SOHU COM INC
Form 10-Q/A
June 24, 2004
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

Amendment No. 1

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2004

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	**98-0204667**
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	**(I.R.S. EMPLOYER IDENTIFICATION NUMBER)**

Suite 1519, Tower 2

Bright China Chang An Building

7 Jianguomen Nei Avenue

Beijing 100005

People s Republic of China

86-10-6510-2160

(ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER, INCLUDING AREA CODE,

OF REGISTRANT S PRINCIPAL EXECUTIVE OFFICES)

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 x No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes x 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 April 30, 2004**
Common stock, $.001 par value	**36,480,557**

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EXPLANATORY NOTE

We are filing this Amendment No. 1 on Form 10-Q/A in response to comments received from the staff of the Securities and Exchange Commission (the SEC) in connection with their review of our Quarterly Report on Form 10-Q originally filed with the SEC on May 10, 2004.

This Amendment No. 1 includes the following amendments to the Form 10-Q we filed on May 10, 2004:

Part I, Item II. Management s Discussion and Analysis of Financial Condition and Results of Operations

The Non-Advertising Cost of Revenues section of Results of Operations has been amended to provide further detail regarding the decrease in e-commerce gross margin for the three months ended March 31, 2004 as compared to the three months ended March 31, 2003.

Part I, Item 6. Exhibits and Reports on Form 8-K

The list of exhibits set forth in, and incorporated by reference from, the Exhibit Index, has been amended to include new Section 13(a)-14(a) certifications and Section 1350 certifications.

No other information in our Quarterly Report on Form 10-Q as filed with the SEC on May 10, 2004 is amended hereby. For ease of reference and convenience, we have restated our entire disclosure in this Amendment No. 1, with the changes summarized above. All information contained in this and our previous filings is subject to updating and supplementing as provided in our periodic reports filed with the Securities and Exchange Commission.

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PART I FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

SOHU.COM INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands)

	March 31, 2004	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 109,835	$ 99,109
Accounts receivable, net	17,386	12,381
Prepaid and other current assets	4,301	4,050
Current portion of long-term investments in marketable debt securities	14,156	29,245
Total current assets	145,678	144,785
Long-term investments in marketable debt securities	26,384	14,216
Fixed assets, net	8,416	6,846
Goodwill	31,626	31,664
Intangible assets, net	4,161	4,082
Other assets, net	3,341	3,462
	$ 219,606	$ 205,055
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,343	$ 1,101
Accrued liabilities	24,788	22,315
Total current liabilities	26,131	23,416
Zero coupon convertible senior notes	90,000	90,000
Total liabilities	116,131	113,416
Commitments and contingencies (Note 5)		
Shareholders equity:		
Common stock: $0.001 par value per share (75,400 authorized, 36,378 and 36,101 shares issued and outstanding at March 31, 2004 and December 31, 2003)	36	36
Treasury stock	(2,003)	(2,003)
Additional paid-in capital	140,919	140,218
Deferred compensation	(8)	(14)
Accumulated other comprehensive income	431	232
Accumulated deficit	(35,900)	(46,830)
Total shareholders equity	103,475	91,639

	$ 219,606	$ 205,055

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

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SOHU.COM INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, in thousands except per share data)

	Three Months Ended	
	March 31, 2004	**March 31, 2003**
Revenues:		
Advertising (including $124 and $0 from related parties for the three months ended March 31, 2004 and 2003, respectively)	$ 11,014	$ 4,476
Non-advertising:		
E-subscription (including $0 and $8,554 from related parties for the three months ended March 31, 2004 and 2003, respectively)	13,391	8,678
E-commerce (including $0 and $1,175 from a related party for the three months ended March 31, 2004 and 2003, respectively)	1,319	1,175
Other	211	82
Subtotal of non-advertising revenues	14,921	9,935
Total revenues	25,935	14,411
Cost of revenues:		
Advertising (including $0 and $36 of related party services for the three months ended March 31, 2004 and 2003, respectively)	2,788	1,602
Non-advertising:		
E-subscription (including $0 and $2,646 of related party services for the three months ended March 31, 2004 and 2003, respectively)	4,549	2,646
E-commerce (including $0 and $1,008 of related party services for the three months ended March 31, 2004 and 2003, respectively)	1,286	1,008
Subtotal of non-advertising cost of revenues	5,835	3,654
Total cost of revenues	8,623	5,256
Gross profit	17,312	9,155
Operating expenses:		
Product development	1,880	1,742
Sales and marketing	3,121	1,992
General and administrative	1,572	1,076
Amortization of intangibles	177	
Total operating expenses	6,750	4,810
Operating profit	10,562	4,345
Other expense	(208)	(81)
Interest income	630	327
Net income before taxes	10,984	4,591
Income tax expense	54	

Net income	$ 10,930	$ 4,591
Basic net income per share	$ 0.30	$ 0.13
Shares used in computing basic net income per share	36,255	34,756
Diluted net income per share	$ 0.27	$ 0.12
Shares used in computing diluted net income per share	41,920	39,186

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

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SOHU.COM INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Three Months Ended	
	March 31, 2004	**March 31, 2003**
Cash flows from operating activities:		
Net income	$ 10,930	$ 4,591
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of other assets	1,296	1,227
Amortization of intangible assets	177	
Other	96	44
Changes in assets and liabilities:		
Accounts receivable	(5,031)	(813)
Accounts receivable from a related party		(2,922)
Prepaid and other current assets	(402)	(431)
Accounts payable	242	(95)
Payable to a related parties		108
Accrued liabilities	1,954	2,274
Net cash provided by operating activities	9,262	3,983
Cash flows from investing activities:		
Long term investments in marketable debt securities	3,122	1,061
Acquisition of fixed assets	(2,075)	(759)
Acquisition of other assets	(130)	(213)
Cash used in acquisitions	(98)	
Net cash provided by investing activities	819	89
Cash flows from financing activities:		
Issuance of common stock	645	214
Net cash provided by financing activities	645	214
Net increase in cash and cash equivalents	10,726	4,286
Cash and cash equivalents at beginning of period	99,109	18,929
Cash and cash equivalents at end of period	$ 109,835	$ 23,215

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

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SOHU.COM INC.

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY

(Unaudited, in thousands)

	Three Months Ended	
	March 31, 2004	**March 31, 2003**
Common stock		
Balance, beginning and end of period	$ 36	$ 35
Additional paid-in capital		
Balance, beginning of period	140,218	129,881
Issuance of common stock pursuant to stock incentive plan	648	214
Tax benefit from stock options	54	
Compensatory stock options	(1)	(30)
Balance, end of period	140,919	130,065
Treasury stock		
Balance, beginning and end of period	(2,003)	(2,003)
Accumulated deficit		
Balance, beginning of period	(46,830)	(73,187)
Net income	10,930	4,591
Balance, end of period	(35,900)	(68,596)
Accumulated other comprehensive income/(loss)		
Balance, beginning of period	232	547
Net unrealized gains (losses) on marketable debt securities	202	6
Foreign currency translation adjustment	(3)	(1)
Balance, end of period	431	552
Deferred Compensation		
Balance, beginning of period	(14)	(42)
Compensatory stock options	6	11
Balance, end of period	(8)	(31)
Total stockholders equity	$ 103,475	$ 60,022

	Number of Shares	
Common stock		
Balance, beginning of period	36,101	34,611
Common stock issued	277	267
Balance, end of period	36,378	34,878

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

Sohu.com Inc. (Sohu or the Company) is a Delaware corporation. The Company does not have any substantive operations of its own and substantially all of its primary business operations are conducted through its intermediate holding company, Sohu.com Limited, its indirect wholly owned subsidiaries, Sohu ITC Information Technology (Beijing) Co., Ltd. (Beijing ITC), Beijing Sohu New Era Information Technology Co., Ltd. (Sohu Era), Beijing Sohu Interactive Software Co., Ltd. (Sohu Software), Kylie Enterprises Limited, All Honest International Limited and its variable interest entities, Beijing Sohu Internet Information Service Co., Ltd. (Sohu Internet) and Beijing Sohu Online Network Information Services, Ltd. (Beijing Sohu).

The Company and its variable interest entities mainly offer content, advertising, wireless, and e-commerce services through the Company s Internet portal sites, Sohu.com, Chinaren.com, Focus.cn, and 17173.com. The Company markets its products and services to clients primarily in the People s Republic of China.

The accompanying unaudited 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, 2004 are not necessarily indicative of the results expected for the full fiscal year or for any future period.

These financial statements have been prepared in accordance with generally accepted accounting principles in the United States 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 generally accepted accounting principles for complete financial statements.

2. SEGMENT INFORMATION

Based on the criteria established by SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, the Company operates in three principal business segments: advertising, e-subscription and e-commerce. The Company does not allocate any operating costs, including Web site operating costs, or assets to its e-subscription and e-commerce segments as management does not use this information to measure the performance of the operating segments. The segment information has been included within condensed consolidated statements of operations (unaudited) for the three months ended March 31, 2004 and 2003, respectively.

3. NET INCOME PER SHARE

Basic net income per share is computed using the weighted average number of common shares outstanding during the period. Diluted net income per share is computed using the weighted average number of common and, if dilutive, potential common shares outstanding during the period. Potential common shares consist of shares issuable upon the exercise of stock options (using the treasury stock method) and zero coupon convertible senior notes.

The following table presents the calculation of basic and diluted net income per share (in thousands, except per share data):

	Three Months Ended March 31,	
	2004	**2003**
Numerator:		
Net income	$ 10,930	$ 4,591
Effect of dilutive securities:		
Liquidated damages on zero coupon convertible senior notes	50	
Amortization of offering costs for zero coupon convertible senior notes	198	
Net income adjusted for dilutive securities	$ 11,178	$ 4,591
Denominator:		
Weighted average basic common shares outstanding	36,255	34,756
Effect of dilutive securities:		
Stock options	3,654	4,430
Zero coupon convertible senior notes	2,011	
Weighted average diluted common shares outstanding	41,920	39,186
Basic net income per share	$ 0.30	$ 0.13
Diluted net income per share	$ 0.27	$ 0.12

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4. VARIABLE INTEREST ENTITIES AND RELATED PARTY TRANSACTIONS

(a) Variable interest entities (VIEs)

The Company has entered into the following arrangements with Dr. Charles Zhang (Dr. Zhang), the Company s founder, Chairman, Chief Executive Officer and a major Sohu shareholder, and certain employees of the Company to satisfy People s Republic of China (PRC) regulations which prohibit or restrict wholly foreign owned enterprises from owning or operating Internet information, value added telecommunication (including wireless and Internet access), and e-commerce and certain other businesses in China. The Company expects that it will continue to be involved in and provide additional financial support under similar arrangements in the future.

Under Section 402 of the Sarbanes-Oxley Act of 2002, issuers subject to the act are prohibited from making personal loans to their directors and executive officers. Under Section 402, issuers are permitted to maintain the loans they made to directors and executive officers prior to the effective date of the Sarbanes-Oxley Act. They are not permitted, however, to renew or materially modify such loans. The Company believes that there is a strong argument that the loans to Dr. Zhang described below are not personal loans, in view of the Company s underlying business purpose for making the loans and the lack of a personal benefit to Dr. Zhang from the loans. In the absence of judicial interpretation, an SEC rule, or an SEC staff interpretation confirming the Company s conclusion, however, the Company intends to treat these loans as if they were personal loans under Section 402 of the Sarbanes-Oxley Act. Accordingly, the Company expects that if it enters into arrangements similar to those described below in the future, any loans made under such arrangements will be made to individuals who are not directors or executive officers of the Company. In addition, should the existing loans to Dr. Zhang, or to the entities in which he is the primary shareholder, need to be renewed or materially modified, such as if the Company needs to advance additional funds to any of these entities, the Company expects that the entities, the ownership of the entities and/or the loans to the entities will be restructured so that the Company could not be deemed to be making a loan to Dr. Zhang. The prohibitions set forth in Section 402 have not had any adverse effect on the Company s operations to date, and the Company does not expect them to have any adverse effect in the future.

In June 2000, the Company extended loans in the amount of $193,000 to Dr. Zhang and $49,000 to He Jinmei, another employee of the Company, to finance their equity investments in Beijing Sohu, a company incorporated in the PRC which engages in Internet information, value added telecommunication and e-commerce services in the PRC on behalf of the Company. Dr. Zhang and He Jinmei hold 80% and 20% interests in Beijing Sohu, respectively. Dr. Zhang and He Jinmei have pledged their shares in Beijing Sohu as collateral for the loan. These loans bear no interest and are due in full on the earlier of demand, in 2010 or at such time as Dr. Zhang or He Jinmei, as the case may be, is not an employee of the Company. A subsidiary of the Company has entered into an option agreement giving it the right, at any time, subject to PRC law, to purchase the entire ownership in Beijing Sohu from Dr. Zhang and He Jinmei for $242,000.

In November 2001, pursuant to a Loan and Share Pledge Agreement (the Century Loan Agreement), the Company extended loans in the amount of $3,676,000 to Dr. Zhang and $919,000 to Li Wei, another employee of the Company, for the purpose of funding the equity investment of $4,595,000 by these two individuals in Beijing Century High Tech Investment Co., Ltd. (High Century), a company incorporated in the PRC which engages in investment holding in the PRC on behalf of the Company. Dr. Zhang and Li Wei hold 80% and 20% interests in High Century, respectively.

In January 2002, pursuant to a Loan and Share Pledge Agreement (the Hengda Loan Agreement), the Company extended loans in the amount of $242,000 to Li Wei for the purpose of funding an equity investment

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of $242,000 by Li Wei in Beijing Hengda Yitong Internet Technology Development Co., Ltd. (Hengda), a company incorporated in the PRC which engages in Internet access services in the PRC on behalf of the Company. The $242,000 investment represents a 20% interest in Hengda, with High Century holding the remaining 80% interest.

In June 2003, pursuant to a Loan and Share Pledge Agreement (the Internet Loan Agreement), the Company extended loans in the amount of $121,000 to He Jinmei for the purpose of funding an equity investment of $121,000 by He Jinmei in Sohu Internet, a company incorporated in the PRC which engages in Internet information and value added telecommunication services in the PRC on behalf of the Company. The $121,000 investment represents a 20% interest in Sohu Internet, with High Century holding the remaining 80% interest.

The Century Loan Agreement, Hengda Loan Agreement and Internet Loan Agreement, which are subject to PRC law, include provisions that (i) the loans can only be repaid to the Company by transferring the shares of High Century, Hengda or Sohu Internet to the Company, (ii) the shares of High Century, Hengda or Sohu Internet cannot be transferred without the approval of the Company, and (iii) the Company has the right to appoint all directors and senior management personnel of High Century, Hengda and Sohu Internet. Dr. Zhang, Li Wei and He Jinmei have pledged all of their shares in High Century, Hengda and Sohu Internet as collateral for the loans and the loans bear no interest and are due on demand after November 2003, in the case of High Century, after January 2003, in the case of Hengda, and after June 2004, in the case of Sohu Internet, or at such time as Dr. Zhang, Li Wei or He Jinmei, as the case may be, is not an employee of the Company. The Company does not intend to request repayment of the loans as long as PRC regulations prohibit the Company from directly investing in businesses being undertaken by High Century, Hengda and Sohu Internet.

Effective July 1, 2003, the Company adopted the provisions of Financial Accounting Standards Board Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46). Pursuant to FIN 46, Beijing Sohu, High Century, Hengda, and Sohu Internet are VIEs and the Company is the primary beneficiary. Accordingly, effective July 1, 2003, the VIEs have been consolidated in the Company s financial statements. The Company has not restated earlier periods for the adoption of FIN 46. Thus, prior to July 1, 2003, these entities were not consolidated in the Company s financial statements and transactions with and balances related to the VIEs have been disclosed as related party transactions. The following table provides information about the VIEs (in thousands):

Name of VIE	Business Purpose	Total assets at March 31, 2004	Total revenues for the three months ended March 31, 2004	Net income/(loss) for the three months ended March 31, 2004
Beijing Sohu	Internet information, value added telecommunication and e-commerce services	$ 397	$ 3,764	$ (201)
Hengda	Internet access services	1,213	306	1
Sohu Internet	Internet information and value added telecommunication services	1,647	9,800	(56)
High Century	Investment holding	4,257		5

(b) Related party transactions

During the three months ended March 31, 2003, Beijing Sohu (1) contracted with network operators for e-subscription revenues of $8,448,000 that were recorded as e-subscription revenues from related parties (the corresponding costs of $2,501,000 were included in e-subscription cost of revenues as related party services); (2) generated e-commerce sales of $1,175,000 that were recorded as e-commerce revenues from a related party (the corresponding costs of e-commerce sales of $1,008,000 were included in e-commerce cost of revenues as related party services); and (3) provided content services of $36,000 included in advertising cost of revenues as related party services. During the three months ended March 31, 2003, Hengda contracted with a fixed line telephone network operator for e-subscription revenues of $66,000 for Internet access services which were recorded as revenues from related parties (the corresponding costs of $145,000 were included in cost of revenues as related party services). During the three months ended March 31, 2004, Beijing Sohu, Sohu Internet and Hengda have been consolidated in the financial statements of the Company as a result of the adoption of FIN46.

Approximately 51% of the Company s e-commerce cash on delivery services in Beijing are being provided by Beijing Qingfan Delivery Co., Ltd. (Qingfan), a company owned by Zhang Tao, the brother of Dr. Zhang. Total delivery fees paid by the Company to Qingfan were approximately $35,000 and $31,000 for the three months ended March 31, 2004 and 2003, respectively.

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During the three months ended March 31, 2004, the Company recognized revenues of $118,000 from an investee of one of the Company s shareholders and $6,000 from a company whose founder, chief executive officer and chairman is one of directors of the Company.

5. COMMITMENTS AND CONTINGENCIES

The Chinese market in which the Company operates poses certain macro-economic and regulatory risks and uncertainties. These uncertainties extend to the ability of the Company to operate an Internet and value added telecommunication business and to offer content, advertising, wireless, and e-commerce services in the People s Republic of China. Though the People s Republic of China 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 or are unclear regarding in what specific segments of these industries foreign owned entities, like the Company, may operate. The Company s legal structure and scope of operations in China could be subjected to restrictions which could result in severe limits to the Company s ability to conduct business in the People s Republic of China.

As of March 31, 2004, the Company had recorded expenses of $280,000 related to notices of penalties and complaints from subsidiaries of China Mobile Communication Corporation for allegations of the breach of certain provisions of the agreements with the mobile network operators. The actual penalties may differ from the amount recorded. However, management does not expect the difference, if any, to have a material impact on the Company s financial position, results of operations or cash flows.

6. RECENT ACCOUNTING PRONOUNCEMENT

In April 2004, the Emerging Issues Task Force issued Statement No. 03-06 Participating Securities and the Two-Class Method Under FASB Statement No. 128, *Earnings Per Share* (EITF 03-06). EITF 03-06 addresses a number of questions regarding the computation of earnings per share by companies that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the company when, and if, it declares dividends on its common stock. The Statement also provides further guidance in applying the two-class method of calculating earnings per share, clarifying what constitutes a participating security and how to apply the two-class method of computing earnings per share once it is determined that a security is participating, including how to allocate undistributed earnings to such a security. EITF 03-06 is effective for fiscal periods beginning after March 31, 2004. The Company is currently evaluating the effect of adopting EITF 03-06 on its financial statements.

7. RECLASSIFICATIONS

Certain amounts from prior periods have been reclassified to conform with current period presentation.

8. SUBSEQUENT EVENT

In April 2004, the Board of Directors of the Company approved a stock repurchase program pursuant to which the Company can purchase from time to time up to $30,000,000 worth of outstanding shares of its common stock in the open market.

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, Sohu and Sohu.com are to Sohu.com Inc., and, except where the context requires otherwise, our subsidiaries ChinaRen Inc. (or ChinaRen), Sohu.com (Hong Kong) Limited (or Sohu Hong Kong), Sohu.com Limited, Kylie Enterprises Limited, All Honest International Limited, Sohu ITC Information Technology (Beijing) Co., Ltd. (or Beijing ITC), Beijing Sohu New Era Information Technology Co., Ltd. (or Sohu Era), and Beijing Sohu Interactive Software Co., Ltd. (or Sohu Software), and our VIEs Beijing Sohu Online Network Information Services, Ltd. (or Beijing Sohu), Beijing Century High Tech Investment Co., Ltd. (or High Century) Beijing Hengda Yitong Internet Technology Development Co., Ltd. (or Hengda) and Beijing Sohu Internet Information Service Co., Ltd. (or Sohu Internet), 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

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information set forth below under the caption Risk Factors. Readers are cautioned not to place undue reliance on these forward-looking statements.

OVERVIEW

We are one of the leading Internet portals in China in terms of brand recognition. Our main portal Sohu.com consists of sophisticated Chinese languages Web navigational and search capabilities, 20 main content channels, Web-based communications, alumni club and community services and a platform for e-commerce, wireless and multiplayer online game services. Each of our interest-specific main channels contains multi-level sub-channels that cover a comprehensive range of topics, including news, business, entertainment, sports and career. We also offer free and paid Web-based e-mail. We offer a universal registration system, whereby a user that has registered for our e-mail service is automatically registered for our chat, bulletin board and other services. Our portal attracts consumers and merchants alike because it is designed to meet the specific needs and interests of Internet users in China. Key features include proprietary Web navigational and search capabilities that reflect the unique cultural characteristics and thinking and viewing habits of PRC Internet users. Chinaren.com is an online portal located in China that targets mainland Chinese Internet users with its strong community products, 17173.com is a Web site that provides information about multiplayer online games in PRC, and Focus.cn is a Web site that provides information about real estate mainly in Beijing and Shanghai.

We derive revenues primarily through the sale of advertising, wireless, and e-commerce.

We were incorporated in August 1996 as Internet Technologies China Incorporated, and launched our original Web site, itc.com.cn, in January 1997. During 1997, we developed Sohu online directory ad search engine and related technology infrastructure, and also focused on recruiting personnel, raising capital and aggregating content to attract and retain users. In February 1998, we re-launched our Web site under the domain name sohu.com and in September 1999, we re-named our company Sohu.com Inc. Substantially all of our primary business operations are conducted through our intermediate holding company, Sohu.com Limited, our indirect wholly owned subsidiaries, Beijing ITC, Sohu Era, Sohu Software, Kylie Enterprises Limited, and All Honest International Limited, and our variable interest entities Sohu Internet and Beijing Sohu.

As of March 31, 2004, we had an accumulated deficit of $35.9 million as a result of significant net losses from our inception through the quarter ended June 30, 2002. These losses have been funded with proceeds of preferred stock private placements and our initial public offering completed in July 2000. We intend to continue spending on marketing and brand development, content enhancements, technology and infrastructure. As a result, net losses could occur in the future. We anticipate funding any such losses with the remaining proceeds from our initial public offering and the proceeds of the private placement of zero coupon convertible senior notes that we completed in July 2003.

CRITICAL ACCOUNTING POLICIES AND MANAGEMENT ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. 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. We believe accounting for advertising revenue, accounting for e-subscriptions revenues and cost of revenues, gross versus net basis of revenue recognition, allowance for doubtful accounts, valuation allowance against deferred tax assets and assessment of impairment for goodwill and other intangible assets represent critical accounting policies that reflect more significant judgments and estimates used in the preparation of our consolidated financial statements.

We generate advertising revenue from standard, sponsorship and retail contracts, most of which are one year or less in duration. Such contracts establish the fixed price and advertising services to be provided. Pursuant to advertising contracts, we provide advertisement placements on various Web site channels and in different formats, including but not limited to banners, links, logos, buttons, content integration and email marketing. Revenue is recognized ratably over the period the advertising is provided and, as such, we consider the services to have been delivered. Based upon our credit assessments of our customers prior to entering into contracts, we determine if collectibility is reasonably assured. In situations where collectibility is not deemed to be reasonably assured, we recognize revenue upon payment from the customer.

Sponsorship contracts may include services similar to those in our standard advertising contracts, are generally for larger dollar amounts and for a longer period of time, may allow advertisers to sponsor a particular area on our Web site, may include brand affiliation services and/or a larger volume of services, and may require some exclusivity or premier placements. Sponsorship advertisement revenues are normally recognized on a straight line basis over the contract period and when collection of the resulting receivable is reasonably assured provided we are meeting our obligations under the contract. Pursuant to retail advertising contracts, which are normally for lower dollar amounts and are with small and medium size enterprises, we provide services which include listings in our search directory or our classified advertisements section, normally for a fixed annual fee, and priority placements on search results for a fixed fee or variable pricing based on bidding by different competitors. For retail advertising contracts, revenue is recognized as the service is provided, which is normally on a straight line basis over the term of the contract, and collection of the resulting receivable is reasonably assured. Material differences could result in the amount and timing of our revenue for any period if management made different judgments or utilized different estimates.

E-subscription revenues and corresponding cost of revenues are included within non-advertising revenues and cost of revenues and are derived principally from providing value added wireless services such as alumni club, dating and friends matching, e-mail, ringtone and logo downloads and various other related products to mobile phone users. E-subscription fees are charged on a monthly or per message basis. E-subscription revenues and cost of revenues are recognized in the month in which the service is performed, provided no significant Sohu obligations remain. We rely on a number of mobile network operators in China to bill mobile phone users for e-subscription fees. In order to meet ownership requirements under PRC law which restrict or prohibit wholly foreign owned enterprises from providing Internet information and value added telecommunication services such as e-subscriptions, we rely on Beijing Sohu and Sohu Internet to contract with the mobile operators. Generally, (i) within 15 to 90 days after the end of each month, Beijing Sohu or Sohu Internet receives a statement from each of the operators confirming the amount of e-subscription charges billed to that operator s mobile phone users and (ii) within 30 to 120 days after delivering a monthly statement to Beijing Sohu or Sohu Internet each operator remits the e-subscription fees, net of its service fees, for the month to Beijing Sohu or Sohu Internet, which then transfers the funds to our subsidiaries Beijing ITC or Sohu Era. In order to recognize revenue and get paid for services provided, we rely on billing confirmations from the mobile network operators as to the actual amount of services they have billed to their mobile customers. We do not collect e-subscription fees from an operator in certain circumstances due to technical issues with the operator s network. This is referred to as the failure rate, which can vary from operator to operator. At the end of each reporting period, where an operator has not provided Beijing Sohu or Sohu Internet with the monthly statement for any month confirming the amount of e-subscription charges billed to that operator s mobile phone users for the month, Sohu, using information generated from its own internal system and historical data, makes estimates of the failure rate and collectable e-subscription fees and accrues revenue accordingly. The quarterly historical differences in our estimated revenue which was recorded in the financial statements compared to the actual revenue have ranged from an underestimation of $400,000 (gross margin underestimate of $300,000) to an overestimation of $160,000 (gross margin overestimate of $120,000) since e-subscription revenues presented a significant portion of our total revenues in 2002. We believe we have the ability to make a reasonable estimate. However, material differences could result in the amount and timing of our revenue and non advertising cost of revenue for any period because of differences between the actual failure rate per an operator s statement and our internal records. For the three months ended March 31, 2004, 96% of our e-subscriptions revenues had been confirmed by the monthly statements received from the mobile operators.

E-commerce revenues are earned from direct sales of consumer products through Sohu s Web site. We rely on Beijing Sohu to conduct our e-commerce business in order to meet ownership requirements under PRC law which restrict or prohibit wholly foreign owned enterprises from providing e-commerce services. In 2001, we established store.sohu.com, where we undertake fulfillment e-commerce activities and conduct e-commerce transactions. Our e-commerce products consist of over 4,000 consumer products such as books, health care products, cosmetics, videos, music and computer equipment. We purchase products from suppliers, stock the goods in our warehouse and, upon receiving the orders from our Web site, arrange for delivery to our customers, most of whom are individuals in Beijing, Shanghai and Guangzhou. Fulfillment is provided by delivery companies or through postal services. Substantially all sales are done on a cash on delivery basis. Product sales include the right of return within 10 days after the goods have been received if the products have quality problems and the buyer has retained the original order form. We record product sales net of the estimated amount of returns. We estimate an amount of product returns that is not significant.

Our management must determine whether to record revenue for our e-subscriptions and e-commerce business lines using the gross or net method of reporting. Determining whether revenue should be reported gross or net is based on an assessment of various factors, principally whether Sohu is acting as the principal in offering services to the customer or whether Sohu is acting as an agent in the transaction. To the extent Sohu is acting as a principal in a transaction Sohu reports as revenue the payments received on a gross basis and reports as costs of revenue the amounts attributable to goods and services provided by third party operators and other vendors. To the extent Sohu is acting as an agent in a transaction Sohu reports as revenue the payments received less commissions and other payments to third parties, i.e., on a net basis. The determination of whether Sohu is

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serving as principal or agent in a transaction is judgmental in nature and based on an evaluation of the terms of an arrangement. Based on our assessment, our e-subscriptions revenues are recorded on a gross basis. We have primary responsibility for fulfillment and acceptability of the e-subscription services. The content and nature of the e-subscription services are designed and developed by us (either independently or with third parties) and originate from our Web sites, our links located on third parties Web sites, or one of our dedicated phone numbers. The mobile operators that we contract with to deliver these services to the end customers are not involved in the design or development of the services that are provided by us. The end customer purchases the wireless content, community access or value added services, such as our online dating, mobile email and mobile alumni club that Sohu provides. The end customer receives identical services from us regardless of which third party mobile operator is used to deliver the message. In addition, when customers register on Sohu s Web sites to use e-subscription services, they execute an online contract with us that sets forth our obligations to the customer and the terms of the service that will be provided. Sohu has determined that in addition to the indicators of gross reporting, there are also certain indicators of net reporting, including the fact that the mobile operators set maximum prices that Sohu can charge and that the contracts call for the assumption of credit risk by the mobile operators after a certain fixed percentage is paid by Sohu as an estimated bad debt expense. This is part of the overall fees paid to the operators. The mobile operators also have the right to set regulations and procedures associated with using their platform. However, Sohu has determined that the gross revenue reporting indicators are stronger, because Sohu is the primary obligor, adds value to the products, has inventory risk related to content and products, and has reasonable pricing latitude.

The majority of our e-commerce revenues are recorded on a gross basis where Sohu is the primary obligor but, depending on the terms of particular contracts with our suppliers, the net basis is also used. Sohu considers itself the primary obligor in situations where Sohu has general and physical inventory risk and where we can set prices without any involvement from the suppliers. Transactions related to certain technology products, such as cameras, computers and memory cards, are recorded on a net basis when the suppliers set minimum prices, Sohu does not have inventory risk, does not maintain inventory to meet estimated customer demand and orders goods from suppliers only after receiving orders from customers.

To the extent revenues are recorded gross, any commissions or other payments to third parties are recorded as expenses so that the net amount (gross revenues, less expenses) flows through operating income. Accordingly, the impact on operating income is the same whether Sohu records the revenue on a gross or net basis.

Our management must make estimates of the uncollectability of our accounts receivables. Management specifically analyzes accounts receivable, historical bad debts, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. Our accounts receivable balance was $17.4 million net of allowance for doubtful accounts of $0.4 million as of March 31, 2004. If the financial condition of Sohu s customers or telecom operators were to deteriorate, resulting in their inability to make payments, additional allowance might be required.

As of March 31, 2004, substantially all of our deferred tax assets are related to United States net operating losses. Because substantially all of our income is earned in China, and we do not intend in the foreseeable future to repatriate this income to the United States where it would be taxable, we have recorded a full valuation allowance against our gross deferred tax assets in order to reduce our deferred tax assets to the amount that is more likely than not to be realized. 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.

Our long-lived assets include goodwill and other intangible assets. We test goodwill for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis, and between annual tests when an event occurs or circumstances change that could more likely than not reduce the fair value of goodwill below its carrying value. Application of a goodwill impairment test requires 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. Significant judgments required to estimate the fair value of reporting units include estimating future cash flows, determining appropriate discount rates and making other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value for each reporting unit. Any impairment losses recorded in the future could have a material adverse impact on our financial condition and results of operations.

As of March 31, 2004, we did not believe that any event or change of circumstances had occurred that would result in material impairment losses in goodwill.

In respect of our intangible assets, which mainly comprise domain names and marks and customer lists, we amortize the costs over their expected future economic lives. Management judgment is required in the assessment of the economic lives. Based on the existence of one or more indicators of impairment, we measure any impairment of intangibles based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our business model. An impairment charge would be recorded if we determine that the carrying value of intangible assets may not be recoverable. Our estimates of future cash flows require significant judgment based on our historical results and anticipated results and are subject to many factors.

As of March 31, 2004, we were not aware of any indication of impairment of our intangible assets.

RESULTS OF OPERATIONS

FOR THE THREE MONTHS ENDED MARCH 31, 2004 AND 2003

REVENUES

Total revenues were $25.9 million and $14.4 million for the three months ended March 31, 2004 and 2003, respectively.

Advertising Revenues

Advertising revenues were $11.0 million and $4.5 million or 42% and 31% of total revenues for the three months ended March 31, 2004 and 2003, respectively. The increase of $6.5 million from 2003 to 2004 consisted of: (1) $6.7 million from new advertisers, as more companies used the Internet as an advertising medium; (2) a $1 million increase in revenues from the advertisers who advertised with us in the three months ended March 31, 2003 and who continued to do so in the three months ended March 31, 2004; and a (3) $1 million increase in fees we receive for listing companies in our search directory, offset by a reduction of $2.17 million in revenues from some of our 2003 advertisers not advertising on our Web site in the three months ended March 31, 2004. No single customer accounted for more than 10% of total advertising revenues for each of the

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three months ended March 31, 2004 and 2003. We have not recorded any revenue from advertising barter transactions. As of March 31, 2004 and March 31, 2003, we had $4.0 million and $1.9 million of deferred revenues, respectively.

Over the past three years, we have been steadily gaining market share in online advertising and we expect that trend to continue. In addition, we believe the upward trend in pricing for corporate brand advertising will continue.

Non-advertising Revenues

Non-advertising revenues are derived principally from monetizing our users (i.e. consumers) via e-subscription services.

Non-advertising revenues were $14.9 million and $9.9 million or 58% and 69% of total revenue for the three months ended March 31, 2004 and 2003, respectively. Non-advertising revenues for the three months ended March 31, 2004 and 2003 included non-advertising revenues from Beijing Sohu and Sohu Internet of $13.6 million and $9.7 million, respectively. Because of restrictions on foreign companies working in the PRC telecommunications industry, we have used Beijing Sohu and Sohu Internet to contract on our behalf with PRC mobile network operators who provide the gateway for sending messages and collect our short messaging fees. Beijing Sohu and Sohu Internet collect the fees from the operators and then transfer them to our subsidiaries. There was no material impact on our revenues or margins from our reliance on these related party arrangements. On July 1, 2003, we prospectively adopted FIN 46, which resulted in the consolidation of our variable interest entities, including Beijing Sohu and Sohu Internet. Thus, e-subscription and e-commerce revenues earned by Beijing Sohu and Sohu Internet after this date are not disclosed as revenue from related parties.

In the three months ended March 31, 2004, non-advertising revenues were derived from e-subscription fees of $13.4 million, e-commerce services of $1.3 million, and other services of $211,000. In the three months ended March 31, 2003, non-advertising revenues were derived from e-subscription fees of $8.7 million, e-commerce services of $1.2 million, and other services of $82,000. Most of the growth in non-advertising revenues was attributable to increases in e-subscriptions revenue associated with our wireless services which include short messaging services, multi messaging services launched in 2003 and other advanced second generation technology (or 2.5G) wireless services. For the three months ended March 31, 2004, e-subscriptions revenue increased by $4.7 million from the three months ended March 31, 2003. The increase was attributable to increases in the wireless user base for our Web based products as well as new products for use with mobile phones. For the three months ended March 31, 2004 and 2003, approximately 91% and 87%, respectively, of e-subscriptions revenues were derived from providing wireless services, such as alumni club, dating and friends matching, e-mail, ringtone and logo downloads and various other related products, to mobile phone users. Short messaging fees are charged on a monthly or per message basis. As of March 31, 2004, approximately 80% of our short messaging revenue is from consumers who subscribe for monthly services, for which we charge a monthly fee ranging from approximately $0.36 to $3.60.

Our wireless services were introduced in China in late 2000 and our growth in this area over the past fifteen months has been mainly attributable to a combination of a number of factors, such as increases in the number of Chinese mobile phone users who have been subscribing for our wireless services and our introduction of new products to the market. The unique characteristics of the China mobile phone and Internet users are important factors for the growth of this business. Product development is especially important because these services have only recently become available in China and some of the services we offer are unique to China. As of March 31, 2004, we provided over 50 different monthly subscription wireless services and over 200 services which are charged on a per message basis. We regularly introduce new products and adaptations to our existing products. Depending on the product, subscribers may use the product for as short as one month or may use it on an ongoing basis. As described below, there are certain products and marketing methods which have contributed to our growth. Price increases have not been a factor in our short messaging growth, because we have many different products and pricing is normally set when the product is launched and remains unchanged during the life of the product. Approximately 35% of our growth in the three months ended March 31, 2004, as compared to the three months ended March 31, 2003, was attributable to improvements in the short messaging billing and transmission platform, as our approximate billing failure rate during the three months ended March 31, 2004 was 10%, as compared to approximately 35% for the three months ended March 31, 2003. However, in March 2004, China Unicom Co., Ltd, or Unicom, one of the mobile network operators, adopted new billing practices and procedures which resulted in a decrease in revenues from Unicom by approximately 28% in March 2004 as compared to the previous month. Our e-subscriptions revenue from Unicom may decrease further. In addition, CMCC, another mobile network operator in China, is changing its operating regulations. As a result of such changes, it is possible that CMCC or its subsidiaries will allege that we breached certain provisions of their agreements with us. Any such allegations of breaches could result in our being required to pay penalties to CMCC or its subsidiaries, which could also lead to a further decrease in our e-subscription revenues.

During the year ended December 31, 2003 the largest contributor to our wireless related e-subscriptions growth was our online dating and friends matching service, which we refer to as Jiqinggongshe or GGMM, and accounted for approximately 25% of our wireless revenue in 2003. For the three months ended March 31, 2004

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approximately 12% of our e-subscriptions revenues were from GGMM as compared to 35% of our e-subscriptions revenue from GGMM for the three months ended March 31, 2003. Most of our GGMM subscribers were acquired through Web site union, where we used third party Web sites to market our products. We also used Web site union for marketing numerous other products, which, excluding GGMM, accounted for approximately 15% of our total e-subscription revenues for the twelve months ended December 31, 2003 and 7% and 0% of our total e-subscription revenues for the three months ended March 31, 2004 and 2003, respectively. At the instruction of the mobile operators, we stopped using Web site union in July 2003. As a result of our inability to use Web site union to promote our products or acquire subscribers, we experienced substantially lower growth in e-subscriptions revenues for the three months ended September 30, 2003 and December 31, 2003 as compared to the three months ended June 30, 2003, March 31, 2003 and December 31, 2002. We experienced a decrease in e-subscriptions revenue for the three months ended March 31, 2004 as compared to the three months ended December 31, 2003, and expect to have a further decrease in e-subscriptions revenue for the three months ended June 30, 2004, due to the high churn rates in some of our existing products. Selected community products are becoming out of fashion, and we expect a gradual downward trend in these community products.

Our subscriber base for products previously promoted through Web site union (especially GGMM) is declining, which is having a negative impact on our revenue growth. Our GGMM subscribers have declined from a high of 2.2 million in April 2003 to 1.3 million at March 31, 2004. We charge a monthly fee of $0.63 for GGMM. Our future growth in e-subscriptions revenue could be materially less than historical growth or there could be further decreases in e-subscriptions revenues.

The future growth and sustainability of our e-subscription revenues is dependent upon user acceptance of our existing and new services, especially services which are paid by way of monthly subscriptions. Because these services are new and untested, we do not have a clear understanding of consumer behavior, making it difficult to predict future growth or usage.

E-commerce revenues are earned from direct sales of consumer products through Sohu s Web site. In 2001, we established store.sohu.com, where we undertake fulfillment e-commerce activities and conduct e-commerce transactions. Our e-commerce products consist of over 4,000 consumer products, such as books, health care products, videos, music and computer equipment. We purchase products from suppliers, stock the goods in our warehouse and, upon receiving the orders from our Web site, arrange for delivery to our customers, most of whom are individuals in Beijing. Fulfillment is provided by delivery companies or through postal services. Substantially all sales are done on a cash on delivery basis. E-commerce revenues increased by $144,000 to $1.3 million for the three months ended March 31, 2004 as compared to the three months ended March 31, 2003 as a result of more people purchasing through our Web site. .

Other services include our design of Web sites and provision of Internet software to third parties.

COSTS AND EXPENSES

Cost of Revenues

Total cost of revenues was $8.6 million and $5.3 million for the three months ended March 31, 2004 and 2003, respectively.

Advertising Cost of Revenues

Advertising cost of revenues includes personnel costs and personnel overhead, content purchases, depreciation and bandwidth, which are fairly fixed in nature and accordingly do not tend to increase or decrease proportionately with revenue. Our advertising gross margin for the three months ended March 31, 2004 was 75% as compared to 64% for the three months ended March 31, 2003. Our gross margins improved because of the fixed nature of the advertising costs of revenues, which have not increased at the same rate as revenue.

Advertising cost of revenues was $2.8 million and $1.6 million for the three months ended March 31, 2004 and 2003, respectively. The increase for the three months ended March 31, 2004 from the three months ended March 31, 2003 of $1.2 million was primarily due to higher spending on headcount of $300,000 and an increase in spending for content of $245,000, as we expanded our channel offerings.

Non-advertising Cost of Revenues

Non-advertising cost of revenues were $5.8 million and $3.7 million for the three months ended March 31, 2004 and 2003, respectively. The increases are consistent with revenue growth. Prior to our adoption of FIN 46 on July 1, 2003, which resulted in the consolidation of our variable interest entities, substantially all non-advertising cost of revenues was from related parties.

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Our e-subscriptions gross margin for the three months ended March 31, 2004 was 67% as compared to 70% for the three months ended March 31, 2003. E-subscriptions cost of revenues was $4.5 million and $2.6 million for the three months ended March 31, 2004 and 2003, respectively, which consists mainly of subscription collection and wireless transmission charges paid to third party network operators. The fees vary between third party operators and include a gateway fee of $0.006 to $0.012 per message, depending on the volume of the monthly total wireless messages, and a collection fee of 12% to 15%, based on the total fees collected by the third party operators from mobile phone users and paid to us. As the operator fees are charged on a per message basis and as a percentage of revenue, the increase in e-subscriptions cost of revenues is consistent with our increase in wireless revenues. Content costs are also included in e-subscription cost of revenues but are immaterial as compared to collection and transmission charges. E-subscription cost of revenues does not include allocations for Web site operating costs. Subsequent to the adoption of FIN 46, e-subscription cost of revenue also includes the business tax paid when VIEs remit to our subsidiaries e-subscription fees which have been collected by the VIEs. The decrease in gross margin is mainly due to the business taxes paid by Sohu for the e-subscription fees transferred from VIEs and a lower mix of monthly subscriptions, which have higher gross margins. There have been no significant changes in the third party network operator fees over the past year.

Our e-commerce gross margin for the three months ended March 31, 2004 was 3% as compared to 14% for the three months ended March 31, 2003. Approximately six percentage points of the reduction in gross margin were attributable to our providing free delivery for orders greater than $6 and approximately five percentage points of the reduction were attributable to our lowering sales prices of our products, both of which we instituted in response to product pricing pressures from our competitors in e-commerce, including Joyo, Bertelsmann Online and Dang Dang, and our initiative to gain market share among consumers in Beijing. For the three months ended March 31, 2004 and 2003, non-advertising cost of revenues included $1.3 million and $1.0 million, respectively, in e-commerce cost of revenues, consisting of the purchase price of consumer products and inbound and outbound shipping charges. E-commerce cost of revenues does not include allocations for Web site operating costs. The change in e-commerce cost of revenues from the comparative period in 2003 is attributable to the change in sales volume.

Our overall non-advertising gross margins for the three months ended March 31, 2004 dropped to 61% from 69% in the fourth quarter of 2003 because of (i) a decrease in revenues from the high gross margin wireless community products due to the high churn rate; (ii) increasing investment in content for our wireless services; and (iii) special promotions.

Product Development Expenses

Product development expenses increased $200,000 to $1.9 million for the three months ended March 31, 2004 as compared to the three months ended March 31, 2003, primarily due to increased salary expense of $300,000 million for additional employees to support our increased investment in our products and online games development and traveling and entertainment of $42,000, partly offset by a $142,000 decrease in office expense.

Sales and Marketing Expenses

Sales and marketing expenses increased by $1.1 million to $3.1 million for the three months ended March 31, 2004 as compared to the three months ended March 31, 2003, primarily due to increased advertising and promotion expense of $629,000 to support our marketing strategy, increased personnel expenses of $295,000, primarily the result of increased bonuses and commissions from increased advertising revenues, and increased traveling, entertainment and office expense of $176,000 in relation to the promotion activities.

General and Administrative Expenses

General and administrative expenses increased by $500,000 to $1.6 million for the three months ended March 31, 2004 as compared to the three months ended March 31, 2003, due mainly to increased professional fees of $280,000, salary expenses of $200,000 and office expense of $20,000.

Amortization of Intangibles

Amortization of intangibles for the three months ended March 31, 2004 of $177,000 was related to the acquisitions of the Focus.cn and 17173.com Web sites in the fourth quarter of 2003. There was no amortization of intangibles recorded during the three months ended March 31, 2003.

Operating Profit

As a result of the foregoing, we had an operating profit of $10.6 million for the three months ended March 31, 2004 as compared to $4.3 million for the three months ended March 31, 2003. The operating profit for the three months ended March 31, 2004 and 2003, respectively, included $5,000 and $18,000 for stock-based compensation expense relating to the grant of certain stock options at an exercise price below fair market value, which amounts are being amortized over the vesting period of the options, ranging from one to four years, and stock-based compensation expense to reflect resignations of certain employees.

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Other Expense

For the three months ended March 31, 2004, other expense was $208,000 and included $198,000 for amortization of the offering costs of our zero coupon convertible senior notes and $10,000 of losses on disposal of fixed assets. For the three months ended March 31, 2003, other expense was $81,000 and included a $86,000 valuation allowance for long-term loans to related parties offset by $5,000 gain on disposal of fixed assets.

Interest Income

Interest income was $630,000 for the three months ended March 31, 2004, as compared to $327,000 for the three months ended March 31, 2003. The increase of $303,000 was mainly due to our increased cash balance and marketable securities as a result of our private placement of zero coupon convertible senior notes in July 2003 and an increase in our profits.

Income Tax Expense

Income tax expense was $54,000 for the three months ended March 31, 2004 due to tax benefit from stock options and there was no income tax expense recorded for the corresponding period in 2003.

Effective for the fourth quarter of 2003, Sohu Era, Sohu Internet and Sohu Software are new technology enterprises, and as such, are subject to taxation at 0% for the years ended December 31, 2003, and 2004 and 2005, 7.5% for the years ending December 31, 2006, 2007 and 2008 and 15% for each year thereafter. If Sohu Era, Sohu Internet and Sohu Software do not continue to meet the definition of a new technology enterprise or there are changes in the taxation policies of the PRC government, their income would be subject to taxation at the rate of 33%. We currently expect most of our income to be earned from Sohu Era.

Income earned in the United States, where Sohu.com Inc. is incorporated, is subject to taxation at 34% or 35%. For the foreseeable future, we anticipate the only significant income earned in the United States and subject to United States taxation to be interest income. If dividends are paid by our non-U.S. subsidiary Sohu.com Limited to Sohu.com Inc., the dividends would be taxed at Sohu.com Inc. s rate of taxation which is 34% or 35%. For the foreseeable future, we do not intend for the China or other non-U.S. subsidiaries to pay dividends to Sohu.com. Inc.

Accordingly, our future effective tax rate could vary between 0% and 35% due to a variety of factors, including, but not limited to, the relevant income contribution by Chinese entities taxed at 0% to 33% and U.S. operations taxed at 34% or 35%, the ability of our operating subsidiaries to meet the requirements of a new technology enterprises, which are taxed at a maximum of 15% (which is less than the normal China corporate tax rate of 33%), dividends paid by Sohu.com Limited to Sohu.com Inc., which would be taxed in the United States at 34% or 35%, the ability of Sohu.com to use its net operating losses, changes in statutory tax rates, the amount of tax exempt interest income generated during the year, the ability to utilize foreign tax credits and non-deductible items relating to acquisitions or other non-recurring charges. We will continue to monitor the effective tax rate on a quarterly basis.

Net Income

As a result of the foregoing, we had net income of $10.9 million for the three months ended March 31, 2004, as compared to a net income of $4.6 million for the three months ended March 31, 2003.

We expect our net income to decrease in the three months ended June 30, 2004, as compared to the three months ended March 31, 2004, as a result of an expected decrease in e-subscriptions revenues, due to the high churn rates in some of our existing products.

LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations principally through private sales of equity securities and convertible notes, and cash provided by operations. From inception through March 31, 2004, we have raised net proceeds of $39.2 million through the sale of preferred stock in private placements, $52.4 million from the sale of common stock in our initial public offering and $87.4 million through the sale of zero coupon convertible senior notes, as described below. Sohu invests its excess cash in marketable debt securities of high quality investment grade. As of March 31, 2004, we had cash, cash equivalents, and investments in marketable debt securities totaling approximately $150.4 million as compared to $47.4 million as of March 31, 2003.

We completed a private placement on July 14, 2003 of $90.0 million principal amount of zero coupon convertible senior notes due July 2023, which resulted in net proceeds to Sohu of approximately $87.4 million after deduction of the initial purchaser s discount and our offering expenses. The notes do not pay any interest, have a zero yield to maturity, and are convertible into Sohu s common stock at a conversion price of $44.76 per share, subject to adjustment. Each $1,000 principal of the notes is initially convertible into 22.3414 shares of Sohu s common stock. Each holder of the notes will have the right, at the holder s option, to require Sohu to

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repurchase all or any portion of the principal amount of the holder s notes on July 14 in 2007, 2013 and 2018 at a price equal to 100% of the outstanding principal amount. Sohu may also redeem all or a portion of the notes for cash at any time on or after July 14, 2008 at 100% of the principal amount of the notes if the closing price of Sohu s common stock for each of the 30 consecutive trading days prior to such time was at least 130% of the conversion price or at such time at least 90% of the initial aggregate principal amount of the notes have been converted, repurchased or redeemed. In addition, upon a change of control event, each holder of the notes may require Sohu to repurchase some or all of its notes at a repurchase price equal to 100% of the principal amount of the notes plus accrued and unpaid interest. We have filed a registration statement with the Securities and Exchange Commission to register for resale the notes and the common stock issuable upon conversion of the notes. However, until the registration statement becomes effective, the notes may be offered and sold only in transactions that are exempt from registration under the U.S. Securities Act of 1933 and the securities laws of any other applicable jurisdiction. Also, because the registration statement was not declared effective by January 10, 2004, we have been and will be required to pay liquidated damages, consisting of interest on the outstanding principal of the notes at the initial annual rate of 0.25% for the first 90 days and thereafter at the annual rate of 0.50%, until the registration statement is declared effective. In April 2004, we paid liquidated damages of approximately $64,000. If the registration statement is not declared effective by June 30, 2004, we will owe approximately an additional $93,500 in liquidated damages.

Net cash provided by operating activities was approximately $9.3 million for the three months ended March 31, 2004, and was primarily attributable to our net income of $10.9 million, depreciation and amortization of $1.3 million, offset by $3.2 million of cash used as working capital. Net cash provided by operating activities was approximately $4 million for the three months ended March 31, 2003, primarily due to net income of $4.6 million and depreciation and amortization of $1.2 million, offset by cash used as working capital of $1.9 million.

Net cash provided by investing activities was $0.8 million for the three months ended March 31, 2004, and was primarily attributable to cash received from matured marketable debts of $3.1 million, offset by the purchase of fixed assets of $2.1 million and addition of other assets of $0.1 million. There was no significant net cash provided by investing activities for the three months ended March 31, 2003. During the three months ended March 31, 2003, $1.0 million of marketable debt securities matured and approximately offset the payment for acquisition of fixed assets and other assets.

Net cash provided by financing activities was $0.6 million of proceeds from issuance of common stock for the three months ended March 31, 2004. There was no significant net cash provided by financing activities for the three months ended March 31, 2003.

We believe that current cash and cash equivalents will be sufficient to meet anticipated working capital (net cash used in operating activities), commitments and capital expenditures for at least the next twelve months. We may, however, require additional cash resources due to changed business conditions or other future developments, including any investments or acquisitions we may decide to pursue.

At March 31, 2004, we have an unused credit facility whereby we can borrow up to $15 million by providing marketable securities on deposit with the financial institution as collateral.

Risk Factors

Risks Related to Sohu.com

We incurred net losses from inception through the second quarter of 2002, and losses could recur in the future.

We incurred significant net losses from our inception in August 1996 through the quarter ended June 30, 2002. We had an accumulated deficit of approximately $35.9 million at March 31, 2004. We may incur substantial net losses in the future due to the relative high risk associated with our revenue and the high level of planned operating and capital expenditures, including sales and marketing costs, personnel hires, and product development. Although we recorded net profits from the quarter ended September 30, 2002 through the quarter ended March 31, 2004, we may not sustain profitability or our profitability could decrease.

We have a limited operating history, which may make it difficult for investors to evaluate our business.

We began offering products and services under the www.Sohu.com Web site in February 1998. Accordingly, we have a limited operating history upon which investors can evaluate our business. In addition, our senior management and employees have worked together at our company for only a relatively short period of time. As an early stage company in the new and rapidly evolving PRC Internet market, we face numerous risks and uncertainties. Some of these risks relate to our ability to:

- increase our online advertising revenues and successfully build our e-commerce and e-subscription services (including wireless services) businesses, given the early stage of development of the PRC Internet industry;
- continue to attract a larger audience to our portal by expanding the type and technical sophistication of the content and services we offer; and

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maintain our current, and develop new, strategic relationships to increase our revenue streams as well as product and service offerings.

If our current ownership structure is found to be in violation of current or future PRC laws, rules or regulations regarding the legality of foreign investment in the PRC Internet sector, we could be subject to severe penalties.

We conduct our Internet and value added telecommunication operations solely in the PRC through our indirect wholly owned subsidiaries, Beijing ITC and Sohu Era, and variable interest entities Sohu Internet and Beijing Sohu. We are a Delaware corporation, and Sohu Hong Kong, our indirect wholly owned subsidiary and the parent company of Beijing ITC and Sohu Era, is a Hong Kong corporation and a foreign person under PRC law. Accordingly, Beijing ITC and Sohu Era are wholly foreign owned enterprises, or WFOEs, under PRC law and our Internet and value added telecommunication business is 100% foreign-owned. In order to meet ownership requirements under PRC law which restrict or prohibit WFOEs from operating in certain industries such as Internet information, Internet access, value added telecommunication and e-commerce services, we have established Beijing Sohu, High Century, Hengda and Sohu Internet, which are companies incorporated in the PRC and owned by Dr. Zhang and certain other employees of Sohu. As of March 31, 2004, Sohu had invested $5.2 million in Beijing Sohu, High Century, Hengda and Sohu Internet through loans to officers and employees. In 2000, we extended loans of $242,000 to Dr. Zhang and a Sohu employee to set up Beijing Sohu. Pursuant to a restructuring in May 2000, we transferred certain of our assets and operations to Beijing Sohu, a PRC company that is 80% owned by Dr. Zhang. In 2001 and 2002, we made loans totaling $4.6 million to Dr. Zhang and an employee of the company to establish High Century for the purposes of undertaking additional investments in the PRC where foreign ownership is prohibited or restricted. In 2002, we loaned $242,000 to an employee of the company for the purpose of funding an investment in Hengda, a company incorporated in the PRC which engages in Internet access services in the PRC on behalf of Sohu. The $242,000 investment represents a 20% interest in Hengda, with High Century holding the remaining 80% interest. In June 2003, we loaned $121,000 to an employee of the company for the purpose of funding an investment in Sohu Internet, a company incorporated in the PRC which engages in Internet information services in the PRC on behalf of Sohu. The $121,000 investment represents a 20% interest in Sohu Internet with High Century holding the remaining 80% interest. We do not have any direct ownership interest in Beijing Sohu, High Century, Hengda or Sohu Internet.

The PRC began several years ago to regulate its Internet sector by making pronouncements or enacting regulations regarding the legality of foreign investment in the PRC Internet sector and the existence and enforcement of content restrictions on the Internet. We believe that our current ownership structure complies with all existing PRC laws, rules and regulations. There are, however, substantial uncertainties regarding the interpretation of current PRC Internet laws and regulations. In addition, new PRC Internet laws and regulations were recently adopted. Accordingly, it is possible that the PRC government will ultimately take a view contrary to ours.

In addition, under the agreement reached in November 1999 between the PRC and the United States concerning the United States support of China s entry into the World Trade Organization, or WTO, foreign investment in PRC Internet services are to be liberalized to allow for 30% foreign ownership in key telecommunication services, including PRC Internet ventures, for the first year after China s entry into the WTO, 49% in the second year and 50% thereafter. China officially entered the WTO on December 11, 2001. However, the implementation of China s WTO accession agreements is still subject to various conditions.

Accordingly, it is possible that the relevant PRC authorities could, at any time, assert that any portion or all of our, Beijing ITC s, Sohu Era s, Beijing Sohu s, Hengda s, High Century s or Sohu Internet s existing or future ownership structure and businesses violate existing or future PRC laws, regulations or policies. It is also possible that the new laws or regulations governing the PRC Internet sector that have been adopted or may be adopted in the future will prohibit or restrict foreign investment in, or other aspects of, any of our, Beijing ITC s, Sohu Era s, Beijing Sohu s, Hengda s, High Century s and Sohu Internet s current or proposed businesses and operations. In addition, any such new laws and regulations may be retroactively applied to us, Beijing ITC, Sohu Era, High Century, Hengda, Beijing Sohu or Sohu Internet.

If we, Beijing ITC, Sohu Era, High Century, Beijing Sohu, Hengda or Sohu Internet were found to be in violation of any existing or future PRC laws or regulations, the relevant PRC authorities would have broad discretion in dealing with such violation, including, without limitation, the following:

levying fines;

confiscating our, Beijing ITC s, Sohu Era s, High Century s, Hengda s, Beijing Sohu s or Sohu Internet s income;

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revoking our, Beijing ITC s, Sohu Era s, High Century s, Hengda s, Beijing Sohu s or Sohu Internet s business license;

shutting down our, Beijing ITC s, Sohu Era s, Beijing Sohu s or Sohu Internet s servers and/or blocking our Web sites;

requiring us, Beijing ITC, Sohu Era, High Century, Hengda, Beijing Sohu or Sohu Internet to restructure its ownership structure or operations; and

requiring us, Beijing ITC, Sohu Era, High Century, Hengda, Beijing Sohu or Sohu Internet to discontinue any portion or all of its Internet and value added telecommunication business.

If we are found to be in violation of current or future PRC laws, rules or regulations regarding Internet-related services and telecom-related activities, we could be subject to severe penalties.

The PRC recently enacted regulations applying to Internet-related services and telecom-related activities. While many aspects of these regulations remain unclear, they purport to limit and require licensing of various aspects of the provision of Internet information and value added telecommunication services. If these regulations are interpreted to be inconsistent with our ownership structure and business operations, our business will be severely impaired and we could be subject to severe penalties as discussed above.

Activities of Internet content providers are or will be subject to additional PRC regulations, which have not yet been put into effect. Our operations may not be consistent with these new regulations when put into effect, and, as a result, we could be subject to severe penalties.

The Ministry of Information Industry, or MII, has stated that the activities of Internet content providers are subject to regulation by various PRC government authorities, depending on the specific activities conducted by the Internet content provider. Various government authorities have stated publicly that they are in the process of preparing new laws and regulations that will govern these activities. The areas of regulation currently include online advertising, online news reporting, online publishing, online securities trading and the provision of industry-specific (e.g., drug-related) information over the Internet. Other aspects of our online operations may be subject to regulation in the future.

Our operations may not be consistent with these new regulations when put into effect and, as a result, we could be subject to severe penalties as discussed above.

We may not be able to collect payments of our e-subscription fees if the PRC government determines that our existing ownership structure does not comply with PRC laws, rules or regulations.

As discussed above, the PRC began several years ago to regulate its Internet sector by making pronouncements or enacting regulations regarding the legality of foreign investment in the PRC Internet sector. We believe that our current ownership structure complies with all existing PRC laws, rules and regulations. There are, however, substantial uncertainties regarding the interpretation of current PRC Internet laws and regulations. In addition, new PRC Internet laws and regulations were recently adopted. Accordingly, it is possible that the PRC government will ultimately take a view contrary to ours. If the PRC government were to take a contrary view, we may not be able to collect payments of our wireless fees, which we receive from Beijing Sohu and Sohu Internet, which in turn collect the fees from mobile network operators.

Even if we are in compliance with PRC governmental regulations relating to licensing and foreign investment prohibitions, the PRC government may prevent us from distributing, and we may be subject to liability for, content that it believes is inappropriate.

The PRC has enacted regulations governing Internet access and the distribution of news and other information. In the past, the PRC government has stopped the distribution of information over the Internet that it believes to violate PRC law, including content that is obscene, incites violence, endangers national security, is contrary to the national interest or is defamatory. In addition, we may not publish certain news items, such as news relating to national security, without permission from the PRC government. Furthermore, the Ministry of Public Security has the authority to cause any local Internet service provider to block any Web site maintained outside the PRC at its sole discretion. Even if we comply with PRC governmental regulations relating to licensing and foreign investment prohibitions, if the PRC government were to take any action to limit or prohibit the distribution of information through our network or to limit or regulate any current or future content or services available to users on our network, our business would be harmed.

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We are also subject to potential liability for content on our Web sites that is deemed inappropriate and for any unlawful actions of our subscribers and other users of our systems under regulations promulgated by the MII.

Furthermore, we are required to delete content that clearly violates the laws of the PRC and report content that we suspect may violate PRC law. It is difficult to determine the type of content that may result in liability for us, and if we are wrong, we may be prevented from operating our Web sites.

We may be unable to collect long-term loans to officers and employees or exercise management influence associated with Beijing Sohu, High Century, Hengda or Sohu Internet.

At March 31, 2004, Sohu had provided long-term loans of $5.2 million to Dr. Zhang and certain of our employees. The long-term loans are used to finance investments in Beijing Sohu and High Century, which are owned 80% by Dr. Zhang and 20% by certain of our employees, Hengda, which is owned 80% by High Century and 20% by an employee, and Sohu Internet, which is owned 80% by High Century and 20% by an employee. Beijing Sohu, High Century, Hengda and Sohu Internet are used to facilitate our participation in telecommunications, Internet content and certain other businesses in China where foreign ownership is either prohibited or restricted.

The agreements contain provisions that, subject to PRC law, (i) the loans can only be repaid to us by transferring the shares of High Century, Hengda, Sohu Internet or Beijing Sohu to us, (ii) the shares of High Century, Hengda, Sohu Internet or Beijing Sohu cannot be transferred without our approval, and (iii) we have the right to appoint all directors and senior management personnel of High Century, Hengda, Sohu Internet and Beijing Sohu. Dr. Zhang and the other employee borrowers have pledged all of their shares in High Century, Hengda, Sohu Internet and Beijing Sohu as collateral for the loans and the loans bear no interest and are due on demand after November 2003, in the case of High Century, the earlier of a demand or 2010, in the case of Beijing Sohu, after January 2003, in the case of Hengda, and after June 2004, in the case of Sohu Internet, or, in any case, at such time as Dr. Zhang or the other employee borrowers, as the case may be, is not an employee of Sohu. Sohu does not intend to request repayment of the loans as long as PRC regulations prohibit it from directly investing in businesses being undertaken by High Century, Hengda, Sohu Internet and Beijing Sohu.

Because these loans can only be repaid by the borrowers transferring the shares of the various entities, our ability to ultimately realize the effective return of the amounts advanced under these loans will depend on the profitability of Beijing Sohu, Hengda, Sohu Internet and High Century, which is uncertain. Furthermore, because of uncertainty associated with PRC law, ultimate enforcement of the loan agreements is uncertain. Accordingly, we may never be able to collect these loans or exercise influence over High Century, Hengda, Sohu Internet and Beijing Sohu.

We depend upon contractual arrangements with Beijing Sohu, Hengda, High Century and Sohu Internet for the success of our business and these arrangements may not be as effective in providing operational control as direct ownership of these businesses and may be difficult to enforce.

Because we conduct our Internet operations only in the PRC, and because we are restricted or prohibited by the PRC government from owning Internet content or telecommunication operations in the PRC, we are dependent on Beijing Sohu, Hengda, High Century and Sohu Internet in which we have no direct ownership interest, to provide those services through contractual agreements between the parties. These arrangements may not be as effective in providing control over our Internet content or telecommunications operations as direct ownership of these businesses. For example, Beijing Sohu and Sohu Internet could fail to take actions required for our business, such as entering into content development contracts with potential content suppliers or failing to maintain the necessary permit for the content servers. If Beijing Sohu, Hengda, High

Century and Sohu Internet fail to perform its obligations under these agreements, we may have to rely on legal remedies under PRC law, which we cannot assure you would be effective or sufficient.

Dr. Zhang is also the majority shareholder of Beijing Sohu, Hengda, High Century and Sohu Internet. As a result, our contractual relationships with those companies could be viewed as entrenching his management position or transferring certain value to him, especially if any conflict arises with him.

We rely on e-subscription services for a significant portion of our revenues. Wireless services constitute the majority of our e-subscription revenues. Our business plan is dependent upon further increases in revenues from wireless services and the expansion of our subscriber base.

We derive a significant portion of our revenues from e-subscription services on our Web sites. We derived our e-subscription revenue in the first three months of 2004 principally from providing to mobile phone users value added wireless services such as alumni club, dating and friends matching, e-mail, ringtone and logo downloads and various other related products. For the three months ended March 31, 2004 and 2003, e-subscription revenues represented approximately 52% and 60%, respectively, of our total revenues. For the three months ended March 31, 2004, wireless services accounted for 91% of our total e-subscription

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revenues. We expect our reliance on the portion of wireless e-subscription revenues to increase. Our business plan is dependent upon further increases in revenues from wireless services and the expansion of our subscriber base. Revenues may not increase and our subscriber base may not expand due to the possibilities that:

- Our consumers may not understand our services or the fees they are being charged, may not be satisfied with our services and/or may not use our services on a regular basis;

- Consumers may cancel their services at any time without notice;

- Currently over 80% of our e-subscriptions revenue is from consumers who subscribe for individual services for which we charge a monthly fee ranging from approximately $0.36 to $3.60. During the quarter ended March 31, 2004, we continued to churn out of our old community products such as GGMM, which led to a decrease in wireless revenues from the previous quarter. We now put more emphasis on new products such as multi messaging services and other 2.5G applications to re-ignite growth in this area. Future growth and sustainability of our e-subscription revenues are dependent upon user acceptance of our existing and new services, especially services which are paid by way of monthly subscriptions. Because these services are new and untested, we do not have a clear understanding of consumer behavior, making it difficult to predict future growth or usage.

- We face intense competition from a number of companies who may launch competing or better products than us at any time. In addition, there are limited barriers to entry in this area; and

- Changes in government policy could restrict or curtail the services which we provide.

We expect our e-subscriptions revenues to decrease in the three months ended June 30, 2004, as compared to the three months ended March 31, 2004, due to the high churn rates in some of our existing products. There could be further decreases in the future.

We rely on contracts with our mobile network operators, CMCC and Unicom, in a number of ways with respect to our wireless services, including for billing of, and collection from, mobile phone users of e-subscription fees. If our arrangements with mobile network operators were to be terminated, altered or not renewed, or if such operators did not provide continuous or adequate service, our revenues could be reduced significantly.

Wireless fees are charged on a monthly or per message basis. Pursuant to contractual arrangements between Beijing Sohu or Sohu Internet and a number of mobile network operators in China which are subsidiaries of China Mobile Communication Corporation, or CMCC, and China Unicom Co., Ltd, or Unicom, Sohu relies on the operators for both billing of, and collection from, mobile phone users of e-subscription fees. The service fees range from approximately 10% to 50% of our e-subscription revenues, and are based on contracted rates that are subject to review and renewal on an annual basis. Generally, (i) within 15 to 90 days after the end of each month, Beijing Sohu or Sohu Internet receives a statement from CMCC and Unicom confirming the amount of e-subscription charges billed to that operator s mobile phone users and (ii) within 30 to 120 days after delivering a monthly statement to Beijing Sohu or Sohu Internet, each operator remits the e-subscription fees, net of its service fees, for the month to Beijing Sohu or Sohu Internet which then transfers the funds to Beijing ITC or Sohu Era.

With respect to our wireless services, we depend on the cooperation of CMCC and Unicom. We rely on CMCC and Unicom in the following ways:

we provide wireless services through CMCC s and Unicom s network and gateway;

we utilize and rely on CMCC and Unicom s billing systems to charge our subscribers through the subscriber s mobile phone bill;

we rely on their collection proxy services to collect payments from subscribers; and

we rely on their infrastructure to further develop our subscription services.

We face significant risks with respect to our arrangements with CMCC and Unicom, such as the following, which could adversely affect our e-subscription services and revenues:

We provide e-subscription services through our Web site and record the delivery of the service in our internal systems. However, in order to recognize revenue and get paid for services provided, we rely on billing confirmations from CMCC and Unicom as to the actual amount of services they have billed to their mobile customers. We do not collect e-subscription fees from an operator in certain circumstances

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due to technical issues with the operator s network. We refer to these failures as an operator s failure rate, which can vary from operator to operator. An operator s failure rate can vary from month to month, ranging from 0% to 80% and may change at any time without notice. If an operator encounters technical problems, increases in the failure rate for that operator could occur. CMCC and its subsidiaries are currently in the process of establishing a new billing platform and may require us to switch to this platform in the near future. The new platform may result in higher failure rates or lower revenues associated with changes in the billing procedures. Changes in failure rates may result in significant reductions or fluctuations in our e-subscription revenues. In March 2004, Unicom also adopted new billing practices and procedures which resulted in a decrease in revenues from Unicom by approximately 28% in March 2004 as compared to the previous month. Our e-subscription revenues from Unicom may decrease further.

The service fees we pay for using an operator s infrastructure are set based on the negotiation of annual contracts. Our contract with Unicom has been extended and will expire in March 2005. Our contracts with CMCC expire at various times from May 2004 to April 2005. Our negotiating power is limited and if an operator increases its service fees, or does not comply with the terms of our contract, our revenue, gross margin and profitability could be materially reduced.

We rely on the operators to pay us the e-subscriptions fees which they have billed to their mobile customers. If an operator refuses to pay us or limits the amount of e-subscriptions fees which can be billed in a month, our revenues could be adversely affected.

An operator could launch competing services at any time.

The refusal of an operator to allow us to supply certain services or its refusal to allow us to charge our desired prices for our services could disrupt our e-subscription services.

If CMCC or Unicom were unwilling to cooperate with us, we would not be able to find substitute partners.

CMCC or Unicom have both recently changed their operating regulations and may make further such changes at any time. Such recent or any such future changes could result in our being required to pay penalties for breaching or being alleged to have breached certain provisions of our agreements with CMCC or Unicom under new billing rules or revised operating procedures, or having our services discontinued without notice. Changes in these operating regulations could also have a material impact on our revenue. For example, in July 2003, CMCC disallowed us from using third party Web sites which do not have Internet content provider licenses, or Web site union, to promote our e-subscriptions products. In addition, as of March 31, 2004, we had recorded expenses of $280,000 related to notices of penalties and complaints from subsidiaries of CMCC based on allegations of the breach of certain provisions of the agreements with the mobile network operators as a result of recent changes in CMCC operating regulations.

As a result of our inability to use Web site union to promote our products or acquire subscribers, we experienced substantially lower growth in e-subscriptions revenues for the three months ended September 30, 2003 and December 31, 2003 as compared to the three months ended June 30, 2003, March 31, 2003 and December 31, 2002. We experienced a decrease in e-subscriptions revenue for the three months ended March 31, 2004 as compared to the three months ended December 31, 2003, and expect to have a further decrease in e-subscriptions revenue for the three months ended June 30, 2004, due to the high churn rates in some of our existing products. Selected community products are becoming out of fashion, and we expect a gradual downward trend in these community products.

We depend on online advertising for a significant portion of our revenues. Our ability to generate and maintain significant online advertising revenues will depend upon our users being attractive to advertisers.

We derive a significant portion of our revenues from the sale of advertising on our Web sites. For the three months ended March 31, 2004 and 2003, advertising revenues represented approximately 43% and 31%, respectively, of our total revenues. No single customer accounted for more than 10% of total advertising revenues for each of the three months ended March 31, 2004 and 2003.

Our ability to generate and maintain significant online advertising revenues in China will depend, among other things, on the development of a large base of users possessing demographic characteristics attractive to advertisers. Accordingly, we may not be successful in generating significant future online advertising revenues.

Our ability to generate and maintain significant online advertising revenues may also be subject to downward pressure on online advertising prices and limitations on inventory.

Our ability to generate and maintain significant online advertising revenues will also depend upon acceptance by advertisers that online advertising is effective.

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Our ability to generate and maintain significant online advertising revenues will also depend upon the effectiveness of our advertising delivery, tracking and reporting systems.

The expansion of Internet advertisement blocking software may result in a decrease of advertising revenues.

The development of Web software that blocks Internet advertisements before they appear on a user s screen may hinder the growth of online advertising. The expansion of ad blocking on the Internet may decrease our revenues because when an ad is blocked, it is not downloaded from our ad server. As a result, such advertisements will not be tracked as a delivered advertisement. In addition, advertisers may choose not to advertise on the Internet or on our portal because of the use by third parties of Internet advertisement blocking software.

Restrictions on the availability of credit to companies imposed by the PRC government may affect our liquidity and business.

The PRC government recently placed a restriction on the availability of credit to companies, especially companies operating in the real estate industry. Our advertisers may decrease their purchases of online advertising through our portals as a result of this restriction, especially purchases through Focus.cn, a leading real estate portal in China which we acquired in November 2003, as substantially all of its revenues are derived from real estate developers.

In addition, the PRC government may, in the future, issue a new policy to further restrict credit to companies. The current restriction, along with any new restriction, could have a negative impact on our liquidity if we necessitate a new credit line in China for any new business expansion or general corporate purposes.

The online shopping market is small and unproven in China and as a result we may not be able to sustain e-commerce revenue growth or maintain existing e-commerce revenue levels.

We may not be able to maintain our existing e-commerce gross margins because of competitors such as Joyo, Bertelsmann Online and Dang Dang.

Credit cards are not widely used in China and, as a result, we rely on cash on delivery for collecting payments, which exposes us to the risk of non-collection from the companies providing delivery service.

Future governmental regulations could restrict us from further expanding or continuing our e-commerce business.

Our operating results are likely to fluctuate significantly and may differ from market expectations.

Our annual and quarterly operating results have varied significantly in the past, and may vary significantly in the future, due to a number of factors which could have an adverse impact on our business, such as our reliance on mobile operators for our e-subscriptions revenue, the fact that the Chinese Internet industry is in an early stage of development and we are unsure if it will continue to grow or at what rate it will grow, and the fact that we are subject to government regulations that may change at any time or without notice. We rely on mobile operators for, among other things, billing of and collection of e-subscription fees from mobile phone users. If our arrangements with the operators were to be terminated, altered or not renewed, or if the operators did not provide continuous or adequate service, our revenues could be reduced significantly.

As a result, we believe that year-to-year and quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. In addition, we have experienced very high growth rates in the recent past and there may be expectations that these growth rates will continue. It is likely that in some future quarter, our operating results will be below the expectations of public market analysts and investors. In this event, the trading price of our common stock may fall.

We will not be able to attract visitors, advertisers, paying subscribers, wireless and e-commerce customers if we do not maintain and develop the Sohu brand.

Maintaining and further developing our brand is critical to our ability to expand our user base and our revenues. We believe that the importance of brand recognition will increase as the number of Internet users in China grows. In order to attract and retain Internet users, advertisers, subscribers, and wireless and e-commerce customers, we may need to substantially increase our expenditures for creating and maintaining brand loyalty. If our revenues do not increase proportionately, our results of operations and liquidity will suffer.

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Our success in promoting and enhancing our brand, as well as our ability to remain competitive, will also depend on our success in offering high quality content, features and functionality. If we fail to promote our brand successfully or if visitors to our portal or advertisers do not perceive our content and services to be of high quality, we may not be able to continue growing our business and attracting visitors, advertisers, and wireless and e-commerce customers.

If we fail to establish and maintain relationships with content and technology providers and mobile network operators, we may not be able to attract and retain users.

We rely on a number of third party relationships to attract traffic and provide content in order to make our portal more attractive to users and advertisers. Some content providers have increased the fees they charge us for their content. This trend could increase our operating expenses and could adversely affect our ability to obtain content at an economically acceptable cost. Most of our arrangements with content providers are short-term and may be terminated at the convenience of the other party. In addition, much of the third party content provided to our portal is also available from other sources or may be provided to other Internet companies. If other Internet companies present the same or similar content in a superior manner, it would adversely affect our visitor traffic.

Substantially all of our e-subscription revenue is generated through wireless services where we depend on mobile network operators for message delivery and payment collection. If we were unable to continue this arrangement, our wireless services would be severely disrupted.

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

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

Our future success is heavily dependent upon the continued service of our key executives, particularly Dr. Zhang, who is also the founder and president of Beijing Sohu and High Century, which is the major shareholder of Sohu Internet and Hengda. We rely on his expertise in our business operations and on his personal relationships with some of our principal shareholders, the relevant regulatory authorities, our customers and suppliers, Beijing Sohu, High Century, and Hengda. If one or more of our key executives and employees are unable or unwilling to continue in their present positions, we may not be able to easily replace them and our business may be severely disrupted. In addition, if any of these key executives or employees joins a competitor or forms a competing company, we may lose customers and suppliers and incur additional expenses to recruit and train personnel. Each of our executive officers has entered into an employment agreement and a confidentiality, non-competition and non-solicitation agreement with us. However, the degree of protection afforded to an employer pursuant to confidentiality and non-competition undertakings governed by PRC law may be more limited when compared to the degree of protection afforded under the laws of other jurisdictions. We do not maintain key-man life insurance for any of our key executives.

We also rely on a number of key technology staff for the operation of Sohu. Given the competitive nature of the industry, the risk of key technology staff leaving Sohu is high and could have a disruptive impact on our operations.

Rapid growth and a rapidly changing operating environment strain our limited resources.

We have limited operational, administrative and financial resources, which may be inadequate to sustain the growth we want to achieve. As our audience and their Internet use increase, as the demands of our audience and the needs of our customers change and as the volume of online advertising, wireless and e-commerce activities increases, we will need to increase our investment in our network infrastructure, facilities and other areas of operations. If we are unable to manage our growth and expansion effectively, the quality of our services could deteriorate and our business may suffer. Our future success will depend on, among other things, our ability to:

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

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We may not be able to track the delivery of advertisements through our portal, which may make us less attractive to potential advertisers.

It is important to advertisers that we accurately measure the demographics of our user base and the delivery of advertisements through our portal. Companies may choose not to advertise on our portal or may pay less for advertising if they do not perceive our portal to be reliable. We depend on third parties to provide us with some of these measurement services. If they are unable to provide these services in the future, we would need to perform these services ourselves or obtain these services from other providers. This could cause us to incur additional costs or cause interruptions or slowdowns in our business during the time we are replacing these services. We are currently implementing additional systems designed to collect information on our users. We may not be able to implement these systems successfully.

Our strategy of acquiring complementary assets, technologies and businesses may fail and may result in equity or earnings dilution.

As a component of our growth strategy, we have acquired and intend to actively identify and acquire assets, technologies and businesses that are complementary to our existing portal business. Our acquisitions could result in the use of substantial amounts of cash, potentially dilutive issuances of equity securities, significant impairment losses related to goodwill or amortization expenses related to intangible assets and exposure to undisclosed or potential liabilities of acquired companies. Moreover, the resources expended in identifying and consummating acquisitions may be significant. Furthermore, any acquisitions we decide to pursue may be subject to the approval of the relevant PRC governmental authorities, as well as any applicable PRC rules and regulations.

The acquisitions and integration of 17173.com and Focus.cn creates certain risks and uncertainties.

In November 2003, we completed the acquisitions of 17173.com and Focus.cn. As a result of the acquisitions, we continue to spend considerable time and effort in integrating into our company the employees, organization, customers and operations of 17173.com and Focus.cn. Also, there can be no assurance that we will succeed in realizing the anticipated economic benefits of the acquisitions, including increased advertising revenues. Further, as a result of the acquisitions, we recorded significant goodwill in our financial statements, which may be subject to future impairment in the event, among others, that revenues and gross margins fail to materialize at anticipated levels.

We may rely on dividends and other distributions on equity paid by Sohu.com Limited, our wholly-owned subsidiary, to fund any cash requirements we may have. We may not be able to obtain cash from distributions to the extent such distributions are restricted by PRC law or future debt covenants.

We are a holding company with no operating assets other than investments in Chinese operating entities, including Beijing ITC, Sohu Era, and Sohu Software, through an intermediate holding company, Sohu.com Limited, our wholly-owned subsidiary in the Cayman Islands, and our variable interest entities, Beijing Sohu, High Century, Hengda and Sohu Internet. We may need to rely on dividends and other distributions on equity paid by Sohu.com Limited for our cash requirements in excess of any cash raised from investors and retained by us. If Beijing ITC, Sohu Era, and Sohu Software incur debt on their own behalf in the future, the instruments governing the debt may restrict Beijing ITC s, Sohu Era s and Sohu Software s ability to pay dividends or make other distributions to us. In addition, PRC legal restrictions permit payment of dividends by Beijing ITC, Sohu Era, and Sohu Software only out of their net income, if any, determined in accordance with PRC accounting standards and regulations. Under PRC law, Beijing ITC, Sohu Era and Sohu Software are also required to set aside 10% of their net income each year to fund certain reserve funds until these reserves equal 50% of the amount of paid-in capital. These reserves are not distributable as cash dividends. Furthermore, dividends received by Sohu.com Inc. would be subject to taxation at United States tax rates of 34% or 35%. We do not expect any dividends or other distributions on equity from Sohu.com Limited in the foreseeable future.

We may not have exclusive rights over the mark Sohu.com in certain areas.

We have applied for registration of the Sohu.com mark in Hong Kong and Taiwan, and plan to apply for registration in Malaysia and Singapore. Completion of these applications is subject to prior rights in the relevant jurisdictions. Any rejection of those applications may adversely affect our legal rights over the mark Sohu.com in those countries and regions.

Unauthorized use of our intellectual property by third parties, and the expenses incurred in protecting our intellectual property rights, may adversely affect our business.

We regard our copyrights, service marks, trademarks, trade secrets and other intellectual property as critical to our success. Unauthorized use of our intellectual property by third parties may adversely affect our

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business and reputation. We rely on trademark and copyright law, trade secret protection and confidentiality agreements with our employees, customers, business partners and others to protect our intellectual property rights. Despite our precautions, it may be possible for third parties to obtain and use our intellectual property without authorization. Furthermore, the validity, enforceability and scope of protection of intellectual property in Internet-related industries is uncertain and still evolving. In particular, the laws of the PRC and certain other countries are uncertain or do not protect intellectual property rights to the same extent as do the laws of the United States. Moreover, litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Future litigation could result in substantial costs and diversion of resources.

We may be subject to intellectual property infringement claims, which may force us to incur substantial legal expenses and, if determined adversely against us, materially disrupt our business.

We cannot be certain that our products and services do not or will not infringe valid patents, copyrights or other intellectual property rights held by third parties. We have in the past been, are currently, and may in the future be, subject to claims and legal proceedings relating to the intellectual property of others in the ordinary course of our business. In particular, if we are found to have violated the intellectual property rights of others, we may be enjoined from using such intellectual property, may be ordered to pay a fine and we may incur licensing fees or be forced to develop alternatives. We may incur substantial expenses in defending against these third party infringement claims, regardless of their merit. Successful infringement claims against us may result in substantial monetary liability or may materially disrupt the conduct of our business by restricting or prohibiting our use of the intellectual property in question.

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

As our services may be used to download and distribute information to others, there is a risk that claims may be made against us for defamation, negligence, copyright or trademark infringement or other claims based on the nature and content of such information. Furthermore, we could be subject to claims for the online activities of our visitors and incur significant costs in their defense. In the past, claims based on the nature and content of information that was posted online by visitors have been made in the United States against companies that provide online services. We do not carry any liability insurance against such risks.

We could be exposed to liability for the selection of listings that may be accessible through our portal or through content and materials that our visitors may post in classifieds, message boards, chat rooms or other interactive services. If any information provided through our services contains errors, third parties may make claims against us for losses incurred in reliance on the information. We also offer Web-based e-mail and subscription services, which expose us to potential liabilities or claims resulting from:

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

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

Risks Related to Our Markets

We will rely on online advertising sales for a significant portion of our future revenues, but the online advertising market is new and rapidly evolving, particularly in China, and the Internet has not been proven as a widely accepted medium for advertising.

We expect to derive a significant portion of our revenue for the foreseeable future from online advertising. If the Internet is not accepted as a medium for advertising, our ability to generate revenues will be adversely affected.

The online advertising market is new and rapidly evolving, particularly in China. As a result, many of our current and potential advertising clients have limited experience using the Internet for advertising purposes and historically have not devoted a significant portion of their advertising budget to Internet-based advertising. Moreover, advertising clients that have invested substantial resources in other methods of conducting business may be reluctant to adopt a new strategy that may limit or compete with their existing efforts. In addition, companies may choose not to advertise on our portal if they do not perceive our online advertising platform to be effective or our audience demographics to be desirable. The failure to successfully address these risks or execute our business strategy would significantly reduce our profitability.

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The acceptance of the Internet as a medium for advertising depends on the development of a measurement standard. No standards have been widely accepted for the measurement of the effectiveness of online advertising.

Industry-wide standards may not develop sufficiently to support the Internet as an effective advertising medium. If these standards do not develop, advertisers may choose not to advertise on the Internet in general or through our portals or search engines.

Many of our current and potential e-subscription customers have only limited experience using the Internet for subscription purposes, and may not be willing to fully embrace the products and services we offer, which would adversely affect our future revenues and business expansion.

The e-subscription market is also new and rapidly evolving in China. Many of our current and potential e-subscription customers have limited experience using the Internet for subscription services. Our e-subscription revenue growth depends upon user acceptance of our existing and new services, such as our wireless dating, email, news, sports and jokes content, mobile alumni club and other products. Because these services are new and untested, we do not have a clear understanding of consumer behavior, making it difficult to predict future growth or usage. Customers may not be willing to fully embrace the products and services we offer.

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

The PRC Internet market is characterized by an increasing number of entrants because, among other reasons, the barriers to entry are relatively low. The market for Internet services and products, particularly Internet search and retrieval services, wireless and e-commerce services and online advertising, is intensely competitive. In addition, the Internet industry is relatively new and constantly evolving and, as a result, our competitors may better position themselves to compete in this market as it matures.

There are many companies that provide or may provide Web sites and online destinations targeted at Internet users in China. Some of our major competitors in China are major United States Internet companies, such as Yahoo! Inc and its newly-acquired 3721.com, and Nasdaq listed companies Sina Corporation, Netease, Tom Online, and Linktone. These competitors may also improve or enhance their positions in the PRC Internet market through mergers and acquisitions. In addition, we may face competition from existing or new domestic PRC Internet companies that are either affiliated with large corporations such as Legend Computer, America Online and Softbank Corporation, or controlled or sponsored by PRC government entities. These competitors may have certain advantages over us, including:

- substantially greater financial and technical resources;
- more extensive and well developed marketing and sales networks;
- better access to original content;
- greater global brand recognition among consumers; and

larger customer bases.

With these advantages, our competitors may be better able to:

develop, market and sell their products and services;

adapt more quickly to new and changing technologies; and

more easily obtain new customers.

We may not be able to compete successfully against our current or future competitors.

The telecommunications infrastructure in China, which is not as well developed as in the United States, may limit our growth.

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

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We depend on ChinaNet, China Netcom, China Telecom and the Beijing Telecom Administration for telecommunications services, and any interruption in these services may result in severe disruptions to our business.

Although private Internet service providers exist in China, almost all access to the Internet is maintained through ChinaNet, currently owned by China Netcom and China Telecom, under the administrative control and regulatory supervision of the MII. In addition, local networks connect to the Internet through a government-owned international gateway. This international gateway is the only channel through which a domestic Chinese user can connect to the international Internet network. We rely on this infrastructure and China Netcom and China Telecom to provide data communications capacity primarily through local telecommunications lines. Although the government has announced aggressive plans to develop the national information infrastructure, this infrastructure may not be developed and the Internet infrastructure in China may not be able to support the continued growth of Internet usage. In addition, we will have no access to alternative networks and services, on a timely basis if at all, in the event of any infrastructure disruption or failure.

We may not be able to lease additional bandwidth from the Beijing Telecom Administration on acceptable terms, on a timely basis or at all. In addition, we will have no means of getting access to alternative networks and services on a timely basis, if at all, in the event of any disruption or failure of the network.

The high cost of Internet access may limit the growth of the Internet in China and impede our growth.

Access to the Internet in China remains relatively expensive, and may make it less likely for users to access and transact business over the Internet. Unfavorable rate developments could further decrease our visitor traffic and our ability to derive revenues from transactions over the Internet.

The acceptance of the Internet as a commerce platform in China depends on the resolution of problems relating to fulfillment and electronic payment.

Our future growth of revenues depends in part on the anticipated expansion of e-commerce activities in China. As China currently does not have a reliable nationwide product distribution network, the fulfillment of goods purchased over the Internet will continue to be a factor constraining the growth of e-commerce. An additional barrier to the development of e-commerce in China is the lack of reliable payment systems. In particular, the use of credit cards or other viable means of electronic payment in sales transactions is not as well developed in China as in some other countries, such as the United States. Various government entities and businesses are working to resolve these fulfillment and payment problems, but these problems are expected to continue to hinder the acceptance and growth of the Internet as a commerce platform in China, which could in turn hinder our growth.

Risks Related to the Internet and Our Technology Infrastructure

To the extent we are unable to scale our systems to meet the increasing PRC Internet population, we will be unable to expand our user base and increase our attractiveness to advertisers and merchants.

As Web page volume and traffic increase in China, we may not be able to scale our systems proportionately. To the extent we do not successfully address our capacity constraints, our operations may be severely disrupted, and we may not be able to expand our user base and increase our attractiveness to advertisers and merchants.

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

Our portal operations are dependent upon Web browsers, Internet service providers, content providers and other Web site operators in China, which have experienced significant system failures and system outages in the past. Our users have in the past experienced difficulties due to system failures unrelated to our systems and services. Any system failure or inadequacy that causes interruptions in the availability of our services, or increases the response time of our services, as a result of increased traffic or otherwise, could reduce our user satisfaction, future traffic and our attractiveness to users and advertisers.

Our operations are vulnerable to natural disasters and other events, as we only have limited backup systems and do not maintain any backup servers outside of China.

We have limited backup systems and have experienced system failures and electrical outages from time to time in the past, which have disrupted our operations. All of our servers and routers are currently hosted in a single location within the premises of Beijing Telecom Administration. We do not maintain any back up servers outside Beijing. We do not have a disaster recovery plan in the event of damage from fire, floods, typhoons, earthquakes, power loss, telecommunications failures, break-ins and similar events. If any of the foregoing

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occurs, we may experience a complete system shutdown. We do not carry any business interruption insurance. To improve the performance and to prevent disruption of our services, we may have to make substantial investments to deploy additional servers or one or more copies of our Web sites to mirror our online resources. Although we carry property insurance with low coverage limits, our coverage may not be adequate to compensate us for all losses, particularly with respect to loss of business and reputation, that may occur.

Concerns about security of e-commerce transactions and confidentiality of information on the Internet may increase our costs, reduce the use of our portal and impede our growth.

A significant barrier to e-commerce and confidential communications over the Internet has been the need for security. Internet usage could decline if any well-publicized compromise of security occurred. We may incur significant costs to protect against the threat of security breaches or to alleviate problems caused by these breaches. If unauthorized persons are able to penetrate our network security, they could misappropriate proprietary information or cause interruptions in our services. As a result, we may be required to expend capital and resources to protect against or to alleviate these problems.

Our network operations may be vulnerable to hacking, viruses and other disruptions, which may make our products and services less attractive and reliable.

Internet usage could decline if any well-publicized compromise of security occurs. Hacking involves efforts to gain unauthorized access to information or systems or to cause intentional malfunctions or loss or corruption of data, software, hardware or other computer equipment. Hackers, if successful, could misappropriate proprietary information or cause disruptions in our service. We may be required to expend capital and other resources to protect our Web site against hackers. We cannot assure you that any measures we may take will be effective. In addition, the inadvertent transmission of computer viruses could expose us to a material risk of loss or litigation and possible liability, as well as materially damage our reputation and decrease our user traffic.

Political, Economic and Regulatory Risks

Regulation and censorship of information distribution in China may adversely affect our business.

China has enacted regulations governing Internet access and the distribution of news and other information. Furthermore, the Propaganda Department of the Chinese Communist Party has been given the responsibility to censor news published in China to ensure, supervise and control a particular political ideology. In addition, the MII has published implementing regulations that subject online information providers to potential liability for content included on their portals and the actions of subscribers and others using their systems, including liability for violation of PRC laws prohibiting the distribution of content deemed to be socially destabilizing. Because many PRC laws, regulations and legal requirements with regard to the Internet are relatively new and untested, their interpretation and enforcement may involve significant uncertainty. In addition, the PRC legal system is a civil law system in which decided legal cases have limited binding force as legal precedents. As a result, in many cases it is difficult to determine the type of content that may result in liability for a Web site operator.

Periodically, the Ministry of Public Security has stopped the distribution over the Internet of information which it believes to be socially destabilizing. The Ministry of Public Security has the authority to cause any local Internet service provider to block any Web site maintained outside China at its sole discretion. If the PRC government were to take action to limit or eliminate the distribution of information through our portal or to limit or regulate current or future applications available to users of our portal, our business would be affected.

The State Secrecy Bureau, which is directly responsible for the protection of state secrets of all PRC government and Chinese Communist Party organizations, is authorized to block any Web site it deems to be leaking state secrets or failing to meet the relevant regulations relating to the protection of state secrets in the distribution of online information. Under the applicable regulations, we may be held liable for any content transmitted on our portal. Furthermore, where the transmitted content clearly violates the laws of the PRC, we will be required to delete it. Moreover, where the transmitted content is considered suspicious, we are required to report such content. We must also undergo computer security inspections, and if we fail to implement the relevant safeguards against security breaches, we may be shut down. In addition, under recently adopted regulations, Internet companies which provide bulletin board systems, chat rooms or similar services, such as our company, must apply for the approval of the State Secrecy Bureau. As the implementing rules of these new regulations have not been issued, however, we do not know how or when we will be expected to comply, or how our business will be affected by the application of these regulations.

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

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All of our business, assets and operations are located in China and all of our revenues are derived from our operations in China. Accordingly, our business could be adversely affected by changes in political, economic or social conditions in China, adjustments in PRC government policies or changes in laws and regulations.

The economy of China differs from the economies of most countries belonging to the Organization for Economic Cooperation and Development in a number of respects, including:

- structure;
- level of government involvement;
- level of development;
- level of capital reinvestment;
- growth rate;
- control of foreign exchange; and
- methods of allocating resources.

Since 1949, China has been primarily a planned economy subject to a system of macroeconomic management. Although the Chinese government still owns a significant portion of the productive assets in China, economic reform policies since the late 1970s have emphasized decentralization, autonomous enterprises and the utilization of market mechanisms. We cannot predict what effects the economic reform and macroeconomic measures adopted by the Chinese government may have on our business or results of operations.

If tax benefits presently available to certain of our subsidiaries and variable interest entities located in China were not available, the income tax rate on most of our profits in China could increase from 0% to 33%.

Our China-based subsidiaries Sohu Era and Sohu Software and our variable interest entity Sohu Internet enjoy tax benefits which are available to new technology enterprises. Presently, PRC law requires that a company, in order to be considered a new technology enterprise : (i) operate in the high-tech industry (which includes the Internet industry), (ii) be incorporated and operating in Beijing Zhongguancun Science Park, (iii) receive 60% of its revenue from high-tech products or services, and (iv) have at least 20% of its employees involved in technology development. Each year new technology enterprises are subject to annual inspection to determine whether they continue to meet these requirements.

Subject to the approval of the relevant tax authorities, the effective income tax rate for new technology enterprises registered and operating in Beijing Zhongguancun Science Park is 15%, while the local income tax will be exempted as long as the enterprise holds the new technology enterprise status. New technology enterprises are exempted from Chinese state corporate income tax for three years, beginning with their first year of operations, and are entitled to a 50% tax reduction at the rate of 7.5% for the subsequent three years. Sohu Era, Sohu Software and Sohu

Internet were incorporated in 2003 and, providing there is no change in their status as a new technology enterprise or a change in the relevant regulations, will be subject to an effective tax rate of 0% in 2004 and 2005, 7.5% in 2006, 2007 and 2008 and 15% thereafter. Sohu Era, Sohu Software and Sohu Internet obtained approval from the relevant tax authorities for these tax benefits.

We currently expect most of our income to be earned from Sohu Era. In addition to the office in Beijing Zhongguancun Science Park, Sohu Era also has an office outside Beijing Zhongguancun Science Park where a part of its operations, mainly including its content and administrative departments, are located. We believe that substantially all of Sohu Era s services are ultimately delivered in Beijing Zhongguancun Science Park. However, the relevant tax authorities could challenge whether Sohu Era is operating outside Beijing Zhongguancun Science Park, which could result in a withdrawal of the approval of the tax benefits by the tax authorities.

If any of the following occurs, we would be subject to enterprise income tax in China at rates up to 33%, which could cause a significant reduction in our after-tax income:

These tax benefits are no longer available to a new technology enterprise;

There is a change in governmental policy or regulations concerning requirements necessary to be deemed a new technology enterprises;

Sohu Era does not meet the requirements of a new technology enterprise; or

The relevant tax authorities withdraw the approval of these tax benefits for Sohu Era.

The PRC legal system embodies uncertainties which could limit the legal protections available to us and you.

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The PRC legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which decided legal cases have little precedential value. In 1979, the PRC government began to promulgate a comprehensive system of laws and regulations governing economic matters in general. Our PRC operating subsidiary, Beijing ITC, is a wholly-foreign owned enterprise, or a WFOE, which is an enterprise incorporated in mainland China and wholly-owned by our indirect subsidiary, Sohu Hong Kong. Beijing ITC is subject to laws and regulations applicable to foreign investment in mainland China. However, these laws, regulations and legal requirements are relatively recent, and their interpretation and enforcement involve uncertainties. These uncertainties could limit the legal protections available to us and other foreign investors, including you. In addition, we cannot predict the effect of future developments in the PRC legal system, particularly with regard to the Internet, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the preemption of local regulations by national laws.

Restrictions on currency exchange may limit our ability to utilize our revenues effectively.

Substantially all of our revenues and operating expenses are denominated in Renminbi. The Renminbi 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.

Currently, Beijing ITC may purchase foreign exchange for settlement of current account transactions , including payment of dividends, without the approval of the State Administration for Foreign Exchange, or SAFE. Beijing ITC may also retain foreign exchange in its current account (subject to a ceiling approved by the SAFE) to satisfy foreign exchange liabilities or to pay dividends. However, the relevant PRC governmental authorities may limit or eliminate our ability to purchase and retain foreign currencies in the future.

Since a significant amount of our future revenues will be in the form of Renminbi, the existing and any future restrictions on currency exchange may limit our ability to utilize revenue generated in Renminbi to fund our business activities outside China, if any, or expenditures denominated in foreign currencies.

Foreign exchange transactions under the capital account are still subject to limitations and require approvals from the SAFE. This could affect Beijing ITC s ability to obtain foreign exchange through debt or equity financing, including by means of loans or capital contributions from us.

We may suffer currency exchange losses if the Renminbi depreciates relative to the U.S. Dollar.

Our reporting currency is the U.S. Dollar. However, substantially all of revenues are denominated in Renminbi. Our revenues as expressed in our U.S. Dollar financial statements will decline in value if the Renminbi depreciates relative to the U.S. Dollar. Very limited hedging transactions are available in China to reduce our exposure to exchange rate fluctuations. 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 availability and effectiveness of these hedges may be limited and we may not be able to successfully hedge our exposure, if at all. In addition, our currency exchange losses may be magnified by PRC exchange control regulations that restrict our ability to convert Renminbi into U.S. Dollars.

It may be difficult to enforce any civil judgments against us or our board of directors or officers, because most of our assets are located outside of the United States.

Although we are incorporated in the State of Delaware, a significant portion of our assets are located in the PRC. As a result, it may be difficult for investors to enforce outside the United States in any actions brought against us in the United States, including actions predicated upon the civil liability provisions of the federal securities laws of the United States or of the securities laws of any state of the United States. In addition, certain of our directors and officers (principally in the PRC) and all or a substantial portion of their assets may be located outside the United States. As a result, it may not be possible for investors to effect service of process within the United States upon those directors and officers, or to enforce against them or us judgments obtained in United States courts, including judgments predicated upon the civil liability provisions of the federal securities laws of the United States or of the securities laws of any state of the United States. We have been advised by our PRC counsel that, in their opinion, there is doubt as to the enforceability in the PRC, in original actions or in actions for enforcement of judgments of United States courts, of civil liabilities predicated solely upon the federal securities laws of the United States or the securities laws of any state of the United States.

Risks Related to Our Common Stock

The market price of our common stock has been and will likely continue to be volatile. The price of our common stock may fluctuate significantly, which may make it difficult for stockholders to sell shares of our common stock when desired or at attractive prices.

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The market price of our common stock has been volatile and is likely to continue to be so. The initial public offering price of our common stock in July 2000 was $13.00 per share. The trading price of our common stock subsequently dropped to a low of $0.52 per share on April 9, 2001. During the last two quarters of 2002, the trading price of our common stock ranged from a low of $1.20 per share to a high of $6.94 per share, and during 2003 and the first and second quarters of 2004, the trading price of our common stock ranged from a low of $6.10 per share to a high of $43.40 per share. On April 29, 2004, the closing price of our common stock was $17.82 per share.

In addition, the Nasdaq Stock Market s National Market has from time to time experienced significant price and volume fluctuations that have affected the market prices for the securities of technology companies, and particularly Internet-related companies.

The price for our common stock may fluctuate in response to a number of events and factors, such as quarterly variations in operating results, announcements of technological innovations or new products and media properties by us or our competitors, changes in financial estimates and recommendations by securities analysts, the operating and stock price performance of other companies that investors may deem comparable to us, and news reports relating to trends in our markets or general economic conditions. Additionally, volatility or a lack of positive performance in our stock price may adversely affect our ability to retain key employees, all of whom have been granted stock options or other stock awards.

Sales of a significant number of shares of our common stock in the public market, or the perception of such sales, could reduce our share price and impair our ability to raise funds in new share offerings.

The sale or availability for sale of substantial amounts of our common stock could adversely affect its market price.

There were 36,377,836 shares of our common stock outstanding as of March 31, 2004, as well as options to purchase an additional 4,612,645 shares of our common stock. Of the outstanding shares, 25,424,216 were issued prior to the initial public offering of our common stock. These shares are either freely tradable without restriction under Rule 144(k) under the Securities Act of 1933 or are tradable subject to the notice, volume and manner of sale restrictions of Rule 144 under the Securities Act.

Sohu issued 4,600,000 shares of common stock in connection with the initial public offering. All of these shares are freely tradable without restriction unless they are held by our affiliates as that term is defined in Rule 144 under the Securities Act.

On October 18, 2000, we issued an aggregate of 4,401,500 shares of our common stock to the former stockholders of ChinaRen in connection with our acquisition of that company. All of these shares are currently freely tradable without restriction.

On November 25, 2003, we issued an aggregate of 65,852 shares of common stock to Asia B2B Online Inc., the seller of the Focus.cn Web site, and to certain individuals in connection with our acquisition, through our wholly-owned subsidiary Sohu.com Limited, of All Honest International Limited, the owner of the Focus.cn Web site. Pursuant to a certain employee incentive plan which we assumed in connection with our purchase of All Honest International, we anticipate issuing to certain individuals on or about May 25, 2004 an additional 2,499 shares of our common stock and on or about November 25, 2004 an additional 23,198 shares of our common stock. Commencing one year after the applicable issue dates, we expect that these shares will be eligible for resale subject to the notice, volume and manner of sale restrictions of Rule 144 under the Securities Act.

The individuals referred to above are parties to an agreement with us that require us to register under the Securities Act for resale by them the shares of our common stock they received in connection with the acquisition and received or will receive pursuant to the employee incentive and retention plan. Pursuant to that agreement, we filed a Registration Statement on Form S-3 (SEC File No. 333-111495) to register the shares, which registration statement has not yet been declared effective by the SEC. When effective, the registration will permit the sale of those shares without regard to the restrictions of Rule 144, so long as the stockholders comply with the prospectus delivery requirements of the Securities Act.

We issued $90.0 million of zero coupon convertible senior notes due July 2023 which we may not be able to repay in cash and could result in dilution of our earnings per share.

In July 2003, we issued $90.0 million aggregate principal amount of zero coupon convertible senior notes due July 2003. The notes are convertible into our common stock at a conversion price of $44.76 per share, subject to adjustment upon the occurrence of specified events, which would result in the issuance of an aggregate of approximately two million shares. Therefore, each $1,000 principal amount of the notes will initially be convertible into 22.3414 shares of our common stock. Each holder of the notes will have the right, at

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the holder s option, to require Sohu to repurchase all or any portion of the principal amount of the holder s notes on July 14 in 2007, 2013 and 2018 at a price equal to 100% of the outstanding principal amount. We may also be required to repurchase all of the notes following a fundamental change of Sohu, such as a change of control, prior to maturity. We may not have enough cash on hand or have the ability to access cash to pay the notes if presented for redemption on a fundamental change, on a redemption date referred to above or at maturity. In addition, the redemption or purchase of our notes with shares of our common stock or the conversion of the notes into our common stock could result in dilution of our earnings per share.

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

Dr. Zhang beneficially owns approximately 24% of the outstanding shares of our common stock and is our largest stockholder. Our second largest stockholder, together with Dr. Zhang, our other executive officers and members of our Board of Directors, beneficially own approximately 37% of the outstanding shares of our common stock. Accordingly these stockholders acting together will have significant influence in determining the outcome of any corporate transaction or other matter submitted to the stockholders for approval, including mergers, consolidations, the sale of all or substantially all of our assets, election of directors and other significant corporate actions. They will also have significant influence in preventing or causing a change in control. In addition, without the consent of these stockholders, we could be prevented from entering into transactions that could be beneficial to us. The interests of these stockholders may differ from the interests of the other stockholders.

Holders of a significant percentage of the outstanding shares of our common stock are parties to an agreement under which they have agreed to vote together in favor of a nominee of one of our stockholders to our board of directors. As a result of their voting power, they will have significant influence in causing that nominee to be elected.

Anti-takeover provisions of the Delaware General Corporation Law, our certificate of incorporation and Sohu s Stockholder Rights Plan could delay or deter a change in control.

Some provisions of our certificate of incorporation and bylaws, as well as various provisions of the Delaware General Corporation Law, may make it more difficult to acquire our company or effect a change in control of our company, even if an acquisition or change in control would be in the interest of our stockholders or if an acquisition or change in control would provide our stockholders with a premium for their shares over then current market prices. For example, our certificate of incorporation provides for the division of the board of directors into two classes with staggered two-year terms and provides that stockholders have no right to take action by written consent and may not call special meetings of stockholders, each of which may make it more difficult for a third party to gain control of our board in connection with, or obtain any necessary stockholder approval for, a proposed acquisition or change in control.

In addition, we have adopted a stockholder rights plan under the terms of which, in general, if a person or group acquires more than 20% of the outstanding shares of common stock, all other Sohu stockholders would have the right to purchase securities from Sohu at a substantial discount to those securities fair market value, thus causing substantial dilution to the holdings of the person or group which acquires more than 20%. The stockholder rights plan may inhibit a change in control and, therefore, could adversely affect the stockholders ability to realize a premium over the then-prevailing market price for the common stock in connection with such a transaction.

The power of our Board of Directors to designate and issue shares of preferred stock could have an adverse effect on holders of our common stock.

Our certificate of incorporation authorizes our board of directors to designate and issue one or more series of preferred stock, having rights and preferences as the board may determine, and any such designations and issuances could have an adverse effect on the rights of holders of common stock.

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 virtually all of our revenues and costs are denominated in Renminbi and a significant portion of our assets and liabilities are denominated in Renminbi. As a result, we are exposed to foreign exchange risk as our revenues and results of operations may be impacted by fluctuations in the exchange rate between U.S. Dollars and Renminbi. If the Renminbi depreciates against the U.S. Dollar, the value of our Renminbi revenues and assets as expressed in our U.S. Dollar financial statements will decline. We

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do not hold any derivative or other financial instruments that expose us to substantial market risk. See Risk Factors We may suffer currency exchange losses if the Renminbi depreciates relative to the U.S. Dollar.

The Renminbi 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. 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 at all. 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.

INVESTMENT RISK

a) Investments in Beijing Sohu, High Century, Hengda and Sohu Internet

We have entered into the following arrangements with Dr. Zhang and certain of our employees to satisfy PRC regulations which prohibit or restrict foreign companies from owning or operating telecommunications, Internet content and certain other businesses in China. We expect that we will continue to be involved in and provide additional financial support under similar arrangements in the future.

Under Section 402 of the Sarbanes-Oxley Act of 2002, issuers subject to the act are prohibited from making personal loans to their directors and executive officers. Under Section 402, issuers are permitted to maintain the loans they made to directors and executive officers prior to the effective date of the Sarbanes-Oxley Act. They are not permitted, however, to renew or materially modify such loans. We believe that there is a strong argument that the loans to Dr. Zhang described below are not personal loans, in view of our underlying business purpose for making the loans and the lack of a personal benefit to Dr. Zhang from the loans. In the absence of judicial interpretation, an SEC rule, or an SEC staff interpretation confirming our conclusion, however, we intend to treat these loans as if they were personal loans under Section 402 of the Sarbanes-Oxley Act. Accordingly, we expect that if we enter into arrangements similar to those described below in the future, any loans made under such arrangements will be made to individuals who are not our directors or executive officers. In addition, should the existing loans to Dr. Zhang, or to the entities in which he is the primary shareholder, need to be renewed or materially modified, such as if we need to advance additional funds to any of these entities, we expect that the entities, the ownership of the entities and/or the loans to the entities will be restructured so that we could not be deemed to be making a loan to Dr. Zhang. The prohibitions set forth in Section 402 have not had any adverse effect on our operations to date, and we do not expect them to have any adverse effect in the future.

In June 2000, we extended loans in the amount of $193,000 to Dr. Zhang and $49,000 to He Jinmei, another employee of Sohu, to finance their investments in Beijing Sohu, a company incorporated in the PRC. The shareholders of Beijing Sohu have pledged their shares in Beijing Sohu as collateral for the loan. These loans bear no interest and are due in full on the earlier of demand, in 2010 or at such time as Dr. Zhang or He Jinmei, as the case may be, is not an employee of Sohu. A subsidiary of Sohu has entered into an option agreement giving it the right, at any time, subject to PRC law, to purchase the entire ownership in Beijing Sohu from the two Beijing Sohu shareholders for $242,000.

In November 2001, we entered into a loan and share pledge agreement with Dr. Zhang, and Li Wei, another employee of Sohu, for the purpose of funding an equity investment of approximately $4.6 million by these two individuals in High Century, a company incorporated in the PRC which engages in investment holding in the PRC on behalf of Sohu. Pursuant to the loan agreement, we have extended total loans amounting to $4.6 million of which $3.7 million and $919,000 were loaned to Charles Zhang and Li Wei, respectively.

In January 2002, we entered into a loan and share pledge agreement with Li Wei for the purpose of funding an equity investment of $242,000 by Li Wei in Hengda, a company incorporated in the PRC which engages in Internet access services in the PRC on behalf of Sohu. The $242,000 investment represents a 20% interest in Hengda, with High Century holding the remaining 80% interest.

In June 2003, we entered into a loan and share pledge agreement with He Jinmei for the purpose of funding an equity investment of $121,000 by He Jinmei in Sohu Internet, a company incorporated in the PRC which engages in Internet information services in the PRC on behalf of Sohu. The $121,000 investment represents a 20% interest in Sohu Internet, with High Century holding the remaining 80% interest.

The loan agreements under which funds are provided to invest in High Century, Hengda and Sohu Internet are subject to PRC law and include provisions that (i) the loans can only be repaid to us by transferring the shares of High Century, Hengda or Sohu Internet to us, (ii) the shares of High Century, Hengda or Sohu Internet cannot be transferred without the approval of Sohu, and (iii) we have the right to appoint all directors and senior management personnel of High Century, Hengda and Sohu Internet. Charles Zhang, Li Wei and He Jinmei have pledged all of their shares in High Century, Hengda and Sohu Internet as collateral for the loans and the loans bear no interest and are due on demand after November 2003, in the case of High Century, after January 2003, in the case of Hengda, and after June 2004, in the case of Sohu Internet, or at such time as Dr. Zhang, Li Wei or He Jinmei, as the case may be, is not an employee of Sohu. We do not intend to request repayment of the loans as long as PRC regulations prohibit us from directly investing in businesses being undertaken by High Century, Hengda and Sohu Internet.

Each of Beijing Sohu, High Century, Hengda, and Sohu Internet is a VIE, as defined under FIN 46, *Consolidation of Variable Interest Entities,* with Sohu as the primary beneficiary and consolidated in Sohu s financial statements. Sohu adopted the provisions of FIN 46 for Beijing Sohu, High Century and Hengda as of July 1, 2003 and for Sohu Internet upon its formation.

(b) Investment in marketable debt securities

Sohu invests in marketable debt securities to preserve principal while at the same time maximizing yields without significantly increasing risk. These marketable debt securities are classified as available-for-sale because we may dispose of the securities prior to maturity and they are thus reported at the market value as of the end of the period. As of March 31, 2004, unrealized gains of $437,000 were recorded as accumulated other comprehensive income in shareholders equity.

INTEREST RATE RISK

Our investment policy limits our investments of excess cash in high-quality corporate securities and limits the amount of credit exposure to any one issuer. We protect and preserve our invested funds by limiting default, market and reinvestment risk.

Investments in both fixed rate debt securities and callable range accrual notes carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates, while callable range accrual notes may not produce any income if interest rates increase and exceed certain levels. Due in part to these factors, our future interest income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell securities, which have declined in market value due to changes in interest rates.

ITEM 4. CONTROLS AND PROCEDURES

Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this quarterly report (the Evaluation Date), have concluded that as of the Evaluation Date our disclosure controls and procedures were effective and designed to ensure that material information relating to Sohu would be made known to them by others within the company. 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

There are no material legal proceedings pending or, to our knowledge, threatened against us. From time to time we become subject to legal proceedings and claims in the ordinary course of our business. Such legal proceedings or claims, even if not meritorious, could result in the expenditure of significant financial and management resources.

ITEM 2. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES

On July 17, 2000, we completed an underwritten initial public offering of our common stock pursuant to a Registration Statement on Form S-1 (SEC file No. 333-96137), which became effective on July 10, 2000. Public trading of the common stock offered in the initial public offering commenced on July 12, 2000. We sold an aggregate of 4,600,000 shares of common stock in the offering at a price to the public of $13 per share, resulting in gross proceeds of $59.8 million. Our net proceeds, after deduction of the underwriting discount of $4.2 million and other offering expenses of $3.2 million, were approximately $52.4 million. All shares sold in the offering were sold by us.

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During the three months ended March 31, 2004, we did not use any proceeds from the offering. The remaining net proceeds from the offering have been invested in cash, cash equivalents, and marketable debt securities. The use of the proceeds from the offering does not represent a material change in the use of proceeds described in the prospectus contained in the Registration Statement on Form S-1 described above.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Please see the Exhibit Index attached hereto.

(b) Reports on Form 8-K.

On February 5, 2004, Sohu filed a Current Report on Form 8-K in connection with its earnings results for the quarter and year ended December 31, 2003.

On March 12, 2004, Sohu filed a Current Report on Form 8-K announcing the appointment of Carol Yu as Chief Financial Officer, succeeding Derek Palaschuk.

Sohu also filed Current Reports on Form 8-K/A on February 6, 2004, February 9, 2004, March 2, 2004 and March 15, 2004 in connection with the acquisitions of the 17173.com and Focus.cn Web sites.

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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.

SOHU.COM INC.

Dated: June 24, 2004

By: /s/ Carol Yu
Chief Financial Officer

(Principal Financial Officer)

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Sohu.com Inc.

Quarterly Report on Form 10-Q For Quarter Ended March 31, 2004

EXHIBITS INDEX

10.1(1)	Employment Agreement, effective as of March 8, 2004, by and between Sohu.com Inc. and Carol Yu
10.2(1)	Resignation Letter of Derek Palaschuk, former Chief Financial Officer of Sohu.com Inc.
31.1(2)	Rule 13a-14(a)/15d-14(a) Certification of Charles Zhang
31.2(2)	Rule 13a-14(a)/15d-14(a) Certification of Carol Yu
32.1(2)	Section 1350 Certification of Charles Zhang
32.2(2)	Section 1350 Certification of Carol Yu

(1) Incorporated by Reference to The registrant s Quarterly Report on Form 10-Q filed on May 10, 2004.
(2) Filed herewith