other distributions on equity paid by the China-based subsidiaries of our subsidiaries Sohu.com Limited, Sogou and Changyou to fund any cash requirements those offshore entities may have. Our offshore entities may not be able to obtain cash from distributions because our subsidiaries and VIEs in China are subject to restrictions imposed by PRC law, and may be subject to future debt covenant restrictions, on paying such dividends or making other payments,” and “- Dividends we receive from our operating subsidiaries located in the PRC are subject to PRC profit appropriation and PRC withholding tax,” and “Risks Related to Our Corporate Structure – Although the Sohu Group holds substantial amounts of cash and cash equivalents, a significant portion of such cash and cash equivalents is held by Changyou and Sogou, and it can be difficult for Sohu to have access to the portion held by Changyou and Sogou. See also “Restrictions and Limitations on Cash Available to Sohu.com Inc.” below and Item 7A “Quantitative and Qualitative Disclosure About Market Risk - Foreign Currency Exchange Rate Risk.”

**Cash Generating Ability**

Our cash flows were summarized below (in thousands):

	<b>Year Ended December 31,</b>		
	<b>2014</b>	<b>2015</b>	<b>2016</b>
Net cash provided by operating activities	\$ 152,283	\$ 506,053	\$ 239,620
Net cash used in investing activities	(438,474)	(69,767)	(50,739)
Net cash used in financing activities	(122,810)	(43,116)	(327,934)
Effect of exchange rate change on cash and cash equivalents	(1,947)	(24,305)	(43,511)
Reclassification of cash and cash equivalents to assets held for sale	0	0	(11,684)
Net increase /(decrease) in cash and cash equivalents	(410,948)	368,865	(194,248)
Cash and cash equivalents at beginning of period	1,287,288	876,340	1,245,205
Cash and cash equivalents at end of period	<u>\$ 876,340</u>	<u>\$ 1,245,205</u>	<u>\$ 1,050,957</u>

**Net Cash Provided by Operating Activities**

For 2016, \$239.6 million net cash provided by operating activities was primarily attributable to our net loss of \$115.0 million, adjusted by (i) the add back of non-cash items consisting of \$204.6 million in depreciation and amortization, \$22.9 million in impairment of intangible and other assets, \$19.1 million of share-based compensation expense, \$7.1 million in provision for allowance for doubtful accounts, and \$0.8 million of other items, (ii) offset by \$13.1 million in change in fair value of financial instruments. The increase in cash from \$113.2 million in working capital items is also included in operating cash flow.

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For 2015, \$506.1 million net cash provided by operating activities was primarily attributable to our net income of \$108.9 million, adjusted by (i) the add back of non-cash items consisting of \$237.4 million in depreciation and amortization expense, \$53.4 million in share-based compensation expense, \$40.3 million in goodwill impairment and impairment of intangible assets acquired as part of business acquisitions, \$17.8 million in impairment of intangible and other assets, a \$7.5 million investment loss from equity investments, and \$3.1 million of other items, (ii) offset by \$55.1 million of gain from the sale of the 7Road business and certain Changyou subsidiaries, \$11.9 million of gain from sale of investments, and a \$1.3 million change in the fair value of financial instruments. The increase in cash from \$106.0 million working capital items is also included in operating cash flow.

For 2014, \$152.3 million net cash provided by operating activities was primarily attributable to our net loss of \$171.2 million, adjusted by (i) the add back of non-cash items consisting of \$208.5 million in depreciation and amortization expense, \$57.3 million in share-based compensation expense, \$52.3 million in goodwill impairment and impairment of intangible assets acquired as part of business acquisitions, and \$1.6 million of other items, (ii) offset by a \$2.3 million change in fair value of put option, a \$1.6 million change in fair value of financial instruments, and \$1.4 million in income from investments in debt securities. The increase in cash from \$9.1 million working capital items is also included in operating cash flow.

### ***Net Cash Used in Investing Activities***

For 2016, \$50.7 million net cash used in investing activities was primarily attributable to (i) \$382.9 million used in purchase of financial instruments, \$288.9 million used in purchase of fixed assets and intangible assets, \$21.0 million used in the purchase of long-term investments, and \$18.1 million used in a matching loan from Changyou to SoEasy, (ii) offset by \$415.4 million of proceeds from financial instruments, \$234.5 million from withdrawal of restricted time deposits (\$225.5 million originally used as collateral for Changyou loans from offshore banks and \$9.0 million originally used as collateral for credit facilities provided by a bank to certain Sogou employees), \$5.1 million from loan repayment by a third party to Changyou, and \$5.2 million cash received from other investing activities.

For 2015, \$69.8 million net cash used in investing activities was primarily attributable to (i) \$646.3 million used in purchase of financial instruments, \$243.3 million used in the purchase of fixed assets and intangible assets, \$39.5 million used in the purchase of long-term investments (mainly composed of Sohu's investment of \$16.3 million in SoEasy Internet Finance Group Limited and Sogou's investment of \$12.0 million in Zhihu), \$20.0 million in funds to a third party, and \$13.1 million used in a matching loan from Changyou to SoEasy, (ii) offset by \$642.5 million of proceeds from financial instruments, \$184.4 million in consideration received from Changyou's sale of the 7Road business (net of cash in 7Road upon its disposition) and certain Changyou subsidiaries, the withdrawal of \$40.4 million in restricted time deposits originally used as collateral for Changyou loans from offshore banks, \$15.9 million in consideration received from sales of equity investments, and \$9.4 million in return of funds from a third party.

For 2014, \$438.5 million net cash used in investing activities was primarily attributable to (i) \$210.2 million used in purchase of fixed assets and intangible assets, \$209.5 million used in purchase of financial instruments, \$106.4 million used in acquisitions, \$26.1 million purchase of long-term investments, (ii) offset by \$82.0 million of proceeds received from debt securities at maturity, \$23.0 million of proceeds from financial instruments, \$5.8 million from withdrawal of restricted time deposits originally used as collateral for Changyou loans from offshore banks, and \$2.9 million cash proceeds from other investing activities.

### ***Net Cash Used in Financing Activities***

For 2016, \$327.9 million net cash used in financing activities was primarily attributable to (i) \$344.5 million used for repayment of Changyou loans from offshore banks, (ii) offset by \$17.0 million Changyou received from a matching loan with SoEasy.

For 2015, \$43.1 million net cash used in financing activities was primarily attributable to (i) \$25.5 million used in Changyou's repayment of loans from offshore banks, \$21.0 million used in Sogou's repurchase of Series A Preferred Shares of Sogou from Photon, and \$14.5 million used in Changyou's repurchase of its ADSs, offset by (ii) \$12.9 million in loan proceeds from Changyou, \$2.1 million received from the exercise of share-based awards, and \$2.9 million in proceeds from other financing activities.

For 2014, \$122.8 million net cash used in financing activities was primarily attributable to (i) Changyou's repayment of \$410.2 million of loans from offshore banks, \$47.3 million used in Sogou's repurchase of Series A Preferred Shares of Sogou from China Web, \$24.6 million used in Sogou's repurchase of its Class A Ordinary Shares from its noncontrolling shareholders, \$3.6 million used for the repurchase of ADSs by Changyou, \$2.8 million used in payment of contingent consideration by Changyou, and \$5.3 million used in other financing activities, (ii) offset by proceeds of loans from offshore banks of \$370.0 million, and \$1.0 million received from the exercise of share-based awards.



## **Restrictions and Limitations on Cash Available to Sohu.com Inc.**

To fund any cash requirements it may have, Sohu.com Inc. may need to rely on dividends and other distributions on equity paid by our subsidiaries Sohu.com Limited, Sogou Inc., and Changyou.com Limited. Since substantially all of our operations are conducted through our indirect Mainland China-based subsidiaries and VIEs, Sohu.com Limited, Sogou Inc., and Changyou.com Limited may need to rely on dividends, loans or advances made by our PRC subsidiaries and VIEs in order to make dividends and other distributions to us.

The ability of Sohu.com Limited, Sogou Inc., and Changyou.com Limited to receive dividends and distributions from our China-based subsidiaries and VIEs, and the amount of cash available for distribution to, and use by, Sohu.com Inc., are subject to certain restrictions and limitations related to PRC law, our subsidiary and VIE structure and U.S. corporate income tax. We do not expect any of such restrictions or taxes to have a material impact on our ability to meet our cash obligations. However, such restrictions and taxes limit our ability to use Sohu Group cash and cash equivalents held by Changyou and its subsidiaries and VIEs, and by Sogou and its subsidiaries and VIEs, for our Sohu business separate from Changyou and Sogou. See “Risk Factors – Risks Related to Our Corporate Structure – Although the Sohu Group holds substantial amounts of cash and cash equivalents, a significant portion of such cash and cash equivalents is held by Changyou and Sogou, and it can be difficult for Sohu to have access to the portion held by Changyou and Sogou.”

## ***PRC Regulations Related to Profit Appropriation, Withholding Tax on Dividends and Foreign Currency Exchange***

Regulations in the PRC currently permit payment of dividends of a PRC company only out of accumulated profits as determined in accordance with accounting standards and regulations in China. Our China-based WFOEs are also required to set aside each year to their general reserves at least 10% of their after-tax profit based on PRC accounting standards, until the cumulative amount reaches 50% of their paid-in capital. These reserves may not be distributed as cash dividends, or as loans or advances. Our WFOEs may also allocate a portion of their after-tax profits, at the discretion of their Boards of Directors, to their staff welfare and bonus funds. Any amounts so allocated may not be distributed by Sohu.com Limited, Sogou’s parent company Sohu.com (Search) Limited, or Changyou.com Limited and, accordingly, would not be available for distribution to Sohu.com Inc.

The CIT Law imposes a 10% withholding income tax for dividends distributed by foreign-invested enterprises in the PRC to their immediate holding companies outside Mainland China. A lower withholding tax rate will be applied if there is a tax treaty arrangement between Mainland China and the jurisdiction of the foreign holding company. A holding company in Hong Kong, for example, will be subject to a 5% withholding tax rate under an arrangement between the PRC and the Hong Kong Special Administrative Region on the “Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital” if such holding company is considered a non-PRC resident enterprise and holds at least 25% of the equity interests in the PRC foreign invested enterprise distributing the dividends, subject to approval of the PRC local tax authority. However, if the Hong Kong holding company is not considered to be the beneficial owner of such dividends under applicable PRC tax regulations, such dividend will remain subject to withholding tax at a rate of 10%. As of December 31, 2016, we had accrued deferred tax liabilities in the amount of \$26.0 million for withholding taxes associated with dividends paid by Changyou’s Mainland China-based WFOEs to Changyou’s Hong Kong subsidiary.

Under regulations of the PRC State Administration of Foreign Exchange (“SAFE”), the RMB is not convertible into foreign currencies for capital account items, such as loans, repatriation of investments and investments outside of Mainland China, unless prior approval of the SAFE is obtained and prior registration with the SAFE is made.

## ***PRC Restrictions Related to Our VIE Structure***

Substantially all of Changyou.com Limited’s operations are conducted through its VIEs, which generate most of Changyou’s online game revenues. Although Changyou’s subsidiaries received or absorbed a majority of the VIEs’ profits or losses pursuant to contractual agreements between the VIEs and Changyou’s PRC subsidiaries providing for payments to the subsidiaries in return for services provided to the VIEs by the PRC subsidiaries, significant cash balances remained in Changyou’s VIEs as of December 31, 2016. As Changyou’s VIEs are not owned by Changyou’s PRC subsidiaries, the VIEs are not able to make dividend payments to the subsidiaries. Therefore, in order for Sohu.com Inc. or our subsidiaries outside of Mainland China to receive any dividends, loans or advances from Changyou’s PRC subsidiaries, we will need to rely on these contractual payments made by Changyou’s VIEs to Changyou’s PRC subsidiaries. Depending on the nature of services provided by Changyou’s PRC subsidiaries to their corresponding VIEs, certain of these payments will subject to PRC taxes, such as VAT, which will effectively reduce the amount that the PRC subsidiary receives from its corresponding VIE. In addition, the PRC government could impose restrictions on such payments or change the tax rates applicable to such payments.

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### **U.S. Corporate Income Tax**

Sohu.com Inc. is a Delaware corporation that is subject to U.S. corporate income tax on its taxable income at a rate of up to 35%. To the extent that its U.S. taxable income is determined to be from sources outside of the U.S., such as Subpart F income or a dividend, subject to certain limitations, Sohu.com Inc. may be able to claim foreign tax credits to offset its U.S. income tax liabilities. Any remaining liabilities are accrued in the Company's consolidated statements of comprehensive income and estimated tax payments are made when required by U.S. law.

In accordance with U.S. GAAP, we do not provide for U.S. federal income taxes or tax benefits on the undistributed earnings or losses of our non-U.S. subsidiaries or consolidated VIEs because, for the foreseeable future, we do not have the intention to repatriate those undistributed earnings or losses to the U.S. (except that, under certain circumstances, we may repatriate to the U.S. income that was previously included in our income for U.S. corporate income tax purposes). However, certain activities conducted in the PRC may give rise to U.S. corporate income tax, even if there are no distributions to Sohu.com Inc. U.S. corporate income taxes would be imposed on Sohu.com Inc. when its subsidiaries that are controlled foreign corporations ("CFCs") generate income that is subject to Subpart F of the U.S. Internal Revenue Code ("Subpart F"). Generally, passive income, such as rents, royalties, interest, dividends, and gains from disposal of our investments is among the types of income subject to taxation under Subpart F. Any income taxable under Subpart F is taxable in the U.S. at federal corporate income tax rates of up to 35%. Subpart F income also includes certain income from intercompany transactions between Sohu.com Inc.'s non-U.S. subsidiaries and VIEs and Changyou's non-U.S. subsidiaries and VIEs, or where Sohu.com Inc.'s non-U.S. subsidiaries or VIEs make an "investment in U.S. property," such as holding the stock in, or making a loan to, a U.S. corporation. Under a provision of the U.S. tax code commonly referred to as the CFC look-through rule, Sohu.com Inc. has not had to treat dividends received by its CFC subsidiaries as Subpart F income includible in Sohu.com Inc.'s taxable income in the U.S. The CFC look-through rule, which is currently scheduled to expire for taxable years beginning after December 31, 2019, has been extended several times by the U.S. Congress. Unless further extended, the CFC look-through rule will be available for Sohu.com Inc.'s CFC subsidiaries and their VIEs only through their taxable years ending November 30, 2020.

### **Dividend Policy**

The Sohu Group intends to retain all available funds and any future earnings for use in the operation and expansion of its own business, and does not anticipate paying any cash dividends on Sohu.com Inc.'s common stock for the foreseeable future. Future cash dividends distributed by Sohu.com Inc., if any, will be declared at the discretion of Sohu.com Inc.'s Board of Directors and will depend upon future operations and earnings, capital requirements and surplus, general financial condition, contractual restrictions and such other factors as our Board of Directors may deem relevant.

### **CONTRACTUAL OBLIGATIONS**

The following table sets forth our contractual obligations as of December 31, 2016 (in thousands):

<b>As of December 31,</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>Thereafter</b>	<b>Total Payments Required</b>
Purchase of content and services - video	112,051	39,203	81	0	0	0	151,335
Purchase of cinema advertisement slot rights	63,174	46,971	22,633	5,060	0	0	137,838
Purchase of bandwidth	61,731	3,500	1,171	1,055	308	0	67,765
Operating lease obligations	14,543	10,004	2,751	586	58	10	27,952
Expenditures for operating rights for licensed games with technological feasibility	4,178	15,122	0	0	0	0	19,300
Purchase of content and services - others	7,943	166	73	30	0	0	8,212
Fees for operating rights for licensed games in development	1,271	348	0	0	0	0	1,619
Expenditures for titles in game development	259	1,197	0	0	0	0	1,456
Purchase of fixed assets	1,175	0	0	0	0	0	1,175
Others	4,005	4	0	0	0	0	4,009
<b>Total Payments Required</b>	<b>270,330</b>	<b>116,515</b>	<b>26,709</b>	<b>6,731</b>	<b>366</b>	<b>10</b>	<b>420,661</b>

## **OTHER LONG-TERM LIABILITIES**

As a result of our adoption of Accounting Standard Codification 740 “Income Taxes” (ASC 740), we recorded long-term tax payable of \$32.6 million related to unrecognized tax benefit, as ASC 740 specifies that tax positions for which the timing of the ultimate resolution is uncertain should be recognized as long-term liabilities.

As a result of our adoption of ASU No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes, which simplifies the presentation of deferred income taxes by requiring deferred tax assets and liabilities to be classified as noncurrent on the balance sheet, we recorded all of our deferred tax liabilities of US\$39.8 million as long-term liabilities.

At this time, we are unable to make a reasonably reliable estimate of the timing of payments or realization of deferred tax liabilities in individual years beyond 12 months due to uncertainties in the timing of the tax impact of the transactions. As a result, this amount is not included in the table above.

## **OFF-BALANCE SHEET COMMITMENTS AND ARRANGEMENTS**

We have not entered into any financial guarantees or other commitments to guarantee the payment obligations of third parties. We are not subject to any additional potential payments. We have not entered into any derivative contracts that are indexed to our shares and classified as shareholder’s equity, or that are not reflected in our consolidated financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or that engages in leasing, hedging or product development services with us.

## **IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS**

*Revenue from Contracts with Customers.* In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606).” This guidance supersedes current guidance on revenue recognition in Topic 605, “Revenue Recognition.” In addition, there are disclosure requirements related to the nature, amount, timing, and uncertainty of revenue recognition. In August 2015, the FASB issued ASU No. 2015-14 to defer the effective date of ASU No. 2014-09 for all entities by one year. For publicly-traded business entities that follow U.S. GAAP, the deferral results in the new revenue standards’ being effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, with early adoption permitted for interim and annual periods beginning after December 15, 2016. We will apply the new revenue standard beginning January 1, 2018, and will not early adopt. We have set up an implementation team that is currently in the process of analyzing each of our revenue streams in accordance with the new revenue standard to determine the impact on our consolidated financial statements. We plan to continue the evaluation, analysis, and documentation of our adoption of ASU 2014-09 (including those subsequently issued updates that clarify ASU 2014-09’s provisions) throughout 2017 as we work towards the implementation and finalize our determination of the impact that the adoption will have on our consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*, which simplifies the presentation of deferred income taxes by requiring deferred tax assets and liabilities to be classified as noncurrent on the balance sheet. The amendments in this update are effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted. Additionally, the new guidance may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. We adopted this guidance retrospectively during the fourth quarter of 2016. Accordingly, our consolidated balance sheets as of December 31, 2016 and 2015 reflect the new classification. As a result of the adoption of this guidance, \$4.7 million of current deferred tax assets and \$24.9 million of deferred tax liabilities were reclassified to non-current as of December 31, 2015.

*Recognition and Measurement of Financial Assets and Financial Liabilities.* On January 5, 2016, the FASB issued ASU 2016-01 (“ASU 2016-01”), *Recognition and Measurement of Financial Assets and Financial Liabilities*, which amends certain aspects of recognition, measurement, presentation and disclosure of financial instruments. This amendment requires all equity investments to be measured at fair value, with changes in the fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee). This standard will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We are evaluating the impact of adopting this standard on our consolidated financial statements.

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*Leases.* On February 25, 2016, the FASB issued ASU No. 2016-02 (“ASU 2016-02”), *Leases*. ASU 2016-02 specifies the accounting for leases. For operating leases, ASU 2016-02 requires a lessee to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in its balance sheet. The standard also requires a lessee to recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term, on a generally straight-line basis. In addition, this standard requires both lessees and lessors to disclose certain key information about lease transactions. ASU 2016-02 is effective for publicly-traded companies for annual reporting periods, and interim periods within those years, beginning after December 15, 2018. Early adoption is permitted. We are currently evaluating the impact of adopting this standard on our consolidated financial statements.

*Compensation – Stock Compensation.* On March 30, 2016, the FASB issued ASU 2016-09 (“ASU 2016-09”), *Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting*, which relates to the accounting for employee share-based payments. This standard addresses several aspects of the accounting for share-based payment award transactions, including: (a) income tax consequences; (b) classification of awards as either equity or liabilities; (c) classification in the statement of cash flows; and (d) accounting for forfeitures of share-based payments. This standard will be effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. We do not expect the standard to have a material impact on us.

*Financial Instruments-Credit Losses.* In June 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-13, *Financial Instruments-Credit Losses (Topic 326)*, which requires entities to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early application will be permitted for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. We are currently evaluating the impact that the standard will have on our consolidated financial statements and related disclosures.

*Statement of Cash Flows – Classification of Certain Cash Receipts and Cash Payments.* In August 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-15, *Statement of Cash Flows – Classification of Certain Cash Receipts and Cash Payments*, which clarifies the presentation and classification of certain cash receipts and cash payments in the statement of cash flows. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the impact that the standard will have on its consolidated financial statements and related disclosures.

*Statement of Cash Flows (Topic 230): Restricted Cash.* In November 2016, the FASB issued Accounting Standards Update (“ASU”) No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. The guidance requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The standard is effective for fiscal years beginning after December 15, 2017, and interim period within those fiscal years. Early adoption is permitted, including adoption in an interim period. The standard should be applied using a retrospective transition method to each period presented. We are currently evaluating the impact of adopting this standard on our consolidated financial statements.

*Business Combinations (Topic 805): Clarifying the Definition of a Business.* In January 2017, the FASB issued Accounting Standards Update (“ASU”) No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*, which clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions or disposals of assets or businesses. The standard is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. The standard should be applied prospectively on or after the effective date. We will evaluate the impact of adopting this standard prospectively upon any transactions of acquisitions or disposals of assets or businesses.

*Simplifying the Test for Goodwill Impairment.* In January 2017, the FASB issued Accounting Standards Update (“ASU”) 2017-04, *“Simplifying the Test for Goodwill Impairment.”* The guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The guidance should be adopted on a prospective basis for the annual or any interim goodwill impairment tests beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We are currently evaluating the impact of adopting this standard on our consolidated financial statements.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK****FOREIGN CURRENCY EXCHANGE RATE RISK**

While our reporting currency is the U.S. dollar, to date the majority 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 the U.S. dollar and the RMB. If the RMB depreciates against the U.S. dollar, the value of our RMB revenues and assets as expressed in our U.S. dollar financial statements will decline. For example, our revenues for the year ended December 31, 2016 were \$1.65 billion and our total assets as of December 31, 2016 were \$2.57 billion, representing revenues of RMB11.45 billion and total assets of RMB17.81 billion at the noon buying rate of RMB 6.9370 to \$1.00 on December 31, 2016. If the value of the RMB were to depreciate by approximately 10% to RMB 7.6307 to \$1.00, the value of the same amount of RMB-denominated revenue and total assets in U.S. dollars would be \$1.50 billion and \$2.33 billion, respectively.

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 U.S. dollar, and the People’s Bank of China will announce the closing prices of foreign currencies such as the U.S. 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. On June 19, 2010, the People’s Bank of China announced that it had decided to proceed further with the reform of the RMB exchange rate regime to enhance the flexibility of the RMB exchange rate and that emphasis would be placed on reflecting market supply and demand with reference to a basket of currencies. While so indicating its intention to make the RMB’s exchange rate more flexible, the People’s Bank of China ruled out any sharp fluctuations in the currency or a one-off adjustment. On March 17, 2014, the People’s Bank of China announced a policy to expand the maximum daily floating range of RMB trading prices against the U.S. dollar in the inter-bank spot foreign exchange market to 2%. In 2016, the RMB depreciated significantly. The center point of the currency’s official trading band was 6.5486 in January and was 6.9189 in December, which contributed to a decline in the Company’s 2016 revenues, which are reported in U.S. dollars. In the long term, the RMB may appreciate or depreciate more significantly in value against the U.S. dollar or other foreign currencies, depending on the market supply and demand with reference to a basket of currencies.

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 sets forth a summary of our foreign currency sensitive financial instruments as of December 31, 2016. These financial instruments are recorded at their fair value.

	Denominated in (in thousands)				Total
	US\$	RMB	HK\$	Others	
Cash and cash equivalents	\$650,768	\$393,762	\$2,872	\$ 3,555	\$1,050,957
Short-term investments	0	247,926	0	0	247,926
Accounts receivable, net	4,548	183,694	925	0	189,167
Prepaid and other current assets	7,151	251,937	224	821	260,133
Available-for-sale equity securities	0	0	0	10,381	10,381
Assets held for sale	0	103,079	0	0	103,079
Restricted time deposits	240	29	0	0	269
Liabilities held for sale	0	3,902	0	0	3,902
Other current liabilities	42,476	886,112	217	35	928,840
Long-term accounts payable	0	744	0	0	744

## **INTEREST RATE RISK**

The basic objectives of our investment program are to protect the invested funds from excessive risk and to provide for liquidity that is sufficient to meet operating and investment cash requirements. Under the investment policy, our excess cash is invested in high-quality securities which are limited as to length of time to maturity and the amount of credit exposure.

Our exposure to interest rate risk primarily relates to the interest income generated from excess cash invested in demand deposits, and interest expense generated from loans to Changyou from offshore banks. We have not used derivative financial instruments in our investment portfolio in order to reduce this risk. We have not been exposed nor do we anticipate being exposed to material risks due to changes in interest rates.

## **INFLATION RATE RISK**

According to the National Bureau of Statistics of China, the consumer price index grew 2.0% in 2016, compared to an increase of 1.4% in 2015. This increase in the rate of inflation and any additional increases in the future could have an adverse effect on our business.

## **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The full text of our audited consolidated financial statements appears beginning on page F-1 of this report and is incorporated into this Item 8. Quarterly Results of Operations information is included in this report and is incorporated into this Item 8.

## **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

## **ITEM 9A. CONTROLS AND PROCEDURES**

### **Evaluation of Disclosure Controls and Procedures**

Our Chief Executive Officer and Acting Chief Financial Officer, after evaluating the effectiveness of our “disclosure controls and procedures” (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act) as of the end of the period covered by this 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.com Inc. 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.

### **Management’s Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Under the supervision and with the participation of our management, including our Chief Executive Officer and Acting Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2016.

Because of the inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. The effectiveness of our internal control over financial reporting as of December 31, 2016 has been audited by PricewaterhouseCoopers Zhong Tian LLP, an independent registered public accounting firm, as stated in their report which is included in this report on pages F-2.

[Table of Contents](#)**Changes in Internal Control over Financial Reporting**

There have not been any changes in our internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act during the Company's fiscal quarter ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**ITEM 9B. OTHER INFORMATION**

None.

**PART III****ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by this item will be included in the Proxy Statement for Sohu's 2017 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission on or about April 28, 2017 and is incorporated herein by reference.

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by this item will be included in the Proxy Statement for Sohu's 2017 Annual Meeting of Stockholders under the heading "Executive Compensation" and is incorporated herein by reference.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this item, other than the table included below, will be included in the Proxy Statement for Sohu's 2017 Annual Meeting of Stockholders under the heading "Beneficial Ownership of Common Stock" and is incorporated herein by reference.

**Equity Compensation Plan Information**

<u>Plan category</u>	<u>Number of securities to be issued upon exercise of outstanding options, warrants and rights (a) (in thousands)</u>	<u>Weighted-average exercise price of outstanding options, warrants and rights (b)</u>	<u>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c) (in thousands)</u>
Equity compensation plans approved by security holders-2010			
Stock Incentive Plan			
Stock Options	75	\$ 0.001	225
Restricted Stock Units	1	0	0
Subtotal	76		225
Equity compensation plans not approved by security holders			
Total	76		225



**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by this item will be included in the Proxy Statement for Sohu's 2017 Annual Meeting of Stockholders under the heading "Transactions with Related Persons" and is incorporated herein by reference.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this item will be included in the Proxy Statement for Sohu's 2017 Annual Meeting of Stockholders under the heading "Principal Accountant Fees, Services and Pre-approval Process" and is incorporated herein by reference.

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a)(1) Consolidated Financial Statements

Please see the accompanying Consolidated Financial Statements beginning on page F-1 of this report which are included in Item 8 above.

(a)(2) Financial Statements Schedule

Schedule I, Condensed Financial Information of Registrant, is included in this report and is incorporated into this Item 15(a)(2) by reference.

All other financial statements schedules have been omitted because the information required to be set forth therein is not applicable or is included in the Consolidated Financial Statements or notes thereto.

(b) Exhibits

See the Exhibit Index following the signature pages of this report.

**ITEM 16. FORM 10-K SUMMARY**

None.



SOHU.COM INC.

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All other schedules have been omitted because the information required to be set forth therein is not applicable or is shown in the Consolidated Financial Statements or Notes.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To Board of Directors and Shareholders of Sohu.com Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Sohu.com Inc. and its subsidiaries at December 31, 2016 and December 31, 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company’s management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in management’s report on internal control over financial reporting appearing under Item 9A of Form 10-K. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company’s internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 2 to the consolidated financial statements, the Company changed the manner in which it classifies deferred income taxes in 2016.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers Zhong Tian LLP  
Beijing, the People’s Republic of China  
February 27, 2017

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

	<u>As of December 31,</u>	
	<u>2015</u>	<u>2016</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$1,245,205	\$1,050,957
Restricted time deposits	227,285	0
Short-term investments	174,515	247,926
Accounts receivable, net	273,617	189,167
Assets held for sale	0	103,079
Prepaid and other current assets (including \$15,820 and \$29,019, respectively, due from a related party as of December 31, 2015 and 2016)	154,217	260,133
Total current assets	<u>2,074,839</u>	<u>1,851,262</u>
Fixed assets, net	508,692	503,631
Goodwill	154,219	68,290
Long-term investments, net	62,093	74,273
Intangible assets, net	55,415	32,131
Restricted time deposits	136,694	269
Prepaid non-current assets	6,254	4,734
Other assets	43,988	29,100
Total assets	<u>\$3,042,194</u>	<u>\$2,563,690</u>
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable (including accounts payable of consolidated variable interest entities (“VIEs”) without recourse to the Company of \$23,757 and \$15,824, respectively, as of December 31, 2015 and 2016)	\$ 129,025	\$ 193,209
Accrued liabilities (including accrued liabilities of consolidated VIEs without recourse to the Company of \$79,012 and \$96,695, respectively, as of December 31, 2015 and 2016)	309,657	324,876
Receipts in advance and deferred revenue (including receipts in advance and deferred revenue of consolidated VIEs without recourse to the Company of \$55,319 and \$44,797, respectively, as of December 31, 2015 and 2016)	135,385	118,951
Accrued salary and benefits (including accrued salary and benefits of consolidated VIEs without recourse to the Company of \$11,357 and \$10,306, respectively, as of December 31, 2015 and 2016)	99,631	92,475
Taxes payable (including taxes payable of consolidated VIEs without recourse to the Company of \$21,244 and \$11,475, respectively, as of December 31, 2015 and 2016)	67,480	40,014
Short-term bank loans (including short-term bank loans of consolidated VIEs without recourse to the Company of nil as of both December 31, 2015 and 2016)	344,500	0
Liabilities held for sale (including liabilities held for sale of consolidated VIEs without recourse to the Company of nil and \$3,232, respectively, as of December 31, 2015 and 2016)	0	3,902
Other short-term liabilities (including other short-term liabilities of consolidated VIEs without recourse to the Company of \$106,976 and \$89,994, respectively, as of December 31, 2015 and 2016, and due to a related party of \$13,005 and \$28,678, respectively, as of December 31, 2015 and 2016.)	154,017	159,315
Total current liabilities	<u>1,239,695</u>	<u>932,742</u>

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	As of December 31,	
	2015	2016
Long-term accounts payable (including long-term accounts payable of consolidated VIEs without recourse to the Company of \$2,858 and nil, respectively, as of December 31, 2015 and 2016)	4,600	744
Long-term taxes payable (including long-term taxes payable of consolidated VIEs without recourse to the Company of \$180 and \$13,463, respectively, as of December 31, 2015 and 2016)	24,732	32,625
Deferred tax liabilities (including deferred tax liabilities of consolidated VIEs without recourse to the Company of \$1,490 and \$1,273, respectively, as of December 31, 2015 and 2016)	42,415	39,784
Total long-term liabilities	71,747	73,153
Total liabilities	<u>\$1,311,442</u>	<u>\$1,005,895</u>
Commitments and contingencies		
<b>SHAREHOLDERS' EQUITY</b>		
Sohu.com Inc. shareholders' equity:		
Common stock: \$0.001 par value per share (75,400 shares authorized; 38,653 shares and 38,742 shares, respectively, issued and outstanding as of December 31, 2015 and 2016)	\$ 45	\$ 45
Additional paid-in capital	798,357	821,867
Treasury stock (5,889 shares as of both December 31, 2015 and 2016)	(143,858)	(143,858)
Accumulated other comprehensive income	50,151	3,220
Retained earnings	536,327	312,306
Total Sohu.com Inc. shareholders' equity	1,241,022	993,580
Noncontrolling interest	489,730	564,215
Total shareholders' equity	1,730,752	1,557,795
Total liabilities and shareholders' equity	<u>\$3,042,194</u>	<u>\$2,563,690</u>

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

## SOHU.COM INC.

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME /(LOSS)**  
(In thousands, except per share data)

	<u>Year Ended December 31,</u>		
	<u>2014</u>	<u>2015</u>	<u>2016</u>
<b>Revenues:</b>			
Online advertising:			
Brand advertising (including revenues generated from a related party of nil, nil and \$862, respectively, for 2014, 2015 and 2016)	\$ 541,158	\$ 577,114	\$ 447,956
Search and search-related	357,839	539,521	597,133
Subtotal of online advertising revenues	<u>898,997</u>	<u>1,116,635</u>	<u>1,045,089</u>
Online games	652,008	636,846	395,709
Others	122,072	183,610	209,633
Total revenues	<u>1,673,077</u>	<u>1,937,091</u>	<u>1,650,431</u>
<b>Cost of revenues:</b>			
Online advertising:			
Brand advertising	307,708	383,187	371,085
Search and search-related	163,918	238,944	290,158
Subtotal of cost of online advertising revenues	<u>471,626</u>	<u>622,131</u>	<u>661,243</u>
Online games	142,549	156,315	96,168
Others	71,459	80,618	102,389
Total cost of revenues	<u>685,634</u>	<u>859,064</u>	<u>859,800</u>
Gross profit	<u>987,443</u>	<u>1,078,027</u>	<u>790,631</u>
<b>Operating expenses:</b>			
Product development	409,285	398,143	353,144
Sales and marketing (including expenses generated for a related party of nil, nil and \$216, respectively, for 2014, 2015 and 2016)	526,514	383,931	434,780
General and administrative	204,325	173,160	119,841
Goodwill impairment and impairment of intangible assets acquired as part of business acquisitions	52,282	40,324	0
Total operating expenses	<u>1,192,406</u>	<u>995,558</u>	<u>907,765</u>
Operating profit /(loss)	<u>(204,963)</u>	<u>82,469</u>	<u>(117,134)</u>
Other income/(expense), net	9,959	74,526	(10,713)
Interest income (including interest income generated from a related party of nil, \$435, and \$1,244, respectively, for 2014, 2015 and 2016)	37,560	30,643	22,499
Interest expense (including interest expense generated from a related party of nil, \$106, and \$662, respectively, for 2014, 2015 and 2016)	(6,583)	(7,184)	(1,356)
Exchange difference	(1,142)	5,337	12,803
Income /(loss) before income tax expense	<u>(165,169)</u>	<u>185,791</u>	<u>(93,901)</u>
Income tax expense	6,050	76,936	21,072
Net income /(loss)	<u>(171,219)</u>	<u>108,855</u>	<u>(114,973)</u>
Less: Net income /(loss) attributable to the noncontrolling interest shareholders	(32,309)	146,542	109,048
Dividend or deemed dividend to a noncontrolling Sogou Series A Preferred shareholder	27,747	11,911	0
Net loss attributable to Sohu.com Inc.	<u>\$ (166,657)</u>	<u>\$ (49,598)</u>	<u>\$ (224,021)</u>



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	Year Ended December 31,		
	2014	2015	2016
Net income /(loss)	<u>\$ (171,219)</u>	<u>\$ 108,855</u>	<u>\$ (114,973)</u>
Foreign currency translation adjustments	(4,621)	(90,665)	(73,235)
Change in unrealized gain /(loss) for available-for-sale securities	<u>(3,769)</u>	<u>3,010</u>	<u>(3,920)</u>
Other comprehensive loss	<u>(8,390)</u>	<u>(87,655)</u>	<u>(77,155)</u>
Comprehensive income /(loss)	<u>(179,609)</u>	<u>21,200</u>	<u>(192,128)</u>
Less: Comprehensive income /(loss) attributable to noncontrolling interest shareholders	<u>(33,797)</u>	<u>118,138</u>	<u>78,824</u>
Dividend or deemed dividend to a noncontrolling Sogou Series A Preferred shareholder	<u>27,747</u>	<u>11,911</u>	<u>0</u>
Comprehensive loss attributable to Sohu.com Inc.	<u>(173,559)</u>	<u>(108,849)</u>	<u>(270,952)</u>
Basic net loss per share attributable to Sohu.com Inc.	<u>\$ (4.33)</u>	<u>\$ (1.28)</u>	<u>\$ (5.79)</u>
Shares used in computing basic net loss per share attributable to Sohu.com Inc.	<u>38,468</u>	<u>38,598</u>	<u>38,706</u>
Diluted net loss per share attributable to Sohu.com Inc.	<u>\$ (4.43)</u>	<u>\$ (1.32)</u>	<u>\$ (5.83)</u>
Shares used in computing diluted net loss per share attributable to Sohu.com Inc.	<u>38,468</u>	<u>38,598</u>	<u>38,706</u>

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

**SOHU.COM INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(In thousands)**

	<b>Year Ended December 31,</b>		
	<b>2014</b>	<b>2015</b>	<b>2016</b>
<b>Cash flows from operating activities:</b>			
Net income /(loss)	\$(171,219)	\$ 108,855	\$(114,973)
Adjustments to reconcile net income /(loss) to net cash provided by operating activities:			
Amortization of intangible assets and purchased video content in prepaid expense	130,044	159,945	131,182
Depreciation	78,417	77,421	73,449
Goodwill impairment and impairment of intangible assets acquired as part of business acquisitions	52,282	40,324	0
Share-based compensation expense	57,264	53,443	19,120
Impairment loss of other assets	1,687	17,837	22,906
Investment (income) /loss from investments in debt securities and equity investments	(1,370)	7,509	2,085
Provision /(Reversal) for allowance for doubtful accounts	(4)	2,175	7,109
Change in fair value of China Web put option	(2,304)	0	0
Gain from sale of the 7Road business and certain Changyou subsidiaries	0	(55,139)	0
Gain from sale of equity investments	0	(11,942)	(149)
Change in fair value of financial instruments	(1,611)	(1,331)	(13,133)
Others	(38)	968	(1,182)
Changes in assets and liabilities, net of acquisition:			
Accounts receivable	(74,428)	(61,917)	62,520
Prepaid and other assets	30,577	101	15,091
Accounts payable	(11,144)	2,208	40,273
Receipts in advance and deferred revenue	14,353	11,782	(8,152)
Taxes payable	(16,256)	29,573	(36,666)
Deferred tax	(20,629)	6,020	5,268
Accrued liabilities and other short-term liabilities	86,662	118,221	34,872
Net cash provided by operating activities	152,283	506,053	239,620
<b>Cash flows from investing activities:</b>			
Purchase of fixed assets	(90,896)	(101,076)	(105,063)
Purchase of intangible and other assets	(119,290)	(142,212)	(183,791)
Purchase of long-term investments	(26,135)	(39,547)	(20,950)
Funds to a third party	0	(20,033)	0
Return of funds from a third party	0	9,415	5,061
Matching loan to a related party	0	(13,086)	(18,115)
Consideration received from sale of the 7Road business and certain Changyou subsidiaries, net of cash in 7Road upon its disposition	0	184,354	0

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	Year Ended December 31,		
	2014	2015	2016
Release of restricted time deposits	5,763	40,372	234,462
Proceeds received from sale of equity investment	0	15,938	0
Proceeds from financial instruments	22,981	642,471	415,383
Purchase of financial instruments	(209,489)	(646,322)	(382,908)
Acquisitions, net of cash acquired	(106,369)	0	0
Proceeds received from debt securities at maturity	82,009	0	0
Other cash proceeds related to investing activities	2,952	(41)	5,182
Net cash used in investing activities	(438,474)	(69,767)	(50,739)
Cash flows from financing activities:			
Matching loan from a related party	0	12,900	17,041
Issuance of common stock	611	2,124	0
Exercise of share-based awards in subsidiary	425	7	291
Repayments of loans from offshore banks	(410,194)	(25,500)	(344,500)
Repurchase of Sogou Series A Preferred Shares from noncontrolling shareholders	(47,285)	(21,015)	0
Repurchase of Changyou American depository shares ("ADSs")	(3,577)	(14,506)	0
Repurchase of Sogou Class A Ordinary Shares from noncontrolling shareholders	(24,679)	0	0
Proceeds of loans from offshore banks	370,000	0	0
Payment of contingent consideration	(2,813)	0	0
Other cash proceeds /(payments) related to financing activities	(5,298)	2,874	(766)
Net cash used in financing activities	(122,810)	(43,116)	(327,934)
Effect of exchange rate changes on cash and cash equivalents	(1,947)	(24,305)	(43,511)
Reclassification of cash and cash equivalents to assets held for sale	0	0	(11,684)
Net increase /(decrease) in cash and cash equivalents	(410,948)	368,865	(194,248)
Cash and cash equivalents at beginning of year	1,287,288	876,340	1,245,205
Cash and cash equivalents at end of year	<u>\$ 876,340</u>	<u>\$1,245,205</u>	<u>\$1,050,957</u>
Supplemental cash flow disclosures:			
Cash paid for income taxes	(5,262)	(43,988)	(25,179)
Cash paid for interest expense	(6,283)	(7,235)	(965)
Barter transactions	1,651	1,808	12,384
Supplemental schedule of non-cash investing activity:			
Changes in payables and other liabilities related to fixed assets and intangible assets additions	53,309	20,270	35,470
Consideration payable for acquisitions and equity investment	5,000	5,722	0

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

**SOHU.COM INC.**  
**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**  
**Year Ended December 31, 2014**  
**(In thousands)**

	<u>Sohu.com Inc. Shareholders' Equity</u>						
	<u>Total</u>	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Treasury Stock</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Retained Earnings</u>	<u>Noncontrolling Interest</u>
Beginning balance	\$1,836,720	\$ 44	\$601,633	\$(143,858)	\$ 116,304	\$ 752,582	\$ 510,015
Issuance of common stock	611	0	611	0	0	0	0
Repurchase of Changyou ADSs	(3,577)	0	(2,432)	0	0	0	(1,145)
Repurchase of Sogou Series A Preferred Shares from noncontrolling shareholders	(47,285)	0	26,276	0	0	(27,747)	(45,814)
Repurchase of Sogou Class A Ordinary Shares from noncontrolling shareholders	(24,679)	0	0	0	0	0	(24,679)
Exercise of right to repurchase from China Web	1,584	0	1,584	0	0	0	0
Purchase of equity interests of a VIE from a third party shareholder	(809)	0	11	0	0	0	(820)
Disposal of a subsidiary	(652)	0	0	0	0	0	(652)
Share-based compensation expense	57,226	0	11,545	0	0	0	45,681
Settlement of share-based awards in subsidiary	809	0	12,828	0	0	0	(12,019)
Acquisition of MoboTap	53,424	0	0	0	0	0	53,424
Acquisition of noncontrolling interest in a subsidiary	(4,857)	0	(1,908)	0	0	0	(2,949)
Net loss attributable to Sohu.com Inc. and noncontrolling interest shareholders	(171,219)	0	0	0	0	(138,910)	(32,309)
Accumulated other comprehensive loss	(8,390)	0	0	0	(6,902)	0	(1,488)
Ending balance	<u>\$1,688,906</u>	<u>\$ 44</u>	<u>\$650,148</u>	<u>\$(143,858)</u>	<u>\$ 109,402</u>	<u>\$ 585,925</u>	<u>\$ 487,245</u>

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

**SOHU.COM INC.**  
**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**  
**Year Ended December 31, 2015**  
(In thousands)

	<u>Sohu.com Inc. Shareholders' Equity</u>						
	<u>Total</u>	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Treasury Stock</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Retained Earnings</u>	<u>Noncontrolling Interest</u>
Beginning balance	\$1,688,906	\$ 44	\$650,148	\$(143,858)	\$ 109,402	\$585,925	\$ 487,245
Issuance of common stock	2,126	1	2,125	0	0	0	0
Repurchase of Changyou ADSs	(14,506)	0	(9,971)	0	0	0	(4,535)
Share-based compensation expense	53,561	0	30,181	0	0	0	23,380
Settlement of share-based awards in subsidiary	516	0	34,697	0	0	0	(34,181)
Repurchase of Sogou Series A Preferred Shares from noncontrolling shareholders	(21,329)	0	90,719	0	0	(11,911)	(100,137)
Purchase of noncontrolling interest in RaidCall	0	0	458	0	0	0	(458)
Noncontrolling interest recognized in domestic companies	278	0	0	0	0	0	278
Net income/(loss) attributable to Sohu.com Inc. and noncontrolling interest shareholders	108,855	0	0	0	0	(37,687)	146,542
Accumulated other comprehensive loss	(87,655)	0	0	0	(59,251)	0	(28,404)
Ending balance	<u>\$1,730,752</u>	<u>\$ 45</u>	<u>\$798,357</u>	<u>\$(143,858)</u>	<u>\$ 50,151</u>	<u>\$536,327</u>	<u>\$ 489,730</u>

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

**SOHU.COM INC.**  
**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**  
**Year Ended December 31, 2016**  
(In thousands)

	<u>Sohu.com Inc. Shareholders' Equity</u>						
	<u>Total</u>	<u>Common Stock</u>	<u>Additional Paid-in Capital</u>	<u>Treasury Stock</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Retained Earnings</u>	<u>Noncontrolling Interest</u>
Beginning balance	\$1,730,752	\$ 45	\$798,357	\$(143,858)	\$ 50,151	\$ 536,327	\$ 489,730
Share-based compensation expense	19,120	0	2,678	0	0	0	16,442
Settlement of share-based awards in subsidiary	337	0	19,501	0	0	0	(19,164)
Contribution from noncontrolling interest shareholder	0	0	1,333	0	0	0	(1,333)
Disposal of noncontrolling interest	(238)	0	0	0	0	0	(238)
Net income/(loss) attributable to Sohu.com Inc. and noncontrolling interest shareholders	(114,973)	0	0	0	0	(224,021)	109,048
Accumulated other comprehensive loss	(77,155)	0	0	0	(46,931)	0	(30,224)
Others	(48)	0	(2)	0	0	0	(46)
Ending balance	<u>\$1,557,795</u>	<u>45</u>	<u>821,867</u>	<u>(143,858)</u>	<u>3,220</u>	<u>312,306</u>	<u>564,215</u>

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

SOHU.COM INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**1. Organization and Nature of Operations**

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

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

**Sohu's Business**

*Brand Advertising Business*

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

- **Sohu Media Portal.** Sohu Media Portal is a leading online news and information provider in China. It provides users comprehensive content through www.sohu.com for PCs, the mobile phone application Sohu News APP and the mobile portal m.sohu.com;
- **Sohu Video.** Sohu Video is a leading online video content and service provider in China through tv.sohu.com for PCs and the mobile phone application Sohu Video APP; and
- **Focus.** Focus (www.focus.cn) is a leading online real estate information and services provider in China.

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

*Other Business*

Sohu also engages in the other business, which consists primarily of paid subscription services, interactive broadcasting services, sub-licensing of purchased video content to third parties, content provided through the platforms of the three main telecommunications operators in China, and the filming business. Revenues generated by Sohu from the other business are classified as other revenues in the Sohu Group's consolidated statements of comprehensive income.

**Sogou's Business**

*Search and Search-related Business*

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



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

### *Other Business*

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

### *Changyou's Business*

Changyou's business lines consist of the online game business; the platform channel business, which consists primarily of online advertising and IVAS business; and the cinema advertising business.

#### *Online Game Business*

Changyou's online game business offers to game players (a) PC games, which are interactive online games that are accessed and played simultaneously by hundreds of thousands of game players through personal computers and require that local client-end game access software be installed on the computers used and (b) mobile games, which are played on mobile devices and require an Internet connection. Prior to the sale of Shenzhen 7Road Technology Co., Ltd., or Shenzhen 7Road, in August 2015, Changyou's online games also included Web games, which became an insignificant part of Changyou's online game business following the sale. All of Changyou's games are operated under the item-based revenue model, meaning that game players can play the games for free, but can choose to pay for virtual items, which are non-physical items that game players can purchase and use within a game, such as gems, pets, fashion items, magic medicine, riding animals, hierograms, skill books and fireworks. Revenues derived from the operation of online games are classified as online game revenues in the Sohu Group's consolidated statements of comprehensive income.

Changyou's dominant game is TLBB, a PC based client-end game. For the year ended December 31, 2016, revenues from the PC game TLBB were \$219.7 million, accounting for approximately 56% of Changyou's online game revenues, approximately 42% of Changyou's total revenues and approximately 13% of the Sohu Group's total revenues.

#### *Platform Channel Business*

Changyou's platform channel business consists primarily of the operation of the 17173.com Website, one of the leading information portals in China, which provides news, electronic forums, online videos and other information services on online games to game players. Changyou's platform channel business also offers a number of software applications for PCs and mobile devices through the Dolphin Browser and RaidCall. RaidCall provides online music and entertainment services, primarily in Taiwan. The Dolphin Browser, which is operated by MoboTap, is a gateway to a host of user activities on mobile devices, with the majority of its users based in Europe, Russia and Japan. As Changyou management had determined that the Dolphin Browser was unable to provide expected synergies with Changyou's platform channel business, in 2016, Changyou's Board of Director approved the disposal of Changyou's 51% equity interest in MoboTap Inc. (collectively with its subsidiaries and VIEs "MoboTap"), which is the mobile technology developer behind the Dolphin Browser. As of December 31, 2016, Changyou has been negotiating with a potential buyer on the terms of disposal. Accordingly, the assets and liabilities attributable to MoboTap are classified as assets and liabilities held for sale and measured at the lower of their carrying amounts or their fair value, less cost to sell, in the Group's consolidated balance sheet as of December 31, 2016. All revenues generated by the 17173.com Website are classified as brand advertising revenues, IVAS revenues generated by the Dolphin Browser and by RaidCall are classified as other revenues, and a relatively small amount of online game revenues generated by the Dolphin Browser are included in online game revenues, in the Group's consolidated statements of comprehensive income.

#### *Cinema Advertising Business*

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

## 2. Summary of Significant Accounting Policies

### *Accounting Standards*

The consolidated financial statements have been prepared in accordance with United States of America generally accepted accounting principles (“U.S. GAAP”) to reflect the financial position and results of operations of the Sohu Group.

### *Use of Estimates*

The preparation of these financial statements requires the Sohu Group to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, costs and expenses, and related disclosures. On an on-going basis, the Group evaluates its 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. Identified below are the accounting policies that reflect the Group’s most significant estimates and judgments, and those that the Group believes are the most critical to fully understanding and evaluating its consolidated financial statements.

### *Basis of Consolidation and Recognition of Noncontrolling Interest*

The Sohu Group’s consolidated financial statements include the accounts of Sohu.com Inc. and its subsidiaries and consolidated VIEs. All intercompany transactions are eliminated.

### *VIE Consolidation*

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

### *Noncontrolling Interest Recognition*

Noncontrolling interests are recognized to reflect the portion of the equity of subsidiaries and VIEs which is not attributable, directly or indirectly, to the controlling shareholders. Currently, the noncontrolling interests in the Sohu Group’s consolidated financial statements primarily consist of noncontrolling interests for Sogou and Changyou.

### *Noncontrolling Interest for Sogou*

#### Sogou’s Share Structure

As of December 31, 2016, Sogou had outstanding a combined total of 334,746,495 ordinary shares and preferred shares held as follows:

- (i) Sohu.com Inc.: 131,697,750 Class A Ordinary Shares, of which 4,484,500 shares may be purchased by Sohu management and key employees under an option arrangement;
- (ii) Photon Group Limited, an investment vehicle of the Sohu Group’s Chairman and Chief Executive Officer Charles Zhang (“Photon”): 32,000,000 Series A Preferred Shares;
- (iii) Tencent: 6,757,875 Class A Ordinary Shares, 65,431,579 Series B Preferred Shares and 79,368,421 non-voting Class B Ordinary Shares; and
- (iv) Various employees of Sogou and Sohu: 19,490,870 Class A Ordinary Shares.

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### Sohu's Shareholding in and Control of Sogou

As of December 31, 2016, Sohu.com Inc. held approximately 36% of the outstanding equity capital of Sogou on a fully-diluted basis assuming for such purpose that all share options under the Sogou 2010 Share Incentive Plan and all share options under the Sohu Management Sogou Share Option Arrangement are granted and exercised, and that all of the Sogou Class A Ordinary Shares that Sogou has repurchased are re-issued to shareholders other than Sohu.com Inc. Also as of December 31, 2016, Sohu.com Inc. held over 50% of the total voting power of Sogou on a fully-diluted basis and controlled the election of a majority of the Board of Directors of Sogou, assuming that Tencent's non-voting Class B Ordinary Shares are converted to voting shares, that all of the Sogou Class A Ordinary Shares that Sogou has repurchased are re-issued to shareholders other than Sohu.com Inc., and that all Sogou share options under the Sogou 2010 Share Incentive Plan and all Sogou share options under the Sohu Management Sogou Share Option Arrangement are granted and exercised.

As Sogou's controlling shareholder, Sohu.com Inc. consolidates Sogou in its consolidated financial statements, and recognizes noncontrolling interest reflecting economic interests in Sogou held by shareholders other than Sohu.com Inc. (the "Sogou noncontrolling shareholders"). Sogou's net income/(loss) attributable to the Sogou noncontrolling shareholders is recorded as noncontrolling interest in the Sohu Group's consolidated statements of comprehensive income. Sogou's cumulative results of operations attributable to the Sogou noncontrolling shareholders, along with changes in shareholders' equity/(deficit) and adjustment for share-based compensation expense in relation to those share-based awards which are unvested and vested but not yet settled and the Sogou noncontrolling shareholders' investments in Sogou Series A Preferred Shares and Series B Preferred Shares (collectively, the "Sogou Preferred Shares") and Ordinary Shares are accounted for as a noncontrolling interest classified as permanent equity in the Sohu Group's consolidated balance sheets, as the Sohu Group has the right to reject a redemption requested by the noncontrolling shareholders. These treatments are based on the terms governing the investment, and on the terms of the classes of Sogou shares held, by the noncontrolling shareholders in Sogou.

### Principles of Allocation of Sogou's Profit and Loss

By virtue of the terms of Sogou Preferred Shares and Class A Ordinary Shares and Class B Ordinary Shares, Sogou's losses are allocated in the following order:

- (i) net losses are allocated to holders of Sogou Class A Ordinary Shares and the holder of Sogou Class B Ordinary Shares until their basis in Sogou decreased to zero;
- (ii) additional net losses are allocated to holders of Sogou Series A Preferred Shares until their basis in Sogou decreased to zero;
- (iii) additional net losses are allocated to the holder of Sogou Series B Preferred Shares until its basis in Sogou decreases to zero; and
- (iv) further net losses are allocated between Sohu.com Inc. and noncontrolling shareholders based on their shareholding percentage in Sogou.

Net income from Sogou is allocated in the following order:

- (i) net income is allocated between Sohu.com Inc. and noncontrolling shareholders based on their shareholding percentage in Sogou until their basis in Sogou increases to zero;
- (ii) additional net income is allocated to the holder of Sogou Series B Preferred Shares to bring its basis back;
- (iii) additional net income is allocated to holders of Sogou Series A Preferred Shares to bring their basis back;
- (iv) further net income is allocated to holders of Sogou Class A Ordinary Shares and the holder of Sogou Class B Ordinary Shares to bring their basis back; and
- (v) further net income is allocated between Sohu.com Inc. and noncontrolling shareholders based on their shareholding percentage in Sogou.

### Key Terms of Sogou Preferred Shares

The following is a summary of some of the key terms of the Sogou Preferred Shares under Sogou's Memorandum and Articles of Association as currently in effect.

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- Dividend Rights

Sogou may not declare or pay dividends on its Class A Ordinary Shares or Class B Ordinary Shares (collectively, “Ordinary Shares”) unless the holders of the Sogou Preferred Shares then outstanding first receive a dividend on each outstanding Preferred Share in an amount at least equal to the sum of (i) the dividends that would have been payable to the holder of such Preferred Share if such share had been converted into Ordinary Shares, at the then-applicable conversion rate, immediately prior to the record date for such dividend, and (ii) all accrued and unpaid Accruing Dividends. “Accruing Dividends” are calculated from the date of issuance of the Series A Preferred Shares at the rate per annum of \$0.0375 per Series A Preferred Share and from the date of issuance of the Series B Preferred Shares at the rate per annum of \$0.411 per Series B Preferred Share.

- Liquidation Rights

In the event of any “Liquidation Event,” such as the liquidation, dissolution or winding up of Sogou, a merger or consolidation of Sogou resulting in a change of control, the sale of substantially all of Sogou’s assets or similar events, the holders of Series B Preferred Shares are entitled to receive an amount per share equal to the greater of (i) \$6.847 plus any unpaid Accruing Dividends or (ii) such amount per share as would have been payable if the Series B Preferred Shares had been converted into Ordinary Shares prior to the Liquidation Event, and holders of Series A Preferred Shares are entitled to receive, after payment to the holders of the Series B Preferred Shares but before any payment to holders of Ordinary Shares, an amount equal to the greater of (i) 1.3 times their original investment in the Series A Preferred Shares plus all accrued but unpaid Accruing Dividends or (ii) such amount per share as would be payable if the Series A Preferred Shares had been converted into Ordinary Shares immediately prior to the Liquidation Event.

- Redemption Rights

The Sogou Preferred Shares are not redeemable at the option of the holders.

- Conversion Rights

Each Sogou Preferred Share is convertible, at the option of the holder, at any time, and without the payment of additional consideration by the holder. Each Sogou Preferred Share is convertible into such number of Class A Ordinary Shares as is determined, in the case of Series A Preferred Shares, by dividing \$0.625 by the then-effective conversion price for Series A Preferred Shares, which is initially \$0.625, and, in the case of Series B Preferred Shares, by dividing \$7.267 by the then-effective conversion price for Series B Preferred Shares, which is initially \$7.267. The conversion prices of the Sogou Preferred Shares are subject to adjustment on a weighted average basis upon the issuance of additional equity shares, or securities convertible into equity shares, at a price per share less than \$0.625, in the case of Series A Preferred Shares, or less than \$7.267, in the case of Series B Preferred Shares, subject to certain customary exceptions, such as shares issued pursuant to the Sogou 2010 Share Incentive Plan. Each Sogou Preferred Share will be automatically converted into Class A Ordinary Shares of Sogou upon the closing of a qualified IPO of Sogou based on the then-effective conversion ratio of such Sogou Preferred Share, which is currently one-for-one for both Series A Preferred Shares and Series B Preferred Shares.

- Voting Rights

Each holder of Sogou Preferred Shares is entitled to cast the number of votes equal to the number of Class A Ordinary Shares into which the Sogou Preferred Shares held by such holder are then convertible.

- Other Rights

The holders of Sogou Preferred Shares have various other rights typical of preferred share investments.

### Key Terms of Sogou Class A Ordinary Shares and Class B Ordinary Shares

The Class A Ordinary Shares and Class B Ordinary Shares have identical rights, except that Class B Ordinary Shares do not have voting rights unless the holders of at least a majority of the then outstanding Class B Ordinary Shares elect, by written notice to Sogou, to convert them into shares with voting rights.

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### Noncontrolling Interest for Changyou

Changyou is a public company listed on the NASDAQ Global Select Market. As of December 31, 2016, Sohu.com Inc. held approximately 69% of the combined total of Changyou's outstanding ordinary shares, and controlled approximately 96% of the total voting power in Changyou.

As Changyou's controlling shareholder, Sohu.com Inc. consolidates Changyou in its consolidated financial statements, and recognizes noncontrolling interest reflecting the economic interest in Changyou held by shareholders other than Sohu.com Inc. (the "Changyou noncontrolling shareholders"). Changyou's net income/(loss) attributable to the Changyou noncontrolling shareholders is recorded as noncontrolling interest in the Sohu Group's consolidated statements of comprehensive income, based on their share of the economic interest in Changyou. Changyou's cumulative results of operations attributable to the Changyou noncontrolling shareholders, along with changes in shareholders' equity, adjustment for share-based compensation expense in relation to those share-based awards which are unvested and vested but not yet settled and adjustment for changes in Sohu.com Inc.'s ownership in Changyou, are recorded as noncontrolling interest in the Sohu Group's consolidated balance sheets.

### **Segment Reporting**

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.

### **Revenue Recognition**

The Sohu Group recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. The recognition of revenues involves certain management judgments. The amount and timing of the revenues could be materially different for any period if management made different judgments or utilized different estimates.

Barter trade transactions in which physical goods or services (other than advertising services) are received in exchange for advertising services are recorded based on the fair values of the goods and services received. For online advertising-for-online advertising barter transactions, no revenue or expense is recognized because the fair value of neither the advertising surrendered nor the advertising received is determinable.

### Online Advertising Revenues

Online advertising revenues include revenues from brand advertising services as well as search and search-related services. The Group recognizes revenue for the amount of fees it receives from its advertisers, after deducting agent rebates and net of value-added tax ("VAT") and related surcharges.

### Brand Advertising Revenues

#### Business Model

Through PCs and mobile devices, the Group provides advertisement placements to its advertisers on different Internet platforms and in different formats, which include banners, links, logos, buttons, full screen, pre-roll, mid-roll, post-roll video screens, pause video screens, loading page ads, news feed ads and in-feed video infomercial ads.

Currently the brand advertising business has four main types of pricing models, consisting of the Fixed Price model, the Cost Per Impression ("CPM") model, the E-commerce model, and the Cost Per click ("CPC") model.

#### Fixed Price model

Under the Fixed Price model, a contract is signed to establish a fixed price for the advertising services to be provided. Revenue is recognized based on the contract price and the period of display.

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### CPM model

Under the CPM model, the unit price for each qualifying display is fixed, but there is no overall fixed price for the advertising services stated in the contract with the advertiser. A qualifying display is defined as the appearance of an advertisement, where the advertisement meets criteria specified in the contract. Revenue is recognized based on the fees charged to the advertisers, which are based on the unit prices and the number of qualifying displays.

### E-commerce model

Under the e-commerce model, revenues were mainly generated from sales of membership cards which allow potential home buyers to purchase specified properties from real estate developers at a discount greater than the price that Focus charges for the card. Membership fees are refundable until the potential home buyer uses the discounts to purchase properties. Focus recognizes such revenues upon obtaining confirmation that the membership card has been redeemed to purchase a property.

### CPC model

Under the CPC model, there is no overall fixed price for advertising services stated in the contract with the advertiser. The Group charges advertisers on a per-click basis when the users click on the advertisements. The unit price for each click is auction-based. The revenue is recognized based on qualified clicks and unit price.

### Revenue Recognition

For brand advertising revenue recognition, prior to entering into contracts, the Sohu Group makes a credit assessment of the advertisers. For contracts for which collectability is determined to be reasonably assured, the Sohu Group recognizes revenue when all revenue recognition criteria are met. In other cases, the Sohu Group only recognizes revenue when the cash is received and all other revenue recognition criteria are met.

The Sohu Group treats advertising contracts with multiple deliverable elements as separate units of accounting for revenue recognition purposes and recognizes revenue on a periodic basis during the contract period when each deliverable service is provided. Since the contract price is for all deliverables under one advertising contract, the Sohu Group allocates the contract price among all the deliverables at the inception of the arrangement on the basis of their relative selling prices according to the selling price hierarchy established by *ASU No. 2009-13*. The Group first uses vendor-specific objective evidence of selling price, if it exists. If vendor-specific objective evidence of selling price does not exist, the Group uses third-party evidence of selling price. If neither vendor-specific objective evidence of selling price nor third-party evidence of selling price exists, the Group uses management's best estimate of selling price for the deliverables.

### Search and Search-related Revenues

Search and search-related services primarily include pay-for-click services, as well as online marketing services on Web directories operated by Sogou.

#### Pay-for-click Services

Pay-for-click services are services that enable advertisers' promotional links to be displayed on Sogou search result pages and Sogou Website Alliance members' Internet properties where the links are relevant to the subject and content of such properties. For pay-for-click services, the Sohu Group introduces Internet users to its advertisers through its auction-based pay-for-click systems and charges advertisers on a per-click basis when the users click on the displayed links. Revenue for pay-for-click services is recognized on a per-click basis when the users click on the displayed links.

#### Online Marketing Services on Web Directories Operated by Sogou

Online marketing services on Web directories operated by Sogou mainly consist of displaying advertisers' promotional links on the Web pages of Web directories. Revenue for online marketing services on Web directories operated by Sogou is normally recognized on a straight-line basis over the contract period, provided the Sohu Group's obligations under the contract have been met and all revenue recognition criteria have been met.

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Both pay-for-click services and online marketing services on Web directories operated by Sogou expand distribution of advertisers' promotional links or advertisements by leveraging traffic on Sogou Website Alliance members' Internet properties including Web content, software and mobile applications. The Group recognizes gross revenue for the amount of fees it receives from advertisers, as the Group has the primary responsibility for fulfillment and acceptability. Payments made to Sogou Website Alliance members are included in cost of search and search-related revenues as traffic acquisition costs. The Group pays Sogou Website Alliance members based on either revenue-sharing arrangements, under which it pays a percentage of pay-for-click revenues generated from clicks by users of their properties, or on a pre-agreed unit price.

### *Online Game Revenues*

Changyou's online game revenues are generated primarily from its self-operated and licensed-out PC games and mobile games. Prior to the sale of the 7Road business in 2015, Changyou also offered Web games, which have been an insignificant part of the Group's business since the sale. Changyou's online game revenues also include a small amount of revenues generated from online card and board games offered by MoboTap on the Dolphin Browser. All of Changyou's games are operated under the item-based revenue model, where the basic game play functions are free of charge and players are charged for purchases of in-game virtual items, including those with a predetermined expiration time and perpetual virtual items.

### *Self-Operated Games*

Changyou is the primary obligor of its self-operated games. Changyou hosts the games on its own servers and is responsible for the sale and marketing of the games as well as customer service. Accordingly, revenues are recorded gross of revenue sharing-payments to third-party developers and/or mobile APP stores, but are net of VAT and discounts to game card distributors where applicable. Changyou obtains revenues from the sale of in-game virtual items. Revenues are recognized over the estimated lives of the virtual items purchased by game players or as the virtual items are consumed. If different assumptions were used in deriving the estimated lives of the virtual items, the timing of the recording of the revenues would be impacted.

### *PC Games*

Proceeds from the self-operation of PC games are collected from players and third-party game card distributors through sales of Changyou's game points on its online payment platform and prepaid game cards. Self-operated PC games are either developed in house or licensed from third-party developers. For licensed PC games, Changyou remits a pre-agreed percentage of the proceeds to the third-party developers, and keeps the balance pursuant to revenue-sharing agreements. Such revenue-sharing amounts paid to third-party developers are recorded in Changyou's cost of revenues.

### *Mobile Games*

For self-operated mobile games, Changyou sells game points to its game players via third-party mobile APP stores. The mobile APP stores in turn pay Changyou proceeds after deducting their share of pre-agreed revenue-sharing amounts.

Self-operated mobile games are either developed in house or licensed from or jointly developed with third-party developers. For licensed and jointly developed mobile games, Changyou remits a pre-agreed percentage of the proceeds to the third-party developers, and keeps the balance pursuant to revenue-sharing agreements. Such revenue-sharing amounts paid to mobile application stores and third-party developers are recorded in Changyou's cost of revenues.

### *Web Games*

Changyou continued to operate a small portfolio of self-operated Web games after its sale of the 7Road business in 2015. Proceeds from self-operated Web games are collected from players through the sale of game points.



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### Licensed Out Games

Changyou also authorizes third parties to operate its online games. Licensed out games include PC games and mobile games developed in house and mobile games jointly developed with third-party developers. Changyou receives monthly revenue-based royalty payments from all the third-party licensee operators. Changyou receives additional up-front license fees from certain third-party licensee operators who are entitled to an exclusive right to operate Changyou's games in specified geographic areas. Since Changyou is obligated to provide post-sale services, the initial license fees are recognized as revenue ratably over the license period, and the monthly revenue-based royalty payments are recognized when relevant services are delivered, provided that collectability is reasonably assured. Changyou views the third-party licensee operators as Changyou's customers and recognizes revenues on a net basis, as Changyou does not have the primary responsibility for fulfillment and acceptability of the game services. Changyou remits to the third-party developers a pre-agreed percentage of revenues from jointly developed and licensed out mobile games, and recognizes revenues on a net basis.

### *Other Revenues*

#### Sohu

Sohu also engages in the other business, which consists primarily of paid subscription services, interactive broadcasting services, sub-licensing of purchased video content to third parties, content provided through the platforms of the three main telecommunications operators in China, and the filming business.

#### Sogou

Other revenues attributable to Sogou are primarily IVAS revenues derived from the operation of Web games and mobile games of third-party developers as well as other services and products that Sogou provides to users.

#### Changyou

Other revenues attributable to Changyou are primarily from its cinema advertising business and IVAS.

In its cinema advertising business, Changyou provides clients advertising placements in slots that are shown in theaters before the screening of movies. The rights to place advertisements in such advertising slots are granted under contracts Changyou signs with different theaters. When all the recognition criteria are met, revenues from cinema advertising are recognized based on a percentage of the advertising slots actually delivered or on a straight-line basis over the contract period.

Changyou provides IVAS primarily through software applications for PCs and mobile devices offered by MoboTap on the Dolphin Browser and by RaidCall. Revenues from IVAS are recognized during the period the service rendered or items consumed under the gross method, as Changyou is the principal obligor for provision of the services.

### **Cost of Revenues**

#### *Cost of Online Advertising Revenues*

Cost of online advertising revenues includes cost of revenues from brand advertising services as well as cost of revenues from search and search-related services.

#### Cost of Brand Advertising Revenues

Cost of brand advertising revenues mainly consists of content and license costs, bandwidth leasing costs, and salary and benefits expense.

#### Cost of Search and Search-related Revenues

Cost of search and search-related revenues mainly consists of traffic acquisition costs, bandwidth leasing costs, depreciation expenses, as well as salary and benefits expenses. Traffic acquisition costs represent payments made to Sogou Website Alliance members. Sogou pays Sogou Website Alliance members based either on revenue-sharing arrangements or on a pre-agreed unit price. Under the revenue-sharing arrangements, the Group pays a percentage of pay-for-click revenues generated from clicks by users of the Website Alliance members' properties.

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### *Cost of Online Game Revenues*

Cost of online game revenues mainly consists of revenue-sharing payments, salary and benefits expense, bandwidth leasing costs, content and license costs, amortization and depreciation expenses, and other direct costs.

### *Cost of Other Revenues*

Cost of other revenues mainly consists of payments to theaters and film production companies for pre-film screening advertising slots, content and license costs related to paid subscription services, revenue-sharing payments related to the IVAS business, and revenue-sharing payments related to interactive broadcasting services.

### **Product Development Expenses**

Product development expenses mainly consist of salary and benefits expenses, content and license expenses, technical service fees, depreciation and amortization expenses, share-based compensation, and facilities expenses. These expenses are incurred for the enhancement and maintenance of the Sohu Group's Internet platforms as well as for its products and services, including the development costs of online games prior to the establishment of technological feasibility and maintenance costs after the online games are available for marketing.

### **Sales and Marketing Expenses**

Sales and marketing expenses mainly consist of advertising and promotional expenses, salary and benefits expenses, travel expenses, and facility expenses. Advertising and promotional expenses generally represent the expenses of promotions to create or stimulate a positive image of the Sohu Group or a desire to subscribe for the Group's products and services. Advertising and promotional expenses are expensed as incurred.

### **General and Administrative Expenses**

General and administrative expenses mainly consist of salary and benefits expenses, professional service fees, facility expenses, travel expenses, share-based compensation expense, and depreciation and amortization expenses.

### **Share-based Compensation Expense**

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

For share-based awards for which a grant date has occurred, share-based compensation expense is recognized as costs and expenses in the consolidated statements of comprehensive income based on the fair value of the related share-based awards on their grant dates. For share-based awards for which the service inception date precedes the grant date, share-based compensation expense is recognized as costs and expenses in the consolidated statements of comprehensive income beginning on the service inception date and is re-measured on each subsequent reporting date before the grant date, based on the estimated fair value of the related share-based awards. Share-based compensation expense is charged to the shareholders' equity or noncontrolling interest section in the consolidated balance sheets. The assumptions used in share-based compensation expense recognition represent management's best estimates, but these estimates involve inherent uncertainties and the application of management judgment. If factors change or different assumptions are used, the Group's share-based compensation expense could be materially different for any period. Moreover, the estimates of fair value are not intended to predict actual future events or the value that ultimately will be realized by employees who receive equity awards, and subsequent events are not indicative of the reasonableness of the original estimates of fair value made by the Group for accounting purposes.

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

#### *Sohu (excluding Sohu Video) Share-based Awards*

In determining the fair value of stock options granted by Sohu (excluding Sohu Video) as share-based awards before 2006, the Black-Scholes valuation model was applied. In determining the fair value of restricted share units granted, the public market price of the underlying shares on the grant dates was applied.

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Options for the purchase of Sohu common stock contractually granted under the Sohu 2010 Stock Incentive Plan are subject to vesting in four equal installments over a period of four years, with each installment vesting upon satisfaction of a service period requirement and certain subjective performance targets. Under *ASC 718-10-25*, no grant date can be established until a mutual understanding is reached between Sohu and the recipients clarifying the subjective performance requirements. In accordance with *ASC 718-10-55*, as the service inception date preceded the grant date, compensation expense was accrued beginning on the service inception date and will be re-measured on each subsequent reporting date before the grant date is established, based on the then-current fair value of the awards. The estimate of the awards' fair values will be fixed in the period in which the grant date occurs, and cumulative compensation expense will be adjusted based on the fair value at the grant date. In determining the fair values of the stock options granted, the public market price of the underlying shares at each reporting date was used, and a binomial valuation model was applied.

### Sogou Share-based Awards

In determining the fair value of share options granted by Sogou as share-based awards, the income approach /discounted cash flow method with a discount for lack of marketability was applied, given that the shares underlying the awards were not publicly traded at the time of grant. Certain persons who became Sogou employees when Tencent's Soso search-related businesses were transferred to Sogou on September 16, 2013 had been granted restricted share units under Tencent's share award arrangements prior to the transfer of the businesses to Sogou. These Tencent restricted share units will continue to vest under the original Tencent share award arrangements provided the transferred employees continue to be employed by Sogou during the requisite service period. After the transfer of the Soso search-related businesses to Sogou, Sogou applied the guidance in *ASC 505-50* to measure the related compensation expense, based on the then-current fair value at each reporting date, as the expense is deemed to have been incurred by Tencent as an investor on Sogou's behalf. To determine the then-current fair value of the Tencent restricted share units granted to these employees, the public market price of the underlying shares at each reporting date was applied. Because Sogou is not required to reimburse Tencent for such share-based compensation expense, the related amount was recorded by Sogou as a capital contribution from Tencent.

### Changyou Share-based Awards

In determining the fair value of ordinary shares and restricted share units granted by Changyou as share-based awards in 2008, the income approach /discounted cash flow method with a discount for lack of marketability was applied, given that the shares underlying the awards were not publicly traded at the time of grant. In determining the fair value of restricted share units granted in 2009 shortly before Changyou's initial public offering, the fair value of the underlying shares was determined based on Changyou's offering price for its initial public offering. In determining the fair value of restricted share units granted after Changyou's initial public offering, the public market price of the underlying shares on the grant dates was applied.

Options for the purchase of Changyou Class A ordinary shares contractually granted under the Changyou 2014 Share Incentive Plan are subject to vesting in four equal installments over a period of four years, with each installment vesting upon satisfaction of a service period requirement and certain subjective performance targets. Under *ASC 718-10-25*, no grant date can be established until a mutual understanding is reached between Changyou and the recipients clarifying the subjective performance requirements. In accordance with *ASC 718-10-55*, as the service inception date preceded the grant date, compensation expense was accrued beginning on the service inception date and will be re-measured on each subsequent reporting date before the grant date is established, based on the then-current fair value of the awards. The estimate of the awards' fair values will be fixed in the period in which the grant date occurs, and cumulative compensation expense will be adjusted based on the fair values at the grant date. In determining the fair values of Changyou share options granted, the public market price of the underlying shares at each reporting date was used, and a binomial valuation model was applied.

### Compensation Expense Recognition

For options and restricted share units granted with respect to Sohu (excluding Sohu Video) shares and Changyou shares, compensation expense is recognized on an accelerated basis over the requisite service period. For share options granted with respect to Sogou shares, compensation expense is recognized on a straight-line basis over the estimated period during which the service period requirement and performance target will be met. For Tencent restricted share units that Tencent had granted to employees who transferred to Sogou with the Soso search-related businesses, compensation expense is recognized by Sogou on an accelerated basis over the requisite service period, and the fair value of the share-based compensation is re-measured at each reporting date until vesting date. The number of share-based awards for which the service is not expected to be rendered over the requisite period is estimated, and no compensation expense is recorded for the number of awards so estimated.

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### *Sohu Video Share-based Awards*

On January 4, 2012, Sohu Video, the holding entity of Sohu's video division, adopted a 2011 Share Incentive Plan (the "Video 2011 Share Incentive Plan") which provides for the issuance of up to 25,000,000 ordinary shares of Sohu Video (representing approximately 10% of the outstanding Sohu Video shares on a fully-diluted basis) to management and key employees of the video division and to Sohu management. As of December 31, 2016, grants of options for the purchase of 16,368,200 ordinary shares of Sohu Video had been contractually made, of which options for the purchase of 4,972,800 ordinary shares were vested.

For purposes of ASC 718-10-25, as of December 31, 2016, no grant date had occurred, because the broader terms and conditions of the option awards had neither been finalized nor mutually agreed upon with the recipients. Therefore the fair value of the awards was not determinable and could not be accounted for. In accordance with ASC 718-10-55, the Group's management determined that the service inception date with respect to vested option awards for the purchase of 4,972,800 shares had preceded the grant date. Therefore, the Group recognized compensation expense for these vested Sohu Video share-based awards and re-measured, and will re-measure, the compensation expense on each subsequent reporting date based on the then-current fair values of these vested awards until the grant date is established.

### **Taxation**

#### *Income Taxes*

Income taxes are accounted for using an asset and liability approach which requires the recognition of income taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the Group's financial statements or tax returns. Deferred income taxes are determined based on the differences between the accounting basis and the tax basis of assets and liabilities and are measured using the currently enacted tax rates and laws. Deferred tax assets are reduced by a valuation allowance, if based on available evidence, it is considered that it is more likely than not that some portion of or all of the deferred tax assets will not be realized. In making such determination, the Group considers factors including future reversals of existing taxable temporary differences, future profitability, and tax planning strategies. If events were to occur in the future that would allow the Group to realize more of its 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 the Group to realize less of its 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.

The Group's deferred tax assets relate to net operating losses and temporary differences between accounting basis and tax basis for its China-Based Subsidiaries and VIEs, which are subject to corporate income tax in the PRC under the PRC Corporate Income Tax Law (the "CIT Law").

In November 2015, the FASB issued Accounting Standards Update 2015-17, Balance Sheet Classification of Deferred Taxes, which requires deferred income tax liabilities and assets to be classified as non-current in a classified balance sheet, and eliminates the prior guidance, which required an entity to separate deferred tax liabilities and assets into a current amount and a non-current amount in a classified balance sheet. The standard is effective for annual reporting periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted. Additionally, the new guidance may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented.

The Group changed the manner in which it classifies deferred tax assets and liabilities retrospectively from the fourth quarter of 2016 due to the early adoption of Accounting Standards Update 2015-17, Balance Sheet Classification of Deferred Taxes. As a result of the adoption of this guidance, the deferred tax assets and deferred tax liabilities as of December 31, 2016 and 2015 were re-classified from current assets and liabilities to long-term assets and liabilities.

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### *PRC Withholding Tax on Dividends*

The CIT Law imposes a 10% withholding income tax on dividends distributed by foreign invested enterprises in the PRC to their immediate holding companies outside Mainland China. A lower withholding tax rate may be applied if there is a tax treaty between Mainland China and the jurisdiction of the foreign holding company. A holding company in Hong Kong, for example, will be subject to a 5% withholding tax rate under an arrangement between the PRC and the Hong Kong Special Administrative Region on the “Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital,” if such holding company is considered a non-PRC resident enterprise and holds at least 25% of the equity interests in the PRC foreign invested enterprise distributing the dividends, subject to approval of the PRC local tax authority. However, if the Hong Kong holding company is not considered to be the beneficial owner of such dividends under applicable PRC tax regulations, such dividend will remain subject to a withholding tax rate of 10%.

### *PRC Value Added Tax*

Effective September 1, 2012, a pilot program (the “Pilot Program”) for transition from the imposition of PRC business tax (“Business Tax”) to the imposition of value-added tax (“VAT”) was implemented for revenues from certain industries and certain cities. Prior to Pilot Program, the Group was mainly subject to a 5% PRC business tax and related surcharges on revenues in the PRC. PRC business tax and the related surcharges are recognized when the revenue is earned.

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

### *U.S. Corporate Income Tax*

Sohu.com Inc. is a Delaware corporation that is subject to U.S. corporate income tax on its taxable income at a rate of up to 35%. To the extent that portions of its U.S. taxable income, such as Subpart F income or a dividend, are determined to be from sources outside of the U.S., subject to certain limitations, Sohu.com Inc. may be able to claim foreign tax credits to offset its U.S. income tax liabilities. Any remaining liabilities are accrued in the Company’s consolidated statements of comprehensive income and estimated tax payments are made when required by U.S. law.

### *Uncertain Tax Positions*

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

### *Net Income/(Loss) per Share*

Basic net income / (loss) per share is computed using the weighted average number of common shares outstanding during the period. Diluted net income / (loss) 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 comprise shares issuable upon the exercise or settlement of share-based awards using the treasury stock method. The dilutive effect of share-based awards with performance requirements is not considered before the performance targets are actually met. The computation of diluted net income / (loss) per share does not assume conversion, exercise, or contingent issuance of securities that would have an anti-dilutive effect (i.e. an increase in earnings per share amounts or a decrease in loss per share amounts) on net income / (loss) per share. Additionally, for purposes of calculating the numerator of diluted net income / (loss) per share, the net income / (loss) attributable to the Sohu Group is adjusted as follows. The adjustment will not be made if there is an anti-dilutive effect.

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- (1) Sogou's net income /(loss) attributable to Sohu.com Inc. is determined using the percentage that the weighted average number of Sogou shares held by Sohu.com Inc. represents of the weighted average number of Sogou Preferred Shares and Ordinary Shares, shares issuable upon the conversion of convertible preferred shares under the if-converted method, and shares issuable upon the exercise or settlement of share-based awards under the treasury stock method, and is not determined by allocating Sogou's net income /(loss) to Sohu.com Inc. using the methodology for the calculation of net income /(loss) attributable to the Sogou noncontrolling shareholders.

In the calculation of Sohu.com Inc.'s diluted net income / (loss) per share, assuming a dilutive effect, the percentage of Sohu.com Inc.'s shareholding in Sogou was calculated by treating convertible preferred shares issued by Sogou as having been converted at the beginning of the period and unvested Sogou share options with the performance targets achieved as well as vested but unexercised Sogou share options as having been exercised during the period. The dilutive effect of share-based awards with a performance requirement was not considered before the performance targets were actually met. Assuming an anti-dilutive effect, all of these Sogou shares and share options are excluded from the calculation of Sohu.com Inc.'s diluted income /(loss) per share. As a result, Sogou's net income /(loss) attributable to Sohu.com Inc. on a diluted basis equals the number used for the calculation of Sohu.com Inc.'s basic net income /(loss) per share.

- (2) Changyou's net income /(loss) attributable to Sohu.com Inc. is determined using the percentage that the weighted average number of Changyou shares held by Sohu.com Inc. represents of the weighted average number of Changyou ordinary shares and shares issuable upon the exercise or settlement of share-based awards under the treasury stock method, and not by using the percentage held by Sohu.com Inc. of the total economic interest in Changyou, which is used for the calculation of basic net income per share.

In the calculation of Sohu.com Inc.'s diluted net income/ (loss) per share, assuming a dilutive effect, all of Changyou's existing unvested restricted share units and share options, and vested restricted share units and share options that have not yet been settled, are treated as vested and settled by Changyou under the treasury stock method, causing the percentage of the weighted average number of shares held by Sohu.com Inc. in Changyou to decrease. As a result, Changyou's net income / (loss) attributable to Sohu.com Inc. on a diluted basis decreased accordingly. Assuming an anti-dilutive effect, all of these Changyou restricted share units and share options are excluded from the calculation of Sohu.com Inc.'s diluted net income /(loss) per share. As a result, Changyou's net income /(loss) attributable to Sohu.com Inc. on a diluted basis equals the number used for the calculation of Sohu.com Inc.'s basic net income /(loss) per share.

### ***Fair Value of Financial Instruments***

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

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

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

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

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

### ***Cash Equivalents***

The Sohu Group's cash equivalents mainly consist of time deposits with original maturities of three months or less, and highly liquid investments that are readily convertible to known amounts of cash.

### ***Short-term Investments***

For investments in financial instruments with a variable interest rate indexed to the performance of underlying assets, the Sohu Group elected the fair value method at the date of initial recognition and carried these investments subsequently at fair value. Changes in fair values are reflected in the consolidated statements of comprehensive income.

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### **Accounts Receivable, Net**

The carrying value of accounts receivable is reduced by an allowance that reflects the Sohu Group's best estimate of the amounts that will not be collected. The Group makes estimations of the collectability of accounts receivable. Many factors are considered in estimating the general allowance, including reviewing delinquent accounts receivable, performing an aging analysis and a customer credit analysis, and analyzing historical bad debt records and current economic trends.

### **Available-for-Sale Securities**

Investments in debt securities and equity securities that have readily determinable fair values not classified as trading securities or as held-to-maturity securities are classified as available-for-sale securities, and are included in long-term investments.

Available-for-sale securities are reported at fair value, with unrealized gains or losses recorded in other comprehensive income or losses in the consolidated balance sheets. Realized gains or losses are included in the consolidated statements of comprehensive income during the period in which the gain or loss is realized. An impairment loss on the available-for-sale securities is recognized in the consolidated statements of comprehensive income when the decline in value is determined to be other-than-temporary.

### **Restricted time deposits**

Restricted time deposits are valued based on the prevailing interest rates in the market using the discounted cash flow method.

### **Foreign exchange forward contracts**

Foreign exchange forward contracts are initially recognized on the date a foreign exchange forward contract is entered into and are subsequently measured at fair value. Changyou entered into such foreign exchange forward contracts in compliance with its risk management policy for the purpose of eliminating the negative impact on earnings and equity resulting from fluctuations in the exchange rate between the U.S. dollar and the RMB. The instruments are marked-to-market at each period-end with the associated changes in fair value recognized in the line item "Other income /(expense), net" in the consolidated statements of comprehensive income and "Prepaid and other current assets" or "Other short-term liabilities" in the consolidated balance sheets.

### **Equity Investments**

Investments in entities are recorded as equity investments under long-term investments. For entities over which the Group does not have significant influence, the cost method is applied, as there is no readily determinable fair value; for entities over which the Group can exercise significant influence but does not own a majority equity interest or control, the equity method is applied. For cost method investments, the Group carries the investment at historical cost after the date of investment. For equity method investments, the Group adjusts the carrying amount of an investment and recognizes investment income or loss for the Group's share of the earnings or loss of the investee after the date of investment.

### **Long-Lived Assets**

Long-lived assets consist primarily of fixed assets and intangible assets.

#### *Fixed Assets*

Fixed assets mainly comprise office buildings, computer equipment and hardware, leasehold improvements, office furniture, and vehicles. Fixed assets are recorded at cost less accumulated depreciation with no residual value. Depreciation is computed using the straight-line method over the estimated useful lives of the assets.

<u>Fixed Assets</u>	<u>Estimated Useful Lives (years)</u>
Office buildings	36-47
Leasehold improvements	Lesser of term of the lease or the estimated useful lives of the assets
Vehicles	4-10
Office furniture	5
Computer equipment and hardware	2-5

Expenditure for maintenance and repairs is expensed as incurred.



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The gain or loss on the disposal of fixed assets is the difference between the net sales proceeds and the lower of the carrying value or fair value less cost to sell the relevant assets and is recognized in operating expenses in the consolidated statements of comprehensive income.

### *Intangible Assets*

Intangible assets mainly comprise domain names and trademarks, purchased video content, operating rights for licensed games, computer software, cinema advertising slot rights, and developed technologies. Intangible assets are recorded at cost less accumulated amortization with no residual value. Amortization of intangible assets other than purchased video content is computed using the straight-line method over their estimated useful lives.

The estimated useful lives of the Group's intangible assets are listed below:

<u>Intangible Assets</u>	<u>Estimated Useful Lives (years)</u>
Domain names and trademarks	4-30
Developed technologies	3-10
Computer software	1-5
Purchased video content	4 months to 2 years, or over the applicable licensing period
Cinema advertising slot rights	over the contract terms
Operating rights for licensed games	over the contract terms

### *Impairment of Long-lived Assets*

In accordance with ASC 360-10-35, the Sohu Group reviews the carrying values of long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Based on the existence of one or more indicators of impairment, the Group measures any impairment of long-lived assets using the projected discounted cash flow method at the asset group level. The estimation of future cash flows requires significant management judgment based on the Group's historical results and anticipated results and is subject to many factors. The discount rate that is commensurate with the risk inherent in the Group's business model is determined by its management. An impairment loss would be recorded if the Group determined that the carrying value of long-lived assets may not be recoverable. The impairment to be recognized is measured by the amount by which the carrying values of the assets exceed the fair value of the assets.

### *Video Content*

Video content consists primarily of purchased video content and self-developed video content. Purchased video content is recognized as intangible assets. Amortization of purchased video content is computed based on the trend in viewership accumulation. For self-developed video content, production costs incurred in excess of the amount of revenue contracted for are expensed as incurred, instead of being recorded as intangible assets.

Sohu Video enters into nonmonetary transactions to exchange online broadcasting rights for purchased video content with other online video broadcasting companies. Under ASC 845, the cost of a nonmonetary asset acquired in exchange for another nonmonetary asset is the fair value of the asset surrendered to obtain the acquired nonmonetary asset, and a gain or loss should be recognized on the exchange. The fair value of the asset received should be used to measure the cost if the fair value of the asset received is more reliable than the fair value of the asset surrendered. The Sohu Group records these nonmonetary exchanges at the fair values of the online broadcasting rights for purchased video content and recognize any net gain or loss from such exchange transactions.

### *Impairment of Video Content*

Purchased video content is stated at the lower of cost less accumulated amortization, or net realizable value ("NRV").

In accordance with ASC 920-350-35, if management's expectations of the programming usefulness of a program, series, package, or daypart are revised downward, it may be necessary to write down unamortized cost to estimated NRV. A write-down from unamortized cost to a lower estimated NRV establishes a new cost basis. Accordingly, the Group measures the video content's impairment loss by comparing its carrying value to its NRV. An impairment loss would be recorded if the carrying value of video content is lower than its NRV. The impairment to be recognized is measured by the amount by which the NRV of video content exceeds its carrying value.

### **Goodwill**

Goodwill represents the excess of the purchase price over the fair value of the identifiable assets and liabilities acquired as a result of the Sohu Group's acquisitions of interests in its subsidiaries and consolidated VIEs. If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports in its financial statements provisional amounts for the items for which the accounting is incomplete. If a measurement period adjustment is identified, the Group recognizes the adjustment as part of the acquisition accounting. The Sohu Group increases or decreases the provisional amounts of identifiable assets or liabilities by means of increases or decreases in goodwill for measurement period adjustments.

In accordance with ASC 350, the Group does not amortize goodwill, but tests it for impairment. The Group tests goodwill for impairment at the reporting unit level on an annual basis as of October 1, and between annual tests when an event occurs or circumstances change that could indicate that the asset might be impaired. Under ASC 350-20-35, the Group has the option to choose whether it will apply a qualitative assessment first and then a quantitative assessment, if necessary, or to apply a quantitative assessment directly. For reporting units applying a qualitative assessment first, the Group starts the goodwill impairment test by assessing qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is mandatory. Otherwise, no further testing is required. The quantitative impairment test consists of a comparison of the fair value of goodwill with its carrying value. For reporting units directly applying the quantitative assessment, the Group performs the goodwill impairment test by quantitatively comparing the fair values of those reporting units to their carrying amounts. After performing the assessment, if the carrying amounts of the reporting units were higher than their fair value, the Group performs the second step of the two-step quantitative goodwill impairment test.

Application of a goodwill impairment test requires significant management 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. The Group estimates fair value using the income approach or market approach. The judgment in estimating the fair value of reporting units includes estimating future cash flows, determining appropriate discount rates, control premium, comparable companies' multipliers and making other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value for each reporting unit.

### **Comprehensive Income**

Comprehensive income is defined as the change in equity of a company during a period from transactions and other events and circumstances excluding transactions resulting from investments from owners and distributions to owners. Accumulated other comprehensive income, as presented on the Sohu Group's consolidated balance sheets, includes a cumulative foreign currency translation adjustment and an unrealized gain/(loss) on available-for-sale securities.

### **Functional Currency and Foreign Currency Translation**

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 the entity primarily generates and expends cash. Management's judgment is essential to determine the functional currency by assessing various indicators, such as cash flows, sales price and market, expenses, financing and inter-company transactions and arrangements. The functional currency of Sohu.com Inc. is the U.S. dollar. The functional currency of the Sohu Group's subsidiaries in the U.S., the Cayman Islands, the British Virgin Islands and Hong Kong is the U.S. dollar. The functional currencies of the Sohu Group's subsidiaries and VIEs in other countries are the national currencies of those countries, rather than the U.S. dollar.

Foreign currency transactions denominated in currencies other than the functional currency are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are re-measured at the applicable rates of exchange in effect at that date. Gains and losses resulting from foreign currency re-measurement are included in the consolidated statements of comprehensive income.

Financial statements of entities with a functional currency other than the U.S. dollar are translated into U.S. dollars, which is the reporting currency. Assets and liabilities are translated at the current exchange rate in effect at the balance sheet date, and revenues and expenses are translated at the average of the exchange rates in effect during the reporting period. Shareholders' equity accounts are translated using the historical exchange rates at the date the entry to shareholders' equity was recorded, except for the change in retained earnings during the year, which is translated using the historical exchange rates used to translate each period's income statement. Differences resulting from translating a foreign currency to the reporting currency are recorded in accumulated other comprehensive income in the consolidated balance sheets.

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### ***Effect of Recent Accounting Pronouncements***

Revenue from Contracts with Customers. In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606).” This guidance supersedes current guidance on revenue recognition in Topic 605, “Revenue Recognition.” In addition, there are disclosure requirements related to the nature, amount, timing, and uncertainty of revenue recognition. In August 2015, the FASB issued ASU No. 2015-14 to defer the effective date of ASU No. 2014-09 for all entities by one year. For public business entities that follow U.S. GAAP, the deferral results in the new revenue standard are being effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, with early adoption permitted for interim and annual periods beginning after December 15, 2016. The Sohu Group will apply the new revenue standard beginning January 1, 2018, and will not early adopt. The Sohu Group has set up an implementation team that is currently in the process of analyzing each of the Sohu Group’s revenue streams in accordance with the new revenue standard to determine the impact on the Group’s consolidated financial statements. The Sohu Group plans to continue the evaluation, analysis, and documentation of its adoption of ASU 2014-09 (including those subsequently issued updates that clarify ASU 2014-09’s provisions) throughout 2017 as the Sohu Group works towards the implementation and finalizes its determination of the impact that the adoption will have on its consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*, which simplifies the presentation of deferred income taxes by requiring deferred tax assets and liabilities to be classified as noncurrent on the balance sheet. The amendments in this update are effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted. Additionally, the new guidance may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. The Sohu Group adopted this guidance retrospectively during the fourth quarter of 2016. Accordingly, the consolidated balance sheets as of December 31, 2016 and 2015 reflect the new classification. As a result of the adoption of this guidance, \$4.7 million of current deferred tax assets and \$24.9 million of deferred tax liabilities were reclassified to non-current as of December 31, 2015.

Recognition and Measurement of Financial Assets and Financial Liabilities. On January 5, 2016, the FASB issued ASU 2016-01 (“ASU 2016-01”), *Recognition and Measurement of Financial Assets and Financial Liabilities*, which amends certain aspects of recognition, measurement, presentation and disclosure of financial instruments. This amendment requires all equity investments to be measured at fair value, with changes in the fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee). This standard will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Sohu Group is currently evaluating the impact of adopting this standard on its consolidated financial statements.

Leases. On February 25, 2016, the FASB issued ASU No. 2016-02 (“ASU 2016-02”), *Leases*. ASU 2016-02 specifies the accounting for leases. For operating leases, ASU 2016-02 requires a lessee to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in its balance sheet. The standard also requires a lessee to recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term, on a generally straight-line basis. In addition, this standard requires both lessees and lessors to disclose certain key information about lease transactions. ASU 2016-02 is effective for public companies for annual reporting periods, and interim periods within those years, beginning after December 15, 2018. Early adoption is permitted. The Sohu Group is currently evaluating the impact of adopting this standard on its consolidated financial statements.

Compensation – Stock Compensation. On March 30, 2016, the FASB issued ASU 2016-09 (“ASU 2016-09”), *Compensation – Stock Compensation: Improvements to Employee Share-Based Payment Accounting*, which relates to the accounting for employee share-based payments. This standard addresses several aspects of the accounting for share-based payment award transactions, including: (a) income tax consequences; (b) classification of awards as either equity or liabilities; and (c) classification on the statement of cash flows; (d) accounting for forfeitures of share-based payments. This standard will be effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The Sohu Group does not expect this standard to have a material impact on its consolidated financial statements

Financial Instruments-Credit Losses. In June 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-13, *Financial Instruments-Credit Losses (Topic 326)*, which requires entities to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early application will be permitted for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Sohu Group is currently evaluating the impact that the standard will have on its consolidated financial statements and related disclosures.

Statement of Cash Flows – Classification of Certain Cash Receipts and Cash Payments. In August 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-15, *Statement of Cash Flows – Classification of Certain Cash Receipts and Cash Payments*, which clarifies the presentation and classification of certain cash receipts and cash payments in the statement of cash flows. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. The Sohu Group is currently evaluating the impact that the standard will have on its consolidated financial statements and related disclosures.

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Statement of Cash Flows (Topic 230): Restricted Cash. In November 2016, the FASB issued Accounting Standards Update (“ASU”) No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. The guidance requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The standard is effective for fiscal years beginning after December 15, 2017, and interim period within those fiscal years. Early adoption is permitted, including adoption in an interim period. The standard should be applied using a retrospective transition method to each period presented. The Sohu Group is currently evaluating the impact of adopting this standard on its consolidated financial statements.

Business Combinations (Topic 805): Clarifying the Definition of a Business. In January 2017, the FASB issued Accounting Standards Update (“ASU”) No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*, which clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions or disposals of assets or businesses. The standard is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. The standard should be applied prospectively on or after the effective date. The Sohu Group will evaluate the impact of adopting this standard prospectively upon any transactions of acquisitions or disposals of assets or businesses.

Simplifying the Test for Goodwill Impairment. In January 2017, the FASB issued Accounting Standards Update (“ASU”) 2017-04, *Simplifying the Test for Goodwill Impairment*. The guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The guidance should be adopted on a prospective basis for the annual or any interim goodwill impairment tests beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Sohu Group is currently evaluating the impact of adopting this standard on its consolidated financial statements.

### 3. Segment Information

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

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

	Year Ended December 31, 2014				
	Sohu	Sogou	Changyou	Eliminations	Consolidated
Revenues (1)	\$ 546,262	\$ 386,382	\$ 755,266	\$ (14,833)	\$ 1,673,077
Segment cost of revenues	(320,035)	(163,426)	(201,710)	1,509	(683,662)
Segment gross profit	226,227	222,956	553,556	(13,324)	989,415
SBC (2) in cost of revenues	(728)	(1,092)	(152)	0	(1,972)
Gross profit	225,499	221,864	553,404	(13,324)	987,443
Operating expenses:					
Product development (3)	(93,227)	(102,329)	(193,044)	4,297	(384,303)
Sales and marketing (1)	(220,479)	(73,932)	(241,202)	14,744	(520,869)
General and administrative	(43,640)	(13,446)	(104,663)	(733)	(162,482)
Goodwill impairment and impairment of intangible assets acquired as part of business acquisitions	0	0	(52,282)	0	(52,282)
SBC (2) in operating expenses	(7,378)	(62,950)	(3,962)	1,820	(72,470)
Total operating expenses	(364,724)	(252,657)	(595,153)	20,128	(1,192,406)
Operating loss	(139,225)	(30,793)	(41,749)	6,804	(204,963)
Other income (3)	8,369	2,462	4,112	(4,984)	9,959
Interest income	8,696	2,773	26,091	0	37,560
Interest expense	(131)	0	(6,452)	0	(6,583)
Exchange difference	(325)	(149)	(668)	0	(1,142)
Loss before income tax expense	(122,616)	(25,707)	(18,666)	1,820	(165,169)
Income tax expense	(3,557)	0	(2,493)	0	(6,050)
Net loss	<u>\$ (126,173)</u>	<u>\$ (25,707)</u>	<u>\$ (21,159)</u>	<u>\$ 1,820</u>	<u>\$ (171,219)</u>

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

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

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

	Year Ended December 31, 2015				
	Sohu	Sogou	Changyou	Eliminations	Consolidated
Revenues (1)	\$ 590,471	\$ 591,803	\$ 761,636	\$ (6,819)	\$1,937,091
Segment cost of revenues	(393,564)	(247,949)	(216,727)	924	(857,316)
Segment gross profit	196,907	343,854	544,909	(5,895)	1,079,775
SBC (2) in cost of revenues	(1,381)	(330)	(37)	0	(1,748)
Gross profit	195,526	343,524	544,872	(5,895)	1,078,027
Operating expenses:					
Product development (3)	(94,392)	(124,210)	(165,130)	4,932	(378,800)
Sales and marketing (1)	(203,332)	(93,055)	(91,334)	6,845	(380,876)
General and administrative	(57,014)	(14,422)	(71,771)	(656)	(143,863)
Goodwill impairment and impairment of intangible assets acquired as part of a business acquisition	0	0	(40,324)	0	(40,324)
SBC (2) in operating expenses	(26,743)	(10,049)	(14,988)	85	(51,695)
Total operating expenses	(381,481)	(241,736)	(383,547)	11,206	(995,558)
Operating profit /(loss)	(185,955)	101,788	161,325	5,311	82,469
Other income (3) (4)	92,455	1,142	64,961	(84,032)	74,526
Interest income (5)	7,690	5,332	23,779	(6,158)	30,643
Interest expense (5)	(5,007)	0	(8,335)	6,158	(7,184)
Exchange difference	1,716	667	2,954	0	5,337
Income /(loss) before income tax expense	(89,101)	108,929	244,684	(78,721)	185,791
Income tax expense	(13,451)	(9,430)	(54,055)	0	(76,936)
Net income /(loss)	<u>\$(102,552)</u>	<u>\$ 99,499</u>	<u>\$ 190,629</u>	<u>\$ (78,721)</u>	<u>\$ 108,855</u>

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

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

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

Note (4): In the third quarter of 2015, Sogou purchased from Sohu 24.0 million Series A Preferred Shares of Sogou for \$78.8 million. Sohu recognized \$78.8 million in other income, which was eliminated in the Group’s consolidated statements of comprehensive income.

Note (5): The elimination represents interest income/ (expense) resulting from intracompany loans between the Sohu segment and the Changyou segment.

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	Year Ended December 31, 2016				
	Sohu	Sogou	Changyou	Eliminations	Consolidated
Revenues (1)	\$ 468,515	\$ 660,408	\$ 525,385	\$ (3,877)	\$1,650,431
Segment cost of revenues	(391,417)	(302,565)	(165,779)	327	(859,434)
Segment gross profit	77,098	357,843	359,606	(3,550)	790,997
SBC (2) in cost of revenues	(164)	(171)	(31)	0	(366)
Gross profit	76,934	357,672	359,575	(3,550)	790,631
Operating expenses:					
Product development (3)	(96,815)	(132,749)	(118,738)	4,342	(343,960)
Sales and marketing (1)	(259,800)	(121,303)	(55,971)	4,688	(432,386)
General and administrative	(47,804)	(19,308)	(45,642)	89	(112,665)
SBC (2) in operating expenses	(1,703)	(8,680)	(8,371)	0	(18,754)
Total operating expenses	(406,122)	(282,040)	(228,722)	9,119	(907,765)
Operating profit /(loss)	(329,188)	75,632	130,853	5,569	(117,134)
Other income /(expense) (3)	5,360	(26,027)	15,523	(5,569)	(10,713)
Interest income (4)	8,879	5,198	21,490	(13,068)	22,499
Interest expense (4)	(10,103)	0	(4,321)	13,068	(1,356)
Exchange difference	2,349	5,346	5,108	0	12,803
Income /(loss) before income tax benefit /(expense)	(322,703)	60,149	168,653	0	(93,901)
Income tax benefit /(expense)	538	(27)	(21,583)	0	(21,072)
Net income /(loss)	<u>\$ (322,165)</u>	<u>\$ 60,122</u>	<u>\$ 147,070</u>	<u>\$ 0</u>	<u>\$ (114,973)</u>

- Note (1): The elimination mainly consists of revenues and expenses generated from marketing services among the Sohu, Sogou and Changyou segments.  
 Note (2): "SBC" stands for share-based compensation expense.  
 Note (3): The elimination mainly consists of leasing income and expenses generated from a building that Sohu leases to Sogou.  
 Note (4): The elimination represents interest income/ (expense) resulting from intracompany loans between the Sohu segment and the Changyou segment.

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

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

	As of December 31, 2016				
	Sohu	Sogou	Changyou	Eliminations	Consolidated
Cash and cash equivalents	\$ 167,691	\$286,078	\$ 597,188	\$ 0	\$1,050,957
Accounts receivable, net	100,317	41,781	47,150	(81)	189,167
Fixed assets, net	196,839	117,022	189,770	0	503,631
Total assets (1)	\$1,241,844	\$499,589	\$1,708,037	\$ (885,780)	\$2,563,690

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

#### 4. Share-based Compensation Expense

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

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Share-based compensation expense was recognized in costs and expenses for the years ended December 31, 2014, 2015 and 2016 as follows (in thousands):

Share-based compensation expense	Year Ended December 31,		
	2014	2015	2016
Cost of revenues	\$ 1,973	\$ 1,748	\$ 366
Product development expenses	24,982	19,344	9,184
Sales and marketing expenses	5,645	3,054	2,394
General and administrative expenses	41,843	29,297	7,176
	<u>\$74,443</u>	<u>\$53,443</u>	<u>\$19,120</u>

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

Share-based compensation expense	Year Ended December 31,		
	2014	2015	2016
For Sohu (excluding Sohu Video) share-based awards	\$ 4,410	\$ 27,811	\$ 2,761
For Sogou share-based awards (1)	61,918	10,310	8,802
For Changyou share-based awards	4,087	15,024	8,402
For Sohu Video share-based awards (2)	4,028	298	(845)
	<u>\$74,443</u>	<u>\$53,443</u>	<u>\$19,120</u>

Note (1): Compensation expense for Sogou share-based awards also includes compensation expense for Tencent restricted share units that Tencent had granted to employees who transferred to Sogou with the Soso search-related businesses, and compensation expense equal to the excess of the repurchase price paid to employees over the fair value at the repurchase date of Sogou Class A Ordinary Shares that Sogou repurchased in the second quarter of 2014.

Note (2): The negative amount resulted from re-measured compensation expense based on the then-current fair value of the awards on each reporting date.

There was no capitalized share-based compensation expense for the years ended December 31, 2016, 2015 and 2014.

### 5. Advertising and Promotional Expenses, included in Sales and Marketing Expenses

Advertising and promotional expenses are included in sales and marketing expenses, and generally represent the expenses of promotions to create or stimulate a positive image of the Sohu Group or a desire to subscribe for the Group's products and services. Advertising expenses are expensed as incurred. For the years ended December 31, 2016, 2015 and 2014, advertising and promotional expenses recognized in the consolidated statements of comprehensive income were \$270.2 million, \$196.9 million and \$310.7 million, respectively.

### 6. Other Income /(Expense), net

The following table summarizes the Sohu Group's other income /(expense) (in thousands):

	Year Ended December 31,		
	2014	2015	2016
Donations (1)	\$ (683)	\$ (1,192)	\$ (27,982)
Investment income/(expense) (2)	2,039	60,264	(1,908)
Gain from the changes in fair value of financial instruments	3,137	9,374	13,133
Government grant	3,618	2,839	2,112
Change in fair value of China Web put option	2,304	0	0
Others	(456)	3,241	3,932
	<u>\$9,959</u>	<u>\$74,526</u>	<u>\$ (10,713)</u>



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Note (1): In the second quarter of 2016, the Sohu Group recognized a one-time expense of \$27.8 million that was related to a donation by Sogou to Tsinghua University related to setting up a joint research institute focusing on artificial intelligence technology.

Note (2): The \$60.3 million in investment income in 2015 primarily included a \$55.1 million disposal gain recognized by Changyou for its sale of the 7Road business and certain Changyou subsidiaries and a \$13.0 million disposal gain recognized by Sohu for its sale of an equity investment, offset by an \$8.9 million investment loss from the Group's other equity investments.

**7. Balance Sheet Components (In thousands)**

	As of December 31,	
	2015	2016
<b>Cash and cash equivalents</b>		
Cash	\$ 517,973	\$ 424,260
Cash equivalents	727,232	626,697
	<u>\$1,245,205</u>	<u>\$1,050,957</u>
<b>Accounts receivable, net</b>		
Accounts receivable:	\$ 277,593	\$ 194,008
Allowance for doubtful accounts:		
Balance at the beginning of year	(4,068)	(3,976)
Additional provision for bad debt, net of recoveries	(2,175)	(7,109)
Write-offs	2,064	5,992
Exchange difference	203	252
Balance at the end of year	<u>(3,976)</u>	<u>(4,841)</u>
	<u>\$ 273,617</u>	<u>\$ 189,167</u>
<b>Prepaid and other current assets</b>		
Prepaid content and license	\$ 57,910	\$ 119,810
Prepaid taxes	13,073	30,308
Matching loan due from a related party (See Note 8)	12,740	29,019
Loans to third parties	9,361	25,494
Due from Shenzhen 7Road	20,579	12,509
Prepaid cost of revenue	8,458	10,085
Prepaid rental deposit	10,231	9,817
Receivables from third party payment platforms	3,673	4,027
Employee advances	3,844	4,013
Due from a related party	3,080	0
Interest receivable	1,058	1,595
Prepaid advertising and promotion fees	1,905	1,506
Prepaid office rent and facilities expenses	2,223	1,378
Others	6,082	10,572
	<u>\$ 154,217</u>	<u>\$ 260,133</u>
<b>Prepaid non-current assets</b>		
Prepaid PRC income tax for the sale of assets associated with 17173.com by Sohu to Changyou	\$ 6,067	\$ 4,733
Others	187	1
	<u>\$ 6,254</u>	<u>\$ 4,734</u>

	As of December 31,	
	2015	2016
<b>Other short-term liabilities</b>		
Deposit received from membership card buyers	\$ 88,990	\$ 61,708
Matching loan due to a related party (See Note 8)	13,005	28,678
Contract deposits from advertisers	21,367	24,385
Donation payable	0	17,299
Consideration payable for equity investment	5,390	5,280
Early exercise of Sogou share options for trust arrangements	4,530	4,504
Accrued liabilities to suppliers	4,110	3,817
Withholding employee individual income tax for options	2,382	2,382
Accrued Business Tax arising from the sale of assets associated with 17173.com by Sohu to Changyou	1,647	1,625
Government grant	1,694	0
Others	10,902	9,637
	<u>\$154,017</u>	<u>\$159,315</u>
<b>Receipts in advance and deferred revenue</b>		
Receipts in advance relating to:		
– brand advertising business	\$ 20,498	\$ 12,332
– search and search-related business	65,911	59,593
– online game business	20,244	15,225
– others business	0	2,732
Total receipts in advance	106,653	89,882
Deferred revenue	28,732	29,069
	<u>\$135,385</u>	<u>\$118,951</u>

## 8. Related Party Transactions

### *Changyou's Loan Arrangements with SoEasy*

Commencing in April 2015, certain subsidiaries of Changyou and certain subsidiaries of SoEasy entered into a series of loan agreements pursuant to which the subsidiaries of Changyou are entitled to draw down HK dollar-denominated or U.S. dollar-denominated loans from the SoEasy subsidiaries and the SoEasy subsidiaries are entitled to draw down equivalent RMB-denominated loans from the subsidiaries of Changyou, to facilitate each other's business operations. All of the loans carry a fixed rate of interest equal to the current market interest rate.

During the first quarter of 2016, Changyou drew down from SoEasy U.S. dollar-denominated loans of approximately \$29.9 million and granted RMB-denominated loans to SoEasy of approximately \$30.2 million. During the second quarter of 2016, Changyou repaid to SoEasy HK dollar-denominated loans of approximately \$12.9 million and received from SoEasy RMB-denominated loans of \$12.1 million. As of December 31, 2016, Changyou had U.S. dollar-denominated loans payable to SoEasy in a total amount of approximately \$28.1 million, which was recorded in other short-term liabilities. As of the same date, Changyou had RMB-denominated loans receivable from SoEasy in a total amount of approximately \$28.1 million, which was recorded in prepaid and other current assets. For the year of 2016, Changyou incurred interest expense of \$0.7 million and earned interest income of \$1.2 million. As of December 31, 2016, total interest expense payable to SoEasy amounted to \$0.6 million, which was recorded in other short-term liabilities; and total interest income receivable from SoEasy was \$0.9 million, which was recorded in prepaid and other current assets.

As of December 31, 2015, Changyou had drawn down from SoEasy loans in an aggregate principal amount of HKD100 million (approximately \$12.9 million), which is recorded in other short-term liabilities, and SoEasy had drawn down from Changyou loans in an aggregate principal amount of RMB80 million (approximately \$12.3 million), which is recorded in prepaid and other current assets. For the year ended December 31, 2015, interest income that Changyou earned from the RMB-denominated loan was \$0.4 million and was recorded as prepaid and other current assets, and interest expense that Changyou accrued for the HK dollar-denominated loan was \$0.1 million and was recorded as other short-term liabilities.

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### **Other Information**

For the year of 2016, the Sohu Group generated brand advertising revenue from SoEasy of \$0.9 million, and incurred sales and marketing expense for SoEasy of \$0.2 million.

### **9. Intracompany Loan and Share Pledge Agreement**

On October 24, 2016, Beijing Sohu New Media Information Technology Co., Ltd. (“Sohu Media”) entered into a loan agreement (the “Loan Agreement”) with Beijing AmazGame Age Internet Technology Co., Ltd. (“AmazGame”), pursuant to which Sohu Media may borrow from time to time from AmazGame up to RMB1.00 billion (or approximately US\$148.64 million). The first request for an advance under the Loan Agreement must be made on or prior to December 31, 2016, and requests for further advances may be made for one year following the initial advance. Such one-year request period may be extended for another one-year period with the consent of AmazGame. Principal amounts outstanding under the Loan Agreement will bear interest at an annual rate of 6%. The outstanding principal of each advance will be due one year from the date of the advance, subject to extension for an additional year with the consent of AmazGame.

Also on October 24, 2016, Sohu.com (Game) Limited (“Sohu Game”), a Cayman Islands company that is an indirect subsidiary of Sohu and is the direct parent of Changyou, and Changyou entered into a share pledge agreement (the “Share Pledge Agreement”) pursuant to which Sohu Game pledged to Changyou an agreed-upon number of Changyou Class B ordinary shares of Changyou held by Sohu Game. The share pledge agreement will give Changyou the right to apply the outstanding principal and accrued interest on the loan to the repurchase of Changyou Class B ordinary shares from Sohu Game in the event that such principal and interest are not paid when due.

In December 2016, Sohu Media received the first advance of RMB500.0 million (or US\$72.1 million) from AmazGame. The intracompany loan has been eliminated upon consolidation.

### **10. Fair Value Measurements**

#### ***Fair Value of Financial Instruments***

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

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

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

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

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

#### ***Financial Instruments Measured at Fair Value***

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

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

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The following table sets forth the financial instruments, measured at fair value by level within the fair value hierarchy, as of December 31, 2016 (in thousands):

Items	As of December 31, 2016	Fair value measurements at reporting date using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents	\$ 626,697	\$ 0	\$ 626,697	\$ 0
Short-term investments	247,926	0	247,926	0
Available-for-sale equity securities	10,381	10,381	0	0
Foreign exchange forward contracts	3,040	0	3,040	0
Restricted time deposits	269	0	269	0
Total	<u>\$ 888,313</u>	<u>\$ 10,381</u>	<u>\$ 877,932</u>	<u>\$ 0</u>

### *Cash Equivalents*

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

### *Short-term Investments*

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

As of December 31, 2016 and 2015, the Sohu Group's investment in financial instruments was \$247.9 million and \$174.5 million, respectively. The investment instruments were issued by commercial banks in China, and have a variable interest rate indexed to performance of underlying assets. Since these investments' maturity dates are within one year, they are classified as short-term investments. For the year ended December 31, 2016, 2015 and 2014, the Sohu Group recorded in the consolidated statements of comprehensive income the gain from the changes in the fair value of short-term investments in the amounts of \$10.1 million, \$9.4 million and \$3.1 million, respectively.

### *Available-for-Sale Equity Securities*

Available-for-sale equity securities are valued using the market approach based on the quoted prices in active markets at the reporting date. The Group classifies the valuation techniques that use these inputs as Level 1 of fair value measurements. On August 12, 2014, Sohu acquired approximately 6% of the total outstanding common shares of Keyeast Co., Ltd., a Korean-listed company ("Keyeast"), for a purchase price of \$15.1 million. The Sohu Group classified this investment as available-for-sale equity securities under long-term investments, and reported it at fair value. As of December 31, 2016, the fair value of the Keyeast available-for-sale equity securities held by Sohu was \$10.4 million. An unrealized loss representing the change in fair value of \$4.7 million was recorded in accumulated other comprehensive income /(loss) in the Sohu Group's consolidated balance sheets.

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### *Assets and Liabilities Held for Sale*

In 2016, Changyou's Board of Directors approved the disposal of the 51% equity interest in MoboTap, which is the mobile technology developer behind the Dolphin Browser. As of December 31, 2016, Changyou has been negotiating with a potential buyer on the terms of disposal. Accordingly, the assets and liabilities attributable to MoboTap are classified as assets and liabilities held for sale and measured at the lower of their carrying amounts or their fair values, less cost to sell, in the consolidated balance sheet as of December 31, 2016 and there is no impairment recognized in the consolidated statements of comprehensive income in 2016. Details of the aggregate assets and liabilities at December 31, 2016 are as follows (in thousands):

	As of December 31, 2016
Cash and cash equivalents	\$ 11,684
Prepaid and other current assets	2,469
Goodwill	83,470
Intangible assets	5,456
<b>Assets held for sale</b>	<b>\$ 103,079</b>
Other liabilities	3,902
<b>Liabilities held for sale</b>	<b>\$ 3,902</b>

### *Foreign Exchange Forward Contracts*

In September 2016, Changyou entered into foreign exchange forward contracts with banks in an aggregate nominal amount of \$100 million. Changyou entered into such foreign exchange forward contracts in compliance with its risk management policy for the purpose of eliminating the negative impact on earnings and equity resulting from fluctuations in the exchange rate between the U.S. dollar and the RMB. There was no cash collateral or settlement under the forward contracts as of December 31, 2016. For the year ended December 31, 2016, the Sohu Group recorded the gain from the changes in the fair value of forward contracts of \$3.0 million in the consolidated statements of comprehensive income.

The Group estimated the fair values of foreign exchange forward contracts using the Black-Scholes model. The fair values of the forward contracts were estimated based on quoted forward exchange prices at the reporting date. The Group classifies the fair value measurement of the forward contracts based on such inputs as Level 2 of fair value measurements.

### *Restricted Time Deposits*

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

### *Collateral related to Sogou Incentive Shares Trust Arrangements*

In February 2013, Sohu deposited \$9.0 million in cash into restricted time deposit accounts at a bank as collateral for credit facilities provided by the bank to certain Sogou employees. The facilities were intended to fund the employees' early exercise of Sogou share options and related PRC individual income tax. In the fourth quarter of 2016, all of these credit facilities were repaid to the bank and the \$9.0 million restricted time deposit that secured these facilities had been released.

### *Changyou Loans from Offshore Banks, Secured by Time Deposits*

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

In the first quarter of 2016, Changyou repaid all of the remaining bank loans of \$344.5 million, and restricted time deposits of \$354.7 million that secured these loans were released. For the years ended December 31, 2016, 2015 and 2014, interest income from the restricted time deposits securing the loans was \$0.5 million, \$12.8 million and \$16.3 million, respectively, and interest expense on the bank loans was \$0.6 million, \$7.1 million and \$6.4 million, respectively.

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### **Other Financial Instruments**

The fair values of other financial instruments are estimated for disclosure purposes as follows:

#### *Long-term Investment*

##### *Long-term Investment in SoEasy*

Under an agreement between Sohu and SoEasy Internet Finance Group Limited (“SoEasy”) entered into in August 2014, Sohu invested \$4.8 million and \$16.1 million in SoEasy on August 2014 and April 2015, respectively. In February 2016, Sohu invested an additional \$10.5 million in SoEasy. Sohu accounted for its investments in SoEasy under long-term investments. These investments include both preferred shares and common shares. Sohu accounted for its investment in SoEasy’s preferred shares under the cost method, since they were not considered to be common shares in substance and had no readily determinable fair value. Sohu accounted for its investment in SoEasy’s common shares under the equity method, since Sohu can exercise significant influence but does not own a majority of SoEasy’s equity capital or control SoEasy. As of December 31, 2016, the carrying value of Sohu’s investment in SoEasy was \$25.0 million.

##### *Long-term Investment in Zhihu*

In September 2015 and December 2016, Sogou invested \$12.0 million and \$5.0 million, respectively, in Zhihu Technology Limited (“Zhihu”), a company that engages primarily in the business of operating an online question and answer-based knowledge and information-sharing platform. Sogou accounted for the investment in Zhihu using the cost method, since Sogou does not have significant influence over Zhihu.

#### *Short-term Receivables and Payables*

Accounts receivable and prepaid and other current assets are financial assets with carrying values that approximate fair value due to their short-term nature. Short-term accounts payable, accrued liabilities, receipts in advance and deferred revenue and other short-term liabilities are financial liabilities with carrying values that approximate fair value due to their short-term nature. For short-term receivables and payables, the Group estimated fair values using the discounted cash flow method, which is unobservable in the market. The Group classifies the valuation technique as Level 2 of fair value measurements.

#### *Long-term Payables*

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

### **Assets Measured at Fair Value on a Nonrecurring Basis**

The following table sets forth assets measured at fair value on a nonrecurring basis by level within the fair value hierarchy as of December 31, 2015 and 2016 (in thousands):

Items	As of December 31, 2015	Fair value measurements at reporting date using			Total Losses
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Prepaid and other current assets	\$ 154,217	\$ 0	\$ 0	\$ 154,217	6,769
Intangible assets, net	55,415	0	0	55,415	19,947
Goodwill	154,219	0	0	154,219	31,445
	<u>\$ 363,851</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 363,851</u>	<u>58,161</u>

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Items	As of December 31, 2016	Fair value measurements at reporting date using			Total Losses
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Prepaid and other current assets	\$ 260,133	\$ 0	\$ 0	\$ 260,133	19,654
Intangible assets, net	32,131	0	0	32,131	3,252
Goodwill	68,290	0	0	68,290	0
	<u>\$ 360,554</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 360,554</u>	<u>22,906</u>

### *Prepaid and other current assets*

Prepaid and other current assets primarily comprise purchased video content with a remaining amortization period of less than one year, prepaid taxes, matching loan due from a related party, loans to third parties and a receivable from Shenzhen 7Road. The impairment losses recognized for prepaid and other current assets were mainly due to Sohu Video purchased content and license rights. See Note 12 – Intangible Assets, Net.

### *Intangible Assets*

Intangible assets mainly comprise domain names and trademarks, purchased video content, operating rights for licensed games, computer software, cinema advertising slot rights, and developed technologies. The impairment losses recognized for intangible assets were mainly due to Sohu Video purchased video content and Changyou purchased content and license rights to games. See Note 12 – Intangible Assets, Net.

### *Goodwill*

Goodwill represents the excess of the purchase price over the fair value of the identifiable assets and liabilities acquired as a result of the Group's acquisitions of interests in its subsidiaries and consolidated VIEs. See Note 13 – Goodwill.

## **11. Fixed Assets**

The following table summarizes the Sohu Group's fixed assets (in thousands):

	As of December 31,	
	2015	2016
<b>Fixed assets, net</b>		
Office buildings	\$ 393,938	\$ 368,758
Computer equipment and hardware	302,832	323,592
Leasehold and building improvements	49,703	46,164
Office furniture	10,784	9,789
Vehicles	4,930	3,480
Fixed assets, gross	762,187	751,783
Accumulated depreciation	(253,495)	(248,152)
	<u>\$ 508,692</u>	<u>\$ 503,631</u>

For the years ended December 31, 2016, 2015 and 2014, depreciation expenses for fixed assets were \$73.4 million, \$77.4 million and \$78.4 million, respectively.



## 12. Intangible Assets, Net

The following table summarizes the Sohu Group's intangible assets, net, as of December 31, 2015 and 2016 (in thousands):

Items	As of December 31, 2015			Net Carrying Amount
	Gross Carrying Amount	Accumulated Amortization	Impairment	
Purchased video content	\$226,832	\$ (201,405)	\$ (11,129)	\$14,298
Domain names and trademarks	35,003	(9,458)	(11,747)	13,798
Operating rights for licensed games	26,869	(9,517)	(9,474)	7,878
Developed technologies	19,352	(3,393)	(12,334)	3,625
Computer software	15,934	(11,173)	0	4,761
Cinema advertising slot rights	12,615	(8,721)	0	3,894
Others	27,760	(11,174)	(9,425)	7,161
Total	<u>\$364,365</u>	<u>\$ (254,841)</u>	<u>\$ (54,109)</u>	<u>\$55,415</u>
Items	As of December 31, 2016			Net Carrying Amount
	Gross Carrying Amount	Accumulated Amortization	Impairment	
Purchased video content	\$181,100	\$ (159,549)	\$ (12,759)	\$ 8,792
Operating rights for licensed games	30,497	(13,178)	(9,208)	8,111
Domain names and trademarks	29,466	(9,872)	(9,758)	9,836
Computer software	16,521	(13,015)	0	3,506
Developed technologies	8,818	(1,252)	(7,369)	197
Cinema advertising slot rights	3,199	(2,625)	0	574
Others	11,568	(4,398)	(6,055)	1,115
Total	<u>\$281,169</u>	<u>\$ (203,889)</u>	<u>\$ (45,149)</u>	<u>\$32,131</u>

### Impairment Losses

In 2016, the Group recognized \$22.9 million in losses for impairment related to Sohu Video's purchased video content and Changyou purchased content and license rights to games. Impairment losses recognized consisted primarily of impairment losses incurred by Sohu of \$18.6 million, including \$2.9 million for intangible assets and \$15.7 million for prepaid and other current assets, mainly due to the restructuring of the sales team of Sohu Video, which had an adverse impact on Sohu Video's performance for 2016 and resulted in a lowering of management's expectations of the programming usefulness of certain Sohu Video's purchased video content.

In 2015, the Group recognized \$19.9 million in losses for impairment of intangible assets, primarily related to the Dolphin Browser operated by MoboTap and related license rights. In 2015, the financial performance of the Dolphin Browser was below original expectations, and Changyou's management concluded that the Dolphin Browser was unable to provide expected synergies with Changyou's platform channel business and accordingly performed a goodwill impairment test for the goodwill generated in the acquisition of MoboTap, and recognized an \$8.9 million impairment loss for intangible assets. The impairment loss is recognized in the consolidated statements of comprehensive income under "goodwill impairment and impairment of intangibles as part of acquisition of a business." The impaired intangible assets primarily consist of user base, technology, trademark and license rights.

In 2014, the Group recognized a \$20.2 million impairment loss related to Changyou's intangible assets. The impairment loss for intangible assets was mainly from developed technologies and domain names, including a \$15.3 million impairment loss related to RaidCall. The impairment loss was recognized in the consolidated statements of comprehensive income as "goodwill impairment and impairment of intangible assets acquired as part of business acquisitions."

### Amortization

In 2016, 2015 and 2014, amortization of intangible assets was \$131.2 million, \$161.1 million and \$77.7 million, respectively.

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As of December 31, 2016, amortization expenses for future periods are estimated to be as follows:

<u>For the year ending December 31,</u>	<u>(in thousands)</u>
2017	\$ 11,593
2018	9,355
2019	2,633
2020	1,300
2021	1,217
Thereafter	6,033
Total expected amortization expense	<u>\$ 32,131</u>

### 13. Goodwill

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

	<u>Sohu</u>	<u>Sogou</u>	<u>Changyou</u>	<u>Total</u>
Balance as of December 31, 2014				
Goodwill	\$ 73,908	\$6,309	\$ 297,999	\$ 378,216
Accumulated impairment losses	(35,788)	0	(39,002)	(74,790)
	<u>\$ 38,120</u>	<u>\$6,309</u>	<u>\$ 258,997</u>	<u>\$ 303,426</u>
Transactions in 2015				
Goodwill associated with the acquisition of 7Road de-recognized upon the sale of the 7Road business	0	0	(109,735)	(109,735)
Impairment loss related to MoboTap	0	0	(29,569)	(29,569)
Goodwill associated with the acquisition of Doyo, transferred to assets held for sale and impaired	0	0	(7,352)	(7,352)
Foreign currency translation adjustment	(928)	(364)	(1,259)	(2,551)
Balance as of December 31, 2015	<u>\$ 37,192</u>	<u>\$5,945</u>	<u>\$ 111,082</u>	<u>\$ 154,219</u>
Balance as of December 31, 2015				
Goodwill	72,980	5,945	181,529	260,454
Accumulated impairment losses	(35,788)	0	(70,447)	(106,235)
	<u>\$ 37,192</u>	<u>\$5,945</u>	<u>\$ 111,082</u>	<u>\$ 154,219</u>
Transactions in 2016				
Goodwill associated with MoboTap and transferred to assets held for sale	0	0	(83,470)	(83,470)
Foreign currency translation adjustment	(969)	(380)	(1,110)	(2,459)
Balance as of December 31, 2016	<u>\$ 36,223</u>	<u>\$5,565</u>	<u>\$ 26,502</u>	<u>\$ 68,290</u>
Balance as of December 31, 2016				
Goodwill	72,011	5,565	96,949	174,525
Accumulated impairment losses	(35,788)	0	(70,447)	(106,235)
	<u>\$ 36,223</u>	<u>\$5,565</u>	<u>\$ 26,502</u>	<u>\$ 68,290</u>

In 2016, there were two separate reporting units under the Sohu segment, consisting of brand advertising and others. There was only one reporting unit under the Sogou segment. There were five main reporting units under the Changyou segment, consisting of the Changyou online game business, the 17173.com Website, RaidCall, MoboTap and the cinema advertising business. The Sohu Group tested goodwill for impairment at the reporting unit level on October 1, 2016. The Group performed impairment tests using the qualitative and quantitative methods.

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For the Sohu segment and the Sogou segment, impairment tests were conducted by quantitatively comparing the fair values of those reporting units to their carrying amounts. Sohu and Sogou estimated the fair values by weighting the results from the income approach. The valuation approach considers a number of factors that include expected future cash flows, growth rates, and discount rates, and requires Sohu and Sogou to make certain assumptions and estimates regarding industry economic factors and future profitability of the business. After the quantitative assessment, management concluded that the fair values of the reporting units exceeded their carrying values, indicating that the goodwill of those reporting units was not impaired. For the Changyou segment, Changyou performed the first step of a two-step quantitative goodwill impairment test by comparing the fair value of these reporting units to their carrying amounts, and the fair value of these reporting units exceeded their carrying values, indicating that the goodwill of those reporting units was not impaired as of December 31, 2016. For the two-step goodwill impairment test, Changyou estimated the fair values using the income approach, and considered factors that included expected future cash flows, growth rates and discount rates, or using the market approach and considered factors that included share price, control premium and comparable companies' multipliers.

In 2016, Changyou's Board of Directors approved the disposal of the 51% equity interest in MoboTap held by Changyou. As of December 31, 2016, Changyou has been negotiating with a potential buyer on the terms of disposal. Accordingly, the assets and liabilities of MoboTap were recognized as "assets held for sale" and "liabilities held for sale," respectively. As of December 31, 2016, goodwill in the amount of \$83.5 million was reclassified from goodwill to "assets held for sale." See Note-10-Assets and Liabilities Held for Sale.

In 2015, Changyou recognized a \$29.6 million goodwill impairment loss related to MoboTap, as Changyou's management concluded that the Dolphin Browser was unable to provide expected synergies with Changyou's platform business. Changyou also recognized a \$1.9 million goodwill impairment loss with respect to Beijing Doyo Internet Technology Co., Ltd. ("Doyo") as the total consideration received by Changyou for the sale of Doyo under an agreement entered into in September 2015 was lower than the carrying value of Doyo's net assets. Doyo was disposed of at the end of 2015.

In 2014, Changyou recognized a \$33.8 million goodwill impairment loss related to RaidCall, as Changyou's management concluded that RaidCall was unable to provide expected synergies with Changyou's online games business.

## 14. Taxation

### *Income Tax Expense and Effective Tax Rate*

#### *Income Tax Expense*

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

The components of income before income taxes are as follows (in thousands):

	Year ended December 31,		
	2014	2015	2016
Income /(loss) before income tax expense			
Income /(loss) from China operations	\$(129,349)	\$171,636	\$(88,440)
Income /(loss) from non-China operations	(35,820)	14,155	(5,461)
Total income /(loss) before income tax expense	<u>\$(165,169)</u>	<u>\$185,791</u>	<u>\$(93,901)</u>
Income tax expense applicable to China operations			
Current tax	\$ 23,295	\$ 55,532	\$ 13,635
Deferred tax	(20,637)	8,735	8,500
Subtotal income tax expense applicable to China operations	2,658	64,267	22,135
Non China income tax expense/(benefit)	1,864	11,291	(2,134)
Non China withholding tax expense	1,528	1,378	1,071
Total income tax expense	<u>\$ 6,050</u>	<u>\$ 76,936</u>	<u>\$ 21,072</u>

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In 2016, of the \$21.1 million income tax expense, \$22.1 million was for PRC tax, mainly attributable to Changyou's business and negative \$2.1 million was for U.S. tax, representing the combined results of income tax expense for U.S. taxable income of 2016 and Sohu's reversal of \$5.0 million for the disposal of an equity investment that occurred in 2015 and was determined in 2016 to be nontaxable.

The combined effects of the income tax exemption and reduction available to the Group are as follows (in thousands, except per share data):

	Year Ended December 31,		
	2014	2015	2016
Tax holiday effect	\$186	\$19,626	\$30,872
Basic net income per share effect	—	0.51	0.80

### *Effective Tax Rate*

The following is reconciliation between the U.S. federal statutory rate and the Group's effective tax rate:

	Year Ended December 31,		
	2014	2015	2016
U.S. federal statutory rate:	35%	35%	35%
Effect of tax holidays applicable to the subsidiaries and the consolidated VIEs*	0%	(11%)	33%
Tax differential from statutory rate applicable to the subsidiaries and the consolidated VIEs	(31%)	(13%)	(3%)
Effect of withholding taxes	(3%)	2%	(4%)
Changes in valuation allowance for deferred tax assets	(22%)	31%	(91%)
Others	17%	(3%)	8%
	<u>(4%)</u>	<u>41%</u>	<u>(22%)</u>

\* The reversal of income tax for the preferential income tax that Changyou's and Sogou's subsidiaries received as KNSE or Software Enterprise for 2015 was included in the "Effect of tax holidays applicable to the subsidiaries and the consolidated VIEs" in the above table.

### *PRC Corporate Income Tax*

#### Principal Entities Qualified as HNTEs

The CIT Law applies an income tax rate of 25% to all enterprises but grants preferential tax treatment to High and New Technology Enterprises ("HNTEs"). Under this preferential tax treatment, HNTEs can enjoy an income tax rate of 15%, but need to re-apply every three years. During this three-year period, an HNTE must conduct a qualification self-review each year to ensure it meets the HNTE criteria and is eligible for the 15% preferential tax rate for that year. If an HNTE fails to meet the criteria for qualification as an HNTE in any year, the enterprise cannot enjoy the 15% preferential tax rate in that year, and must instead use the regular 25% CIT rate.

As of December 31, 2016, the following principal entities of the Sohu Group were qualified as HNTEs and were entitled to an income tax rate of 15%.

#### For Sohu's Business

- Beijing Sohu New Momentum Information Technology Co., Ltd. ("Sohu New Momentum"). Sohu New Momentum qualified as an HNTE for the years 2016 to 2018, and will need to re-apply for HNTE qualification in 2019.
- Beijing Sohu Internet Information Service Co., Ltd. ("Sohu Internet"). Sohu Internet qualified as an HNTE for the years 2015 to 2017, and will need to re-apply for HNTE qualification in 2018.
- Beijing Sohu New Era Information Technology Co., Ltd. ("Sohu Era"), Sohu Media and Guangzhou Qianjun Network Technology Co., Ltd ("Guangzhou Qianjun"). Sohu Era, Sohu Media and Guangzhou Qianjun are each qualified as HNTEs for the years 2014 to 2016, and will need to re-apply for HNTE qualification in 2017.

#### For Sogou's Business

- Beijing Sogou Information Service Co., Ltd. ("Sogou Information"). Sogou Information qualified as an HNTE for the years 2015 to 2017, and will need to re-apply for HNTE qualification in 2018.

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- Beijing Sogou Technology Development Co., Ltd. (“Sogou Technology”). Sogou Technology qualified as an HNTE for the years 2014 to 2016, and will need to re-apply for HNTE qualification in 2017.
- Beijing Sogou Network Technology Co., Ltd. (“Sogou Network”). Sogou Network qualified as an HNTE for the years 2016 to 2018, and will need to re-apply for HNTE qualification in 2019.

### For Changyou’s Business

- Beijing AmazGame Age Internet Technology Co., Ltd. (“AmazGame”) and Beijing Gamease Age Digital Technology Co., Ltd. (“Gamease”). AmazGame and Gamease are each qualified as HNTEs for the years 2014 to 2016, and will need to re-apply for HNTE qualification in 2017.

### Principal Entities Qualified as Software Enterprises and KNSE

The CIT Law and its implementing regulations provide that a “Software Enterprise” is entitled to an income tax exemption for two years beginning with its first profitable year and a 50% reduction to a rate of 12.5% for the subsequent three years. An entity that qualifies as a “Key National Software Enterprise” (a “KNSE”) is entitled to a further reduced preferential income tax rate of 10%. Enterprises wishing to enjoy the status of a Software Enterprise or KNSE must perform a self-assessment each year to ensure they meet the criteria for qualification and file required supporting documents with the tax authorities before using the preferential CIT rates. These enterprises will be subject to the tax authorities’ assessment each year as to whether they are entitled to use the relevant preferential CIT treatments. If at any time during the preferential tax treatment years an enterprise uses the preferential CIT rates but the relevant authorities determine that it fails to meet applicable criteria for qualification, the relevant authorities may revoke the enterprise’s Software Enterprise/KNSE status.

### For Sohu’s Business

- Sohu New Momentum. In 2016, Sohu New Momentum was in the first of three years in which it is entitled to a 50% reduction to a rate of 12.5% as a Software Enterprise, but will need to apply during 2017 for qualification as a Software Enterprise for 2016.

### For Sogou’s business:

- Sogou Technology. Sogou Technology performed the self-assessment and filed required supporting documents in 2016 for KNSE status for 2015. Sogou Technology was qualified as a KNSE after the relevant government authorities’ assessment and was entitled to a preferential income tax rate of 10% for 2015. As a result, a reversal of income tax of \$3.8 million for the preferential income tax rate was recorded in the consolidated statements of comprehensive income for the year ended December 31, 2016. Same process will be followed in 2017 by Sogou Technology for its preferential income tax treatment as a KNSE for 2016.
- Sogou Network. Sogou Network performed the self-assessment and filed required supporting documents in 2016 for Software Enterprise status for 2015. Sogou Network was qualified as a Software Enterprise after the relevant government authorities’ assessment and was entitled to a preferential income tax rate of 12.5% for 2015.

### For Changyou’s business:

- AmazGame. AmazGame qualified as a KNSE and enjoyed a preferential income tax rate of 10% for each of 2013 and 2014. AmazGame performed the self-assessment and filed required supporting documents in 2016 for KNSE status for 2015. AmazGame was qualified as a KNSE after the relevant government authorities’ assessment and was entitled to a preferential income tax rate of 10% for 2015. As a result, a reversal of income tax of \$10.6 million for the preferential income tax rate was recorded in the consolidated statements of comprehensive income for the year ended December 31, 2016. Same process will be followed in 2017 by AmazGame for its preferential income tax treatment as a KNSE for 2016.
- Beijing Changyou Gamespace Software Technology Co., Ltd. (“Gamespace”). In 2016, Gamespace was in the third of three years in which it was entitled to a 50% reduction to a rate of 12.5% as a Software Enterprise. Gamespace will need to apply during 2017 for qualification as a Software Enterprise for 2016.
- Baina (Wuhan) Information Technology Co., Ltd. (“Wuhan Baina Information”). In 2016, Wuhan Baina Information was in the first of two years in which it is entitled to income tax exemption as a Software Enterprise. Gamespace will need to re-apply in 2017 for qualification as a Software Enterprise for 2016.

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### *PRC Withholding Tax on Dividends*

The CIT Law imposes a 10% withholding income tax on dividends distributed by foreign invested enterprises in the PRC to their immediate holding companies outside Mainland China. A lower withholding tax rate may be applied if there is a tax treaty between Mainland China and the jurisdiction of the foreign holding company. A holding company in Hong Kong, for example, will be subject to a 5% withholding tax rate under an arrangement between the PRC and the Hong Kong Special Administrative Region on the “Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital,” if such holding company is considered a non-PRC resident enterprise and holds at least 25% of the equity interests in the PRC foreign invested enterprise distributing the dividends, subject to approval of the PRC local tax authority. However, if the Hong Kong holding company is not considered to be the beneficial owner of such dividends under applicable PRC tax regulations, such dividend will remain subject to a withholding tax rate of 10%.

In order to fund the distribution of a dividend to shareholders of the Sohu Group’s majority-owned subsidiary Changyou, Changyou’s management determined to cause one of its PRC subsidiaries to declare and distribute a cash dividend of all of its stand-alone 2012 earnings and half of its stand-alone subsequent years’ earnings to its direct overseas parent company, Changyou.com (HK) Limited (“Changyou HK”). As of December 31, 2016, Changyou had accrued deferred tax liabilities in the amount of \$26.0 million for PRC withholding tax.

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

### *PRC Value-Added Tax*

Effective September 1, 2012, a pilot program (the “Pilot Program”) for transition from the imposition of PRC business tax (“Business Tax”) to the imposition of value-added tax (“VAT”) was implemented for revenues from certain industries and certain cities. Prior to Pilot Program, the Group was mainly subject to a 5% PRC business tax and related surcharges on revenues in the PRC. PRC business tax and the related surcharges are recognized when the revenue is earned.

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

### *U.S. Corporate Income Tax*

Sohu.com Inc. is a Delaware corporation that is subject to U.S. corporate income tax on its taxable income at a rate of up to 35%. To the extent that portions of its U.S. taxable income, such as Subpart F income or a dividend, are determined to be from sources outside of the U.S., subject to certain limitations, Sohu.com Inc. may be able to claim foreign tax credits to offset its U.S. income tax liabilities. Any remaining liabilities are accrued in the Company’s consolidated statements of comprehensive income and estimated tax payments are made when required by U.S. law.

In accordance with U.S. GAAP, Sohu.com Inc. does not provide for U.S. federal income taxes or tax benefits on the undistributed earnings or losses of its non-U.S. subsidiaries or consolidated VIEs because, for the foreseeable future, Sohu.com Inc. does not have the intention to repatriate those undistributed earnings or losses to the U.S. (except that, under certain circumstances, Sohu.com Inc. may repatriate to the U.S. income that was previously included in its income for U.S. corporate income tax purposes). However, certain activities conducted in the PRC may give rise to U.S. corporate income tax, even if there are no distributions to Sohu.com Inc. U.S. corporate income taxes would be imposed on Sohu.com Inc. if its subsidiaries that are controlled foreign corporations generate income that is subject to the Subpart F regime of the U.S. Internal Revenue Code.

Cumulative undistributed earnings were included in consolidated retained earnings on the balance sheets in the amounts of \$396.7 million and \$614.1 million, respectively, as of December 31, 2016 and 2015. An estimated \$138.8 million and \$214.9 million in U.S. income and foreign withholding taxes would be due if these earnings were remitted as dividends, after payment of all deferred taxes as of December 31, 2016 and 2015.

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### **Deferred Tax Assets and Liabilities**

Significant components of the Group's deferred tax assets and liabilities consist of the following (in thousands):

	As of December 31,	
	2015	2016
<b>Deferred tax assets:</b>		
Net operating loss from operations	\$ 145,964	\$ 206,967
Accrued bonus and commissions	21,004	22,069
Intangible assets transfer	1,156	746
Others	2,321	7,525
Total deferred tax assets	170,445	237,307
Less: Valuation allowance	(141,951)	(216,176)
Net deferred tax assets	<u>\$ 28,494</u>	<u>\$ 21,131</u>
<b>Deferred tax liabilities</b>		
Withholding tax for Dividend	\$ (24,884)	\$ (26,002)
Deferred U.S. tax	(12,450)	(9,175)
Intangible assets from business acquisitions	(1,465)	(1,273)
Others	(3,616)	(3,334)
Total deferred tax liabilities	<u>\$ (42,415)</u>	<u>\$ (39,784)</u>

The Group elected to early adopt the FASB issued Accounting Standards Update 2015-17, Balance Sheet Classification of Deferred Taxes retrospectively from the fourth quarter of 2016. As a result of the adoption of this guidance, \$4.7 million of current deferred tax assets and \$24.9 million of current deferred tax liabilities were reclassified to non-current as of December 31, 2015.

As of December 31, 2016, the Group had net operating losses from PRC entities of approximately \$760.6 million available to offset against future net profit for income tax purposes. The Group anticipates that it is more likely than not that these net operating losses (except for the net operating losses generated by Changyou's VIEs) may not be utilized based on its estimate of the operation performance of these PRC entities; therefore, \$190.1 million in deferred tax assets generated from net operating losses were offset by a valuation allowance.

In 2016, \$11.8 million of PRC net operating losses generated from previous years expired. The remaining PRC net operating losses will expire successively commencing in 2017.

### **Uncertain Tax Positions**

The Sohu Group did not have any significant unrecognized uncertain tax positions for the year ended December 31, 2016. The Group did not have any significant penalties or interest associated with tax positions for the year ended December 31, 2016.

The following table summarizes the Group's recognized uncertain tax positions from January 1, 2014 to December 31, 2016 (in thousands):

	As of December 31,		
	2014	2015	2016
Beginning balance	\$24,369	\$24,515	\$39,244
Decreases related to prior year tax positions	0	0	(6,649)
Increases related to current year tax positions	146	14,729	87
Ending balance	<u>\$24,515</u>	<u>\$39,244</u>	<u>\$32,682</u>

In 2016, the decreases related to prior year tax positions mainly represented a payment of \$5.3 million to PRC tax authorities for a portion of an uncertain tax position arising from certain equity transactions recognized in 2013.

In 2015, the Sohu Group recognized tax payable in the amount of \$14.6 million as management determined that certain business transactions that took place during the year may result in additional tax obligations under relevant tax rules.

The Group does not anticipate that the uncertain tax positions will significantly increase or decrease within twelve months of December 31, 2016.



## 15. Commitments and Contingencies

### Contractual Obligations

The following table sets forth the Group's contractual obligations as of December 31, 2016 (in thousands):

As of December 31,	2017	2018	2019	2020	2021	Thereafter	Total Payments Required
Purchase of content and services – video	112,051	39,203	81	0	0	0	151,335
Purchase of cinema advertisement slot rights	63,174	46,971	22,633	5,060	0	0	137,838
Purchase of bandwidth	61,731	3,500	1,171	1,055	308	0	67,765
Operating lease obligations(1)	14,543	10,004	2,751	586	58	10	27,952
Expenditures for operating rights for licensed games with technological feasibility	4,178	15,122	0	0	0	0	19,300
Purchase of content and services – others	7,943	166	73	30	0	0	8,212
Fees for operating rights for licensed games in development	1,271	348	0	0	0	0	1,619
Expenditures for titles in game development	259	1,197	0	0	0	0	1,456
Purchase of fixed assets	1,175	0	0	0	0	0	1,175
Others	4,005	4	0	0	0	0	4,009
<b>Total Payments Required</b>	<b>270,330</b>	<b>116,515</b>	<b>26,709</b>	<b>6,731</b>	<b>366</b>	<b>10</b>	<b>420,661</b>

Note (1): For the years ended December 31, 2016, 2015 and 2014, rental expense included in the operating lease was approximately \$23.9 million, \$27.9 million, and \$34.6 million, respectively.

### Litigation

The Sohu Group is a party to various litigation matters which it considers routine and incidental to its business. The Sohu Group records a liability when the likelihood of an unfavorable outcome is probable and the amount of loss can be reasonably estimated. The Sohu Group evaluates, on a regular basis, developments in litigation matters that could affect the amount of liability that has been previously accrued and makes adjustments as appropriate. Management believes that the total liabilities to the Sohu Group that may arise as a result of currently pending legal proceedings will not have a material adverse effect on the Group's business, results of operations, financial condition and cash flows.

### PRC Law and Regulations

The Chinese market in which the Sohu Group operates poses certain macro-economic and regulatory risks and uncertainties. These uncertainties extend to the ability to operate an Internet business and to conduct brand advertising, search and search-related, online game, and other services in the PRC. Though the PRC has, since 1978, implemented a wide range of market-oriented economic reforms, continued reforms and progress towards a full market-oriented economy are uncertain. In addition, the telecommunication, information, and media industries remain highly regulated. Restrictions are currently in place and are unclear with respect to which segments of these industries foreign-owned entities, like the Sohu Group, may operate. The Chinese government may issue from time to time new laws or new interpretations of existing laws to regulate areas such as telecommunication, information and media. The Sohu Group's legal structure and scope of operations in China could be subject to restrictions, which could result in limits on its ability to conduct business in the PRC. Certain risks related to PRC law that could affect the Sohu Group's VIE structure are discussed in Note 16 – VIEs.

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

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

## 16. VIEs

### *Background*

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

### *VIEs Consolidated within the Sohu Group*

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

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

Under contractual agreements with the Sohu Group, Dr. Charles Zhang and those other executive officers and employees of the Sohu Group who are shareholders of the consolidated VIEs are required to transfer their ownership in these entities to the Group, if permitted by PRC laws and regulations, or, if not so permitted, to designees of the Group at any time as requested by the Group to repay the loans outstanding. All voting rights of the consolidated VIEs are assigned to the Sohu Group, and the Group has the right to designate all directors and senior management personnel of the consolidated VIEs, and also has the obligation to absorb losses of the consolidated VIEs. Dr. Charles Zhang and those other executive officers and employees of the Sohu Group who are shareholders of the consolidated VIEs have pledged their shares in the consolidated VIEs as collateral for the loans. As of December 31, 2016, the aggregate amount of these loans was \$9.4 million.

Under its contractual arrangements with the consolidated VIEs, the Sohu Group has the power to direct activities of the VIEs, and can have assets transferred freely out of the VIEs without any restrictions. Therefore, the Group considers that there is no asset of a consolidated VIE that can be used only to settle obligations of the VIEs, except for registered capital and PRC statutory reserves of the VIEs. As of December 31, 2016, the registered capital and PRC statutory reserves of the consolidated VIEs totaled \$60.0 million. As all of the consolidated VIEs are incorporated as limited liability companies under the PRC Company Law, creditors of the consolidated VIEs do not have recourse to the general credit of the Sohu Group for any of the liabilities of the consolidated VIEs. Currently there is no contractual arrangement that could require the Sohu Group to provide additional financial support to the consolidated VIEs. As the Sohu Group is conducting certain business in the PRC mainly through the consolidated VIEs, the Group may provide such support on a discretionary basis in the future, which could expose the Group to a loss.

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

### *Basic Information for Principal VIEs and Subsidiaries of Principal VIEs*

#### For Sohu's Business

- High Century

Beijing Century High Tech Investment Co., Ltd. ("High Century") was incorporated in 2001. As of December 31, 2016, the registered capital of High Century was \$4.6 million and Dr. Charles Zhang and Wei Li held 80% and 20% interests, respectively, in this entity.

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- Heng Da Yi Tong

Beijing Heng Da Yi Tong Information Technology Co., Ltd. (“Heng Da Yi Tong”) was incorporated in 2002. As of December 31, 2016, the registered capital of Heng Da Yi Tong was \$1.2 million and Dr. Charles Zhang and Wei Li held 80% and 20% interests, respectively, in this entity.

- Sohu Internet

Sohu Internet was incorporated in 2003. As of December 31, 2016, the registered capital of Sohu Internet was \$1.6 million and High Century held a 100% interest in this entity.

- Donglin

Beijing Sohu Donglin Advertising Co., Ltd. (“Donglin”) was incorporated in 2010. As of December 31, 2016, the registered capital of Donglin was \$1.5 million and Sohu Internet held a 100% interest in this entity.

- Tianjin Jinhu

Tianjin Jinhu Culture Development Co., Ltd. (“Tianjin Jinhu”) was incorporated in 2011. In October, 2016, Ye Deng transferred its 50% equity interest in Tianjin Jinhu to Xiufeng Deng. As of December 31, 2016, the registered capital of Tianjin Jinhu was \$0.5 million and Xiufeng Deng and Xuemei Zhang each held a 50% interest in this entity.

- Guangzhou Qianjun

Guangzhou Qianjun was acquired in November 2014. As of December 31, 2016, the registered capital of Guangzhou Qianjun was \$3.3 million and Tianjin Jinhu held a 100% interest in this entity.

- Focus Interactive

Beijing Focus Interactive Information Service Co., Ltd. (“Focus Interactive”) was incorporated in July 2014. As of December 31, 2016, the registered capital of Focus Interactive was \$1.6 million and Heng Da Yi Tong held 100% of the equity interests in this entity.

### For Sogou’s Business

- Sogou Information

Sogou Information was incorporated in 2005. As of December 31, 2016, the registered capital of Sogou Information was \$2.5 million and Xiaochuan Wang, Sogou’s Chief Executive Officer, High Century and Tencent held 10%, 45% and 45% interests, respectively, in this entity.

### For Changyou’s Business

- Gamease

Gamease was incorporated in 2007. As of December 31, 2016, the registered capital of Gamease was \$1.3 million and High Century held a 100% interest in this entity.

- Guanyou Gamespace

Beijing Guanyou Gamespace Digital Technology Co., Ltd. (“Guanyou Gamespace”) was incorporated in 2010. As of December 31, 2016, the registered capital of Guanyou Gamespace was \$1.5 million and Beijing Changyou Star Digital Technology Co., Ltd (“Changyou Star”) held a 100% interest in this entity.

- Shanghai ICE

Shanghai ICE Information Technology Co., Ltd. (“Shanghai ICE”) was acquired by Changyou in 2010. As of December 31, 2016, the registered capital of Shanghai ICE was \$1.2 million and Gamease held a 100% interest in this entity.

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### • Wuhan Baina Information

Baina (Wuhan) Information Technology Co., Ltd. (“Wuhan Baina Information”) was acquired by Gamease in July 2014. As of December 31, 2016, the registered capital of Wuhan Baina Information was \$3.0 million and Changyou Star and Yongzhi Yang, the former chief executive officer of MoboTap, held 60% and 40% interests, respectively, in this entity.

### Financial Information

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

	<u>As of December 31,</u>	
	<u>2015</u>	<u>2016</u>
<b>ASSETS:</b>		
Cash and cash equivalents	\$ 131,270	\$ 94,859
Accounts receivable, net	135,925	72,151
Prepaid and other current assets	101,951	86,722
Assets held for sale	0	12,551
Intercompany receivables due from the Company’s subsidiaries	140,396	197,438
Total current assets	<u>509,542</u>	<u>463,721</u>
Long-term investments, net	15,960	17,472
Fixed assets, net	7,362	4,372
Intangible assets, net	18,266	14,545
Goodwill	36,351	35,161
Other non-current assets	12,057	4,052
Total assets	<u>\$599,538</u>	<u>\$539,323</u>
<b>LIABILITIES:</b>		
Accounts payable	\$ 23,757	\$ 15,824
Accrued liabilities	79,012	96,695
Receipts in advance and deferred revenue	55,319	44,797
Liabilities held for sale	0	3,232
Other current liabilities	139,577	111,775
Intercompany payables due to the Company’s subsidiaries	175,178	129,431
Total current liabilities	<u>472,843</u>	<u>401,754</u>
Long-term accounts payable	2,858	0
Long-term taxes payable	180	13,463
Deferred tax liabilities	1,490	1,273
Intercompany payables due to the Company’s subsidiaries	21,717	19,620
Total liabilities	<u>\$499,088</u>	<u>\$436,110</u>

	<u>As of December 31,</u>		
	<u>2014</u>	<u>2015</u>	<u>2016</u>
Net revenue	\$ 1,063,655	\$ 1,181,354	\$ 894,697
Net income /(loss)	<u>\$ (90,840)</u>	<u>\$ (78,722)</u>	<u>\$ 9,557</u>
	<u>Year ended December 31,</u>		
	<u>2014</u>	<u>2015</u>	<u>2016</u>
Net cash provided by /(used in) operating activities	\$ 69,171	\$ 38,628	\$ (17,804)
Net cash provided by /(used in) investing activities	(159,094)	55,108	(2,273)
Net cash provided by financing activities	<u>\$ 17,742</u>	<u>\$ 2,855</u>	<u>\$ 0</u>

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### *Summary of Significant Agreements Currently in Effect*

#### *Agreements Between Subsidiaries, Consolidated VIEs and Nominee Shareholders*

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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### Business Arrangements Between Subsidiaries and Consolidated VIEs

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

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

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

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

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

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

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

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



**VIE-Related Risks**

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

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

The Sohu Group's operations and businesses rely on the operations and businesses of its VIEs, which hold certain recognized and unrecognized revenue-producing assets. The recognized revenue-producing assets include goodwill and intangible assets acquired through business acquisitions. Goodwill primarily represents the expected synergies from combining an acquired business with the Sohu Group. Intangible assets acquired through business acquisitions mainly consist of customer relationships, non-compete agreements, user bases, copyrights, trademarks and developed technologies. Unrecognized revenue-producing assets mainly consist of licenses and intellectual property. Licenses include operations licenses, such as Internet information service licenses and licenses for providing content. Intellectual property developed by the Sohu Group mainly consists of patents, copyrights, trademarks, and domain names. The Sohu Group's operations and businesses may be adversely impacted if the Sohu Group loses the ability to use and enjoy assets held by these VIEs.

**17. Sohu.com Inc. Shareholders' Equity**

Summary of Sohu.com Inc.'s outstanding shares (in thousands):

	Number of Outstanding Shares As of December 31,		
	2014	2015	2016
<b>Common stock:</b>			
Balance, beginning of year	38,326	38,507	38,653
Issuance of common stock	181	146	89
Balance, end of year	<u>38,507</u>	<u>38,653</u>	<u>38,742</u>

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### ***Takeover Defense***

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

### ***Treasury Stock***

Treasury stock consists of shares repurchased by Sohu.com Inc. that are no longer outstanding and are held by Sohu.com Inc. Treasury stock is accounted for under the cost method. For the years ended December 31, 2016, 2015 and 2014, the Company did not repurchase any shares of its common stock.

### ***Stock Incentive Plans***

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

#### *1) Sohu.com Inc. Share-based Awards*

##### *Sohu's 2000 Stock Incentive Plan*

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

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

##### *Sohu's 2010 Stock Incentive Plan*

On July 2, 2010, the Company's shareholders adopted the Sohu 2010 Stock Incentive Plan, which provides for the issuance of up to 1,500,000 shares of common stock, including stock issued pursuant to the vesting and settlement of restricted stock units and pursuant to the exercise of stock options. The maximum term of any stock right granted under the Sohu 2010 Stock Incentive Plan is ten years from the grant date. The Sohu 2010 Stock Incentive Plan will expire on July 1, 2020. As of December 31, 2016, 560,430 shares were available for grant under the Sohu 2010 Stock Incentive Plan.

#### *i) Summary of stock option activity*

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

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

On February 7, 2016, 253,250 of these stock options were granted and became vested, as a mutual understanding of the subjective performance targets was reached between the Company and the recipients, the targets had been satisfied, and the service period requirements had been fulfilled. The cumulative share-based compensation expense for these granted stock options has been adjusted and fixed based on the fair value at the grant date of \$10.8 million.

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A summary of stock option activity under the Sohu 2010 Stock Incentive Plan as of and for the year ended December 31, 2016 is presented below:

<u>Options</u>	<u>Number Of Shares (in thousands)</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Life (Years)</u>	<u>Aggregate Intrinsic Value (1) (in thousands)</u>
Outstanding at January 1, 2016	0	\$		\$
Granted	253	0.001		
Exercised	(60)	0.001		
Forfeited or expired	0			
Outstanding at December 31, 2016	193	0.001	8.10	6,549
Vested at December 31, 2016	193	0.001	8.10	6,549
Exercisable at December 31, 2016	193	0.001	8.10	6,549

Note (1): The aggregated intrinsic value in the preceding table represents the difference between Sohu's closing stock price of \$33.89 on December 31, 2016 and the nominal exercise prices of the stock options.

For the year ended December 31, 2016 and 2015, total share-based compensation expense recognized for these stock options was \$1.4 million and \$25.6 million, respectively.

### ii) Summary of restricted stock unit activity

A summary of restricted stock unit activity under the Sohu 2010 Stock Incentive Plan as of and for the year ended December 31, 2016 is presented below:

<u>Restricted Share Units</u>	<u>Number of Units (in thousands)</u>	<u>Weighted-Average Grant-Date Fair Value</u>
Unvested at January 1, 2016	32	\$ 70.24
Granted	11	51.00
Vested	(23)	62.11
Forfeited	(9)	63.45
Unvested at December 31, 2016	11	73.32
Expected to vest after December 31, 2016	8	73.32

For the years ended December 31, 2016, 2015 and 2014, total share-based compensation expense recognized for restricted stock units was \$1.3 million, \$2.2 million and \$3.0 million, respectively.

As of December 31, 2016, there was \$0.3 million of unrecognized compensation expense related to unvested restricted stock units. The expense is expected to be recognized over a weighted average period of 0.61 years. The total fair value on their respective vesting dates of restricted stock units vested during the years ended December 31, 2016, 2015 and 2014 was \$0.9 million, \$1.6 million and \$1.2 million, respectively.

### 2) Sogou Inc. Share-based Awards

#### Sogou 2010 Share Incentive Plan

Sogou adopted a share incentive plan on October 20, 2010. The number of Sogou ordinary shares issuable under the plan was 41,500,000 after an amendment that was effective August 22, 2014 (as amended, the "Sogou 2010 Share Incentive Plan"). Awards of share rights may be granted under the Sogou 2010 Share Incentive Plan to management and employees of Sogou and of any present or future parents or subsidiaries or VIEs of Sogou. The maximum term of any share right granted under the Sogou 2010 Share Incentive Plan is ten years from the grant date. The Sogou 2010 Share Incentive Plan will expire on October 19, 2020. As of December 31, 2016, Sogou had contractually granted options for the purchase of 38,209,700 Sogou ordinary shares under the 2010 Sogou Share Incentive Plan.

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Of the contractually-granted Sogou share options for the purchase of 38,209,700 Sogou ordinary shares, options for the purchase of 31,009,700 Sogou ordinary shares vest and become exercisable upon a service period requirement being met, as well as Sogou's achievement of performance targets for the corresponding period. Subject to achievement of the applicable performance targets, of these Sogou share options for the purchase of 31,009,700 Sogou ordinary shares, options for the purchase of 29,822,750 Sogou ordinary shares vest and become exercisable in four equal installments and options for the purchase of 1,186,950 Sogou ordinary shares vest and become exercisable in two to four installments over varying periods. Of these Sogou share options for the purchase of 31,009,700 Sogou ordinary shares, the terms of options for the purchase of 900,000 Sogou ordinary shares, which had previously included as vesting conditions a service period requirement and Sogou's completion of an IPO of its ordinary shares ("Sogou's IPO"), were amended in the first quarter of 2016 to remove as a condition of vesting the completion of Sogou's IPO and add as a condition of vesting achievement of performance targets. For purposes of recognition of share-based compensation expense, each installment is considered to be granted as of the date that the performance target has been set. As of December 31, 2016, Sogou had granted options for the purchase of 25,245,808 Sogou ordinary shares under the 2010 Sogou Share Incentive Plan. As of December 31, 2016, options for the purchase of 24,894,886 Sogou ordinary shares had become vested and exercisable because both the service period and the performance requirements had been met, and of such vested options, options for the purchase of 22,994,909 Sogou ordinary shares had been exercised.

Of the contractually granted Sogou share options, options for the purchase of 7,200,000 Sogou ordinary shares vest and become exercisable in five equal installments, with (i) the first installment vesting upon Sogou's IPO and the expiration of all underwriters' lockup periods applicable to Sogou's IPO, and (ii) each of the four subsequent installments vesting on the first, second, third and fourth anniversary dates, respectively, of the closing of Sogou's IPO. The completion of an IPO is considered to be a performance condition of the awards. An IPO is not considered to be probable until it is completed. Under ASC 718, compensation cost should be accrued if it is probable that the performance condition will be achieved and should not be accrued if it is not probable that the performance condition will be achieved. As a result, no compensation expense will be recognized related to these Sogou share options until the completion of an IPO, and hence no share-based compensation expense was recognized for the years ended December 31, 2016, 2015 and 2014 for the options for the purchase of 7,200,000 Sogou ordinary shares that are subject to vesting upon completion of Sogou's IPO.

As of December 31, 2016, for purposes of recognition of share-based compensation expense, Sogou had granted Sogou share options for the purchase of 32,445,808 Sogou ordinary shares, of which options for the purchase of 9,450,899 Sogou ordinary shares were outstanding. A summary of Sogou share option activity under the Sogou 2010 Share Incentive Plan as of and for the year ended December 31, 2016 is presented below:

<u>Options</u>	<u>Number Of Shares (in thousands)</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Life (Years)</u>
Outstanding at January 1, 2016	12,209	\$ 0.369	
Granted	2,337	0.001	
Exercised	(3,876)	0.001	
Forfeited or expired	(1,219)	0.001	
Outstanding at December 31, 2016	9,451	0.476	6.31
Vested at December 31, 2016 and expected to vest thereafter	2,251		
Exercisable at December 31, 2016	1,900		

For the years ended December 31, 2016, 2015 and 2014, total share-based compensation expense recognized for Sogou share options under the Sogou 2010 Share Incentive Plan was \$7.6 million, \$7.3 million and \$31.4 million, respectively.

As of December 31, 2016, there was \$0.8 million of unrecognized compensation expense related to the unvested Sogou share options. The expense is expected to be recognized over a weighted average period of 0.57 years.

The fair value of the ordinary shares of Sogou was assessed using the income approach /discounted cash flow method, with a discount for lack of marketability, given that the shares underlying the awards were not publicly traded at the time of grant, and was determined with the assistance of a qualified professional appraiser using management's estimates and assumptions. This assessment required complex and subjective judgments regarding Sogou's projected financial and operating results, its unique business risks, the liquidity of its ordinary shares and its operating history and prospects at the time the grants were made.

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

<u>Assumptions Adopted</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
Average risk-free interest rate	2.62%~3.05%	2.48%~2.77%	1.90%~2.77%
Exercise multiple	2~3	2~3	2~3
Expected forfeiture rate (post-vesting)	0%~12%	1%~12%	0%~12%
Weighted average expected option life	7	8	7
Volatility rate	49%~54%	47%~51%	43%~50%
Dividend yield	0%	0%	0%
Fair value	5.85~6.35	3.58	3.18~3.93

Sogou estimated the risk-free rate based on the market yields of U.S. Treasury securities with an estimated country-risk differential as of the valuation date. An exercise multiple was estimated as the ratio of the fair value of the Sogou ordinary shares over the exercise price as of the time the Sogou share option is exercised, based on consideration of research studies regarding exercise patterns based on historical statistical data. In Sogou’s valuation analysis, a multiple of two was applied for employees and a multiple of three was applied for management. Sogou estimated the forfeiture rate to be 0% or 1% for the Sogou share options granted to Sogou management as of December 31, 2016 and 12% for the Sogou share options granted to Sogou employees as of December 31, 2016. The life of the Sogou share options is the contract life of the option. Based on the option agreement, the contract life of the Sogou share options is 10 years. As there is no trading market for Sogou’s ordinary shares, the expected volatility at the valuation date was estimated based on the historical volatility of comparable companies for the period before the grant date with length commensurate with the expected term of the Sogou share options. Sogou has no history or expectation of paying dividends on its ordinary shares. Accordingly, the dividend yield was estimated to be 0%.

### Sohu Management Sogou Share Option Arrangement

Under an arrangement providing for Sogou share-based awards to be available for grants to members of Sohu’s Board of Directors, management and other key employees (“Sohu Management Sogou Share Option Arrangement”), which was approved by the boards of directors of Sohu and Sogou in March 2011, Sohu has the right to provide to members of Sohu’s Board of Directors, management and other key employees the opportunity to purchase from Sohu up to 12,000,000 ordinary shares of Sogou at a fixed exercise price of \$0.625 or \$0.001 per share. Of these 12,000,000 ordinary shares, 8,800,000 are Sogou ordinary shares previously held by Sohu and 3,200,000 are Sogou ordinary shares that were newly-issued on April 14, 2011 by Sogou to Sohu at a price of \$0.625 per share, or a total of \$2.0 million. As of December 31, 2016, Sohu had contractually granted options for the purchase of 10,705,000 Sogou ordinary shares to members of Sohu’s Board of Directors, management and other key employees under the Sohu Management Sogou Share Option Arrangement.

Of the contractually-granted Sogou share options for the purchase of 10,705,000 Sogou ordinary shares, options for the purchase of 8,290,000 Sogou ordinary shares vest and become exercisable in four equal installments, with each installment vesting upon a service period requirement for Sohu’s management and key employees being met, as well as Sogou’s achievement of performance targets for the corresponding period. For purposes of recognition of share-based compensation expense, each installment is considered to be granted as of the date that the performance target has been set. As of December 31, 2016, Sohu had granted Sogou share options for the purchase of 8,290,000 Sogou ordinary shares under the Sohu Management Sogou Share Option Arrangement. As of December 31, 2016, options for the purchase of 8,290,000 Sogou ordinary shares had become vested and exercisable because both the service period and the performance requirements had been met, and vested options for the purchase of 7,512,500 Sogou ordinary shares had been exercised.

Options for the purchase of 15,000 Sogou ordinary shares were granted to members of Sohu’s Board of Directors. All of these Sogou share options vested and were exercised in 2015, as the service period requirement for vesting had been met.

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The remaining options for the purchase of 2,400,000 Sogou ordinary shares vest and become exercisable in five equal installments, with (i) the first installment vesting upon Sogou's IPO and the expiration of all underwriters' lockup periods applicable to the IPO, and (ii) each of the four subsequent installments vesting on the first, second, third and fourth anniversary dates, respectively, of the closing of Sogou's IPO. All installments of the Sogou share options for the purchase of 2,400,000 Sogou ordinary shares that are subject to vesting upon the completion of Sogou's IPO were considered granted upon the issuance of the options. The completion of a firm commitment IPO is considered to be a performance condition of the awards. An IPO event is not considered to be probable until it is completed. Under ASC 718, compensation cost should be accrued if it is probable that the performance condition will be achieved and should not be accrued if it is not probable that the performance condition will be achieved. As a result, no compensation expense will be recognized related to these Sogou share options until the completion of an IPO, and hence no share-based compensation expense was recognized for the years ended December 31, 2016, 2015 and 2014 for these options for the purchase of 2,400,000 Sogou ordinary shares.

As of December 31, 2016, for purposes of recognition of share-based compensation expense, Sohu had granted options for the purchase of 10,705,000 Sogou ordinary shares, of which options for the purchase of 3,189,500 Sogou ordinary shares were outstanding. A summary of Sogou share option activity under the Sohu Management Sogou Share Option Arrangement as of and for the year ended December 31, 2016 is presented below:

<b>Options</b>	<b>Number Of Shares (in thousands)</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Life (Years)</b>
Outstanding at January 1, 2016	3,664	\$ 0.623	
Granted	58	0.625	
Exercised	(532)	0.625	
Forfeited or expired	0		
Outstanding at December 31, 2016	3,190	0.623	5.78
Vested at December 31, 2016 and expected to vest thereafter	790		
Exercisable at December 31, 2016	790		

For the years ended December 31, 2016, 2015 and 2014, total share-based compensation expense recognized for Sogou share options under the Sohu Management Sogou Share Option Arrangement was \$0.4 million, \$1.0 million and \$8.9 million, respectively.

As of December 31, 2016, there was no unrecognized compensation expense related to unvested Sogou share options.

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

<b>Assumptions Adopted</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
Average risk-free interest rate	2.62%~2.93%	2.67%~3.01%	2.01%~2.15%
Exercise multiple	2~3	2~3	2~3
Expected forfeiture rate (Post-vesting)	0%~8%	0%	0%
Weighted average expected option life	7	8	6
Volatility rate	52%~54%	50%~53%	43%~47%
Dividend yield	0%	0%	0%
Fair value	5.23	2.96~7.03	2.56~3.31

### Option Modification

In the first and second quarter of 2013, a portion of the Sogou share options granted under the Sogou 2010 Share Incentive Plan and the Sohu Management Sogou Share Option Arrangement were exercised early, and the Sogou ordinary shares issued upon exercise were transferred to trusts with the original option grantees as beneficiaries. The trusts will distribute the Sogou ordinary shares to those beneficiaries in installments based on the vesting requirements under the option agreements. Although these trust arrangements caused a modification of the terms of these Sogou share options, the modification was not considered substantive. Accordingly, no incremental fair value related to these Sogou ordinary shares resulted from the modification, and the remaining share-based compensation expense for these Sogou ordinary shares will continue to be recognized over the original remaining vesting period.

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As of December 31, 2016, options for the purchase of 11,370,000 Sogou ordinary shares granted under the Sogou 2010 Share Incentive Plan had been exercised early but had not been distributed to the beneficiaries of the trusts. All of the early-exercised Sogou ordinary shares that were distributed to those beneficiaries by the trusts in accordance with the vesting requirements under the option agreements have been included in the disclosures under the heading “Sogou 2010 Share Incentive Plan” above.

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

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

As of December 31, 2016, unvested Tencent restricted share unit awards held by these employees provided for the issuance of up to 53,100 ordinary shares of Tencent, taking into consideration a five-for-one split of Tencent’s shares that became effective in May 2014. For the years ended December 31, 2016, 2015 and 2014, share-based compensation expense of \$0.8 million, \$2.0 million and \$4.9 million, respectively, related to these Tencent restricted share units was recognized in the Group’s consolidated statements of comprehensive income. As of December 31, 2016, there was \$0.2 million of unrecognized compensation expense related to these unvested Tencent restricted share units. This amount is expected to be recognized over a weighted average period of 1.2 years.

### 3) Changyou.com Limited Share-based Awards

#### Changyou’s 2008 Share Incentive Plan

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

Prior to the completion of Changyou’s initial public offering, Changyou had granted under the Changyou 2008 Share Incentive Plan 15,000,000 Changyou ordinary shares to its former chief executive officer Tao Wang, through Prominence Investments Ltd., which is an entity that may be deemed under applicable rules of the Securities and Exchange Commission to be beneficially owned by Tao Wang. Through December 31, 2016, Changyou had also granted under the Changyou 2008 Share Incentive Plan restricted share units, settleable upon vesting by the issuance of an aggregate of 4,614,098 Changyou ordinary shares, to certain members of its management other than Tao Wang, and certain other Changyou employees.

#### i) Share-based Awards granted before Changyou’s IPO

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

#### ii) Share-based Awards granted after Changyou’s IPO

Through December 31, 2016, in addition to the share-based awards granted before Changyou’s IPO, Changyou had granted restricted share units, settleable upon vesting with the issuance of an aggregate of 1,581,226 Changyou ordinary shares, to certain members of its management other than Tao Wang and to certain of its other employees. These Changyou restricted share units are subject to vesting over a four-year period commencing on their grant dates. Share-based compensation expense for such Changyou restricted share units is recognized on an accelerated basis over the requisite service period. The fair value of Changyou restricted share units was determined based on the market price of Changyou’s ADSs on the grant date.



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A summary of activity for these Changyou restricted share units as of and for the year ended December 31, 2016 is presented below:

<b>Restricted Share Units</b>	<b>Number of Units (in thousands)</b>	<b>Weighted-Average Grant-Date Fair Value</b>
Unvested at January 1, 2016	20	\$ 14.25
Granted	0	
Vested	(10)	
Forfeited	0	
Unvested at December 31, 2016	10	14.25
Expected to vest after December 31, 2016	10	14.25

For the years ended December 31, 2016, 2015 and 2014, total share-based compensation expense recognized for these Changyou restricted share units was \$0.1 million, negative \$0.2 million and \$1.3 million, respectively. The negative amount in 2015 resulted from Changyou's reversal of share-based compensation expense for Changyou restricted share units that were cancelled due to the termination of the holders' employment prior to vesting.

As of December 31, 2016, there was \$31,000 of unrecognized compensation expense related to these unvested Changyou restricted share units. The expense is expected to be recognized over a weighted average period of 0.55 year. The total fair value of these Changyou restricted share units vested during the years ended December 31, 2016, 2015 and 2014 was \$0.1 million, \$1.1 million and \$1.1 million, respectively.

### Changyou 2014 Share Incentive Plan

On June 27, 2014, Changyou reserved 2,000,000 of its Class A ordinary shares under the Changyou.com Limited 2014 Share Incentive Plan (the "Changyou 2014 Share Incentive Plan") for the purpose of making share incentive awards to certain members of its management and key employees. On November 2, 2014, the number of Class A ordinary shares reserved under the Changyou 2014 Share Incentive Plan increased from 2,000,000 to 6,000,000. The maximum term of any share right granted under the Changyou 2014 Share Incentive Plan is ten years from the grant date. The Changyou 2014 Share Incentive Plan will expire in June 2024. As of December 31, 2016, 2,823,000 shares were available for grant under the Changyou 2014 Share Incentive Plan.

#### i) Summary of share option activity

On November 2, 2014, Changyou approved the contractual grant of an aggregate of 2,416,000 Class A restricted share units to certain members of its management and certain other employees. On February 16, 2015, Changyou's Board of Directors approved the conversion of 2,400,000 of these Class A restricted share units into options for the purchase of Class A ordinary shares at an exercise price of \$0.01. On June 1, 2015, Changyou's Board of Directors approved the contractual grant of options for the purchase of an aggregate of 1,998,000 Class A ordinary shares to certain members of its management and certain other employees at an exercise price of \$0.01. On July 28, 2016, Changyou's Board of Directors approved the contractual grant of options for the purchase of an aggregate of 100,000 Class A ordinary shares to certain member of its management at an exercise price of \$0.01. These Changyou share options vest in four equal installments over a period of four years, with each installment vesting upon satisfaction of a service period requirement and the achievement of certain subjective performance targets. These Changyou share options are substantially similar to restricted share units except for the nominal exercise price, which would be zero for restricted share units.

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

On November 2, 2015, June 1, 2016 and November 2, 2016, 450,000, 329,000 and 450,000, respectively, of these Changyou share options were granted and vested, as a mutual understanding of the subjective performance targets had been reached between Changyou and the recipients, the targets had been satisfied, and the service period requirements had been fulfilled. The share-based compensation expense for these granted Changyou share options has been adjusted and fixed based on their fair value of \$4.7 million, \$3.2 million and \$5.9 million, respectively, at the grant date.

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A summary of Changyou share option activity under the Changyou 2014 Share Incentive Plan as of and for the year ended December 31, 2016 is presented below:

<b>Options</b>	<b>Number Of Shares (in thousands)</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Life (Years)</b>	<b>Aggregate Intrinsic Value (1) (in thousands)</b>
Outstanding at January 1, 2016	450	\$ 0.01	8.84	\$ 5,580
Granted	779	0.01		
Exercised	(377)	0.01		
Forfeited or expired	0			
Outstanding at December 31, 2016	852	0.01	7.93	9,032
Vested at December 31, 2016	852	0.01		
Exercisable at December 31, 2016	852	0.01		

Note (1): The aggregated intrinsic value in the preceding table represents the difference between Changyou's closing price of \$21.22 per ADS, or \$10.61 per Class A ordinary share, on December 31, 2016 and the nominal exercise prices of the share options.

For the years ended December 31, 2016, 2015 and 2014, total share-based compensation expense recognized for these share options under the Changyou 2014 Share Incentive Plan was \$8.3 million, \$15.2 million and \$2.6 million, respectively. The total fair values of these Changyou share options vested on their respective vesting dates for the years ended December 31, 2016, 2015 and 2014 were \$9.1 million, \$4.7 million and nil, respectively.

The weighted average grant date fair values of options granted during the years ended December 31, 2015 and 2016 were \$6.3 million and \$5.9 million, respectively. There were no share options exercised for the year ended December 31, 2015. The total intrinsic value of share options exercised for the year ended December 31, 2016 was \$4.3 million.

### ii) Summary of restricted share unit activity

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

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

### 4) Sohu Video Share-based Awards

On January 4, 2012, Sohu Video adopted the Video 2011 Share Incentive Plan, under which 25,000,000 ordinary shares of Sohu Video are reserved for the purpose of making share incentive awards to management and key employees of Sohu Video and to Sohu management. The maximum term of any share incentive award granted under the Video 2011 Share Incentive Plan is ten years from the grant date. The Video 2011 Share Incentive Plan will expire on January 3, 2021. As of December 31, 2016, grants of options for the purchase of 16,368,200 ordinary shares of Sohu Video had been contractually made and were subject to vesting in four equal installments, with each installment vesting upon a service period requirement being met, as well as Sohu Video's achievement of performance targets for the corresponding period. For purposes of ASC 718-10-25, as of December 31, 2016, no grant date had occurred, because the broader terms and conditions of the option awards had neither been finalized nor mutually agreed upon with the recipients. As of December 31, 2016, options for the purchase of 4,972,800 Sohu Video ordinary shares were vested.

For the years ended December 31, 2016, 2015 and 2014, total share-based compensation expense recognized for vested Sohu Video options under the Video 2011 Share Incentive Plan was negative \$0.8 million, \$0.3 million and \$4.0 million, respectively.

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

<b>Assumptions Adopted</b>	
Average risk-free interest rate	2.63%
Exercise multiple	2.8
Expected forfeiture rate (post-vesting)	19%
Weighted average expected option life	5.0
Volatility rate	46.8%
Dividend yield	0
Fair value	0.71

## **18. Business Combination**

### *MoboTap*

On July 16, 2014, Changyou, through a wholly-owned subsidiary, entered into an investment agreement with MoboTap and MoboTap's shareholders pursuant to which Changyou purchased from then existing shareholders of MoboTap at the closing, which took place on July 31, 2014, shares of MoboTap representing 51% of the equity interests in MoboTap on a fully-diluted basis for approximately \$90.8 million in cash. In addition, Changyou has the right to purchase up to 10% of the equity interests in MoboTap from the noncontrolling shareholders, at a price of 20% below the IPO price, before a qualified IPO of MoboTap. If MoboTap achieves specified performance milestones for 2016 and certain specified key employees continue their employment with MoboTap at the time the milestones are achieved, but there has not been an IPO by MoboTap, the noncontrolling shareholders of MoboTap will have a one-time right to put to Changyou shares of MoboTap held by them, representing up to 15% of the equity interests in MoboTap, for an aggregate price of up to \$53.0 million. The Sohu Group began to consolidate MoboTap's financial statements commencing with the closing of the acquisition.

On the acquisition date, the allocation of the consideration of the assets acquired and liabilities assumed based on their fair values was as follows (in thousands):

	<b>As of July 31, 2014</b>
Cash consideration	<u>\$ 90,830</u>
Repurchase option	793
Identifiable intangible assets acquired	27,000
Goodwill	113,040
Other assets	6,714
Put option	(298)
Liabilities assumed	(2,995)
Noncontrolling interest	(53,424)
Total	<u>\$ 90,830</u>

The acquired identifiable intangible assets represent the Dolphin Browser user base, technology and trademark, the useful lives of which were 2.4 years, 5.4 years and 10.4 years, respectively. The acquired user base was valued with the cost saving approach, and the acquired technology and trademark were valued with the income approach. Goodwill of \$113.0 million primarily represents the expected synergies from combining the operations of Changyou and MoboTap, which are complementary to each other. In accordance with ASC 350, goodwill is not amortized but is tested for impairment and is not deductible for tax purposes.

Based on an assessment of MoboTap's financial performance conducted in connection with the acquisition, MoboTap was not considered material to the Sohu Group. Thus the Sohu Group's management concluded that the presentation of pro forma financial information with respect to the results of operations of the Sohu Group including the acquired MoboTap was not necessary. The operating results of MoboTap, which are not significant to the Sohu Group, have been included in the Sohu Group's consolidated financial statements since the acquisition date. As the Dolphin Browser serves as a gateway to a host of user activities on mobile devices and contributes to Changyou's platform channel business, MoboTap is reported under the Changyou segment.

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In 2015, given that the performance of the Dolphin Browser operated by MoboTap was below original expectations, Changyou's management concluded that the Dolphin Browser was unable to provide the expected synergies with Changyou's platform business. Accordingly, Changyou recognized a \$29.6 million impairment loss for goodwill and a \$8.9 million impairment loss for acquired intangible assets generated in the acquisition of the MoboTap business.

In 2016, Changyou's Board of Directors approved the disposal of Changyou's 51% equity interest in MoboTap. As of December 31, 2016, Changyou has been negotiating with a potential buyer on the terms of disposal. Accordingly, the assets and liabilities attributable to MoboTap are classified as assets and liabilities held for sale and measured at the lower of their carrying amounts and their fair values, less selling costs, in the consolidated balance sheet as of December 31, 2016. Details see Note 10 – Fair Value Measurements.

### **19. Noncontrolling Interest**

Currently, the noncontrolling interests in the Sohu Group's consolidated financial statements primarily consist of noncontrolling interests for Sogou and Changyou.

#### ***Noncontrolling Interest in the Consolidated Balance Sheets***

As of December 31, 2015 and 2016, noncontrolling interest in the consolidated balance sheets was \$489.7 million and \$564.2 million, respectively.

	As of December 31,	
	2015	2016
Sogou	\$125,314	\$165,584
Changyou	364,416	398,631
Total	<u>\$489,730</u>	<u>\$564,215</u>

#### ***Noncontrolling Interest of Sogou***

As of December 31, 2016 and 2015, noncontrolling interest of Sogou of \$165.6 million and \$125.3 million, respectively, was recognized in the Sohu Group's consolidated balance sheets, representing Sogou's cumulative results of operations attributable to shareholders other than Sohu.com Inc., and reflecting the reclassification of Sogou's share-based compensation expense from shareholders' additional paid-in capital to noncontrolling interest, the investments of shareholders other than Sohu.com Inc. in Preferred Shares and Ordinary Shares of Sogou, the repurchase of Sogou Series A Preferred Shares from noncontrolling shareholders in March 2014 and September 2015, and Sogou's repurchase of Class A Ordinary Shares from noncontrolling shareholders in June 2014.

#### ***Noncontrolling Interest of Changyou***

As of December 31, 2016 and 2015, noncontrolling interest of Changyou of \$398.6 million and \$364.4 million, respectively, was recognized in the Sohu Group's consolidated balance sheets, representing a 31% economic interest for both 2016 and 2015 in Changyou's net assets held by shareholders other than Sohu.com Inc. and reflecting the reclassification of Changyou's share-based compensation expense from shareholders' additional paid-in capital to noncontrolling interest.

#### ***Noncontrolling Interest in the Consolidated Statements of Comprehensive Income/(Loss)***

For the years ended December 31, 2016, 2015 and 2014, respectively, the Sohu Group had net income of \$109.0 million, net income of \$146.5 million and net loss of \$32.3 million, respectively, attributable to the noncontrolling interest in the consolidated statements of comprehensive income/(loss).

	Year Ended December 31,		
	2014	2015	2016
Sogou	\$(14,202)	\$101,656	\$ 61,403
Changyou	(18,873)	44,886	47,645
Others	766	0	0
Total	<u>\$(32,309)</u>	<u>\$146,542</u>	<u>\$109,048</u>

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### *Noncontrolling Interest of Sogou*

For the years ended December 31, 2016, 2015 and 2014, respectively, a \$61.4 million net income, a \$101.7 million net income and a \$14.2 million net loss, respectively, attributable to the noncontrolling interest of Sogou was recognized in the Sohu Group's consolidated statements of comprehensive income /(loss), representing Sogou's net income /(loss) attributable to shareholders other than Sohu.com Inc.

### *Noncontrolling Interest of Changyou*

For the years ended December 31, 2016, 2015 and 2014, respectively, a \$47.6 million net income, a \$44.9 million net income and a \$18.9 million net loss, respectively, attributable to the noncontrolling interest of Changyou was recognized in the Sohu Group's consolidated statements of comprehensive income /(loss), representing a 31%, 31% and 32%, respectively, economic interest in Changyou attributable to shareholders other than Sohu.com Inc.

## **20. Net Income /(Loss) per Share**

Basic net income /(loss) per share is computed using the weighted average number of common shares outstanding during the period. Diluted net income /(loss) 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 comprise shares issuable upon the exercise or settlement of share-based awards using the treasury stock method. The dilutive effect of share-based awards with performance requirements is not considered before the performance targets are actually met. The computation of diluted net income /(loss) per share does not assume conversion, exercise, or contingent issuance of securities that would have an anti-dilutive effect (i.e. an increase in earnings per share amounts or a decrease in loss per share amounts) on net income /(loss) per share. For the year ended December 31, 2016, 232,488 common shares potentially issuable upon the exercise or settlement of share-based awards using the treasury stock method were anti-dilutive and excluded from the denominator for calculation of diluted net loss per share.

Additionally, for purposes of calculating the numerator of diluted net income /(loss) per share, the net income /(loss) attributable to Sohu.com Inc. is adjusted as follows. The adjustment will not be made if there is an anti-dilutive effect.

- (1) Sogou's net income /(loss) attributable to Sohu.com Inc. is determined using the percentage that the weighted average number of Sogou shares held by Sohu.com Inc. represents of the weighted average number of Sogou Preferred Shares and Ordinary Shares, shares issuable upon the conversion of convertible preferred shares under the if-converted method, and shares issuable upon the exercise or settlement of share-based awards under the treasury stock method, and is not determined by allocating Sogou's net income /(loss) to Sohu.com Inc. using the methodology for the calculation of net income /(loss) attributable to the Sogou noncontrolling shareholders discussed in Note 19 – Noncontrolling Interest.

In the calculation of Sohu.com Inc.'s diluted net income /(loss) per share, assuming a dilutive effect, the percentage of Sohu.com Inc.'s shareholding in Sogou was calculated by treating convertible preferred shares issued by Sogou as having been converted at the beginning of the period and unvested Sogou share options with the performance targets achieved as well as vested but unexercised Sogou share options as having been exercised during the period. The dilutive effect of share-based awards with a performance requirement was not considered before the performance targets were actually met. The effect of this calculation is presented as "incremental dilution from Sogou" in the table below. Assuming an anti-dilutive effect, all of these Sogou shares and share options are excluded from the calculation of Sohu.com Inc.'s diluted income /(loss) per share. As a result, Sogou's net income /(loss) attributable to Sohu.com Inc. on a diluted basis equals the number used for the calculation of Sohu.com Inc.'s basic net income /(loss) per share.

For the year ended December 31, 2016, all of these Sogou shares and share options had an anti-dilutive effect, and therefore were excluded from the calculation of Sohu.com Inc.'s diluted net income /(loss) per share, and "incremental dilution from Sogou" in the table below was zero.

- (2) Changyou's net income /(loss) attributable to Sohu.com Inc. is determined using the percentage that the weighted average number of Changyou shares held by Sohu.com Inc. represents of the weighted average number of Changyou ordinary shares and shares issuable upon the exercise or settlement of share-based awards under the treasury stock method, and not by using the percentage held by Sohu.com Inc. of the total economic interest in Changyou, which is used for the calculation of basic net income per share.

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In the calculation of Sohu.com Inc.'s diluted net income /(loss) per share, assuming a dilutive effect, all of Changyou's existing unvested restricted share units and share options, and vested restricted share units and share options that have not yet been settled, are treated as vested and settled by Changyou under the treasury stock method, causing the percentage of the weighted average number of shares held by Sohu.com Inc. in Changyou to decrease. As a result, Changyou's net income /(loss) attributable to Sohu.com Inc. on a diluted basis decreased accordingly. The effect of this calculation is presented as "incremental dilution from Changyou" in the table below. Assuming an anti-dilutive effect, all of these Changyou restricted share units and share options are excluded from the calculation of Sohu.com Inc.'s diluted net income /(loss) per share. As a result, Changyou's net income /(loss) attributable to Sohu.com Inc. on a diluted basis equals the number used for the calculation of Sohu.com Inc.'s basic net income /(loss) per share.

For the year ended December 31, 2016, all of these Changyou restricted share units had a dilutive effect, and therefore were included in the calculation of Sohu.com Inc.'s diluted net income /(loss) per share. This impact is presented as "incremental dilution from Changyou" in the table below.

In March 2014, Sogou purchased from China Web 14.4 million Series A Preferred Shares of Sogou for an aggregate purchase price of \$47.3 million. In September 2015, Sogou purchased from Photon 6.4 million Series A Preferred Shares of Sogou for an aggregate purchase price of \$21.0 million. These transactions gave rise to deemed dividends of \$27.7 million and \$11.9 million, respectively, which were deemed to have been contributed by Sohu.com Inc., as a holder of ordinary shares of Sogou, representing a portion of the differences between the prices Sogou paid to China Web and Photon for the Series A Preferred Shares and the carrying amounts of these Series A Preferred Shares in the Group's consolidated financial statements.

The following table presents the calculation of the Sohu Group's basic and diluted net loss per share (in thousands, except per share data).

	Year Ended December 31,		
	2014	2015	2016
<b>Numerator:</b>			
Net loss attributable to Sohu.com Inc., basic (after subtracting the dividend or deemed dividend to noncontrolling Sogou Series A Preferred shareholders)	\$(166,657)	\$(49,598)	\$(224,021)
<b>Effect of dilutive securities:</b>			
Incremental dilution from Sogou	(3,919)	0	0
Incremental dilution from Changyou	0	(1,231)	(1,639)
Net loss attributable to Sohu.com Inc., diluted	\$(170,576)	\$(50,829)	\$(225,660)
<b>Denominator:</b>			
Weighted average basic common shares outstanding	38,468	38,598	38,706
<b>Effect of dilutive securities:</b>			
Share options and restricted share units	0	0	0
Weighted average diluted common shares outstanding	\$ 38,468	\$ 38,598	\$ 38,706
Basic net loss per share attributable to Sohu.com Inc.	\$ (4.33)	\$ (1.28)	\$ (5.79)
Diluted net loss per share attributable to Sohu.com Inc.	\$ (4.43)	\$ (1.32)	\$ (5.83)

## 21. China Contribution Plan

The Sohu Group's subsidiaries and consolidated VIEs in China participate in a government-mandated multi-employer defined contribution plan pursuant to which certain retirement, medical and other welfare benefits are provided to employees. Chinese labor regulations require the Group's subsidiaries and consolidated VIEs to pay to the local labor bureau a monthly contribution at a stated contribution rate based on the monthly compensation of qualified employees. The relevant local labor bureau is responsible for meeting all retirement benefit obligations; the Group's China-based subsidiaries and consolidated VIEs have no further commitments beyond their monthly contributions. For the years ended December 31, 2016, 2015 and 2014, the Group's China based subsidiaries and consolidated VIEs contributed a total of \$131.6 million, \$132.6 million and \$134.2 million, respectively, to these funds.

## 22. Profit Appropriation

The Sohu Group's China-based subsidiaries and VIEs are required to make appropriations to certain non-distributable reserve funds.

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In accordance with the China Foreign Investment Enterprises laws, those of the Group's China-based subsidiaries that are considered under PRC law to be WFOEs are required to make appropriations from their after-tax profit as determined under generally accepted accounting principles in the PRC (the "after-tax-profit under PRC GAAP") to non-distributable reserve funds, including (i) a general reserve fund, (ii) an enterprise expansion fund, and (iii) a staff bonus and welfare fund. Each year, at least 10% of the after-tax-profit under PRC GAAP is required to be set aside as general reserve fund until such appropriations for the fund equal 50% of the registered capital of the applicable entity. The appropriation for the other two reserve funds is at the Group's discretion as determined by the Board of Directors of each entity.

Pursuant to the China Company Laws, those of the Group's China-based subsidiaries that are considered under PRC law to be domestically funded enterprises, as well as the Group's VIEs, are required to make appropriations from their after-tax-profit under PRC GAAP to non-distributable reserve funds, including a statutory surplus fund and a discretionary surplus fund. Each year, at least 10% of the after-tax-profit under PRC GAAP is required to be set aside as statutory surplus fund until such appropriations for the fund equal 50% of the registered capital of the applicable entity. The appropriation for the discretionary surplus fund is at the Company's discretion as determined by the Board of Directors of each entity.

Upon certain regulatory approvals and subject to certain limitations, the general reserve fund and the statutory surplus fund can be used to offset prior year losses, if any, and can be converted into paid-in capital of the applicable entity.

For the years ended December 31, 2016, 2015 and 2014, the total amount of profits contributed to these funds by the Group was \$4.3 million, \$7.7 million and \$4.9 million, respectively. As of December 31, 2016 and 2015, the total amount of profits contributed to these funds by the Group was \$51.0 million and \$46.8 million, respectively.

As a result of these and other restrictions under PRC laws and regulations, the Group's China-based subsidiaries and VIEs are restricted in their ability to transfer a portion of their net assets in the form of non-distributable reserve funds to the Company in the form of dividends, loans or advances. Even though the Company currently does not require any such dividends, loans or advances from its China-based subsidiaries and VIEs for working capital and other funding purposes, the Company may in the future require additional cash resources from its China-based subsidiaries and VIEs due to changes in business conditions, to fund future acquisitions and development, or to declare and pay dividends to or make distributions to its shareholders.

### **23. Concentration Risks**

Because its operations are substantially conducted in the PRC, the Sohu Group is subject to PRC-related political, economic and legal risks. Besides these risks, the Sohu Group may also have the following concentration risks.

#### ***Operation Risk***

For the years ended December 31, 2016, 2015 and 2014, there are no revenues from clients that individually represent greater than 10% of the total revenues.

For the year ended December 31, 2016, 13% of the Sohu Group's total revenue and 56% of the Sohu Group's online game revenue was derived from a single PC game, TLBB, which was launched in May 2007.

Financial instruments that potentially subject the Sohu Group to concentration risks consist primarily of cash and cash equivalents and short-term investments. Cash and cash equivalents in Sohu Group are mainly denominated in RMB and in U.S. dollars. Short-term investments are denominated in RMB. The Group may experience economic losses and negative impacts on earnings and equity as a result of fluctuations in the exchange rate between the U.S. dollar and the RMB. Moreover, the Chinese government imposes controls on the convertibility of RMB into foreign currencies and, in certain cases, the remittance of currency out of the PRC. The Group may experience difficulties in completing the administrative procedures necessary to obtain and remit foreign currency.

#### ***Credit Risk***

As of December 31, 2016, approximately 38% of the Sohu Group's cash and cash equivalents were held in 15 financial institutions in China. The remaining cash and cash equivalents were held primarily in financial institutions in Macao and Hong Kong.

As of December 31, 2015, approximately 59% of the Sohu Group's cash and cash equivalents were held in 16 financial institutions in China. The remaining cash and cash equivalents were held primarily in financial institutions in Hong Kong and the U.S.



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The Sohu Group holds its cash and bank deposits at Chinese financial institutions that are among the largest and most respected in the PRC and at international financial institutions with high ratings from internationally-recognized rating agencies. The management chooses these institutions because of their reputations and track records for stability, and their known large cash reserves, and management periodically reviews these institutions' reputations, track records, and reported reserves.

Management expects that any additional institutions that the Sohu Group uses for its cash and bank deposits will be chosen with similar criteria for soundness. As a further means of managing its credit risk, the Sohu Group holds its cash and bank deposits in a number of different financial institutions. As of December 31, 2016 and 2015, the Sohu Group held its cash and bank deposits in different financial institutions and held no more than approximately 32% and 28%, respectively, of its total cash at any single institution.

Under PRC law, it is generally required that a commercial bank in the PRC that holds third party cash deposits protect the depositors' rights over and interests in their deposited money; PRC banks are subject to a series of risk control regulatory standards; and PRC bank regulatory authorities are empowered to take over the operation and management of any PRC bank that faces a material credit crisis.

For the credit risk related to accounts receivable, the Sohu Group performs ongoing credit evaluations of its customers and, if necessary, maintains reserves for potential credit losses. Historically, such losses have been within management's expectations.

### **24. Restricted Net Assets**

Relevant PRC law and regulations permit payment of dividends by PRC-based operating entities only out of their retained earnings, if any, as determined in accordance with PRC accounting standards and regulations. In addition, a PRC-based operating entity is required to annually appropriate 10% of net after-tax income to the statutory surplus reserve fund (see Note 22) prior to payment of any dividends, unless such reserve funds have reached 50% of the entity's registered capital. As a result of these and other restrictions under PRC law and regulations, PRC-based operating entities are restricted in their ability to transfer a portion of their net assets to the Company either in the form of dividends, loans or advances. Even though the Company currently does not require any such dividends, loans or advances from PRC-based operating entities for working capital and other funding purposes, the Company may in the future require additional cash resources from PRC-based operating entities due to changes in business conditions, to fund future acquisitions and development, or to declare and pay dividends to or distribution to its shareholders.

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**SCHEDULE I – CONDENSED FINANCIAL INFORMATION OF REGISTRANT  
SOHU.COM INC.  
CONDENSED BALANCE SHEETS  
(In thousands)**

	<b>As of December 31,</b>	
	<b>2015</b>	<b>2016</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 16,096	\$ 8,990
Prepaid and other current assets	8,320	6,218
Due from subsidiaries and VIEs	3,806	3,806
Total current assets	28,222	19,014
Interests in subsidiaries and VIEs	1,232,327	989,875
Total assets	<u>\$1,260,549</u>	<u>\$1,008,889</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities	4,558	4,501
Long-term liabilities	14,969	10,808
Total liabilities	<u>19,527</u>	<u>15,309</u>
Shareholders' equity:		
Common stock: \$0.001 par value per share (75,400 shares authorized; 38,653 shares and 38,742 shares, respectively, issued and outstanding as of December 31, 2015 and 2016)	45	45
Additional paid-in capital	798,357	821,867
Treasury stock (5,889 shares as of both December 31, 2015 and 2016)	(143,858)	(143,858)
Accumulated other comprehensive income	50,151	3,220
Retained earnings	536,327	312,306
Total shareholders' equity	<u>1,241,022</u>	<u>993,580</u>
Total liabilities and shareholders' equity	<u>\$1,260,549</u>	<u>\$1,008,889</u>

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**CONDENSED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS)**  
**(In thousands)**

	Year Ended December 31,		
	2014	2015	2016
Revenues	\$ 0	\$ 0	\$ 0
Cost of revenues	0	0	0
Gross profit	0	0	0
Operating expenses:			
General and administrative	7,829	22,091	8,845
Operating loss	(7,829)	(22,091)	(8,845)
Equity in loss of subsidiaries and VIEs	(129,324)	(4,430)	(217,408)
Other expense	(28)	(12)	(54)
Interest income	76	95	107
Loss before income tax expense /(benefit)	(137,105)	(26,438)	(226,200)
Income tax expense /(benefit)	1,805	11,249	(2,179)
Net loss	(138,910)	(37,687)	(224,021)
Other comprehensive loss	(6,903)	(59,251)	(46,931)
Comprehensive loss	<u><u>\$ (145,813)</u></u>	<u><u>\$ (96,938)</u></u>	<u><u>\$ (270,952)</u></u>

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**CONDENSED STATEMENTS OF CASH FLOWS**  
**(In thousands)**

	Year Ended December 31,		
	2014	2015	2016
Cash flows from operating activities:			
Net loss	\$(138,910)	\$(37,687)	\$(224,021)
Adjustments to reconcile net loss to net cash used in operating activities:			
Investment income from subsidiaries and VIEs	129,324	4,430	217,408
Share-based compensation expense	1,120	15,393	1,309
Changes in current assets and liabilities:			
Prepaid and other current assets	(110)	(71)	842
Taxes payable	(510)	811	(630)
Accrued liabilities	(3,996)	7,905	(2,014)
Net cash used in operating activities	(13,082)	(9,219)	(7,106)
Cash flows from investing activities:			
Dividend received	0	0	0
Net cash provided by investing activities	0	0	0
Cash flows from financing activities:			
Issuance of common stock	612	2,126	0
Net cash provided by financing activities	612	2,126	0
Net decrease in cash and cash equivalents	(12,470)	(7,093)	(7,106)
Cash and cash equivalents at beginning of year	35,659	23,189	16,096
Cash and cash equivalents at end of year	<u>\$ 23,189</u>	<u>\$ 16,096</u>	<u>\$ 8,990</u>

NOTES TO SCHEDULE I – CONDENSED FINANCIAL INFORMATION OF SOHU.COM INC.

1. The condensed financial statements of Sohu.com Inc. (the “Company”) have been prepared in accordance with U.S. GAAP.
2. The Company records its investment in subsidiaries under the equity method. Such investment and long-term loans to subsidiaries are presented on the balance sheets as interests in subsidiaries and consolidated VIEs and the profit of the subsidiaries is presented as equity in profit of subsidiaries and consolidated VIEs on the statements of comprehensive income.

For VIEs where the Company is the primary beneficiary, the amount of the Company’s investment is included on the balance sheets as interests in subsidiaries and consolidated VIEs, and the profit or loss of the subsidiaries and consolidated VIEs is included in equity in profit of subsidiaries and consolidated VIEs on the statements of comprehensive income.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in U.S. have been condensed or omitted. The footnote disclosures contain supplemental information relating to the operations of the Company and, as such, these statements should be read in conjunction with the notes to the Consolidated Financial Statements of the Company.

3. As of December 31, 2016 and 2015, there were no material contingencies, significant provisions of long-term obligations, or mandatory dividend or redemption requirements of redeemable stocks or guarantees of the Company, except for those which have been separately disclosed in the Consolidated Financial Statements, if any.

**EXHIBIT INDEX**

<u>Exhibit No.</u>	<u>Description</u>
3.1(1)	Sixth Amended and Restated Certificate of Incorporation of Sohu.com Inc. as filed with the Delaware Secretary of State on July 17, 2000.
3.2(15)	Second Amended and Restated By-Laws of Sohu.com Inc., effective February 7, 2015.
10.1(2)	Loan and Share Pledge Agreement dated November 19, 2001 among Sohu.com Inc., Dr. Charles Zhang and Li Wei.
10.2(4)	Purchasing Agreement of Real Property between Sohu Era and Vision Hua Qing.
10.3(5)	Master Transaction Agreement, dated January 1, 2009, by and between Sohu.com Inc. and Changyou.com Limited.
10.4(5)	Project Cooperation Agreement, dated November 20, 2009, by and between Beijing Raycom Real Estate Development Co., Ltd. and Beijing Sohu Media.
10.5(6)	Amended and Restated Marketing Services Agreement, dated January 1, 2010, by and between Sohu.com Inc. and Changyou.com Limited.
10.6(7)	Project Cooperation Agreement of Changyou, dated August 23, 2010.
10.7(7)	Amended and Restated 2010 Stock Incentive Plan.
10.8(7)	Cooperation Agreement, dated September 30, 2010. (Portions of this exhibit have been omitted pursuant to a request for confidential treatment, and the omitted information has been filed separately with the Securities and Exchange Commission).
10.9(8)	Share Transfer Framework Agreement for Shenzhen 7Road dated April 22, 2011 (Portions of this exhibit have been omitted pursuant to a request for confidential treatment, and the omitted information has been filed separately with the Securities and Exchange Commission).
10.10(9)	Master Transaction Agreement, dated as of November 29, 2011, between, on the one hand, the registrant, Sohu.com Limited, Sohu Internet, Sohu Era, and Sohu Media, and, on the other hand, Changyou.com Limited, Changyou.com HK, Gamespace, and Guanyou Gamespace.
10.11(9)	Amended and Restated Non-Competition Agreement, dated as of November 29, 2011, between Changyou.com Limited and the registrant.
10.12(9)	Services Agreement, dated as of November 29, 2011, between Changyou Gamespace and Sohu Media.
10.13(9)	Online Links and Advertising Agreement, dated as of November 29, 2011, between Guanyou Gamespace and Sohu Media.
10.14(10)	2011 Share Incentive Plan of Sohu Video.
10.15(10)	English Translation of Services and Maintenance Agreement, dated November 30, 2007, between AmazGame and Gamease.
10.16(10)	English Translation of Technology Support and Utilization Agreement, dated August 20, 2008, between AmazGame and Gamease.
10.17(10)	English Translation of Exclusive Technology Consulting and Services Agreement, dated September 26, 2010, between Sogou Technology and Sogou Information.

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- 10.18(11) Acquisition Framework Agreement, dated as of May 1, 2013, between Changyou.com Webgames (HK) Limited, Burgeon Max Limited, and others. (Portions of this exhibit have been omitted pursuant to a request for confidential treatment, and the omitted information has been filed separately with the Securities and Exchange Commission)
- 10.19(12) Subscription Agreement dated September 16, 2013 among Sogou Inc, Sohu Search, Photon and THL A21 Limited.
- 10.20(12) Shareholders' Agreement dated September 16, 2013 among Sogou Inc, Sohu Search, Photon, THL A21 Limited, Sogou Management and Management Trusts.
- 10.21(12) Second Restated Articles of Association of Sogou Inc. adopted on September 16, 2013.
- 10.22(12) Voting Agreement dated September 16, 2013 among Sogou Inc, Sohu Search, Photon, Sogou Management and Management Trusts.
- 10.23(12) Termination Agreement dated September 16, 2013 among Sogou Inc, China Web, Photon and Sohu Search regarding Amended and Restated Investors' Rights Agreement Amended and Restated Right of First Refusal and Co-Sale Agreement.
- 10.24(12) Repurchase Option Agreement dated September 16, 2013 between Sogou Inc and Sohu Search.
- 10.25(12) Repurchase Option Agreement dated September 16, 2013 between Sogou Inc and China Web.
- 10.26(12) Repurchase Option Agreement dated September 16, 2013 between Sogou Inc and Photon.
- 10.27(12) Equity Transfer Contract dated September 16, 2013 between Tencent Computer System Company Limited and Sogou Information.
- 10.28(13) English Translation of Loan Agreement, dated December 2, 2013, between Sogou Technology and Xiaochuan Wang.
- 10.29(13) English Translation of Share Pledge Agreement, dated December 2, 2013, among Sogou Technology, Sogou Information and the shareholders of Sogou Information.
- 10.30(13) English Translation of Exclusive Equity Interest Purchase Rights Agreement, dated December 2, 2013, among Sogou Technology, Sogou Information and the shareholders of Sogou Information.
- 10.31(13) English Translation of Business Operation Agreement, dated December 2, 2013, among Sogou Technology, Sogou Information and the shareholders of Sogou Information.
- 10.32(13) English Translation of Power of Attorney, dated December 2, 2013, by the shareholders of Sogou Information in favor of Sogou Technology.
- 10.33(13) English Translation of Exclusive Technology Consulting and Services Agreement August 2, 2012, between Sohu Internet and Sohu Era.
- 10.34(13) English Translation of Loan Facility Letter, dated August 13, 2013, among Hang Seng Bank Limited, Changyou.com HK Limited and Changyou.com Limited.
- 10.35(13) English Translation of Loan Facility Letter, dated July 26, 2013, between the Bank of East Asia, Limited and Changyou.com Limited.
- 10.36(13) English Translation of Loan Facility Letter, dated May 8, 2013, among Hang Seng Bank Limited, Changyou.com HK Limited and Changyou.com Limited.
- 10.37(13) English Translation of Investment Agreement, dated November 19, 2013, among Koram Games Limited, Heroic Vision Holdings Limited, and others. (Portions of this exhibit have been omitted pursuant to a request for confidential treatment, and the omitted information has been filed separately with the Securities and Exchange Commission)



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- 10.38(13) English Translation of Supplementary Agreement to Investment Agreement, dated December 24, 2013, among Koram Games Limited, Heroic Vision Holdings Limited, and others. (Portions of this exhibit have been omitted pursuant to a request for confidential treatment, and the omitted information has been filed separately with the Securities and Exchange Commission)
- 10.39 (14) English Translation of Convertible Bond Subscription Agreement, dated July 16, 2014, between MoboTap Inc. and Glory Loop Limited.
- 10.40(14) English Translation of Investment Agreement, dated July 16, 2014, among Glory Loop Limited, Beijing Gamease Age Internet Technology Co., Ltd, and others. (Portions of this exhibit have been omitted pursuant to a request for confidential treatment, and the omitted information has been filed separately with the Securities and Exchange Commission)
- 10.41(14) English Translation of Shareholder Agreement, dated July 31, 2014, among Glory Loop Limited, Beijing Gamease Age Internet Technology Co., Ltd, and others. (Portions of this exhibit have been omitted pursuant to a request for confidential treatment, and the omitted information has been filed separately with the Securities and Exchange Commission)
- 10.42(16) Sixth Amended and Restated Memorandum of Association of Sogou Inc.
- 10.43(16) 2010 Share Incentive Plan of Sogou Inc. (as amended and restated)
- 10.44(16) 2014 Share Incentive Plan of Changyou.com Limited
- 10.45(16) Employment Agreement effective as of January 1, 2015, entered into on December 31, 2014, between Sohu.com Inc. and Charles Zhang.
- 10.46(16) English Translation of Loan Agreement, dated November 15, 2011, between Video Tianjin and Ye Deng, the shareholder of Tianjin Jinhu.
- 10.47(16) English Translation of Loan Agreement, dated December 4, 2013, between Video Tianjin and Xuemei Zhang, the shareholder of Tianjin Jinhu.
- 10.48(16) English Translation of Equity Pledge Agreement, dated November 15, 2011, between Video Tianjin and Ye Deng, the shareholder of Tianjin Jinhu.
- 10.49(16) English Translation of Equity Pledge Agreement, dated December 4, 2013, between Video Tianjin and Xuemei Zhang, the shareholder of Tianjin Jinhu.
- 10.50(16) English Translation of Exclusive Equity Interest Purchase Right Agreement, dated December 4, 2013, between Video Tianjin, Tianjin Jinhu and the shareholders of Tianjin Jinhu.
- 10.51(16) English Translation of Business Operation Agreement, dated December 4, 2013, among Video Tianjin, Tianjin Jinhu and the shareholders of Tianjin Jinhu.
- 10.52(16) English Translation of Powers of Attorney, dated December 4, 2013, executed by the shareholders of Tianjin Jinhu in favor of Video Tianjin.
- 10.53(16) English Translation of Exclusive Technology Consulting and Services Agreement, dated December 4, 2013, between Video Tianjin and Tianjin Jinhu.
- 10.54(16) English Translation of Share Pledge Agreement, dated July 31, 2014, among Beijing Baina Technology, Wuhan Baina Information and the shareholders of Wuhan Baina Information. (Portions of this exhibit have been omitted pursuant to a request for confidential treatment, and the omitted information has been filed separately with the Securities and Exchange Commission)
- 10.55(16) English Translation of Exclusive Call Option Agreement, dated July 31, 2014, among Beijing Baina Technology, Gamease, Wuhan Baina Information and Yongzhi Yang. (Portions of this exhibit have been omitted pursuant to a request for confidential treatment, and the omitted information has been filed separately with the Securities and Exchange Commission)

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- 10.56(16) English Translation of Assignment Agreement in relation to Shareholders Rights, dated July 31, 2014, among Beijing Baina Technology, Gamease, Wuhan Baina Information and Yongzhi Yang. (Portions of this exhibit have been omitted pursuant to a request for confidential treatment, and the omitted information has been filed separately with the Securities and Exchange Commission)
- 10.57(16) English Translation of Exclusive Services Agreement, dated July 31, 2014, between Beijing Baina Technology and Wuhan Baina Information.
- 10.58(16) Loan and Share Pledge Agreement, effective as of April 28, 2014, by and among Sohu.com Limited, Charles Zhang and Wei Li. (Portions of this exhibit have been omitted pursuant to a request for confidential treatment, and the omitted information has been filed separately with the Securities and Exchange Commission)
- 10.59(17) English Translation of Loan Assignment and Equity Interest Transfer Agreement, dated March 31, 2015, among AmazGame, Gamease, Tao Wang, High Century and Dewen Chen.
- 10.60(17) English Translation of Loan Assignment and Equity Interest Transfer Agreement, dated April 15, 2015, among AmazGame, Gamease, Dewen Chen, High Century and Tao Wang.
- 10.61(17) English Translation of Loan Agreement, dated April 15, 2015, between AmazGame and High Century.
- 10.62(17) English Translation of Equity Interest Pledge Agreement, dated April 15, 2015 among AmazGame, Gamease and High Century.
- 10.63(17) English Translation of Equity Interest Purchase Right Agreement, dated April 15, 2015, between AmazGame, Gamease and High Century.
- 10.64(17) English Translation of Power of Attorney, dated April 15, 2015, executed by High Century in favor of AmazGame.
- 10.65(17) English Translation of Business Operation Agreement, dated April 15, 2015, among AmazGame, Gamease and High Century.
- 10.66(18) Loan and Share Pledge Agreement, dated July 1, 2015, among Sohu Media, Charles Zhang and Wei Li.
- 10.67(18) Loan and Share Pledge Agreement, dated July 1, 2015, among Focus HK, Charles Zhang and Wei Li.
- 10.68(19) English translation of Loan Agreement, dated July 6, 2015, between Gamespace and Changyou Star.
- 10.69(19) English translation of Equity Interest Purchase Right Agreement, dated July 6, 2015, among Gamespace, Guanyou Gamespace and Changyou Star.
- 10.70(19) English translation of Equity Pledge Agreements, dated July 6, 2015, among Gamespace, Guanyou Gamespace and Changyou Star.
- 10.71(19) English translation of Business Operation Agreement, dated July 6, 2015, among Gamespace, Guanyou Gamespace and Changyou Star.
- 10.72(19) English translation of Power of Attorney, dated July 6, 2015, executed by Changyou Star in favor of Gamespace.
- 10.73(19) English translation of Share Pledge Agreement, dated September 30, 2015, among Beijing Baina Technology, Changyou Star and Yongzhi Yang.
- 10.74(19) English translation of Exclusive Call Option Agreement, dated September 30, 2015, among Beijing Baina Technology, Changyou Star, Wuhan Baina Information and Yongzhi Yang.

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10.75(19)	English translation of Exclusive Services Agreement, dated September 30, 2015, between Beijing Baina Technology and Wuhan Baina Information.
10.76(19)	English translation of Business Operation Agreement, dated September 30, 2015, among Beijing Baina Technology, Wuhan Baina Information, Changyou Star and Yongzhi Yang.
10.77(19)	English translation of Power of Attorney, dated September 30, 2015, executed by the shareholders of Wuhan Baina Information in favor of Beijing Baina Technology.
10.78(19)	English translation of Share Purchase Agreement, dated April 16, 2015, between Gamease and Shanghai Yong Chong.
10.79(20)	Letter Agreement dated June 27, 2016 between Changyou.com Limited and Carol Yu.
10.80(21)	Letter Agreement dated June 8, 2016 between Sohu.com Inc. and Carol Yu.
10.81(21)	Amendment, dated July 30, 2016, of Letter Agreement between Sohu.com Inc. and Carol Yu.
10.82(22)	English Translation of Loan Agreement, dated as of October 24, 2016, between AmazGame and Sohu Media.
10.83(22)	Share Pledge Agreement, dated as of October 24, 2016, between Sohu Game and Changyou.
10.84(23)	English translation of Employment Agreement effective as of April 1, 2012, between Sohu Era and Joanna Lv.
10.85(23)	English translation of Agreement Changing One Party to Employment Agreement effective as of April 1, 2013, among Sohu Era, Joanna Lv and Sohu Media.
10.86(23)	Employment Agreement effective as of January 1, 2015, between Changyou and Dewen Chen.
10.87(23)	English translation of Employment Agreement effective as of November 30, 2012, between Sogou Technology and Xiaochuan Wang.
14.1(3)	Code of Ethics and Conduct.
21.1(23)	Subsidiaries of the registrant.
23.1(23)	Consent of Independent Registered Public Accounting Firm.
23.2(23)	Consent of Haiwen & Partners, PRC Counsel.
24.1(23)	Power of Attorney (included in signature page to Form 10-K).
31.1(23)	Rule 13a-14(a)/15d-14(a) Certification of Dr. Charles Zhang.
31.2(23)	Rule 13a-14(a)/15d-14(a) Certification of Joanna Lv.
32.1(23)	Section 1350 Certification of Dr. Charles Zhang.
32.2(23)	Section 1350 Certification of Joanna Lv.
101(23)	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Condensed Consolidated Balance Sheets as of December 31, 2016 and 2015; (ii) Condensed Consolidated Statements of Comprehensive Income for the years ended December 31, 2016, 2015, and 2014; (iii) Condensed Consolidated Statements of Cash Flows for the years ended December 31, 2016, 2015, and 2014; (iv) Condensed Consolidated Statements of Changes in Equity for the years ended December 31, 2016, 2015, and 2014; (v) Notes to Condensed Consolidated Financial Statements, tagged using four different levels of detail; and (vi) Schedule I – Condensed Financial Information Of Registrant.

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(1) Incorporated herein by reference to the registrant's Quarterly Report on Form 10-Q filed on November 14, 2000.

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- (2) Incorporated herein by reference to the registrant's Annual Report on Form 10-K filed on March 15, 2002.
- (3) Incorporated herein by reference to the registrant's Annual Report on Form 10-K filed on March 2, 2004.
- (4) Incorporated herein by reference to the registrant's Quarterly Report on Form 10-Q filed on May 8, 2007.
- (5) Incorporated herein by reference to the registrant's Annual Report on Form 10-K filed on February 26, 2010.
- (6) Incorporated herein by reference to the registrant's Quarterly Report on Form 10-Q filed on May 7, 2010.
- (7) Incorporated herein by reference to the registrant's Quarterly Report on Form 10-Q filed on November 8, 2010.
- (8) Incorporated herein by reference to the registrant's Quarterly Report on Form 10-Q filed on August 8, 2011.
- (9) Incorporated herein by reference to the registrant's Current Report on Form 8-K filed on December 1, 2011.
- (10) Incorporated herein by reference to the registrant's Annual Report on Form 10-K filed on February 28, 2013.
- (11) Incorporated herein by reference to the registrant's Quarterly Report on Form 10-Q filed on August 8, 2013.
- (12) Incorporated herein by reference to the registrant's Quarterly Report on Form 10-Q filed on November 8, 2013.
- (13) Incorporated herein by reference to the registrant's Annual Report on Form 10-K filed on February 28, 2014.
- (14) Incorporated herein by reference to the registrant's Quarterly Report on Form 10-Q filed on November 7, 2014.
- (15) Incorporated herein by reference to the registrant's Current Report on Form 8-K filed on February 12, 2015.
- (16) Incorporated herein by reference to the registrant's Annual Report on Form 10-K filed on March 2, 2015.
- (17) Incorporated herein by reference to the registrant's Quarterly Report on Form 10-Q filed on August 7, 2015.
- (18) Incorporated herein by reference to the registrant's Quarterly Report on Form 10-Q filed on November 6, 2015.
- (19) Incorporated herein by reference to the registrant's Annual Report on Form 10-K filed on February 26, 2016.
- (20) Incorporated herein by reference to the registrant's Current Report on Form 8-K filed on June 27, 2016.
- (21) Incorporated herein by reference to the registrant's Quarterly Report on Form 10-Q filed on August 8, 2016.
- (22) Incorporated herein by reference to the registrant's Current Report on Form 8-K filed on October 24, 2016.
- (23) Filed herewith.

## EMPLOYMENT AGREEMENT

This Employment Agreement (hereinafter referred to as the "Agreement") is made by and between the following parties:

**Party A: Beijing Sohu New Era Information Technology Co., Ltd**, a PRC corporation, and

**Party B: Joanna Lv**, an individual.

NOW THEREFORE, the above parties have entered into this Agreement upon equal negotiation for their joint observance according to the Labor Law of the People's Republic of China, the Employment Contract Law of the People's Republic of China and other applicable laws and regulations.

### 1. Type and Term

1.1 This Agreement is an open-ended employment agreement.

1.2 The term of this Agreement starts from April 1, 2012, and ends when Party B reaches the age of retirement, or when other mandatory circumstances for termination occur.

### 2. Work Content and Place

2.1 When signing this Agreement, the title or position of Party B is senior director, and the work place is in Beijing. During the term hereof, Party A may adjust the above position or place based on its needs of operation or work, or Party B's competence and performance. The above adjustment includes any change of Party B's work content or place, promotion, lateral move, and demotion, and also includes any change of work content, responsibility or scope, while the title or position remains the same.

2.2 Party B shall complete the work assignment meeting the specified quantity, quality and indicator according to Party A's requirements for corresponding position, work, assignment and responsibility. During work, Party B may not act beyond the powers authorized by Party A.

- (1) Party B shall comply with the Constitution and other laws and regulations of China, and shall be devoted to her duty, work diligently, and perform the duties of her position;
- (2) During work, Party B shall ensure that her work meets the standards of duties of her position specified by Party A. Meanwhile, if required by work, Party B shall further complete any ad hoc assignment other than the duties of her position arranged by Party A.
- (3) Party B shall maintain Party A's trade secrets confidential, and may not use such trade secrets to seek improper economic benefit for herself or for other economic organizations or individuals.

### 3. Working Hours; Rest and Vacation

3.1 Upon execution of this Agreement, Party B's working hours shall be governed by one of the three ways based on the characteristics of her work:

- (1) Where the standard working system is applied, the daily working hours of Party B shall not exceed 8, and the weekly working hours shall not exceed 40.

- (2) Where the comprehensive working hour system is applied, the average working hours shall not exceed the statutory standard working hours.
  - (3) Where the flexible working hour system is applied, Party B's working hours shall be flexible, provided that she shall complete the work task assigned by Party A.
- 3.2 Party B may enjoy the following statutory holidays: (1) New Year's Day; (2) Spring Festival; (3) International Labor Day; (4) National Day; (5) Qingming Festival; (6) Mid-autumn Festival; (7) other holidays specified by laws and regulations.
- 3.3 If required by work, Party A may arrange Party B to work overtime, including arranging Party B to work on public holidays and statutory holidays, and shall make overtime pay or arrange deferred holidays.
- 3.4 If Party B extends her working hours for failing to complete any work task, or without Party A's request or approval, she may not request Party A to pay for such additional working hours.

#### **4. Compensation**

- 4.1 The compensation payable to Party B is set forth in the offer or notice of adjustment of position/salary sent by Party A to Party B.
- 4.2 During the statutory working hours, if Party B completes the specified work task, Party A shall pay salary to Party B on the payment date specified by the company in cash, by wire transfer or in other ways Party B deems appropriate. The salary paid by Party A according to Article 4.1 hereof has included various subsidies and allowances specified by the State or the government, which includes but not limited to travel allowance, allowance for separate household heating for residential clean energy, and other subsidies or allowances.
- 4.3 Party A may adjust Party B's salary according to Party B's performance, the adjustment of Party B's position (or work content), or Party A's internal policies or rules and regulations regarding salary. The adjustment includes increase or decrease of the salary standards of Party B.
- 4.4 Where Party B's is sick or suffers non-work-related injury, the medical period and relevant salary for sick leave, sickness benefit, and medical treatment shall be governed by relevant provisions of the local government and Party A's rules and regulations. If the local government does not formulate any specific provisions relating to sick pay, and Party B does not approve the above rules and regulations of Party A, the standard of sick pay for Party B shall be 80% of the minimum salary standard provided for by the local government of Party B's place.
- 4.5 Party A may deduct part of the salary, other compensation or reimbursement of Party B, to offset any amount and/or other taxes payable according to laws or regulations (e.g., individual income tax) and expenses, and/or for other lawful purposes.

4.6 To keep confidential the salary and income of Party B and other employees, Party B agrees that Party A shall apply the confidential salary system in the company, and Party B agrees to comply with the system. If Party B discloses the amount of salary, or becomes aware of other's salary through any improper channel, she is willing to accept the penalties set forth in the system.

## **5. Social Insurances and Other Benefits**

5.1 The parties hereto shall maintain the insurances for endowment, unemployment, medical care, work-related injury and other social insurances. Party A shall withhold and pay to relevant taxation authority the part of insurance premium payable by Party B from her salary.

Party B shall promptly submit the valid certificates to Party A for going through the formalities of social insurances and housing provident fund. If any consequence arises due to Party B's delay in submission, Party B shall take corresponding liabilities.

5.2 If Party B suffers any work-related injury or occupational sickness, her work-related injury treatment shall be governed by relevant provisions of the State and the local government of Party B's place.

5.3 The treatment of Party B for pregnancy period, perinatal period and lactation period shall be governed by relevant policies of the local government for maternity insurance.

5.4 Party A may decide whether to pay bonus to its employees based on the operating performance. If it decides to pay bonus, the bonus will be only award to the employee who has completed the assignment and made additional contribution (subject to performance review). Therefore, if the employment agreement between the parties hereto is rescinded or terminated before the performance review, Party B shall not be entitled to the above bonus.

## **6. Labor Discipline; Rules and Regulations**

6.1 Party A will formulate rules and regulations and labor disciplines according to law, based on its needs of operation. Party B shall follow Party A's arrangement of work, strictly comply with the national laws and regulations and the rules and regulations, labor disciplines and work rules formulated by Party A according to law, take good care of Party A's properties, observe professional ethics, and actively participate the training organized by Party A to promote her professional skills.

6.2 Where Party B violates Party A's labor discipline or rules and regulations, Party A is entitled to handle the violation according to its rules and regulations, including but not limited to imposing corresponding disciplinary sanctions and economic punishment etc., up to termination of this Agreement.

6.3 Where Party A suffers any loss due to Party B's fault or violation, Party A is entitled to request for economic compensation from Party B, and to seek Party B's liabilities according to law.



6.4 Party A is entitled to reasonably amend its rules and regulations from time to time based on its needs of operation and management, and may notify Party B thereof in any ways it deems appropriate, including but not limited to notification, announcement, email, memorandum and employee handbook etc.

6.5 If Party B has any dissatisfaction or opinion of Party A, she may resolve such issue through complaint procedure, and may not express such dissatisfaction or opinion in any way that affects the company's operation or unity of colleagues.

## **7. Labor Protection, Working Conditions and Prevention of Occupational Hazards**

7.1 Party A shall provide the required labor conditions and tools to Party B, and shall strictly perform the provisions of the State relating to labor safety, labor protection and occupational health. Moreover, Party A shall actively assist with Party B's work, provide corresponding conditions for her performance of the obligations hereunder, and comply with this Agreement and Party A's internal rules and regulations.

7.2 Party A shall establish and complete the accountability system of prevention and treatment of occupational disease, strengthen the management of occupational disease, and promote the level of such prevention and treatment.

## **8. Rescission and Termination**

8.1 The parties hereto shall rescind, terminate or renew this Agreement according to the Employment Contract Law of the People's Republic of China and relevant regulations of the State and local government.

8.2 If Party A is required to pay economic compensation to Party B for rescinding or terminating this Agreement according to law, the payment standard shall be governed by relevant provisions of the Employment Contract Law of the People's Republic of China.

8.3 When this Agreement is rescinded or terminated, or expires, Party B shall immediately stop all activities in the name of Party A, complete the unsettled matters as requested by Party A, settle all accounts, and return Party A's properties on the date of such termination, rescission and expiration, including but not limited to:

- (1) All documents, files and copies thereof relating to Party A and its management, operation and product, which are kept, used or controlled by Party B;
- (2) The name list and information of Party A's suppliers, clients and other contact entities and individuals;
- (3) The software, disk, hardware and CDs containing Party A's information and data; and
- (4) The tools, instruments, equipment and other office supplies provided by Party A for Party B's work.

8.4 When this Agreement is rescinded or terminated, Party B shall hand over her work promptly and completely according to Party A's procedure. Where Party A is required to pay economic compensation to Party B according to law, it shall pay after Party B completes the handover.

8.5 Where this Agreement is rescinded or terminated, Party A shall issue certificate of rescission or termination, and transfer Party B's files and social insurances according to law.

## **9. Protection of Trade Secrets and Intellectual Properties**

9.1 "Trade Secrets" means the practical information and operating information which is owned or kept confidential by the company, not available to the public, and restricted by the company by taking measures, and can bring economic benefit to the company, including but not limited to any tangible or intangible information or materials known by the employees through or due to their employment with the company, such as the information of investment and financing, know-how, marketing strategy, name list of clients, partners and details of cooperation, the financial information and market information, the future business plans and the information of intellectual properties etc.

9.2 Party B shall comply with Party A's rules and regulations of confidentiality, and shall not directly or indirectly disclose any trade secrets of Party A to any third party. Party B shall not use, or permit any third party to use, the trade secrets of Party A. Party B shall assume the confidentiality obligations, regardless whether she is employed by Party A.

9.3 Where Party B violates the confidentiality obligations under this Agreement or any confidentiality agreement otherwise entered into, and causes loss to Party A, she shall compensate Party A according to relevant provisions of the Anti-Unfair-Competition Law of the People's Republic of China, and the agreement between the parties hereto.

9.4 Where Party B is not clear of the nature and degree of secrecy of any trade secret, she shall confirm actively with her supervisor.

9.5 Where both parties hereto sign a separate non-competition agreement, the agreement shall constitute an integral part hereof. Both parties shall conform to the provisions thereof.

9.6 Party B acknowledges that any works, researches, creations and inventions, and other intellectual properties relating to her position completed during her employment with Party A through/using the company's assets, materials, or site, whether developed at present or in the future, including but not limited to works (texts, pictures, animations or other forms), trademarks (expressed by characters, graphs, or their combinations), patents (whether having applied or being applying for registration), software, disclosed or undisclosed know-how, and other statutory rights, shall be owned by Party A. Party B undertakes that she will use her best efforts to cooperate with Party B, and help Party B obtain complete rights and maintain its lawful rights and interests.

## **10. Labor Dispute**

Where any dispute arises between the parties relating to this Agreement, both parties shall first negotiate to resolve such dispute. If negotiation fails, either party may apply for arbitration to the competent labor dispute arbitration commission at the place of Party A. If either party objects to the award of the commission, it may file a lawsuit to the people's court of first instance at the place of Party A.

**11. Additional Provisions**

The parties hereto agree to add the following provisions to this Agreement:

None.

**12. Miscellaneous Provisions**

12.1 This Agreement is written in Chinese in duplicate, and each party holds one copy.

12.2 This Agreement constitutes the entire agreement between the parties hereto relating to the subject matter hereof, and supersedes all prior unfulfilled employment agreement and related agreements and understandings between the parties. The unfulfilled employment agreement between the parties shall become void, and the rights and obligations relating to the employment between the parties shall be subject to this Agreement, from the effectiveness date hereof.

12.3 No delay or failure to exercise any right hereunder by either party shall constitute a waiver of such right.

Party A (seal): Beijing Sohu New Era Information Technology Co., Ltd

Party B (signature): /s/ Joanna Lv

Name: Joanna Lv

(Company Seal)

Signing date: April 1, 2012

Signing date: April 1, 2012

### Agreement of Changing One Party to the Employment Agreement

**Party A:** Beijing Sohu New Era Information Technology Co., Ltd

**Party B** (employee): Joanna Lv

**Party C:** Beijing Sohu New Media Information Technology Co., Ltd

Upon equal negotiation between Party A, Party B and Party C, the parties hereto have reached the following agreement with respect to performance by Party B and Party C of the employment agreement made between Party A and Party B.

1. From execution hereof, Party A who has employed Party B shall transfer all of its rights and obligations under the employment agreement to Party C. Party C will replace Party A as a party to, and continue to perform, the employment agreement between Party A and Party B. Meanwhile, Party A will stop acting as a party to the employment Agreement.
2. If Party A and Party B entered into other separate contract or agreement during the employment, such as confidentiality agreement, non-competition agreement or training agreement, Party C will replace Party A to continue to perform such contract or agreement according to the provisions of Article 1 hereof, as the party to the employment agreement changes.
3. Party C undertakes that from execution hereof it will assume all of Party A's rights and obligations under the employment agreement and other separate contract or agreement between Party A and Party B. Party C further undertakes that Party B's years of service at Party A may be combined with those at Party C, and will be consolidated into Party B's years of service at Sohu.
4. Party B undertakes that from execution hereof she will continue to exercise and perform, with Party C, her rights and obligations under the employment agreement and other separate contract or agreement between her and Party A.
5. This agreement is made in three counterparts, and each party hereto holds one.

Party A (seal): Beijing Sohu New Era Information Technology Co., Ltd

(Company Seal)

Party B (signature): /s/ Joanna Lv

Name: Joanna Lv

Party C (seal): Beijing Sohu New Media Information Technology Co., Ltd

(Company Seal)

Date: April 1, 2013

**EXECUTIVE EMPLOYMENT AGREEMENT**

EXECUTIVE EMPLOYMENT AGREEMENT (this "Agreement"), is entered into as of January 28, 2015 and effective as of January 1, 2015, by and between Changyou.com Limited, a Cayman Islands company (the "Company"), and Dewen Chen, an individual (the "Employee").

1. Definitions. Capitalized terms used herein and not otherwise defined in the text below will have the meanings ascribed thereto on Annex 1.

2. Employment; Duties.

(a) The Company agrees to employ the Employee in the capacity and with such responsibilities as are generally set forth on Annex 2.

(b) The Employee hereby agrees to devote his full time and best efforts in such capacities as are set forth on Annex 2 on the terms and conditions set forth herein. Notwithstanding the foregoing, the Employee may engage in other activities, such as activities involving professional, charitable, educational, religious and similar types of organizations, provided that the Employee complies with the Employee Non-competition, Non-solicitation, Confidential Information and Work Product Agreement effective as of January 1, 2015 and attached hereto as Annex 3 (the "Employee Obligations Agreement") and such other activities do not interfere with or prohibit the performance of the Employee's duties under this Agreement, or conflict in any material way with the business of the Company or of its subsidiaries and affiliates (including the Company's variable interest entities). The provisions of the Employee Obligations Agreement between the Company and the Employee as in effect prior to January 1, 2015 (the "Prior Employee Obligations Agreement") shall continue with full force and effect with respect to all matters arising with respect to periods through December 31, 2014. The Employee Obligations Agreement will be effective as of January 1, 2015 and will have full force and effect on and after such date.

(c) The Employee will use best efforts during the Term to ensure that the Company's business and those of its subsidiaries and variable interest entities are conducted in accordance with all applicable laws and regulations of all jurisdictions in which such businesses are conducted.

3. Compensation.

(a) Base Annual Income. During the Term, the Company will pay the Employee an annual base salary as set forth on Annex 2, payable monthly pursuant to the Company's normal payroll practices.

(b) Discretionary Bonus. During the Term, the Company, in its sole discretion, may award to the Employee an annual bonus based on the Employee's performance and other factors deemed relevant by the Company's Board of Directors.

(c) Share Incentive Awards. The Employee will be eligible to participate in any share incentive programs available to officers or employees of the Company.

(d) Reimbursement of Expenses. The Company will reimburse the Employee for reasonable expenses incurred by the Employee in the course of, and necessary in connection with, the performance by the Employee of his or her duties to the Company, provided that such expenses are substantiated in accordance with the Company's policies.

4. Other Employee Benefits.

(a) Vacation; Sick Leave. The Employee will be entitled to such number of weeks of paid vacation each year as are set forth on Annex 2, the taking of which must be coordinated with the Employee's supervisor in accordance with the Company's standard vacation policy. Unless otherwise approved by the Company's Board of Directors, vacation that is not used in a particular year may only be carried forward to subsequent years in accordance with the Company's policies in effect from time to time. The Employee will be eligible for sick leave in accordance with the Company's policies in effect from time to time.

(b) Healthcare Plan. The Company will arrange for membership in the Company's group healthcare plan for the Employee and the Employee's spouse, in accordance with the Company's standard policies from time to time with respect to health insurance and in accordance with the rules established for individual participation in such plan and under applicable law.

(c) Life and Disability Insurance. The Company will provide term life and disability insurance payable to the Employee, in each case in an amount up to a maximum of one times the Employee's base salary in effect from time to time, provided however, that such amount will be reduced by the amount of any life insurance or death or disability benefit coverage, as applicable, that is provided to the Employee under any other benefit plans or arrangements of the Company. Such policies will be in accordance with the Company's standard policies from time to time with respect to such insurance and the rules established for individual participation in such plans and under applicable law.

(d) Other Benefits. Pursuant to the Company's policies in effect from time to time and the applicable plan rules, the Employee will be eligible to participate in the other employee benefit plans of general application, which may include, without limitation, housing allowance or reimbursement and in which, in any event, shall include the benefits at the levels set forth on Annex 2.

5. Certain Representations, Warranties and Covenants of the Employee.

(a) Related Company Positions. The Employee agrees that the Employee and members of the Employee's immediate family will not have any financial interest directly or indirectly (including through any entity in which the Employee or any member of the Employee's immediate family has a position or financial interest) in any transactions with the Company or any subsidiaries or affiliates (including the Company's variable interest entities) thereof unless all such transactions, prior to being entered into, have been disclosed to the Board of Directors and approved by a majority of the independent members of the Board of Directors and comply with all other Company policies and applicable law as may be in effect from time to time. The Employee also agrees that he or she will inform the Board of Directors of the Company of any transactions involving the Company or any of its subsidiaries or affiliates (including the Company's variable interest entities) in which senior officers, including but not limited to the Employee, or their immediate family members have a financial interest.

(b) Discounts, Rebates or Commissions. Unless expressly permitted by written policies and procedures of the Company in effect from time to time that may be applicable to the Employee, neither the Employee nor any immediate family member will be entitled to receive or obtain directly or indirectly any discount, rebate or commission in respect of any sale or purchase of goods or services effected or other business transacted (whether or not by the Employee) by or on behalf of the Company or any of its subsidiaries or affiliates (including the Company's variable interest entities), and if the Employee or any immediate family member (or any firm or company in which the Employee or any immediate family member is interested) obtains any such discount, rebate or commission, the Employee will pay to the Company an amount equal to the amount so received (or the proportionate amount received by any such firm or company to the extent of the Employee's or family member's interest therein).

6. Term; Termination.

(a) Unless sooner terminated pursuant to the provisions of this Section 6, the term of this Agreement (the "Term") will commence on the date hereof and end on December 31, 2017.

(b) Voluntary Termination by the Employee. Notwithstanding anything herein to the contrary, the Employee may voluntarily Terminate this Agreement by providing the Company with ninety (90) days' advance written notice ("Voluntary Termination"), in which case, the Employee will not be entitled to receive payment of any severance benefits or other amounts by reason of the Termination other than accrued salary and vacation through the date of the Termination. The Employee's right to all other benefits will terminate as of the date of Termination, other than any continuation required by applicable law. Without limiting the foregoing, if, in connection with a Change in Control, the surviving entity or successor to Changyou's business offers the Employee employment on substantially equivalent terms to those set forth in this Agreement and such offer is not accepted by the Employee, the refusal by the Employee to accept such offer and the subsequent termination of the Employee's employment by the Company shall be deemed to be a voluntary termination of employment by the Employee and shall not be treated as a termination by the Company without Cause.

(c) Termination by the Company for Cause. Notwithstanding anything contained herein to the contrary, the Company may Terminate this Agreement for Cause by written notice to the Employee, effective immediately upon the delivery of such notice. In such case, the Employee will not be entitled to receive payment of any severance benefits or other amounts by reason of the Termination other than accrued salary and vacation through the date of the Termination. The Employee's right to all other benefits will terminate, other than any continuation required by applicable law.



(d) Termination by the Employee with Good Reason or Termination by the Company without Cause. Notwithstanding anything contained herein to the contrary, the Employee may Terminate this Agreement for Good Reason, and the Company may Terminate this Agreement without Cause, in either case upon thirty (30) days' advance written notice by the party Terminating this Agreement to the other party and the Termination shall be effective as of the expiration of such thirty (30) day period. If the Employee Terminates with Good Reason or the Company Terminates without Cause, the Employee will be entitled to continue to receive payment of severance benefits equal to the Employee's monthly base salary in effect on the date of Termination for the shorter of (i) six (6) months and (ii) the remainder of the Term of this Agreement (the "Severance Period"), provided that the Employee complies with the Employee Obligations Agreement during the Severance Period and executes a release agreement in the form requested by the Company at the time of such Termination that releases the Company from any and all claims arising from or related to the employment relationship and/or such Termination. Such payments will be made ratably over the Severance Period according to the Company's standard payroll schedule. The Employee will also receive payment of the bonus for the remainder of the year of the Termination, but only to the extent that the bonus would have been earned had the Employee continued in employment through the end of such year, as determined in good faith by the Company's CEO, Board of Directors or its Compensation Committee based on the specific corporate and individual performance targets established for such fiscal year, and only to the extent that bonuses are paid for such fiscal year to other similarly situated employees. Health insurance benefits with the same coverage (i.e., medical, dental, optical and/or mental health coverage) provided to the Employee prior to the Termination and in all other material respects comparable to those in place immediately prior to the Termination will be provided at the Company's expense during the Severance Period. The Company will also continue to carry the Employee on its Directors and Officers insurance policy for six (6) years following the Date of Termination at the Company's expense with respect to insurable events which occurred during the Employee's term as a director or officer of the Company, with such coverage being at least comparable to that in effect immediately prior to the Termination Date; provided, however, that (i) such terms, conditions and exceptions will not be, in the aggregate, materially less favorable to the Employee than those in effect on the Termination Date and (ii) if the aggregate annual premiums for such insurance at any time during such period exceed two hundred percent (200%) of the per annum rate of premium currently paid by the Company for such insurance, then the Company will provide the maximum coverage that will then be available at an annual premium equal to two hundred percent (200%) of such rate.

(e) Termination by Reason of Death or Disability. A Termination of the Employee's employment by reason of death or Disability shall not be deemed to be a Termination by the Company (for or without Cause) or by the Employee (for or without Good Reason). In the event that the Employee's employment with the Company Terminates as a result of the Employee's death or Disability, the Employee or the Employee's estate or representative, as applicable, will receive all accrued salary and accrued vacation as of the date of the Employee's death or Disability and any other benefits payable under the Company's then existing benefit plans and policies in accordance with such plans and policies in effect on the date of death or Disability and in accordance with applicable law. In addition, the Employee or the Employee's estate or representative, as applicable, will receive the bonus for the year in which the death or Disability occurs to the extent that a bonus would have been earned had the Employee continued in employment through the end of such year, as determined in good faith by the Company's CEO, Board of Directors or Compensation Committee of the Board of Directors based on the specific corporate and individual performance targets established for such fiscal year, and only to the extent that bonuses are paid for such fiscal year to other similarly situated employees.

(f) Misconduct After Termination of Employment. Notwithstanding the foregoing, if the Employee after the termination of his or her employment violates or fails to fully comply with the Employee Obligations Agreement, thereafter (i) the Employee shall not be entitled to any payments from the Company, (ii) any insurance or other benefits that have continued shall terminate immediately, (iii) the Employee shall promptly reimburse to the Company all amounts that have been paid to the Employee pursuant to this Section 6; and (iv) if the Employee would not, in the absence of such violation or failure to comply, have been entitled to severance payments from the Company equal to at least six (6) months' base salary, the Employee shall pay to the Company an amount equal to the difference between six (6) months' base salary and the amount of severance pay measured by base salary reimbursed to the Company by the Employee pursuant to clause (iii) of this sentence.

7. Employee Obligations Agreement. By signing this Agreement, the Employee hereby agrees to execute and deliver to the Company the Employee Obligations Agreement, and such execution and delivery shall be a condition to the Employee's entitlement to his or her rights under this Agreement.

8. Governing Law. This Agreement will be governed by and construed in accordance with the laws of the State of New York without regard to the conflicts of law principles thereof.

9. Dispute Resolution.

(a) At the option of the party initiating the claim, any dispute, controversy or claim arising out of or relating to this Agreement may be settled by arbitration to be held in the Hong Kong S.A.R. under the Hong Kong International Arbitration Centre Administered Arbitration Rules (the "Arbitration Rules") in force when a Notice of Arbitration with respect thereto is submitted in accordance with the Arbitration Rules. The award rendered in such an arbitration proceeding will be final and binding and judgment on the award rendered may be entered in any court having jurisdiction over the parties.

(b) The number of arbitrators will be three, one of whom will be appointed by the party asserting a claim against the other party or parties, one of whom will be appointed by the party or parties (acting together), as the case may be, against whom a claim has been asserted, and the third of whom will be selected by mutual agreement, if possible, within thirty days after the selection of the second arbitrator.

(c) The language of the arbitration will be Mandarin Chinese and any foreign language documents presented at such arbitration will be accompanied by a Mandarin Chinese translation thereof that shall be prepared at the expense of the party seeking to present such document.

(d) Any award of the arbitrators (i) will be in writing, (ii) will state the reasons upon which such award is based and (iii) may include an award of costs, including reasonable attorneys' fees and disbursements.

(e) The arbitrators will have no authority to award punitive damages or any other damages not measured by the prevailing party's actual damages, and may not, in any event, make any ruling, finding or award that does not conform to the terms and conditions of this Agreement.

(f) Notwithstanding the foregoing, any party may apply to any court having jurisdiction over the parties to obtain injunctive relief in order to maintain the status quo until such time as an arbitration award may be rendered or the dispute, controversy or claim may be otherwise resolved.

10. Notices. All notices, requests and other communications under this Agreement will be in writing (including email, facsimile or similar writing and express mail or courier delivery or in person delivery, but excluding ordinary mail delivery) and will be given to the address stated below:

(a) if to the Employee, by email or to the address or facsimile number that is on file with the Company from time to time, as may be updated by the Employee;

(b) if to the Company:

Changyou.com Limited  
Changyou Building, Raycom Creative Industrial Park,  
65 Bajiao East Road, Shijingshan District,  
Beijing, People's Republic of China, 100043  
Attention: Charles Zhang  
Chairman of the Board of Directors  
Fax: 86-10-6272-6588  
Email: charles@sohu-inc.com

with a copy to:

Goulston & Storrs, P.C.  
400 Atlantic Avenue  
Boston, MA 02110, U.S.A.  
Attention: Timothy B. Bancroft, Esq.  
Fax: (617) 574-7568  
Email: tbancroft@goulstonstorrs.com

or to such other email address, address or facsimile number as either party may hereafter specify for the purpose by written notice to the other party in the manner provided in this Section 10. All such notices, requests and other communications will be deemed received: (i) if given by email or facsimile transmission, when transmitted to the email address or facsimile number specified in this Section 10 if confirmation of receipt is received; (ii) if given by express mail or courier delivery, five (5) days after sent; and (iii) if given in person, when delivered.

11. Miscellaneous.

(a) Entire Agreement. This Agreement, together with the Employee Obligations Agreement, constitutes the entire understanding between the Company and the Employee relating to the subject matter hereof on and after January 1, 2015 and supersedes and cancels all prior and contemporaneous written and oral agreements and understandings with respect to the subject matter of this Agreement. No agreements or representations, oral or otherwise, express or implied, with respect to the subject matter hereof have been made by either party which are not set forth expressly in this Agreement.

(b) Modification; Waiver. No provision of this Agreement may be modified, waived or discharged unless modification, waiver or discharge is agreed to in writing signed by the Employee and such officer of the Company as may be specifically designated by its Board of Directors. No waiver by either party at any time of any breach by the other party of, or compliance with, any condition or provision of this Agreement to be performed by such other party will be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time.

(c) Successors; Binding Agreement. This Agreement will be binding upon and will inure to the benefit of the Employee, the Employee's heirs, executors, administrators and beneficiaries, and the Company and its successors (whether direct or indirect, by purchase, merger, consolidation or otherwise), subject to the terms and conditions set forth herein.

(d) Withholding Taxes. All amounts payable to the Employee under this Agreement will be subject to applicable withholding of income, wage and other taxes to the extent required by applicable law.

(e) Validity. The invalidity or unenforceability of any provision or provisions of this Agreement will not affect the validity or enforceability of any other provision of this Agreement, which will remain in full force and effect.

(f) Language. This Agreement is written in the English language only. The English language also will be the controlling language for all future communications between the parties hereto concerning this Agreement.

(g) Counterparts. This Agreement may be signed in any number of counterparts, each of which will be deemed an original, with the same effect as if the signatures thereto and hereto were upon the same instrument.

[remainder of this page intentionally left blank]

IN WITNESS WHEREOF, the parties hereto have executed this Executive Employment Agreement as of the date first above written.

Signature of Employee:

Changyou.com Limited

/s/ Dewen Chen

By: /s/ Charles Zhang

Printed name of employee:  
Dewen Chen

Name: Charles Zhang  
Title: Chairman of the Board of Directors

## Annex 1

### Certain Definitions

“Cause” means:

- (i) willful misconduct or gross negligence by the Employee, or any willful or grossly negligent omission to perform any act, resulting in injury to the Company or any subsidiaries or affiliates (including the Company’s variable interest entities) thereof;
- (ii) misconduct or negligence of the Employee that results in gain or personal enrichment of the Employee to the detriment of the Company or any subsidiaries or affiliates (including the Company’s variable interest entities) thereof;
- (iii) breach of any of the Employee’s agreements with the Company, including those set forth herein and in the Employee Obligations Agreement, and including, but not limited to, the repeated failure to perform substantially the Employee’s duties to the Company or any subsidiaries or affiliates (including the Company’s variable interest entities) thereof, excessive absenteeism or dishonesty;
- (iv) any attempt by the Employee to assign or delegate this Agreement or any of the rights, duties, responsibilities, privileges or obligations hereunder without the prior consent of the Company (except in respect of any delegation by the Employee of his employment duties hereunder to other employees of the Company in accordance with its usual business practice);
- (v) the Employee’s indictment or conviction for, or confession of, a felony or any crime involving moral turpitude under the laws of the United States or any State thereof, or under the laws of China, or Hong Kong;
- (vi) declaration by a court that the Employee is insane or incompetent to manage his business affairs;
- (vii) habitual drug or alcohol abuse which materially impairs the Employee’s ability to perform his duties; or
- (viii) filing of any petition or other proceeding seeking to find the Employee bankrupt or insolvent.

“Change in Control” means the occurrence of any of the following events:

- (i) any person (within the meaning of Section 13(d) or Section 14(d)(2) of the Securities Exchange Act of 1934) other than the Company, any trustee or other fiduciary holding securities under an employee benefit plan of the Company or any corporation owned, directly or indirectly, by the stockholders of the Company in substantially the same proportion as their ownership of stock of the Company, becomes the direct or beneficial owner of securities representing fifty percent (50%) or more of the combined voting power of the Company’s then-outstanding securities;

- (ii) during any period of two (2) consecutive years after the date of this Agreement, individuals who at the beginning of such period constitute the Board of Directors of the Company, and all new directors (other than directors designated by a person who has entered into an agreement with the Company to effect a transaction described in (i), (iii), or (iv) of this definition) whose election or nomination to the Board was approved by a vote of at least two-thirds of the directors then in office, cease for any reason to constitute at least a majority of the members of the Board;
- (iii) the effective date of a merger or consolidation of the Company with any other entity, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior to such merger or consolidation continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) more than 50% of the combined voting power of the voting securities of the surviving entity outstanding immediately after such merger or consolidation and with the power to elect at least a majority of the board of directors or other governing body of such surviving entity;
- (iv) the complete liquidation of the Company or the sale or disposition by the Company of all or substantially all of the Company's assets; or
- (v) there occurs any other event of a nature that would be required to be reported in response to Item 6(e) of Schedule 14A of Regulation 14A (or a response to any similar item on any similar schedule or form) promulgated under the Exchange Act (as defined below), whether or not the Company is then subject to such reporting requirement.

"Company" means Changyou.com Limited and, unless the context suggests to the contrary, all of its subsidiaries and related companies.

"Disability" means the Employee becomes physically or mentally impaired to an extent which renders him or her unable to perform the essential functions of his or her job, with or without reasonable accommodation, for a period of six consecutive months, or an aggregate of nine months in any two year period.

"Good Reason" means the occurrence of any of the following events without the Employee's express written consent, provided that the Employee has given notice to the Company of such event and the Company has not remedied the problem within fifteen (15) days:

- (i) any significant change in the duties and responsibilities of the Employee inconsistent in any material and adverse respect with the Employee's title and position (including status, officer positions and reporting requirements), authority, duties or responsibilities as contemplated by Annex 2 to this Agreement. For the purposes of this Agreement, because of the evolving nature of the Employer's business, the Company's changing of Employee's reporting relationships and department(s) will not be considered a significant change in duties and responsibilities;

- (ii) any material breach by the Company of this Agreement, including without limitation any reduction of the Employee's base salary or the Company's failure to pay to the Employee any portion of the Employee's compensation; or
- (iii) the failure, in the event of a Change in Control in which the Company is not the surviving entity, of the surviving entity or the successor to the Company's business to assume this Agreement pursuant to its terms or to offer the Employee employment on substantially equivalent terms to those set forth in this Agreement.

"Termination" (and any similar, capitalized use of the term, such as "Terminate") means, according to the context, the termination of this Agreement or the Employee's ceasing to render employment services.



**Annex 2**

**Particular Terms of Employee's Employment**

Title(s): Co-Chief Executive Officer

Reporting Requirement: The Employee will report to the Company's Board of Directors and to the Company's Chief Executive Officer.

Responsibilities: Such duties and responsibilities as are ordinarily associated with the Employee's title(s) in a United States publicly-traded corporation and such other duties as may be specified by the Board of Directors from time to time.

Job Location: The Employee's duties shall be rendered at the Company's headquarters located in Beijing, China, or at such other place or places and at such times as the needs of the Company may from time-to-time dictate.

Base Salary: ¥ 2,700,000 per year or as adjusted by the Board of Directors from time to time.

# of Weeks of Paid Vacation per Year: 3 (three)

**FORM OF EMPLOYEE NON-COMPETITION, NON-SOLICITATION, CONFIDENTIAL INFORMATION AND WORK PRODUCT AGREEMENT**

## EMPLOYEE NON-COMPETITION, NON-SOLICITATION, CONFIDENTIAL INFORMATION AND WORK PRODUCT AGREEMENT

In consideration of my employment and the compensation paid to me by Changyou.com Limited, a Cayman Island company, or a subsidiary or variable interest entity thereof (Changyou.com Limited or any such subsidiary or variable interest entity referred to herein individually and collectively as "Changyou"), and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, I agree as follows:

1. Non-Competition. During the term of my employment agreement with Changyou.com Limited and continuing after the termination of such employment agreement for the longer of (i) one year after the termination of such employment agreement for any reason and (ii) such period of time as Changyou is paying to me any severance benefits (the "Noncompete Period"), I will not, on my own behalf, or as owner, manager, stockholder (other than as stockholder of less than 2% of the outstanding stock of a company that is publicly traded or listed on a stock exchange), consultant, director, officer or employee of or in any other manner connected with any business entity, participate or be involved in any Competitor without the prior written authorization of Changyou. "Competitor" means any business of the type and character of business in which Changyou engages or proposes to engage and may include, without limitation, an individual, company, enterprise, partnership enterprise, government office, committee, social organization or other organization that, in any event, produces, distributes or provides the same or substantially similar kind of product or service as Changyou. On the date of this Employee Non-competition, Non-solicitation, Confidential Information and Work Product Agreement (this "Agreement"), "Competitors" of Changyou include without limitation: Shanda Interactive Entertainment Limited, Netease.com Inc., Tencent Holdings Ltd., Perfect World Co. Ltd, Giant Interactive Group, Inc., The9 Limited, Netdragon Websoft, Inc., Taomee Holdings Limited, Shenzhen ZQ Game Technology Corporation, Guangzhou Huaduo Network Technology Co., Ltd (duowan.com), Kongzhong Corp, KingSoft Corporation Limited, Kalends Inc., Idereamsky Technology Limitd and other private companies in China devoted to game development oroperation and international competitors. Such list of examples of "Competitors" of Changyou may be updated by Changyou from time to time so that includes all competitors listed in Changyou's annual reports on Form 20-F filed from time to time with the U.S. Securities and Exchange Commission (the "SEC").

2. Nonsolicitation. During the Noncompete Period, I will not, either for my own account or for the account of any other person: (i) solicit, induce, attempt to hire, or hire any employee or contractor of Changyou or any other person who may have been employed or engaged by Changyou during the term of my employment with Changyou unless that person has not worked with Changyou within the six months following my last day of employment with Changyou; (ii) solicit business or relationship in competition with Changyou from any of Changyou's customers, suppliers or partners or any other entity with which Changyou does business; (iii) assist in such hiring or solicitation by any other person or business entity or encourage any such employee to terminate his or her employment with Changyou; or (iv) encourage any such customer, supplier or partner or any other entity to terminate its relationship with Changyou.

### 3. Confidential Information.

(a) While employed by Changyou and indefinitely thereafter, I will not, directly or indirectly, use any Confidential Information (as hereinafter defined) other than pursuant to my employment by and for the benefit of Changyou, or disclose any such Confidential Information to anyone outside of Changyou or to anyone within Changyou who has not been authorized to receive such information, except as directed in writing by an authorized representative of Changyou.

(b) "Confidential Information" means all trade secrets, proprietary information, and other data and information, in any form, belonging to Changyou or any of their respective clients, customers, consultants, licensees or affiliates that is held in confidence by Changyou. Confidential Information includes, but is not limited to computer software, the structure of Changyou's online game development platform, business plans and arrangements, customer lists, marketing materials, financial information, research, and any other information identified or treated as confidential by Changyou or any of their respective clients, customer, consultants, licensees or affiliates. Notwithstanding the foregoing, Confidential Information does not include information which Changyou has voluntarily disclosed to the public without restriction, or which is otherwise known to the public at large.

### 4. Rights in Work Product.

(a) I agree that all Work Product (as hereinafter defined) will be the sole property of Changyou. I agree that all Work Product that constitutes original works of authorship protectable by copyright are "works made for hire," as that term is defined in the United States Copyright Act and, therefore, the property of Changyou. I agree to waive, and hereby waive and irrevocably and exclusively assign to Changyou, all right, title and interest I may have in or to any other Work Product and, to the extent that such rights may not be waived or assigned, I agree not to assert such rights against Changyou or its licensees (and sublicensees), successors or assigns.

(b) I agree to promptly disclose all Work Product to the appropriate individuals in Changyou as such Work Product is created in accordance with the requirements of my job and as directed by Changyou.

(c) "Work Product" means any and all inventions, improvements, developments, concepts, ideas, expressions, processes, prototypes, plans, drawings, designs, models, formulations, specifications, methods, techniques, shop-practices, discoveries, innovations, creations, technologies, formulas, algorithms, data, computer databases, reports, laboratory notebooks, papers, writings, photographs, source and object codes, software programs, other works of authorship, and know-how and show-how, or parts thereof conceived, developed, or otherwise made by me alone or jointly with others (i) during the period of my employment with Changyou or (ii) during the six month period next succeeding the termination of my employment with Changyou if the same in any way relates to the present or proposed products, programs or services of Changyou or to tasks assigned to me during the course of my employment, whether or not patentable or subject to copyright or trademark protection, whether or not reduced to tangible form or reduced to practice, whether or not made during my regular working hours, and whether or not made on Changyou premises.

5. Employee's Prior Obligations. I hereby certify I have no continuing obligation to any previous employer or other person or entity which requires me not to disclose any information to Changyou.

6. Employee's Obligation to Cooperate. At any time during my employment with Changyou and thereafter upon the request of Changyou, I will execute all documents and perform all lawful acts that Changyou considers necessary or advisable to secure its rights hereunder and to carry out the intent of this Agreement. Without limiting the generality of the foregoing, I agree to render to Changyou or its nominee all reasonable assistance as may be required:

- (a) In the prosecution or applications for letters patent, foreign and domestic, or re-issues, extensions and continuations thereof;
- (b) In the prosecution or defense of interferences which may be declared involving any of said applications or patents;
- (c) In any administrative proceeding or litigation in which Changyou may be involved relating to any Work Product; and
- (d) In the execution of documents and the taking of all other lawful acts which Changyou considers necessary or advisable in creating and protecting its copyright, patent, trademark, trade secret and other proprietary rights in any Work Product.

The reasonable out-of-pocket expenses incurred by me in rendering such assistance at the request of Changyou will be reimbursed by Changyou. If I am no longer an employee of Changyou at the time I render such assistance, Changyou will pay me a reasonable fee for my time.

7. Termination; Return of Changyou Property. Upon the termination of my employment with Changyou for any reason, or at any time upon Changyou's request, I will return to Changyou all Work Product and Confidential Information and notes, memoranda, records, customer lists, proposals, business plans and other documents, computer software, materials, tools, equipment and other property in my possession or under my control, relating to any work done for Changyou, or otherwise belonging to Changyou, it being acknowledged that all such items are the sole property of Changyou. Further, before obtaining my final paycheck, I agree to sign a certificate stating the following:

"Termination Certificate

This is to certify that I do not have in my possession or custody, nor have I failed to return, any Work Product (as defined in the Employee Non-competition, Non-solicitation, Confidential Information and Work Product Agreement between Changyou.com Limited ("Changyou") and me) or any notes, memoranda, records, customer lists, proposals, business plans or other documents or any computer software, materials, tools, equipment or other property (or copies of any of the foregoing) belonging to Changyou."

8. General Provisions.

(a) This Agreement contains the entire agreement between me and Changyou with respect to the subject matter hereof and supersedes all prior and contemporaneous agreements and understandings related to the subject matter hereof, whether written or oral; *provided however*, that this Agreement shall not supersede (i) the Trade Secret and Confidentiality Agreement and (ii) the Non-Compete Agreement, each between Beijing AmazGame Age Internet Technology Co., Ltd., a company incorporated in the People's Republic of China (the "Beijing AmazGame"), and me (collectively, the "Beijing AmazGame Agreements"), and (iii) the Employee Obligations Agreement between Changyou and me as in effect prior to the date hereof (the "Prior Employee Obligations Agreement"), which shall continue with full force and effect with respect to, or arising in connection with, all of the subject matters thereof through the date immediately prior to the date hereof, provided, however that in the event of a conflict between any provision of this Agreement and any provision of either of the Beijing AmazGame Agreements or any provision of the Prior Employee Obligations Agreement, the provision of this Agreement shall prevail. This Agreement may not be modified except by a written agreement signed by Changyou and me.

(b) This Agreement will be governed by and construed in accordance with the laws of the State of New York without regard to the conflicts of law principles thereof. At the option of the party initiating the claim, any dispute, controversy or claim arising out of or relating to this Agreement may be settled by arbitration to be held in the Hong Kong S.A.R. under the Hong Kong International Arbitration Centre Administered Arbitration Rules (the "Arbitration Rules") in force when a Notice of Arbitration with respect thereto is submitted in accordance with the Arbitration Rule. The award rendered in such an arbitration proceeding will be final and binding and judgment on the award rendered may be entered in any court having jurisdiction over the parties. The number of arbitrators will be three, one of whom will be appointed by the party asserting a claim against the other party or parties, one of whom will be appointed by the party or parties (acting together), as the case may be, against whom a claim has been asserted, and the third of whom will be selected by mutual agreement, if possible, within thirty days after the selection of the second arbitrator. The language of the arbitration will be Mandarin Chinese and any foreign language documents presented at such arbitration will be accompanied by a Mandarin Chinese translation thereof that shall be prepared at the expense of the party seeking to present such document. Any award of the arbitrators (i) will be in writing, (ii) will state the reasons upon which such award is based and (iii) may include an award of costs, including reasonable attorneys' fees and disbursements. The arbitrators will have no authority to award punitive damages or any other damages not measured by the prevailing party's actual damages, and may not, in any event, make any ruling, finding or award that does not conform to the terms and conditions of this Agreement. Notwithstanding the foregoing, any party may apply to any court having jurisdiction over the parties to obtain injunctive relief in order to maintain the status quo until such time as an arbitration award may be rendered or the dispute, controversy or claim may be otherwise resolved.

(c) In the event that any provision of this Agreement is determined by any court of competent jurisdiction to be unenforceable by reason of its extending for too great a period of time, over too large a geographic area, or over too great a range of activities, it will be interpreted to extend only over the maximum period of time, geographic area or range of activities as to which it may be enforceable.

(d) If, after application of paragraph (c) above, any provision of this Agreement will be determined to be invalid, illegal or otherwise unenforceable by any court of competent jurisdiction, the validity, legality and enforceability of the other provisions of this Agreement will not be affected thereby. Any invalid, illegal or unenforceable provision of this Agreement will be severed, and after any such severance, all other provisions hereof will remain in full force and effect.

(e) Changyou and I agree that either of us may waive or fail to enforce violations of any part of this Agreement without waiving the right in the future to insist on strict compliance with all or parts of this Agreement.

(f) My obligations under this Agreement will survive the termination of my employment with Changyou regardless of the manner of or reasons for such termination, and regardless of whether such termination constitutes a breach of any other agreement I may have with Changyou. My obligations under this Agreement will be binding upon my heirs, executors and administrators, and the provisions of this Agreement will inure to the benefit of the successors and assigns of Changyou.

(g) I agree and acknowledge that the rights and obligations set forth in this Agreement are of a unique and special nature and necessary to ensure the preservation, protection and continuity of Changyou's business, employees, Confidential Information, and intellectual property rights. Accordingly, Changyou is without an adequate legal remedy in the event of my violation of any of the covenants set forth in this Agreement. I agree, therefore, that, in addition to all other rights and remedies, at law or in equity or otherwise, that may be available to Changyou, each of the covenants made by me under this Agreement shall be enforceable by injunction, specific performance or other equitable relief, without any requirement that Changyou post a bond or that Changyou prove any damages.

[remainder of this page intentionally left blank]

IN WITNESS WHEREOF, the undersigned employee and Changyou have executed this Employee Non-competition, Non-solicitation, Confidential Information and Work Product Agreement effective as of January 1, 2015.

Signature of Employee:

Changyou.com Limited

/s/ Dewen Chen

By: /s/ Charles Zhang

Printed name of employee:

Name: Charles Zhang

Dewen Chen

Title: Chairman of the Board of Directors



## EMPLOYMENT AGREEMENT

This Employment Agreement (hereinafter referred to as the "Agreement") is made by and between the following parties:

**Party A: Beijing Sogou Technology Development Co., Ltd**, a PRC corporation, and

**Party B: Xiaochuan Wang**, an individual.

NOW THEREFORE, the above parties have entered into this Agreement upon equal negotiation for their joint observance according to the Labor Law of the People's Republic of China, the Employment Contract Law of the People's Republic of China and other applicable laws and regulations.

## 1. Type and Term

- 1.1 This Agreement is an open-ended employment agreement.
- 1.2 The term of this Agreement starts from November 30, 2012, and ends when Party B reaches the age of retirement, or when other mandatory circumstances for termination occur.

## 2. Work Content and Place

- 2.1 When signing this Agreement, the title or position of Party B is CEO, and the work place is in Beijing. During the term hereof, Party A may adjust the above position or place based on its needs of operation or work, or Party B's competence and performance. The above adjustment includes any change of Party B's work content or place, promotion, lateral move, and demotion, and also includes any change of work content, responsibility or scope, while the title or position remains the same.
- 2.2 Party B shall complete the work assignment meeting the specified quantity, quality and indicator according to Party A's requirements for corresponding position, work, assignment and responsibility. During work, Party B may not act beyond the powers authorized by Party A.
  - (1) Party B shall comply with the Constitution and other laws and regulations of China, and shall be devoted to his or her duty, work diligently, and perform the duties of his or her position;
  - (2) During work, Party B shall ensure that his or her work meets the standards of duties of his or her position specified by Party A. Meanwhile, if required by work, Party B shall further complete any ad hoc assignment other than the duties of his or her position arranged by Party A.
  - (3) Party B shall maintain Party A's trade secrets confidential, and may not use such trade secrets to seek improper economic benefit for herself or for other economic organizations or individuals.

### **3. Working Hours; Rest and Vacation**

- 3.1 Upon execution of this Agreement, Party B's working hours shall be governed by one of the three ways based on the characteristics of his or her work:
- (1) Where the standard working system is applied, the daily working hours of Party B shall not exceed 8, and the weekly working hours shall not exceed 40.
  - (2) Where the comprehensive working hour system is applied, the average working hours shall not exceed the statutory standard working hours.
  - (3) Where the flexible working hour system is applied, Party B's working hours shall be flexible, provided that he or she shall complete the work task assigned by Party A.
- 3.2 Party B may enjoy the following statutory holidays: (1) New Year's Day; (2) Spring Festival; (3) International Labor Day; (4) National Day; (5) Qingming Festival; (6) Mid-autumn Festival; (7) other holidays specified by laws and regulations.
- 3.3 If required by work, Party A may arrange Party B to work overtime, including arranging Party B to work on public holidays and statutory holidays, and shall make overtime pay or arrange deferred holidays.
- 3.4 If Party B extends his or her working hours for failing to complete any work task, or without Party A's request or approval, he or she may not request Party A to pay for such additional working hours.

### **4. Compensation**

- 4.1 The compensation payable to Party B is set forth in the offer or notice of adjustment of position/salary sent by Party A to Party B.
- 4.2 During the statutory working hours, if Party B completes the specified work task, Party A shall pay salary to Party B on the payment date specified by the company in cash, by wire transfer or in other ways Party B deems appropriate. The salary paid by Party A according to Article 4.1 hereof has included various subsidies and allowances specified by the State or the government, which includes but not limited to travel allowance, allowance for separate household heating for residential clean energy, and other subsidies or allowances.
- 4.3 Party A may adjust Party B's salary according to Party B's performance, the adjustment of Party B's position (or work content), or Party A's internal policies or rules and regulations regarding salary. The adjustment includes increase or decrease of the salary standards of Party B.
- 4.4 Where Party B's is sick or suffers non-work-related injury, the medical period and relevant salary for sick leave, sickness benefit, and medical treatment shall be governed by relevant provisions of the local government and Party A's rules and regulations. If the local government does not formulate any specific provisions relating to sick pay, and Party B does not approve the above rules and regulations of Party A, the standard of sick pay for Party B shall be 80% of the minimum salary standard provided for by the local government of Party B's place.
- 4.5 Party A may deduct part of the salary, other compensation or reimbursement of Party B, to offset any amount and/or other taxes payable according to laws or regulations (e.g., individual income tax) and expenses, and/or for other lawful purposes.

4.6 To keep confidential the salary and income of Party B and other employees, Party B agrees that Party A shall apply the confidential salary system in the company, and Party B agrees to comply with the system. If Party B discloses the amount of salary, or becomes aware of other's salary through any improper channel, he or she is willing to accept the penalties set forth in the system.

## **5. Social Insurances and Other Benefits**

5.1 The parties hereto shall maintain the insurances for endowment, unemployment, medical care, work-related injury and other social insurances. Party A shall withhold and pay to relevant taxation authority the part of insurance premium payable by Party B from his or her salary.

Party B shall promptly submit the valid certificates to Party A for going through the formalities of social insurances and housing provident fund. If any consequence arises due to Party B's delay in submission, Party B shall take corresponding liabilities.

5.2 If Party B suffers any work-related injury or occupational sickness, his or her work-related injury treatment shall be governed by relevant provisions of the State and the local government of Party B's place.

5.3 The treatment of Party B for pregnancy period, perinatal period and lactation period shall be governed by relevant policies of the local government for maternity insurance.

5.4 Party A may decide whether to pay bonus to its employees based on the operating performance. If it decides to pay bonus, the bonus will be only award to the employee who has completed the assignment and made additional contribution (subject to performance review). Therefore, if the employment agreement between the parties hereto is rescinded or terminated before the performance review, Party B shall not be entitled to the above bonus.

## **6. Labor Discipline; Rules and Regulations**

6.1 Party A will formulate rules and regulations and labor disciplines according to law, based on its needs of operation. Party B shall follow Party A's arrangement of work, strictly comply with the national laws and regulations and the rules and regulations, labor disciplines and work rules formulated by Party A according to law, take good care of Party A's properties, observe professional ethics, and actively participate the training organized by Party A to promote his or her professional skills.

6.2 Where Party B violates Party A's labor discipline or rules and regulations, Party A is entitled to handle the violation according to its rules and regulations, including but not limited to imposing corresponding disciplinary sanctions and economic punishment etc., up to termination of this Agreement.

6.3 Where Party A suffers any loss due to Party B's fault or violation, Party A is entitled to request for economic compensation from Party B, and to seek Party B's liabilities according to law.

6.4 Party A is entitled to reasonably amend its rules and regulations from time to time based on its needs of operation and management, and may notify Party B thereof in any ways it deems appropriate, including but not limited to notification, announcement, email, memorandum and employee handbook etc.

6.5 If Party B has any dissatisfaction or opinion of Party A, he or she may resolve such issue through complaint procedure, and may not express such dissatisfaction or opinion in any way that affects the company's operation or unity of colleagues.

## **7. Labor Protection, Working Conditions and Prevention of Occupational Hazards**

7.1 Party A shall provide the required labor conditions and tools to Party B, and shall strictly perform the provisions of the State relating to labor safety, labor protection and occupational health. Moreover, Party A shall actively assist with Party B's work, provide corresponding conditions for his or her performance of the obligations hereunder, and comply with this Agreement and Party A's internal rules and regulations.

7.2 Party A shall establish and complete the accountability system of prevention and treatment of occupational disease, strengthen the management of occupational disease, and promote the level of such prevention and treatment.

## **8. Rescission and Termination**

8.1 The parties hereto shall rescind, terminate or renew this Agreement according to the Employment Contract Law of the People's Republic of China and relevant regulations of the State and local government.

8.2 If Party A is required to pay economic compensation to Party B for rescinding or terminating this Agreement according to law, the payment standard shall be governed by relevant provisions of the Employment Contract Law of the People's Republic of China.

8.3 When this Agreement is rescinded or terminated, or expires, Party B shall immediately stop all activities in the name of Party A, complete the unsettled matters as requested by Party A, settle all accounts, and return Party A's properties on the date of such termination, rescission and expiration, including but not limited to:

- (1) All documents, files and copies thereof relating to Party A and its management, operation and product, which are kept, used or controlled by Party B;
- (2) The name list and information of Party A's suppliers, clients and other contact entities and individuals;
- (3) The software, disk, hardware and CDs containing Party A's information and data; and
- (4) The tools, instruments, equipment and other office supplies provided by Party A for Party B's work.

8.4 When this Agreement is rescinded or terminated, Party B shall hand over his or her work promptly and completely according to Party A's procedure. Where Party A is required to pay economic compensation to Party B according to law, it shall pay after Party B completes the handover.

8.5 Where this Agreement is rescinded or terminated, Party A shall issue certificate of rescission or termination, and transfer Party B's files and social insurances according to law.

## **9. Protection of Trade Secrets and Intellectual Properties**

- 9.1 "Trade Secrets" means the practical information and operating information which is owned or kept confidential by the company, not available to the public, and restricted by the company by taking measures, and can bring economic benefit to the company, including but not limited to any tangible or intangible information or materials known by the employees through or due to their employment with the company, such as the information of investment and financing, know-how, marketing strategy, name list of clients, partners and details of cooperation, the financial information and market information, the future business plans and the information of intellectual properties etc.
- 9.2 Party B shall comply with Party A's rules and regulations of confidentiality, and shall not directly or indirectly disclose any trade secrets of Party A to any third party. Party B shall not use, or permit any third party to use, the trade secrets of Party A. Party B shall assume the confidentiality obligations, regardless whether he or she is employed by Party A.
- 9.3 Where Party B violates the confidentiality obligations under this Agreement or any confidentiality agreement otherwise entered into, and causes loss to Party A, he or she shall compensate Party A according to relevant provisions of the Anti-Unfair-Competition Law of the People's Republic of China, and the agreement between the parties hereto.
- 9.4 Where Party B is not clear of the nature and degree of secrecy of any trade secret, he or she shall confirm actively with his or her supervisor.
- 9.5 Where both parties hereto sign a separate non-competition agreement, the agreement shall constitute an integral part hereof. Both parties shall conform to the provisions thereof.
- 9.6 Party B acknowledges that any works, researches, creations and inventions, and other intellectual properties relating to his or her position completed during his or her employment with Party A through/using the company's assets, materials, or site, whether developed at present or in the future, including but not limited to works (texts, pictures, animations or other forms), trademarks (expressed by characters, graphs, or their combinations), patents (whether having applied or being applying for registration), software, disclosed or undisclosed know-how, and other statutory rights, shall be owned by Party A. Party B undertakes that he or she will use his or her best efforts to cooperate with Party B, and help Party B obtain complete rights and maintain its lawful rights and interests.

## **10. Labor Dispute**

Where any dispute arises between the parties relating to this Agreement, both parties shall first negotiate to resolve such dispute. If negotiation fails, either party may apply for arbitration to the competent labor dispute arbitration commission at the place of Party A. If either party objects to the award of the commission, it may file a lawsuit to the people's court of first instance at the place of Party A.

## 11. Additional Provisions

The parties hereto agree to add the following provisions to this Agreement:

None.

## 12. Miscellaneous Provisions

- 12.1 This Agreement is written in Chinese in duplicate, and each party holds one copy.
- 12.2 This Agreement constitutes the entire agreement between the parties hereto relating to the subject matter hereof, and supersedes all prior unfulfilled employment agreement and related agreements and understandings between the parties. The unfulfilled employment agreement between the parties shall become void, and the rights and obligations relating to the employment between the parties shall be subject to this Agreement, from the effectiveness date hereof.
- 12.3 No delay or failure to exercise any right hereunder by either party shall constitute a waiver of such right.

Party A (seal): Beijing Sogou Technology  
Development Co., Ltd

(Company Seal)

Signing date: November 30, 2012

Party B (signature): /s/ Xiaochuan Wang

Name: Xiaochuan Wang

Signing date: November 30, 2012

## Principal Subsidiaries of the Registrant

<u>Direct and Indirect Subsidiaries</u>	<u>Jurisdiction of Organization</u>	<u>Ownership</u>
Sohu.com Limited	Cayman Islands	100%
Sohu.com (Hong Kong) Ltd.	Hong Kong	100%
Beijing Sohu New Era Information Technology Co., Ltd.	People's Republic of China	100%
Beijing Sohu New Momentum Information Technology Co., Ltd.	People's Republic of China	100%
Beijing Sohu New Media Information Technology Co., Ltd.	People's Republic of China	100%
Go2Map Inc.	Cayman Islands	100%
Fox Video Investment Holding Limited	Cayman Islands	100%
Fox Video Limited	Cayman Islands	100%
Fox Video (HK) Limited	Hong Kong	100%
Fox Information Technology (Tianjin) Limited	People's Republic of China	100%
Sohu.com (Search) Limited	Cayman Islands	100%
Sogou Inc.	Cayman Islands	39%
Sogou (BVI) Limited	British Virgin Islands	39%
Sogou Hong Kong Limited	Hong Kong	39%
Beijing Sogou Technology Development Co., Ltd.	People's Republic of China	39%
Sogou Technology Hong Kong Limited	Hong Kong	39%
Vast Creation Advertising Media Services Limited	Hong Kong	39%
Beijing Sogou Network Technology Co., Ltd	People's Republic of China	39%
Focus Investment Holding Limited	Cayman Islands	100%
Sohu Focus Limited	Cayman Islands	100%
Sohu Focus (HK) Limited	Hong Kong	100%
All Honest International Limited	British Virgin Islands	100%
Sohu.com (Game) Limited	Cayman Islands	100%
Changyou.com Limited	Cayman Islands	69%
Changyou.com (HK) Limited	Hong Kong	69%
Changyou.com Webgames (HK) Limited	Hong Kong	69%
7Road.com Limited	Cayman Islands	69%
7Road.com HK limited	Hong Kong	69%
Shenzhen Brilliant Imagination Technologies Co., Ltd.	People's Republic of China	69%
Beijing Yang Fan Jing He Information Consulting Co., Ltd.	People's Republic of China	69%
Shanghai Jingmao Culture Communication Co., Ltd.	People's Republic of China	69%
Beijing Changyou Jingmao Film & Culture Communication Co., Ltd.	People's Republic of China	69%
Beijing AmazGame Age Internet Technology Co., Ltd.	People's Republic of China	69%
Beijing Changyou Gamespace Software Technology Co., Ltd.	People's Republic of China	69%
Glory Loop Limited.	British Virgin Islands	69%
MoboTap Inc.	Cayman	35%
MoboTap Inc. Limited	Hong Kong	35%
Baina Zhiyuan(Beijing) Technology Co., Ltd.	People's Republic of China	35%

**Consent of Independent Registered Public Accounting Firm**

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (No. 333-61814, No. 333-117412, No. 333-125960, No. 333-174955) of Sohu.com Inc. of our report dated February 27, 2017 relating to the consolidated financial statements, financial statement schedule and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

PricewaterhouseCoopers Zhong Tian LLP  
Beijing, the People's Republic of China  
February 27, 2017



**Consent of Haiwen & Partners, PRC Counsel**

February 27, 2017

Sohu.com Inc.  
18/F, SOHU.com Media Plaza  
Block 3, No. 2 Kexueyuan South Road  
Haidian District  
Beijing 100190  
People's Republic of China

Subject: Consent of Haiwen & Partners

We hereby consent to the filing of this consent letter as an exhibit to the annual report on Form 10-K of Sohu.com Inc. (the "Company") for the Company's fiscal year ended December 31, 2016 being filed with the U.S. Securities and Exchange Commission (the "SEC") on or about February 27, 2017 (the "Form 10-K").

We also hereby consent to the use of our firm name and summaries of our firm's opinions under the headings "Business— Government Regulation and Legal uncertainties" in the Form 10-K.

Yours faithfully,

Haiwen & Partners

I, Charles Zhang, certify that:

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

Date: February 27, 2017

/s/ Charles Zhang

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

I, Joanna Lv, certify that:

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

Date: February 27, 2017

/s/ Joanna Lv

Joanna Lv, Acting Chief Financial Officer

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

In connection with the Annual Report of Sohu.com Inc. (the "Company") on Form 10-K for the fiscal year ended December 31, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Charles Zhang, Chief Executive Officer and Chairman of the Board of Directors of the Company, certify, pursuant to U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition of the Company as of December 31, 2016 and results of operations of the Company for the fiscal year ended December 31, 2016.

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

February 27, 2017

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

In connection with the Annual Report of Sohu.com Inc. (the "Company") on Form 10-K for the fiscal year ended December 31, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Joanna Lv, Acting Chief Financial Officer of the Company, certify, pursuant to U.S.C. ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition of the Company as of December 31, 2016 and results of operations of the Company for the fiscal year ended December 31, 2016.

/s/ Joanna Lv

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Joanna Lv, Acting Chief Financial Officer

February 27, 2017