

SOHU COM INC
Form 10-Q
May 09, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2011

OR

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

FOR THE TRANSITION PERIOD FROM ____ TO ____

COMMISSION FILE NUMBER 0-30961

Sohu.com Inc.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

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Delaware
(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)
Level 12, Sohu.com Internet Plaza
No. 1 Unit Zhongguancun East Road, Haidian District
Beijing 100084
People's Republic of China
(011) 8610-6272-6666

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

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

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

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

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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

Class	Outstanding at March 31, 2011
Common stock, \$.001 par value	38,283,701

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

	As of	
	March 31, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 737,935	\$ 678,389
Investment in debt securities	76,220	75,529
Accounts receivable, net	68,668	62,603
Prepaid and other current assets (including nil and \$4,983, respectively, shareholder loan to an equity investee)	13,917	19,646
Total current assets	896,740	836,167
Fixed assets, net	126,824	120,627
Goodwill	72,956	67,761
Intangible assets, net	38,807	17,308
Prepaid non-current assets	138,905	137,999
Other assets	4,087	7,728
Total assets	\$ 1,278,319	\$ 1,187,590
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 23,252	\$ 5,940
Accrued liabilities	65,342	65,229
Receipts in advance and deferred revenue	55,224	51,513
Accrued salary and benefits	35,628	35,409
Taxes payable	25,822	31,719
Other short-term liabilities	24,469	21,862
Contingent consideration	1,373	0
Total current liabilities	231,110	211,672
Contingent consideration	0	1,359
Long-term accounts payable	2,454	0
Total long-term liabilities	2,454	1,359
Total liabilities	233,564	213,031
Commitments and contingencies		
Shareholders' equity		
Sohu.com Inc. shareholders' equity:	44	43

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Common stock: \$0.001 par value per share (75,400 shares authorized; 38,284 shares and 38,025 shares, respectively, issued and outstanding)		
Additional paid-in capital	334,792	338,033
Treasury stock (5,389 shares)	(114,690)	(114,690)
Accumulated other comprehensive income	44,788	38,228
Retained earnings	579,310	534,503
Total Sohu.com Inc. shareholders' equity	844,244	796,117
Noncontrolling interest	200,511	178,442
Total shareholders' equity	1,044,755	974,559
Total liabilities and shareholders' equity	\$ 1,278,319	\$ 1,187,590

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

Table of Contents**SOHU.COM INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)****(In thousands, except per share data)**

	Three Months Ended March 31,	
	2011	2010
Revenues:		
Online brand advertising	\$ 57,153	\$ 39,512
Online game	94,930	72,072
Sponsored search	7,979	2,824
Wireless	11,704	13,288
Others	2,603	1,758
Total revenues	174,369	129,454
Cost of revenues:		
Online brand advertising	22,445	17,283
Online game	8,968	5,384
Sponsored search	4,877	2,753
Wireless	6,892	6,911
Others	2,670	495
Total cost of revenues	45,852	32,826
Gross profit	128,517	96,628
Operating expenses:		
Product development	22,782	15,518
Sales and marketing	30,177	23,009
General and administrative	11,998	9,883
Amortization of intangible assets	192	108
Total operating expenses	65,149	48,518
Operating profit	63,368	48,110
Other income /(expense)	510	(25)
Interest income and exchange difference	2,293	1,199
Income before income tax expense	66,171	49,284
Income tax expense	11,002	7,963
Net income	55,169	41,321
Less: Net income attributable to the noncontrolling interest shareholders	10,362	11,130
Net income attributable to Sohu.com Inc.	\$ 44,807	\$ 30,191
Basic net income per share attributable to Sohu.com Inc.	\$ 1.17	\$ 0.80
Shares used in computing basic net income per share attributable to Sohu.com Inc.	38,193	37,778

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Diluted net income per share attributable to Sohu.com Inc.	\$	1.01	\$	0.73
Shares used in computing diluted net income per share attributable to Sohu.com Inc.		38,767		38,443

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

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

	Three Months Ended March 31,	
	2011	2010
Cash flows from operating activities:		
Net income	\$ 55,169	\$ 41,321
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	5,873	4,593
Share-based compensation expense	5,268	6,528
Amortization and impairment of intangible assets	6,437	475
Provision for allowance for doubtful accounts	461	88
Excess tax benefits from share-based payment arrangements	(173)	(531)
Others	350	132
Changes in assets and liabilities, net of acquisition:		
Accounts receivable	1,839	(1,336)
Prepaid and other current assets	8,177	(3,184)
Accounts payable	2,190	2,627
Taxes payable	(5,470)	266
Accrued liabilities	(14,085)	619
Receipts in advance and deferred revenue	3,712	(4,071)
Other short-term liabilities	2,607	(4,598)
Net cash provided by operating activities	72,355	42,929
Cash flows from investing activities:		
Purchase of fixed assets	(8,445)	(6,113)
Purchase of intangible and other assets	(10,028)	(1,071)
Acquisitions, net of cash acquired	(1,408)	(1,239)
Net cash used in investing activities	(19,881)	(8,423)
Cash flows from financing activities:		
Issuance of common stock	1,219	252
Cash contribution received from the noncontrolling interest shareholders	941	0
Excess tax benefits from share-based payment arrangements	173	531
Net cash provided by financing activities	2,333	783
Effect of exchange rate changes on cash and cash equivalents	4,739	82
Net increase in cash and cash equivalents	59,546	35,371
Cash and cash equivalents at beginning of period	678,389	563,782
Cash and cash equivalents at end of period	\$ 737,935	\$ 599,153
Supplemental schedule of non-cash investing activity:		
Consideration payable for business acquisition	915	0

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

Table of Contents**SOHU.COM INC.****CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)****Three Months Ended March 31, 2011**

(In thousands)

	Sohu.com Inc. Shareholders' Equity								
	Accumulated								
	Other		Comprehensive		Additional		Retained		
	Total	Income	Common Stock	Paid-in Capital	Treasury Stock	Income	Earnings	Noncontrolling Interest	
Beginning balance	\$ 974,559	\$ 0	\$ 43	\$ 338,033	\$ (114,690)	\$ 38,228	\$ 534,503	\$ 178,442	
Contribution received from the noncontrolling interest shareholders	941	0	0	0	0	0	0	941	
Issuance of common stock	1,219	0	1	1,218	0	0	0	0	
Share-based compensation expense	5,268	0	0	3,498	0	0	0	1,770	
Exercise of share-based awards in subsidiary	0	0	0	(8,130)	0	0	0	8,130	
Excess tax benefits from share-based awards	173	0	0	173	0	0	0	0	
Comprehensive income:									
Net income	55,169	55,169	0	0	0	0	44,807	10,362	
Other comprehensive income:									
Foreign currency translation adjustment	7,426	7,426	0	0	0	6,560	0	866	
Total other comprehensive income	7,426	7,426							
Total comprehensive income	62,595	62,595							
Comprehensive income attributable to the noncontrolling interest shareholders		(11,228)							
Comprehensive income attributable to Sohu.com Inc.		\$ 51,367							
Ending balance	\$ 1,044,755		\$ 44	\$ 334,792	\$ (114,690)	\$ 44,788	\$ 579,310	\$ 200,511	

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

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SOHU.COM INC.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)

Three Months Ended March 31, 2010

(In thousands)

	Sohu.com Inc. Shareholders Equity								
	Total	Comprehensive Income	Common Stock	Additional Paid-in Capital	Treasury Stock	Accumulated		Retained Earnings	Noncontrolling Interest
Comprehensive Income						Other Income			
Beginning balance	\$ 677,776	\$ 0	\$ 43	\$ 317,052	\$ (114,690)	\$ 21,502	\$ 385,874	\$ 67,995	
Issuance of common stock	252	0	0	252	0	0	0	0	
Share-based compensation expense	6,528	0	0	3,577	0	0	0	2,951	
Exercise of share-based awards in subsidiary	0	0	0	(3,077)	0	0	0	3,077	
Excess tax benefits from share-based awards	531	0	0	531	0	0	0	0	
Comprehensive income:									
Net income	41,321	41,321	0	0	0	0	30,191	11,130	
Other comprehensive income:									
Foreign currency translation adjustment	72	72	0	0	0	64	0	8	
Total other comprehensive income	72	72							
Total comprehensive income	41,393	41,393							
Comprehensive income attributable to the noncontrolling interest shareholders		(11,138)							
Comprehensive income attributable to Sohu.com Inc.		\$ 30,255							
Ending balance	\$ 726,480		\$ 43	\$ 318,335	\$ (114,690)	\$ 21,566	\$ 416,065	\$ 85,161	

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

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SOHU.COM INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. The Company and Basis of Presentation

Nature of Operations

Sohu.com Inc. (Sohu or the Company), a Delaware corporation organized in 1996, is a leading online media, search, gaming, community and mobile service group providing comprehensive online products and services in the People's Republic of China (the PRC or China). The Company, together with its wholly-owned and majority-owned subsidiaries and variable interest entities (collectively the Sohu Group) mainly offers online brand advertising services, online game services (through Changyou.com Limited), sponsored search services (through Sogou Inc.), and wireless services through its Internet sites: sohu.com, 17173.com, focus.cn, chinaren.com, changyou.com and sogou.com.

Online brand advertising and online game are the two core businesses of the Sohu Group. The online brand advertising business provides advertisements on the Sohu Group's portal matrix to advertisers who wish to build up their brand awareness online. The online game business is conducted by a majority-owned subsidiary, Changyou.com Limited (Changyou), which currently operates seven massively multi-player online role-playing games (MMORPGs), (i) Tian Long Ba Bu (TLBB), (ii) Blade Online (BO), (iii) Blade Hero 2 (BH 2) which is the sequel to BO, (iv) Da Hua Shui Hu (DHS), (v) Zhong Hua Ying Xiong (ZHYX), (vi) Immortal Faith (IF); and (vii) San Jie Qi Yuan (SJQY). TLBB is Changyou's first in-house developed MMORPG and is one of the most popular online games in China.

On April 7, 2009, Changyou completed its initial public offering on the NASDAQ Global Select Market, trading under the symbol CYOU. After Changyou's offering, Sohu continues to consolidate Changyou in Sohu's consolidated financial statements, as Sohu is Changyou's controlling shareholder, but recognizes noncontrolling interest reflecting shares held by shareholders other than Sohu. As of March 31, 2011, approximately 30% of the economic interest in Changyou was recognized as noncontrolling interest in Sohu's consolidated financial statements. See Note 2 - Changyou Transactions - Sohu's Shareholding in Changyou.

Basis of Consolidation and Recognition of Noncontrolling Interest

The consolidated financial statements include the accounts of Sohu and its wholly-owned and majority-owned subsidiaries and variable interest entities (VIEs). VIEs are consolidated if the Company is the primary beneficiary. All intercompany transactions are eliminated.

For majority-owned subsidiaries and VIEs, noncontrolling interest is recognized to reflect the portion of their equity which is not attributable, directly or indirectly, to the controlling shareholder.

Basis of Presentation

The accompanying unaudited condensed consolidated interim financial statements reflect all normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of the results for the interim periods presented. Results for the three months ended March 31, 2011 are not necessarily indicative of the results expected for the full fiscal year or for any future period. Certain comparative figures have been reclassified to conform to the current presentation.

These financial statements have been prepared in accordance with Generally Accepted Accounting Principles in the United States (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

These financial statements should be read in conjunction with the consolidated financial statements and related footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

2. Changyou Transactions

Share-based Award to Tao Wang, Chief Executive Officer of Changyou

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In January 2008, Sohu communicated to and agreed with Tao Wang, who is now the Chief Executive Officer of Changyou, to grant him 700,000 ordinary shares and 800,000 restricted ordinary shares, in lieu of his contingent right in Beijing Fire Fox Digital Technology Co., Ltd. (Beijing Fire Fox), which was one of Sohu's subsidiaries devoted to the development of TLBB. The 800,000 restricted ordinary shares were subject to a four-year vesting period commencing February 1, 2008. In addition, Tao Wang would not be entitled to participate in any distributions on Changyou shares, whether or not vested, until the earlier of Changyou's completion of an initial public offering or February 2012, and in any event entitlement to distributions would be subject to vesting of the shares.

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In January 2009, under Changyou's 2008 Share Incentive Plan described below, Changyou issued 700,000 of its Class B ordinary shares and 800,000 of its Class B restricted ordinary shares to Tao Wang through Prominence Investments Ltd. (Prominence), which is an entity deemed under applicable Securities and Exchange Commission (SEC) rules to be beneficially owned by Tao Wang.

In February 2009, 200,000 Class B restricted ordinary shares held by Prominence became vested. Upon this vesting, the number of Class B ordinary shares held beneficially by Tao Wang increased to 900,000 shares and the number of Class B restricted ordinary shares held beneficially by Tao Wang decreased to 600,000 shares.

In March 2009, in preparation for its initial public offering, Changyou effected a ten-for-one share split that resulted in the aforementioned 900,000 Class B ordinary shares and 600,000 Class B restricted ordinary shares becoming 9,000,000 Class B ordinary shares and 6,000,000 Class B restricted ordinary shares, respectively.

Upon the completion of Changyou's initial public offering in April 2009, vested Class B ordinary shares held by Prominence became entitled to participate in distributions on Changyou shares. Since the completion of the initial public offering, Class B restricted ordinary shares held by Prominence have continued, and will continue, to become vested from time to time in accordance with their terms.

Changyou's 2008 Share Incentive Plan

On December 31, 2008, Changyou reserved 2,000,000 of its ordinary shares, which included 1,774,000 Class B ordinary shares and 226,000 Class A ordinary shares, for issuance to certain of its executive officers and to certain of its employees as incentive compensation under Changyou's 2008 Share Incentive Plan. As described above, 700,000 ordinary shares and 800,000 restricted ordinary shares were granted to Tao Wang through Prominence under this incentive plan.

In March 2009, the 2,000,000 reserved ordinary shares were subject to a ten-for-one share split effected by Changyou and became 20,000,000 ordinary shares.

Initial Public Offering of Changyou

On April 7, 2009, Changyou completed its initial public offering of 7,500,000 Class A ordinary shares on the NASDAQ Global Select Market, and Sohu sold 9,750,000 Class A ordinary shares of Changyou. Changyou is currently trading under the symbol CYOU.

The initial public offering consisted of American depositary shares (ADSs), with each ADS representing two Class A ordinary shares. Changyou's ordinary shares are divided into Class A ordinary shares and Class B ordinary shares. Holders of Class A ordinary shares and holders of Class B ordinary shares have the same rights in Changyou, with the exception of voting and conversion rights. Each Class A ordinary share is entitled to one vote on all matters subject to a shareholder vote, and each Class B ordinary share is entitled to ten votes on all matters subject to a shareholder vote. Each Class B ordinary share is convertible into one Class A ordinary share at any time at the election of the holder. Class A ordinary shares are not convertible into Class B ordinary shares under any circumstances.

Sohu's Shareholding in Changyou

Shareholding and Control

As of March 31, 2011, Changyou had outstanding a combined total of 104,663,000 Class A and Class B ordinary shares, consisting of (i) 70,250,000 Class B ordinary shares held by Sohu through its indirectly wholly-owned subsidiary Sohu.com (Game) Limited (Sohu Game); (ii) 14,400,000 Class B ordinary shares held by Tao Wang through Prominence, including 2,000,000 Class B restricted ordinary shares that were not vested; (iii) 17,850,000 Class A ordinary shares held by public shareholders; (iv) 1,805,000 Class A ordinary shares issued to certain of Changyou's executive officers other than Tao Wang and to certain of its employees upon conversion of Class B ordinary shares that had been issued upon the vesting and settlement of Class B restricted share units granted to them; and (v) 358,000 Class A ordinary shares issued to certain of Changyou's executive officers other than Tao Wang and to certain of its employees upon the vesting and settlement of Class A restricted share units granted to them.

As of March 31, 2011, treating Tao Wang's 2,000,000 Class B restricted ordinary shares as owned by Tao Wang, Sohu held approximately 67% of the combined total of Changyou's outstanding Class A and Class B ordinary shares and controlled approximately 81% of the total voting power in Changyou. As a result, Sohu had the power to elect the entire Board of Directors of Changyou and determine the outcome of all matters submitted to a shareholder vote. As Changyou's controlling shareholder, Sohu will continue to consolidate Changyou in Sohu's consolidated financial statements but recognize noncontrolling interest reflecting shares held by shareholders other than Sohu, as discussed in

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Note 12 Noncontrolling Interest Noncontrolling Interest for Changyou.

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Economic Interest

Because Tao Wang's 2,000,000 Class B restricted ordinary shares are subject to forfeiture to Sohu until they become vested, for accounting purposes those shares are treated as owned by Sohu, rather than as owned by Tao Wang, and therefore those shares are not included in the noncontrolling interest line items in Sohu's consolidated financial statements. As a result, as of March 31, 2011, Sohu was treated as holding approximately 70% of the economic interest in Changyou. Accordingly, shareholders other than Sohu were treated as holding the remaining 30% of the economic interest, which was recognized as noncontrolling interest in Sohu's consolidated financial statements, as discussed above in Note 12 Noncontrolling Interest Noncontrolling Interest for Changyou.

Sohu's economic interest in Changyou, as well as the noncontrolling interest recognized for Changyou in Sohu's consolidated financial statements, will continue to change as the Class B restricted ordinary shares granted to Tao Wang become vested, and the restricted share units granted to certain of Changyou's executive officers other than Tao Wang and to certain of its employees become vested and settled.

Dilutive Impact

As of March 31, 2011, Changyou had outstanding a combined total of 2,264,200 Class A and Class B restricted ordinary shares and restricted share units.

Because no Class A ordinary shares or Class B ordinary shares will be issued with respect to these restricted share units until the restricted share units are vested and settled, the unvested restricted share units and vested restricted share units that have not yet been settled are not included as outstanding shares of Changyou and have no impact on Sohu's basic net income per share. Unvested restricted share units and vested restricted share units that have not yet been settled do, however, have a dilutive impact on Sohu's diluted net income per share.

In the calculation of Sohu's diluted net income per share, Sohu's economic interest in Changyou is calculated treating all of Changyou's existing unvested restricted shares, unvested restricted share units, and vested restricted share units that have not yet been settled as vested, in the case of restricted shares, and vested and settled, in the case of restricted shares units. See Note 13 - Net Income per Share.

3. Sogou Transactions

Restructuring Transactions

During 2010, the Company restructured its sponsored search business in preparation for the sale by its online search subsidiary Sogou Inc. (Sogou) of newly-issued Series A Preferred Shares to Alibaba Investment Limited (Alibaba), a private investment subsidiary of Alibaba Group Holding Limited, China Web Search (HK) Limited (China Web), an investment vehicle of Yunfeng Fund, LP, and Photon Group Limited (Photon), the investment fund of Sohu's Chairman and Chief Executive Officer Dr. Charles Zhang.

In the restructuring, the Company transferred to Sogou certain assets and liabilities associated with the mobile version of Sogou Pinyin, and transferred to Sohu certain non-search assets and liabilities that had been held by Sogou. Sogou will remain liable for a loan payable to Sohu in the amount of \$45 million, which will be payable solely from the proceeds of an initial public offering by Sogou. The loan amount consists primarily of losses historically incurred in search business and previously funded by Sohu.

On October 22, 2010, Sogou completed the sale of newly-issued Series A Preferred Shares to Alibaba, China Web and Photon for \$15 million, \$9 million, and \$24 million, respectively.

Sogou Series A Terms

The following is a summary of some of the key terms of the Sogou Series A Preferred Shares.

Dividend Rights

Sogou may not declare or pay dividends on its ordinary shares unless the holders of the Series A Preferred Shares then outstanding first receive a dividend on each outstanding Series A 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 Series A Preferred Share if such share had been converted into ordinary shares, at the then-applicable conversion rate, immediately prior to the record date for such dividend, and (ii) all accrued and unpaid Accruing Dividends. Accruing Dividends are calculated from the date of issuance of the Series A Preferred Shares at the rate per annum of US \$0.0375 per Series A Preferred Share.

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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 A Preferred Shares are entitled to receive, before any payment to holders of ordinary shares, an amount equal to the greater of (i) 1.3 times the original \$48 million of the Series A Preferred Shares plus all accrued but unpaid Accruing Dividends and any other accrued and unpaid dividends on the Series Preferred Shares or (ii) such amount per share as would be payable if the Series A Preferred Shares had been converted into ordinary shares, at the then-applicable conversion rate, immediately prior to the Liquidation Event.

Redemption Rights

The Series A Preferred Shares are not redeemable.

Conversion Rights

Each Series A Preferred Share is convertible, at the option of the holder, at any time, and without the payment of additional consideration by the holder. Each Series A Preferred Share is convertible into such number of ordinary shares as is determined by dividing the original issue price of Series A Preferred Share by the then-effective conversion price. The conversion price is initially the same as the original issue price of \$0.625, and is 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 the original price per share of the Series A Preferred Shares, subject to certain customary exceptions, such as shares issued pursuant to the Sogou 2010 Share Incentive Plan. Each Series A Preferred Share will be automatically converted into ordinary shares of Sogou upon the closing of a qualified initial public offering of Sogou based on the then-effective conversion price.

Voting Rights

Each holder of Series A Preferred Shares is entitled to cast the number of votes equal to the number of ordinary shares into which the Series A Preferred Shares held by such holder are then convertible.

Other Rights

The Series A Terms include various other provisions typical of preferred share investments, such as rights of first refusal and co-sale, and registration rights.

Sohu's Shareholding in Sogou

As of March 31, 2011, Series A Preferred Shares of Sogou held by Alibaba, China Web and Photon represent approximately 10%, 6% and 16%, respectively, of the outstanding share capital of Sogou on a fully-diluted basis. Sohu will retain approximately 53% of Sogou on a fully-diluted basis, and intends in any event to retain a majority of the outstanding share capital of Sogou on a fully-diluted basis. As Sogou's controlling shareholder, Sohu will continue to consolidate Sogou but will recognize noncontrolling interest reflecting shares held by shareholders other than Sohu, as discussed in Note 12 Noncontrolling Interest Noncontrolling Interest for Sogou.

Sogou's 2010 Share Incentive Plan

Sogou 2010 Share Incentive Plan

On October 20, 2010, Sogou adopted the Sogou 2010 Share Incentive Plan (the Sogou 2010 Share Incentive Plan), which provides for the issuance of up to 24,000,000 ordinary shares of Sogou to management and key employees of Sogou and of any present or future parents or subsidiaries or variable interest entities of Sogou. The maximum term of any issued share right 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 March 31, 2011, no share rights had been issued under this Plan.

Share-based Awards to Sohu management

Under an arrangement approved by Sohu and Sogou's Board of Directors in March 2011, Sohu has the right to provide to members of Sohu's executive management the opportunity to purchase from Sohu up to 12,000,000 ordinary shares of Sogou. Of these 12,000,000 ordinary shares,

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8,800,000 are Sogou ordinary shares currently held by Sohu and 3,200,000 are Sogou ordinary shares to be newly-issued by Sogou to Sohu for a price of \$0.625 per share, or a total of \$2 million. As of March 31, 2011, no share rights had been issued under this arrangement.