August 31, 2012

Mr. Kai-Fu Lee:

You stated the point of your letter as:

> **"It is not my intention to support or challenge Citron's recommendations, but only to expose Citron's ignorance and deception, and raise the question whether any investor should ever trust them."**

So you say you have no intention of adding insight to a valuation discussion about Qihoo and Sohu. You only intend to attack Citron.

Citron has written on over 120 companies over 11 years, and every one of those writings is posted on our website archives for all to see and evaluate. Well over 25 of those companies and its officers have since been subjected to criminal indictment, SEC regulatory intervention, delisting, and/or accounting restatements … with devastation for investors who did not listen to Citron.

Citron invites all readers to compare Citron's track record against your investment track record.

You distorted Citron's work to serve your own agenda. The valuation of Qihoo and Sohu will be determined by the market over time.

Your attack forced you to ignore the main point of Citron's commentary on Sohu, which was Citron's update of a JP Morgan analyst sum-of-the-parts analysis, as impacted by two recent market valuation events.

Apparently you are not familiar with "sum-of-the-parts" valuation analysis. Citron recommends JP Morgan's work on Sohu as a good starting point. The main point of Citron's original post was simply to comment on that work in light of:

- the market valuation of the YOKU/TUDO merger
- the $700 - $800 million market cap valuation added to Qihoo by virtue of its having "entered search", even though entirely unmonetized.

Both of these points might be seen as raising Sohu's value.

But since you have now used our playful challenge only to restate your distortions and deception, Citron posts this point-by-point reply:

1 – 2) Citron's discussion of Sogou's Pinyin entry, browser and search was to support the observation that Sogou, (74% owned by SOHU), has over six years invested methodically and consistently in a home-grown competitive technology within the China search market. With those investments, it has created a stable foothold in the search **business** which is appx 10% of the size of Baidu, easily measured by internationally recognized industry-standard internet traffic measurement technologies.

Qihoo, by contrast, enters **search without a business infrastructure** (which is where **most** of the cost, and **all** of the revenue, is created) , based on :

- A free anti-virus and malware platform whose main reason for existence is the vast number of unlicensed copies (therefore unpatched) of Microsoft's Windows XP installed in China
- A browser based on a codebase copied from Microsoft's Internet Explorer without permission
- A variety of software tricks intended to mislead consumers, including deceptive warning messages to prevent users from uninstalling Qihoo, and "Trojan-horse"-style product installations masquerading as Microsoft security patches.
- Its unmonetized entry into search has now ignited a fight with Baidu, which confuses and inconveniences users, creates no innovation, and likely results in another bad outcome for Qihoo, which is disadvantaged relative to Baidu's financial and technology strength
- Challenges facing Qihoo in comparison to Sohu, in direct quote of Wedge Partners, a supporter of Qihoo. Pleases look at the source of our information.

Citron's point is that creating a search business takes years of investment and improvement. If Qihoo persists, and invests lots of money in making a better user experience, it **might** gain a 10% foothold in search in China …. **after several years**.

But until Qihoo fully monetizes its search, there is little to be learned from early disruptions in traffic patterns from Qihoo's demonstration of unsponsored ("free") search. Comparing a demo of an unmonetized search feature with a sustainable search business is comparing "apples" to "oranges".

3) The traffic comparison cited by Citron was published by iResearch, which compares traffic of a variety of Chinese internet sites. (Citron notes that Qihoo has relied exclusively on iResearch statistics since its US IPO prospectus.) Their published data states, as corroborated by Alexa, Comscore, CNZZ and other independent traffic measurement resources, that **SOHU's web properties generate significantly more internet traffic than Qihoo's. Both portals and navigation sites are gateways to the internet and are not apples and oranges -- that is why iResearch put them in the same category.**

The market value of these companies going forward will be assessed on monetization of that traffic.

4) The "financial comparisons" between Sohu and Qihoo are for every investor to draw their own conclusions. But it is Citron's opinion that it is foolish to make a lot of noise about Qihoo's "high growth rates" when its reported revenues are riddled with fraud. So instead of going back and forth over every questionable source of Qihoo's revenue, we invited you to explain the most obvious of their ridiculous claims. And we understand why you want to deflect the point: game revenue is the main source of Qihoo's earnings growth over the past two quarters.

5) **You** apparently do not understand search monetization because Qihoo itself states it generates zero current revenue from its search. Nonetheless, Citron accepts Qihoo analysts estimate of $100 million for search revenue for FY 2013, as we wrote **twice** -- in our tables on **page 2** and **page 7**. **Yet you insist for the second time that it is not there. Citron suggests you read the tables this time.**

6) Citron's analysis of the internet video market is based upon a JP Morgan's analysis. There are no "business issues" missed, because Qihoo has no internet video business in China. Sohu does operate a

video business, and qualified parties are invited to debate its value. It is Citron's opinion that JP Morgan's $200 million estimate is too low.

7) "Citron's adding market cap" is only wild and ridiculous, if you ignore or do not understand JP Morgan's sum-of-the-parts analysis of Sohu. Go read it, and don't expect any further responses from Citron until you give an opinion about it.

8) It should be noted that today Qihoo announced the purchase of an office facility for $218 mil USD. Citron notes that SOHU already owns a building in Beijing they purchased in 2009 for $127 mil, of which $108 million is already paid for—another asset which adds even more value to the sum-of-the-parts model.

So now Citron has responded point-by-point, as you have invited. We do not wish to create a tedious "back and forth", but hopefully this helps clarify the issues for readers. As for agendas, it should be noted that one of -- if not the largest -- investor in your fund also happens to be one of the largest investors in QIHU.

Citron's agenda is the truth and it is not hidden.

The challenge stands for the 100,000 RMB to your charity if you can actually answer the ARPU question about Qihoo's game revenue.

Citron Research