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

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**FORM 10-Q**

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- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2017  
OR  
 **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_  
COMMISSION FILE NUMBER 0-30961

**Sohu.com Inc.**

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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Delaware  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

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

Level 18, SOHU.com Media Plaza  
Block 3, No. 2 Kexueyuan South Road, Haidian District  
Beijing 100190  
People's Republic of China  
(011) 8610-6272-6666  
(Address, including zip code, of registrant's principal executive offices and registrant's telephone number, including area code)

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

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

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

Class  
**Common stock, \$.001 par value**

Outstanding at June 30, 2017  
**38,867,032**

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SOHU.COM INC.

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**PART I – FINANCIAL INFORMATION**

**ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**SOHU.COM INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)**  
(In thousands, except par value)

	As of	
	December 31, 2016	June 30, 2017
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,050,957	\$ 933,711
Short-term investments	247,926	308,928
Accounts receivable, net	189,167	252,551
Assets held for sale	103,079	0
Prepaid and other current assets (including \$29,019 and \$30,290, respectively, due from a related party as of December 31, 2016 and June 30, 2017)	260,133	239,854
Total current assets	<u>1,851,262</u>	<u>1,735,044</u>
Fixed assets, net	503,631	517,565
Goodwill	68,290	153,643
Long-term investments, net	74,273	74,724
Intangible assets, net	32,131	32,956
Restricted time deposits	269	269
Prepaid non-current assets	4,734	4,362
Other assets	29,100	25,707
Total assets	<u>\$ 2,563,690</u>	<u>\$2,544,270</u>
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable (including accounts payable of consolidated variable interest entities (“VIEs”) without recourse to the Company of \$15,824 and \$33,767, respectively, as of December 31, 2016 and June 30, 2017)	\$ 193,209	\$ 246,680
Accrued liabilities (including accrued liabilities of consolidated VIEs without recourse to the Company of \$96,695 and \$72,944, respectively, as of December 31, 2016 and June 30, 2017)	324,876	321,441
Receipts in advance and deferred revenue (including receipts in advance and deferred revenue of consolidated VIEs without recourse to the Company of \$44,797 and \$43,613, respectively, as of December 31, 2016 and June 30, 2017)	118,951	118,016
Accrued salary and benefits (including accrued salary and benefits of consolidated VIEs without recourse to the Company of \$10,306 and \$8,648, respectively, as of December 31, 2016 and June 30, 2017)	92,475	75,552
Taxes payable (including taxes payable of consolidated VIEs without recourse to the Company of \$11,475 and \$12,678, respectively, as of December 31, 2016 and June 30, 2017)	40,014	57,216
Short-term bank loans (including short-term bank loans of consolidated VIEs without recourse to the Company of nil and \$6,309, respectively, as of December 31, 2016 and June 30, 2017)	0	7,516
Liabilities held for sale (including liabilities held for sale of consolidated VIEs without recourse to the Company of \$3,232 and nil, respectively, as of December 31, 2016 and June 30, 2017)	3,902	0
Other short-term liabilities (including other short-term liabilities of consolidated VIEs without recourse to the Company of \$89,994 and \$83,278, respectively, as of December 31, 2016 and June 30, 2017, and due to a related party of \$28,678 and \$29,724, respectively, as of December 31, 2016 and June 30, 2017)	159,315	150,547
Total current liabilities	<u>932,742</u>	<u>976,968</u>
Long-term accounts payable (including long-term accounts payable of consolidated VIEs without recourse to the Company of nil as of both December 31, 2016 and June 30, 2017)	744	1,060
Long-term taxes payable (including long-term taxes payable of consolidated VIEs without recourse to the Company of \$13,463 and \$13,787, respectively, as of December 31, 2016 and June 30, 2017)	32,625	30,601
Deferred tax liabilities (including deferred tax liabilities of consolidated VIEs without recourse to the Company of \$1,273 and \$1,253, respectively, as of December 31, 2016 and June 30, 2017)	39,784	42,054
Total long-term liabilities	<u>73,153</u>	<u>73,715</u>
Total liabilities	<u>1,005,895</u>	<u>1,050,683</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; 38,742 shares and 38,867 shares, respectively, issued and outstanding as of December 31, 2016 and June 30, 2017)	45	45
Additional paid-in capital	821,867	834,160
Treasury stock (5,889 shares as of both December 31, 2016 and June 30, 2017)	(143,858)	(143,858)
Accumulated other comprehensive income	3,220	11,550
Retained earnings	312,306	155,875
Total Sohu.com Inc. shareholders' equity	<u>993,580</u>	<u>857,772</u>
Noncontrolling interest	564,215	635,815
Total shareholders' equity	<u>1,557,795</u>	<u>1,493,587</u>
Total liabilities and shareholders' equity	<u>\$ 2,563,690</u>	<u>\$2,544,270</u>

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

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

	Three Months Ended		Six Months Ended	
	June 30,	2017	2016	2017
Revenues:				
Online advertising:				
Brand advertising (including revenues generated from a related party of \$10 and nil, respectively, for the three months ended June 30, 2016 and 2017, and of \$862 and nil, respectively, for the six months ended June 30, 2016 and 2017)	\$ 112,887	\$ 86,071	\$ 238,390	\$ 167,483
Search and search-related advertising	160,152	186,747	293,966	328,782
Subtotal of online advertising revenues	<u>273,039</u>	<u>272,818</u>	<u>532,356</u>	<u>496,265</u>
Online games	99,227	122,398	201,756	207,723
Others	47,872	65,952	93,978	131,283
Total revenues	<u>420,138</u>	<u>461,168</u>	<u>828,090</u>	<u>835,271</u>
Cost of revenues:				
Online advertising:				
Brand advertising	93,654	124,730	179,290	204,927
Search and search-related advertising	71,998	96,692	134,090	178,799
Subtotal of cost of online advertising revenues	<u>165,652</u>	<u>221,422</u>	<u>313,380</u>	<u>383,726</u>
Online games	25,380	11,613	51,513	28,118
Others	21,226	45,159	40,212	85,229
Total cost of revenues	<u>212,258</u>	<u>278,194</u>	<u>405,105</u>	<u>497,073</u>
Gross profit	<u>207,880</u>	<u>182,974</u>	<u>422,985</u>	<u>338,198</u>
Operating expenses:				
Product development	88,959	100,146	171,638	184,244
Sales and marketing (including expenses generated from a related party of \$202 and nil, respectively, for the three months ended June 30, 2016 and 2017, and of \$216 and nil, respectively, for the six months ended June 30, 2016 and 2017)	117,966	94,845	208,013	184,931
General and administrative	29,650	27,657	57,257	56,007
Total operating expenses	<u>236,575</u>	<u>222,648</u>	<u>436,908</u>	<u>425,182</u>
Operating loss	<u>(28,695)</u>	<u>(39,674)</u>	<u>(13,923)</u>	<u>(86,984)</u>
Other income /(loss)	(24,573)	3,306	(20,649)	7,405
Interest income (including interest income generated from a related party of \$442 and \$284, respectively, for the three months ended June 30, 2016 and 2017, and \$663 and \$563, respectively, for the six months ended June 30, 2016 and 2017)	5,284	5,813	11,121	10,284
Interest expense (including interest expense generated from a related party of \$218 and \$178, respectively, for the three months ended June 30, 2016 and 2017, and \$299 and \$353, respectively, for the six months ended June 30, 2016 and 2017)	(244)	(205)	(942)	(380)
Exchange difference	3,866	(4,528)	2,844	(5,294)
Loss before income tax expense	(44,362)	(35,288)	(21,549)	(74,969)
Income tax expense	2,430	12,764	14,298	23,436
Net loss	(46,792)	(48,052)	(35,847)	(98,405)
Less: Net income attributable to the noncontrolling interest shareholders	16,232	40,131	47,463	58,026
Net loss attributable to Sohu.com Inc.	<u>\$ (63,024)</u>	<u>\$ (88,183)</u>	<u>\$ (83,310)</u>	<u>\$ (156,431)</u>
Net loss	(46,792)	(48,052)	(35,847)	(98,405)
Foreign currency translation adjustments	(28,831)	17,169	(27,412)	22,137
Change in unrealized loss for available-for-sale securities	(1,384)	(573)	(1,428)	(1,251)
Other comprehensive income /(loss)	(30,215)	16,596	(28,840)	20,886
Comprehensive loss	(77,007)	(31,456)	(64,687)	(77,519)
Less: Comprehensive income attributable to noncontrolling interest shareholders	5,420	50,003	37,551	70,582
Comprehensive loss attributable to Sohu.com Inc.	<u>(82,427)</u>	<u>(81,459)</u>	<u>(102,238)</u>	<u>(148,101)</u>
Basic net loss per share attributable to Sohu.com Inc.	<u>\$ (1.63)</u>	<u>\$ (2.27)</u>	<u>\$ (2.15)</u>	<u>\$ (4.03)</u>
Shares used in computing basic net loss per share attributable to Sohu.com Inc.	<u>38,691</u>	<u>38,855</u>	<u>38,678</u>	<u>38,833</u>
Diluted net loss per share attributable to Sohu.com Inc.	<u>\$ (1.64)</u>	<u>\$ (2.28)</u>	<u>\$ (2.17)</u>	<u>\$ (4.05)</u>
Shares used in computing diluted net loss per share attributable to Sohu.com Inc.	<u>38,691</u>	<u>38,855</u>	<u>38,678</u>	<u>38,833</u>

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

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

	<u>Six Months Ended June 30,</u>	
	<u>2016</u>	<u>2017</u>
Cash flows from operating activities:		
Net loss	\$ (35,847)	\$ (98,405)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Amortization of intangible assets and purchased video content in prepaid expense	62,500	83,438
Depreciation	34,685	39,270
Impairment of intangible assets and other assets	5,171	44,929
Provision for allowance for doubtful accounts	3,103	3,158
Share-based compensation expense	2,977	15,900
Investment loss from equity investments	814	680
Change in fair value of financial instruments	(4,899)	(1,928)
Others	(571)	(315)
Changes in assets and liabilities, net of acquisition:		
Accounts receivable	49,697	(60,765)
Prepaid and other assets	6,419	(4,291)
Accounts payable	16,116	5,950
Accrued liabilities and other short-term liabilities	51,405	(58,122)
Receipts in advance and deferred revenue	(9,372)	(3,789)
Taxes payable	(33,272)	13,089
Deferred tax	2,721	6,338
Net cash provided by /(used in) operating activities	<u>151,647</u>	<u>(14,863)</u>
Cash flows from investing activities:		
Purchase of financial instruments	(177,188)	(263,311)
Purchase of fixed assets	(47,688)	(39,819)
Purchase of intangible and other assets	(81,382)	(31,038)
Purchase of long-term investments	(12,715)	(2,466)
Matching loan to a related party	(18,115)	0
Cash released from restricted time deposits and time deposits, net	225,462	0
Proceeds from financial instruments	201,248	200,421
Return of funds from a third party	3,619	4,928
Other cash proceeds related to investing activities	978	170
Net cash provided by /(used in) investing activities	<u>94,219</u>	<u>(131,115)</u>
Cash flows from financing activities:		
Proceeds from short-term bank loan	0	7,516
Matching loan from a related party	17,041	0
Exercise of share-based awards in subsidiaries	291	493
Repayments of loans from offshore banks	(344,500)	0
Repurchase of Sogou Class A Common Shares from a noncontrolling shareholder	0	(3,190)
Other cash proceeds related to financing activities	0	0
Net cash provided by /(used in) financing activities	<u>(327,168)</u>	<u>4,819</u>
Effect of exchange rate changes on cash and cash equivalents	(15,833)	12,229
Reclassification of cash and cash equivalents from assets held for sale	0	11,684
Net decrease in cash and cash equivalents	(97,135)	(117,246)
Cash and cash equivalents at beginning of period	<u>1,245,205</u>	<u>1,050,957</u>
Cash and cash equivalents at end of period	<u>\$ 1,148,070</u>	<u>\$ 933,711</u>
Supplemental cash flow disclosures:		
Barter transactions recognized in revenue	8,845	4,238
Supplemental schedule of non-cash investing activity:		
Changes in payables and other liabilities related to fixed assets and intangible assets additions	14,903	55,829

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

**SOHU.COM INC.**  
**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)**

**Six Months Ended June 30, 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>	
Beginning balance	\$1,730,752	\$ 45	\$798,357	\$(143,858)	\$ 50,151	\$536,327	\$ 489,730
Share-based compensation expense	2,998	0	(631)	0	0	0	3,629
Settlement of share-based awards in subsidiary	336	0	18,834	0	0	0	(18,498)
Contribution from noncontrolling interest shareholder	0	0	1,333	0	0	0	(1,333)
Disposal of noncontrolling interest	(238)	0	0	0	0	0	(238)
Net income /(loss) attributable to Sohu.com Inc. and noncontrolling interest shareholders	(35,847)	0	0	0	0	(83,310)	47,463
Accumulated other comprehensive loss	(28,840)	0	0	0	(18,928)	0	(9,912)
Ending balance	<u>\$1,669,161</u>	<u>\$ 45</u>	<u>\$817,893</u>	<u>\$(143,858)</u>	<u>\$ 31,223</u>	<u>\$453,017</u>	<u>\$ 510,841</u>

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

**SOHU.COM INC.**  
**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)**  
**Six Months Ended June 30, 2017**  
(In thousands)

	Sohu.com Inc. Shareholders' Equity						
	Total	Common Stock	Additional Paid-in Capital	Treasury Stock	Accumulated Other Comprehensive Income	Retained Earnings	
Beginning balance	\$1,557,795	\$ 45	\$821,867	\$(143,858)	\$ 3,220	\$ 312,306	\$ 564,215
Share-based compensation expense	15,900	0	213	0	0	0	15,687
Settlement of share-based awards in subsidiaries	494	0	12,080	0	0	0	(11,586)
Repurchase of Sogou Class A Common Shares from a noncontrolling shareholder	(3,190)	0	0	0	0	0	(3,190)
Disposal of noncontrolling interest	(80)	0	0	0	0	0	(80)
Net income /(loss) attributable to Sohu.com Inc. and noncontrolling interest shareholders	(98,405)	0	0	0	0	(156,431)	58,026
Accumulated other comprehensive income	20,886	0	0	0	8,330	0	12,556
Other	187	0	0	0	0	0	187
Ending balance	<u>\$1,493,587</u>	<u>\$ 45</u>	<u>\$834,160</u>	<u>\$(143,858)</u>	<u>\$ 11,550</u>	<u>\$ 155,875</u>	<u>\$ 635,815</u>

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

**SOHU.COM INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**1. THE COMPANY AND BASIS OF PRESENTATION**

***Nature of Operations***

Sohu.com Inc. (NASDAQ: SOHU), a Delaware corporation organized in 1996, is a leading Chinese online media, search and game service group providing comprehensive online products and services on PCs and mobile devices in the People's Republic of China (the "PRC" or "China"). Sohu.com Inc.'s businesses are conducted by Sohu.com Inc. and its subsidiaries and VIEs (collectively referred to as the "Sohu Group" or "the Group"). The Sohu Group consists of Sohu, which when referred to in this report, unless the context requires otherwise, excludes the businesses and the corresponding subsidiaries and VIEs of Sogou Inc. ("Sogou") and Changyou.com Limited ("Changyou"), Sogou and Changyou. Sogou and Changyou are indirect controlled subsidiaries of Sohu.com Inc. Sohu is a leading Chinese language online media content and services provider. Sogou is a leading online search 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"), its mobile game TLBB 3D, and its mobile game Legacy TLBB, 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 advertising 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](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 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, sub-licensing of purchased video content to third parties, interactive broadcasting services, and content provided through the platforms of the three main telecommunications operators in China. 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 consists primarily of search and search-related advertising services offered by Sogou. Search and search-related advertising services enable advertisers' promotional links to be displayed on Sogou's search results pages and other properties and third parties' Internet properties where the links are relevant to the subject and content of searches and such properties. Sogou's advertising services expand distribution of advertisers' promotional links and advertisements by leveraging traffic on third parties' 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 advertising revenues in the Sohu Group's consolidated statements of comprehensive income.

### *Other Business*

Sogou also engages in other business, by offering Internet value-added services ("IVAS") primarily with respect to the operation of Web games and mobile games developed by third parties, as well as by offering other products and services to users. Revenues generated by Sogou from Sogou's 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 also includes IVAS; 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 are online games that are played through a Web browser with no local game software installation requirements. Following the sale of Shenzhen 7Road, Web games became an insignificant part of Changyou's online game business. 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 PC game is TLBB, a PC-based client-end game. For the three and six months ended June 30, 2017, revenues from TLBB were \$47.8 million and \$101.1 million, respectively, accounting for approximately 39% and 49%, respectively, of Changyou's online game revenues, approximately 32% and 37%, respectively, of Changyou's total revenues, and approximately 10% and 12%, respectively, of the Sohu Group's total revenues. For the three and six months ended June 30, 2016, revenues from TLBB were \$51.5 million and \$106.9 million, respectively, accounting for approximately 52% and 53%, respectively, of Changyou's online game revenues, approximately 40% and 41%, respectively, of Changyou's total revenues and approximately 12% and 13%, respectively, of the Sohu Group's total revenues.

In the second quarter of 2017, Changyou launched a new mobile game, Legacy TLBB. For the three months ended June 30, 2017, revenues from Legacy TLBB were \$48.0 million, accounting for approximately 39% of Changyou's online game revenues, approximately 32% of Changyou's total revenues, and approximately 10% 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 regarding 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 Inc. (collectively with its subsidiaries and VIEs "MoboTap"), is a gateway to a host of user activities on mobile devices, with the majority of its users based in Europe, North America, Russia and Japan.

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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. Accordingly, the assets and liabilities attributable to MoboTap were 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 Sohu Group's consolidated balance sheet as of December 31, 2016. Due to the suspension of negotiations with a potential buyer of MoboTap in the first quarter of 2017, Changyou's management determined that the disposal is unlikely to be completed within one year. As a result, the assets held for sale and liabilities held for sale related to MoboTap were reclassified and have been recorded as assets and liabilities held for use and measured at the lower of the carrying value before MoboTap was classified as held for sale, adjusted for any depreciation and amortization expense that would have been recognized had the assets and liabilities been continuously classified as held for use, or the fair value as of the reclassification date in the Sohu Group's consolidated balance sheets commencing on the reclassification date. In the first quarter of 2017, Changyou recorded a \$1.4 million expense in the consolidated statements of comprehensive income for catch-up of depreciation and amortization expense of the assets held for sale before the reclassification. 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 Sohu 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.

### ***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 intra-Group 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. 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 June 30, 2017, Sogou had outstanding a combined total of 335,919,409 ordinary shares and preferred shares held as follows:

- (i) Sohu.com Inc.: 130,920,250 Class A Ordinary Shares, of which 3,707,000 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: 21,441,284 Class A Ordinary Shares.

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### Sohu's Shareholding in and Control of Sogou

As of June 30, 2017, 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 June 30, 2017, 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 share-based awards that 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 investments of, 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 decreases to zero;
- (ii) additional net losses are allocated to holders of Sogou Series A Preferred Shares until their basis in Sogou decreases 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 percentages 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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### (i) 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 dividends (“Accrued Dividends”). “Accrued 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.

### (ii) 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 Accrued 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 Accrued 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.

### (iii) Redemption Rights

The Sogou Preferred Shares are not redeemable at the option of the holders.

### (iv) 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 an initial public offering (“IPO”) of Sogou with certain parameters 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.

### (v) 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.

### (vi) 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 June 30, 2017, Sohu.com Inc. held approximately 68% of the combined total of Changyou’s outstanding ordinary shares, and controlled approximately 95% of the total voting power in Changyou.

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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 the noncontrolling shareholders' 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.

### **Basis of Presentation**

These financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements and related footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

The accompanying unaudited condensed consolidated interim financial statements reflect all normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of the results for the interim periods presented. Results for the six months ended June 30, 2017 are not necessarily indicative of the results expected for the full fiscal year or for any future period.

## **2. SEGMENT INFORMATION**

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

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

	Three Months Ended June 30, 2016				
	Sohu	Sogou	Changyou	Eliminations	Consolidated
Revenues (1)	\$ 116,305	\$ 175,548	\$ 129,160	\$ (875)	\$ 420,138
Segment cost of revenues	(95,571)	(75,035)	(41,867)	159	(212,314)
Segment gross profit	20,734	100,513	87,293	(716)	207,824
SBC (2) in cost of revenues	73	0	(17)	0	56
Gross profit	20,807	100,513	87,276	(716)	207,880
Operating expenses:					
Product development (3)	(24,027)	(34,563)	(29,778)	1,108	(87,260)
Sales and marketing (1)	(76,245)	(29,508)	(13,054)	1,002	(117,805)
General and administrative	(12,852)	(4,173)	(11,906)	21	(28,910)
SBC (2) in operating expenses	1,403	(608)	(3,395)	0	(2,600)
Total operating expenses	(111,721)	(68,852)	(58,133)	2,131	(236,575)
Operating profit/(loss)	(90,914)	31,661	29,143	1,415	(28,695)
Other income/(expense) (3) (4)	1,077	(27,757)	3,522	(1,415)	(24,573)
Interest income (5)	2,194	1,824	4,155	(2,889)	5,284
Interest expense (5)	(2,211)	0	(922)	2,889	(244)
Exchange difference	997	419	2,450	0	3,866
Income/(loss) before income tax benefit/(expense)	(88,857)	6,147	38,348	0	(44,362)
Income tax benefit/(expense)	3,517	(935)	(5,012)	0	(2,430)
Net income/(loss)	\$ (85,340)	\$ 5,212	\$ 33,336	\$ 0	\$ (46,792)

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- Note (1): The elimination mainly consists of revenues and expenses generated from marketing services among the Sohu, Sogou and Changyou segments.
- Note (2): “SBC” stands for share-based compensation expense.
- Note (3): The elimination mainly consists of leasing income and expenses generated from a building that Sohu leases to Sogou.
- Note (4): In the second quarter of 2016, the Sohu Group recognized a one-time expense of \$27.8 million that was related to a donation by Sogou to Tsinghua University related to setting up a joint research institute focusing on artificial intelligence, or AI, technology.
- Note (5): The elimination represents interest income/ (expense) resulting from intra-Group loans between the Sohu segment and the Changyou segment.

	Three Months Ended June 30, 2017				
	Sohu	Sogou	Changyou	Eliminations	Consolidated
Revenues (1)	\$ 100,850	\$ 210,943	\$150,361	\$ (986)	\$ 461,168
Segment cost of revenues	(137,547)	(105,460)	(34,978)	19	(277,966)
Segment gross profit	(36,697)	105,483	115,383	(967)	183,202
SBC (2) in cost of revenues	(182)	(2)	(44)	0	(228)
Gross profit	(36,879)	105,481	115,339	(967)	182,974
Operating expenses:					
Product development (3)	(27,047)	(37,486)	(32,226)	1,538	(95,221)
Sales and marketing (1)	(46,943)	(36,591)	(11,782)	1,401	(93,915)
General and administrative	(7,403)	(5,301)	(8,387)	31	(21,060)
SBC (2) in operating expenses	(2,357)	(657)	(9,438)	0	(12,452)
Total operating expenses	(83,750)	(80,035)	(61,833)	2,970	(222,648)
Operating profit /(loss)	(120,629)	25,446	53,506	2,003	(39,674)
Other income/(expense) (3)	2,592	131	2,586	(2,003)	3,306
Interest income (4)	1,728	2,139	8,194	(6,248)	5,813
Interest expense (4)	(5,365)	0	(1,088)	6,248	(205)
Exchange difference	(807)	(2,163)	(1,558)	0	(4,528)
Income /(loss) before income tax expense	(122,481)	25,553	61,640	0	(35,288)
Income tax expense	(677)	(2,027)	(10,060)	0	(12,764)
Net income /(loss)	<u>\$(123,158)</u>	<u>\$ 23,526</u>	<u>\$ 51,580</u>	<u>\$ 0</u>	<u>\$ (48,052)</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 intra-Group loans between the Sohu segment and the Changyou segment.

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	Six Months Ended June 30, 2016				
	Sohu	Sogou	Changyou	Eliminations	Consolidated
Revenues (1)	\$ 247,877	\$ 322,877	\$ 259,000	\$ (1,664)	\$ 828,090
Segment cost of revenues	(181,993)	(139,606)	(83,724)	217	(405,106)
Segment gross profit	65,884	183,271	175,276	(1,447)	422,984
SBC (2) in cost of revenues	11	0	(10)	0	1
Gross profit	65,895	183,271	175,266	(1,447)	422,985
Operating expenses:					
Product development (3)	(46,563)	(65,285)	(60,375)	2,281	(169,942)
Sales and marketing (1)	(127,616)	(56,607)	(25,610)	1,995	(207,838)
General and administrative	(25,083)	(7,563)	(23,553)	49	(56,150)
SBC (2) in operating expenses	1,502	(2,352)	(2,128)	0	(2,978)
Total operating expenses	(197,760)	(131,807)	(111,666)	4,325	(436,908)
Operating profit /(loss)	(131,865)	51,464	63,600	2,878	(13,923)
Other income /(expense) (3) (4)	2,453	(27,593)	7,369	(2,878)	(20,649)
Interest income (5)	4,454	3,528	8,207	(5,068)	11,121
Interest expense (5)	(3,876)	0	(2,134)	5,068	(942)
Exchange difference	663	338	1,843	0	2,844
Income /(loss) before income tax benefit /(expense)	(128,171)	27,737	78,885	0	(21,549)
Income tax benefit /(expense)	870	(2,422)	(12,746)	0	(14,298)
Net income /(loss)	<u>\$ (127,301)</u>	<u>\$ 25,315</u>	<u>\$ 66,139</u>	<u>\$ 0</u>	<u>\$ (35,847)</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 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 AI technology.

Note (5): The elimination represents interest income/ (expense) resulting from intra-Group loans between the Sohu segment and the Changyou segment.

	Six Months Ended June 30, 2017				
	Sohu	Sogou	Changyou	Eliminations	Consolidated
Revenues (1)	\$ 193,342	\$ 373,227	\$ 270,231	\$ (1,529)	\$ 835,271
Segment cost of revenues	(229,749)	(192,914)	(74,066)	70	(496,659)
Segment gross profit	(36,407)	180,313	196,165	(1,459)	338,612
SBC (2) in cost of revenues	(341)	(5)	(68)	0	(414)
Gross profit	(36,748)	180,308	196,097	(1,459)	338,198
Operating expenses:					
Product development (3)	(53,026)	(70,335)	(56,630)	2,999	(176,992)
Sales and marketing (1)	(101,994)	(61,356)	(22,318)	2,332	(183,336)
General and administrative	(18,308)	(9,936)	(17,178)	63	(45,359)
SBC (2) in operating expenses	449	(4,997)	(14,947)	0	(19,495)
Total operating expenses	(172,879)	(146,624)	(111,073)	5,394	(425,182)
Operating profit /(loss)	(209,627)	33,684	85,024	3,935	(86,984)
Other income/(expense) (3)	6,333	154	4,853	(3,935)	7,405
Interest income (4)	3,399	3,797	14,610	(11,522)	10,284
Interest expense (4)	(9,741)	0	(2,161)	11,522	(380)
Exchange difference	(192)	(2,802)	(2,300)	0	(5,294)
Income /(loss) before income tax expense	(209,828)	34,833	100,026	0	(74,969)
Income tax expense	(1,872)	(3,079)	(18,485)	0	(23,436)
Net income /(loss)	<u>\$ (211,700)</u>	<u>\$ 31,754</u>	<u>\$ 81,541</u>	<u>\$ 0</u>	<u>\$ (98,405)</u>

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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 intra-Group loans between the Sohu segment and the Changyou segment.

	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 intra-Group loans between the Sohu segment and the Changyou segment, and elimination of long-term investments in subsidiaries and consolidated VIEs.

	As of June 30, 2017				
	Sohu	Sogou	Changyou	Eliminations	Consolidated
Cash and cash equivalents	\$ 104,408	\$ 310,864	\$ 518,439	\$ 0	\$ 933,711
Accounts receivable, net	111,992	46,523	94,119	(83)	252,551
Fixed assets, net	197,060	131,568	188,937	0	517,565
Total assets (1)	\$ 1,156,548	\$ 555,511	\$ 1,846,355	\$ (1,014,144)	\$ 2,544,270

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

### 3. SHARE-BASED COMPENSATION EXPENSE

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

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

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

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

Options for the purchase of Sohu common stock contractually granted under the Sohu 2010 Stock Incentive Plan and 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 the companies and the recipients clarifying the subjective performance requirements. In accordance with ASC 718-10-55, as the service inception date preceded the grant date, compensation expense was accrued beginning on the service inception date, and was re-measured and will be re-measured on each subsequent reporting date before the grant date is established, based on the then-current fair value of the awards. The estimate of the awards' fair value will be fixed in the period in which the grant date occurs, and cumulative compensation expense will be adjusted based on the fair value at the grant date. In determining the fair value of stock options and share options granted by Sohu and Changyou, the public market price of the underlying shares at each reporting date was used, and a binomial valuation model was applied.



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For Sogou Class A Ordinary Shares repurchased by Sogou from the former President and Chief Financial Officer of the Sohu Group in the first quarter of 2017, share-based compensation expense is recognized by the Sohu Group in the consolidated statements of comprehensive income in an amount equal to the excess of the repurchase price over the fair value of the Sogou Class A Ordinary Shares at the repurchase date.

### **Sohu Video Share-based Awards**

On January 4, 2012, Sohu Video, the holding entity of Sohu's video division, adopted a 2011 Share Incentive Plan (the "Video 2011 Share Incentive Plan") which provides for the issuance of up to 25,000,000 ordinary shares of Sohu Video (representing approximately 10% of the outstanding Sohu Video shares on a fully-diluted basis) to management and key employees of the video division and to Sohu management. As of June 30, 2017, grants of options for the purchase of 16,368,200 ordinary shares of Sohu Video had been contractually made, of which options for the purchase of 4,972,800 ordinary shares were vested.

For purposes of ASC 718-10-25, as of June 30, 2017, 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.

### **Share-based Compensation Expense Recognition**

Share-based compensation expense was recognized in costs and expenses for the three and six months ended June 30, 2016 and the three and six months ended June 30, 2017 as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2017	2016	2017
Share-based compensation expense				
Cost of revenues (1) (3)	\$ (56)	\$ 228	\$ (1)	\$ 414
Product development expenses (3)	1,699	4,925	1,696	7,252
Sales and marketing expenses (3)	161	930	175	1,595
General and administrative expenses (3)	740	6,597	1,107	10,648
	<u>\$2,544</u>	<u>\$12,680</u>	<u>\$2,977</u>	<u>\$19,909</u>

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2017	2016	2017
Share-based compensation expense				
For Sohu (excluding Sohu Video) share-based awards (1) (3)	\$ (618)	\$ 2,445	\$ (890)	\$ 2
For Sogou share-based awards (2)	595	654	2,325	4,991
For Changyou share-based awards (3)	3,412	9,482	2,138	15,015
For Sohu Video share-based awards (1) (3)	(845)	99	(596)	(99)
	<u>\$2,544</u>	<u>\$12,680</u>	<u>\$2,977</u>	<u>\$19,909</u>

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Note (1): The negative amount represented re-measured compensation expense based on the then-current fair value of the awards on the reporting date, as well as reversals of share-based compensation expense for awards that were forfeited due to termination of employment prior to vesting.

Note (2): Compensation expense for Sogou share-based awards also includes compensation expense for Tencent restricted share units that Tencent had granted to employees who transferred to Sogou with the Soso search and search-related businesses and compensation expense of \$4.0 million, recognized in the first quarter of 2017 in connection with Sogou's repurchase of Sogou Class A Ordinary Shares from the former President and Chief Financial Officer of the Sohu Group, which is equal to the excess of the repurchase price over the fair value of the Sogou Class A Ordinary Shares as of the repurchase date.

Note (3): The differences for the three and six months ended June 30, 2017 compared to the corresponding periods of 2016 were mainly due to differences in the fair values of certain awards as of the respective reporting dates, as well as reversals of share-based compensation expense for awards that were forfeited due to termination of employment prior to vesting.

There was no capitalized share-based compensation expense for the three and six months ended June 30, 2016 and 2017.

For details of the share-based compensation expenses of the Sohu Group, see Note 12.

## **4. RELATED PARTY TRANSACTIONS**

### **Changyou's Loan Arrangements with Fox Financial Technology Group Limited ("Fox Financial," formerly known as "SoEasy Internet Finance Group Limited")**

Commencing in April 2015, certain subsidiaries of Changyou and certain subsidiaries of Fox Financial (Fox Financial is one of Sohu's equity investments, see Note 6 - FAIR VALUE MEASUREMENTS ) 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 Fox Financial subsidiaries and the Fox Financial 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.

As of June 30, 2017, Changyou had U.S. dollar-denominated loans payable to Fox Financial in a total amount of approximately \$28.8 million, which was recorded in other short-term liabilities, and RMB-denominated loans receivable from Fox Financial in a total amount of approximately \$28.8 million, which was recorded in prepaid and other current assets. For the three months and six months ended June 30, 2017, Changyou incurred interest expense of \$0.2 million and \$0.4 million, respectively, and earned interest income of \$0.3 million and \$0.6 million, respectively. As of June 30, 2017, total interest expense payable to Fox Financial amounted to \$0.9 million, which was recorded in other short-term liabilities; and total interest income receivable from Fox Financial was \$1.5 million, which was recorded in prepaid and other current assets.

### **Other Information**

For the three months ended June 30, 2017 and 2016, the Sohu Group generated brand advertising revenue from Fox Financial of nil and \$10,000, respectively, and incurred sales and marketing expense for Fox Financial of nil and \$0.2 million, respectively. For the six months ended June 30, 2017 and 2016, the Sohu Group generated brand advertising revenue from Fox Financial of nil and \$0.9 million, respectively, and incurred sales and marketing expense for Fox Financial of nil and \$0.2 million, respectively.

## **5. INTRA-GROUP LOAN AND SHARE PLEDGE AGREEMENT**

On October 24, 2016, Beijing Sohu New Media Information Technology Co., Ltd. ("Sohu Media"), a subsidiary of Sohu, entered into a loan agreement (the "Loan Agreement") with Beijing AmazGame Age Internet Technology Co., Ltd. ("AmazGame"), a subsidiary of Changyou, pursuant to which Sohu Media may borrow from time to time from AmazGame up to RMB1.00 billion (or approximately \$144.9 million). The first request for an advance under the Loan Agreement was required to be made on or prior to December 31, 2016, and requests for further advances may be made for one year following the initial advance. The one-year request period may be extended for another one-year period with the consent of AmazGame. Principal amounts outstanding under the Loan Agreement 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.

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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 11,386,228 Class B ordinary shares of Changyou held by Sohu Game. The number of Class B ordinary shares pledged by Sohu Game to Changyou is subject to upward adjustment from time to time while amounts are outstanding under the Loan Agreement if the price of Changyou’s American depository shares (“ADSs”) on the Nasdaq Global Select Market drops for at least 10 consecutive trading days by an amount of 20% or more from such price as of the date of the Share Pledge Agreement, and is subject to further upward adjustment in the event of any additional incremental drops of 20% or more in the price of Changyou’s ADSs during 10 consecutive trading days. The share pledge agreement gives 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 under the Loan Agreement are not paid when due. As of June 30, 2017, the number of Class B ordinary shares pledged by Sohu Game to Changyou was 13,704,663.

In December 2016, March 2017 and April 2017, Sohu Media received RMB500.0 million (or approximately \$73.8 million), RMB200.0 million (or \$29.5 million) and RMB 300.0 million (or \$44.3 million), respectively, from AmazGame. As of June 30, 2017, the total outstanding balance of the loan was RMB1.00 billion (or \$147.6 million). The intra-Group loan has been eliminated upon consolidation.

## 6. FAIR VALUE MEASUREMENTS

### *Fair Value of Financial Instruments*

The Sohu Group’s financial instruments 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, short-term bank loans, 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 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 recognized in prepaid and other current assets	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>

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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 June 30, 2017 (in thousands):

Items	As of June 30, 2017	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	\$463,000	\$ 0	\$ 463,000	\$ 0
Short-term investments	308,928	0	308,928	0
Available-for-sale equity securities	9,130	9,130	0	0
Restricted time deposits	269	0	269	0
Total Assets	<u>\$781,327</u>	<u>\$ 9,130</u>	<u>\$ 772,197</u>	<u>\$ 0</u>
Foreign exchange forward contracts recognized in other short-term liabilities	<u>\$ 670</u>	<u>\$ 0</u>	<u>\$ 670</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

As of June 30, 2017 and December 31, 2016, the Sohu Group's investment in financial instruments was \$308.9 million and \$247.9 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 three and six months ended June 30, 2017, the Sohu Group recorded in the consolidated statements of comprehensive income changes in the fair value of short-term investments in the amounts of \$3.1 million and \$5.7 million, respectively. For the three and six months ended June 30, 2016, the Sohu Group recorded in the consolidated statements of comprehensive income changes in the fair value of short-term investments in the amounts of \$1.0 million and \$2.5 million, respectively.

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.

### Available-for-Sale Equity Securities

Available-for-sale equity securities are valued using the market approach based on the quoted prices in active markets at the reporting date. The Group classifies the valuation techniques that use these inputs as Level 1 of fair value measurements. On August 12, 2014, Sohu acquired approximately 6% of the total outstanding common shares of Keyeast Co., Ltd., a Korean-listed company ("Keyeast"), for a purchase price of \$15.1 million. The Sohu Group classified this investment as available-for-sale equity securities under long-term investments, and reported it at fair value. As of June 30, 2017, the fair value of the Keyeast available-for-sale equity securities held by Sohu was \$9.1 million. An unrealized loss representing the change in fair value of \$5.9 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. 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 Sohu Group's consolidated balance sheet as of December 31, 2016. Due to the suspension of negotiations with a potential buyer of MoboTap in the first quarter of 2017, Changyou's management determined that the disposal is unlikely to be completed within one year. As a result, the assets held for sale and liabilities held for sale related to MoboTap were reclassified and have been recorded as assets and liabilities held for use and measured at the lower of the carrying value before MoboTap was classified as held for sale, adjusted for any depreciation and amortization expense that would have been recognized had the assets and liabilities been continuously classified as held for use, or their fair value as of the reclassification date, respectively, in the Sohu Group's consolidated balance sheet since the reclassification date. In the first quarter of 2017, Changyou recorded a \$1.4 million expense in the consolidated statements of comprehensive income for catch-up of depreciation and amortization expense of the assets held for sale before the reclassification.

### *Foreign Exchange Forward Contracts*

In September 2016 and January 2017, Changyou entered into foreign exchange forward contracts with banks in an aggregate nominal amount of \$100 million and \$50 million, respectively. Changyou entered into the 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 June 30, 2017. For the three and six months ended June 30, 2017, the Sohu Group recorded loss from changes in the fair value of the forward contracts of \$3.2 million and \$3.7 million, respectively, 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.

### **Other Financial Instruments**

The fair values of other financial instruments are estimated for disclosure purposes as follows:

#### **Long-term Investments**

##### *Long-term Investment in Fox Financial*

Under an agreement between Sohu and Fox Financial entered into in August 2014, Sohu invested \$4.8 million and \$16.1 million in Fox Financial on August 2014 and April 2015, respectively. In February 2016, Sohu invested an additional \$10.5 million in Fox Financial. Sohu accounted for its investments in Fox Financial under long-term investments. These investments include both preferred shares and common shares. Sohu accounted for its investment in Fox Financial'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 Fox Financial's common shares under the equity method, since Sohu can exercise significant influence but does not own a majority of Fox Financial's equity capital or control Fox Financial.

In March 2017, Fox Financial issued additional common shares to new investors, while shares held by Sohu remained unchanged. As a result, Sohu's shareholding percentage of common shares was diluted from 7% to 6%. In accordance with ASC 320-10-40, the Group recognized dilution gain of \$0.7 million in other income in the first quarter of 2017. As of June 30, 2017, the carrying value of Sohu's investment in Fox Financial was \$25.4 million.

##### *Long-term Investment in Zhihu*

As of June 30, 2017, Sogou had invested a cumulative total of \$18.9 million 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 and the underlying shares are not considered in-substance common stock.

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### **Short-term Receivables and Payables**

Accounts receivable and prepaid and other current assets are financial assets with carrying values that approximate fair value due to their short-term nature. Short-term accounts payable, accrued liabilities, receipts in advance and deferred revenue, short-term bank loans and other short-term liabilities are financial liabilities with carrying values that approximate fair value due to their short-term nature. For short-term receivables and payables, the Group estimated fair values using the discounted cash flow method. The Group classifies the valuation technique as Level 2 of fair value measurements.

#### *Short-term Bank Loans*

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

- Factoring contract with recourse with HongKong and Shanghai Banking Corporation Limited (“HSBC”)

In May 2017, Sohu entered into a one year factoring contract with recourse with HSBC, pursuant to which Sohu may borrow from HSBC from time to time up to a combined aggregate of RMB180.0 million (or \$26.6 million), which is the upper limit reviewed by HSBC at least annually. The loan is secured by up to RMB198.0 million (or \$29.2 million) of Sohu’s accounts receivable and guaranteed by Sohu Media. Interest will accrue on the principal amounts of the loans outstanding at an annual rate published by the People’s Bank of China (the “PBOC”). As of June 30, 2017, the total outstanding balance of the loan was RMB50.9 million (or \$7.5 million), which is secured by a pledge of accounts receivable equal to 110% of this amount.

- Credit agreements with Ping An Bank Co., Ltd. (“Ping An Bank”)

In May 2017, Sohu entered into credit agreements with Ping An Bank, pursuant to which Sohu will be entitled to borrow from Ping An Bank from time to time until May 18, 2020 up to a combined aggregate of RMB2.50 billion (or \$369.0 million). The loan is secured by pledges of Sohu’s two buildings and guaranteed by Sohu.com (Game) Limited (“Sohu Game”). Interest will accrue on the principal amounts of the loans outstanding at an annual rate equal to 115% of the rate published by the PBOC. As of June 30, 2017, there was no outstanding loan balance under the credit agreements. In July 2017, Sohu entered into an amendment of its loan arrangements with Ping An Bank, pursuant to which interest on outstanding principal amounts will accrue at a rate designated separately upon each drawdown based on the benchmark loan rate published by the PBOC with reference to then prevailing market interest rates.

#### *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. The Sohu Group classifies the valuation technique as Level 2 of fair value measurements.

## **7. IMPAIRMENT OF PURCHASED VIDEO CONTENT**

In the second quarter of 2017, the Sohu Group recognized an impairment loss of \$44.9 million in cost of revenues with respect to its purchased video content, which was mainly due to the ongoing restructuring of the sales team of Sohu Video as well as a strategic shift to reduce purchasing of licensed video content beginning in the second half of 2016. These two factors had an adverse impact on Sohu Video’s performance for the second quarter of 2017, which has failed to meet the management’s expectation. The management also revised downward their expectations of the programming usefulness of certain of Sohu Video’s purchased video content. The discounted cash flow method has been used to determine the fair value of these purchased video content.

## 8. 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, 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>
Transactions in 2017				
Goodwill associated with MoboTap and reclassification of assets held for sale to assets held for use (1)	0	0	83,470	83,470
Goodwill associated with an acquisition	1,000	0	0	1,000
Foreign currency translation adjustment	359	133	391	883
Balance as of June 30, 2017	<u>\$ 37,582</u>	<u>\$5,698</u>	<u>\$110,363</u>	<u>\$ 153,643</u>
Balance as of June 30, 2017				
Goodwill	\$ 73,370	\$5,698	\$180,810	\$ 259,878
Accumulated impairment losses	(35,788)	0	(70,447)	(106,235)
	<u>\$ 37,582</u>	<u>\$5,698</u>	<u>\$110,363</u>	<u>\$ 153,643</u>

Note (1): Represents goodwill associated with the reclassification of assets held for sale to assets held for use in connection with MoboTap. See Note 6 – Fair Value Measurements.

## 9. TAXATION

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

### PRC Corporate Income Tax

#### Principal Entities Qualified as HNTEs

The PRC Corporate Income Tax Law (the “CIT Law”) applies an income tax rate of 25% to all enterprises but grants preferential tax treatment to High and New Technology Enterprises (“HNTEs”). Under this preferential tax treatment, HNTEs can enjoy an income tax rate of 15%, 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 June 30, 2017, 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 were each qualified as HNTEs for the years 2014 to 2016. Sohu Media and Guangzhou Qianjun will re-apply for HNTE qualification in the third quarter of 2017.

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### *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.
- 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 the third quarter of 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 were both qualified as HNTEs for the years 2014 to 2016, and will need to re-apply for HNTE qualification in the third quarter of 2017.
- Beijing Changyou Gamespace Software Technology Co., Ltd. ("Gamespace"). Gamespace qualified as HNTE for the years 2017 to 2019, and will need to re-apply for HNTE qualification in 2020.

### **Principal Entities Qualified as Software Enterprises and KNSEs**

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 a 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 the second quarter of 2017, Sohu New Momentum completed a self-assessment and filed required supporting documents to entitle it to the first year of an income tax rate reduction from 25% to 12.5% as a Software Enterprise for 2016, and will follow the same process in 2018 to entitle it to the second year of an income tax rate reduction from 25% to 12.5%.

### *For Sogou's Business*

- Sogou Technology. In the second quarter of 2017, Sogou Technology completed a self-assessment and filed required supporting documents for KNSE status for 2016, and will follow the same process in 2018 for KNSE status for 2017.

### *For Changyou's Business*

- AmazGame. In the second quarter of 2017, AmazGame completed a self-assessment and filed required supporting documents for KNSE status for 2016, and will follow the same process in 2018 for KNSE status for 2017.
- Baina (Wuhan) Information Technology Co., Ltd. ("Wuhan Baina Information"). In the second quarter of 2017, Wuhan Baina Information completed a self-assessment and filed required supporting documents to entitle it to the first year of an income tax exemption as a Software Enterprise for 2016, and will follow the same process in 2018 to entitle it to the second year of an income tax exemption for 2017.



### ***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 June 30, 2017, Changyou had accrued deferred tax liabilities in the amount of \$28.2 million for PRC withholding tax.

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

### ***PRC Value-Added Tax***

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

### ***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.

The Group did not have any significant penalties or significant interest associated with tax positions for the three and six months ended June 30, 2017, nor did the Group have any significant unrecognized uncertain tax positions for the three and six months ended June 30, 2017.

## 10. COMMITMENTS AND CONTINGENCIES

### *Contractual Obligations*

The following table sets forth our contractual obligations as of June 30, 2017 (in thousands):

<b>As of June 30,</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 cinema advertisement slot rights	35,112	72,620	36,689	15,162	1,272	8	160,863
Purchase of content and services – video	44,152	15,595	17,842	0	0	0	77,589
Purchase of bandwidth	49,733	9,736	1,246	1,092	315	0	62,122
Operating lease obligations	9,458	13,833	2,925	832	59	10	27,117
Expenditures for operating rights for licensed games with technological feasibility	1,124	18,602	0	0	0	0	19,726
Purchase of content and services – others	10,338	877	284	45	0	0	11,544
Purchase of fixed assets	3,586	0	0	0	0	0	3,586
Fees for operating rights for licensed games in development	1,347	1,172	0	0	0	0	2,519
Expenditures for rights to titles of games in development	259	1,208	0	0	0	0	1,467
Others	3,181	406	74	0	0	0	3,661
<b>Total Payments Required</b>	<b>158,290</b>	<b>134,049</b>	<b>59,060</b>	<b>17,131</b>	<b>1,646</b>	<b>18</b>	<b>370,194</b>

### *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 advertising, 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 11 - 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.

## 11. VIES

### **Background**

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

### **VIEs Consolidated within the Sohu Group**

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

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

Under contractual agreements with the Sohu Group, Dr. Charles Zhang and those other executive officers and employees of the Sohu Group who are shareholders of the consolidated VIEs are required to transfer their ownership in these entities to the Group, if permitted by PRC laws and regulations, or, if not so permitted, to designees of the Group at any time as requested by the Group to repay the loans outstanding. All voting rights of the consolidated VIEs are assigned to the Sohu Group, and the Group has the right to designate all directors and senior management personnel of the consolidated VIEs, and also has the obligation to absorb losses of the consolidated VIEs. Dr. Charles Zhang and those other executive officers and employees of the Sohu Group who are shareholders of the consolidated VIEs have pledged their shares in the consolidated VIEs as collateral for the loans. As of June 30, 2017, 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 June 30, 2017, the registered capital and PRC statutory reserves of the consolidated VIEs totaled \$79.7 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 June 30, 2017, the registered capital of High Century was \$4.6 million and Dr. Charles Zhang and Wei Li held 80% and 20% interests, respectively, in this entity.
- **Heng Da Yi Tong**  
Beijing Heng Da Yi Tong Information Technology Co., Ltd. ("Heng Da Yi Tong") was incorporated in 2002. As of June 30, 2017, 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.

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- **Sohu Internet**

Sohu Internet was incorporated in 2003. As of June 30, 2017, the registered capital of Sohu Internet was \$1.6 million and High Century held a 100% interest in this entity.
- **Donglin**

Beijing Sohu Donglin Advertising Co., Ltd. (“Donglin”) was incorporated in 2010. As of June 30, 2017, the registered capital of Donglin was \$1.5 million and Sohu Internet held a 100% interest in this entity.
- **Tianjin Jinhua**

Tianjin Jinhua Culture Development Co., Ltd. (“Tianjin Jinhua”) was incorporated in 2011. In October, 2016, Ye Deng transferred its 50% equity interest in Tianjin Jinhua to Xiufeng Deng. As of June 30, 2017, the registered capital of Tianjin Jinhua 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 June 30, 2017, the registered capital of Guangzhou Qianjun was \$3.3 million and Tianjin Jinhua held a 100% interest in this entity.
- **Focus Interactive**

Beijing Focus Interactive Information Service Co., Ltd. (“Focus Interactive”) was incorporated in July 2014. As of June 30, 2017, the registered capital of Focus Interactive was \$1.6 million and Heng Da Yi Tong held 100% of the equity interests in this entity.

### *For Sogou’s Business*

- **Sogou Information**

Sogou Information was incorporated in 2005. As of June 30, 2017, 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 June 30, 2017, the registered capital of Gamease was \$1.3 million and High Century held a 100% interest in this entity.
- **Guanyou Gamespace**

Beijing Guanyou Gamespace Digital Technology Co., Ltd. (“Guanyou Gamespace”) was incorporated in 2010. As of June 30, 2017, the registered capital of Guanyou Gamespace was \$1.5 million and Beijing Changyou Star Digital Technology Co., Ltd (“Changyou Star”) held a 100% interest in this entity.
- **Shanghai ICE**

Shanghai ICE Information Technology Co., Ltd. (“Shanghai ICE”) was acquired by Changyou in 2010. As of June 30, 2017, the registered capital of Shanghai ICE was \$1.2 million and Gamease held a 100% interest in this entity.
- **Wuhan Baina Information**

Baina (Wuhan) Information Technology Co., Ltd. (“Wuhan Baina Information”) was acquired by Gamease in July 2014. As of June 30, 2017, 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.

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**Financial Information**

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

	As of	
	December 31, 2016	June 30, 2017
<b>ASSETS:</b>		
Cash and cash equivalents	\$ 94,859	\$ 62,665
Accounts receivable, net	72,151	94,180
Prepaid and other current assets	86,722	33,581
Assets held for sale	12,551	0
Intra-Group receivables due from the Company's subsidiaries	197,438	340,392
Total current assets	<u>463,721</u>	<u>530,818</u>
Long-term investments, net	17,472	16,856
Fixed assets, net	4,372	3,604
Intangible assets, net	14,545	13,000
Goodwill	35,161	36,597
Other non-current assets	4,052	2,855
Total assets	<u>\$ 539,323</u>	<u>\$603,730</u>
<b>LIABILITIES:</b>		
Accounts payable	\$ 15,824	\$ 33,767
Accrued liabilities	96,695	72,944
Receipts in advance and deferred revenue	44,797	43,613
Liabilities held for sale	3,232	0
Other current liabilities	111,775	110,913
Intra-Group payables due to the Company's subsidiaries	129,431	150,052
Total current liabilities	<u>401,754</u>	<u>411,289</u>
Long-term taxes payable	13,463	13,787
Deferred tax liabilities	1,273	1,253
Intra-Group payables due to the Company's subsidiaries	19,620	20,079
Total liabilities	<u>\$ 436,110</u>	<u>\$446,408</u>

	Three months ended June 30,		Six months ended June 30,	
	2016	2017	2016	2017
Net revenue	\$ 228,018	\$ 236,251	\$ 446,682	\$ 426,959
Net income /(loss)	<u>\$ 9,924</u>	<u>\$ 42,776</u>	<u>\$ 15,516</u>	<u>\$ 52,208</u>

	Six months ended June 30,	
	2016	2017
Net cash provided by/(used in) operating activities	\$ 30,899	\$ (55,266)
Net cash provided by/(used in) investing activities	(931)	3,841
Net cash provided by financing activities	<u>\$ 0</u>	<u>\$ 6,309</u>

**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.

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*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, who holds 10% of the equity interest in 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 Mr. Wang 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 rights 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 and is 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 and is 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 Jinhu. The loan agreements provide for loans to the shareholders of Tianjin Jinhu for them to make contributions to the registered capital of Tianjin Jinhu in exchange for the equity interests in Tianjin Jinhu. Under the equity pledge agreements, the shareholders of Tianjin Jinhu pledge to Video Tianjin their equity interests in Tianjin Jinhu to secure the performance of their obligations under the loan agreements and Tianjin Jinhu’s obligations to Video Tianjin under their business agreements. The loans are interest free and are repayable on demand, but the shareholders can only repay the loans by transferring to Video Tianjin their equity interests in Tianjin Jinhu.

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

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

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

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*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.

### *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.

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*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.



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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.

## **12. SOHU.COM INC. SHAREHOLDERS' EQUITY**

### ***Takeover Defense***

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

### ***Treasury Stock***

Treasury stock consists of shares repurchased by Sohu.com Inc. that are no longer outstanding and are held by Sohu.com Inc. Treasury stock is accounted for under the cost method. For the six months ended June 30, 2017 and 2016, 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.

#### *Sohu.com Inc. Share-based Awards*

##### *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 June 30, 2017, 584,280 shares were available for grant under the Sohu 2010 Stock Incentive Plan.

##### *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.

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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, February 7, 2017, and May 1, 2017, 253,250, 175,000, and 3,250, respectively, of these stock options had been granted and had become vested on their respective vesting dates, 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 their aggregate fair value at the grant date of \$10.8 million, \$7.0 million, and \$0.1 million, respectively.

A summary of stock option activity under the Sohu 2010 Stock Incentive Plan as of and for the six months ended June 30, 2017 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, 2017	193	\$		\$
Granted	178	0.001		
Exercised	(125)	0.001		
Forfeited or expired	0			
Outstanding at June 30, 2017	246	0.001	7.62	11,073
Vested at June 30, 2017	246	0.001	7.62	11,073
Exercisable at June 30, 2017	246	0.001	7.62	11,073

Note (1): The aggregated intrinsic value in the preceding table represents the difference between Sohu's closing stock price of \$45.06 on June 30, 2017 and the nominal exercise prices of the stock options.

For the three and six months ended June 30, 2017, total share-based compensation expense recognized for these stock options was \$2.4 million and negative \$0.1 million, respectively. For the three and six months ended June 30, 2016, total share-based compensation expense recognized for these stock options was negative \$1.0 million and negative \$1.7 million, respectively.

### 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 six months ended June 30, 2017 is presented below:

<b>Restricted Stock Units</b>	<b>Number of Units (in thousands)</b>	<b>Weighted-Average Grant-Date Fair Value</b>
Unvested at January 1, 2017	11	\$ 70.24
Granted	0	—
Vested	(2)	64.00
Forfeited	(4)	66.73
Unvested at June 30, 2017	5	82.59
Expected to vest after June 30, 2017	4	82.59

For the three and six months ended June 30, 2017, total share-based compensation expense recognized for restricted stock units was \$81,928 and \$144,963, respectively. For the three and six months ended June 30, 2016, total share-based compensation expense recognized for restricted stock units was \$0.4 million and \$0.8 million, respectively.

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As of June 30, 2017, there was \$0.1 million of unrecognized compensation expense related to unvested restricted stock units. The expense is expected to be recognized over a weighted average period of 0.31 years. No restricted stock units vested during the second quarter of 2017. The total fair value on their respective vesting dates of restricted stock units that vested during the three and six months ended June 30, 2017 was \$nil and \$86,078, respectively. The total fair value on their respective vesting dates of restricted stock units that vested during the three and six months ended June 30, 2016 was \$0.1 million and \$0.3 million, respectively.

### *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 June 30, 2017, Sogou had contractually granted options for the purchase of 38,086,200 Sogou ordinary shares under the 2010 Sogou Share Incentive Plan.

Of the contractually-granted Sogou share options for the purchase of 38,086,200 Sogou ordinary shares, options for the purchase of 30,886,200 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 30,886,200 Sogou ordinary shares, options for the purchase of 29,754,250 Sogou ordinary shares vest and become exercisable in four equal installments and options for the purchase of 1,131,950 Sogou ordinary shares vest and become exercisable in two to four installments over varying periods. For purposes of recognition of share-based compensation expense, each installment is considered to be granted as of the date that the performance target has been set. As of June 30, 2017, Sogou had granted options for the purchase of 25,236,495 Sogou ordinary shares under the 2010 Sogou Share Incentive Plan. As of June 30, 2017, options for the purchase of 25,167,933 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 24,887,823 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 three and six months ended June 30, 2017 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 June 30, 2017, for purposes of recognition of share-based compensation expense, Sogou had granted Sogou share options for the purchase of 32,436,495 Sogou ordinary shares, of which options for the purchase of 7,548,672 Sogou ordinary shares were outstanding. A summary of Sogou share option activity under the Sogou 2010 Share Incentive Plan as of and for the six months ended June 30, 2017 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, 2017	9,451	\$ 0.476	
Granted	0		
Exercised	(1,893)	0.001	
Forfeited or expired	(9)	0.001	
Outstanding at June 30, 2017	7,549	0.596	5.73
Vested at June 30, 2017 and expected to vest thereafter	349		
Exercisable at June 30, 2017	280		

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For the three and six months ended June 30, 2017, total share-based compensation expense recognized for share options under the Sogou 2010 Share Incentive Plan was \$0.3 million and \$0.7 million, respectively. For the three and six months ended June 30, 2016, total share-based compensation expense recognized for share options under the Sogou 2010 Share Incentive Plan was \$0.1 million and \$1.2 million, respectively.

As of June 30, 2017, there was \$0.1 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 0.35 years.

The fair value of the ordinary shares of Sogou was assessed using the income approach /discounted cash flow method, with a discount for lack of marketability, given that the shares underlying the 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.

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:

<b>Assumptions Adopted</b>	
Average risk-free interest rate	2.14%~2.26%
Exercise multiple	2~3
Expected forfeiture rate (post-vesting)	1%~12%
Weighted average expected option life	9
Volatility rate	47%
Dividend yield	0%
Fair value	3.18

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 1% for the Sogou share options granted to Sogou management and 12% for the Sogou share options granted to Sogou employees. 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 (the "Sohu Management Sogou Share Option Arrangement") that 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 key employees of the Sohu Group the opportunity to purchase from Sohu up to 12,000,000 ordinary shares of Sogou at a fixed exercise price of \$0.625 or \$0.001 per share. Of these 12,000,000 ordinary shares, 8,800,000 are Sogou ordinary shares previously held by Sohu and 3,200,000 are Sogou ordinary shares that were newly-issued on April 14, 2011 by Sogou to Sohu at a price of \$0.625 per share, or a total of \$2.0 million. As of June 30, 2017, 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 June 30, 2017, 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 June 30, 2017, 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 8,290,000 Sogou ordinary shares had been exercised.

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Options for the purchase of 15,000 Sogou ordinary shares that were granted to members of Sohu's Board of Directors in 2015 vested and became exercisable in 2015, as the service period requirement for vesting had been met.

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 completion 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 three and six months ended June 30, 2017 for these options for the purchase of 2,400,000 Sogou ordinary shares.

As of June 30, 2017, 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 2,412,000 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 six months ended June 30, 2017 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, 2017	3,190	\$ 0.623	
Granted	0		
Exercised	(778)	0.625	
Forfeited or expired	0		
Outstanding at June 30, 2017	<u>2,412</u>	0.622	5.68
Vested at June 30, 2017	<u>12</u>		
Exercisable at June 30, 2017	<u>12</u>		

For the three and six months ended June 30, 2017, total share-based compensation expense recognized for share options under the Sohu Management Sogou Share Option Arrangement were both nil. For the three and six months ended June 30, 2016, total share-based compensation expense recognized for share options under the Sohu Management Sogou Share Option Arrangement was nil and \$0.3 million, respectively.

As of June 30, 2017, 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. There was no share-based compensation expense recognized under the Sohu Management Sogou Share Option Arrangement for the three and six months ended June 30, 2017.

### *Sogou Share Repurchase Transaction*

In January 2017, Sogou repurchased 720,000 of its Class A Ordinary Shares from the former President and Chief Financial Officer of the Sohu Group for an aggregate price of \$7.2 million. Approximately \$4.0 million incremental share-based compensation expense associated with the repurchase, which was made pursuant to letter agreements entered into in 2016 between the Sohu Group and the former President and Chief Financial Officer of the Sohu Group in connection with her resignation, which amount is equal to the excess of the repurchase price over the fair value of Sogou Class A Ordinary Shares as of the repurchase date, related to events occurring in 2016 and was recorded in the Sohu Group's statements of comprehensive income for the first quarter of 2017. The Group assessed the impact and determined that it was not material to the quarter ended December 31, 2016, the year ended December 31, 2016, or the six months ended June 30, 2017.

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### *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 resulting 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 original 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 continued to be recognized over the original remaining vesting period.

As of June 30, 2017, 10,327,500 Sogou ordinary shares that were purchased upon the early exercise of options granted under the Sogou 2010 Share Incentive Plan remained unvested in accordance with the vesting requirements under the original option agreements. All Sogou ordinary shares purchased upon such early-exercise are included in the disclosures under the heading “Sogou 2010 Share Incentive Plan” and “Sohu Management Sogou Share Option Arrangement” above.

### *Tencent Share-based Awards Granted to Employees Who Transferred to Sogou with the Soso Search and Search-related Business*

Certain persons who became Sogou employees when Tencent’s Soso search and 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. Following the transfer of the businesses, 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 and 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.

As of June 30, 2017, unvested Tencent restricted share unit awards held by these employees provided for the issuance of up to 40,300 ordinary shares of Tencent, taking into consideration a five-for-one split of Tencent’s shares that became effective in May 2014. For the three and six months ended June 30, 2017, share-based compensation expense of \$0.3 million and \$0.3 million, respectively, related to these Tencent restricted share units was recognized in the Group’s consolidated statements of comprehensive income. For the three and six months ended June 30, 2016, share-based compensation expense of \$0.5 million and \$0.8 million, respectively, related to these Tencent restricted share units was recognized in the Group’s consolidated statements of comprehensive income. As of June 30, 2017, there was \$0.1 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 0.85 years.

### *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 June 30, 2017, 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.

#### *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.

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### *Share-based Awards granted after Changyou's IPO*

Through June 30, 2017, 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.

A summary of activity for these restricted share units as of and for the six months ended June 30, 2017 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, 2017	10	\$ 14.25
Granted	0	
Vested	0	
Forfeited	0	
Unvested at June 30, 2017	10	14.25
Expected to vest after June 30, 2017	10	14.25

For the three and six months ended June 30, 2017, total share-based compensation expense recognized for the above restricted share units was \$9,000 and \$18,000, respectively. For the three and six months ended June 30, 2016, total share-based compensation expense recognized for the above restricted share units was \$22,000 and \$44,000, respectively.

As of June 30, 2017, there was \$12,000 of unrecognized compensation expense related to unvested restricted share units that were unvested. The expense is expected to be recognized over a weighted average period of 0.42 years. No restricted share units vested during the three and six months ended June 30, 2017. Therefore, the total fair value of restricted share units that vested during the three and six months ended June 30, 2017 was nil for both periods. The total fair value of these restricted share units that were vested during the three and six months ended June 30, 2016 was nil and nil, 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 June 30, 2017, 2,886,000 shares were available for grant under the Changyou 2014 Share Incentive Plan.

### 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.

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As of June 30, 2017, 1,524,000 of these Changyou share options had been granted and had become vested on their respective vesting dates, as a mutual understanding of the subjective performance targets had been reached between Changyou and the recipients, the targets had been satisfied, and the service period requirements had been fulfilled. The cumulative share-based compensation expense for these granted share options has been adjusted and fixed based on their aggregate fair value at the grant date of \$19.5 million.

A summary of share option activity under the Changyou 2014 Share Incentive Plan as of and for the six months ended June 30, 2017 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, 2017	852	\$ 0.01	7.93	\$ 9,032
Granted	295			
Exercised	(570)	0.01		
Forfeited or expired	0			
Outstanding at June 30, 2017	<u>577</u>	0.01	7.65	11,180
Vested at June 30, 2017	<u>577</u>	0.01		11,180
Exercisable at June 30, 2017	<u>577</u>	0.01		

Note (1): The aggregated intrinsic value in the preceding table represents the difference between Changyou's closing price of \$38.76 per ADS, or \$19.38 per Class A ordinary share, on June 30, 2017 and the nominal exercise price of share option.

For the three and six months ended June 30, 2017, share-based compensation expense recognized for these share options under the Changyou 2014 Share Incentive Plan was \$9.5 million and \$15.0 million, respectively. For the three and six months ended June 30, 2016, share-based compensation expense recognized for these share options under the Changyou 2014 Share Incentive Plan was \$3.4 million and \$2.1 million, respectively.

### **Sohu Video Share-based Awards**

On January 4, 2012, Sohu Video adopted the Video 2011 Share Incentive Plan, under which 25,000,000 ordinary shares of Sohu Video are reserved for the purpose of making share incentive awards to management and key employees of Sohu Video and to Sohu management. The maximum term of any share incentive award granted under the Video 2011 Share Incentive Plan is ten years from the grant date. The Video 2011 Share Incentive Plan will expire on January 3, 2021. As of June 30, 2017, grants of options for the purchase of 16,368,200 ordinary shares of Sohu Video had been contractually made and were subject to vesting in four equal installments, with each installment vesting upon a service period requirement being met, as well as Sohu Video's achievement of performance targets for the corresponding period. For purposes of ASC 718-10-25, as of June 30, 2017, no grant date had occurred, because the broader terms and conditions of the option awards had neither been finalized nor mutually agreed upon with the recipients. As of June 30, 2017, options for the purchase of 4,972,800 Sohu Video ordinary shares were vested.

For the three and six months ended June 30, 2017, total share-based compensation expense recognized for vested options under the Video 2011 Share Incentive Plan was \$99,456 and negative \$99,456, respectively. For the three and six months ended June 30, 2016, total share-based compensation expense recognized for vested options under the Video 2011 Share Incentive Plan was negative \$0.8 million and negative \$0.6 million, respectively.

The fair value as of June 30, 2017 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:

<u>Assumptions Adopted</u>	
Average risk-free interest rate	2.52%
Exercise multiple	2.8
Expected forfeiture rate (post-vesting)	14%
Weighted average expected option life	4.5
Volatility rate	44.4%
Dividend yield	0.00%
Fair value	0.68



### 13. NONCONTROLLING INTEREST

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 June 30, 2017 and December 31, 2016, noncontrolling interest in the consolidated balance sheets was \$635.8 million and \$564.2 million, respectively.

	As of	
	December 31, 2016	June 30, 2017
Sogou	\$ 165,584	\$ 188,879
Changyou	398,631	446,792
Other	0	144
Total	<u>\$ 564,215</u>	<u>\$ 635,815</u>

#### *Noncontrolling Interest of Sogou*

As of June 30, 2017 and December 31, 2016, noncontrolling interest of Sogou of \$188.9 million and \$165.6 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 and January 2017.

#### *Noncontrolling Interest of Changyou*

As of June 30, 2017 and December 31, 2016, noncontrolling interest of Changyou of \$446.8 million and \$398.6 million, respectively, was recognized in the Sohu Group's consolidated balance sheets, representing a 32% and a 31% economic interest, respectively, in Changyou's net assets held by shareholders other than Sohu.com Inc., and reflected 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*

For the three and six months ended June 30, 2017, net income attributable to noncontrolling interests in the consolidated statements of comprehensive income was \$40.1 million and \$58.0 million, respectively. For the three and six months ended June 30, 2016, net income attributable to noncontrolling interests in the consolidated statements of comprehensive income was \$16.2 million and \$47.5 million, respectively.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2017	2016	2017
Sogou	\$ 5,488	\$23,688	\$26,100	\$32,086
Changyou	10,744	16,478	21,363	25,986
Other	0	(35)	0	(46)
Total	<u>\$16,232</u>	<u>\$40,131</u>	<u>\$47,463</u>	<u>\$58,026</u>

#### *Noncontrolling Interest of Sogou*

For the three months ended June 30, 2017 and 2016, net income of \$23.7 million and \$5.5 million, respectively, attributable to the noncontrolling interest of Sogou was recognized in the Sohu Group's consolidated statements of comprehensive income, representing Sogou's net income attributable to shareholders other than Sohu.com Inc.

### **Noncontrolling Interest of Changyou**

For the three months ended June 30, 2017 and 2016, net income of \$16.5 million and \$10.7 million, respectively, attributable to the noncontrolling interest of Changyou, was recognized in the Sohu Group's consolidated statements of comprehensive income, representing a 32% and a 31% economic interest, respectively, in Changyou attributable to shareholders other than Sohu.com Inc.

### **14. 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 three and six months ended June 30, 2017, 270,805 and 286,725, respectively, 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. For the three and six months ended June 30, 2016, 244,000 and 255,000, respectively, 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.

- (i) 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 13 - 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 three and six months ended June 30, 2017, 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.

- (ii) 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. 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.

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For the three and six months ended June 30, 2017, all of these Changyou restricted share units and share options 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.

The following table presents the calculation of the Sohu Group's basic and diluted net loss per share (in thousands, except per share data).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2017	2016	2017
<b>Numerator:</b>				
Net loss attributable to Sohu.com Inc., basic	\$(63,024)	\$(88,183)	\$(83,310)	\$(156,431)
Effect of dilutive securities:				
Incremental dilution from Sogou	0	0	0	0
Incremental dilution from Changyou	(362)	(515)	(653)	(931)
Net loss attributable to Sohu.com Inc., diluted	<u>\$(63,386)</u>	<u>\$(88,698)</u>	<u>\$(83,963)</u>	<u>\$(157,362)</u>
<b>Denominator:</b>				
Weighted average basic shares of common stock outstanding	38,691	38,855	38,678	38,833
Effect of dilutive securities:				
Share options and restricted share units	0	0	0	0
Weighted average diluted common shares outstanding	<u>38,691</u>	<u>38,855</u>	<u>38,678</u>	<u>38,833</u>
Basic net loss per share attributable to Sohu.com Inc.	<u>\$ (1.63)</u>	<u>\$ (2.27)</u>	<u>\$ (2.15)</u>	<u>\$ (4.03)</u>
Diluted net loss per share attributable to Sohu.com Inc.	<u>\$ (1.64)</u>	<u>\$ (2.28)</u>	<u>\$ (2.17)</u>	<u>\$ (4.05)</u>

## 15. 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 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.

**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.

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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 on the statement of cash flows; and (d) accounting for forfeitures of share-based payments. This guidance became effective for reporting periods beginning after December 15, 2016. The Group adopted this new guidance on January 1, 2017. The Sohu Group elected to continue to account for forfeitures by estimating expected forfeitures, and this standard does not have a material impact on the Group’s 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.

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 to each period presented using a retrospective transition method. 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.

## **16. SUBSEQUENT EVENT**

In July 2017, Sohu received RMB400.0 million (or approximately \$59.0 million) from Ping An Bank pursuant to the loan arrangements at an interest rate of 6.525%, which is 150% of the rate published by the PBOC as of the date of the drawdown.

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

As used in this report, references to “us,” “we,” “our,” “our company,” “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 Yi He Jia Xun Information Technology Co., Ltd., Tianjin Jinhua Culture Development Co., Ltd. (“Tianjin Jinhua”), Guangzhou Qianjun Network Technology Co., Ltd. (“Guangzhou Qianjun”), Beijing Modu Legendary Culture Media Co., Ltd., Shenzhen Shi Ji Guang Su Information Technology Co., Ltd., Chengdu Easypay Technology Co., Ltd., Beijing Shi Ji Si Su Technology Co., Ltd., Tianjin Sogou Network Technology Co., Ltd. Chongqing Qogir Enterprise Management Consulting 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”) 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, 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), TMobi Limited (formerly known as Muse Entertainment Limited), Dstore Technology Limited, Mobo Information Technology Pte. Ltd., Changyou Mobo Glint 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 Changyou Creative Technology Co., Ltd., BeiJing Changmica Culture 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” in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016 filed with the Securities and Exchange Commission (“SEC”) on February 27, 2017, as updated by Part II Item 1A of this report. Readers are cautioned not to place undue reliance on these forward-looking statements.

## 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 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"), its mobile game TLBB 3D, and its mobile game Legacy TLBB, 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.

### 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. 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. We continuously refined Sohu News App's design and introduce new features to meet users' appetites. In the second quarter of 2017, we continued to upgrade Sohu News App by introducing more video-based content and improve the algorithm to recommend personalized content to our users. On the sales front, in the second quarter of 2017, large brand advertisers' performance remained soft, while the demand from small and medium enterprise ("SME") customers was healthy.

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, especially the prices of premium TV dramas. Since 2016, Sohu Video has been shifting our focus to the self-developed content category, which, in our view, will create long-lasting value to our platform. 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. From the second quarter of 2017, Sohu Video has stopped chasing the costly domestic TV dramas that are schedule to be released in 2018. We expect this decision will generate substantial cost savings and help improve the bottom-line results for Sohu Video in 2018.

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 June 2017, Sogou's mobile search traffic had grown 50% from the end of June 2016. Mobile search revenues accounted for 76% of total search revenues. We also made solid progress in artificial intelligence, in particular with voice technology. As of June 30, 2017, daily use of voice input through Sogou Mobile Keyboard had increased by over 80% from a year ago.

For Changyou's online game business, we saw solid growth in both revenue and profit due to the successful launch of the mobile game Legacy TLBB in the second quarter. We will continue to direct our strategic focus on massively multiplayer online role-playing games ("MMORPGs"), advanced casual games and simulation games ("SLG"). We remain committed to delivering the highest quality games possible as we work hard to develop our next blockbuster. For Changyou's PC games, the decline in revenue of TLBB PC game was more moderate than our previous expectations. We will continue to focus on user stability of existing games. For the three months ended June 30, 2017, the PC games and mobile games of Changyou had approximately 9.8 million Average Monthly Active Accounts and approximately 3.4 million Quarterly Aggregate Active Paying Accounts.

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### **Our Business**

Through the operation of Sohu, Sogou and Changyou, we generate online advertising revenues (including brand advertising revenues and search and search-related advertising revenues), online games revenues and other revenues. Online advertising and online games are our core businesses. For the three months ended June 30, 2017, total revenues generated by Sohu, Sogou and Changyou were approximately \$461.2 million, including:

Sohu:

- \$79.0 million in brand advertising revenues, of which \$41.3 million was from Sohu Media Portal, \$21.7 million was from Sohu Video, and \$16.0 million was from Focus; and
- \$20.9 million in other revenues, mainly attributable to revenues from paid subscription services, sub-licensing of purchased video content to third parties, interactive broadcasting services, and content provided through the platforms of the three main telecommunications operators in China.

Total revenues generated by Sohu were \$99.9 million.

Sogou:

- \$186.7 million in search and search-related advertising revenues; and
- \$24.2 million in other revenues, attributable to Sogou's offering of Internet value-added services (or "IVAS") primarily with respect to the operation of Web games and mobile games developed by third parties, as well as offering of other products and services to users.

Total revenues generated by Sogou were \$210.9 million.

Changyou:

- \$122.4 million in online game revenues;
- \$7.1 million in brand advertising revenues, mainly attributable to Changyou's 17173.com Website; and
- \$20.9 million in other revenues attributable to Changyou's cinema advertising business and IVAS business.

Total revenues generated by Changyou were \$150.4 million.

For the three months ended June 30, 2017 our total brand advertising revenues were \$86.1 million, total search and search-related advertising revenues were \$186.7 million, total online game revenues were \$122.4 million, and total other revenues were \$66.0 million.

### **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.



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### *Other Business*

Sohu also engages in the other business, which consists primarily of paid subscription services, sub-licensing of purchased video content to third parties, interactive broadcasting services, and content provided through the platforms of the three main telecommunications operators in China. 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 consists primarily of search and search-related advertising services offered by Sogou. Search and search-related advertising services enable advertisers' promotional links to be displayed on Sogou's search results pages and other properties and third parties' Internet properties where the links are relevant to the subject and content of searches and such properties. Sogou's advertising services expand distribution of advertisers' promotional links and advertisements by leveraging traffic on third parties' 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 advertising revenues in our consolidated statements of comprehensive income.

#### *Other Business*

Sogou also engages in the other business, by offering IVAS primarily with respect to the operation of Web games and mobile games developed by third parties, as well as by offering other products and services 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.

#### *Online Game Business*

Changyou's online game business offers to game players (a) PC games, which are interactive online games that are accessed and played simultaneously by hundreds of thousands of game players through personal computers and require that local client-end game access software be installed on the computers used; (b) mobile games, which are played on mobile devices and require an Internet connection. Prior to the sale of Shenzhen 7Road in August 2015, Changyou's online games also included Web games, which are online games that are played through a Web browser with no local game software installation requirements. Following the sale of Shenzhen 7Road, Web games became an insignificant part of Changyou's online game business. 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 our consolidated statements of comprehensive income.



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### *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 regarding 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 Inc. (collectively with its subsidiaries and VIEs "MoboTap"), is a gateway to a host of user activities on mobile devices, with the majority of its users based in Europe, North America, 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. 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. Due to the suspension of negotiations with a potential buyer of MoboTap in the first quarter of 2017, Changyou's management determined that the disposal is unlikely to be completed within one year. As a result, the assets held for sale and liabilities held for sale related to MoboTap were reclassified and have been as assets and liabilities held for use and measured at the lower of the carrying value before MoboTap was classified as held for sale, adjusted for any depreciation and amortization expense that would have been recognized had the assets and liabilities been continuously classified as held for use, or their fair value as of the reclassification date, in the Sohu Group's consolidated balance sheet since the reclassification date. Changyou recorded a \$1.4 million expense in the consolidated statements of comprehensive income for catch-up of depreciation and amortization expense of the assets held for sale before the reclassification. 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 our consolidated statements of comprehensive income.

## **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 generally accepted accounting principles ("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 and Recognition of Noncontrolling Interest**

Our consolidated financial statements include the accounts of Sohu.com Inc. and its subsidiaries and consolidated VIEs. All intra-Group 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. 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 June 30, 2017, Sogou had outstanding a combined total of 335,919,409 ordinary shares and preferred shares held as follows:

- (i) Sohu.com Inc.: 130,920,250 Class A Ordinary Shares, of which 3,707,000 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: 21,441,284 Class A Ordinary Shares.

#### Sohu's Shareholding in and Control of Sogou

As of June 30, 2017, 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 June 30, 2017, 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 investments from, 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 decreases to zero;
- (ii) additional net losses are allocated to holders of Sogou Series A Preferred Shares until their basis in Sogou decreases 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.

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;

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- (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.

#### (i) 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 dividends ("Accrued Dividends"). Accrued 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.

#### (ii) 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 Accrued 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 Accrued 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.

#### (iii) Redemption Rights

The Sogou Preferred Shares are not redeemable at the option of the holders.

#### (iv) 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 an IPO of Sogou with certain parameters 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.

#### (v) 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.

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### (vi) 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 June 30, 2017, we held approximately 68% of the combined total of Changyou's outstanding ordinary shares, and controlled approximately 95% 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 advertising 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.

### 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.

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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.

### (i) 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.

### (ii) 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.

### (iii) 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.

### (iv) 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 recognize 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 Advertising Revenues*

Search and search-related services consist primarily of search and search-related advertising services offered by Sogou.

### *Pay-for-click Services*

Pay-for-click services are services that enable our advertisers’ promotional links to be displayed on Sogou’s search results pages and third parties’ Internet properties where the links are relevant to the subject and content of searches and such properties. For pay-for-click services, we introduce Internet users to our advertisers through our auction-based 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.

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### Other Online Advertising Services

Other online advertising services mainly consist of displaying advertisers' promotional links on Sogou's Internet properties. Revenue for time-based advertising 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. Revenue for performance-based advertising services is recognized when our obligations under the contract have been met.

Sogou's advertising services expand distribution of advertisers' promotional links and advertisements by leveraging traffic on third parties' Internet properties, including Web content, software, and mobile applications. We recognize gross revenue for the amount of fees we receive from advertisers, as we are the primary obligator to the advertisers. Payments made to operators of third-party Internet properties are included in traffic acquisition costs, which are included in cost of search and search-related advertising revenues.

### 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 Shenzhen 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.

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 Shenzhen 7Road in 2015. Proceeds from those 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 (such as its mobile game Legacy TLBB) 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 the revenue-sharing amounts paid to third-party developers as cost of revenues or product development expenses.

### **Other Revenues**

#### *Sohu*

Other revenues attributable to Sohu consist primarily of revenues from paid subscription services, sub-licensing of purchased video content to third parties, interactive broadcasting services, and content provided through the platforms of the three main telecommunications operators in China.

#### *Sogou*

Other revenues attributable to Sogou are IVAS revenues primarily derived from Sogou's offering of Web games and mobile games developed by third parties, and revenues from other products and services that Sogou provides to users.

#### *Changyou*

Other revenues attributable to Changyou are primarily from its cinema advertising business and are also 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 is rendered or items are consumed under the gross method, as Changyou is the principal obligor for provision of the services.

### **Product Development Expenses**

Product development expenses mainly consist of salary and benefits expenses, content and license expenses, development, upgrade and technical support 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 cost of upgrades and technical support after the online games are available for marketing.

### **Advertising Expenses**

Advertising expenses are included in sales and marketing expenses, and 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.

### **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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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.

#### *Sogou Share-based Awards*

In determining the fair value of share options granted by Sogou as share-based awards, a binomial model was applied. The determination of the fair value is affected by the fair value of the ordinary shares as well as assumptions regarding a number of complex and subjective variables, including risk-free interest rates, exercise multiples, expected forfeiture rates, the expected share price volatility rates, and expected dividends. The fair values of the ordinary shares were 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. Certain persons who became Sogou employees when Tencent's Soso search and 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 and search-related businesses to Sogou, Sogou applied the guidance in ASC 505-50 to measure the related compensation expense, as the expense is deemed to have been incurred by Tencent as an investor on Sogou's behalf, based on the then-current fair value at each reporting date. 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.



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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 over the estimated period during which the service period requirement and performance target will be met, which is usually within one year. For Tencent restricted share units that Tencent had granted to employees who transferred to Sogou with the Soso search and 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 the service has been provided. 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.

For Sogou Class A Ordinary Shares repurchased from our former President and Chief Financial Officer in the first quarter of 2017, share-based compensation expense is recognized by the Sohu Group in the consolidated statements of comprehensive income in an amount equal to the excess of the repurchase price over the fair value of the Sogou Class A Ordinary Shares at the repurchase date.

### *Sohu Video Share-based Awards*

On January 4, 2012, Sohu Video, the holding entity of Sohu's video division, adopted a 2011 Share Incentive Plan (the "Video 2011 Share Incentive Plan") which provides for the issuance of up to 25,000,000 ordinary shares of Sohu Video (representing approximately 10% of the outstanding Sohu Video shares on a fully-diluted basis) to management and key employees of the video division and to Sohu management. As of June 30, 2017, grants of options for the purchase of 16,368,200 ordinary shares of Sohu Video had been contractually made, of which options for the purchase of 4,972,800 ordinary shares were vested.

For purposes of ASC 718-10-25, as of June 30, 2017, 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.

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Our deferred tax assets are related 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.

### *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 June 30, 2017, the following principal entities were qualified as HNTEs and were entitled to an income tax rate of 15%.

#### 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. Sohu Media and Guangzhou Qianjun will re-apply for HNTE qualification in the third quarter of 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 the third quarter of 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 the third quarter of 2017.
- Gamespace. Gamespace qualified as HNTE for the years 2017 to 2019, and will need to re-apply for HNTE qualification in 2020.

#### 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 a 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.

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### For Sohu's Business

- Sohu New Momentum. In the second quarter of 2017, Sohu New Momentum completed a self-assessment and filed required supporting documents to entitle it to the first year of an income tax rate reduction from 25% to 12.5% as a Software Enterprise for 2016, and will follow the same process in 2018 to entitle it to the second year of an income tax rate reduction from 25% to 12.5% for 2017.

### For Sogou's Business

- Sogou Technology. In the second quarter of 2017, Sogou Technology completed a self-assessment and filed required supporting documents for KNSE status for 2016, and will follow the same process in 2018 for KNSE status for 2017.

### For Changyou's Business

- AmazGame. In the second quarter of 2017, AmazGame completed a self-assessment and filed required supporting documents for KNSE status for 2016, and will follow the same process in 2018 for KNSE status for 2017.
- Wuhan Baina Information. In the second quarter of 2017, Wuhan Baina Information completed a self-assessment and filed required supporting documents to entitle it to the first year of an income tax exemption as a Software Enterprise for 2016, and will follow the same process in 2018 to entitle it to the second year of an income tax exemption for 2017.

### **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**

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.

- (i) 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.

- (ii) 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, short-term bank loans, 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.

### **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.

### **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.

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### **Long-Lived Assets**

Long-lived assets include fixed assets and intangible assets.

#### ***Fixed Assets***

Fixed assets mainly comprise office buildings, leasehold improvements, building improvements, vehicles, office furniture and computer equipment and hardware. 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><u>Fixed Assets</u></b>	<b><u>Estimated Useful Lives (years)</u></b>
Office buildings	36-47
Leasehold improvements	Lesser of term of the lease or the estimated useful lives of the assets
Building improvements	10
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 domain names and trademarks, developed technologies, computer software, purchased video content, cinema advertising slot rights and operating rights for licensed games. 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><u>Intangible Assets</u></b>	<b><u>Estimated Useful Lives (years)</u></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.

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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 the content’s carrying value to its NRV. An impairment loss will be recorded if the carrying value of video content is higher than its NRV. The impairment to be recognized is measured by the amount by which the carrying value of video content exceeds its NRV.

### **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 are 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 the 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.

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**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):

	Three Months Ended June 30,						Six Months Ended June 30,					
	2016		2017		2017 vs 2016		2016		2017		2017 vs 2016	
	Amount	Percentage of the total revenue	Amount	Percentage of the total revenue	Amount	Incremental ratio	Amount	Percentage of the total revenue	Amount	Percentage of the total revenue	Amount	Incremental ratio
Revenues												
Online advertising:												
Brand advertising	\$112,887	27%	\$ 86,071	19%	\$(26,816)	(24)%	\$238,390	29%	\$167,483	20%	\$(70,907)	(30)%
Search and search-related advertising	160,152	38%	186,747	40%	26,595	17%	293,966	35%	328,782	39%	34,816	12%
Subtotal of online advertising revenues	273,039	65%	272,818	59%	(221)	0%	532,356	64%	496,265	59%	(36,091)	(7)%
Online game	99,227	24%	122,398	27%	23,171	23%	201,756	24%	207,723	25%	5,967	3%
Others	47,872	11%	65,952	14%	18,080	38%	93,978	12%	131,283	16%	37,305	40%
Total revenues	\$420,138	100%	461,168	100%	\$ 41,030	10%	\$828,090	100%	\$835,271	100%	\$ 7,181	1%



### **Online Advertising Revenues**

Online advertising revenues were \$272.8 million and \$496.3 million, respectively, for the three and six months ended June 30, 2017, compared to \$273.0 million and \$532.4 million, respectively, for the corresponding periods in 2016. Online advertising revenues were generally stable compared to the three months ended June 30, 2016 to the three months ended June 30, 2017, while the decrease from the six months ended June 30, 2016 to the six months ended June 30, 2017 was \$36.1 million, representing a year-on-year decrease of 7%.

### **Brand Advertising Revenues, Generated by Sohu and Changyou**

Brand advertising revenues were \$86.1 million and \$167.5 million, respectively, for the three and six months ended June 30, 2017, compared to \$112.9 million and \$238.4 million, respectively, for the corresponding periods in 2016. The decrease in brand advertising revenues from the three months ended June 30, 2016 to the three months ended June 30, 2017 was \$26.8 million, representing a year-on-year decrease of 24%, and the decrease from the six months ended June 30, 2016 to the six months ended June 30, 2017 was \$70.9 million, representing a year-on-year decrease of 30%. The year-on-year decrease in brand advertising revenues were mainly from Sohu Video and Focus.

### **Sohu**

- *Sohu Media Portal*

Revenues from Sohu Media Portal were \$41.3 million and \$78.1 million, respectively, for the three and six months ended June 30, 2017, compared to \$47.0 million and \$92.2 million, respectively, for the corresponding periods in 2016. The decrease in revenues from Sohu Media Portal from the three months ended June 30, 2016 to the three months ended June 30, 2017 was \$5.7 million, representing a year-on-year decrease of 12%, and the decrease from the six months ended June 30, 2016 to the six months ended June 30, 2017 was \$14.1 million, representing a year-on-year decrease of 15%. The average amount spent per advertiser was approximately \$17,000 and \$24,000, respectively, for the three months and six months ended June 30, 2017, compared to \$35,000 and \$47,000, respectively, for the corresponding periods 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 2,483 and 3,267, respectively, for the three and six months ended June 30, 2017, compared to 1,361 and 1,957, respectively, for the corresponding periods in 2016.

- *Sohu Video*

Revenues from Sohu Video were \$21.7 million and \$43.4 million, respectively, for the three and six months ended June 30, 2017, compared to \$31.6 million and \$73.0 million, respectively, for the corresponding periods in 2016. The decrease in revenues from Sohu Video from the three months ended June 30, 2016 to the three months ended June 30, 2017 was \$9.9 million, representing a year-on-year decrease of 31%, and the decrease from the six months ended June 30, 2016 to the six months ended June 30, 2017 was \$29.6 million, representing a year-on-year decrease of 41%. The changes were mainly attributable to fluctuations both in the number of advertisers and in the average amount spent per advertiser. Both the number of advertisers and the average amount spent per advertiser for the three and six months ended June 30, 2017 decreased compared to the corresponding periods in 2016, which led to the decreases in revenues from Sohu Video. The number of advertisers for Sohu Video was 165 and 246, respectively, for the three and six months ended June 30, 2017, compared to 206 and 324, respectively, for the corresponding periods in 2016. The average amount spent per advertiser was approximately \$132,000 and \$176,000, respectively, for the three and six months ended June 30, 2017, compared to \$153,000 and \$225,000, respectively, for the corresponding periods in 2016.

- *Focus*

Revenues from Focus were \$16.0 million and \$33.0 million, respectively, for the three and six months ended June 30, 2017, compared to \$22.7 million and \$53.8 million, respectively, for the corresponding periods in 2016. The decrease in revenues from Focus from the three months ended June 30, 2016 to the three months ended June 30, 2017 was \$6.7 million, representing a year-on-year decrease of 30%, and the decrease from the six months ended June 30, 2016 to the six months ended June 30, 2017 was \$20.8 million, representing a year-on-year decrease of 39%.

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Revenues from Focus were generated through the Fixed Price model and the E-commerce model.

For the Fixed Price model, revenues were \$10.8 million and \$22.0 million, respectively, for the three and six months ended June 30, 2017, compared to \$9.3 million and \$25.3 million, respectively, for the corresponding periods in 2016, representing a year-on-year increase of 16% and a year-on-year decrease of 13%, respectively, from the three months ended June 30, 2016 to the three months ended June 30, 2017 and from the six months ended June 30, 2016 to the six months ended June 30, 2017.

For the E-commerce model, revenues were \$5.2 million and \$11.0 million, respectively, for the three and six months ended June 30, 2017, compared to \$13.4 million and \$28.5 million, respectively, for the corresponding periods in 2016, representing a year-on-year decrease of 61% for both from the three months ended June 30, 2016 to the three months ended June 30, 2017 and from the six months ended June 30, 2016 to the six months ended June 30, 2017. The decrease was mainly driven by sharp declines in the numbers of paying subscribers and cooperative developers, resulting from the PRC government's implementation of tightened real estate policies starting from the beginning of 2017. The number of developers with which we had cooperation arrangements was 384 and 670, respectively, for the three and six months ended June 30, 2017, compared to 643 and 897, respectively, for the corresponding periods in 2016. The number of paying subscribers for the membership services was 7,787 and 18,875, respectively, for the three and six months ended June 30, 2017, compared to 24,645 and 47,817, respectively, for the corresponding periods in 2016.

### Changyou

- *17173.com Website*

Revenues from the 17173.com Website were \$7.1 million and \$12.9 million, respectively, for the three and six months ended June 30, 2017, compared to \$11.6 million and \$19.4 million, respectively, for the corresponding periods in 2016. The decrease in revenues from 17173.com Website for the three months ended June 30, 2017 compared to the three months ended June 30, 2016 was \$4.5 million, representing a year-on-year decrease of 39%, and the decrease for the six months ended June 30, 2017 compared to the six months ended June 30, 2016 was \$6.5 million, representing a year-on-year decrease of 34%. The decrease was primarily a result of fewer games being marketed on the 17173.com Website. The number of advertisers on the 17173.com Website was 88 and 122, respectively, for the three and six months ended June 30, 2017, compared to 94 and 123, respectively, for the corresponding periods in 2016. The average amount spent per advertiser was approximately \$81,000 and \$106,000, respectively, for the three months and six months ended June 30, 2017, compared to \$123,000 and \$158,000, respectively, for the corresponding periods in 2016.

### *Search and Search-related Advertising Revenues, Generated by Sogou*

Revenues from search and search-related advertising were \$186.7 million and \$328.8 million, respectively, for the three and six months ended June 30, 2017, compared to \$160.2 million and \$294.0 million, respectively, for the corresponding periods in 2016. The increase in revenues from search and search-related advertising from the three months ended June 30, 2016 to the three months ended June 30, 2017 was \$26.5 million, representing a year-on-year growth of 17%, and the increase from the six months ended June 30, 2016 to the six months ended June 30, 2017 was \$34.8 million, representing a year-on-year growth of 12%.

The increase in revenues from revenues from search and search-related advertising was mainly attributable to an increase in revenues from pay-for-click services which was driven by healthy growth in mobile traffic and monetization.

Revenues from pay-for-click services accounted for approximately 86% and 85%, respectively, of the total search and search-related advertising revenues for the three and six months ended June 30, 2017, compared to 83% and 82%, respectively, for the corresponding periods in 2016. The growth in revenues from pay-for-click services was principally attributable to an increase in the number of paid clicks, driven by growth in mobile search traffic.

### *Online Game Revenues Generated by Changyou*

Revenues from the online game business were \$122.4 million and \$207.7 million, respectively, for the three and six months ended June 30, 2017, compared to \$99.2 million and \$201.8 million, respectively, for the corresponding periods in 2016. The increase was mainly driven by the successful launch of the new mobile game Legacy TLBB in the second quarter of 2017.

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### *PC Games and Mobile Games*

Revenues from PC games were \$57.6 million and \$122.5 million, respectively, for the three and six months ended June 30, 2017, compared to \$65.6 million and \$133.9 million, respectively, for the corresponding periods in 2016. The decrease in revenues from PC games from the three months ended June 30, 2016 to the three months ended June 30, 2017 was \$8.0 million, representing a year-on-year decrease of 12%, and the decrease from the six months ended June 30, 2016 to the six months ended June 30, 2017 was \$11.4 million, representing a year-on-year decrease of 9%. 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. For the three and six months ended June 30, 2017, the PC game TLBB generated \$47.8 million and \$101.1 million, respectively, in revenues, accounting for approximately 39% and 49%, respectively, of Changyou's online game revenues, approximately 32% and 37%, respectively, of Changyou's total revenues and approximately 10% and 12%, respectively, of the Sohu Group's total revenues.

Revenues from mobile games were \$64.3 million and \$84.1 million, respectively, for the three and six months ended June 30, 2017, compared to \$32.5 million and \$65.2 million, respectively, for the corresponding periods in 2016. The increase in revenues from mobile games from the three months ended June 30, 2016 to the three months ended June 30, 2017 was \$31.8 million, representing a year-on-year increase of 98%, and the increase from the six months ended June 30, 2016 to the six months ended June 30, 2017 was \$18.9 million, representing a year-on-year increase of 29%. The increase in revenues from mobile games was mainly driven by the successful launch of the new mobile game Legacy TLBB in the second quarter of 2017.

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	
	PC games	Mobile games	PC games	Mobile games
2016	3.0	3.2	2.9	2.4
2017	2.4	1.1	2.4	7.4

  

Quarterly Aggregate Active Paying Accounts (2) (in millions)	Three Months Ended March 31		Three Months Ended June 30	
	PC games	Mobile games	PC games	Mobile games
2016	1.1	0.8	1.0	0.6
2017	0.9	0.3	0.9	2.5

- (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 were used at least once during the quarter.

### *Web Games*

Revenues from Web games were \$0.5 million and \$1.1 million, respectively, for the three and six months ended June 30, 2017, compared to \$1.1 million and \$2.7 million, respectively, for the corresponding periods in 2016.

### *Other Revenues*

Revenues from other services were \$66.0 million and \$131.3 million, respectively, for the three and six months ended June 30, 2017, compared to \$47.9 million and \$94.0 million, respectively, for the corresponding periods in 2016.

The increase from the three months ended June 30, 2016 to the corresponding period of 2017 was \$18.1 million, consisting of a \$4.9 million increase in revenues from sub-licensing of purchased video content to third parties, a \$4.8 million increase in IVAS revenues, a \$4.6 million increase in paid subscription services, and a \$3.8 million increase in revenues from the cinema advertisement business.

The increase from the six months ended June 30, 2016 to the corresponding period of 2017 was \$37.3 million, consisting mainly of a \$14.8 million increase in revenues from the cinema advertisement business, a \$9.7 million increase in IVAS revenues, a \$8.3 million increase in paid subscription service revenues, and a \$3.6 million increase in interactive broadcasting service revenues.

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**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):

	Three Months Ended June 30,						Six Months Ended June 30,					
	2016		2017		2017 vs 2016		2016		2017		2017 vs 2016	
	Amount	Percentage of the total cost	Amount	Percentage of the total cost	Amount	Incremental ratio	Amount	Percentage of the total cost	Amount	Percentage of the total cost	Amount	Incremental ratio
Cost of revenues:												
Online advertising:												
Brand advertising	\$ 93,654	44%	\$ 124,730	45%	\$ 31,076	33%	\$ 179,290	44%	\$ 204,927	41%	\$ 25,637	14%
Search and search-related advertising	71,998	34%	96,692	35%	24,694	34%	134,090	33%	178,799	36%	44,709	33%
Subtotal of cost of online advertising revenues	165,652	78%	221,422	80%	55,770	34%	313,380	77%	383,726	77%	70,346	22%
Online game	25,380	12%	11,613	4%	(13,767)	(54)%	51,513	13%	28,118	6%	(23,395)	(45)%
Others	21,226	10%	45,159	16%	23,933	113%	40,212	10%	85,229	17%	45,017	112%
Total cost of revenues	\$212,258	100%	\$278,194	100%	\$ 65,936	31%	\$405,105	100%	\$497,073	100%	\$ 91,968	23%

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### *Cost of Online Advertising Revenues*

Cost of online advertising revenues was \$221.4 million and \$383.7 million, respectively, for the three and six months ended June 30, 2017, compared to \$165.7 million and \$313.4 million, respectively, for the corresponding periods in 2016. The increase in cost of online advertising revenues from the three months ended June 30, 2016 to the three months ended June 30, 2017 was \$55.7 million, representing a year-on-year growth of 34%. The increase in cost of online advertising revenues from the six months ended June 30, 2016 to the six months ended June 30, 2017 was \$70.3 million, representing a year-on-year growth of 22%.

### *Cost of Brand Advertising Revenues*

Cost of brand advertising revenues mainly consists of content and license costs, bandwidth leasing costs, salary and benefits expense, and depreciation expense.

Cost of brand advertising revenues was \$124.7 million and \$204.9 million, respectively, for the three and six months ended June 30, 2017, compared to \$93.7 million and \$179.3 million, respectively, for the corresponding periods in 2016.

The increase in cost of brand advertising revenues from the three months ended June 30, 2016 to the three months ended June 30, 2017 was \$31.0 million, representing a year-on-year growth of 33%. The increase mainly consisted of a \$39.5 million increase in content and license costs, resulting primarily from an impairment charge related to video content in the second quarter of 2017, offset by a \$6.6 million decrease in bandwidth leasing costs and a \$2.5 million decrease in salary and benefits expense. In the second quarter of 2017, we recognized an impairment loss of \$44.9 million, which was mainly due to the ongoing restructuring of the sales team of Sohu Video as well as a strategic shift to reduce purchasing of licensed video content beginning in the second half of 2016. These two factors had an adverse impact on Sohu Video's performance for the second quarter of 2017, which has failed to meet the management's expectation. The management also revised downward their expectations of the programming usefulness of certain of Sohu Video's purchased video content.

The increase in cost of brand advertising revenues from the six months ended June 30, 2016 to the six months ended June 30, 2017 was \$25.6 million, representing a year-on-year growth of 14%. The increase mainly consisted of a \$41.6 million increase in content and license costs resulting primarily from an impairment charge related to video content in the second quarter of 2017, offset by a \$12.1 million decrease in bandwidth leasing costs and a \$4.0 million decrease in salary and benefits expense.

Our brand advertising gross margin was negative 45% and negative 22%, respectively, for the three and six months ended June 30, 2017, as compared to 17% and 25%, respectively, for the corresponding periods in 2016. The sharp decrease in our brand advertising gross margin was mainly due to recognition of an impairment charge related to video content in the second quarter of 2017.

### *Cost of Search and Search-related Advertising Revenues*

Cost of search and search-related advertising revenues mainly consists of traffic acquisition costs, bandwidth leasing costs, depreciation expenses, as well as salary and benefits expenses.

Cost of search and search-related advertising revenues was \$96.7 million and \$178.8 million, respectively, for the three and six months ended June 30, 2017, compared to \$72.0 million and \$134.1 million, respectively, for the corresponding periods in 2016.

The increase in cost of search and search-related advertising revenues from the three months ended June 30, 2016 to the three months ended June 30, 2017 was \$24.7 million. The increase mainly consisted of a \$20.2 million increase in traffic acquisition costs and a \$3.7 million increase in depreciation expenses.

The increase in cost of search and search-related advertising revenues from the six months ended June 30, 2016 to the six months ended June 30, 2017 was \$44.7 million. The increase mainly consisted of a \$34.3 million increase in traffic acquisition costs and a \$7.0 million increase in depreciation expenses.

Our search and search-related advertising gross margin was 48% and 46%, respectively, for the three and six months ended June 30, 2017, as compared to 55% and 54%, respectively, for the corresponding periods in 2016. The decrease in our search and search-related advertising gross margin was mainly due to higher traffic acquisition costs as a percentage of search and search-related advertising revenues.

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### *Cost of Online Game Revenues*

Cost of online game revenues mainly consists of revenue-sharing payments, salary and benefits expense, amortization and depreciation expenses, and content and license costs.

Cost of online game revenues was \$11.6 million and \$28.1 million, respectively, for the three and six months ended June 30, 2017, compared to \$25.4 million and \$51.5 million, respectively, for the corresponding periods in 2016.

The decrease in cost of online game revenues from the three months ended June 30, 2016 to the three months ended June 30, 2017 was \$13.8 million, representing a year-on-year decrease of 54%. The decrease consisted primarily of a \$7.6 million decrease in revenue-sharing payments to mobile APP stores and third-party developers, a \$4.6 million decrease in bandwidth leasing costs, and a \$1.4 million decrease in salary and benefits expense.

The decrease in cost of online game revenues from the six months ended June 30, 2016 to the six months ended June 30, 2017 was \$23.4 million, representing a year-on-year decrease of 45%. The decrease consisted primarily of a \$12.9 million decrease in revenue-sharing payments to mobile APP stores and third-party developers, a \$5.4 million decrease in bandwidth leasing costs, and a \$3.6 million decrease in salary and benefits expense.

Our online game gross margin was 91% and 86%, respectively, for the three and the six months ended June 30, 2017, compared to 74% for both the three and the six months ended June 30, 2016. The increase in our online game gross margin was mainly due to the successful launch of Legacy TLBB in the second quarter of 2017, which has a high gross margin as revenue is recognized on a net basis after revenue-sharing with the third-party licensee operator.

### *Cost of Other revenues*

Cost of other revenues mainly consists of payments to theaters 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.

Cost of other revenues was \$45.2 million and \$85.2 million, respectively, for the three and six months ended June 30, 2017, compared to \$21.2 million and \$40.2 million, respectively, for the corresponding periods in 2016. The increase in cost of other revenues for the three and six months period was mainly due to increased payments to theaters for pre-film screening advertising slots of \$8.6 million and \$17.2 million, respectively, and increased content and license costs related to paid subscription services of \$7.8 million and \$17.1 million, respectively.

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**Operating Expenses**

The following table presents our operating expenses by nature and by proportion for the periods indicated (in thousands, except percentages):

	Three Months Ended June 30,						Six Months Ended June 30,					
	2016		2017		2017 vs 2016		2016		2017		2017 vs 2016	
	Amount	Percentage of the total expense	Amount	Percentage of the total expense	Amount	Incremental ratio	Amount	Percentage of the total expense	Amount	Percentage of the total expense	Amount	Incremental ratio
Operating expenses:												
Product development	\$ 88,959	38%	\$100,146	45%	\$ 11,187	13%	\$171,638	39%	\$184,244	43%	\$ 12,606	7%
Sales and marketing	117,966	50%	94,845	43%	(23,121)	(20)%	208,013	48%	184,931	43%	(23,082)	(11)%
General and administrative	29,650	12%	27,657	12%	(1,993)	(7)%	57,257	13%	56,007	14%	(1,250)	(2)%
Total operating expenses	<u>\$236,575</u>	100%	<u>\$222,648</u>	100%	<u>\$(13,927)</u>	(6)%	<u>\$436,908</u>	100%	<u>\$425,182</u>	100%	<u>\$(11,726)</u>	(3)%

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### *Product Development Expenses*

Product development expenses mainly consist of salary and benefits expenses, content and license expenses, development, upgrade and technical support service fees, share-based compensation expense, depreciation and amortization expenses, and facilities expenses.

Product development expenses were \$100.1 million and \$184.2 million, respectively, for the three and six months ended June 30, 2017, compared to \$89.0 million and \$171.6 million, respectively, for the corresponding periods in 2016.

The increase in product development expenses from the three months ended June 30, 2016 to the three months ended June 30, 2017 was \$11.1 million. The increase mainly consisted of a \$6.5 million increase in content and license expenses, a \$3.2 million increase in share-based compensation expense, a \$1.4 million increase in technical service fees, and a \$1.2 million increase in salary and benefits expenses, offset by a \$1.1 million decrease in depreciation and amortization expenses.

The increase in product development expenses from the six months ended June 30, 2016 to the six months ended June 30, 2017 was \$12.6 million. The increase mainly consisted of a \$6.6 million increase in content and license expenses, a \$5.6 million increase in share-based compensation expense, and a \$1.4 million increase in technical service fees, offset by a \$1.2 million decrease in depreciation and amortization expenses.

### *Sales and Marketing Expenses*

Sales and marketing expenses mainly consist of advertising and promotional expenditures, salary and benefits expenses, travel expenses, and facility expenses.

Sales and marketing expenses were \$94.8 million and \$184.9 million, respectively, for the three and six months ended June 30, 2017, compared to \$118.0 million and \$208.0 million, respectively, for the corresponding periods in 2016.

The decrease in sales and marketing expenses from the three months ended June 30, 2016 to the three months ended June 30, 2017 was \$23.2 million. The decrease mainly consisted of a \$20.3 million decrease in advertising and promotional expenditures, and a \$3.9 million decrease in salary and benefits expenses, offset by a \$1.2 million increase in travel expenses.

The decrease in sales and marketing expenses from the six months ended June 30, 2016 to the six months ended June 30, 2017 was \$23.1 million. The decrease mainly consisted of a \$19.0 million decrease in advertising and promotional expenditures and a \$5.6 million decrease in salary and benefits expenses, offset by a \$1.6 million increase in travel expenses.

### *General and Administrative Expenses*

General and administrative expenses mainly consist of salary and benefits expenses, share-based compensation expense, professional service fees, travel expenses, depreciation and amortization expenses, and facility expenses.

General and administrative expenses were \$27.7 million and \$56.0 million, respectively, for the three and six months ended June 30, 2017, compared to \$29.7 million and \$57.3 million, respectively, for the corresponding periods in 2016.

The decrease in general and administrative expenses from the three months ended June 30, 2016 to the three months ended June 30, 2017 was \$2.0 million. The decrease mainly consisted of a \$4.5 million decrease in salary and benefits expenses, a \$1.6 million decrease in facilities expenses, and a \$1.4 million decrease in professional service fees, offset by a \$5.9 million increase in share-based compensation expense.

The decrease in general and administrative expenses from the six months ended June 30, 2016 to the six months ended June 30, 2017 was \$1.3 million. The decrease mainly consisted of a \$5.1 million decrease in salary and benefits expenses, a \$3.6 million decrease in professional service fees and a \$2.2 million decrease in facilities expenses, offset by a \$9.5 million increase in share-based compensation expense.



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### Share-based Compensation Expense

Share-based compensation expense was recognized in costs and expenses for the three and six months ended June 30, 2016 and the three and six months ended June 30, 2017 as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2017	2016	2017
Share-based compensation expense				
Cost of revenues (1) (3)	\$ (56)	\$ 228	\$ (1)	\$ 414
Product development expenses (3)	1,699	4,925	1,696	7,252
Sales and marketing expenses (3)	161	930	175	1,595
General and administrative expenses (3)	740	6,597	1,107	10,648
	<u>\$2,544</u>	<u>\$12,680</u>	<u>\$2,977</u>	<u>\$19,909</u>

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2017	2016	2017
Share-based compensation expense				
For Sohu (excluding Sohu Video) share-based awards (1) (3)	\$ (618)	\$ 2,445	\$ (890)	\$ 2
For Sogou share-based awards (2)	595	654	2,325	4,991
For Changyou share-based awards (3)	3,412	9,482	2,138	15,015
For Sohu Video share-based awards (1) (3)	(845)	99	(596)	(99)
	<u>\$2,544</u>	<u>\$12,680</u>	<u>\$2,977</u>	<u>\$19,909</u>

Note (1): The negative amount represented re-measured compensation expense based on the then-current fair value of the awards on the reporting date, as well as reversals of share-based compensation expense for awards that were forfeited due to termination of employment prior to vesting.

Note (2): Compensation expense for Sogou share-based awards also includes compensation expense for Tencent restricted share units that Tencent had granted to employees who transferred to Sogou with the Soso search and search-related businesses and compensation expense of \$4.0 million, recognized in the first quarter of 2017 in connection with Sogou's repurchase of Sogou Class A Ordinary Shares from the former President and Chief Financial Officer of the Sohu Group, which is equal to the excess of the repurchase price over the fair value of the Sogou Class A Ordinary Shares as of the repurchase date.

Note (3): The differences for the three and six months ended June 30, 2017 compared to the corresponding periods of 2016 were mainly due to differences in the fair values of certain awards as of the respective reporting dates, as well as reversals of share-based compensation expense for awards that were forfeited due to termination of employment prior to vesting.

As of June 30, 2017, 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 June 30, 2017
For Sohu (excluding Sohu Video) share-based awards	\$ 111
For Sogou share-based awards (4)	183
For Changyou share-based awards	25
	<u>\$ 319</u>

Note (4): Includes the unrecognized compensation expense for employees who transferred from Tencent with the Soso search and search-related businesses.

### Operating Profit/(Loss)

For the three and six months ended June 30, 2017, we had an operating loss of \$39.7 million and \$87.0 million, respectively, compared to an operating loss of \$28.7 million and \$13.9 million, respectively, for the corresponding periods in 2016.

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### ***Other Income/(Expense)***

We had other income of \$3.3 million and \$7.4 million, respectively, for the three and six months ended June 30, 2017, compared to other expense of \$24.6 million and \$20.6 million, respectively, for the corresponding periods in 2016. The change was mainly due to 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 \$5.8 million and \$10.3 million, respectively, for the three and six months ended June 30, 2017, compared to \$5.3 million and \$11.1 million, respectively, for the corresponding periods of 2016.

### ***Interest Expense***

Interest expense was \$0.2 million and \$0.4 million, respectively, for the three and six months ended June 30, 2017, compared to \$0.2 million and \$0.9 million, respectively, for the corresponding periods of 2016.

### ***Income Tax Expense***

Income tax expense was \$12.8 million and \$23.4 million, respectively, for the three and six months ended June 30, 2017, compared to \$2.4 million and \$14.3 million, respectively, for the corresponding periods of 2016.

The increase in income tax expense was mainly due to (i) Sohu having recognized a reversal in the second quarter of 2016 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; (ii) an increase in online game revenues as a result of the launch of Changyou's new mobile game Legacy TLBB in the second quarter of 2017.

### ***Net Loss***

For the three and six months ended June 30, 2017, we had a net loss of \$48.1 million and \$98.4 million, respectively, compared to net loss of \$46.8 million and \$35.8 million, respectively, for the corresponding periods of 2016.

### ***Net Income Attributable to Noncontrolling Interest***

Net income attributable to noncontrolling interest was \$40.1 million and \$58.0 million, respectively, for the three and six months ended June 30, 2017, compared to \$16.2 million and \$47.5 million, respectively, for the corresponding periods of 2016.

### ***Net Loss Attributable to Sohu.com Inc.***

As a result of the foregoing, we had a net loss attributable to Sohu.com Inc. of \$88.2 million and \$156.4 million, respectively, for the three and six months ended June 30, 2017, compared to a net loss attributable to Sohu.com Inc. of \$63.0 million and \$83.3 million, respectively, for the corresponding periods of 2016.

## **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 June 30, 2017, we had cash and cash equivalents of approximately \$933.7 million, and short-term investments of \$308.9 million. Of our cash and cash equivalents, \$324.0 million was held in financial institutions inside Mainland China and \$609.7 million was held in financial institutions outside of Mainland China. Our VIEs held \$62.7 million of our cash and cash equivalents and \$871.0 million was held outside of our VIEs.

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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 “Restrictions and Limitations on Cash Available to Sohu.com Inc.” below and Item 3 “Quantitative and Qualitative Disclosure About Market Risk - Foreign Currency Exchange Rate Risk.”

### **Contractual Obligations**

The following table sets forth our contractual obligations as of June 30, 2017 (in thousands):

<b>As of June 30,</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 cinema advertisement slot rights	35,112	72,620	36,689	15,162	1,272	8	160,863
Purchase of content and services – video	44,152	15,595	17,842	0	0	0	77,589
Purchase of bandwidth	49,733	9,736	1,246	1,092	315	0	62,122
Operating lease obligations	9,458	13,833	2,925	832	59	10	27,117
Expenditures for operating rights for licensed games with technological feasibility	1,124	18,602	0	0	0	0	19,726
Purchase of content and services – others	10,338	877	284	45	0	0	11,544
Purchase of fixed assets	3,586	0	0	0	0	0	3,586
Fees for operating rights for licensed games in development	1,347	1,172	0	0	0	0	2,519
Expenditures for rights to titles of games in development	259	1,208	0	0	0	0	1,467
Others	3,181	406	74	0	0	0	3,661
<b>Total Payments Required</b>	<b>158,290</b>	<b>134,049</b>	<b>59,060</b>	<b>17,131</b>	<b>1,646</b>	<b>18</b>	<b>370,194</b>

### **Cash Generating Ability**

Our cash flows are summarized below (in thousands):

	<b>Six Months Ended June 30,</b>	
	<b>2016</b>	<b>2017</b>
Net cash provided by / (used in) operating activities	\$ 151,647	\$ (14,863)
Net cash provided by / (used in) investing activities	94,219	(131,115)
Net cash provided by / (used in) financing activities	(327,168)	4,819
Effect of exchange rate change on cash and cash equivalents	(15,833)	12,229
Reclassification of cash and cash equivalents to held-for-sale assets	0	11,684
Net decrease in cash and cash equivalents	(97,135)	(117,246)
Cash and cash equivalents at beginning of period	1,245,205	1,050,957
Cash and cash equivalents at end of period	<u>\$1,148,070</u>	<u>\$ 933,711</u>

### **Net Cash Provided by / (Used in) Operating Activities**

For the six months ended June 30, 2017, \$14.9 million net cash used in operating activities was primarily attributable to our net loss of \$98.4 million, adjusted by (i) the add back of non-cash items consisting of \$122.7 million in depreciation and amortization, \$44.9 million in impairment of intangible assets, \$15.9 million in share-based compensation expense, \$3.2 million in provision for allowance for doubtful accounts, and \$0.7 million in investment loss from equity investments, (ii) offset by \$1.9 million in change in fair value of financial instruments, and \$0.4 million of other items. A decrease in cash from \$101.6 million in working capital items is also included in operating cash flow.

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For the six months ended June 30, 2016, \$151.6 million net cash provided by operating activities was primarily attributable to our net loss of \$35.8 million, adjusted by (i) the add back of non-cash items consisting of \$97.2 million in depreciation and amortization, \$5.2 million in impairment of intangible assets, \$3.1 million in provision for allowance for doubtful accounts, and \$3.0 million share-based compensation expense, (ii) offset by \$4.9 million in change in fair value of short-term investments and time deposits. The increase in cash from \$83.7 million working capital items is also included in operating cash flow.

### ***Net Cash Provided by/(Used in) Investing Activities***

For the six months ended June 30, 2017, \$131.1 million net cash used in investing activities was primarily attributable to (i) \$263.3 million used in purchase of financial instruments, \$70.9 million used in purchase of fixed assets and intangible assets, and \$2.5 million used in the purchase of a long-term investment, (ii) offset by \$200.4 million in proceeds from financial instruments, \$4.9 million from loan repayment to Changyou by a third party, and \$0.3 million in proceeds from other investing activities.

For the six months ended June 30, 2016, \$94.2 million net cash provided by investing activities was primarily attributable to (i) \$225.5 million withdrawal of restricted time deposits originally used as collateral for Changyou loans from offshore banks, \$24.1 million proceeds from investments in financial products, \$3.6 million from a third party's repayment to Changyou of a loan, and \$1.0 million cash received from other investing activities, (ii) offset by \$129.1 million used in purchase of fixed assets and intangible assets, \$18.1 million used in a matching loan from Changyou to SoEasy, and \$12.7 million used in purchase of long-term investments.

### ***Net Cash Provided by/(Used in) Financing Activities***

For the six months ended June 30, 2017, \$4.8 million net cash provided by financing activities was primarily attributable to (i) \$7.5 million in proceeds from a short-term bank loan and \$0.5 million received from exercise of share-based awards in a subsidiary, (ii) offset by \$3.2 million used in the repurchase of Sogou Class A Common Shares from a noncontrolling shareholder.

For the six months ended June 30, 2016, \$327.2 million net cash used in financing activities was primarily attributable to (i) \$344.5 million used in repayments of Changyou loans from offshore banks, (ii) offset by \$17.0 million Changyou received from the matching loan with SoEasy.

### **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 pay dividends and make 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.

### ***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.

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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 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 June 30, 2017, we had accrued deferred tax liabilities in the amount of \$28.2 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 June 30, 2017. 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.

### ***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.

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 intra-Group 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.

## **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.

*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 the 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.

*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, generally on a 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 compensation. This standard addresses several aspects of the accounting for share-based 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 awards. This guidance became effective for reporting periods beginning after December 15, 2016. We adopted this new guidance on January 1, 2017. We elected to continue to account for forfeitures by estimating expected forfeitures, and this standard does not have a material impact on our consolidated financial statements.

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*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 our 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 to each period presented using a retrospective transition method. 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 3. 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.

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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 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 June 30, 2017. These financial instruments are recorded at their fair value.

	Denominated in (in thousands)				Total
	US\$	RMB	HK\$	Others	
Cash and cash equivalents	\$605,893	\$322,975	\$4,040	\$ 803	\$933,711
Short-term investments	0	308,928	0	0	308,928
Accounts receivable, net	3,973	247,462	859	257	252,551
Prepaid and other current assets	3,747	235,766	0	341	239,854
Available-for-sale equity securities	9,130	0	0	0	9,130
Restricted time deposits	240	29	0	0	269
Current liabilities	41,791	933,265	1,811	101	976,968
Long-term accounts payable	0	1,060	0	0	1,060

### **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 1.4% in the first half of 2017, compared to an increase of 2.1% in the first half of 2016. While the increase for the first half of 2017 represented a decline in the rate of inflation compared to the corresponding period in 2016, there may be increases in the rate of inflation in the future that could have an adverse effect on our business.



**ITEM 4. 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 of 1934) 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.

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

**PART II - OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

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

**ITEM 1A. RISK FACTORS**

*Changyou’s new mobile game Legacy TLBB contributes a substantial portion of our revenue, and any decrease in the popularity of Legacy TLBB may have an adverse impact on us.*

In the second quarter of 2017, the launch of Changyou’s new mobile game Legacy TLBB was well received initially and revenues from Legacy TLBB were \$48.0 million, accounting for approximately 39% of Changyou’s online game revenues, and approximately 10% of the Sohu Group’s total revenues. However, due to the short lifespan of mobile games, as well as the availability of various mobile games in the market, Legacy TLBB may become less popular among mobile game players over time and the revenues derived from Legacy TLBB may decrease. As Changyou’s online game contributes a significant portion of our revenues, net income and operating cash flows, a decline in revenues from Legacy TLBB would have an adverse impact on us on our results of operations.

With the exception of the foregoing, there are no material changes or updates to the risk factors previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016 filed with the SEC on February 27, 2016.

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

**USE OF PROCEEDS**

On July 17, 2000, Sohu.com Inc. completed an underwritten initial public offering of its common stock pursuant to a Registration Statement on Form S-1 (SEC file No. 333-96137), which became effective on July 10, 2000. There has been no change in the information regarding use of proceeds from the offering that was included in our Annual Report on Form 10-K for the year ended December 31, 2016 filed with the SEC on February 27, 2017.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

None.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

Please see the Exhibit Index attached hereto.

**SIGNATURES**

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

Dated: August 7, 2017

**SOHU.COM INC.**

By: /s/ Joanna Lv  
Joanna Lv  
Acting Chief Financial Officer

Sohu.com Inc.

Quarterly Report on Form 10-Q for Quarter Ended June 30, 2017

**EXHIBIT INDEX**

10.1(1)	English translation of Credit Agreement, dated May 19, 2017, between Ping An Bank and Beijing Sohu New Media Information Technology Co., Ltd.
10.2(1)	English translation of Credit Agreement, dated May 19, 2017, between Ping An Bank and Fox Information Technology (Tianjin) Limited
10.3(1)	English translation of Credit Agreement, dated May 19, 2017, between Ping An Bank and Tianjin Jinhua Culture Development Co., Ltd.
10.4(1)	English translation of Form of Loan Agreement
10.5(1)	English translation of Asset Pledge Agreement, dated May 19, 2017, between Ping An Bank and Beijing Sohu New Momentum Information Technology Co., Ltd.
10.6(1)	English translation of Asset Pledge Agreement, dated May 19, 2017, between Ping An Bank and Beijing Sohu New Media Information Technology Co., Ltd.
10.7(1)	English translation of Asset Pledge Agreement, dated May 19, 2017, between Ping An Bank and Beijing Sohu New Era Information Technology Co., Ltd.
10.8(1)	English translation of Guaranty Agreement, dated May 19, 2017, between Ping An Bank and Sohu.com (Game) Limited
10.9(1)	English translation of Commitment Letter, dated May 19, 2017, between Ping An Bank and the registrant
10.10(1)	English translation of Strategic Cooperation Agreement, dated May 19, 2017, between Ping An Bank and the registrant
31.1	Rule 13a-14(a)/15d-14(a) Certification of Charles Zhang
31.2	Rule 13a-14(a)/15d-14(a) Certification of Joanna Lv
32.1	Section 1350 Certification of Charles Zhang
32.2	Section 1350 Certification of Joanna Lv
101	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) Condensed Consolidated Balance Sheets as of June 30, 2017 and December 31, 2016; (ii) Condensed Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2017 and 2016; (iii) Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2017 and 2016; (iv) Condensed Consolidated Statements of Changes in Equity for the Six Months Ended June 30, 2017 and 2016; and (v) Notes to Condensed Consolidated Financial Statements, tagged using four different levels of detail.

(1) Incorporated herein by reference to the registrant's Current Report on Form 8-K filed on May 19, 2017

I, Charles Zhang, certify that:

1. I have reviewed this quarterly report on Form 10-Q 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 reporting 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.

Dated: August 7, 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 quarterly report on Form 10-Q 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 reporting 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.

Dated: August 7, 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 Quarterly Report of Sohu.com Inc. (the "Company") on Form 10-Q for the period ended June 30, 2017 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 June 30, 2017 and results of operations of the Company for the three months ended June 30, 2017.

/s/ Charles Zhang

Charles Zhang, Chief Executive Officer and Chairman of the Board  
of Directors  
August 7, 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 Quarterly Report of Sohu.com Inc. (the "Company") on Form 10-Q for the period ended June 30, 2017 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 June 30, 2017 and results of operations of the Company for the three months ended June 30, 2017.

/s/ Joanna Lv

Joanna Lv, Acting Chief Financial Officer

August 7, 2017