REALNETWORKS INC
Form 10-K
February 29, 2008

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)

þ	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** **For the Fiscal Year Ended December 31, 2007**
	OR
o	**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 0-23137
RealNetworks, Inc.
(Exact name of registrant as specified in its charter)

Washington *(State of incorporation)*	**91-1628146** *(I.R.S. Employer Identification Number)*
2601 Elliott Avenue, Suite 1000 **Seattle, Washington** *(Address of principal executive offices)*	**98121** *(Zip Code)*

Registrant s telephone number, including area code:
(206) 674-2700
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, Par Value $0.001 per share	The NASDAQ Stock Market LLC
Preferred Share Purchase Rights	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:
None
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act Yes o No þ

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o
(Do not check if a smaller reporting company)

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

The aggregate market value of the Common Stock held by non-affiliates of the registrant was $815,600,373 on June 30, 2007, based on the closing price of the Common Stock on that date, as reported on the Nasdaq Global Select Market.(1)

The number of shares of the registrant s Common Stock outstanding as of January 31, 2008 was 142,325,923.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement relating to the registrant s 2008 Annual Meeting of Shareholders to be held on or about June 3, 2008 are incorporated by reference into Part III of this Report.

(1) Excludes shares held of record on that date by directors, executive officers and 10% shareholders of the registrant. Exclusion of such shares should not be construed to indicate that any such person directly or indirectly possesses the power to direct or cause the direction of the management of the policies of the registrant.

TABLE OF CONTENTS

Table of Contents

PART I.

This Annual Report on Form 10-K and the documents incorporated herein by reference contain forward-looking statements that have been made pursuant to the provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on current expectations, estimates, and projections about RealNetworks industry, products, management s beliefs, and certain assumptions made by management. Words such as anticipates, expects, intends, plans, believes, seeks, estimates, and similar expressions are intended to identify forward-lo statements. Forward-looking statements include statements with respect to:

future revenues, income taxes, net income per diluted share, acquisition costs and related amortization, and other measures of results of operations;

the effects of our acquisitions, including WiderThan, Sony NetServices GmbH and Exomi Oy, and our position as a technology services provider for leading wireless carriers;

plans, strategies and expected opportunities for growth, increased profitability and innovation in 2008 and future years;

the expected growth and profitability of our Technology Products and Solutions business;

the governance, management, accounting and integration of our Rhapsody America venture;

the dilutive impact on our shareholders if the call or put rights contained in the limited liability agreement for Rhapsody America are exercised and result in the issuance of additional shares of our common stock;

the financial performance and growth of our Games business, including future international growth;

the migration of our Media Software and Services businesses from general purpose subscription businesses toward premium services and free-to-consumer services, the popularity of the RealPlayer and our expected introduction of new products and innovations in our Media Software and Services business;

our ability to grow our Music business, including opportunities for us to become the platform of choice for the consumer electronics industry, the integration of our Rhapsody DNA into the digital devices of an expanding list of partners and our plans to introduce additional innovations;

the effect of future interoperability on our Music business, the significance of growth opportunities in the digital music market and our expectations for short-term progress and long-term success in our Music business;

our financial position and the availability of resources;

our expectations regarding acquisition activity in 2008 and our focus on the integration of completed acquisitions;

our relationships with our employees;

future competition; and

the degree of seasonality in our revenue.

These statements are not guarantees of future performance and actual actions or results may differ materially. These statements are subject to certain risks, uncertainties and assumptions that are difficult to predict, including those noted in the documents incorporated herein by reference. Particular attention should also be paid to the cautionary language included or referred to in the section of Item 1 entitled Competition, in Item 1A entitled Risk Factors and in Item 3 entitled Legal Proceedings. RealNetworks undertakes no obligation to update publicly any forward-looking statements as a result of new information, future events or otherwise, unless required by law. Readers should, however, carefully review the risk factors included in other reports or documents filed by RealNetworks from time to time with the Securities and Exchange Commission, particularly the Quarterly Reports on Form 10-Q and any Current Reports on Form 8-K.

Table of Contents

Item 1. *Business*

Overview

RealNetworks, Inc. helps consumers enjoy digital entertainment whenever and wherever they want. We pioneered the development of technology for the transmission of digital media over the Internet and have sustained a long heritage and a continued focus in creating and delivering digital media content such as music, games and video to consumers around the world.

We sell digital entertainment services to consumers for use with a variety of platforms such as PCs, portable music players, mobile phones, home entertainment systems and other consumer electronic devices. We are a market leader in providing pioneering products and services, including: RealPlayer®, the first mainstream media player to enable one-click downloading and recording of Internet video; the award-winning Rhapsody® digital music service, which delivers more than one billion songs per year; RealArcade®, one of the largest casual games services on the Internet; and a variety of mobile entertainment services, such as ringback tones, music-on-demand and video-on-demand, offered to consumers through leading mobile operators around the world. We also developed and provide a suite of software and services for Internet media delivery for business customers, including RealServer and the Helix product portfolio.

Our strategy is to continue to (1) develop technology that provides meaningful differentiation to our chosen markets in digital entertainment services; (2) build a direct relationship with, and grow, our worldwide user base; and (3) create strong business partnerships with device makers, media companies, service providers and other distribution channels in order to build a sustainable and profitable global business. We intend to continue to expand our products and services beyond the PC to mobile devices and to create compelling digital media experiences on a variety of entertainment devices. We also intend to use our strong cash position to continue to seek acquisition opportunities to further our strategic initiatives and to enhance our competitive position.

In August 2007, we and MTV Networks, a division of Viacom International Inc. (MTVN), created Rhapsody America LLC, a Delaware limited liability company, which operates the companies joint business-to-consumer digital audio music service. Rhapsody America s music service is a subscription and advertising-supported service that offers a combination of permanent downloads, conditional downloads and on demand streaming services and is the exclusive digital audio music service offered by each of us and MTVN in the United States for a multi-year period for online, web-based service offerings and mobile-based service offerings. The elements necessary to create, build, operate, market and grow Rhapsody America s music service were contributed, licensed to or provided as services to Rhapsody America by each of us and MTVN through a series of commercial agreements. As of December 31, 2007, we own 51% of the outstanding equity interest in Rhapsody America, and MTVN owns the remaining 49%.

We were incorporated in 1994 in the State of Washington. Our common stock is listed on the Nasdaq Global Select Market under the symbol RNWK.

Music

We own and manage a comprehensive set of digital music products and services designed to provide consumers with broad access to digital music. Our goal is to enable consumers to access digital music content anytime, anywhere and from a variety of devices. One of our music services is Rhapsody, a subscription-based music service offering unlimited access to a catalog of millions of music tracks. Our Rhapsody service provided in the United States is now operated through our joint venture with MTVN, Rhapsody America LLC. Rhapsody America also operates Rhapsody.com, a free Web-based version of our digital music service and the RealPlayer Music Store, which enables consumers to purchase and download individual digital music tracks. Our other music services include RadioPass, an

Internet radio subscription service, and RealMusic, an offering to consumers outside the U.S. that includes Internet radio and other music content.

Rhapsody. The Rhapsody music service and jukebox software operated by Rhapsody America is the centerpiece of our music offerings. Rhapsody allows consumers to manage their entire digital music collection

Table of Contents

in one application, and subscribers to our Rhapsody Unlimited service receive legal, unlimited, streaming access to over four million music tracks for a monthly fee. Rhapsody Unlimited enables subscribers to stream or conditionally download songs on-demand to their PC or to a range of consumer electronics devices, features significant editorial content and provides user-friendly ways for subscribers to explore, organize, listen to and share music. Rhapsody Unlimited subscribers can build and share playlists, create customized radio stations, and customize their own homepage within Rhapsody to receive recommendations, new release information and other content specific to their music tastes and listening history. Rhapsody Unlimited subscribers can also purchase most of the music tracks available from the service and can use the Rhapsody jukebox software to download an unlimited number of songs to their computer to listen offline as long as they remain subscribers.

Rhapsody To Go, a premium service also operated by Rhapsody America, provides subscribers all of the benefits of Rhapsody Unlimited in addition to the ability to transfer their music to portable devices. Rhapsody DNA is the proprietary software developed by us that enables the Rhapsody To Go service on a number of third party MP3 players and other digital music products. Rhapsody DNA facilitates the secure transfer of subscription-based music tracks to portable devices in a user friendly manner. We jointly launched with Best Buy and major MP3 player manufacturers, including SanDisk, Samsung and others, the extensible Rhapsody optimized program. This program optimizes the all-inclusive experience of using MP3 players with Microsoft Corporation s PlaysForSure technology when the device is connected to the Rhapsody service. Rhapsody optimized MP3 players can play Rhapsody channels, transmit rating information to the service, access Rhapsody metadata such as artist information and receive firmware updates from the service.

Our Rhapsody music services are marketed through a family of websites, including Rhapsody.com, as well as by our partner MTVN and are also distributed through a variety of third-party distribution channels, including broadband service providers (Comcast Corporation), music retailers (Best Buy), home entertainment hardware providers (Sonos) and MP3 manufacturers (SanDisk and Samsung). For example, Rhapsody America has partnered with Best Buy to launch and provide the Best Buy online music service powered by Rhapsody and with TiVo Inc. to deliver to consumers instant access in the home to the Rhapsody music service through any broadband-connected TiVo box.

Rhapsody.com. Rhapsody America also offers a free version of Rhapsody over the Internet called Rhapsody.com. Rhapsody.com enables consumers in the U.S. to listen to up to 25 songs per month for free utilizing their web browser. This service is offered as a marketing program for the premium version of Rhapsody and is also monetized through advertising related revenue. Rhapsody America also manages the Rollingstone.com website pursuant to a licensing agreement with Rolling Stone.

RadioPass. We offer consumers a subscription-based Internet radio product called RadioPass. RadioPass subscribers gain access to over 90 pre-programmed, ad-free, high fidelity digital music radio stations in addition to simulcasts of 3,200 worldwide broadcast stations for a monthly subscription fee. We also operate Rhapsody Radio, a version of our Internet radio service for distribution to customers via the PC and through certain wireless phone carriers. We have agreements with broadband service providers to provide our radio services on a wholesale basis in order to expose their customers to our online music services.

RealPlayer Music Store. The RealPlayer Music Store is a music download service available through our RealPlayer media player software. The RealPlayer Music Store enables customers to purchase individual digital music tracks without subscribing to one of our music subscription services. The RealPlayer Music Store has over four million songs available for purchase by U.S. consumers.

RealMusic. RealMusic is a music offering we make available to consumers outside the U.S., featuring Internet radio, a la carte music downloads, music news, and other music content. RealMusic is currently available in Europe and Japan.

Table of Contents

Consumer

Media Software and Services

RealPlayer. Our RealPlayer media player software includes features and services that enable consumers to discover, play and manage audio and video programming on the Internet via a PC. RealPlayer plays nearly all major digital media types and is compatible with over 100 portable music devices. RealPlayer is available to consumers as a free download from the Real.com website.

SuperPass. The subscription service, SuperPass, offers consumers a broad range of video, digital music and games content, as well as commercial-free Internet radio stations, advanced CD and DVD burning and expanded features for the RealPlayer. SuperPass provides a single source for consumers to access popular news, sports, music and entertainment online. Additionally, the service can be used by content owners to offer exclusive access to content and to potentially profit from multiple revenue opportunities. Subscribers to SuperPass are also entitled to receive other special offers, including security software, one game download and ten song downloads per month.

Advertising and Third-Party Software. We market and sell advertising on our Real.com family of websites and client software. In addition, we distribute third-party software products, such as the Google toolbar, to consumers who wish to download additional applications when downloading our software products.

Games

We own and operate a comprehensive digital games service that includes a broad range of downloadable and online games products and subscription services focused primarily on casual gamers for PC and mobile wireless platforms.

We develop original content for these services through our GameHouse, Mr. Goodliving, and Zylom game studios. We also publish content from numerous affiliated studios located around the world and distribute other third-party game content to our customers. We market our games products and services domestically and internationally through our own family of websites as well as through paid search advertising, affiliate marketing programs and third-party distribution channels, such as broadband service providers and online portals and content publishers. Our owned and operated consumer retail distribution services include websites operated under the RealArcade, GameHouse, Zylom and Atrativa brands. These sites focus on casual gamers for the PC and offer a variety of free and paid casual game play experiences, including GamePass and FunPass, two Internet-based games subscription services.

PC Games. The digital media distribution services that power our family of websites as well as our third-party distribution services enable consumers to purchase games from our catalog of over 600 downloadable PC games and over 200 online games across a variety of popular casual game genres, including puzzle, word, hidden object and arcade type games. These services make it easy for consumers to discover, manage and play both online and downloadable PC games. All games are made available with a free trial and can be purchased on an individual basis or as part of our subscription services. In exchange for a monthly subscription fee, GamePass subscribers receive a credit to download one game each month from our game catalog and receive discounts for additional game purchases. Subscribers to FunPass have unlimited access to play over 200 downloadable games in exchange for a monthly subscription fee. FunPass is available in the U.S. on GameHouse.com and in Europe on Zylom.com.

We believe that the PC platform is especially appropriate for generating advertising-based revenue, and in 2007, we successfully launched nearly 40 casual downloadable games supported by in-game advertising on RealArcade and Gamehouse.com. We intend to continue to launch more advertising-supported games through our own family of websites as well as through third-party distribution channels.

We continue to grow our PC games business through organic efforts and through strategic acquisitions. In the past two years we have made three acquisitions to improve the geographic reach and product service offerings of our Games business. In January 2006, we acquired Zylom Media Group B.V., a distributor and developer of casual online games in Europe, to strengthen our Games business in Europe. In November 2006, we acquired Atrativa Latin America Ltd., a distributor of casual downloadable and online games in Latin America. In October 2007, we acquired Game Trust, Inc., a casual game infrastructure company that develops and operates innovative community, social networking and commerce tools designed to more deeply engage casual games players.

Mobile Games. We develop and publish original content that consumers can purchase individually or packaged through a subscription mobile games service available through wireless network carriers in the U.S. and Europe. Under our Mr. Goodliving brand, we have created a technology development platform, called EMERGE, that enables us to efficiently convert game content for use on over 700 mobile handsets.

Technology Products and Solutions

We develop and market services and technologies that enable wireless carriers, cable companies and other media and communications companies to deliver superior entertainment experiences to their customers. We believe that we are at the forefront of innovation in digital entertainment delivery, creating new ways for mobile carriers and other businesses to provide their customers with digital media wherever they are. In recent periods, our Technology Products and Solutions segment has increasingly focused on sales of application services to wireless carriers. We believe that the transition to an application service provider (ASP) business model will create a more stable, recurring, and scalable revenue stream compared with our traditional system software license sales model.

In October 2006, we increased our ASP service offerings through our acquisition of WiderThan Co., Ltd., a global leader for delivering integrated digital entertainment solutions to communications service providers. WiderThan has a rich technology background and history of innovation, including assisting SK Telecom s launch of one of the world s first commercial ringback tone services in South Korea, as well as creating a leading, integrated mobile and on-line music-on-demand service.

In 2007, we made two additional acquisitions to strengthen our Technology Products and Solutions segment. In May 2007, we further increased our ASP service offerings through our acquisition of Sony NetServices GmbH (SNS), a Salzburg, Austria provider to mobile operators throughout Europe of end-to-end white label digital music services. In June 2007, we acquired Exomi Oy, a Finland based provider of mobile value-added service provisioning, delivery and management solutions for Short Message Service (SMS), Multimedia Messaging Service (MMS), Wireless Application Protocol (WAP) and wireless data.

We believe that following these three acquisitions, we are now at the forefront of delivery of new digital media applications to mobile carriers to provide their subscribers with digital entertainment in many forms, including ringback tones, music-on-demand, mobile games, ringtones, messaging and information. In addition, our ASP services are currently deployed with over 78 communications service providers in over 37 countries globally, including AT&T, Sprint Nextel Corp., T-Mobile USA and Verizon Wireless in the Americas, Bharti Airtel, Globe, SK Telecom and Telstra in Asia and Vodafone, among others, in Europe.

The application services that we provide are described below.

Ringback Tones. We sell our ringback tone (RBT) service to wireless carriers and communications service providers throughout the world. Our RBT service enables callers to hear music chosen by the subscriber, instead of the traditional electronic ringing sound, while waiting for the subscriber to answer. Our RBT service enables users to select from a variety of high-quality ringback content, including music, pre-recorded messages by celebrities, and sound effects. Carriers generally offer the RBT service to their subscribers through monthly subscriptions and/or on a per RBT basis. In return for operating and managing our RBT service, we generally enter into revenue-sharing arrangements with our carrier customers.

Music-On-Demand. Our music-on-demand (MOD) service allows carriers to enable their subscribers to listen to a wide range of song titles by downloading or streaming to PCs, certain MP3-enabled mobile phones, and certain portable audio players that are equipped with approved digital rights management systems. Users typically pay carriers for MOD service through monthly subscriptions or on a per-download basis, and we generally receive from the carriers some combination of a monthly fixed fee, a percentage of monthly subscription fees and a percentage of content download fees for providing the service.

Table of Contents

Video-On-Demand. Our video-on-demand (VOD) service allows wireless carriers and other telecom providers to enable their subscribers to view a wide range of video clips by downloading or streaming to video-enabled mobile phones that are equipped with approved digital rights management systems. Users typically pay for VOD services through monthly subscriptions and/or content download fees paid to the carriers, and we generally receive from the carriers some combination of a monthly fixed fee, a percentage of monthly subscription fees and a percentage of content download fees for providing the service.

Messaging. Our principal messaging service is our inter-carrier messaging (ICM) service which routes and delivers SMS messages between wireless carriers within the U.S. and internationally to multiple wireless devices, under the brand name of Metcalf. We provide this service to carriers in partnership with VeriSign, Inc. The ICM service allows subscribers with any text messaging capable handset to send and receive text messages to and from subscribers on other networks. We earn revenue from this service from fees paid by the carriers based on the number of messages handled for them through the ICM service, subject to our revenue-sharing arrangement with VeriSign. Our messaging services also include e-mail messaging, multi-media messaging, voice messaging, and multimedia application gateway management, primarily to wireless carriers.

The Technology Products and Solutions that we sell as software are described below.

Helix Server. Our Helix server software allows companies to broadcast live and on-demand audio, video and other multimedia programming to large numbers of simultaneous users over the Internet. We market and sell our Helix Server software to carriers, media companies and other enterprises that typically pay upfront fees for either a perpetual or term-based license plus annual fees for upgrades and support.

RealProducer. RealProducer is a multimedia creation and publishing tool that content owners use to convert audio and video content into our RealAudio and RealVideo formats. Customers pay upfront fees for RealProducer for either a perpetual or term-based license plus annual fees for upgrades and support.

Exomi Messaging Gateway. The Exomi Messaging Gateway (EMG) provides a solution for the delivery and management of value-added SMS and MMS services for carriers. It provides a single point of management for all applications and services, including short codes, and has simple application program interfaces (APIs) for other media companies and service providers to connect to a carrier s network. Customers pay upfront fees for EMG for either a term- or volume/capacity-based license plus annual fees for upgrades and support.

Exomi WAP Gateway. The Exomi WAP Gateway is a complete WAP infrastructure solution for carriers that enables a carrier s subscribers to browse via WAP, send and receive MMS messages, perform application downloads and access entertainment services. It primarily provides access management and filtering and has flexible charging and rating schemes for carriers. Customers generally pay upfront license fees for the Exomi WAP Gateway based on the number of users plus annual fees for upgrades and support.

Other Technology Licensing. We have also created enhanced versions of our media player and server products for use in wireless applications and we license our server software and products to a variety of mobile network operators on a worldwide basis. For example, our RealPlayer Mobile Player and related media server enable consumers to access streaming or downloaded content via 2.5G and 3G mobile networks. We have entered into agreements with wireless carriers, including AT&T, to use our mobile platform (primarily in international markets) and with mobile handset manufacturers, including Motorola, Nokia, Qualcomm, and Sony Ericsson, to preinstall our mobile player software on mobile phones.

In connection with our technology and entertainment services and the licensing of our business software products, we also provide professional services and specialized technical support to certain customers. The nature of these services varies from customer to customer and from period to period. In general, these services are designed to customize and integrate our technology with our customers existing systems and technology.

See Notes to Consolidated Financial Statements Segment Information (Note 18) for information regarding our reporting segments and geographic regions.

Research and Development

We devote a substantial portion of our resources to developing new products, enhancing existing products, expanding and improving our fundamental technology, and strengthening our technological expertise in all our businesses. During the years ended December 31, 2007, 2006 and 2005, we expended 18%, 20%, and 22%, respectively, of our net revenue on research and development activities.

Customers and Seasonality

Our customers include consumers and businesses located throughout the world. Sales to customers outside the U.S., primarily in Asia and Europe, were 36%, 28%, and 23% of our net revenue during the years ended December 31, 2007, 2006, and 2005, respectively. Sales to one of our international Technology Products and Solutions customers, SK Telecom, accounted for approximately 13% of our consolidated revenues in the year ended December 31, 2007.

We are increasingly experiencing seasonality in our business, particularly with respect to the fourth quarter of our fiscal year. Our consumer businesses, which include advertising revenue, make up a large percentage of our revenue, and the fourth quarter has traditionally been the seasonally strongest quarter for internet advertising. In addition, as we have begun partnering more closely with device manufacturers for our consumer music services, we expect sales of these devices to follow typical consumer buying patterns with a majority of consumer electronics being sold in the fourth quarter. Finally, our Technology Products and Solutions business has seen a concentration of system sales, deployments, and consulting revenue in the fourth quarter.

Sales, Marketing and Distribution

Our marketing programs are aimed at increasing brand awareness of our products and services and stimulating market demand. We use a variety of methods to market our products and services, including paid search advertising, affiliate marketing programs, advertising in print, electronic and other online media, television, direct mail and e-mail offers to qualified potential and existing customers and providing product specific information through our websites. We have a substantial number of employees focused on marketing our Technology Products and Solutions to companies and organizations around the world. We also have subsidiaries and offices in several countries that market and sell our products outside the U.S.

Music and Consumer Marketing

We market and sell the music products and services offered through Rhapsody America directly through the website *www.rhapsody.com*, and our other consumer products and services directly through our own websites (*www.real.com, www.realarcade.com, www.gamehouse.com, www.zylom.com, etc.*). In addition, pursuant to one of the commercial agreements between Rhapsody America and MTVN, Rhapsody America has committed to purchase $230 million in advertising and integrated marketing on MTVN cable channels over the term of the agreement. Our music products and services are also offered through our client software and a variety of third-party distribution channels, such as broadband service providers, retailers, and other partners. These websites and client software provide us with a low-cost, globally accessible sales channel that is generally available 24 hours per day, seven days per week. We also have an advertising sales force that markets and sells advertising on our websites and client software. We sell our international advertising inventory directly to clients and agencies in foreign markets and through third-party advertising representation firms.

Technology Products and Solutions Marketing

Our sales, marketing and business development team works closely with many of our enterprise, infrastructure, wireless, broadband and media customers to identify new business opportunities for our entertainment applications, services and systems. Through ongoing communications with product and marketing divisions of our customers, we tailor our ASP services to the strategic direction of the carriers and the preferences of their subscribers. Our market channels consist of various online and offline methods of promoting our products and services, media relations, industry trade shows, speaking opportunities and other events. We also market and sell our Technology Products and Solutions directly through our websites and through other distributors, including hardware server companies, content aggregators, Internet service providers (ISPs) and other hosting providers that redistribute or provide end users access to our streaming technology from their websites and systems. We also have agreements with many popular software and hardware companies and websites to distribute our products as a click-through or to bundle our player products into their applications and software.

Customer Support

Customer support is integral to the provision of our consumer products and services, our carrier application services, and to the success of our system software customers. Consumers who purchase our consumer software products and services, including games, music, and entertainment services, can get assistance via the Internet, e-mail or telephone. We contract with third-party outsource support vendors to provide the primary staffing for our first-tier customer support globally. We also provide various support service options for our business customers and for software developers using our software products and associated services. Support service options include hotline telephone support, online support services, and on-site support personnel covering technical and business-related support topics.

Competition

The market for software and services for digital media delivery over the Internet and wireless networks is intensely competitive. Many of our current and potential competitors have longer operating histories, greater name recognition or brand awareness, more employees and/or significantly greater resources than we do.

We compete in the market for delivery of online content services primarily on the basis of the quality and quantity of the content available in our services, the quality and usability of our software products, the reach of our media formats, and the price and perceived value of our products and services to consumers.

Music

The Rhapsody music subscription services operated by Rhapsody America and our RealPlayer Music Store face competition from traditional offline music distribution companies and from other online digital music services, including Apple Inc. s iTunes music stores and Napster, Inc. s music subscription services, as well as a wide variety of other competitors that are now offering digital music for sale over the Internet. Microsoft Corporation also offers premium music services in conjunction with its Zune product line, Windows Media Player and MSN services. We also expect increasing competition from media companies, online retailers such as Amazon.com and online community companies such as imeem, Inc. that offer consumers free, advertising-supported music content and applications through their websites. Our music offerings also face substantial competition from the illegal use of free peer-to-peer services. The ongoing presence of these free services substantially impairs the marketability of legitimate services such as Rhapsody and the RealPlayer Music Store.

Our Rhapsody subscription services compete primarily on the basis of the overall quality and perceived value of the user experience and on the effectiveness of our distribution network and marketing programs. We believe that Rhapsody s subscription-based services offer customers a superior value compared to the purchase of individual digital music tracks through competing online music download sites. We also believe that Rhapsody s tools to search for and discover music, as well as its editorial content, organization of music and related artists, and overall ease of use differentiates Rhapsody from other online digital music services. As the market for purchasing music online grows, we expect that competition for subscribers and purchasers will be intense. In particular, Apple heavily markets and promotes its brand and digital music download services in order to drive sales of its higher margin hardware products. We expect that music subscription services will continue to compete aggressively for new subscribers and that Apple will continue to spend significantly to market and promote its brand and the sale of downloadable music to further its business model. We also expect that other competitors will continue to spend heavily to promote their brands and to attract and retain consumers for their services. We further believe that our ability to compete in the digital music business has been negatively impacted by the historical lack of a compelling portable device solution for our music subscription services. We have attempted to address this competitive problem by introducing our Rhapsody DNA software and Rhapsody optimization specification and enabling portable wireless players, such as the ibiza Rhapsody by Haier America Trading, LLC, that can connect directly to the Rhapsody service without the use of a PC. Sales of our Rhapsody To Go subscription service will be increasingly dependent on the sales of our partners MP3 players and the sales efforts of our music retailer partners like Best Buy.

Consumer

Games

Our Games business competes with a variety of distributors, publishers and developers of casual games for the PC, and mobile wireless platforms. Our family of websites serving the PC casual games market competes with other high volume distribution channels for downloadable games including Yahoo! Games, MSN Gamezone, Pogo.com, and Shockwave. We compete in this market primarily on the basis of the quality and convenience of our services, the reach and quality of our distribution arrangements and the quality and breadth of our game catalog. Our GameHouse, Mr. Goodliving, and Zylom content development studios compete with other developers and publishers of downloadable PC and mobile games. Our studios compete based on our ability to develop and publish high quality games that resonate with consumers, our effectiveness at building our brands, our ability to license and execute digital games based on popular third-party intellectual properties like Monopoly, Scrabble and South Park, and our ability to secure broad distribution relationships for our titles, including distribution of mobile titles through mobile carriers.

Media Software and Services

Our media software and services business, including our SuperPass subscription service, faces competition from existing competitive alternatives and other emerging services and technologies. We face competition in these markets from traditional media outlets such as television, radio, CDs, DVDs, videocassettes and others. We also face significant competition from emerging Internet media sources and established companies entering into the Internet media content market, including Time Warner s AOL subsidiary, Microsoft, Apple, Yahoo!, Google and YouTube as well as broadband Internet service providers, many of which provide similar or alternative services for free or bundle these types of services with other offerings. We also face competition from alternative streaming media playback technologies such as Microsoft Windows Media Player and Adobe Flash. We expect this competition to become more intense as the markets and business models for Internet video content mature and more competitors enter these new markets. Our video services compete primarily on the basis of the quality and perceived value of the content and services we provide, and on the effectiveness of our distribution network and marketing programs.

Technology Products and Solutions

Carrier Application Services

We compete with a large number of domestic and international companies in our carrier application services. We compete largely based on time-to-market, feature sets, operational expertise, customer care as well as price. Many of the carrier application services we provide require a high degree of integration with carrier or service provider networks and thus require a high degree of operational expertise. Those companies, like us, that can understand the intricacies of deploying highly sophisticated carrier-grade services quickly and efficiently generally have an advantage. In addition, the ability to enhance services with new features as the digital entertainment market develops is critical.

Our principal competitors in the ringback tone service market are NMS Technologies, Comverse Technology and Huawei Technologies. Our principal competitors in the music-on-demand service market include Groove Mobile, Omnifone, Musiwave (acquired by Microsoft Corporation) and Napster. Our principal competitors in the video-on-demand service market include MobiTV, QuickPlay and ThePlatform. And our principal competitors in the messaging market are Sybase365, a division of Sybase, Inc., and Syniverse Technologies.

Server Software

We currently compete primarily with Microsoft Corporation in the market for digital media servers, players, encoders, digital rights management, codecs and other technology and services related to digital distribution of media. Other competitors include Adobe and Apple. We believe that the primary competitive factors in the media delivery market include the quality, reliability, price and licensing terms of the overall media delivery solution, ubiquitous and easy consumer accessibility to media playback capability, access to distribution channels necessary to achieve broad distribution and use of products, and the ability to license and support popular and emerging media formats for digital media delivery. Microsoft distributes its competing streaming media server, player, tools and digital rights management products by bundling them with its Windows operating systems, including Windows NT, and Windows XP and Windows Vista, at no additional cost or otherwise making them available free of charge. We expect that by leveraging its monopoly position in operating systems and tying streaming of digital media into its operating systems and its Web browser, Microsoft will in the future distribute substantially more copies of its Windows Media Player, which competes with our media player products, than it has in the past and may be able to attract more users and content providers to use its streaming or digital media products.

Intellectual Property

As of December 31, 2007, we had 58 U.S. patents, 15 patents in South Korea, and over 100 pending patent applications relating to various aspects of our technology. We are continuously preparing additional patent applications on other current and anticipated features of our technology in various jurisdictions across the world. As of December 31, 2007, we had 57 registered U.S. trademarks or service marks, 23 registered South Korea trademarks or service marks, and had applications pending for several more trademark or service marks in various jurisdictions across the world. We also have several unregistered trademarks. In addition, we have several foreign trademark registrations and pending applications. Many of our marks begin with the word Real (such as RealPlayer, RealAudio and RealVideo). We are aware of other companies that use Real in their marks alone or in combination with other words, and we do not expect to be able to prevent all third-party uses of the word Real for all goods and services.

To protect our proprietary rights, we rely on a combination of patent, trademark, copyright and trade secret laws, confidentiality agreements with our employees and third parties, and protective contractual provisions. These efforts to protect our intellectual property rights may not be effective in preventing misappropriation of our technology, or may not prevent the development and design by others of products or technologies similar to or competitive with those we develop.

Employees

At December 31, 2007, we had 1,722 full-time employees and 192 part-time and contingent employees, of which 1,076 were based in the Americas, 388 were based in Asia, and 258 were based in Europe. None of our employees are subject to a collective bargaining agreement, and we believe that our relations with our employees are good.

Position on Charitable Responsibility

In periods where we achieve profitability, we intend to donate 5% of our net income to charitable organizations, which will reduce our net income for those periods. The non-profit RealNetworks Foundation manages our charitable giving efforts. We attempt to encourage employee giving by using a portion of our intended contribution to match charitable donations made by employees.

Available Information

Our corporate Internet address is www.realnetworks.com. We make available free of charge on www.investor.realnetworks.com our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (SEC). However, the information found on our corporate website is not part of this or any other report.

Executive Officers of the Registrant

The executive officers of RealNetworks as of February 28, 2008 were as follows:

Name	Age	Position
Robert Glaser	46	Chairman of the Board and Chief Executive Officer
Michael Eggers	36	Senior Vice President, Chief Financial Officer and Treasurer
Savino (Sid) Ferrales	57	Senior Vice President Human Resources
John Giamatteo	41	President -- Technology Products and Solutions and International Operations
Robert Kimball	44	Senior Vice President, Legal and Business Affairs, General Counsel and Corporate Secretary
Dan Sheeran	41	Senior Vice President Corporate Partnerships and Business Development
Robert J. Williams	42	Senior Vice President Music Products of RealNetworks
Harold Zeitz	44	Senior Vice President Games and Media Software and Services

ROBERT GLASER has served as Chairman of the Board and Chief Executive Officer of RealNetworks since its inception in February 1994, and as Treasurer from February 1994 to April 2000. Mr. Glaser s professional experience also includes ten years of employment with Microsoft Corporation where he focused on the development of new businesses related to the convergence of the computer, consumer electronics and media industries. Mr. Glaser holds a B.A. and an M.A. in Economics and a B.S. in Computer Science from Yale University.

MICHAEL EGGERS has served as Senior Vice President, Chief Financial Officer and Treasurer of RealNetworks since February 2006. Mr. Eggers joined RealNetworks in 1997 as the Manager of Financial Reporting and has held various positions leading to his appointment as the Chief Financial Officer. Prior to RealNetworks, Mr. Eggers was employed by KPMG in the audit practice division. Mr. Eggers holds a B.A., *magna cum laude*, in Business Administration with a concentration in accounting from the University of Washington.

SAVINO SID FERRALES has served as Senior Vice President, Human Resources of RealNetworks since April 2004. From February 1998 to April 2004, Mr. Ferrales served as Senior Vice President and Chief Human Resources Officer of Interland, Inc., a provider of Web hosting and online solutions to small businesses. Over the past twenty-five years, Mr. Ferrales has been employed as a human resources executive at several high technology companies, including Power Computing Corporation, Digital Equipment Corporation, Dell Computer Corporation, and Motorola, Inc. Mr. Ferrales holds a B.A. in Sociology from Texas State University and an M.A. in Social Rehabilitation from Sam Houston State University.

JOHN GIAMATTEO has served as President, Technology Products and Solutions and International Operations of RealNetworks since October 2006. Mr. Giamatteo joined RealNetworks in June 2005 and served as Executive Vice President, Worldwide Business Products and Services and International Operations from June 2005 to October 2006. From 1988 to June 2005, Mr. Giamatteo was employed by Nortel Networks Corporation, a provider of communications solutions, where he held various management positions, most recently serving as President, Asia

Pacific. Mr. Giamatteo holds a B.S. in Accounting and an M.B.A. from St. John s University.

ROBERT KIMBALL has served as Senior Vice President, Legal and Business Affairs, General Counsel and Corporate Secretary of RealNetworks since January 2005. From January 2003 to January 2005, Mr. Kimball served as Vice President, Legal and Business Affairs, General Counsel and Corporate Secretary of RealNetworks. Mr. Kimball held the positions of Vice President, Legal and Business Affairs of RealNetworks from May 2001 to January 2003 and Associate General Counsel from March 1999 to April 2001. Mr. Kimball holds a B.A. with distinction from the University of Michigan and a J.D., *magna cum laude*, from the University of Michigan Law School.

DAN SHEERAN has served as Senior Vice President, Corporate Partnerships and Business Development of RealNetworks since February 2007. Mr. Sheeran joined RealNetworks in August 2001 and served as Senior Vice President, International Operations from March 2004 to July 2005, and as Senior Vice President, Premium Consumer Services from July 2005 to November 2005 and as Senior Vice President, Music from November 2005 to February 2007. From June 2003 to March 2004, Mr. Sheeran served as Senior Vice President, Marketing of RealNetworks and from August 2001 to June 2003, Mr. Sheeran served as Vice President, Media Systems Marketing. Mr. Sheeran holds a B.S. in the School of Foreign Service, *cum laude*, from Georgetown University and an M.B.A. from Northwestern University.

ROBERT J. WILLIAMS has served as Senior Vice President, Music Products of RealNetworks since August 2007. Mr. Williams joined RealNetworks in July 2005 and served as Vice President, Music Software from December 2005 to August 2007, and as Area Vice President, Music Software from July 2005 to December 2005. Prior to joining RealNetworks, Mr. Williams was employed by Openwave Systems Inc., a mobile and broadband services company, where he held the positions of General Manager, Client Products from January 2004 to December 2004 and Vice President Engineering, Client Products, from 2002 to January 2004. Mr. Williams holds a Bachelor of Applied Science degree in Electrical Engineering from the University of Waterloo.

HAROLD ZEITZ has served as Senior Vice President, Games and Media Software and Services of RealNetworks since January 2007. Mr. Zeitz joined RealNetworks in June 2006 and served as Senior Vice President, Media Software and Services from June 2006 to January 2007. From March 2002 to June 2006, Mr. Zeitz served as the Chief Operating Officer and Chief Marketing Officer of ShareBuilder Corporation, an online securities brokerage company. From January 2000 to August 2001, Mr. Zeitz served as the President and Chief Operating Officer of WorldStream Communications, a multimedia communications service company. From 1990 to 2000 Mr. Zeitz was employed by McCaw Cellular/AT&T Wireless where he held various senior management positions, most recently as the senior consumer marketing executive. Mr. Zeitz holds a B.A. in Economics from Northwestern University and an MBA from the Stanford Graduate School of Business.

Item 1A. *Risk Factors*

You should carefully consider the risks described below together with all of the other information included in this annual report on Form 10-K. The risks and uncertainties described below are not the only ones facing our company. If any of the following risks actually occurs, our business, financial condition or operating results could be harmed. In such case, the trading price of our common stock could decline, and investors in our common stock could lose all or part of their investment.

Risks Related to Our Music, Games and Media Software and Services Businesses

We require the consent of Viacom International Inc. with respect to certain matters in the governance and management of our Rhapsody America joint venture. Any disagreement with Viacom on such matters may have an adverse impact on the business, results of operations and financial condition of Rhapsody America and, consequently, our business.

We and MTVN have formed Rhapsody America LLC, a Delaware limited liability company. We own, through a wholly owned subsidiary, 51% of the limited liability company membership interests of Rhapsody America and MTVN owns, through a wholly owned subsidiary, the remaining 49%. We are entitled to appoint the general manager to manage the day-to-day operations of Rhapsody America. Rhapsody America is

14

Table of Contents

governed by a limited liability company agreement which, among other things, requires unanimous approval of the members for certain actions, including but not limited to the following:

authorizing the annual operating budget and making capital expenditures in excess of a certain percentage over the budgeted amount for capital expenditures;

the issuance, sale or repurchase of Rhapsody America s membership interests;

declaring of or making any distribution by Rhapsody America;

merging, consolidating or reorganizing Rhapsody America, acquiring or selling assets not in the ordinary course of business in excess of a certain amount, or acquiring or selling businesses valued in excess of a certain amount;

entering into any transaction with a value in excess of a certain amount with our affiliates or affiliates of MTVN; and

the appointment of a new general manager if the existing general manager is required to resign as a result of Rhapsody America not meeting certain financial tests.

If we are not able to agree with MTVN on any of the foregoing items, or if the members are unable to agree on any other significant operational or financial matter requiring approval of the members, the business, results of operations and financial condition of Rhapsody America may be adversely affected and, consequently, our business may suffer.

If there is a change in management or change of control of MTVN or any other event occurs that adversely impacts our relationship with MTVN, the business, results of operations and financial condition of Rhapsody America may be adversely affected. MTVN s investments or activities generally may from time to time conflict with our interests or those of Rhapsody America. MTVN may have economic or other business interests or goals that are inconsistent with our or Rhapsody America s business interests or goals.

The integration strategy we plan to implement with respect to the assets that have been combined in Rhapsody America may fail or be less successful than anticipated and the management of these assets creates operational complexities.

Our realization of the anticipated benefits of Rhapsody America will depend on our ability to integrate the assets contributed by us and MTVN. Neither we nor the current management of Rhapsody America have extensive experience in managing and operating complex joint ventures of this nature and the integration and operational activities may strain our internal resources, distract us from managing our day-to-day operations, and impact our ability to retain key employees in Rhapsody America. Our business, results of operations and financial condition could be materially and adversely affected if we are unable to successfully integrate and manage these assets.

The nature of our and MTVN s contributions of services and assets to Rhapsody America required detailed cost allocation agreements that are complex to implement and manage and may result in significant costs that could adversely affect our operating results. For example, the advertising commitment from MTVN includes direct and integrated marketing services and programs, some of which may be difficult to value and may not generate expected returns. In addition, we are required to provide various support services, including facilities, information technology systems, personnel and other corporate administrative support, to Rhapsody America. The allocation of these support service costs is based on various measures depending on the service provided, much of which must be tracked and then accounted for and reported to Rhapsody America on a periodic basis. Tracking and reporting these costs require significant internal resources, and many of the allocation methodologies are complicated, which may result in inaccuracies in the total charges to be billed to Rhapsody America. In addition, the variable nature of these costs to be allocated to Rhapsody America may result in fluctuations in the period-over-period results of our Music business.

We and MTVN have certain contractual rights relating to the purchase and sale of MTVN s membership interest in Rhapsody America that may be settled in part through the issuance of additional shares of our capital stock, which would dilute our other shareholders voting and economic interests in us, and may require us to pay MTVN a price that exceeds the appraised value of their proportionate interest in Rhapsody America.

Pursuant to the terms of the Rhapsody America limited liability company agreement, we have a right to purchase from MTVN, and MTVN has a right to require us to purchase, MTVN s membership interest in Rhapsody America. These call and put rights are exercisable upon the occurrence of certain events and during certain periods in each of 2012, 2013 and 2014 and every two years thereafter and may be settled, in part, through the issuance of shares of our capital stock, subject to specified limitations. If a portion of the purchase price for MTVN s membership interest is payable in shares of our capital stock, such shares could represent up to 15% of the outstanding shares of our common stock immediately prior to the transaction. In addition, we may also be obligated to issue shares of our non-voting stock representing up to an additional 4.9% of the outstanding shares of our common stock immediately prior to the transaction. If we pay a portion of the purchase price for MTVN s membership interest in shares of our common stock and non-voting stock, our other shareholders voting and economic interests in us will be diluted, and MTVN will become one of our significant shareholders. In certain situations, if MTVN exercises its right to require us to purchase its membership interests in Rhapsody America, we may be required to pay MTVN a price that provides a return to MTVN over the appraised value of MTVN s proportionate interest in Rhapsody America.

The success of our subscription services businesses depends upon our ability to increase subscription revenue.

Our operating results could be adversely impacted by the loss of subscription revenue. Internet subscription businesses are a relatively new media delivery model and we cannot predict with accuracy our long-term ability to maintain or increase subscription revenue. Subscribers may cancel their subscriptions to our services for many reasons, including a perception that they do not use the services sufficiently or that the service does not provide enough value, a lack of attractive or exclusive content generally or as compared to competitive service offerings (including Internet piracy), or because customer service issues are not satisfactorily resolved. In recent periods, we have seen an increase in the number of gross customer cancellations of our subscription services due in part to an increasingly large subscriber base. As our subscription business evolves, we have increased our focus on free-to-consumer products and services. In addition, certain subscription based products and services with mobile carriers and broadband service providers are sold on a flat-fee or revenue-share basis. It is not clear what the long-term impact of this evolution will have on our subscription revenue.

Our digital content subscription business, and our online music services in particular, depend on our continuing ability to license compelling content on commercially reasonable terms.

We must continue to obtain compelling digital media content for our video, music, and games services in order to maintain and increase usage, subscription service revenue, and overall customer satisfaction for these products. Our online music service offerings now available through our Rhapsody America venture depend on music licenses from the major music labels and publishers, and the failure of any such parties to renew these licenses under terms that are acceptable to us would harm Rhapsody America s ability to offer successful music subscription services and therefore our operating results. If we cannot obtain premium digital content for any of our digital content subscription services on commercially reasonable terms, or at all, our business will be harmed.

RealPlayer 11 may not achieve consumer or market acceptance and may be subject to legal challenge.

We launched a new version of our media delivery software, RealPlayer 11. Consumers can use RealPlayer 11 to record and download videos from websites on the Internet with a single click on a Download this Video button that appears in the consumer s web browser when a video is playing. Consumers can also simultaneously download and record multiple videos in a number of popular formats and can save the videos to CDs with the free version of RealPlayer 11 and to DVDs with a premium version that can be purchased

16

through our websites. We cannot predict the rate of adoption or level of usage of RealPlayer 11 or whether it will lead to increased sales of any of our consumer products or services.

Although we believe RealPlayer 11 is legal, there are risks associated with the distribution of RealPlayer 11, including the risk that content owners may claim that the recording and downloading of their content with RealPlayer 11 infringes their intellectual property rights even though RealPlayer 11 automatically recognizes and will not download content protected by digital rights management. Responding to these potential claims may require us to enter into royalty and licensing agreements on unfavorable terms, require us to stop distributing or selling, or to redesign, RealPlayer 11, or to pay damages.

Music publishing royalty rates for music subscription services offered through RealNetworks and Rhapsody America are not yet fully established; a determination of high royalty rates could negatively impact our operating results.

Publishing royalty rates associated with music subscription services in the U.S. and abroad are not fully established. Public performance licenses are negotiated individually, and we have not yet agreed to rates with all of the performing rights societies for all of our music subscription service activities, including those now conducted by Rhapsody America. We or Rhapsody America may be required to pay a rate that is higher than we expect, as the issue was recently submitted to a Rate Court by the American Society of Composers, Authors and Publishers (ASCAP) for judicial determination. We have license agreements to reproduce musical compositions with the Harry Fox Agency, an agency that represents music publishers, and with many independent music publishers as required in the creation and delivery of on demand streams and tethered downloads, but these license agreements do not include final royalty rates. The license agreements anticipate industry-wide agreement on rates, or, if no industry-wide agreement can be reached, determination by a copyright royalty board (CRB), an administrative judicial proceeding supervised by the U.S. Copyright Office. If the rates agreed to or determined by a CRB or by Congress are higher than we expect, the increased expense could negatively impact our operating results. The publishing rates associated with our international music streaming services are also not yet determined and may be higher than our current estimates.

An appeal of, or other industry settlement relating to, the April 2007 Copyright Royalty Board decision regarding Internet radio royalties and minimum payments could result in material expenses that would harm our operating results and our ability to provide popular radio services.

In April 2007, the Copyright Royalty Board (CRB) issued a decision setting new royalty rates for the use of sound recordings in Internet radio from 2006 through 2010. These rates are still under appeal and are also subject to industry-wide settlement negotiations, in some of which we are a participant. The appeal or other industry settlement, whether or not we directly participate in the settlement, may result in higher rates or other terms that are unfavorable to us, which could adversely impact our operating results and our ability to provide our radio services in the future.

Our music, games and media software and services businesses face substantial competitive challenges that may prevent us from being successful in, and negatively impact future growth in, those businesses.

Music. Our online music services now offered through our Rhapsody America joint venture with MTVN face significant competition from traditional offline music distribution competitors and from other online digital music services, as well as online theft or piracy. Some of these competing online services have spent substantial amounts on marketing and have received significant media attention, including Apple s iTunes music download service, which it markets closely with its extremely popular iPod line of portable digital audio players and its iPhone. Microsoft has also begun offering premium music services in conjunction with its Windows Media Player and also markets a portable music player and related download software and music service called Zune. We also expect increasing competition from online retailers such as Amazon.com. Our online music services also face significant competition from free peer-to-peer services which allow consumers to directly access a wide variety of free content without securing licenses from content providers. Enforcement efforts have not effectively shut down these services and there can be no assurance that these

Table of Contents

services will ever be shut down. The ongoing presence of these free services substantially impairs the marketability of legitimate services like ours. Rhapsody America may not be able to compete effectively in this highly competitive market, which may negatively impact the future growth of our Music business.

Media Software and Services. Our media software and services (primarily our SuperPass subscription service) face competition from existing competitive alternatives and other free emerging services and technologies, such as user generated content services like YouTube and alternative streaming media playback technologies including Microsoft Windows Media Player and Adobe Flash. Content owners are increasingly marketing their content on their own websites rather than licensing to other distributors such as us. We face competition in these markets from traditional media outlets such as television, radio, CDs, DVDs, videocassettes and others. We also face competition from emerging Internet media sources and established companies entering into the Internet media content market, including Time Warner s AOL subsidiary, Microsoft, Apple, Adobe, Yahoo! and broadband ISPs. We expect this competition to continue to be intense as the market and business models for Internet video content mature and more competitors enter these new markets. Competing services may be able to obtain better or more favorable access to compelling video content than us, may develop better offerings than us and may be able to leverage other assets to promote their offerings successfully. If we are unable to compete successfully, the future growth of our Media Software and Services business will be negatively impacted.

Games. Our RealArcade, GameHouse, and Zylom branded services compete with other online distributors of downloadable casual PC games. Some of these distributors have high volume distribution channels and greater financial resources than we do, including Yahoo! Games, MSN Gamezone, Pogo.com, and Shockwave. We expect competition to intensify in this market from these and other competitors and no assurance can be made that we will be able to continue to grow our revenue. Our GameHouse, Zylom, and Mr. Goodliving content development studios compete with other developers and publishers of downloadable PC and mobile games. Our development studios compete primarily with other developers of downloadable and mobile casual PC games and must continue to develop popular and high-quality game titles to maintain our competitive position and help maintain the growth of our Games business.

We may not be successful in maintaining and growing our distribution of digital media products.

We cannot predict whether consumers will continue to download and use our digital media products consistent with past usage, especially in light of the fact that Microsoft bundles its competing Windows Media Player with its Windows operating system and the popularity of the Adobe Flash format. Our inability to maintain continued high volume distribution of our digital media products could hold back the growth and development of related revenue streams from these market segments, including the distribution of third-party products, and therefore could harm our business and our prospects.

The success of music services offered through Rhapsody America depend, in part, on interoperability with our customers music playback hardware.

In order for the digital music services offered through Rhapsody America to continue to grow, we must design services that interoperate effectively with a variety of hardware products, including portable digital audio players, mobile handsets, home stereos and PCs. We and Rhapsody America depend on significant cooperation with manufacturers of these products and with software manufacturers that create the operating systems for such hardware devices to achieve our objectives. To date, Apple has not agreed to design its popular iPod line of portable digital audio players or its new iPhone to function with our music services. If we cannot successfully design our service to interoperate with the music playback devices that our customers own, our business will be harmed.

Table of Contents

Risks Related to Our Technology Products and Solutions Business

Recent acquisitions in our Technology Products and Solutions business could expose us to new risks, disrupt our business and adversely impact our results of operations.

In November 2006, we completed the acquisition of substantially all of WiderThan Co., Ltd. (WiderThan). We also acquired Sony NetServices GmbH (SNS) and Exomi Oy (Exomi) in May 2007 and June 2007, respectively. The integration of these acquisitions, particularly WiderThan, is continuing and may divert the attention of management and other key personnel from other core business operations, which could adversely impact our financial performance in the near term. Moreover, the integration of WiderThan s operations into the Company will require expansions to our system of internal controls over financial reporting. Any failure to successfully operate and integrate WiderThan could have an adverse effect on our results of operations.

Our businesses may be adversely affected by developments affecting the South Korean economy amid increased tensions with North Korea.

With the acquisition of WiderThan, we generate a material portion of our revenue from operations in the Republic of Korea (South Korea). On a consolidated basis, during the year ended December 31, 2007 we derived 15% of our revenue from our operations in South Korea and expect that we will generate a portion of our revenue from South Korea in 2008. Operating in this market subjects us to risks that were not previously relevant to us, including risks associated with the general state of the economy in South Korea and the potential instability of the Democratic People s Republic of Korea (North Korea).

Relations between South Korea and North Korea have been tense throughout Korea s modern history. The level of tension between the two Koreas has fluctuated and may increase or change abruptly as a result of current and future events, including ongoing contacts at the highest levels of the governments of South Korea and North Korea. Any further increase in tensions, which may occur, for example, if high-level contacts break down or military hostilities occur, could have a material adverse effect on our business, financial condition, and results of operations.

Our traditional system software licensing business has been negatively impacted by the effects of our competitors, and our settlement agreement with Microsoft may not improve sales of our system software products.

We believe that our traditional system software sales have been negatively impacted primarily by the competitive effects of Microsoft, which markets and often bundles its competing technology with its market leading operating systems and server software. Although the settlement agreement we entered into with Microsoft relating to our claims regarding Microsoft s anticompetitive practices contained a substantial cash payment to us and a series of technology agreements, Microsoft will continue to be an aggressive competitor with our traditional systems software business. We cannot be sure whether the portions of the settlement agreement designed to limit Microsoft s ability to leverage its market power will be effective, and we cannot predict when, or if, we will experience increased demand for our system software products or if we will be able to apply the proceeds from the settlement agreement in a way that improves our operating results or shareholder return on an investment in our stock.

A majority of the revenue that we generate in South Korea is dependent upon our relationship with SK Telecom, the largest wireless carrier in Korea; any deterioration of this relationship could materially harm our business.

We offer our mobile entertainment services to consumers in South Korea through SK Telecom, the largest wireless carrier in South Korea. In the near term, we expect that we will continue to generate a significant portion of our total revenue through SK Telecom. If SK Telecom fails to market or distribute our applications or terminates its business contracts with us, or if our relationship with SK Telecom deteriorates in any significant way, we may be unable to replace the affected business arrangements with acceptable alternatives, which could have a material negative impact on our revenue and operating results. Also, if we are unable to continue our service development in conjunction with SK Telecom, our ability to develop, test, and introduce new services will be materially harmed.

Contracts with our carrier customers subject us to significant risks that could negatively impact our revenue or otherwise harm our operating results.

We derive a material portion of our revenue from carrier application services. Many of our carrier application services contracts provide for revenue sharing arrangements but we have little control over the pricing decisions of our carrier customers. Furthermore, most of these contracts do not provide for guaranteed minimum payments or usage levels. Because most of our carrier customer contracts are nonexclusive, it is possible that our wireless carriers could purchase similar application services from third parties, and cease to use our services in the future. As a result, our revenue derived under these agreements could be substantially reduced depending on the pricing and usage decisions of our carrier customers.

In addition, none of our carrier application services contracts obligates our carrier customers to market or distribute any of our applications. As a result, revenue related to our application services are, to a large extent, dependent upon the marketing and promotion activities of our carrier customers. The loss of carrier customers or a reduction in marketing or promotion of our applications would likely result in the loss of future revenues from our carrier application services.

Many of our carrier contracts are short term and allow for early termination by the carrier with or without cause. These contracts are therefore subject to renegotiation of pricing or other key terms that could be adverse to our interests, and leave us vulnerable to non-renewal by the carriers. If our carrier contracts are terminated, not renewed, or renegotiated in a manner less favorable to us, our application services revenue would be negatively impacted.

Finally, certain of our carrier contracts obligate us to indemnify the carrier customer for certain liabilities and losses incurred by them, including liabilities resulting from third party claims for damages that arise out of the use of our technology. These indemnification terms provide us with certain procedural safeguards, including the right to control the defense of the indemnified party. We have accepted tenders of indemnification from two of our carrier customers related to one pending patent infringement proceeding, and we are vigorously defending them. This pending proceeding or future claims against which we may be obligated to defend our carrier customers could result in paying amounts pursuant to these obligations that could materially harm our operating results.

Our carrier customers could begin developing some or all of our carrier applications services on their own, which could result in the loss of future revenues.

Most of our carrier customers do not offer internally-developed application services that compete with ours. If, however our carrier customers begin developing these application services internally, we could be forced to lower our prices or increase the amount of service we provide in order to maintain our business with those carrier customers. This could result in the loss of future revenues from our carrier application services or the reduction of margins related to such revenues.

The mobile entertainment market is highly competitive.

The market for mobile entertainment services, including ringback tone and music-on-demand solutions, is highly competitive. Current and potential future competitors include major media companies, Internet portal companies, content aggregators, wireless software providers and other pure-play wireless entertainment publishers. In connection with music-on-demand in particular, we may in the future compete with current providers of music-on-demand services for online or other non-mobile platforms, some of which have greater financial resources than we do. In addition, the major music labels may demand more aggressive revenue sharing arrangements or seek an alternative business model less favorable to us. Increased competition has in the past resulted in pricing pressure, forcing us to lower the selling price of our services. If we are not as successful as our competitors in our target markets, our sales could decline, our margins could be negatively impacted and we could lose market share, any of which could materially harm our business.

Table of Contents

Our Helix open source initiative is subject to risks associated with open source technology.

Although we have invested substantial resources in the development of the underlying technology within our Helix DNA Platform and the Helix Community process, the market and industry may not accept these technologies and, therefore, we may not derive royalty or support revenue from them. Moreover, the introduction of the Helix DNA Platform open source and community source licensing schemes may adversely affect sales of our commercial system software products to mobile operators, broadband providers, corporations, government agencies, educational institutions and other business and non-business organizations.

Our patents may not improve our business prospects.

Our primary strategy with regard to patents is to use our patent portfolio to increase licensing and usage of our Helix products. We do not know whether our patents will ultimately be deemed enforceable, valid, or infringed. Accordingly, we cannot predict whether our patent strategy will be successful or will improve our financial results. Moreover, we may be forced to litigate to determine the validity and scope of our patents. Any such litigation could be costly and may not achieve the desired results.

Risks Related to Our Business in General

Our operating results are difficult to predict and may fluctuate, which may contribute to fluctuations in our stock price.

As a result of the rapidly changing markets in which we compete, our operating results may fluctuate from period-to-period. In past periods, our operating results have been affected by personnel reductions and related charges, charges relating to losses on excess office facilities, and impairment charges for certain of our equity investments. Our operating results may be adversely affected by similar or other charges or events in future periods, including, but not limited to our inability to realize SAB No. 51 gains in future periods or impairments of goodwill and other long-lived assets, any of which could cause the trading price of our stock to decline. Certain of our expense decisions (for example, research and development and sales and marketing efforts) are based on predictions regarding business and the markets in which we compete. To the extent that these predictions prove inaccurate, our revenue may not be sufficient to offset these expenditures, and our operating results may be harmed. In addition, we recently acquired the operations of WiderThan. We have limited experience managing these assets which may make it more difficult for us to accurately predict our operating results.

Our products and services must compete with the products and services of strong or dominant competitors.

Our software and services must compete with strong existing competitors and new competitors that may enter with competitive new products, services and technologies. These market conditions have in the past resulted in, and could likely continue to result in the following consequences, any of which could adversely affect our business, our operating results and the trading price of our stock:

- reduced prices, revenue and margins;
- increased expenses in responding to competitors;
- loss of current and potential customers, market share and market power;
- lengthened sales cycles;

degradation of our stature and reputation in the market;

changes in our business and distribution and marketing strategies;

changes to our products, services, technology, licenses and business practices, and other disruption of our operations;

strained relationships with partners; and

pressure to prematurely release products or product enhancements.

Many of our current and potential competitors have longer operating histories, greater name recognition, more employees and significantly greater resources than we do. Our competitors across the breadth of our product lines include a number of large and powerful companies, such as Microsoft and Apple.

Failure to develop and introduce new products and services that achieve market acceptance could result in a loss of market opportunities and negatively affect our operating results.

The process of developing new, and enhancing existing, products and services is complex, costly and uncertain. Our business depends on providing products and services that are attractive to subscribers and consumers, which, in part, is subject to unpredictable and volatile factors beyond our control, including end-user preferences and competing products and services. Any failure by us to timely respond to or accurately anticipate consumers changing needs and emerging technological trends could significantly harm our current market share or result in the loss of market opportunities. In addition, we must make long-term investments, develop or obtain appropriate intellectual property and commit significant resources before knowing whether our predictions will accurately reflect consumer demand for our products and services. Therefore, our operating results could be negatively impacted.

We are experiencing greater fluctuations in revenue due to seasonality than at any time in our past, and we expect this trend to continue.

We are increasingly experiencing seasonality in our business, particularly with respect to the fourth quarter of our fiscal year. Our music, games and media software and services businesses, which include advertising revenue, make up a large percentage of our revenue, and the fourth quarter has traditionally been the seasonally strongest quarter for internet advertising. In addition, as we have begun partnering more closely with device manufacturers for our consumer music services, we expect sales of these devices to follow typical consumer buying patterns with a majority of consumer electronics being sold in the fourth quarter. Finally, WiderThan s historical business has seen a concentration of system sales, deployments, and consulting revenue in the fourth quarter. These factors may result in increasing seasonality in our business and we cannot predict with accuracy how these factors will impact our quarterly financial results.

We depend upon our executive officers and key personnel, but may be unable to attract and retain them, which could significantly harm our business and results of operations.

Our success depends on the continued employment of certain executive officers and key employees, particularly Robert Glaser, our founder, Chairman of the Board and Chief Executive Officer. The loss of the services of Mr. Glaser or other key executive officers or employees could harm our business.

Our success is also dependent upon our ability to identify, attract and retain highly skilled management, technical, and sales personnel, both in our domestic operations and as we expand internationally. Qualified individuals are in high demand and competition for such qualified personnel in our industry is intense, and we may incur significant costs to retain or attract them. There can be no assurance that we will be able to attract and retain the key personnel necessary to sustain our business or support future growth.

Our industry is experiencing consolidation that may cause us to lose key relationships and intensify competition.

The Internet and media distribution industries are undergoing substantial change, which has resulted in increasing consolidation and formation of strategic relationships. Acquisitions or other consolidating transactions could harm us in a number of ways, including the loss of customers if competitors or users of competing technologies consolidate with our current or potential customers, or our current competitors become stronger, or new competitors emerge from consolidations. Any of these events could put us at a competitive disadvantage, which could cause us to lose customers, revenue and market share. Consolidation in our industry, or in related industries such as broadband carriers, could force us to expend greater resources to meet new or additional competitive threats, which could also harm our operating results.

Industry consolidation could also cause the loss of strategic relationships if our strategic partners are acquired by or enter into relationships with a competitor. Because we rely on strategic relationships with third parties, including relationships providing for content acquisition and distribution of our products, the loss of current strategic relationships (due to industry consolidation or otherwise), the inability to find other strategic partners, our failure to effectively manage these relationships or the failure of our existing relationships to achieve meaningful positive results could harm our business.

Acquisitions involve costs and risks that could harm our business and impair our ability to realize potential benefits from acquisitions.

As part of our business strategy, we have acquired technologies and businesses in the past and expect that we will continue to do so in the future. The failure to adequately manage the costs and address the financial, legal and operational risks raised by acquisitions of technology and businesses could harm our business and prevent us from realizing the benefits of the acquisitions.

Acquisition-related costs and financial risks related to completed and potential future acquisitions may harm our financial position, reported operating results, or stock price. Previous acquisitions have resulted in significant expenses, including amortization of purchased technology and amortization of acquired identifiable intangible assets, which are reflected in our operating expenses. New acquisitions and any potential future impairment of the value of purchased assets could have a significant negative impact on our future operating results.

Acquisitions also involve operational risks that could harm our existing operations or prevent realization of anticipated benefits from an acquisition. These operational risks include:

- difficulties and expenses in assimilating the operations, products, technology, information systems, and/or personnel of the acquired company;
- retaining key management or employees of the acquired company;
- entrance into unfamiliar markets, industry segments, or types of businesses;
- operating and integrating acquired businesses in remote locations;
- integrating and managing businesses based in countries in which we have little or no prior experience;
- diversion of management time and other resources from existing operations to integration activities for acquired businesses;
- impairment of relationships with employees, affiliates, advertisers or content providers of our business or acquired business; and
- assumption of known and unknown liabilities of the acquired company, including intellectual property claims.

We need to develop relationships and technical standards with manufacturers of non-PC media and communication devices to grow our business.

Access to the Internet through devices other than a PC, such as personal digital assistants, cellular phones, television set-top devices, game consoles, Internet appliances and portable music and games devices has increased dramatically and is expected to continue to increase. If a substantial number of alternative device manufacturers do not license and incorporate our technology and services into their devices, we may fail to capitalize on the opportunity to deliver digital media to non-PC devices which could harm our business prospects. If we do not successfully make our products and technologies compatible with emerging standards and the most popular devices used to access digital media, we may miss market opportunities and our business and results will suffer.

Our business and operating results will suffer if our systems or networks fail, become unavailable, unsecured or perform poorly so that current or potential users do not have adequate access to our products, services and websites.

Our ability to provide our products and services to our customers and operate our business depends on the continued operation of our information systems and networks. A significant or repeated reduction in the performance, reliability or availability of our information systems and network infrastructure could harm our ability to conduct our business, and harm our reputation and ability to attract and retain users, customers, advertisers and content providers. We have on occasion experienced system errors and failures that caused interruption in availability of products or content or an increase in response time. Problems with our systems and networks could result from our failure to adequately maintain and enhance these systems and networks, natural disasters and similar events, power failures, HVAC failures, intentional actions to disrupt our systems and networks and many other causes. The vulnerability of a large portion of our computer and communications infrastructure is enhanced because much of it is located at a single leased facility in Seattle, Washington, an area that is at heightened risk of earthquake, flood, and volcanic events. Many of our services do not currently have fully redundant systems or a formal disaster recovery plan, and we may not have adequate business interruption insurance to compensate us for losses that may occur from a system outage.

Our network is subject to security risks that could harm our business and reputation and expose us to litigation or liability.

Online commerce and communications depend on the ability to transmit confidential information and licensed intellectual property securely over private and public networks. Any compromise of our ability to transmit and store such information and data securely, and any costs associated with preventing or eliminating such problems, could hurt customer demand for our products, hurt our ability to distribute products and services and collect revenue, threaten the proprietary or confidential nature of our technology, harm our reputation, and expose us to litigation or liability. We also may be required to expend significant capital or other resources to alleviate problems caused by such breaches or attacks, which expenditures could adversely effect our operating results.

The growth of our business is dependent in part on successfully implementing our international expansion strategy.

A key part of our strategy is to develop localized products and services in international markets through subsidiaries, branch offices and joint ventures. If we do not successfully implement this strategy, we may not recoup our international investments and we may fail to develop or maintain worldwide market share. In addition, our recent acquisitions of Exomi, SNS, WiderThan, Zylom and Mr. Goodliving have increased our revenue from, and business exposure to, our international operations. Our international operations involve risks inherent in doing business on an international level, including difficulties in managing operations due to distance, language, and cultural differences, different or conflicting laws and regulations, taxes, and exchange rate fluctuations. Any of these factors could harm operating results and financial condition. Our foreign currency exchange risk management program reduces, but does not eliminate, the impact of currency exchange rate movements.

We may be unable to adequately protect our proprietary rights and may face risks associated with third-party claims relating to our intellectual property.

Our ability to compete partly depends on the superiority, uniqueness and value of our technology, including both internally developed technology and technology licensed from third parties. To protect our proprietary rights, we rely on a combination of patent, trademark, copyright and trade secret laws, confidentiality agreements with our employees and third parties, and protective contractual provisions. However, our efforts to protect our intellectual property rights may not assure our ownership rights in our intellectual property, protect or enhance the competitive position of our products and services or effectively prevent misappropriation of our technology. As disputes regarding the ownership of technologies and rights associated with streaming media, digital distribution, and online businesses are common and likely to arise in the future,

Table of Contents

we may be forced to litigate to enforce or defend our intellectual property rights or to determine the validity and scope of other parties proprietary rights, enter into royalty or licensing agreements on unfavorable terms or redesign our product features and services. Any such dispute would likely be costly and distract our management, and the outcome of any such dispute could harm our business.

From time to time we receive claims and inquiries from third parties alleging that our technology may infringe the third parties proprietary rights, especially patents. Third parties have also asserted and most likely will continue to assert claims against us alleging infringement of copyrights, trademark rights, trade secret rights or other proprietary rights, or alleging unfair competition or violations of privacy rights. Currently we are investigating or litigating a variety of such pending claims, some of which are described in Item 3 of this report under the heading Legal Proceedings.

We may be subject to market risk and legal liability in connection with the data collection capabilities of our products and services.

Many of our products are interactive Internet applications that by their very nature require communication between a client and server to operate. To provide better consumer experiences and to operate effectively, our products send information to our servers. Many of the services we provide also require that a user provide certain information to us. We have an extensive privacy policy concerning the collection, use and disclosure of user data involved in interactions between our client and server products. Any failure by us to comply with our posted privacy policy and existing or new legislation regarding privacy issues could impact the market for our products and services, subject us to litigation, and harm our business.

We may be subject to assessment of sales and other taxes for the sale of our products, license of technology or provision of services.

Currently we do not collect sales or other taxes on the sale of our products, license of technology, or provision of services in states and countries other than those in which we have offices or employees. Our business would be harmed if one or more states or any foreign country were to require us to collect sales or other taxes from past sales or income related to products, licenses of technology, or provision of services.

Effective July 1, 2003, we began collecting Value Added Tax, or VAT, on sales of electronically supplied services provided to European Union residents, including software products, games, data, publications, music, video and fee-based broadcasting services. There can be no assurance that the European Union will not make further modifications to the VAT collection scheme, the effects of which could require significant enhancements to our systems and increase the cost of selling our products and services into the European Union. The collection and remittance of VAT subjects us to additional currency fluctuation risks.

The Internet Tax Freedom Act, or ITFA, which Congress extended until November 2014, among other things, imposed a moratorium on discriminatory taxes on electronic commerce. The imposition by state and local governments of various taxes upon Internet commerce could create administrative burdens for us and could decrease our future sales.

We may be subject to additional income tax assessments.

We are subject to income taxes in the U.S. and numerous foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes, income taxes payable, and net deferred tax assets. In the ordinary course of business, there are many transactions and calculations where the ultimate tax determination is uncertain. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation could be materially different than that which is reflected in our historical financial statements. An audit or litigation can result in significant additional income taxes payable in the U.S. or foreign jurisdictions which could have a material adverse effect on our financial condition and results of operations.

We donate a portion of our net income to charity.

In periods where we achieve profitability, we intend to donate 5% of our annual net income to charitable organizations, which would reduce our net income for those periods.

Table of Contents

Risks Related to the Securities Markets and Ownership of Our Common Stock

Our directors and executive officers beneficially own approximately one third of our stock, which gives them significant control over certain major decisions on which our shareholders may vote, may discourage an acquisition of us, and any significant sales of stock by our officers and directors could have a negative effect on our stock price.

Our executive officers, directors and affiliated persons beneficially own more than one third of our common stock. Robert Glaser, our Chief Executive Officer and Chairman of the Board, beneficially owns the majority of that stock. As a result, our executive officers, directors and affiliated persons will have significant influence to:

- elect or defeat the election of our directors;
- amend or prevent amendment of our articles of incorporation or bylaws;
- effect or prevent a merger, sale of assets or other corporate transaction; and
- control the outcome of any other matter submitted to the shareholders for vote.

Management s stock ownership may discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of RealNetworks, which in turn could reduce our stock price or prevent our shareholders from realizing a premium over our stock price.

Provisions of our charter documents, Shareholder Rights Plan, and Washington law could discourage our acquisition by a third-party.

Our articles of incorporation provide for a strategic transaction committee of the board of directors. Without the prior approval of this committee, and subject to certain limited exceptions, the board of directors does not have the authority to:

- adopt a plan of merger;
- authorize the sale, lease, exchange or mortgage of assets representing more than 50% of the book value of our assets prior to the transaction or on which our long-term business strategy is substantially dependent;
- authorize our voluntary dissolution; or
- take any action that has the effect of any of the above.

RealNetworks has also entered into an agreement providing Mr. Glaser with certain contractual rights relating to the enforcement of our charter documents and Mr. Glaser s roles and authority within RealNetworks.

We have adopted a shareholder rights plan that provides that shares of our common stock have associated preferred stock purchase rights. The exercise of these rights would make the acquisition of RealNetworks by a third-party more expensive to that party and has the effect of discouraging third parties from acquiring RealNetworks without the approval of our board of directors, which has the power to redeem these rights and prevent their exercise.

Washington law imposes restrictions on some transactions between a corporation and certain significant shareholders. The foregoing provisions of our charter documents, shareholder rights plan, our agreement with Mr. Glaser, our zero coupon convertible subordinated notes and Washington law, as well as our charter provisions that provide for a classified board of directors and the availability of blank check preferred stock, could have the effect of making it more difficult or more expensive for a third-party to acquire, or of discouraging a third-party from attempting to acquire, control of us. These provisions may therefore have the effect of limiting the price that investors might be willing to pay in the future for our common stock.

Our stock price has been volatile in the past and may continue to be volatile.

The trading price of our common stock has been highly volatile. For example, during the 52-week period ended December 31, 2007, the price of our common stock ranged from $5.45 to $11.17 per share. Our stock price could be subject to wide fluctuations in response to factors such as actual or anticipated variations in

Table of Contents

quarterly operating results, changes in financial estimates, recommendations by securities analysts, changes in the competitive environment, as well as any of the other risk factors described above.

Financial forecasting of our operating results will be difficult because of the changing nature of our products and business, and our actual results may differ from forecasts.

As a result of the dynamic markets in which we compete, it is difficult to accurately forecast our operating results and metrics. Our inability or the inability of the financial community to accurately forecast our operating results could result in our reported net income (loss) in a given quarter to differ from expectations, which could cause a decline in the trading price of our common stock.

Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

Our corporate and administrative headquarters and certain research and development and sales and marketing personnel are located at our facility in Seattle, Washington.

We lease properties primarily in the following locations that are utilized by all of our business segments, unless otherwise noted below, to house our research and development, sales and marketing, and general and administrative personnel:

Location	Area leased (sq. feet)	Monthly rent	Lease expiration
Seattle, Washington	264,000	$ 468,000	September 2014, with an option to renew for two five-year periods
Seattle, Washington(1)	133,000	398,000	September 2010
Seoul, Republic of Korea(2)	78,000	127,000	October 2008
Reston, Virginia(2)	35,000	76,000	December 2011

(1) In 2001, we re-evaluated our facilities requirements and as a result, decided to sublet all of this office space for the remainder of the term of our lease.

(2) This facility is utilized only by our Technology Products and Solutions segment.

In addition, we lease smaller facilities with multi-year terms in the U.S. and foreign countries, some of which support the operations of all of our business segments while others are dedicated to a specific business segment. We also lease various other smaller facilities in the U.S. and foreign countries primarily for our sales and marketing personnel. A majority of these other leases are for a period of less than one year. We believe that our properties are in good condition, adequately maintained and suitable for the conduct of our business. For additional information regarding our obligations under leases, see Notes to Consolidated Financial Statements Commitments and Contingencies (Note 16).

Item 3. ***Legal Proceedings***

See Notes to Consolidated Financial Statements Commitments and Contingencies (Note 16) for information regarding legal proceedings.

Item 4. ***Submission of Matters to a Vote of Security Holders***

No matters were submitted to a vote of our shareholders during the fourth quarter of our fiscal year ended December 31, 2007.

PART II.

Item 5. ***Market for Registrant s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities***

Our common stock has been traded on the Nasdaq Stock Market LLC under the symbol RNWK since our initial public offering in November 1997. There is no assurance that any quantity of the common stock could be sold at or near reported trading prices.

The following table sets forth for the periods indicated the high and low sale prices for our common stock, as reported on the Nasdaq Stock Market LLC. These quotations represent prices between dealers and do not include retail markups, markdowns or commissions and may not necessarily represent actual transactions.

	Years Ended December 31,			
	2007		2006	
	High	Low	High	Low
First Quarter	$ 11.17	$ 7.55	$ 8.60	$ 7.20
Second Quarter	8.76	7.42	11.05	8.27
Third Quarter	8.27	5.45	11.20	9.12
Fourth Quarter	7.35	5.74	12.08	10.44

As of January 31, 2008, there were approximately 736 holders of record of our common stock. Most shares of our common stock are held by brokers and other institutions on behalf of shareholders. We have not paid any cash dividends. Payment of dividends in the future will depend on our continued earnings, financial condition and other factors.

In May 2007, our Board of Directors authorized a new share repurchase program for the repurchase of up to an aggregate of $100.0 million of our outstanding common stock. Below is a summary of share repurchases during the quarters ended September 30, 2007 and December 31, 2007. All of the repurchases in the table below were made through the Board of Directors authorized share repurchase program. No purchases were made in October 2007.

Period	Total Number of Shares Repurchased (In thousands)		Average Price Paid Per Share
7/1/2007 7/31/2007	2,100	$	7.88
8/1/2007 8/31/2007	842	$	6.43
9/1/2007 9/30/2007	1,900		6.47
11/1/2007 11/30/2007	4,400	$	6.66
12/1/2007 12/31/2007	1,180		6.21
Total	10,422	$	6.80

For further information regarding our share repurchase plan see Note 14 of Notes to Consolidated Financial Statements.

Table of Contents

Item 6. *Selected Financial Data*

The following selected consolidated financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and Notes to Consolidated Financial Statements included elsewhere in this report.

	Years Ended December 31,				
	2007	2006	2005	2004	2003
	(In thousands, except per share data)				
Consolidated Statements of Operations Data:					
Net revenue	$ 567,620	$ 395,261	$ 325,059	$ 266,719	$ 202,377
Cost of revenue	213,491	124,108	98,249	97,145	68,343
Gross profit	354,129	271,153	226,810	169,574	134,034
Operating expenses:					
Research and development	102,731	77,386	70,731	52,066	47,730
Sales and marketing	209,412	165,602	130,515	96,779	77,335
Advertising with related party	24,360				
General and administrative	67,326	57,332	50,697	31,538	21,160
Restructuring charge	3,748				
Loss on excess office facilities		738		866	7,098
Subtotal operating expenses	407,577	301,058	251,943	181,249	153,323
Antitrust litigation (benefit) expenses, net	(60,747)	(220,410)	(422,500)	11,048	1,574
Total operating expenses (benefit)	346,830	80,648	(170,557)	192,297	154,897
Operating income (loss)	7,299	190,505	397,367	(22,723)	(20,863)
Other income (expenses), net	68,472	37,248	32,176	248	(444)
Income (loss) before income taxes	75,771	227,753	429,543	(22,475)	(21,307)
Income taxes	(27,456)	(82,537)	(117,198)	(522)	(144)
Net income (loss)	$ 48,315	$ 145,216	$ 312,345	$ (22,997)	$ (21,451)
Basic net income (loss) per share	$ 0.32	$ 0.90	$ 1.84	$ (0.14)	$ (0.13)
Diluted net income (loss) per share	$ 0.29	$ 0.81	$ 1.70	$ (0.14)	$ (0.13)
Shares used to compute basic net income (loss) per share	151,665	160,973	169,986	168,907	160,309
Shares used to compute diluted net income (loss) per share	166,410	179,281	184,161	168,907	160,309

	As of December 31,				
	2007	2006	2005	2004	2003

	(In thousands)				
Consolidated Balance Sheets Data:					
Cash, cash equivalents, and short-term investments	$ 556,629	$ 678,920	$ 781,327	$ 363,621	$ 373,593
Working capital	351,066	584,125	710,804	287,599	310,679
Other intangible assets, net	107,677	105,109	7,337	8,383	1,065
Goodwill	353,153	309,122	123,330	119,217	97,477
Total assets	1,275,442	1,303,416	1,112,997	602,502	580,939
Convertible debt	100,000	100,000	100,000	100,000	100,000
Shareholders equity	875,104	969,766	841,733	380,805	366,486

Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations*

Overview

We are a leading creator of digital media services and software. Our mission is to deliver world class digital entertainment experiences - music, video or games - wherever and whenever consumers want them. Consumers use our services and software, such as Rhapsody, RealArcade, and RealPlayer to find, play, purchase, and manage free and premium digital content, including music, games, and video. Broadcasters, cable and wireless communication companies, media companies and enterprises, such as AT&T and Verizon in the U.S., Vodafone in Europe, and SK Telecom in Korea, use our digital media applications and services to create, secure and deliver digital media to PCs, mobile phones, portable music players and other consumer electronics devices and to provide entertainment services to their subscribers.

Our strategy is to continue to (1) develop technology that provides meaningful differentiation to our chosen markets in digital entertainment services; (2) build a direct relationship with, and grow, our worldwide user base; and (3) create strong business partnerships with device makers, media companies, service providers and other distribution channels in order to build a sustainable and profitable global business. We intend to continue to expand our products and services beyond the PC to mobile devices and to create compelling digital media experiences on a variety of entertainment devices. We also intend to use our strong cash position to continue to seek acquisition opportunities to further our strategic initiatives and to enhance our competitive position.

In the year ended December 31, 2007, we recorded the highest total annual revenue in our history due to the inclusion of the operating results from our acquisitions, primarily WiderThan which we acquired in October 2006, and also due to significant growth in revenue from our Music and Consumer segments. The growth in our consumer businesses, as compared with 2006, was driven primarily by increased revenue from our Games and Music businesses. This growth was partially offset by a decline in revenue in our Media Software and Services business from 2006 to 2007, due primarily to a decline in revenue from our SuperPass subscription service.

In recent years, we have focused our efforts on growing our consumer businesses through both internal initiatives and strategic acquisitions of businesses and technologies. We have also increased our focus on free-to-consumer products and services, such as our Rhapsody.com website, and our introduction of downloadable games containing in-game advertising. These products and services generate advertising revenue and are also designed to increase the exposure of our paid digital music and games products and services to consumers. As a result, combined revenue in our Music and Consumer segments grew 12% and 15% during the years ended December 31, 2007 and 2006, respectively.

Revenue in 2007 from our Technology Products and Solutions segment grew significantly compared with 2006, increasing by 185%. This increase was driven primarily by our acquisitions of WiderThan in October 2006 and Sony NetServices GmbH (SNS) and Exomi Oy (Exomi) during the second quarter of 2007. WiderThan delivers integrated digital entertainment solutions to communications service providers worldwide. WiderThan s applications, content, and services enable wireless carriers to provide a broad range of mobile entertainment to their subscribers, including ringback tones, music-on-demand, mobile games, ringtones, messaging, and information services.

On October 1, 2007, we acquired all of the outstanding securities of Game Trust, Inc. (Game Trust), a provider of scalable and secure infrastructures for community and commerce applications in online casual games. We believe that combining Game Trust s assets and technology with our existing business will enhance our casual game offerings in our existing markets.

On August 20, 2007, we and MTV Networks, a division of Viacom International Inc. (MTVN), created Rhapsody America to jointly own and operate a business-to-consumer digital audio music service. The Rhapsody America music service is a subscription and advertising-supported service that offers a combination of permanent downloads, conditional downloads and on demand streaming services. The elements necessary to create, build, operate and grow the Rhapsody America music service were contributed, licensed to, or provided as services to Rhapsody America by each of MTVN and us, through a series of commercial agreements.

Rhapsody America will operate primarily in the United States, although the parties are not precluded from expanding the territory in the future by mutual agreement.

On June 8, 2007, we acquired all of the outstanding securities of Exomi, a provider of short message service (SMS) messaging and wireless application protocol gateway products and services with customers primarily in Europe and Latin America. We believe that combining Exomi s assets and network with our products and services will enhance our presence in the Latin American market.

On May 15, 2007, we acquired all of the outstanding securities of SNS, a provider of comprehensive white label digital music services to mobile operators in Europe. We believe that combining SNS assets and technology with our existing business will enhance our digital music offerings in the European market.

On October 31, 2006, we acquired 99.7% of the outstanding common shares and American Depository Shares of WiderThan Co. Ltd. (WiderThan), a leading provider of ringback tones, music-on-demand and other mobile entertainment services to wireless carriers. We acquired substantially all of the remaining 0.3% of the outstanding common shares and American Depository Shares of WiderThan during the quarter ended June 30, 2007. The acquisition further enhanced our strategy of providing end-to-end digital media solutions to partners including music, casual games and video services.

On January 31, 2006, we acquired all of the outstanding securities of Zylom Media Group B.V. (Zylom), a distributor, developer, and publisher of PC-based games in Europe. We believe that combining Zylom s assets and distribution network with our downloadable PC-based games assets and distribution platform will enhance our presence in the European games market.

In October 2005, we entered into an agreement to settle all of our antitrust disputes worldwide with Microsoft. Upon settlement of the legal disputes, we also entered into two commercial agreements with Microsoft that provide for collaboration in digital music and casual games. Pursuant to these commercial agreements we received payments and other consideration of $478.0 million in 2005, $221.9 million in 2006 and $61.1 million in 2007 for a total of $761.0 million. As of December 31, 2007, we have received all the proceeds and other consideration from this settlement.

We manage our business, and correspondingly report segment revenue and profit (loss), based on three segments: Music, Consumer and Technology Products and Solutions, each of which is described further below under Revenue by Segment and Costs of Revenue by Segment.

Table of Contents

The following table sets forth certain financial data for the periods indicated as a percentage of total net revenue:

	Years Ended December 31, 2007	2006	2005
Net revenue	100.0%	100.0%	100.0%
Cost of revenue	37.6	31.4	30.2
Gross profit	62.4	68.6	69.8
Operating expenses:			
Research and development	18.1	19.6	21.8
Sales and marketing	36.9	41.9	40.2
Advertising with related party	4.3		
General and administrative	11.9	14.5	15.6
Restructuring charge	0.6		
Loss on excess office facilities		0.2	
Subtotal operating expenses	71.8	76.2	77.6
Antitrust litigation benefit, net	(10.7)	(55.8)	(130.0)
Total operating expenses (benefit)	61.1	20.4	(52.4)
Operating income	1.3	48.2	122.2
Other income, net	12.0	9.4	9.9
Income before income taxes	13.3	57.6	132.1
Income taxes	(4.8)	(20.9)	(36.1)
Net income	8.5%	36.7%	96.0%

Critical Accounting Policies and Estimates

The preparation of our financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. Our critical accounting policies and estimates are as follows:

Revenue recognition;

Estimating music publishing rights and music royalty accruals;

Recoverability of deferred costs;

Estimating allowances for doubtful accounts and sales returns;

Estimating losses on excess office facilities;

Determining whether declines in the fair value of investments are other-than-temporary and estimating fair market value of investments in privately held companies;

Valuation of other intangible assets;

Valuation of goodwill;

Stock-based compensation;

Minority interest;

Accounting for gains on sale of subsidiary stock; and

Accounting for income taxes.

Revenue Recognition. We recognize revenue in accordance with the following authoritative literature: AICPA Statement of Position (SOP) No. 97-2, *Software Revenue Recognition;* SOP No. 98-9, *Software Revenue Recognition with Respect to Certain Arrangements*; SOP No. 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*; Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition in Financial Statements*; Financial Accounting Standards Board s Emerging Issues Task Force (EITF) Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables;* and EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*. Generally we recognize revenue when there is persuasive evidence of an arrangement, the fee is fixed or determinable, the product or services have been delivered and collectability of the resulting receivable is reasonably assured.

Consumer subscription products are paid in advance, typically for monthly, quarterly or annual periods. Subscription revenue is recognized ratably over the related subscription period. Revenue from sales of downloaded individual music tracks, albums and games are recognized at the time the music or game is made available, digitally, to the end user.

We recognize revenue under the residual method for multiple element software arrangements when vendor-specific objective evidence (VSOE) exists for all of the undelivered elements of the arrangement, but does not exist for one or more of the delivered elements in the arrangement, under SOP No. 97-2. Under the residual method, at the outset of the arrangement with a customer, we defer revenue for the fair value of the arrangement s undelivered elements such as Post Contract Support (PCS), and recognize revenue for the remainder of the arrangement fee attributable to the elements initially delivered, such as software licenses. VSOE for PCS is established on standard products for which no installation or customization is required based upon amount charged when PCS is sold separately. For multiple element software arrangements involving significant production, modification, or customization of the software, which are accounted for in accordance with the provisions of SOP No. 81-1, VSOE for PCS is established if customers have an optional renewal rate specified in the arrangement and the rate is substantive.

We have arrangements whereby customers pay one price for multiple products and services and in some cases, involve a combination of products and services. For arrangements with multiple deliverables, revenue is recognized upon the delivery of the individual deliverables in accordance with EITF Issue No. 00-21. In the event that there is no objective and reliable evidence of fair value of the delivered items, the revenue recognized upon delivery is the total arrangement consideration less the fair value of the undelivered items. We apply significant judgment in establishing the fair value of multiple elements within revenue arrangements.

We recognize revenue on a gross or net basis in accordance with EITF Issue No. 99-19. In many arrangements, we contract directly with end user customers, are the primary obligor and carry all collectability risk. In such arrangements we report the revenue on a gross basis. In some cases, we utilize third-party distributors to sell products or services directly to end user customers and carry no collectability risk. In such instances we report the revenue on a net basis.

Revenue generated from advertising appearing on our websites and from advertising included in our products is recognized as revenue as the delivery of the advertising occurs.

Music Publishing Rights and Music Royalty Accruals. We must make estimates of amounts owed related to our music publishing rights and music royalties for our domestic and international music services. Material differences may result in the amount and timing of our expense for any period if management made different judgments or utilized different estimates. Under copyright law, we may be required to pay licensing fees for digital sound recordings and compositions we deliver. Copyright law generally does not specify the rate and terms of the licenses, which are determined by voluntary negotiations among the parties or, for certain compulsory licenses where voluntary negotiations are unsuccessful, by arbitration. There are certain geographies and agencies for which we have not yet completed negotiations with regard to the royalty rate to be applied to the current or historic sales of our digital music offerings. Our estimates are based on contracted or statutory rates, when established, or management s best estimates based on facts and circumstances regarding the specific music services and agreements in similar geographies or with similar agencies. While we base our estimates on historical experience and on various other assumptions that management believes to be reasonable under the circumstances, actual results may differ materially from these estimates under different assumptions or conditions.

Recoverability of Deferred Costs. We defer costs on projects for service revenue and system sales. Deferred costs consist primarily of direct and incremental costs to customize and install systems, as defined in individual customer contracts, including costs to acquire hardware and software from third parties and payroll costs for our employees and other third parties.

We recognize such costs in accordance with our revenue recognition policy by contract. For revenue recognized under the completed contract method, costs are deferred until the products are delivered, or upon completion of services or, where applicable, customer acceptance. For revenue recognized under the percentage of completion method, costs are recognized as products are delivered or services are provided in accordance with the percentage of completion calculation. For revenue recognized ratably over the term of the contract, costs are recognized ratably over the term of the contract, commencing on the date of revenue recognition. At each balance sheet date, we review deferred costs, to ensure they are ultimately recoverable. Any anticipated losses on uncompleted contracts are recognized when evidence indicates the estimated total cost of a contract exceeds its estimated total revenue.

Allowances for Doubtful Accounts and Sales Returns. We must make estimates of the uncollectability of our accounts receivable. We specifically analyze the age of accounts receivable and historical bad debts, customer credit-worthiness and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. Similarly, we must make estimates of potential future product returns related to current period revenue. We analyze historical returns, current economic trends, and changes in customer demand and acceptance of our products when evaluating the adequacy of the sales returns allowance. Significant judgments and estimates must be made and used in connection with establishing allowances for doubtful accounts and sales returns in any accounting period. Material differences may result in the amount and timing of our revenue for any period if we were to make different judgments or utilize different estimates.

Accrued Loss on Excess Office Facilities. We made significant estimates in determining the appropriate amount of accrued loss on excess office facilities. If we made different estimates, our loss on excess office facilities could be significantly different from that recorded, which could have a material impact on our operating results. Our original estimate has been revised in previous periods in response to changes in market conditions for commercial real estate in the area where the excess office facilities are located, or to reflect negotiated changes in sublease rates charged to occupying tenants.

Impairment of Investments. We periodically evaluate whether any declines in the fair value of our investments are other-than-temporary. Significant judgments and estimates must be made to assess whether an other-than-temporary decline in fair value of investments has occurred and to estimate the fair value of investments in privately held companies. Material differences may result in the amount and timing of any impairment charge if we were to make different judgments or utilize different estimates.

Valuation of Other Intangible Assets. Other intangible assets consist primarily of fair value of customer agreements and contracts, developed technology, trademarks, patents, and tradenames acquired in business combinations. Other intangible assets are amortized on a straight line basis over their useful lives and are subject to periodic review for impairment. The initial recording and periodic review processes require extensive use of estimates and assumptions, including estimates of future cash flows expected to be generated by the acquired assets. Should conditions be different than management s current assessment, material write-downs of intangible assets may be required. We periodically review the estimated remaining useful lives of other intangible assets. A reduction in the estimated remaining useful life could result in accelerated amortization expense in future periods.

Valuation of Goodwill. We assess the impairment of goodwill on an annual basis, in our fourth quarter, or whenever events or changes in circumstances indicate that the fair value of the reporting unit to which goodwill relates is less than the carrying value. Factors we consider important that could trigger an impairment review include the following:

- poor economic performance relative to historical or projected future operating results;

significant negative industry, economic or company specific trends;

changes in the manner of our use of the assets or the plans for our business; and

loss of key personnel.

If we were to determine that the fair value of a reporting unit was less than its carrying value, including goodwill, based upon the annual test or the existence of one or more of the above indicators of impairment, we would measure impairment based on a comparison of the implied fair value of reporting unit goodwill with the carrying amount of goodwill. The implied fair value of goodwill is determined by allocating the fair value of a reporting unit to its assets (recognized and unrecognized) and liabilities in a manner similar to a purchase price allocation. The residual fair value after this allocation is the implied fair value of the goodwill of the reporting unit. To the extent the carrying amount of reporting unit goodwill is greater than the implied fair value of reporting unit goodwill, we would record an impairment charge for the difference. Judgment is required in determining our reporting units and assessing fair value of the reporting units. There were no impairments related to goodwill in any of the periods presented in this report.

Stock-Based Compensation. We account for stock-based compensation in accordance with Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment*. Under the provisions of SFAS No. 123R, which we adopted as of January 1, 2006, stock-based compensation cost is estimated at the grant date based on the award s fair-value as calculated by the Black-Scholes option-pricing model and is recognized as expense over the requisite service period, which is the vesting period. The Black-Scholes model requires various highly judgmental assumptions including volatility in our common stock price and expected option life. If any of the assumptions used in the Black-Scholes model change significantly, stock-based compensation expense may differ materially in the future from the amounts recorded in our consolidated statement of operations. We are required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. Prior to the adoption of SFAS No. 123R, we measured compensation expense for our employee stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*. Under APB No. 25, when the exercise price of our employee stock options was equal to the market price of the underlying stock on the date of the grant, no compensation expense was recognized.

Minority Interests. The Company records minority interest expense (benefit) which reflects the portion of the earnings (losses) of majority-owned entities which are applicable to the minority interest partners in accordance with Accounting Research Bulletin No. 51, *Consolidated Financial Statements* (ARB No. 51). Redeemable minority interests that are redeemable at either fair value or are based on a formula that is intended to approximate fair value are accounted for in accordance with ARB No. 51. As of December 31, 2007, the Company s minority interests solely related to redeemable minority interests in Rhapsody America. Minority interest expense (benefit) is included in the consolidated statement of operations and comprehensive income for 2007.

Accounting for Gains on Sale of Subsidiary Stock. We account for any changes in our ownership interest resulting from the issuance of equity capital by consolidated subsidiaries as either a gain or loss in the statement of operations pursuant to SAB No. 51 *Accounting for the Sales of Stock of a Subsidiary*. SAB No. 51 requires that the difference between the carrying amount of the parent s investment in a subsidiary and the underlying net book value of the subsidiary after the issuance of stock by the subsidiary be reflected as either a gain or loss in the statement of operations if the appropriate recognition criteria has been met or reflected as an equity transaction. We have elected to reflect SAB No. 51 gains or losses in our consolidated statement of operations and comprehensive income.

Accounting for Income Taxes. We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax basis of assets and liabilities and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities and operating loss and tax credit carryforwards are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences and operating loss and tax credit carryforwards are expected to be recovered or settled. We must make assumptions, judgments and estimates to determine current provision for income taxes, deferred tax assets and liabilities and any valuation allowance to be recorded against deferred tax assets. Our judgments, assumptions, and estimates relative to the current provision for income tax take into account current tax laws, our interpretation of current tax laws and possible outcomes of future audits conducted by foreign and domestic tax authorities. Changes in tax law or our interpretation of tax laws and future tax audits could significantly impact the amounts provided for income taxes in our consolidated financial statements.

Each reporting period we must periodically assess the likelihood that our deferred tax assets will be recovered from future taxable income, and to the extent that recovery is not more likely than not, a valuation allowance must be established. The establishment of a valuation allowance and increases to such an allowance result in either increases to income tax expense or reduction of income tax benefit in the statement of operations and comprehensive income. Factors we consider in making such an assessment include, but are not limited to: past performance and our expectation of future taxable income, macroeconomic conditions and issues facing our industry, existing contracts, our ability to project future results and any appreciation of our investments and other assets.

We have not provided for U.S. deferred income taxes or withholding taxes on non-U.S. subsidiaries undistributed earnings. These earnings are intended to be permanently reinvested in operations outside of the U.S. If these amounts were distributed to the U.S., in the form of dividends or otherwise, we could be subject to additional U.S. income taxes. It is not practicable to determine the U.S. federal income tax liability or benefit on such earnings due to the availability of foreign tax credits and the complexity of the computation if such earnings were not deemed to be permanently reinvested.

Balance at January 1, 2007	$	7.5
Increases/(Decreases) related to prior year tax positions		
Increases/(Decreases) related to current year tax positions		1.5
Settlements		
Expiration of the statute of limitations		
Balance at December 31, 2007	$	9.0

We file numerous consolidated and separate income tax returns in the United States Federal, state, local, and foreign jurisdictions. With few exceptions, we are no longer subject to United States Federal, state, local, or foreign income tax examinations for years before 1993. However, the Company has been notified by the I.R.S. that WiderThan Americas, Inc. (WTA), a wholly owned subsidiary of the Company, was selected for a federal audit for the period ending December 31, 2005. The audit is expected to begin in 2008.

Revenue by Segment

Revenue by segment is as follows (dollars in thousands):

		2007	Change		2006	Change		2005
Music	$	149,126	21%	$	123,033	21%	$	101,769

Consumer	211,851	6	199,739	12	178,195
Technology products and solutions	206,643	185	72,489	61	45,095
Total net revenue	$ 567,620	44%	$ 395,261	22%	$ 325,059

Revenue by segment as a percentage of total net revenue is as follows:

	2007	2006	2005
Music	26%	31%	31%
Consumer	37	51	55
Technology products and solutions	37	18	14
Total net revenue	100%	100%	100%

Music. Music revenue primarily includes revenue from: our Rhapsody and RadioPass subscription services; sales of digital music content through our Rhapsody service and our RealPlayer music store; and advertising from our music websites. These products and services are sold and provided primarily through the Internet and we charge customers credit cards at the time of sale. Subscription services billings typically occur monthly, quarterly or annually, depending on the service purchased.

Music revenue increased 21% during the year ended December 31, 2007 compared with the year ended December 31, 2006 due primarily to growth in subscription revenue from our subscription-based music products which accounted for 86% of this increase. Music revenue increased 21% during the year ended December 31, 2006 compared with the year ended December 31, 2005 due primarily to growth in subscription revenue from our subscription-based music products which accounted for 73% of this increase.

Consumer. Consumer revenue primarily includes revenue from: digital media subscription services such as GamePass, FunPass, SuperPass and stand-alone subscriptions; sales and distribution of third-party software and services; sales of game downloads; sales of premium versions of our RealPlayer and related products; and advertising, excluding Music advertising. These products and services are sold and provided primarily through the Internet and we charge customers credit cards at the time of sale. Billings for subscription services typically occur monthly, quarterly or annually, depending on the service purchased.

Consumer revenue increased 6% during the year ended December 31, 2007 compared with the year ended December 31, 2006 due primarily to increased sales of our Games products offset by decreases in our SuperPass revenue. Additional factors contributing to the change in revenue are discussed below in the section entitled Consumer Revenue . We believe the growth in Games was due in part to the continued shift in our marketing and promotional efforts for these services as well as product improvements and increasing consumer acceptance and adoption of digital media products and services.

Consumer revenue increased 12% during the year ended December 31, 2006 compared with the year ended December 31, 2005 due primarily to increased sales of our Games products. Detailed factors contributing to the change in revenue are discussed below in the section entitled Consumer Revenue.

Technology Products and Solutions. Technology Products and Solutions revenue is derived from products and services that enable wireless carriers, cable companies, and other media and communications companies to distribute digital media content to PCs, mobile phones and other non-PC devices. Technology Products and Solutions that we sell as application services consist of ringback tones, music-on-demand, video-on-demand and inter-carrier messaging, and are primarily sold to wireless carriers. Technology Products and Solutions that we sell as software consist of Helix system software and related authoring and publishing tools, digital rights management technology, messaging gateways, and support and maintenance services that we sell to customers. We also offer broadcast hosting and consulting services to our customers. These products and services are primarily sold to corporate, government and educational customers. We do not require collateral from our customers, but we often require payment before or at the time products and services are delivered. Many of our customers are given standard commercial credit terms, and for these customers we do not require payment before products and services are delivered.

Technology Products and Solutions revenue increased 185% during the year ended December 31, 2007 compared with the year ended December 31, 2006 due primarily to our acquisitions of WiderThan (acquired in October 2006), SNS (acquired in May 2007), and Exomi (acquired in June 2007). Technology Products and Solutions revenue increased 61% during the year ended December 31, 2006 compared with the year ended December 31, 2005 due primarily to our acquisition of WiderThan during the fourth quarter of 2006.

Consumer Revenue

A further analysis of our Consumer revenue is as follows (dollars in thousands):

	2007	Change	2006	Change	2005
Media software and services	$ 103,348	(9)%	$ 113,503	(7)%	$ 121,918
Games	108,503	26	86,236	53	56,277
Total consumer products and services revenue	$ 211,851	6%	$ 199,739	12%	$ 178,195

Media Software and Services. Media Software and Services revenue primarily includes revenue from: our SuperPass and stand-alone premium video subscription services; RealPlayer Plus and related products; sales and distribution of third-party software products; and all advertising other than that related directly to our Music and Games businesses.

Media Software and Services revenue decreased 9% during the year ended December 31, 2007 compared with the year ended December 31, 2006 due primarily to a decline in revenue from the SuperPass subscription service accounting for 92% of this revenue decrease. This decrease was due primarily to a shift in our marketing and promotional efforts towards our Music and Games businesses, which we believe represent a greater growth opportunity for us. Media Software and Services revenue decreased 7% during the year ended December 31, 2006 compared with the year ended December 31, 2005 due primarily to a decline in revenue from the SuperPass subscription service and other stand-alone subscriptions, which accounted for 83% of the revenue decrease. No other single factor contributed materially to these changes during these periods.

Games. Games revenue primarily includes revenue from: the sale of individual games through our RealArcade service and our games related websites including GameHouse and Zylom (acquired in January 2006); our GamePass subscription service; advertising through RealArcade and our games related websites; and sales of games through wireless carriers.

Games revenue increased 26% during the year ended December 31, 2007 compared with the year ended December 31, 2006 due primarily to increased advertising, syndication and subscription revenue generated through our RealArcade service and our websites, including Zylom and GameHouse. Advertising, syndication and subscription revenue together accounted for substantially all of this increase. Additionally, we believe the increased focus of our marketing efforts on our Games business and the addition of new game titles to our RealArcade and GamePass offerings contributed to the growth in our Games business. Games revenue increased 53% during the year ended December 31, 2006 compared with the year ended December 31, 2005 due primarily to increased sales of individual games through our RealArcade, Zylom, and GameHouse services and growth in the number of subscribers to our GamePass and FunPass subscription services. These factors accounted for 66% of the revenue increase in 2006. No other single factor contributed materially to these changes during these periods.

Geographic Revenue

Revenue by region is as follows (dollars in thousands):

	2007	Change	2006	Change	2005

United States	$ 360,676	27%	$ 283,433	13%	$ 249,855
Europe	84,368	35	62,270	39	44,867
Republic of Korea	82,549	344	18,597	n/a	
Rest of the World	40,027	29	30,961	2	30,337
Total	$ 567,620	44%	$ 395,261	22%	$ 325,059

Revenue generated in the U.S. increased 27% and 13%, respectively, in 2007 and 2006 due primarily to the growth of our Music and Games businesses. See Revenue by Segment above for further discussion of these changes.

Table of Contents

Revenue generated in Europe increased 35% and 39%, respectively, in 2007 and 2006 due primarily to the growth of our Games and Technology Products and Solutions businesses driven primarily by additional revenue from our Zylom, Exomi and SNS product offerings subsequent to their acquisition in 2006 and 2007, respectively. This increase was partially offset by a decrease in revenue from our SuperPass subscription service in Europe. See Revenue by Segment above for further discussion of these changes.

Revenue generated in the Republic of Korea and in the Rest of the World increased due primarily to our acquisition of WiderThan in October 2006. The increase in the Republic of Korea and Rest of the World revenue for 2007 was partially offset by a decrease in revenue from our SuperPass subscription service due to a decrease in subscribers.

At December 31, 2007 and 2006, accounts receivable from one international customer accounted for 19% and 25% of trade accounts receivable, respectively. The increase in international accounts receivable as a percentage of trade accounts receivables primarily resulted from the acquisition of WiderThan.

The functional currency of our foreign subsidiaries is the local currency of the country in which the subsidiary operates. We currently manage a portion of our foreign currency exposures through the use of foreign currency exchange forward contracts. Our foreign currency exchange risk management program reduces, but does not eliminate, the impact of currency exchange rate movements. We currently do not hedge a portion of our foreign currency exposures and therefore are subject to the risk of changes in exchange rates. The gross margins on domestic and international revenue are substantially the same.

License and Service Revenue

In accordance with SEC regulations, we also present our revenue based on License fees and Service revenue as set forth below (dollars in thousands):

	2007	Change	2006	Change	2005
License fees	$ 92,718	2%	$ 90,684	12%	$ 80,785
Service revenue	474,902	56	304,577	25	244,274
Total net revenue	$ 567,620	44%	$ 395,261	22%	$ 325,059

License fees and Service revenue as a percentage of total revenue is as follows:

	2007	2006	2005
License fees	16%	23%	25%
Service revenue	84	77	75
Total net revenue	100%	100%	100%

License Fees. License fees primarily include revenue from: sales of content such as game licenses and digital music tracks; sales of our media delivery system software; sales of premium versions of our RealPlayer Plus and related products; sales of messaging gateways to mobile carriers; and sales of third-party products. License fees include revenue from all of our reporting segments.

License fee revenue increased 2% in 2007 due primarily to an increase in revenue from the sale of individual games through our RealArcade service and our websites, including Zylom and GameHouse. The increase in license fees revenue was partially offset by a decrease in sales of individual music tracks through our Rhapsody music subscription service and our RealPlayer Music Store. No other single factor contributed materially to these changes during these periods. See Revenue by Segment above for further discussion of these changes.

License fee revenue increased 12% in 2006 due primarily to an increase in revenue from the sale of individual games through our RealArcade service and our websites, including Zylom (acquired in January 2006). In addition, license fee revenue increased due to the sale of individual games for mobile phones, primarily through our Mr. Goodliving (acquired in May 2005) product offerings and the online sale of individual music tracks through our Rhapsody music subscription service and our RealPlayer Music Store. The increase in license fees revenue was partially offset by a decrease in sales of our system software. No other single factor contributed materially to these changes during these periods. See Revenue by Segment above for further discussion of these changes.

Service Revenue. Service revenue primarily includes revenue from: digital media subscription services such as SuperPass, Rhapsody, RadioPass, GamePass, FunPass and stand-alone subscriptions; sales of application services sold to wireless carriers to deliver ringback tones, music-on-demand, video-on-demand, messaging, and information services to wireless carriers customers; support and maintenance services that we sell to customers who purchase our software products; broadcast hosting and consulting services that we offer to our customers; distribution of third-party software; and advertising. Service revenue includes revenue from all of our reporting segments.

Service revenue increased 56% and 25%, respectively, in 2007 and 2006 due primarily to an increase in revenue from the increase in the number of subscribers, as well as price per subscription, to certain of our music and games subscription services, advertising through our web properties, consulting services provided to certain of our corporate customers, inclusion of revenue from WiderThan (acquired in October 2006), and distribution of third-party products. These increases were partially offset by a decrease in revenue related to a decrease in the number of subscribers to our SuperPass subscription service and decreased sales of certain stand-alone subscription services. No other single factor contributed materially to these changes during these periods. See Revenue by Segment above for further discussion of these changes.

Deferred Revenue

Deferred revenue is comprised of unrecognized revenue related to unearned subscription services, support contracts, and other prepayments for which the earnings process has not been completed. Total deferred revenue at December 31, 2007 was $42.2 million compared with $27.6 million at December 31, 2006. Substantially all of the increase in deferred revenue was due to prepayments from wireless carriers for applications to deliver ringback tone, music-on-demand, and video-on-demand services.

Cost of Revenue by Segment

Cost of revenue by segment is as follows (dollars in thousands):

	2007
Music	$ 81,462
Consumer	39,840
Technology products and solutions	92,189
Total cost of revenue	$ 213,491

Cost of revenue as a percentage of segment revenue is as follows:

	2007
Music	55%
Consumer	19

Technology products and solutions	45
Total cost of revenue	38

Cost of Music. Cost of Music revenue consists primarily of cost of content and delivery of the content included in our music subscription service offerings; royalties paid on sales and streams of music; hardware devices and accessories; and fees paid to third-party vendors for order fulfillment and support services.

Cost of Consumer. Cost of Consumer revenue consist primarily of cost of content and delivery of the content included in our digital media subscription service offerings; amortization of acquired technology, royalties paid on sales of games and other third-party products; amounts paid for licensed technology; costs of product media, duplication, manuals and packaging materials; and fees paid to third-party vendors for order fulfillment and support services.

Cost of Technology Products and Solutions. Cost of Technology Products and Solutions revenue includes amounts paid for licensed technology, amortization of acquired technology, costs of product media, duplication, manuals, packaging materials, fees paid to service carriers and third-party vendors for order fulfillment, cost of personnel providing support and consulting services, and expenses incurred in providing our streaming media hosting services.

We have not provided comparative results for the years ended December 31, 2006 and 2005 for cost of revenue by segment as we changed our allocation methodology in the third quarter of 2007 to accommodate the formation of Rhapsody America. We were able to use the new allocation methodology for amounts incurred since January 1, 2007, however we do not have the data available to perform the allocation of amounts incurred prior to January 1, 2007. We deemed it impracticable to perform the allocation under the old method for the current period to provide comparative information due to the complexity of the calculations required. However, we plan to provide comparative data in future periods with the corresponding period in 2007.

Cost of License Fees and Service Revenue

In accordance with SEC regulations, we also present our cost of revenue based on license fees and service revenue as set forth below (dollars in thousands).

	2007	Change	2006	Change	2005
License fees	$ 34,927	(6)%	$ 37,089	10%	$ 33,770
Service revenue	178,564	105	87,019	35	64,479
Total cost of revenue	$ 213,491	72%	$ 124,108	26%	$ 98,249
As a percentage of total net revenue	38%		31%		30%

Cost of revenue as a percentage of related revenue is as follows:

	2007	2006	2005
License fees	37%	41%	42%
Service revenue	38	29	26
Total cost of revenue	38	31	30

Cost of License Fees. Cost of license fees includes royalties paid on sales of games, music and other third-party products, amounts paid for licensed technology, amortization of acquired technology, costs of product media, duplication, manuals, packaging materials, and fees paid to third-party vendors for order fulfillment. Cost of license fees decreased 6% in 2007 primarily due to the decrease in online sales of individual songs through our Rhapsody subscription service and our RealPlayer Music Store. Decreases in these costs accounted for 69% of the decline. No other single factor contributed materially to the change.

Cost of license fees increased 10% in the year ended December 31, 2006, due primarily to an increase in revenue and associated licensing costs related to games licensing. These increases were partially offset by a decrease in the amortization of other intangible assets related to the acquisition of GameHouse as these other intangibles are now fully amortized. The increase in games licensing offset by the intangibles amortization accounted for substantially all the of the net increase. No other single factor contributed materially to these changes during these periods.

Cost of Service Revenue. Cost of service revenue includes the cost of content and delivery of the content included in our digital media subscription and mobile service offerings, cost of in-house and contract personnel providing support, amortization of acquired technology, and consulting services, royalties, and expenses incurred in providing our streaming media hosting services. Content costs are expensed over the period the content is available to our subscription services customers. Cost of service revenue increased 105% in the year ended December 31, 2007, due primarily to: (1) the costs of service revenue related to the acquisition of WiderThan; and (2) increased content costs related to our digital music subscription services. Costs related to the development and delivery of application services sold to wireless carriers accounted for

70% of the increase in cost of service revenue, and costs related to the delivery of streaming music accounted for 16% of the increase in total cost of service.

Cost of service revenue increased 35% in the year ended December 31, 2006, due primarily to: (1) the costs of service revenue related to the acquisition of WiderThan; and (2) increased content costs related to our digital music subscription services. The increase in costs was partly offset by: (1) the discontinuation of certain content offerings related to our SuperPass subscription service; and (2) a decrease in sales and the discontinuation of certain stand-alone subscription services. Costs related to the development and delivery of application services sold to wireless carriers accounted for 59% of the increase in cost of service revenue, and costs related to the delivery of streaming music accounted for 36% of the increase in total cost of service.

Other segment and geographical information

Operating expenses of our Music, Consumer and Technology Products and Solutions segments include costs directly attributable to those segments and an allocation of general and administrative and other corporate overhead costs. In conjunction with the formation of Rhapsody America in August of 2007, we changed the method in which corporate overhead and general and administrative costs are allocated. We were able to use the new allocation methodology for amounts incurred since January 1, 2007. However, we do not have data available to perform the allocation of amounts incurred prior to January 1, 2007. Therefore comparative data from 2006 and 2005 is not presented.

Reconciliation of segment operating income (loss) to income (loss) before income taxes for the year ended December 31, 2007 is as follows (in thousands):

	Music	Consumer	Technology Products and Solutions	Reconciling Amounts	Consolidated
Net revenue	$ 149,126	$ 211,851	$ 206,643	$	$ 567,620
Cost of revenue	81,462	39,840	92,189		213,491
Gross profit	67,664	172,011	114,454		354,129
Advertising with related party	24,360				24,360
Restructuring charge				3,748	3,748
Other operating expenses	103,482	142,749	130,551	(58,060)	318,722
Operating income (loss)	(60,178)	29,262	(16,097)	54,312	7,299
Other income, net	36,194			32,278	68,472
Income (loss) before income taxes	$ (23,984)	$ 29,262	$ (16,097)	$ 86,590	$ 75,771

Operating Expenses

Research and Development

Research and development expenses consist primarily of salaries and related personnel costs, expense associated with stock-based compensation, and consulting fees associated with product development. To date, all research and development costs have been expensed as incurred because technological feasibility for software products is generally not established until substantially all development is complete. Research and developments costs and year-over-year changes are as follows (dollars in thousands):

	2007	Change	2006	Change	2005
Research and development	$ 102,731	33%	$ 77,386	9%	$ 70,731
As a percentage of total net revenue	18%		20%		22%

Research and development expenses, including non-cash stock-based compensation, increased 33% in 2007. The inclusion of a full year of expenses from WiderThan (acquired in the fourth quarter of 2006) and increased consulting expenses year over year accounted for approximately 90% of the total increase. The decrease in research and development expenses as a percentage of total net revenue from 20% in 2006 to 18%

in 2007 is due primarily to a higher growth in total net revenue. No other single factor contributed materially to these changes during these periods.

Substantially all the 9% increase in research and development expenses in 2006 were due primarily to: (1) personnel and related costs due to the inclusion of WiderThan; and (2) inclusion of stock-based compensation related to the adoption of SFAS No. 123R. The decrease in research and development expenses as a percentage of total net revenue from 22% in 2005 to 20% in 2006 is due primarily to a higher growth in total net revenue. No other single factor contributed materially to these changes during these periods.

Sales and Marketing

Sales and marketing expenses consist primarily of salaries and related personnel costs, sales commissions, amortization of certain intangible assets capitalized in our acquisitions, credit card fees, subscriber acquisition costs, consulting fees, trade show expenses, advertising costs and costs of marketing collateral. Sales and marketing costs and year-over-year changes are as follows (dollars in thousands):

	2007	Change	2006	Change	2005
Sales and marketing	$ 209,412	26%	$ 165,602	27%	$ 130,515
As a percentage of total net revenue	37%		42%		40%

Sales and marketing expenses increased 26% in 2007. The inclusion of a full year of expenses of WiderThan and other payroll related expenses accounted for approximately 81% of this increase. The decrease in sales and marketing expenses as a percentage of total net revenue from 42% in 2006 to 37% in 2007 is due primarily to a higher growth in total net revenue. No other single factor contributed materially to these changes during these periods.

Sales and marketing expenses increased in 2006 in dollars and as a percentage of total net revenue due primarily to an increase in: (1) personnel and related costs due to the inclusion of WiderThan; (2) inclusion of stock-based compensation related to the adoption of SFAS No. 123R; (3) amortization of certain other intangible assets capitalized in our acquisitions during 2006, primarily WiderThan; and (4) our ongoing direct marketing programs to promote our products and services. These factors accounted for approximately 70% of the overall increase in the expense. No other single factor contributed materially to these changes during these periods.

Advertising with Related Party

Rhapsody America spent $24.4 million in advertising with MTVN during the year ended December 31, 2007. MTVN owns 49% of Rhapsody America. No such amounts were spent during the years ended December 31, 2006 and 2005.

General and Administrative

General and administrative expenses consist primarily of salaries and related personnel costs, fees for professional and temporary services and contractor costs, stock-based compensation, and other general corporate costs. General and administrative costs and year-over-year changes are as follows (dollars in thousands):

	2007	Change	2006	Change	2005

General and administrative	$ 67,326	17%	$ 57,332	13%	$ 50,697
As a percentage of total net revenue	12%		15%		16%

General and administrative expenses, including non-cash stock-based compensation, increased 17% in 2007. The inclusion of a full year of expenses from WiderThan and an increase in other payroll related expenses offset by a decrease in charitable donations in the year accounted for approximately 92% of the overall increase. The decrease in general and administrative expenses as a percentage of total net revenue from 15% in 2006 to 12% in 2007 is primarily due to a higher growth in total net revenue. No other single factor contributed materially to these changes during these periods.

Table of Contents

General and administrative expenses, including non-cash stock-based compensation, increased 13% in 2006 due primarily to: (1) inclusion of stock-based compensation related to the adoption of SFAS No. 123R; (2) increase in overall compensation expense due to the inclusion of WiderThan; and (3) an increase in legal and professional fees. These increases were partially offset by a decrease in our donation to the RealNetworks Foundation, based on 5% of our net income. These net increases accounted for substantially all of the change in 2006. The decrease in general and administrative expenses as a percentage of total net revenue from 16% in 2005 to 15% in 2006 is primarily due to a higher growth in total net revenue. No other single factor contributed materially to these changes during these periods.

Restructuring Charges

During the quarter ended December 31, 2007, we recorded a restructuring charge of $3.7 million, primarily related to severance. These charges were a result of workforce reductions and other realized synergies among our recent acquisitions. Severance charges accounted for the majority of the $3.7 million recorded. No such amounts were incurred during the years ended December 31, 2006 and 2005.

Loss on Excess Office Facilities

The accrued loss of $10.7 million for estimated future losses on excess office facilities located near our corporate headquarters in Seattle Washington at December 31, 2007, is shown net of expected future sublease income of $6.8 million, which was committed under sublease contracts at the time of the estimate. We regularly evaluate the market for office space in the cities where we have operations. If the market for such space declines further in future periods, we may have to revise our estimates further, which may result in additional losses on excess office facilities.

Antitrust Litigation Benefit, net

Antitrust litigation benefit, net of $60.7 million, $220.4 million, and $422.5 million for the years ended December 31, 2007, 2006, and 2005, respectively, consist of settlement income, legal fees, personnel costs, communications, equipment, technology and other professional services costs incurred directly attributable to our antitrust case against Microsoft, as well as our participation in various international antitrust proceedings against Microsoft, including the European Union. On October 11, 2005, we entered into a settlement agreement with Microsoft pursuant to which we agreed to settle all antitrust disputes worldwide with Microsoft, including the U.S. litigation. The 2007, 2006 and 2005 antitrust litigation benefit, net reflects the impact of $61.1 million, $221.9 million and $478.0 million, respectively, in payments and other consideration received from Microsoft under the settlement and commercial agreements with Microsoft. At December 31, 2007, all amounts due from Microsoft under the settlement agreement have been received. See Notes to Consolidated Financial Statements Commitments and Contingencies (Note 16) for a description of this action.

Other Income, Net

Other income, net consists primarily of: interest income on our cash, cash equivalents and short-term investments, which are net of interest expense from amortization of offering costs related to our convertible debt; gain related to the sale of certain of our equity investments; equity in net (income) loss of investments; minority interest in Rhapsody America; gain from the sales of interest in Rhapsody America; and impairment of certain equity investments. Other income, net and year-over-year changes are as follows (dollars in thousands):

	2007	Change	2006	Change	2005
Interest income, net	$ 30,874	(18)%	$ 37,622	159%	$ 14,511
Gain on sale of equity investments	98	(96)	2,286	(88)	19,330
Equity in net income (loss) of investments	(440)	(235)	326	(131)	(1,068)
Impairment of equity investments		(100)	(3,116)	1,071	(266)
Minority interest in Rhapsody America	19,784	n/a		n/a	
Gain on sale of interest in Rhapsody America	16,410	n/a		n/a	
Other income (expenses)	1,746	1,243	130	(139)	(331)
Other income, net	$ 68,472	84%	$ 37,248	16%	$ 32,176

Other income, net increased during 2007 primarily due to: (1) minority interest in the net loss in Rhapsody America; and (2) gain related to the sale of our interest in Rhapsody America. The increase was partially offset by a decrease in interest income due to lower effective interest rates on our investment balances and an overall decrease in our investment balances.

Other income, net increased during 2006 due primarily to an increase in interest income due to higher effective interest rates on our investment balances and an overall increase in our investment balances which was offset by reduced gains on sales of equity investments. The sales of our interests in MusicNet and J-Stream accounted for substantially all of the 2005 balance of gains on sale of equity investments. The overall increase in other income, net, was also partially offset by an impairment charge related to an equity investment in a privately held company during the fourth quarter of 2006.

Income Taxes

During the years ended December 31, 2007, 2006, and 2005, we recognized income tax expense of $27.5 million, $82.5 million, and $117.2 million, respectively, related to U.S. and foreign income taxes. We must assess the likelihood that our deferred tax assets will be recovered from future taxable income. In making this assessment, all available evidence must be considered including the current economic climate, our expectations of future taxable income, our ability to project such income, and the appreciation of our investments and other assets. As of December 31, 2007, we continue to have a valuation allowance of $39.7 million relating primarily to net operating losses that are restricted under Internal Revenue Code Section 382 that may expire unused, losses not yet realized for tax purposes on certain equity investments, and foreign losses which may not be utilized. As of December 31, 2006, we had a valuation allowance of $35.2 million relating primarily to net operating losses that are restricted under Internal Revenue Code Section 382, and losses not yet realized for tax purposes on certain equity investments.

Recently Issued Accounting Standards

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. In November 2007, the FASB provided a one year deferral for the implementation of FAS 157 for other nonfinancial assets and liabilities. We are currently assessing the impact of SFAS No. 157 on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which provides companies with an option to report selected financial assets and liabilities at fair value. The objective of SFAS No. 159 is to reduce both the complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently.

SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We are currently assessing the impact of SFAS No. 159 on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations* (SFAS 141R), which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. The requirements of SFAS 141R are effective for periods beginning after December 15, 2008. We are in the process of evaluating this guidance and therefore has not yet determined the impact that SFAS 141R will have on our financial position or results of operations upon adoption.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interest in Consolidated Financial Statements*, an amendment of ARB No. 51 (SFAS 160), which will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity within the consolidated balance sheets. The requirements of SFAS 160 are effective for periods beginning after December 15, 2008. We are in the process of evaluating this guidance and therefore have not yet determined the impact that SFAS 160 will have on our financial position or results of operations upon adoption.

Liquidity and Capital Resources

The following summarizes working capital, cash, cash equivalents, trading securities, short-term investments, and restricted cash (in thousands):

	December 31,	
	2007	**2006**
Working capital	$ 351,066	$ 584,125
Cash, cash equivalents, and short-term investments	556,629	678,920
Restricted cash	15,509	17,300

Working capital decreased primarily due to the use of $178.8 million for the repurchase of our common stock offset by cash generated from operations. Restricted cash declined by $1.8 million due to a change in the contractual terms of the related letter of credit.

The following summarizes cash flows (in thousands):

	Years Ended December 31,		
	2007	**2006**	**2005**
Cash provided by operating activities	$ 68,409	$ 170,920	$ 460,753
Cash (used in) provided by investing activities	467	(294,065)	6,989
Cash used in financing activities	(113,620)	(4,764)	(34,608)

Net cash provided by operating activities in 2007 resulted primarily from net income and decreases in accounts receivable, prepaids and other assets of $32.8 million which were partially offset by decreases in accrued and other liabilities of $33.1 million. Net cash provided by operating activities in 2006 resulted primarily from net income, which was partially offset by increases in accounts receivable, prepaids and other assets of $11.0 million and decreases in accrued and other liabilities of $19.8 million. Net cash provided by operating activities in 2005 resulted primarily from net income and decreases of accrued and other liabilities of $56.0 million.

Net cash provided by our investing activities was $0.5 million and $7.0 million in 2007 and 2005, respectively. Net cash used in our investing activities in 2006 was $294.1 million. Net cash provided by investing activities in 2007 was due primarily to net sales and purchases of short-term investments, which was offset by purchases of equipment and cash used in our acquisitions of SNS, Exomi and Game Trust. Net cash used in investing activities in 2006 was primarily due to net sales and purchases of short-term investments and proceeds from the sale of certain equity investments, as well as cash used in our acquisitions of Zylom and WiderThan for $257.8 million, net of cash received, and purchases of equipment and intangible assets of

$13.8 million. Net cash provided by investing activities in 2005 was due primarily to net sales and purchases of short-term investments and proceeds from the sale of certain equity investments, which was offset by purchases of equipment and intangible assets and cash used in acquisitions.

Net cash used in financing activities was $113.6 million, $4.8 million and $34.6 million in 2007, 2006 and 2005, respectively. Net cash used in financing activities in 2007, 2006 and 2005 was due primarily to the repurchase of common stock, which was partially offset by the net proceeds from the exercise of stock options and issuance of stock under our employee stock purchase plan. Net cash used in 2007 was also partially offset by $48.7 million of net proceeds from sales of interest in Rhapsody America. Use of cash in 2006 was also partially offset by the excess tax benefit from stock option exercises of $39.2 million due to the adoption of SFAS No. 123R.

Our Board of Directors has authorized share repurchase programs for the repurchase of our outstanding common stock, and all repurchases have been made pursuant to these authorized programs. During 2005, we repurchased 8.6 million shares for an aggregate value of $54.3 million at an average cost of $6.29 per share. During 2006, we purchased 11.8 million shares for an aggregate value of $98.9 million at an average cost of $8.35 per share. During 2007, we repurchased 23.8 million shares for an aggregate value of $178.8 million at an average cost of $7.52 per share. The purchases made through December 31, 2007 completed the authorized amount for all of the repurchase programs.

We currently have no planned significant capital expenditures for 2008 other than those in the ordinary course of business. In the future, we may seek to raise additional funds through public or private equity financing, or through other sources such as credit facilities. The sale of additional equity securities could result in dilution to our shareholders. In addition, in the future, we may enter into cash or stock acquisition transactions or other strategic transactions that could reduce cash available to fund our operations or result in dilution to shareholders.

Our principal commitments include office leases and contractual payments due to content and other service providers. We believe that our current cash, cash equivalents, and short-term investments will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next 12 months.

We do not hold derivative financial instruments or equity securities in our short-term investment portfolio. Our cash equivalents and short-term investments consist of high quality securities, as specified in our investment policy guidelines. The policy limits the amount of credit exposure to any one non-U.S. Government or non-U.S. Agency issue or issuer to a maximum of 5% of the total portfolio. These securities are subject to interest rate risk and will decrease in value if interest rates increase. Because we have historically had the ability to hold our fixed income investments until maturity, we do not expect our operating results or cash flows to be significantly affected by a sudden change in market interest rates in our securities portfolio.

We conduct our operations in ten primary functional currencies: the U.S. dollar, the Korean won, the Japanese yen, the British pound, the Euro, the Mexican peso, the Brazilian real, the Australian dollar, the Hong Kong dollar, and the Singapore dollar. Historically, neither fluctuations in foreign exchange rates nor changes in foreign economic conditions have had a significant impact on our financial condition or results of operations. We currently do not hedge the majority of our foreign currency exposures and are therefore subject to the risk of exchange rate fluctuations. We invoice our international customers primarily in U.S. dollars, except in Korea, Japan, Germany, France, the United Kingdom and Australia, where we invoice our customers primarily in won, yen, euros, pounds, and Australian dollars, respectively. We are exposed to foreign exchange rate fluctuations as the financial results of foreign subsidiaries are translated into U.S. dollars in consolidation. Our exposure to foreign exchange rate fluctuations also arises from intercompany payables and receivables to and from our foreign subsidiaries. Foreign exchange rate fluctuations did not have a material impact on our financial results in 2007, 2006, and 2005.

At December 31, 2007, we had commitments to make the following payments:

Contractual Obligations	Total	Less than 1 Year	1-3 Years	3-5 Years	After 5 Years
			(In thousands)		
Office leases	$ 65,520	$ 15,101	$ 26,038	$ 14,620	$ 9,761
Convertible debt	Up to 100,000	Up to 100,000			
Other contractual obligations	20,420	11,182	9,238		
Total contractual cash obligations	Up to $ 185,940	Up to $ 126,283	$ 35,276	$ 14,620	$ 9,761

The terms and conditions of the convertible debt are described more fully in Note 13. Other contractual obligations primarily relate to minimum contractual payments due to content and other service providers.

In addition to the amounts shown in the table above, $9.0 million of unrecognized tax benefits have been recorded as liabilities in accordance with FIN 48, and we are uncertain as to if or when such amounts may be settled. We cannot make a reasonably reliable estimate of the amount and period of related future payments for such liability.

We have a commitment to purchase $205 million over the next five years from MTVN related to the Rhapsody America venture. The $205 million is excluded from the table above as the timing and amount of these payments will vary.

Off Balance Sheet Arrangements

Our only significant off-balance sheet arrangements relate to operating lease obligations for office facility leases and other contractual obligations related primarily to minimum contractual payments due to content and other service providers. Future annual minimum rental lease payments and other contractual obligations are included in the commitment schedule above.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

The following discussion about our market risk involves forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements.

Interest Rate Risk. Our exposure to interest rate risk from changes in market interest rates relates primarily to our short-term investment portfolio. We do not hold derivative financial instruments or equity investments in our short-term investment portfolio. Our short-term investments consist of high quality debt securities as specified in our investment policy. Investments in both fixed and floating rate instruments carry a degree of interest rate risk. The fair value of fixed rate securities may be adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Additionally, a declining rate environment creates reinvestment risk because as securities mature the proceeds are reinvested at a lower rate, generating less interest income. Due in part to these factors, our future interest income may be adversely impacted due to changes in interest rates. In addition, we may incur losses in principal if we are forced to sell securities that have declined in market value due to changes in interest rates. Because we have historically had the ability to hold our short-term investments until maturity and the substantial majority of our short-term investments mature within one year of purchase, we would not expect our operating results or cash flows to be significantly impacted by a sudden change in market interest rates. There have been no material changes in our investment methodology regarding our cash equivalents and short-term investments during the year ended December 31, 2007. Based on our cash, cash equivalents, short-term investments, and restricted cash equivalents at December 31, 2007, a hypothetical 10% increase/decrease in interest rates would increase/decrease our annual interest income and cash flows by approximately $2.0 million.

Table of Contents

The table below presents the amounts related to weighted average interest rates and contractual maturities of our short-term investment portfolio at December 31, 2007 (dollars in thousands):

	Weighted Average Interest Rate	Expected Maturity Dates 2008	2009	2010 - 2012	Amortized Cost	Estimated Fair Value
Short-term investments:						
Corporate notes and bonds	5.24%	$ 19,509	$ 2,260	$ 20,802	$ 43,552	$ 42,571
U.S. Government agency securities	4.71%	37,361			37,296	37,361
Total short-term investments	4.94%	$ 56,870	$ 2,260	$ 20,802	$ 80,848	$ 79,932

The table below presents the amounts related to weighted average interest rates and contractual maturities of our short-term investment portfolio at December 31, 2006 (dollars in thousands):

	Weighted Average Interest Rate	Expected Maturity Dates 2007	2008	Amortized Cost	Estimated Fair Value
Short-term investments:					
U.S. Government agency securities	3.34%	$ 120,945	$ 32,743	$ 153,520	$ 153,688
Total short-term investments	3.34%	$ 120,945	$ 32,743	$ 153,520	$ 153,688

Investment Risk. As of December 31, 2007, we had investments in voting capital stock of both publicly traded and privately-held technology companies for business and strategic purposes. Our investments in publicly traded companies are accounted for as available-for-sale, carried at current market value and are classified as long-term as they are strategic in nature. We periodically evaluate whether any declines in fair value of our investments are other-than-temporary based on a review of qualitative and quantitative factors. For investments with publicly quoted market prices, these factors include the time period and extent by which its accounting basis exceeds its quoted market price. We consider additional factors to determine whether declines in fair value are other-than-temporary, such as the investee s financial condition, results of operations, and operating trends. The evaluation also considers publicly available information regarding the investee companies. For investments in private companies with no quoted market price, we consider similar qualitative and quantitative factors as well as the implied value from any recent rounds of financing completed by the investee. Based upon an evaluation of the facts and circumstances during 2006, we determined that an other-than-temporary decline in fair value had occurred in one of our privately-held investments resulting in an impairment charge of $3.1 million to reflect changes in the fair value. Based upon an evaluation of the facts and circumstances during 2005, we determined that an other-than-temporary decline in fair value had occurred in one of our privately-held investments resulting in an impairment charge of $266,000 to reflect changes in the fair value. Based upon an evaluation of the facts and circumstances during 2007, we determined that no additional other-than-temporary decline in fair value had occurred and therefore no impairment charges were recorded.

Foreign Currency Risk. We conduct business internationally in several currencies. As such, we are exposed to adverse movements in foreign currency exchange rates.

Our exposure to foreign exchange rate fluctuations arise in part from: (1) translation of the financial results of foreign subsidiaries into U.S. dollars in consolidation; (2) the re-measurement of non-functional currency assets, liabilities and intercompany balances into U.S. dollars for financial reporting purposes; and (3) non-U.S. dollar denominated sales to foreign customers. A portion of these risks is managed through the use of financial derivatives, but fluctuations could impact our results of operations and financial position.

Generally, our practice is to manage foreign currency risk for the majority of material short-term intercompany balances through the use of foreign currency forward contracts. These contracts require us to exchange currencies at rates agreed upon at the contract s inception. Because the impact of movements in currency exchange rates on forward contracts offsets the related impact on the short-term intercompany balances, these financial instruments help alleviate the risk that might otherwise result from certain changes in currency exchange rates. We do not designate our foreign exchange forward contracts related to short-term intercompany accounts as hedges and, accordingly, we adjust these instruments to fair value through results of operations. However, we may periodically hedge a portion of our foreign exchange exposures associated with material firmly committed transactions, long-term investments, highly predictable anticipated exposures and net investments in foreign subsidiaries.

Our foreign currency risk management program reduces, but does not entirely eliminate, the impact of currency exchange rate movements.

Historically, neither fluctuations in foreign exchange rates nor changes in foreign economic conditions have had a significant impact on our financial condition or results of operations. Foreign exchange rate fluctuations did not have a material impact on our financial results for the years ended December 31, 2007, 2006, and 2005.

Table of Contents

Item 8. ***Financial Statements and Supplementary Data***

REALNETWORKS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2007	December 31, 2006
	(In thousands, except per share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 476,697	$ 525,232
Short-term investments	79,932	153,688
Trade accounts receivable, net of allowances for doubtful accounts and sales returns of $2,455 in 2007 and $2,490 in 2006	84,674	65,751
Deferred costs, current portion	6,408	1,643
Deferred tax assets, net, current portion		891
Prepaid expenses and other current assets	33,845	21,990
Total current assets	681,556	769,195
Equipment, software, and leasehold improvements, at cost:		
Equipment and software	109,621	83,587
Leasehold improvements	30,632	29,665
Total equipment, software, and leasehold improvements	140,253	113,252
Less accumulated depreciation and amortization	83,756	65,509
Net equipment, software, and leasehold improvements	56,497	47,743
Restricted cash equivalents	15,509	17,300
Equity investments	9,976	22,649
Other assets	10,161	5,148
Deferred tax assets, net, non-current portion	40,913	27,150
Other intangible assets, net of accumulated amortization of $41,579 in 2007 and $16,637 in 2006	107,677	105,109
Goodwill	353,153	309,122
Total assets	$ 1,275,442	$ 1,303,416
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 56,160	$ 52,097
Accrued and other liabilities	114,136	104,328
Deferred revenue, current portion	39,564	24,137
Related party payable	17,241	

Convertible debt, current portion	100,000	
Accrued loss on excess office facilities, current portion	3,389	4,508
Total current liabilities	330,490	185,070
Deferred revenue, non-current portion	2,663	3,440
Accrued loss on excess office facilities, non-current portion	7,311	9,993
Deferred rent	4,518	4,331
Deferred tax liabilities, net, non-current portion	22,060	27,076
Convertible debt, non-current portion		100,000
Other long-term liabilities	13,683	3,740
Total liabilities	380,725	333,650
Minority interest in Rhapsody America ($59.9 million redemption value at December 31, 2007)	19,613	
Commitments and contingencies		
Shareholders equity:		
Preferred stock, $0.001 par value, no shares issued and outstanding Series A: authorized 200 shares		
Undesignated series: authorized 59,800 shares		
Common stock, $0.001 par value authorized 1,000,000 shares; issued and outstanding 142,298 shares in 2007 and 163,278 shares in 2006	142	162
Additional paid-in capital	653,904	791,108
Deferred stock-based compensation		
Accumulated other comprehensive income	17,732	23,485
Retained earnings	203,326	155,011
Total shareholders equity	875,104	969,766
Total liabilities and shareholders equity	$ 1,275,442	$ 1,303,416

See accompanying notes to consolidated financial statements.

Table of Contents

REALNETWORKS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

	Years Ended December 31,		
	2007	2006	2005
	(In thousands, except per share data)		
Net revenue(A)	$ 567,620	$ 395,261	$ 325,059
Cost of revenue(B)	213,491	124,108	98,249
Gross profit	354,129	271,153	226,810
Operating expenses:			
Research and development	102,731	77,386	70,731
Sales and marketing	209,412	165,602	130,515
Advertising with related party	24,360		
General and administrative	67,326	57,332	50,697
Restructuring charge	3,748		
Loss on excess office facilities		738	
Subtotal operating expenses	407,577	301,058	251,943
Antitrust litigation benefit, net	(60,747)	(220,410)	(422,500)
Total operating expenses (benefit)	346,830	80,648	(170,557)
Operating income	7,299	190,505	397,367
Other income (expenses):			
Interest income, net	30,874	37,622	14,511
Gain on sale of equity investments	98	2,286	19,330
Equity in net income (loss) of investments	(440)	326	(1,068)
Minority interest in Rhapsody America	19,784		
Gain on sale of interest in Rhapsody America	16,410		
Impairment of equity investments		(3,116)	(266)
Other income (expenses)	1,746	130	(331)
Other income, net	68,472	37,248	32,176
Income before income taxes	75,771	227,753	429,543
Income taxes	(27,456)	(82,537)	(117,198)
Net income	$ 48,315	$ 145,216	$ 312,345
Basic net income per share	$ 0.32	$ 0.90	$ 1.84
Diluted net income per share	$ 0.29	$ 0.81	$ 1.70
Shares used to compute basic net income per share	151,665	160,973	169,986
Shares used to compute diluted net income per share	166,410	179,281	184,161

Comprehensive income:			
Net income	$ 48,315	$ 145,216	$ 312,345
Unrealized gain (loss) on investments:			
Unrealized holding (losses) gains, net of tax	(8,482)	(14,399)	17,864
Adjustments for gains reclassified to net income			(4,052)
Foreign currency translation gains (losses)	2,729	11,160	(1,677)
Comprehensive income	$ 42,562	$ 141,977	$ 324,480
(A)Components of net revenue:			
License fees	$ 92,718	$ 90,684	$ 80,785
Service revenue	474,902	304,577	244,274
	$ 567,620	$ 395,261	$ 325,059
(B)Components of cost of revenue:			
License fees	$ 34,927	$ 37,089	$ 33,770
Service revenue	178,564	87,019	64,479
	$ 213,491	$ 124,108	$ 98,249

See accompanying notes to consolidated financial statements.

Table of Contents

REALNETWORKS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2007	2006	2005
	(In thousands)		
Cash flows from operating activities:			
Net income	$ 48,315	$ 145,216	$ 312,345
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	45,225	20,980	16,243
Stock-based compensation	23,918	18,151	128
Changes in deferred income taxes	(9,549)	54,986	107,208
Impairment of equity investments		3,116	266
Loss on disposal of property, software, and leasehold improvements	302	276	
Excess tax benefit from stock option exercises	(562)	(39,183)	
Accrued loss on excess office facilities	(3,801)	(3,515)	(6,244)
Gain on sale of equity investments	(98)	(2,286)	(19,330)
Purchases of trading securities	(270,000)		
Sales and maturities of trading securities	270,000		
Equity in net (income) loss of investments	440	(326)	1,068
Minority Interest	(19,784)		
Gain on sale of interest in Rhapsody America	(16,410)		
Accrued loss on content agreement			(2,917)
Other	95	97	804
Changes in certain assets and liabilities, net of acquisitions:			
Trade accounts receivable	(13,083)	(7,962)	(1,479)
Prepaid expenses and other assets	(19,710)	(3,126)	(3,409)
Accounts payable	(1,329)	4,276	44
Accrued and other liabilities	34,440	(19,780)	56,026
Net cash provided by operating activities	68,409	170,920	460,753
Cash flows from investing activities:			
Purchases of equipment, software, and leasehold improvements	(26,658)	(13,808)	(13,782)
Purchases of short-term investments	(133,427)	(204,841)	(153,491)
Sales and maturities of short-term investments	207,183	180,973	168,358
Purchases of intangible and other assets	(2,796)		(1,125)
Decrease in restricted cash equivalents	1,805		2,851
Proceeds from sale of equity investments	1,615	2,286	19,530
Purchases of equity investments	(1,656)	(834)	(647)
Cash used in acquisitions, net of cash acquired	(45,599)	(257,841)	(14,705)
Net cash (used in) provided by investing activities	467	(294,065)	6,989
Cash flows from financing activities:			

Net proceeds from sales of common stock under employee stock purchase plan and exercise of stock options	15,894	54,929	20,361
Repayment of long-term note payable			(648)
Net proceeds from sales of interest in Rhapsody America	48,716		
Excess tax benefit from stock option exercises	562	39,183	
Repurchase of common stock	(178,792)	(98,876)	(54,321)
Net cash used in financing activities	(113,620)	(4,764)	(34,608)
Effect of exchange rate changes on cash	(3,791)	1,170	(589)
Net (decrease) increase in cash and cash equivalents	(48,535)	(126,739)	432,545
Cash and cash equivalents, beginning of year	525,232	651,971	219,426
Cash and cash equivalents, end of year	$ 476,697	$ 525,232	$ 651,971
Supplemental disclosure of cash flow information:			
Cash paid during the year for income taxes	$ 36,615	$ 16,487	$ 149
Supplemental disclosure of non-cash investing and financing activities:			
Accrued acquisition consideration	$	$ 2,000	$
Payable for repurchase of common stock	$	$	$ 5,116

See accompanying notes to consolidated financial statements.

Table of Contents

REALNETWORKS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Notes Receivable from Shareholders	Deferred Stock-Based Compensation	Accumulated Other Comprehensive Income	Retained Earnings (Deficit)	Total Shareholders Equity
	(In thousands)							
Balances, December 31, 2004	170,626	$ 171	$ 668,752	$ (10)	$ (147)	$ 14,589	$ (302,550)	$ 380,805
Common stock issued for exercise of stock options and employee stock purchase plan	4,056	3	20,358					20,361
Common shares repurchased	(8,642)	(8)	(54,313)					(54,321)
Notes receivable retired	(18)		(26)	10				(16)
Amortization of deferred stock compensation					128			128
Shares issued for director payments	15		91					91
Unrealized gain on investments, net of income tax						17,864		17,864
Adjustments for gains reclassified to net income						(4,052)		(4,052)
Translation adjustment						(1,677)		(1,677)
Net deferred tax adjustment			170,205					170,205
Net income							312,345	312,345
Balances, December 31, 2005	166,037	166	805,067		(19)	26,724	9,795	841,733
Common stock issued for exercise of stock options and employee stock purchase plan	9,067	8	54,921					54,929
Common shares repurchased	(11,836)	(12)	(98,864)					(98,876)
Shares issued for director payments	10		97					97
Stock-based compensation			18,132		19			18,151
Unrealized loss on investments, net of income tax						(14,399)		(14,399)

Translation adjustment					11,160		11,160
Tax benefit from stock option exercises			11,755				11,755
Net income						145,216	145,216
Balances, December 31, 2006	163,278	162	791,108		23,485	155,011	969,766
Common stock issued for exercise of stock options, employee stock purchase plan, and vesting of restricted shares	2,747	3	15,868				