

SOHU COM INC  
Form 10-Q  
November 03, 2017  
Table of Contents

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

**FORM 10-Q**

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

**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 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)**

**Delaware**  
**(STATE OR OTHER JURISDICTION OF**

**98-0204667**  
**(I.R.S. EMPLOYER**

**INCORPORATION OR ORGANIZATION)**

**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)**

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

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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

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

<b>Class</b>	<b>Outstanding at September 30, 2017</b>
<b>Common stock, \$.001 par value</b>	<b>38,881,382</b>

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

	<b>PAGE</b>
<b>PART I</b>	
<b><u>FINANCIAL INFORMATION</u></b>	
Item 1	3
	3
	4
	5
	6
	8
Item 2	48
Item 3	83
Item 4	85
<b>PART II</b>	
<b><u>OTHER INFORMATION</u></b>	
Item 1	85
Item 1A	85
Item 2	96
Item 3	96
Item 4	96
Item 5	96
Item 6	96
	97
	98

**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	
	December 31, 2016	September 30, 2017
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,050,957	\$ 1,040,564
Restricted cash	0	1,501
Short-term investments	247,926	304,264
Accounts receivable, net	189,167	280,372
Assets held for sale	103,079	0
Prepaid and other current assets (including \$29,019 and \$31,213, respectively, due from a related party as of December 31, 2016 and September 30, 2017)	260,133	228,206
<b>Total current assets</b>	<b>1,851,262</b>	<b>1,854,907</b>
Fixed assets, net	503,631	529,734
Goodwill	68,290	70,957
Long-term investments, net	74,273	86,585
Intangible assets, net	32,131	31,463
Restricted time deposits	269	270
Prepaid non-current assets	4,734	4,205
Other assets	29,100	27,162
<b>Total assets</b>	<b>\$ 2,563,690</b>	<b>\$ 2,605,283</b>
<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 \$56,945, respectively, as of December 31, 2016 and September 30, 2017)	\$ 193,209	\$ 270,939
Accrued liabilities (including accrued liabilities of consolidated VIEs without recourse to the Company of \$96,695 and \$79,203, respectively, as of December 31, 2016 and September 30, 2017)	324,876	342,555
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 \$48,307, respectively, as of December 31, 2016 and September 30,	118,951	131,723

2017)

Accrued salary and benefits (including accrued salary and benefits of consolidated VIEs without recourse to the Company of \$10,306 and \$7,770, respectively, as of December 31, 2016 and September 30, 2017)	92,475	72,635
Taxes payable (including taxes payable of consolidated VIEs without recourse to the Company of \$11,475 and \$12,099, respectively, as of December 31, 2016 and September 30, 2017)	40,014	73,118
Short-term bank loans (including short-term bank loans of consolidated VIEs without recourse to the Company of nil as of both December 31, 2016 and September 30, 2017)	0	61,027
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 September 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 \$77,106, respectively, as of December 31, 2016 and September 30, 2017, and due to a related party of \$28,678 and \$30,525, respectively, as of December 31, 2016 and September 30, 2017)	159,315	146,115
<b>Total current liabilities</b>	<b>932,742</b>	<b>1,098,112</b>
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 September 30, 2017)	744	778
Long-term taxes payable (including long-term taxes payable of consolidated VIEs without recourse to the Company of \$13,463 and \$14,072, respectively, as of December 31, 2016 and September 30, 2017)	32,625	30,901
Deferred tax liabilities (including deferred tax liabilities of consolidated VIEs without recourse to the Company of \$1,273 and \$3,954, respectively, as of December 31, 2016 and September 30, 2017)	39,784	45,860
<b>Total long-term liabilities</b>	<b>73,153</b>	<b>77,539</b>
<b>Total liabilities</b>	<b>1,005,895</b>	<b>1,175,651</b>
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 38,881 shares, respectively, issued and outstanding as of December 31, 2016 and September 30, 2017)	45	45
Additional paid-in capital	821,867	840,483
Treasury stock (5,889 shares as of both December 31, 2016 and September 30, 2017)	(143,858)	(143,858)
Accumulated other comprehensive income	3,220	31,192
Retained earnings	312,306	51,915
<b>Total Sohu.com Inc. shareholders' equity</b>	<b>993,580</b>	<b>779,777</b>
<b>Noncontrolling interest</b>	<b>564,215</b>	<b>649,855</b>
<b>Total shareholders' equity</b>	<b>1,557,795</b>	<b>1,429,632</b>

Total liabilities and shareholders equity	\$ 2,563,690	\$ 2,605,283
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2016</b>	<b>2017</b>	<b>2016</b>	<b>2017</b>
<b>Revenues:</b>				
<b>Online advertising:</b>				
Brand advertising (including revenues generated from a related party of nil for both the three months ended September 30, 2016 and the three months ended September 30, 2017, and of \$862 and nil, respectively, for the nine months ended September 30, 2016 and 2017)	\$ 110,871	\$ 74,832	\$ 349,261	\$ 242,315
Search and search-related advertising	150,667	225,363	444,633	554,145
<b>Subtotal of online advertising revenues</b>	<b>261,538</b>	<b>300,195</b>	<b>793,894</b>	<b>796,460</b>
Online games	98,553	132,427	300,309	340,150
Others	50,491	83,439	144,469	214,722
<b>Total revenues</b>	<b>410,582</b>	<b>516,061</b>	<b>1,238,672</b>	<b>1,351,332</b>
<b>Cost of revenues:</b>				
<b>Online advertising:</b>				
Brand advertising	102,137	75,733	281,427	280,660
Search and search-related advertising	76,457	115,422	210,547	294,221
<b>Subtotal of cost of online advertising revenues</b>	<b>178,594</b>	<b>191,155</b>	<b>491,974</b>	<b>574,881</b>
Online games	23,719	17,560	75,232	45,678
Others	20,571	53,679	60,783	138,908
<b>Total cost of revenues</b>	<b>222,884</b>	<b>262,394</b>	<b>627,989</b>	<b>759,467</b>
<b>Gross profit</b>	<b>187,698</b>	<b>253,667</b>	<b>610,683</b>	<b>591,865</b>
<b>Operating expenses:</b>				
Product development	90,007	105,162	261,645	289,406
Sales and marketing (including expenses generated for a related party of nil for both the three months ended September 30, 2016 and the three months ended September 30, 2017, and of \$216 and nil, respectively, for the nine months ended September 30, 2016 and 2017)	110,584	111,935	318,597	296,866



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General and administrative	38,670	31,038	95,927	87,045
Goodwill impairment and impairment of intangible assets acquired as part of business acquisitions	0	86,882	0	86,882
<b>Total operating expenses</b>	<b>239,261</b>	<b>335,017</b>	<b>676,169</b>	<b>760,199</b>
Operating loss	(51,563)	(81,350)	(65,486)	(168,334)
Other income /(loss)	3,678	(5,068)	(16,971)	2,337
Interest income (including interest income generated from a related party of \$294 and \$295, respectively, for the three months ended September 30, 2016 and 2017, and \$956 and \$859, respectively, for the nine months ended September 30, 2016 and 2017)	6,327	6,497	17,448	16,781
Interest expense (including interest expense generated from a related party of \$184 and \$185, respectively, for the three months ended September 30, 2016 and 2017, and \$488 and \$537, respectively, for the nine months ended September 30, 2016 and 2017)	(209)	(1,141)	(1,151)	(1,521)
Exchange difference	702	(5,032)	3,546	(10,326)
Loss before income tax expense	(41,065)	(86,094)	(62,614)	(161,063)
Income tax expense	(974)	(15,927)	(15,272)	(39,363)
Net loss	(42,039)	(102,021)	(77,886)	(200,426)
Less: Net income attributable to the noncontrolling interest shareholders	32,775	1,939	80,238	59,965
<b>Net loss attributable to Sohu.com Inc.</b>	<b>\$ (74,814)</b>	<b>\$ (103,960)</b>	<b>\$ (158,124)</b>	<b>\$ (260,391)</b>
Net loss	(42,039)	(102,021)	(77,886)	(200,426)
Foreign currency translation adjustments	(7,619)	19,015	(35,031)	41,152
Change in unrealized gain /(loss) for available-for-sale securities	(693)	12,496	(2,121)	11,245
<b>Other comprehensive income/(loss)</b>	<b>(8,312)</b>	<b>31,511</b>	<b>(37,152)</b>	<b>52,397</b>
Comprehensive loss	(50,351)	(70,510)	(115,038)	(148,029)
Less: Comprehensive income attributable to noncontrolling interest shareholders	29,724	13,808	67,275	84,390
<b>Comprehensive loss attributable to Sohu.com Inc.</b>	<b>\$ (80,075)</b>	<b>\$ (84,318)</b>	<b>\$ (182,313)</b>	<b>\$ (232,419)</b>
<b>Basic net loss per share attributable to Sohu.com Inc.</b>	<b>\$ (1.93)</b>	<b>\$ (2.67)</b>	<b>\$ (4.09)</b>	<b>\$ (6.70)</b>
Shares used in computing basic net income per share attributable to Sohu.com Inc.	38,728	38,877	38,695	38,848
<b>Diluted net loss per share attributable to Sohu.com Inc.</b>	<b>\$ (1.94)</b>	<b>\$ (2.67)</b>	<b>\$ (4.12)</b>	<b>\$ (6.72)</b>

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Shares used in computing diluted net income per share attributable to Sohu.com Inc.	38,728	38,877	38,695	38,848
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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

	<b>Nine Months Ended September 30,</b>	
	<b>2016</b>	<b>2017</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (77,886)	\$ (200,426)
<b>Adjustments to reconcile net income /(loss) to net cash provided by operating activities:</b>		
Amortization of intangible assets and purchased video content in prepaid expense	105,773	110,883
Depreciation	53,769	61,000
Goodwill impairment and impairment of intangible assets acquired as part of business acquisitions	0	86,882
Impairment of other intangible assets and other assets	6,027	44,989
Provision for allowance for doubtful accounts	4,341	4,403
Share-based compensation expense	16,147	22,455
Investment loss from equity investments	1,006	850
Impairment of available-for-sale securities	0	5,754
Change in fair value of financial instruments	(7,732)	(5,566)
Others	(407)	(434)
<b>Changes in assets and liabilities, net of acquisition:</b>		
Accounts receivable	56,560	(84,542)
Prepaid and other assets	7,520	21,101
Accounts payable	17,507	20,624
Accrued liabilities and other short-term liabilities	64,720	(44,733)
Receipts in advance and deferred revenue	(2,792)	7,432
Taxes payable	(35,520)	26,463
Deferred tax	5,191	6,837
<b>Net cash provided by operating activities</b>	<b>214,224</b>	<b>83,972</b>
<b>Cash flows from investing activities:</b>		
Purchase of financial instruments	(282,000)	(568,686)
Purchase of fixed assets	(89,990)	(64,764)
Purchase of intangible and other assets	(134,513)	(46,310)
Purchase of long-term investments	(12,940)	(7,680)
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	295,591	500,344
Return of funds from a third party	3,619	4,928
Other cash proceeds/(payments) related to investing activities	3,840	(3,065)
<b>Net cash used in investing activities</b>	<b>(9,046)</b>	<b>(185,233)</b>

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Cash flows from financing activities:			
Proceeds from short-term bank loan		0	67,785
Matching loan from a related party		17,041	0
Exercise of share-based awards in subsidiaries		291	493
Repayments of loans from banks		(344,500)	(6,914)
Repurchase of Sogou Class A Common Shares from noncontrolling shareholders		0	(3,190)
Other cash payments related to financing activities		(423)	(909)
Net cash provided by/(used in) financing activities		(327,591)	57,265
Effect of exchange rate changes on cash and cash equivalents		(20,427)	21,919
Reclassification of cash and cash equivalents from assets held for sale		(10,280)	11,684
Net decrease in cash and cash equivalents		(153,120)	(10,393)
Cash and cash equivalents at beginning of period		1,245,205	1,050,957
Cash and cash equivalents at end of period	\$	1,092,085	\$ 1,040,564
Supplemental cash flow disclosures:			
Barter transactions recognized in revenue	\$	9,259	\$ 4,771
Supplemental schedule of non-cash investing activity:			
Changes in payables and other liabilities related to fixed assets and intangible assets additions		0	54,071

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

**Table of Contents****SOHU.COM INC.****CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (unaudited)****Nine Months Ended September 30, 2016**

(In thousands)

	<b>Sohu.com Inc. Shareholders' Equity</b>							
	<b>Additional</b>			<b>Accumulated</b>				
	<b>Total</b>	<b>Common</b>	<b>Paid-in</b>	<b>Treasury</b>	<b>Comprehensive</b>	<b>Other</b>	<b>Retained</b>	<b>Noncontrolling</b>
		<b>Stock</b>	<b>Capital</b>	<b>Stock</b>	<b>Income</b>	<b>Income</b>	<b>Earnings</b>	<b>Interest</b>
Beginning balance	\$ 1,730,752	\$ 45	\$ 798,357	\$ (143,858)	\$ 50,151		\$ 536,327	\$ 489,730
Share-based compensation expense	16,145	0	5,095	0	0		0	11,050
Settlement of share-based awards in subsidiary	337	0	19,136	0	0		0	(18,799)
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)
Other	(46)	0	0	0	0		0	(46)
Net income/(loss) attributable to Sohu.com Inc. and noncontrolling interest shareholders	(77,886)	0	0	0	0		(158,124)	80,238
Accumulated other comprehensive loss	(37,152)	0	0	0	(24,189)		0	(12,963)
Ending balance	\$ 1,631,912	\$ 45	\$ 823,921	\$ (143,858)	\$ 25,962		\$ 378,203	\$ 547,639

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

Table of Contents

## SOHU.COM INC.

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

Nine Months Ended September 30, 2017

(In thousands)

	Sohu.com Inc. Shareholders Equity						
	Total	Common Stock	Additional Paid-in Capital	Treasury Stock	Accumulated		Noncontrolling Interest
Comprehensive Income					Retained Earnings		
Beginning balance	\$ 1,557,795	\$ 45	\$ 821,867	\$ (143,858)	\$ 3,220	\$ 312,306	\$ 564,215
Share-based compensation expense	22,455	0	4,512	0	0	0	17,943
Settlement of share-based awards in subsidiaries	494	0	14,104	0	0	0	(13,610)
Repurchase of Sogou Class A Common Shares from noncontrolling shareholders	(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	(200,426)	0	0	0	0	(260,391)	59,965
Accumulated other comprehensive income	52,397	0	0	0	27,972	0	24,425
Other	187	0	0	0	0	0	187
Ending balance	\$ 1,429,632	\$ 45	840,483	(143,858)	31,192	51,915	649,855

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

**Table of Contents**

**SOHU.COM INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

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

*Nature of Operations*

Sohu.com Inc. (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 search-related services and mobile Internet products 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) as well as 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 Sohu 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 Internet 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 the products and services provided by Tencent.



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**Table of Contents**

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 Sogou Business*

Sogou also offers Internet value-added services (IVAS), primarily with respect to the operation of Web games and mobile games developed by third parties, and offers other products and services, including smart hardware products. 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 game is TLBB, a PC-based client-end game. For the three and nine months ended September 30, 2017, revenues from TLBB were \$48.3 million and \$149.4 million, respectively, accounting for approximately 36% and 44%, respectively, of Changyou's online game revenues, approximately 29% and 34%, respectively, of Changyou's total revenues, and approximately 9% and 11%, respectively, of the Sohu Group's total revenues. For the three and nine months ended September 30, 2016, revenues from TLBB were \$56.0 million and \$162.9 million, respectively, accounting for approximately 57% and 54%, respectively, of Changyou's online game revenues, approximately 41% and 41%, respectively, of Changyou's total revenues and approximately 14% and 13%, respectively, of the Sohu Group's total revenues.

In the second quarter of 2017, Changyou launched a new mobile game, Legacy TLBB, which is operated by Tencent under license from Changyou. For the three months ended September 30, 2017, revenues from Legacy TLBB were \$56.2 million, accounting for approximately 42% of Changyou's online game revenues, approximately 34% of Changyou's total revenues, and approximately 11% 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 two platforms, RaidCall and MoboTap. RaidCall provides online music and entertainment services, primarily in Taiwan. MoboTap provides (a) software applications for PCs and mobile devices through Dolphin Browser, which is a gateway to a host of user activities on mobile devices with the majority of its users based in overseas markets, and (b) domestic online card and board games.

In 2014, Changyou purchased 51% of the equity interests in MoboTap on a fully-diluted basis for approximately \$91 million in cash. Changyou's intention in making the acquisition was to generate benefits from expected synergies of MoboTap's Dolphin Browser with Changyou's platform channel business.

## **Table of Contents**

In 2015, the financial performance of the Dolphin Browser was below original expectations, and Changyou's management concluded that the Dolphin Browser was unable to provide the expected synergies with Changyou's platform channel business. Accordingly management performed a goodwill impairment test using the discounted cash flow method for the goodwill generated in the acquisition of MoboTap. As a result, Changyou recorded \$29.6 million and \$8.9 million, respectively, in goodwill and intangible assets impairment losses. MoboTap then switched its focus to the development and operation of card and board games in China, which have been MoboTap's main source of revenue since 2015.

In 2016, Changyou's Board of Directors approved the disposal of Changyou's 51% equity interest in MoboTap. 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.

In the first quarter of 2017, Changyou's management determined that the disposal was unlikely to be completed within one year due to the suspension of negotiations with a potential buyer of MoboTap. As a result, the assets 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.

In the third quarter of 2017, due to reinforced restrictions the Chinese regulatory authorities imposed on card and board games, some of Changyou's key distribution partners informed Changyou that they had decided to stop the distribution and promotion of card and board games, which had an adverse impact on MoboTap's current performance, and also increased the uncertainty for its future operations and cash flow. As a result, Changyou determined that it is unlikely for MoboTap to gain users and grow its online card and board games revenues in China, Changyou management performed an impairment test in the third quarter of 2017 using the discounted cash flow method and impairment charges of \$86.9 million were recognized to reflect the fair value of the MoboTap business, of which an \$83.5 million impairment loss was recognized for goodwill and a \$3.4 million impairment loss was recognized for intangible assets.

All revenues generated by the 17173.com Website are classified as brand advertising revenues, online card and board games revenues generated by MoboTap are classified as online game revenues, and IVAS revenues generated by MoboTap through the Dolphin Browser and generated by RaidCall are classified as other 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.

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**Table of Contents**

***Noncontrolling Interest for Sogou***

**Sogou's Share Structure**

As of September 30, 2017, Sogou had outstanding a combined total of 336,194,956 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: 21,716,831 Class A Ordinary Shares.

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

As of September 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 September 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.

**Table of Contents**

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.

(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.



**Table of Contents**

(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.

**Voting Agreement Signed among Sohu, Tencent, and Sogou in August 2017**

In August 2017, in anticipation of Sogou's previously-announced currently pending proposed IPO, Sohu, Tencent, and Sogou entered into a voting agreement (the "Voting Agreement") that will take effect upon the completion of the proposed IPO. Effective upon the completion of the proposed IPO, all of the Sogou shares held by Sohu for its own account and all of the Sogou shares held by Tencent will be redesignated as Class B Ordinary Shares. Each Class B Ordinary Share will be entitled to ten votes per share on any matter brought to a vote of Sogou shareholders, whereas Class A Ordinary Shares, which will be held by shareholders other than Sohu and Tencent, will be entitled to one vote per share. As a result of the additional voting power of the Class B Ordinary Shares, upon the completion of the proposed IPO Sogou and Tencent will together have the power to determine all matters that may come to a vote of Sogou's shareholders, including the election of directors. Under the Voting Agreement, following the completion of Sogou's proposed IPO, Sohu will have the right to appoint a majority of Sogou's Board of Directors and Tencent will have the right to appoint two directors. Sohu will continue to consolidate Sogou in its financial statements following the completion of the proposed IPO, and will provide for non-controlling interests reflecting ordinary shares in Sogou held by shareholders other than Sohu.

***Noncontrolling Interest for Changyou***

Changyou is a public company listed on the NASDAQ Global Select Market. As of September 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.

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 nine months ended September 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.

**Table of Contents**

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

	<b>Three Months Ended September 30, 2016</b>				
	<b>Sohu</b>	<b>Sogou</b>	<b>Changyou</b>	<b>Eliminations</b>	<b>Consolidated</b>
Revenues (1)	\$ 109,560	\$ 165,952	\$ 135,862	\$ (792)	\$ 410,582
Segment cost of revenues	(102,772)	(78,788)	(41,071)	42	(222,589)
Segment gross profit	6,788	87,164	94,791	(750)	187,993
SBC (2) in cost of revenues	(266)	(3)	(26)	0	(295)