

REALNETWORKS INC  
Form 10-Q  
November 06, 2014

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

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended September 30, 2014

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 0-23137

RealNetworks, Inc.  
(Exact name of registrant as specified in its charter)

Washington 91-1628146  
(State of incorporation) (I.R.S. Employer Identification Number)

1501 First Avenue South, Suite 600 98134  
Seattle, Washington  
(Address of principal executive offices) (Zip Code)

(206) 674-2700  
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

The number of shares of the registrant's Common Stock outstanding as of October 31, 2014 was 36,034,025.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## REALNETWORKS, INC. AND SUBSIDIARIES

## UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	September 30, 2014	December 31, 2013
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 114,073	\$ 151,235
Short-term investments	63,948	74,920
Trade accounts receivable, net of allowances	17,679	24,613
Deferred costs, current portion	1,023	1,601
Deferred tax assets, net, current portion	296	306
Prepaid expenses and other current assets	8,382	9,124
Total current assets	205,401	261,799
Equipment, software, and leasehold improvements, at cost:		
Equipment and software	83,230	86,721
Leasehold improvements	3,616	3,482
Total equipment, software, and leasehold improvements, at cost	86,846	90,203
Less accumulated depreciation and amortization	68,392	67,031
Net equipment, software, and leasehold improvements	18,454	23,172
Restricted cash equivalents and investments	3,000	3,000
Equity method investment	10,000	12,473
Available for sale securities	2,848	7,181
Other assets	2,925	2,332
Deferred costs, non-current portion	913	946
Deferred tax assets, net, non-current portion	1,424	1,409
Other intangible assets, net	10,954	12,993
Goodwill	17,615	17,476
Total assets	\$ 273,534	\$ 342,781
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 18,155	\$ 19,987
Accrued and other current liabilities	25,885	41,893
Deferred tax liabilities, net, current portion	768	899
Deferred revenue, current portion	6,908	7,498
Total current liabilities	51,716	70,277
Deferred revenue, non-current portion	143	166
Deferred rent	1,293	1,318
Deferred tax liabilities, net, non-current portion	1,805	1,556
Other long-term liabilities	563	483
Total liabilities	55,520	73,800
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	—	—
	36	36

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Common stock, \$0.001 par value authorized 250,000 shares; issued and outstanding 36,034 shares in 2014 and 35,833 shares in 2013			
Additional paid-in capital	616,260	610,167	
Accumulated other comprehensive loss	(53,778)	(47,695)	)
Retained deficit	(344,504)	(293,527)	)
Total shareholders' equity	218,014	268,981	
Total liabilities and shareholders' equity	\$273,534	\$342,781	
See accompanying notes to unaudited condensed consolidated financial statements.			

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REALNETWORKS, INC. AND SUBSIDIARIES  
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 AND COMPREHENSIVE INCOME (LOSS)

(In thousands, except per share data)

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Net revenue (A)	\$34,157	\$48,958	\$120,706	\$155,601
Cost of revenue (B)	18,928	18,990	58,500	59,015
Extinguishment of liability (See Note 10)	—	—	(10,580)	—
Gross profit	15,229	29,968	72,786	96,586
Operating expenses:				
Research and development	12,784	15,707	40,110	45,951
Sales and marketing	13,283	19,427	51,022	59,830
General and administrative	7,723	9,869	25,617	28,506
Restructuring and other charges	2,048	1,877	3,805	4,075
Lease exit and related charges	154	—	703	3,066
Loss on legal settlements	—	11,525	—	11,525
Total operating expenses	35,992	58,405	121,257	152,953
Operating income (loss)	(20,763)	(28,437)	(48,471)	(56,367)
Other income (expenses):				
Interest income, net	80	166	396	992
Gain (loss) on sale of available for sale securities, net	—	—	2,371	—
Equity in net loss of Rhapsody investment	(1,530)	(2,629)	(4,170)	(6,209)
Other income (expense), net	325	(118)	153	(146)
Total other income (expenses), net	(1,125)	(2,581)	(1,250)	(5,363)
Income (loss) before income taxes	(21,888)	(31,018)	(49,721)	(61,730)
Income tax expense (benefit)	290	357	1,256	(210)
Net income (loss)	\$(22,178)	\$(31,375)	\$(50,977)	\$(61,520)
Basic net income (loss) per share	\$(0.62)	\$(0.88)	\$(1.42)	\$(1.73)
Diluted net income (loss) per share	\$(0.62)	\$(0.88)	\$(1.42)	\$(1.73)
Shares used to compute basic net income (loss) per share	36,003	35,670	35,912	35,490
Shares used to compute diluted net income (loss) per share	36,003	35,670	35,912	35,490
Comprehensive income (loss):				
Unrealized investment holding gains (losses), net of reclassification adjustments	\$(323)	\$(1,043)	\$(3,936)	\$(28)
Foreign currency translation adjustments, net of reclassification adjustments	(2,338)	1,235	(2,147)	(391)
Total other comprehensive income (loss)	(2,661)	192	(6,083)	(419)
Net income (loss)	(22,178)	(31,375)	(50,977)	(61,520)
Comprehensive income (loss)	\$(24,839)	\$(31,183)	\$(57,060)	\$(61,939)
(A) Components of net revenue:				
License fees	\$5,925	\$10,503	\$21,168	\$33,494
Service revenue	28,232	38,455	99,538	122,107
	\$34,157	\$48,958	\$120,706	\$155,601
(B) Components of cost of revenue:				
License fees	\$2,044	\$2,062	\$6,426	\$6,377
Service revenue	16,884	16,928	52,074	52,638
	\$18,928	\$18,990	\$58,500	\$59,015

See accompanying notes to unaudited condensed consolidated financial statements.

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REALNETWORKS, INC. AND SUBSIDIARIES  
 UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (In thousands)

	Nine Months Ended September 30,	
	2014	2013
Cash flows from operating activities:		
Net income (loss)	\$(50,977	) \$(61,520
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	8,876	15,045
Stock-based compensation	4,158	5,671
Equity in net loss of Rhapsody	4,170	6,209
Deferred income taxes, net	(64	) (1,238
Gain on sale of available for sale securities	(2,371	) —
Realized translation gain	(48	) (35
Extinguishment of liability	(10,580	) —
Other	—	51
Net change in certain operating assets and liabilities:		
Trade accounts receivable	6,553	6,466
Prepaid expenses and other assets	1,353	4,772
Accounts payable	(1,606	) 26
Accrued and other liabilities	(5,106	) (3,750
Net cash provided by (used in) operating activities	(45,642	) (28,303
Cash flows from investing activities:		
Purchases of equipment, software, and leasehold improvements	(2,054	) (5,798
Proceeds from sale of available for sale securities	2,754	—
Purchases of short-term investments	(63,574	) (85,670
Proceeds from sales and maturities of short-term investments	74,546	110,359
Decrease (increase) in restricted cash equivalents and investments, net	—	5,000
Acquisitions of businesses, net of cash acquired	(733	) (22,480
Other	(467	) —
Net cash provided by (used in) investing activities	10,472	1,411
Cash flows from financing activities:		
Proceeds from issuance of common stock (stock options and stock purchase plan)	641	408
Tax payments from shares withheld upon vesting of restricted stock	(403	) (911
Payment of contingent consideration	(696	) (828
Net cash provided by (used in) financing activities	(458	) (1,331
Effect of exchange rate changes on cash and cash equivalents	(1,534	) (96
Net increase (decrease) in cash and cash equivalents	(37,162	) (28,319
Cash and cash equivalents, beginning of period	151,235	163,198
Cash and cash equivalents, end of period	\$114,073	\$134,879
Supplemental disclosure of cash flow information:		
Cash received from income tax refunds	\$292	\$8,354
Cash paid for income taxes	\$1,457	\$2,988
Non-cash investing activities:		
Increase (decrease) in accrued purchases of equipment, software, and leasehold improvements	\$(371	) \$1,096
See accompanying notes to unaudited condensed consolidated financial statements.		





REALNETWORKS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Quarters and Nine Months Ended September 30, 2014 and 2013

Note 1. Description of Business and Summary of Significant Accounting Policies

Description of Business. RealNetworks, Inc. and subsidiaries is a leading global provider of network-delivered digital media applications and services that make it easy to manage, play and share digital media. The Company also develops and markets software products and services that enable the creation, distribution and consumption of digital media, including audio and video.

Inherent in our business are various risks and uncertainties, including a limited history of certain of our product and service offerings. RealNetworks' success will depend on the acceptance of our technology, products and services and the ability to generate related revenue.

In this Quarterly Report on Form 10-Q (10-Q or Report), RealNetworks, Inc. and Subsidiaries is referred to as "RealNetworks", the "Company", "we", "us", or "our". "RealPlayer", "LISTEN" and other trademarks of ours appearing in this report are our property.

Basis of Presentation. The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany balances and transactions have been eliminated in consolidation.

The unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal, recurring adjustments that, in the opinion of the Company's management, are necessary for a fair presentation of the results of operations for the periods presented. Operating results for the quarter and nine months ended September 30, 2014 are not necessarily indicative of the results that may be expected for any subsequent period or for the year ending December 31, 2014. Certain information and disclosures normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2013 (the 10-K).

Use of Estimates. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. In addition, current economic conditions may require the use of additional estimates, and certain estimates we make are subject to a greater degree of uncertainty as a result of the current economic conditions.

Note 2. Recent Accounting Pronouncements

In August 2014, the Financial Accounting Standards Board (FASB) issued a new standard, "Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern". This standard provides guidance around management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The new guidance is effective for all annual and interim periods ending after December 15, 2016. We do not expect the adoption of this standard to have a material effect on our consolidated financial statements.

In May 2014, the FASB issued new revenue recognition guidance. The guidance will require an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The new guidance will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new guidance is effective for us on January 1, 2017. Early application is not permitted. The guidance permits the use of either the retrospective or cumulative effect transition method. We are evaluating the effect that the guidance will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method nor determined the effect of the standard on our ongoing financial reporting.

In April 2014, the FASB issued new guidance related to discontinued operations. The guidance changes the criteria for reporting discontinued operations and modifies the related disclosure requirements. Under the new guidance, a discontinued operation is defined as a disposal of a component or group of components that represents a strategic shift that has, or will have, a major effect on an entity's operations and financial results. The new guidance is effective for us on January 1, 2016. We are evaluating the impact that this guidance may have on our consolidated financial statements and related disclosures.

There have been no other recent accounting pronouncements or changes in accounting pronouncements to be implemented that are of significance or potential significance to RealNetworks.

Note 3. Acquisitions

In the quarter ended June 30, 2013, we acquired 100% of the voting interests in Slingo, Inc., a social casino games company based in the U.S., for total cash consideration of \$15.6 million. The tangible and intangible assets and liabilities recognized are reported within the Games segment. The identifiable intangible assets associated with the acquisition totaled \$8.0 million. Of this total, \$4.5 million was related to tradenames and trademarks determined to have indefinite useful lives and will be evaluated annually in our fourth quarter for impairment, or more frequently, if circumstances indicate an impairment may exist. The remaining \$3.5 million includes developed game technology and existing customer relationships with finite lives, and is being amortized over their useful lives. We recorded a net deferred tax liability of \$2.7 million related to the intangible assets acquired. Goodwill totaling \$9.9 million was recorded, representing the excess of purchase consideration over the fair value of net acquired assets, and was primarily related to the assembled workforce and expected synergies in the rapidly growing social casino games market. The goodwill is not deductible for income tax purposes. We expect this acquisition to enhance our footprint in the social casino games arena.

In the quarter ended September 30, 2013, we acquired 100% of the voting interests in Muzicall Limited, a ringback tone company based in London, for total cash consideration of \$6.7 million. The tangible and intangible assets and liabilities recognized are reported in the Mobile Entertainment segment. The identifiable intangible assets associated with the acquisition totaled \$5.4 million, and include tradenames and trademarks, developed technology, user base and carrier relationships. All identifiable intangible assets from this acquisition have finite lives, and are being amortized over their useful lives. We recorded a net deferred tax asset of \$3.4 million related to the assets acquired, and a full valuation allowance. Goodwill totaling \$1.3 million was recorded, representing the excess of purchase consideration over the fair value of net acquired assets acquired, and was primarily related to the assembled workforce and expected synergies in the ringback tone industry. The goodwill is not deductible for income tax purposes. This acquisition is intended to accelerate our growth initiatives within the Mobile Entertainment segment.

Note 4. Stock-Based Compensation

Total stock-based compensation expense recognized in our consolidated statements of operations includes amounts related to stock options, restricted stock units, and employee stock purchase plans and was as follows (in thousands):

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Total stock-based compensation expense	\$ 1,148	\$ 1,613	\$ 4,158	\$ 5,671

The fair value of options granted determined using the Black-Scholes model used the following weighted-average assumptions:

	Quarters Ended		Nine Months Ended		
	September 30,		September 30,		
	2014	2013	2014	2013	
Expected dividend yield	0	% 0	% 0	% 0	%
Risk-free interest rate	1.30	% 0.96	% 1.20	% 0.82	%
Expected life (years)	4.5	3.8	3.9	4.0	
Volatility	42	% 48	% 40	% 48	%

The total stock-based compensation amounts for 2014 and 2013 disclosed above are recorded in their respective line items within operating expenses in the consolidated statement of operations. As of September 30, 2014, we had \$12.1 million of total unrecognized compensation cost, net of estimated forfeitures, related to stock awards. The unrecognized compensation cost is expected to be recognized over a weighted-average period of approximately 3 years.

Note 5. Rhapsody Joint Venture

As of September 30, 2014 we owned approximately 45% of the issued and outstanding stock of Rhapsody and account for our investment using the equity method of accounting.

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Rhapsody was initially formed in 2007 as a joint venture between RealNetworks and MTV Networks, a division of Viacom International Inc. (MTVN), to own and operate a business-to-consumer digital audio music service known as Rhapsody. Prior to March 31, 2010, we held a 51% interest in Rhapsody and MTVN owned the remaining 49%. On March 31, 2010, restructuring transactions involving Rhapsody were completed, and as a result, effective March 31, 2010 RealNetworks owned approximately 47% of Rhapsody. Subsequent to the restructuring transaction, we have accounted for our investment in Rhapsody using the equity method of accounting.

As part of the 2010 restructuring transactions, RealNetworks contributed \$18.0 million in cash, the Rhapsody brand and certain other assets, including content licenses, in exchange for shares of convertible preferred stock of Rhapsody, carrying a \$10.0 million preference upon certain liquidation events.

Subsequent to the 2010 restructuring transactions, RealNetworks provided certain operational transition services to Rhapsody. These transition services were completed in 2013, and RealNetworks has no further obligations or liabilities pursuant to the support services agreement.

We recorded our share of losses of Rhapsody of \$1.5 million and \$4.2 million for the quarter and nine months ended September 30, 2014, respectively. Because of the \$10.0 million liquidation preference on the preferred stock we hold in Rhapsody, under the equity method of accounting we do not record any share of Rhapsody losses that would reduce our carrying value of Rhapsody, which is impacted by Rhapsody equity transactions, below \$10.0 million, unless Rhapsody's book value is reduced below \$10.0 million. The carrying value of our Rhapsody investment was \$12.5 million as of December 31, 2013 and as of September 30, 2014 was \$10.0 million.

Our share of the losses of Rhapsody for the quarter and nine months ended September 30, 2013 were \$2.6 million and \$6.2 million, respectively.

Summarized financial information for Rhapsody, which represents 100% of their financial information (in thousands):

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Net revenue	\$44,148	\$35,190	\$128,578	\$103,831
Gross profit	7,739	7,800	24,730	24,412
Net loss	(7,965	) (5,621	) (14,312	) (14,812

#### Note 6. Fair Value Measurements

##### Items Measured at Fair Value on a Recurring Basis

The following table presents information about our financial assets that have been measured at fair value on a recurring basis as of September 30, 2014 and December 31, 2013, and indicates the fair value hierarchy of the valuation inputs utilized to determine such fair value (in thousands).

	Fair Value Measurements as of				Amortized Cost as of September 30, 2014
	September 30, 2014				
	Level 1	Level 2	Level 3	Total	
Cash and cash equivalents:					
Cash	\$28,213	\$—	\$—	\$28,213	\$28,213
Money market funds	—	5,092	—	5,092	5,092
Corporate notes and bonds	—	80,768	—	80,768	80,768
Total cash and cash equivalents	28,213	85,860	—	114,073	114,073
Short-term investments:					
Corporate notes and bonds	—	53,246	—	53,246	53,195
U.S. government agency securities	10,702	—	—	10,702	10,701
Total short-term investments	10,702	53,246	—	63,948	63,896
Restricted cash equivalents and investments	—	3,000	—	3,000	3,000

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Equity investment in publicly traded securities	2,848	—	—	2,848	428
Total	\$41,763	\$142,106	\$—	\$183,869	\$181,397

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	Fair Value Measurements as of				Amortized Cost as of
	December 31, 2013				December 31, 2013
	Level 1	Level 2	Level 3	Total	
Cash and cash equivalents:					
Cash	\$46,978	\$—	\$—	\$46,978	\$46,978
Money market funds	1	26,913	—	26,914	26,914
Corporate notes and bonds	—	77,043	—	77,043	77,044
U.S. government agency securities	—	300	—	300	300
Total cash and cash equivalents	46,979	104,256	—	151,235	151,236
Short-term investments:					
Corporate notes and bonds	—	59,766	—	59,766	59,713
U.S. government agency securities	14,077	1,077	—	15,154	15,159
Total short-term investments	14,077	60,843	—	74,920	74,872
Restricted cash equivalents and investments	—	3,000	—	3,000	3,000
Equity investment in publicly traded securities	7,181	—	—	7,181	842
Total	\$68,237	\$168,099	\$—	\$236,336	\$229,950

Restricted cash equivalents and investments amounts as of September 30, 2014, and December 31, 2013 relate to cash pledged as collateral against a letter of credit in connection with a lease agreement.

Realized gains or losses on sales of short-term investment securities for the quarters and nine months ended September 30, 2014 and 2013 were not significant. Gross unrealized gains and gross unrealized losses on short-term investment securities as of September 30, 2014 and December 31, 2013 were not significant.

Investments with remaining contractual maturities of five years or less are classified as short-term because the investments are marketable and highly liquid, and we have the ability to utilize them for current operations.

Contractual maturities of short-term investments as of September 30, 2014 (in thousands):

	Estimated Fair Value
Within one year	\$47,671
Between one year and five years	16,277
Total short-term investments	\$63,948

Our equity investment in a publicly traded company as of September 30, 2014 and December 31, 2013 consisted of J-Stream Inc., a Japanese media services company. This equity investment is accounted for as available for sale. In March 2014 we sold a portion of the J-Stream shares we held, resulting in cash proceeds of \$2.8 million and a pre-tax gain of \$2.4 million.

#### Items Measured at Fair Value on a Non-recurring Basis

Certain of our assets and liabilities are measured at estimated fair value on a non-recurring basis, using Level 3 inputs. These instruments are subject to fair value adjustments only in certain circumstances (for example, when there is evidence of impairment). During the nine months ended September 30, 2014 and 2013, we did not record any impairments on those assets required to be measured at fair value on a non-recurring basis.

#### Note 7. Allowance for Doubtful Accounts Receivable and Sales Returns

Activity in the allowance for doubtful accounts receivable and sales returns (in thousands):

	Allowance For	
	Doubtful Accounts Receivable	Sales Returns
Balances, December 31, 2013	\$966	\$569
Addition (reduction) to allowance	403	(185 )
Amounts written off	—	(5 )
Foreign currency translation	(54 )	(1 )
Balances, September 30, 2014	\$1,315	\$378

One customer accounted for 17% of trade accounts receivable and one other customer accounted for 14% of trade accounts receivable, as of September 30, 2014. One customer accounted for 17% of trade accounts receivable as of December 31, 2013.

One customer accounted for 24% and 20% of consolidated revenue, or \$8.2 million and \$24.6 million, during the quarter and nine months ended September 30, 2014, and is reflected in our Mobile Entertainment segment. One customer accounted for approximately 12% and 14% of consolidated revenue, or \$6.0 million and \$21.1 million, during the quarter and nine months ended September 30, 2013, and is reflected in our RealPlayer Group and Games segments. One additional customer accounted for approximately 14%, or \$6.8 million, and 11% or \$17.3 million, of consolidated revenue during the quarter and nine months ended September 30, 2013, respectively, and is reflected in our Mobile Entertainment segment.

#### Note 8. Other Intangible Assets

Other intangible assets (in thousands):

	September 30, 2014			December 31, 2013		
	Gross Amount	Accumulated Amortization	Net	Gross Amount	Accumulated Amortization	Net
Amortizing intangible assets:						
Customer relationships	\$34,876	\$ 32,372	\$2,504	\$35,156	\$ 31,262	\$3,894
Developed technology	28,871	25,922	2,949	29,097	25,039	4,058
Patents, trademarks and tradenames	3,945	3,624	321	4,021	3,627	394
Service contracts	6,426	5,746	680	5,679	5,532	147
	74,118	67,664	6,454	73,953	65,460	8,493
Non-amortizing intangible assets:						
Trademarks and tradenames	4,500	—	4,500	4,500	—	4,500
Total	\$78,618	\$ 67,664	\$10,954	\$78,453	\$ 65,460	\$12,993

In the second quarter of 2014 a small acquisition of a business related to our RealPlayer Group resulted in an intangible asset of \$0.8 million being recorded.

No impairments of other intangible assets were recognized in either of the nine months ended September 30, 2014 or 2013.

#### Note 9. Goodwill

Changes in goodwill (in thousands):

Balance, December 31, 2013	\$17,476
Increases due to current year acquisitions	460
Effects of foreign currency translation	(321 )
Balance, September 30, 2014	\$17,615



Goodwill by segment (in thousands):

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	September 30, 2014
RealPlayer Group	\$1,003
Mobile Entertainment	2,073
Games	14,539
Total goodwill	\$17,615

In the second quarter of 2014 a small acquisition of a business related to our RealPlayer Group resulted in goodwill of \$0.5 million being recorded.

No impairment of goodwill was recognized in either of the nine months ended September 30, 2014 or 2013.

#### Note 10. Accrued and Other Current Liabilities

Accrued and other current liabilities (in thousands):

	September 30, 2014	December 31, 2013
Royalties and other fulfillment costs	\$4,537	\$16,467
Employee compensation, commissions and benefits	8,086	10,060
Sales, VAT and other taxes payable	6,644	7,237
Other	6,618	8,129
Total accrued and other current liabilities	\$25,885	\$41,893

During the quarter ended March 31, 2014, certain accrued royalty liabilities of \$10.6 million associated with our historical music business, which had originally been recorded based on statutory rates, were extinguished.

#### Note 11. Restructuring Charges

Restructuring and other charges in 2014 and 2013 consist of costs associated with the ongoing reorganization of our business operations and our ongoing expense alignment efforts. The expense amounts in both years relate primarily to severance costs due to workforce reductions.

In the latter half of 2012, we announced the elimination of approximately 160 positions worldwide, which was concluded as of the second quarter of 2013. During 2013 and 2014, we have incurred restructuring charges consisting of costs associated with the reorganization of our business operations and our ongoing expense alignment efforts.

These costs are reflected in the table below.

Restructuring charges by type of cost (in thousands):

	Employee Separation Costs	Asset Related and Other Costs	Total
Costs incurred and charged to expense for the nine months ended September 30, 2014	\$3,805	—	\$3,805
Costs incurred and charged to expense for the nine months ended September 30, 2013	\$2,891	1,184	\$4,075

Changes to the accrued restructuring cost liability (in thousands):

	Employee Separation
	Costs
Accrued liability as of December 31, 2013	\$756
Costs incurred and charged to expense for the nine months ended September 30, 2014	3,805
Cash payments	(3,626 )
Accrued liability at September 30, 2014 (included in Accrued and other current liabilities)	\$935

Note 12. Lease Exit and Related Charges

As a result of the reduction in use of RealNetworks' office space, losses have been recognized representing rent and contractual operating expenses over the remaining life of the leases.

Changes to accrued lease exit and related charges (in thousands):

Accrued loss as of December 31, 2013	\$254
Additions and adjustments to the lease exit charges accrual, including sublease income estimate revision	480
Less amounts paid, net of sublease amounts	(611 )
Accrued loss as of September 30, 2014 (included in Accrued and other current liabilities)	\$123

Note 13. Shareholders' Equity

Accumulated Other Comprehensive Income (Loss)

Changes in components of accumulated other comprehensive income (in thousands):

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
<b>Investments</b>				
Accumulated other comprehensive income (loss), beginning of period	\$2,784	\$27,700	\$6,397	26,685
Unrealized gains (losses), net of tax effects of \$0, \$587, \$0 and \$(129)	(323 )	(1,043 )	(1,565 )	(28 )
Reclassification adjustments for losses (gains) included in other income (expense), net of tax effects of \$0, \$0, \$(4) and \$0	—	—	(2,371 )	—
Net current period other comprehensive income	(323 )	(1,043 )	(3,936 )	(28 )
Accumulated other comprehensive income (loss) balance, end of period	\$2,461	\$26,657	\$2,461	\$26,657
<b>Foreign currency translation</b>				
Accumulated other comprehensive income (loss), beginning of period	\$(53,901 )	\$(54,851 )	\$(54,092 )	\$(53,225 )
Translation adjustments	(2,338 )	1,235	(2,099 )	(356 )
Reclassification adjustments for losses (gains) included in other income (expense)	—	—	(48 )	(35 )
Net current period other comprehensive income	(2,338 )	1,235	(2,147 )	(391 )
Accumulated other comprehensive income (loss) balance, end of period	\$(56,239 )	\$(53,616 )	\$(56,239 )	\$(53,616 )
Total accumulated other comprehensive income (loss), end of period	\$(53,778 )	\$(26,959 )	\$(53,778 )	\$(26,959 )

Note 14. Income Taxes



As of September 30, 2014, there have been no material changes to RealNetworks' uncertain tax positions disclosures as provided in Note 14 of the 2013 10-K. We currently anticipate the expiration of the statute of limitations within the next twelve months that may decrease the Company's total unrecognized tax benefit by an amount up to \$0.9 million of which \$0.4 million could potentially impact tax expense.

We file numerous consolidated and separate income tax returns in the U.S including federal, state and local, as well as foreign jurisdictions. With few exceptions, we are no longer subject to U.S federal income tax examinations for tax years before 2008 or state, local, or foreign income tax examinations for years before 1993. We are currently under audit by various states and foreign jurisdictions for certain tax years subsequent to 1993. We are currently under United States federal audit for the consolidated group (RealNetworks, Inc. and Subsidiaries) for the year ended December 31, 2012.

#### Note 15. Earnings (Loss) Per Share

Basic net income (loss) per share (EPS) is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted EPS is computed by dividing net income (loss) by the weighted average number of common and dilutive potential common shares outstanding during the period. Basic and diluted EPS (in thousands, except per share amounts):

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Net income (loss)	\$(22,178 )	\$(31,375 )	\$(50,977 )	\$(61,520 )
Weighted average common shares outstanding used to compute basic EPS	36,003	35,670	35,912	35,490
Dilutive effect of stock based awards	—	—	—	—
Weighted average common shares outstanding used to compute diluted EPS	36,003	35,670	35,912	35,490
Basic EPS	\$(0.62 )	\$(0.88 )	\$(1.42 )	\$(1.73 )
Diluted EPS	\$(0.62 )	\$(0.88 )	\$(1.42 )	\$(1.73 )

During the quarter and nine months ended September 30, 2014, 6.3 million and 6.2 million shares of common stock, respectively, of potentially issuable shares from stock awards were excluded from the calculation of diluted EPS because of their antidilutive effect.

During the quarter and nine months ended September 30, 2013, 4.6 million and 4.4 million shares of common stock, respectively, of potentially issuable shares from stock awards were excluded from the calculation of diluted EPS because of their antidilutive effect.

#### Note 16. Commitments and Contingencies

We may become subject to legal proceedings, governmental investigations and claims in the ordinary course of business, including employment claims, contract-related claims, and claims of alleged infringement of third-party patents, trademarks and other intellectual property rights. Such claims, even if not meritorious, could force us to expend significant financial and managerial resources. In addition, given the broad distribution of some of our consumer products, any individual claim related to those products could give rise to liabilities that may be material to us. In the event of a determination adverse to us, we may incur substantial monetary liability, and/or be required to change our business practices. Either of these could have a material adverse effect on our consolidated financial statements.

#### Note 17. Guarantees

In the ordinary course of business, RealNetworks is subject to potential obligations for standard warranty and indemnification provisions that are contained within many of our customer license and service agreements. Our warranty provisions are consistent with those prevalent in our industry, and we do not have a history of incurring losses on warranties; therefore, we do not maintain accruals for warranty-related obligations. With regard to indemnification provisions, nearly all of our carrier contracts obligate us to indemnify our carrier customers for certain liabilities that may be incurred by them. We have received in the past, and may receive in the future, claims for

indemnification from carrier customers.

In relation to the patents and other technology assets we sold to Intel in the second quarter of 2012, we have specific obligations to indemnify Intel for breaches of the representations and warranties that we made and covenants that we agreed to

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in the asset purchase agreement for certain potential future intellectual property infringement claims brought by third parties against Intel. The amount of any potential liabilities related to our indemnification obligations to Intel will not be determined until a claim has been made, but we are obligated to indemnify Intel up to the amount of the gross purchase price that we received in the sale.

#### Note 18. Segment Information

We have three reportable segments: (1) RealPlayer Group, which includes sales of our RealPlayer media player software and related products, such as the distribution of third party software products, advertising on RealPlayer websites, and sales of RealPlayer Plus software licenses to consumers, sales of intellectual property licenses, and consumer subscriptions such as SuperPass and our RealPlayer Cloud service; (2) Mobile Entertainment, which includes our SaaS services, our LISTEN product, and sales of technology licenses of our software products such as Helix; and (3) Games, which includes all our games-related businesses, including sales of games licenses, online games subscription services, advertising on games sites and social network sites, microtransactions from online and social games, and sales of mobile games.

We allocate certain corporate expenses which are directly attributable to supporting the business to our reportable segments. These corporate expenses include but are not limited to a portion of finance, legal, human resources and headquarters facilities. Remaining expenses, which are not directly attributable to supporting the business, are reported as corporate items. All restructuring, lease exit and related charges, and loss on litigation settlements are included in the corporate segment.

RealNetworks reports three reportable segments based on factors such as how we manage our operations and how our Chief Operating Decision Maker reviews results. Our Chief Operating Decision Maker is considered to be the CEO Staff (CEOS), which includes the Chief Executive Officer, Chief Financial Officer, our Presidents, and General Counsel. The CEOS reviews financial information presented on both a consolidated basis and on a business segment basis. The accounting policies used to derive segment results are the same as those described in Note 1, Description of Business and Summary of Significant Accounting Policies, in the 10-K.

Segment results for the quarters and nine months ended September 30, 2014 and 2013 (in thousands):

#### RealPlayer Group

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Revenue	\$6,565	\$17,641	\$30,336	\$58,407
Cost of revenue	3,566	3,264	10,704	12,984
Gross profit	2,999	14,377	19,632	45,423
Operating expenses	12,392	14,449	42,668	44,656
Operating income (loss)	\$(9,393)	) \$(72	) \$(23,036	) \$767

#### Mobile Entertainment

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Revenue	\$19,190	\$19,948	\$62,285	\$59,035
Cost of revenue	12,626	11,972	38,874	33,974
Gross profit	6,564	7,976	23,411	25,061
Operating expenses	7,086	9,453	26,126	26,976
Operating income (loss)	\$(522)	) \$(1,477	) \$(2,715	) \$(1,915

Games

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	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Revenue	\$8,402	\$11,369	\$28,085	\$38,159
Cost of revenue	2,573	3,216	8,419	10,397
Gross profit	5,829	8,153	19,666	27,762
Operating expenses	8,658	11,513	27,193	35,120
Operating income (loss)	\$(2,829)	) \$(3,360)	) \$(7,527)	) \$(7,358)

## Corporate

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Cost of revenue	\$163	\$538	\$503	\$1,660
Extinguishment of liability	—	—	(10,580)	) —
Operating expenses	7,856	22,990	25,270	46,201
Operating income (loss)	\$(8,019)	) \$(23,528)	) \$(15,193)	) \$(47,861)

Our customers consist primarily of consumers and corporations located in the U.S., Europe, Republic of Korea and various foreign countries (Rest of the world). Revenue by geographic region (in thousands):

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
United States	\$12,280	\$21,039	\$47,800	\$70,525
Europe	5,749	8,750	21,129	29,278
Republic of Korea	9,728	11,839	31,114	32,062
Rest of the world	6,400	7,330	20,663	23,736
Total net revenue	\$34,157	\$48,958	\$120,706	\$155,601

Long-lived assets (consists of equipment, software, leasehold improvements, other intangible assets, and goodwill) by geographic region (in thousands):

	September 30,	December 31,
	2014	2013
United States	\$35,375	\$40,347
Europe	7,352	8,280
Republic of Korea	655	936
Rest of the world	3,641	4,078
Total long-lived assets	\$47,023	\$53,641

## Note 19. Related Party Transactions

Transactions with Rhapsody. See Note 5, Rhapsody Joint Venture, for details on the 2010 restructuring transaction involving Rhapsody. Subsequent to the restructuring transaction, we were obligated to provide Rhapsody with certain support services. These support services, which included information technology and limited operational support provided directly to Rhapsody, were completed in 2013. RealNetworks has no further obligations or liabilities pursuant to the support services agreement.



## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q 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-looking statements. All statements contained in this report that do not relate to matters of historical fact should be considered forward-looking statements. Forward-looking statements include statements with respect to:

- the expected benefits and other consequences of our growth plans, strategic initiatives, and restructurings;
- our expected introduction, and related monetization, of new and enhanced products, services and technologies across our businesses;
- future revenues, operating expenses, income and other taxes, tax benefits, net income (loss) per diluted share available to common shareholders, acquisition costs and related amortization, and other measures of results of operations;
- the effects of our past acquisitions and expectations for future acquisitions and divestitures;
- plans, strategies and expected opportunities for future growth, increased profitability and innovation;
- the expected financial position, performance, growth and profitability of, and investment in, our businesses and the availability of resources;
- the effects of legislation, regulations, administrative proceedings, court rulings, settlement negotiations and other factors that may impact our businesses;
- the continuation and expected nature of certain customer relationships;
- impacts of competition and certain customer relationships on the future financial performance and growth of our businesses;
- our involvement in potential claims, legal proceedings and government investigations, and the potential outcomes and effects of such potential claims, legal proceedings and governmental investigations on our business, prospects, financial condition or results of operations;
- the effects of U.S. and foreign income and other taxes on our business, prospects, financial condition or results of operations; and
- the effect of economic and market conditions on our business, prospects, financial condition or results of operations.

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 in Item 1A of Part II entitled "Risk Factors." 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.

### Overview

RealNetworks creates innovative products and services that make it easy to connect with and enjoy digital media. We invented the streaming media category in 1995 and continue to connect consumers with their digital media both directly and through partners, aiming to support every network, device, media type and social network.

We manage our business and report revenue and operating income (loss) in three segments: (1) RealPlayer Group, (2) Mobile Entertainment, and (3) Games. Within our RealPlayer Group, revenue is derived from the sale of our RealPlayer media player software and related products, such as the distribution of third party software products, advertising on RealPlayer websites, and sales of RealPlayer Plus software licenses to consumers, sales of intellectual property licenses, and consumer subscriptions such as SuperPass and our RealPlayer Cloud service. Our Mobile Entertainment business generates revenue from the sale of its SaaS services, which include ringback tones, music on demand, intercarrier messaging, and our LISTEN product, and sales of technology licenses of our software products such as Helix. Our Games business, through its Slingo, GameHouse and Zylom brands, derives revenue from sales of

games licenses, online games subscription services, advertising on games sites and social networks, microtransactions within online and social games, and sales of mobile games.

We allocate certain corporate expenses which are directly attributable to supporting our businesses, including but not limited to a portion of finance, legal, human resources and headquarters facilities, to our reportable segments. The allocation of these costs to our business units ensures accountability for financial and operational performance within each of our reportable segments. Our most significant expenses relate to cost of revenue, compensating employees, and selling and marketing our products and services.

For the quarter and nine months ended September 30, 2014, our consolidated revenue declined by \$14.8 million and \$34.9 million, respectively, compared to the same periods in 2013. The decline in revenue for the quarter in our RealPlayer Group was \$11.1 million, \$3.0 million in Games and \$0.8 million in Mobile Entertainment. For the year to date period, the decline was primarily due to a decline of \$28.1 million in our RealPlayer Group and a decline of \$10.1 million in Games. For the year to date period, revenue increased by \$3.3 million in Mobile Entertainment. Revenue from our legacy products continues to decline as a result of certain changes in our businesses and market-driven factors. In our RealPlayer Group segment, revenue suffered from pricing pressure and lower distribution in our intellectual property licensing business as well as lower rates, distribution and installations from transitioning to a new partner in our third party software distribution business. Moreover, as we focus more of our distribution and marketing efforts on our new RealPlayer Cloud service, sales of RealPlayer Plus licenses are declining, resulting in reduced revenue. The business also continues to be negatively impacted by a decline in subscribers, attributable solely to our SuperPass product. These changes have also negatively impacted gross margins in the RealPlayer Group, as described in more detail in Segment Operating Results below. In our Games segment, our business continues to be challenged in line with overall trends in the online games market, including the shift from downloadable PC games to social networks and mobile devices. In our Mobile Entertainment segment, the revenue increase in the year-to-date period was related primarily to our music on demand services in Korea and our acquisition of Muzicall in the third quarter of 2013, which increased our direct-to-consumer ringback tones revenue. Partially offsetting these increases was a loss in revenue due to termination of carrier contracts.

Over the past several quarters we have developed a growth plan, implemented strategic initiatives, and executed certain restructuring efforts, all in an effort to grow our businesses, move towards profitability, and streamline our operations. In line with our growth plan, we continue to invest in each of our three business units. During the first half of 2014, we released RealPlayer Cloud worldwide. This global roll out allows us to reach our base of millions of active RealPlayer users around the world. In our Mobile Entertainment business we continue our efforts to roll out our new LISTEN product. LISTEN leverages our pioneering leadership in ringback tones, and our large, global installed base of over 18 million active ringback tone subscribers with more than 20 carriers worldwide, to create a hybrid distribution model that combines partnership with carriers with direct-to-consumer marketing. In our Games business, we launched Slingo Adventure worldwide on Facebook in mid-September and plan to launch the product on mobile platforms worldwide during the fourth quarter of 2014. We expect to continue to invest heavily in our growth initiatives, including further development and marketing efforts around our products. These investments have negatively impacted our recent operating results, which may continue until the expected revenue growth materializes. During the quarter ended March 31, 2014 certain accrued royalty liabilities of \$10.6 million associated with our historical music business, which had originally been recorded based on statutory rates, were extinguished.

Condensed consolidated results of operations were as follows (dollars in thousands):

	Quarters ended September 30, 2014				Nine months ended September 30, 2014			
	2014	2013	\$ Change	% Change	2014	2013	\$ Change	% Change
Total revenue	\$34,157	\$48,958	\$(14,801)	(30)%	\$120,706	\$155,601	\$(34,895)	(22)%
Cost of revenue	18,928	18,990	(62)	—	58,500	59,015	(515)	(1)%
Extinguishment of liability	—	—	—	—	(10,580)	—	(10,580)	(100)%
Gross profit	15,229	29,968	(14,739)	(49)%	72,786	96,586	(23,800)	(25)%
Gross margin	45%	61%			60%	62%		
Operating expenses	35,992	58,405	(22,413)	(38)%	121,257	152,953	(31,696)	(21)%
Operating income (loss)	\$(20,763)	\$(28,437)	\$7,674	27%	\$(48,471)	\$(56,367)	\$7,896	(14)%

In the third quarter of 2014, our total consolidated revenue declined by \$14.8 million, compared with the year-earlier period. The reduction in revenue resulted from a decline of \$11.1 million in our RealPlayer Group segment, \$3.0 million in our Games segment, and \$0.8 million in Mobile Entertainment, due to the factors described above. Gross margin decreased to 45% from 61% during the quarter ended September 30, 2014, primarily related to our RealPlayer

segment, as described in more detail in Segment Operating Results below. Operating expenses decreased by \$22.4 million in the quarter ended September 30, 2014, compared with the prior year, primarily due to a litigation settlement of \$11.5 million in the prior year, reduced marketing costs in 2014 of \$4.6 million in line with the decrease in our third party distribution revenue and reductions in personnel and related costs of \$2.4 million.

For the nine months ended September 30, 2014, our consolidated revenue declined by \$34.9 million, compared with the year-earlier period. The reduction in revenue primarily resulted from a decline of \$28.1 million in our RealPlayer Group and a decline of \$10.1 million in our Games segment, due to the factors described above, partially offset by an increase in Mobile Entertainment revenue of \$3.3 million primarily due to an increase in music on demand services in Korea. Gross margin decreased to 60% from 62% for the year-earlier period primarily due to a decline in higher margin revenue. Operating expenses decreased by \$31.7 million in the nine months ended September 30, 2014, compared with the prior year, primarily due to a litigation settlement of \$11.5 million in the prior year and reduced marketing costs in 2014 of \$6.5 million and reductions in personnel and related costs of \$7.4 million.

### Segment Operating Results

#### RealPlayer Group

RealPlayer Group segment results of operations were as follows (dollars in thousands):

	Quarters ended September 30, 2014				Nine months ended September 30, 2014			
	2014	2013	\$ Change	% Change	2014	2013	\$ Change	% Change
Revenue	\$6,565	\$17,641	\$(11,076)	(63)%	\$30,336	\$58,407	\$(28,071)	(48)%
Cost of revenue	3,566	3,264	302	9%	10,704	12,984	(2,280)	(18)%
Gross profit	2,999	14,377	(11,378)	(79)%	19,632	45,423	(25,791)	(57)%
Gross margin	46%	81%			65%	78%		
Operating expenses	12,392	14,449	(2,057)	(14)%	42,668	44,656	(1,988)	(4)%
Operating income (loss)	\$(9,393)	\$(72)	\$(9,321)	—%	\$(23,036)	\$767	\$(23,803)	—%

Total RealPlayer Group revenue decreased by \$11.1 million in the quarter ended September 30, 2014, compared with the year-earlier period. This decrease was primarily a result of our transition to a new third party distribution partner, which resulted in lower rates, decreased distribution and decreased installations compared to our previous partner resulting in a decrease of \$5.4 million in our third party distribution revenue. In addition, lower distribution of intellectual property licenses decreased revenue by \$2.0 million. Further contributing to the decline was a decrease in RealPlayer Plus license revenue of \$1.8 million due to our focus on increasing RealPlayer Cloud subscriptions.

Total RealPlayer Group revenue decreased by \$28.1 million in the nine months ended September 30, 2014, compared with the year-earlier period. This decrease was primarily a result of reduced rates that caused a decrease in our third party distribution revenue by \$11.2 million and lower subscriptions revenue of \$4.7 million due to fewer subscribers, attributable solely to our SuperPass product. Further contributing to the decline was a decrease in RealPlayer license revenue of \$5.3 million due to our focus on increasing RealPlayer Cloud subscriptions and a decrease of \$4.7 million in distribution of intellectual property licenses.

Cost of revenue decreased by \$2.3 million during the nine months ended September 30, 2014, compared with the year-earlier period. Costs related to our RealPlayer Plus licensing business decreased by \$1.2 million due to lower license royalties. Costs related to our subscription business declined \$1.0 million in connection with lower subscription revenue.

Gross margin during the quarter ended September 30, 2014 declined primarily as a result of our transition to a new third party distribution partner at significantly lower rates compared to our previous partner. Although gross margins will be lower on the revenue derived under our new third party distribution arrangement, we expect that our marketing costs related to this business will decline as well.

Operating expenses decreased by \$2.1 million and \$2.0 million, respectively, in the quarter and nine months ended September 30, 2014, compared with the year-earlier period primarily due to decreased marketing spend related to our third party distribution arrangements.

#### Mobile Entertainment

Mobile Entertainment segment results of operations were as follows (dollars in thousands):





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	Quarters ended September 30, 2014				Nine months ended September 30, 2014			
	2014	2013	\$ Change	% Change	2014	2013	\$ Change	% Change
Revenue	\$19,190	\$19,948	\$(758 )	(4 )%	\$62,285	\$59,035	\$3,250	6 %
Cost of revenue	12,626	11,972	654	5 %	38,874	33,974	4,900	14 %
Gross profit	6,564	7,976	(1,412 )	(18 )%	23,411	25,061	(1,650 )	(7 )%
Gross margin	34	% 40	%		38	% 42	%	
Operating expenses	7,086	9,453	(2,367 )	(25 )%	26,126	26,976	(850 )	(3 )%
Operating income (loss)	\$(522 )	\$(1,477 )	\$955	65 %	\$(2,715 )	\$(1,915 )	\$(800 )	(42 )%

Total Mobile Entertainment revenue decreased by \$0.8 million in the quarter ended September 30, 2014, compared with the year-earlier period. A decrease of \$2.2 million was primarily due to discounts in our ringback tones business, the termination of our carrier application services in Asia and a decrease in our direct to consumer business that was part of our Muzicall acquisition in 2013. Partially offsetting this decrease was an increase in music on demand revenue of \$1.4 million in our Korea business.

Total Mobile Entertainment revenue increased by \$3.3 million in the nine months ended September 30, 2014, compared with the year-earlier period. The increase was primarily due to an increase of \$6.7 million in music on demand revenue in Korea and an increase of \$1.7 million in our direct to consumer ringback tones business due to our Muzicall acquisition. Partially offsetting this increase was a decrease of \$2.7 million due to termination of carrier contracts, in addition to slower growth in our ringback tones business of \$0.7 million and \$1.5 million related to the termination of our video on demand service in 2013.

Cost of revenue increased by \$0.7 million and \$4.9 million in the quarter and nine months ended September 30, 2014, respectively, compared with the year-earlier periods, primarily due to an increase in label royalties related to our music on demand services. This is partially offset by a decrease of \$0.5 million and \$1.6 million in the quarter and nine months ended September 30, 2014, respectively, from our integrated music project.

Gross margin declined for the quarter and nine months ended September 30, 2014, due to a decline in higher margin revenues.

Operating expenses decreased by \$2.4 million for the quarter ended September 30, 2014, compared with the year-earlier period, primarily due to savings of \$1.1 million in marketing related expenses and a decrease of \$0.8 million due to reductions in personnel and related costs.

#### Games

Games segment results of operations were as follows (dollars in thousands):

	Quarters ended September 30, 2014				Nine months ended September 30, 2014			
	2014	2013	\$ Change	% Change	2014	2013	\$ Change	% Change
Revenue	\$8,402	\$11,369	\$(2,967 )	(26 )%	\$28,085	\$38,159	\$(10,074 )	(26 )%
Cost of revenue	2,573	3,216	(643 )	(20 )%	8,419	10,397	(1,978 )	(19 )%
Gross profit	5,829	8,153	(2,324 )	(29 )%	19,666	27,762	(8,096 )	(29 )%
Gross margin	69	% 72	%		70	% 73	%	
Operating expenses	8,658	11,513	(2,855 )	(25 )%	27,193	35,120	(7,927 )	(23 )%
Operating income (loss)	\$(2,829 )	\$(3,360 )	\$531	16 %	\$(7,527 )	\$(7,358 )	\$(169 )	(2 )%

Total Games revenue decreased by \$3.0 million in the quarter ended September 30, 2014, compared with the year-earlier period. Lower revenue from our subscription products, licensing and advertising due to continued declines in our storefront and subscription businesses contributed \$1.4 million, \$0.4 million and \$0.8 million, respectively, to the overall decrease.

Total Games revenue decreased by \$10.1 million in the nine months ended September 30, 2014, compared with the year-earlier period. Lower revenue from our subscription products, licensing and advertising due to continued declines in our storefront and subscription businesses contributed \$4.0 million, \$2.5 million and \$2.7 million, respectively, to the overall decrease.

Cost of revenue decreased by \$0.6 million and \$2.0 million in the quarter and nine months ended September 30, 2014, respectively, compared with the year-earlier period. The decreases were due to the decrease in partner royalties expense, which

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has a direct correlation with the decrease in Games revenue. The decrease in cost of revenue was also due to a decline in our advertising business. Gross margin declined during the quarter and nine months ended September 30, 2014 to 69% from 72% and to 70% from 73%, respectively, due primarily to a higher proportion of lower margin revenue in the current year.

Operating expenses declined by \$2.9 million in the quarter ended September 30, 2014, compared with the year-earlier period. The decrease was due to reductions in personnel and related costs of \$1.1 million and reduced marketing spend of \$1.4 million.

Operating expenses declined by \$7.9 million in the nine months ended September 30, 2014, compared with the year-earlier period. The decrease was due to reductions in personnel and related costs of \$2.4 million and reduced marketing spend of \$3.7 million.

#### Corporate

We allocate certain corporate expenses which are directly attributable to supporting the business to our reportable segments. These allocated corporate expenses include but are not limited to a portion of finance, legal, human resources and headquarters facilities. Remaining expenses, which are not directly attributable to supporting the business, are reported as corporate items. All restructuring, and lease exit and related charges, are included in the corporate segment.

Corporate segment results of operations were as follows (dollars in thousands):

	Quarters ended September 30, 2014				Nine months ended September 30, 2014			
	2014	2013	\$ Change	% Change	2014	2013	\$ Change	% Change
Cost of revenue	\$163	\$538	\$(375)	(70)%	\$503	\$1,660	\$(1,157)	(70)%
Extinguishment of liability	—	—	—	—	(10,580)	—	(10,580)	(100)%
Operating expenses	7,856	22,990	(15,134)	(66)%	25,270	46,201	(20,931)	(45)%
Operating income (loss)	\$(8,019)	\$(23,528)	\$15,509	66%	\$(15,193)	\$(47,861)	\$32,668	68%

During the quarter ended March 31, 2014 certain accrued royalty liabilities of \$10.6 million associated with our historical music business, which had originally been recorded based on statutory rates, were extinguished.

Operating expenses decreased by \$15.1 million in the quarter ended September 30, 2014 compared with the year-earlier period. The decrease was primarily due to a litigation settlement of \$11.5 million in the prior year and \$2.1 million in savings from the relocation of our Seattle headquarters.

Operating expenses decreased by \$20.9 million in the nine months ended September 30, 2014, compared with the year-earlier period. The decrease was primarily due to a litigation settlement of \$11.5 million in the prior year and \$2.4 million of reduced expense for lease exit charges. An additional savings of \$4.0 million resulted from the relocation of our Seattle headquarters.

#### Consolidated Operating Expenses

Our operating expenses consist primarily of salaries and related personnel costs including stock based compensation, consulting fees associated with product development, sales commissions, amortization of certain intangible assets capitalized in our acquisitions, professional service fees, advertising costs, and restructuring charges. Operating expenses were as follows (dollars in thousands):

	Quarters ended September 30, 2014				Nine months ended September 30, 2014			
	2014	2013	\$ Change	% Change	2014	2013	\$ Change	% Change
Research and development	\$12,784	\$15,707	\$(2,923)	(19)%	\$40,110	\$45,951	\$(5,841)	(13)%
Sales and marketing	13,283	19,427	(6,144)	(32)%	51,022	59,830	(8,808)	(15)%
General and administrative	7,723	9,869	(2,146)	(22)%	25,617	28,506	(2,889)	(10)%
Restructuring and other charges	2,048	1,877	171	9%	3,805	4,075	(270)	(7)%

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Lease exit and related charges	154	—	154	—	703	3,066	(2,363 )	(77 )%
Loss on litigation settlements	—	11,525	(11,525 )	100 %	—	11,525	(11,525 )	100 %
Total consolidated operating expenses	\$35,992	\$58,405	\$(22,413)	(38 )%	\$121,257	\$152,953	\$(31,696)	(21 )%

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Research and development expenses decreased by \$2.9 million and \$5.8 million, respectively, in the quarter and nine months ended September 30, 2014, compared with the year-earlier period. The decrease was primarily due to savings resulting from the relocation of our Seattle headquarters of \$1.5 million and \$3.8 million, respectively.

Sales and marketing expenses decreased by \$6.1 million in the quarter ended September 30, 2014, compared with the year-earlier period. The decrease was primarily due to reduced marketing spend of \$4.6 million and \$0.9 million in reduced personnel and related costs.

Sales and marketing expenses decreased by \$8.8 million in the nine months ended September 30, 2014, compared with the year-earlier period. The decrease was primarily due to reduced marketing spend of \$6.5 million and \$1.5 million from the relocation of our Seattle headquarters.

General and administrative expenses decreased by \$2.1 million in the quarter ended September 30, 2014, compared with the year-earlier period. The decrease was primarily due to higher legal fees related to litigation in the prior year and tax refunds.

General and administrative expenses decreased by \$2.9 million in the nine months ended September 30, 2014, compared with the year-earlier period. The decrease was primarily due to \$1.8 million in higher legal fees related to litigation in the prior year.

Restructuring and other charges and Lease exit and related charges consist of costs associated with the ongoing reorganization of our business operations and our ongoing expense alignment efforts. The restructuring expense amounts in both years primarily related to severance costs due to workforce reductions. For additional details on these charges see Note 11, Restructuring Charges and Note 12, Lease Exit and Related Charges.

#### Other Income (Expenses)

Other income (expenses), net was as follows (dollars in thousands):

	Quarters ended September 30, 2014				Nine months ended September 30, 2014			
	2014	2013	\$ Change	% Change	2014	2013	\$ Change	% Change
Interest income, net	\$80	\$166	\$(86)	(52)%	\$396	\$992	\$(596)	(60)%
Gain (loss) on sale of available for sale securities, net	—	—	—	—	2,371	—	2,371	100%
Equity in net loss of Rhapsody	(1,530)	(2,629)	1,099	42%	(4,170)	(6,209)	2,039	33%
Other income (expense), net	325	(118)	443	375%	153	(146)	299	205%
Total other income (expense), net	\$(1,125)	\$(2,581)	\$1,456	56%	\$(1,250)	\$(5,363)	\$4,113	77%

As described further in Note 5, Rhapsody Joint Venture, we account for our investment in Rhapsody under the equity method of accounting. The net carrying value of our investment in Rhapsody is not necessarily indicative of the underlying fair value of our investment.

The increase in Other income (expense), net, of \$4.1 million for the nine months ended September 30, 2014 was primarily due to the \$2.4 million gain on sale of a portion of our shares held in J-Stream, as discussed further in Note 6, Fair Value Measurements, as well as our lower recorded net loss associated with our investment in Rhapsody.

#### Income Taxes

During the quarters ended September 30, 2014 and 2013, we recognized income tax expense of \$0.3 million and \$0.4 million, respectively, related to U.S. and foreign income taxes.

During the nine months ended September 30, 2014 and 2013, we recognized income tax expense of \$1.3 million and an income tax benefit of \$0.2 million, respectively, related to U.S. and foreign income taxes. The change in income tax expense during the quarter and nine months ended September 30, 2014 was largely the result of an income tax benefit related to the acquisition of Slingo, Inc. recognized in the quarter ending September 30, 2013 and changes in our jurisdictional income.

As of September 30, 2014, there have been no material changes to RealNetworks' uncertain tax positions disclosures as provided in Note 14 of the 2013 10-K. We currently anticipate the expiration of the statute of limitations within the next twelve



months that may decrease the Company's total unrecognized tax benefit by an amount up to \$0.9 million of which \$0.4 million could potentially impact tax expense.

The majority of our tax expense is due to income in our foreign jurisdictions and we have not benefitted from losses in the U.S. and certain foreign jurisdictions in the third quarter of 2014. We generate income in a number of foreign jurisdictions, some of which have higher or lower tax rates relative to the U.S. federal statutory rate. Our tax expense could fluctuate significantly on a quarterly basis to the extent income is less than anticipated in countries with lower statutory tax rates and more than anticipated in countries with higher statutory tax rates. For the quarters ended September 30, 2014, decreases in tax expense from income generated in foreign jurisdictions with lower tax rates in comparison to the U.S. federal statutory rate was offset by increases in tax expense from income generated in foreign jurisdictions having comparable, or higher tax rates in comparison to the U.S. federal statutory rate. As such, the effect of differences in foreign tax rates on the Company's tax expense for the third quarter of 2014 is minimal.

As of September 30, 2014, we have not provided for U.S. federal and state income taxes on certain undistributed earnings of our foreign subsidiaries, since such earnings are considered indefinitely reinvested outside the U.S. or may be remitted tax-free to the U.S. If these amounts were distributed to the U.S., in the future in the form of dividends or otherwise, we could be subject to additional U.S. income and foreign withholding taxes. It is not practicable to determine the foreign withholding and U.S. income tax liability or benefit on such earnings due to the timing of such future distributions, the availability of foreign tax credits, and the complexity of the computation if such earnings were not deemed to be permanently reinvested. If future events, including material changes in estimates of cash, working capital, and long-term investment requirements necessitate that these earnings be distributed, an additional provision for U.S. income and foreign withholding taxes, net of foreign tax credits, may be necessary.

We file numerous consolidated and separate income tax returns in the U.S., including federal, state and local returns, as well as in foreign jurisdictions. With few exceptions, we are no longer subject to United States federal income tax examinations for tax years prior to 2008 or state, local or foreign income tax examinations for years prior to 1993. We are currently under audit by various states and foreign jurisdictions for certain tax years subsequent to 1993. We are currently under United States federal audit for the consolidated group (RealNetworks, Inc. and Subsidiaries) for the year ended December 31, 2012.

#### Geographic Revenue

Revenue by geographic region was as follows (dollars in thousands):

	Quarters ended September 30, 2014				Nine months ended September 30, 2014			
	2014	2013	\$ Change	% Change	2014	2013	\$ Change	% Change
United States	\$12,280	\$21,039	\$(8,759)	(42)%	\$47,800	\$70,525	\$(22,725)	(32)%
Europe	5,749	8,750	(3,001)	(34)%	21,129	29,278	(8,149)	(28)%
Republic of Korea	9,728	11,839	(2,111)	(18)%	31,114	32,062	(948)	(3)%
Rest of world	6,400	7,330	(930)	(13)%	20,663	23,736	(3,073)	(13)%
Total net revenue	\$34,157	\$48,958	\$(14,801)	(30)%	\$120,706	\$155,601	\$(34,895)	(22)%

Revenue in the United States declined by \$8.8 million in the quarter ended September 30, 2014, compared with the year-earlier period. The decline was due primarily to lower revenue generated from the distribution of third party software products of \$4.9 million, lower revenue generated from our games business of \$1.3 million, lower revenue from our SuperPass subscription revenue of \$1.0 million and a decline in our RealPlayer Plus license revenue of \$0.7 million.

Revenue in the United States declined by \$22.7 million in the nine months ended September 30, 2014, compared with the year-ago period. The decline was due primarily to lower revenue generated from the distribution of third party software products of \$10.2 million, a decline in our SuperPass subscription revenue of \$4.0 million, a decrease in our games revenue of \$3.8 million, a decrease in our RealPlayer Plus license revenue of \$2.7 million and a decline in SaaS revenue of \$1.5 million.

Revenue in Europe declined by \$3.0 million in the quarter ended September 30, 2014, compared with the year-earlier period. The decrease was primarily due to lower revenue from our Games business of \$1.7 million, lower revenue from RealPlayer Plus licenses of \$0.5 million, a decline in third party software distribution revenue of \$0.5 million as

well a decline in our SaaS revenue of \$0.3 million.

Revenue in Europe declined by \$8.1 million in the nine months ended September 30, 2014, compared with the year-ago period. The decline was due primarily to a decrease in revenue from our Games business of \$6.1 million, a decrease in RealPlayer Plus license revenue of \$1.5 million, offset in part by an increase in SaaS revenue of \$0.7 million.



Revenue in Korea decreased \$2.1 million in the quarter ended September 30, 2014, compared with the year-earlier period. The decrease was primarily due to lower intellectual property license revenue of \$2.6 million and lower revenue from our SaaS offerings (excluding music on demand) of \$0.9 million, including ringback tones revenue partially offset by higher music on demand revenue of \$1.5 million.

Revenue in Korea decreased \$0.9 million in the nine months ended September 30, 2014, compared with the year-ago period. The decrease was mainly due to lower intellectual property license revenue of \$5.3 million and lower revenue from our SaaS offerings (excluding music on demand) of \$2.6 million, including ringback tones revenue partially offset by higher music on demand revenue of \$7.4 million.

Revenue in the rest of world decreased by \$0.9 million in the quarter ended September 30, 2014, compared with the year-earlier period. The decrease was primarily due to lower revenue from our RealPlayer Plus licenses of \$0.6 million, a decrease in our third party distribution revenue of \$0.3 million and a decrease in our mobile entertainment revenue of \$0.3 million. These decreases were partially offset by an increase in our intellectual property license revenue of \$0.5 million.

Revenue in the rest of world decreased by \$3.1 million in the nine months ended September 30, 2014, compared with the year-ago period. The decrease was due to lower revenue from our RealPlayer Plus licenses of \$1.9 million, \$1.3 million from SaaS revenue, and \$1.0 million from our subscription revenue. These decreases were partially offset by an increase in system integration services in Japan of \$1.3 million.

#### New Accounting Pronouncements

See Note 2, Recent Accounting Pronouncements.

#### Liquidity and Capital Resources

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

	September 30, 2014	December 31, 2013
Working capital	\$153,685	\$191,522
Cash, cash equivalents, and short-term investments	178,021	226,155
Restricted cash equivalents and investments	3,000	3,000

The 2014 decrease of cash, cash equivalents, and short-term investments from December 31, 2013 was primarily due to cash used in operating activities of \$(45.6) million in the first nine months of 2014.

The following summarizes cash flow activity (in thousands):

	Nine Months Ended September 30,	
	2014	2013
Cash provided by (used in) operating activities	\$(45,642	) \$(28,303
Cash provided by (used in) investing activities	10,472	1,411
Cash provided by (used in) financing activities	(458	) (1,331

Cash used in operating activities consisted of net income (loss) adjusted for certain non-cash items such as depreciation and amortization, and the effect of changes in certain operating assets and liabilities.

Cash used in operating activities was \$17.3 million more in the nine months ended September 30, 2014, as compared to the same period in 2013. This increase was primarily due to the decline in revenue of \$34.9 million for the nine months ended September 30, 2014 compared with the prior year period, which was only partially offset by a decline in cash operating expenses.

For the nine months ended September 30, 2014, cash provided by investing activities of \$10.5 million was primarily due to sales and maturities, net of purchases, of short-term investments of \$11.0 million and cash proceeds received from the sale of available for sale securities during the first quarter of \$2.8 million, partially offset by purchases of

equipment, software and leasehold improvements of \$2.1 million.

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For the nine months ended September 30, 2013, cash provided by investing activities of \$1.4 million was primarily due to net cash received of \$24.7 million from the sales, maturity and purchases of short-term investments. Partially offsetting these proceeds was a cash outlay of \$22.5 million for the acquisitions of businesses, net of cash acquired. Financing activities for the nine months ended September 30, 2014 used cash totaling \$0.5 million primarily from the payment of the principal amount of contingent consideration of \$0.7 million related to an earlier period business acquisition.

Financing activities for the nine months ended September 30, 2013 used cash totaling \$1.3 million primarily from certain tax payments from shares withheld upon the vesting of employee restricted stock of \$0.9 million as well as the payment of the principal amount of contingent consideration of \$0.8 million related to an earlier period business acquisition.

We currently have no planned significant capital expenditures for the remainder of 2014 other than those in the ordinary course of business.

Our principal future cash commitments include office leases. 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.

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 cash equivalents and short-term investments consist of investment grade 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 primarily in five functional currencies: the U.S. dollar, the Korean won, the Japanese yen, the British pound and the euro. 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 for certain countries where we invoice our customers primarily in the respective foreign currencies. 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.

As of September 30, 2014, approximately \$24.1 million of the \$178.0 million of cash, cash equivalents, and short-term investments was held by our foreign subsidiaries. If these funds are needed for our operations in the U.S., we may be required to accrue and pay U.S. income and foreign withholding taxes to repatriate these funds. However, our intent is to permanently reinvest these funds outside of the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations. Additionally, the Company currently has significant net operating losses and other tax attributes that could be used to offset potential U.S. income tax that could result if these amounts were distributed to the U.S. We utilize a variety of tax planning and financing strategies in an effort to ensure that our worldwide cash is available in the locations in which it is needed. We do not expect restrictions or potential taxes on repatriation of amounts held outside of the U.S. to have a material effect on our overall liquidity, financial condition or results of operations.

As of September 30, 2014, we have not provided for U.S. federal and state income taxes on certain undistributed earnings of our foreign subsidiaries, since such earnings are considered indefinitely reinvested outside the U.S. or may be remitted tax-free to the U.S. If these amounts were distributed to the U.S., in the future in the form of dividends or otherwise, we could be subject to additional U.S. income and foreign withholding taxes. It is not practicable to determine the foreign withholding and U.S. income tax liability or benefit on such earnings due to the timing of such future distributions, the availability of foreign tax credits, other tax attributes, and the complexity of the computation if such earnings were not deemed to be permanently reinvested. If future events, including material changes in

estimates of cash, working capital, and long-term investment requirements necessitate that these earnings be repatriated, an additional provision for U.S. income and foreign withholding taxes, net of foreign tax credits, may be necessary.

**Off-Balance Sheet Arrangements**

We have operating lease obligations for office facility leases with future cash commitments that are not required to be recorded on our consolidated balance sheet. Accordingly, these operating lease obligations constitute off-balance sheet

arrangements. In addition, since we do not maintain accruals associated with certain guarantees, as discussed in Note 17, Guarantees, those guarantee obligations also constitute off-balance sheet arrangements.

#### 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;
- Estimating recoverability of deferred costs;
- Estimating allowances for doubtful accounts and sales returns;
- Valuation of equity method investments;
- Valuation of definite-lived assets;
- Valuation of goodwill and indefinite-lived intangible assets;
- Stock-based compensation; and
- Accounting for income taxes.

**Revenue Recognition.** We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collection is probable. Physical products are considered delivered to the customer once they have been shipped and title and risk of loss have been transferred. For online sales, the products or services are considered delivered at the time the product or services are made available, digitally, to the end user.

We recognize revenue on a gross or net basis. In most arrangements, we contract directly with end user customers, and are the primary obligor. In such arrangements, we recognize revenue on a gross basis. In some cases, we utilize third-party distributors who are the primary obligor to sell products or services directly to end user customers. In such instances, we recognize revenue on a net basis.

In our direct to consumer business segments, we derive revenue primarily through (1) subscriptions of SuperPass within our RealPlayer Group segment and subscriptions sold by our Games segment, (2) sales of content downloads, software and licenses offered by our RealPlayer Group, Mobile Entertainment, and Games segments and (3) the sale of advertising and the distribution of third-party products on our websites and in our games.

Consumer subscription products are paid in advance, typically for monthly, quarterly or annual duration. Subscription revenue is recognized ratably over the related subscription time period. Revenue from sales of content downloads, software and licenses is recognized at the time the product is made available, digitally, to the end user. Revenue generated from advertising on our websites and from advertising and the distribution of third-party products included in our products is recognized as revenue at the time of delivery.

We also generate revenue through business-to-business channels by providing services within our Mobile Entertainment segment enabling mobile carriers to deliver audio and video content to their customers and by selling software licenses and products and related support and other services. Revenue generated from services provided to mobile carriers that enable the delivery of audio and video content to their customers is recognized as the services are provided. Setup fees to build these services are recognized ratably upon launch of the service over the remaining expected term of the service.

Non-software revenue arrangements containing multiple elements are divided into separate units of accounting, after being evaluated for specific criteria. If the criteria for separation are met, revenue is allocated to the individual units using the relative price method. If the criteria are not met, the elements are treated as one unit of accounting and revenue recognition is delayed until all elements have been delivered. In the case of revenue arrangements containing software, elements are divided into separate units of accounting only when vendor-specific objective evidence has been established. In cases where vendor-specific objective evidence has not been established, undelivered elements are combined into one unit of accounting and are not recognized in revenue until all elements have been delivered.

**Estimating Music Publishing Rights and Music Royalty Accruals.** We must make estimates of amounts that may be owed related to music royalties for our domestic and international music services, primarily the Rhapsody music

service which was separated from our operating results beginning April 1, 2010. Material differences may impact 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 completed negotiations with regard to the royalty rate to be applied to the 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.

**Estimating 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 as a component of cost of revenue, the timing of which is dependent upon the 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.

Assessing the recoverability of deferred project costs is based on significant assumptions and estimates, including future revenue and cost of sales. Significant or sustained decreases in revenue or increases in cost of sales in future periods could result in impairments of deferred project costs. We cannot accurately predict the amount and timing of any such impairments. Should the value of deferred project costs become impaired, we would record the appropriate charge, which could have a material adverse effect on our financial condition or results of operations.

**Estimating Allowances for Doubtful Accounts and Sales Returns.** We make estimates of the uncollectible portion 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 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 are made and used in connection with establishing allowances for doubtful accounts and sales returns. 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 or actual future experience was different from the judgments and estimates.

**Valuation of Equity Method Investments.** We use the equity method of accounting for investments in circumstances where we have the ability to exert significant influence, but not control, over an investee or joint venture. We initially record our investment based on a fair value analysis of the investment.

We record our percentage interest in the investee's recorded income or loss and changes in the investee's capital under this method, which will increase or decrease the reported value of our investment. We record investee losses up to the aggregate amount of the investment. See Note 5 Rhapsody Joint Venture for a discussion of the \$10.0 million preference on the convertible preferred stock we hold in Rhapsody and its impact on our equity method of accounting for this investment.

We evaluate impairment of an investment valued under the equity method if events and circumstances warrant. An impairment charge would be recorded if a decline in value of an equity investment below its carrying amount were determined to be other than temporary. In determining if a decline is other than temporary, we consider factors such as the length of time and extent to which the fair value of the investment has been less than the carrying amount of the investee or joint venture, the near-term and longer-term operating and financial prospects of the investee or joint venture and our intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery.

**Valuation of Definite-Lived Assets.** Definite-lived assets consist primarily of property, plant and equipment, as well as amortizable intangible assets acquired in business combinations. Definite-lived assets are depreciated or amortized on a straight line basis over their estimated useful lives. We review definite-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of such assets may not be recoverable. Recoverability

of these assets is measured by comparison of their carrying amount to future undiscounted cash flows the assets are expected to generate. If definite-lived assets are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the assets exceeds their fair market value.

The impairment analysis of definite-lived assets is based upon estimates and assumptions relating to our future revenue, cash flows, operating expenses, costs of capital and capital purchases. These estimates and assumptions are complex and subject to a significant degree of judgment with respect to certain factors including, but not limited to, the estimation of the related future revenues, the cash flows of our long-term operating plans, valuation multiples, market and interest rate risk, and risk-commensurate discount rates and cost of capital. Significant or sustained declines in future revenue or cash flows, or



adverse changes in our business climate, among other factors, and their resulting impact on the estimates and assumptions relating to the value of our definite-lived assets could result in the need to perform an impairment analysis in future periods which could result in a significant impairment. While we believe our estimates and assumptions are reasonable, due to their complexity and subjectivity, these estimates and assumptions could vary from period to period. Changes in these estimates and assumptions could materially affect the estimate of future undiscounted cash flows and related fair market values of these assets and result in significant impairments, which could have a material adverse effect on our financial condition or results of operations.

As of September 30, 2014, we had approximately \$10 million and \$8 million in total carrying value of definite-lived assets related to our Mobile Entertainment and our RealPlayer groups, respectively. In accordance with our policy as described above, we reviewed these assets for impairment as of September 30, 2014. Our estimate of the fair value of these asset groups indicate that the carrying amounts are expected to be recovered and, therefore, no impairment is indicated as of September 30, 2014. However, it is reasonably possible that the estimate of the fair value of either or both of the Mobile Entertainment and RealPlayer groups may change in the near term should we experience adverse changes in our estimates and assumptions, which could result in impairments of those assets. For further discussion, please see the risk factor entitled, "Any impairment to our goodwill, indefinite-lived intangible assets or definite-lived assets could result in a significant charge to our earnings" under Item 1A Risk Factors.

**Valuation of Goodwill and Indefinite-Lived Intangible Assets.** We test goodwill for impairment on an annual basis, in our fourth quarter, or more frequently if circumstances indicate reporting unit carrying values may exceed their fair values. Circumstances that may indicate a reporting unit's carrying value exceeds its fair value include, but are not limited to: 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. Due to the ongoing difficult economic environment and the decline in revenues in our businesses, we continue to monitor whether there could be potential impairment of goodwill.

When evaluating goodwill for impairment, based upon our annual test or due to changes in circumstances described above, we first perform a qualitative assessment to determine if the fair value of a reporting unit is more likely than not less than the reporting unit's carrying amount including goodwill. If this assessment indicates it is more likely than not, we then compare the carrying value of the reporting unit to the estimated fair value of the reporting unit. If the carrying value of the reporting unit exceeds the estimated fair value, we then calculate the implied estimated fair value of goodwill for the reporting unit and compare it to the carrying amount of goodwill for the reporting unit. If the carrying amount of goodwill exceeds the implied estimated fair value, an impairment charge to current operations is recorded to reduce the carrying value to implied estimated value.

Significant judgments and estimates are required in determining the reporting units and assessing the fair value of the reporting units. These estimates and assumptions are complex and subject to a significant degree of judgment with respect to certain factors including, but not limited to, the estimation of the related future revenues, the cash flows of long-term operating plans, valuation multiples, market and interest rate risk, and risk-commensurate discount rates and cost of capital. While we believe our estimates and assumptions are reasonable, due to their complexity and subjectivity, these estimates and assumptions could vary from period to period. Changes in these estimates and assumptions could materially affect the estimated fair market values of the reporting units and result in significant impairments, which could have a material adverse effect on our financial condition or results of operations.

We evaluate indefinite-lived intangible assets (primarily tradenames and trademarks) for impairment on an annual basis, in the fourth quarter, or more frequently if an event occurs or changes in circumstances indicate that impairment may exist. When evaluating indefinite-lived intangible assets for impairment, we may first perform a qualitative assessment to determine if the fair value of the intangible assets is more likely than not greater than its carrying amount. If we do not perform a qualitative assessment or if the fair value of the intangible assets is not more likely than not greater than its carrying amount, we calculate the estimated fair value of the intangible assets. If the carrying amount of the intangible assets exceeds the estimated fair value, an impairment charge is recorded to reduce the carrying value to the implied estimated fair value.

Significant judgments and estimates are required in assessing the fair value of the indefinite-lived intangible assets. These estimates and assumptions are complex and subject to a significant degree of judgment with respect to certain

factors including, but not limited to, the estimation of the related future revenues, the cash flows of long-term operating plans, valuation multiples, market and interest rate risk, and risk-commensurate discount rates and cost of capital. While we believe our estimates and assumptions are reasonable, due to their complexity and subjectivity, these estimates and assumptions could vary from period to period. Changes in these estimates and assumptions could materially affect the estimated fair market values of these assets and result in significant impairments, which could have a material adverse effect on our financial condition or results of operations.

**Stock-Based Compensation.** Stock-based compensation cost is estimated at the grant date based on the award's fair value and is recognized as expense over the requisite service period, which is the vesting period. For stock options, the fair value is calculated by the Black-Scholes option-pricing model or other appropriate valuation models. The valuation models require various highly judgmental assumptions including volatility in our common stock price and expected option life. If any of the assumptions used in the valuation models change significantly, stock-based compensation expense may differ materially in the future from the amounts recorded in our consolidated statement of operations. For all awards, 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 forfeitures and record stock-based compensation expense only for those awards that are expected to vest.

**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 sources of 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. In certain instances, changes in the valuation allowance may be allocated directly to the related components of shareholders' equity on the consolidated balance sheet. 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.

As of September 30, 2014, \$24.1 million of the \$178.0 million of cash, cash equivalents, and short-term investments was held by our foreign subsidiaries.

As of September 30, 2014, we have not provided for U.S. federal and state income taxes on certain undistributed earnings of our foreign subsidiaries, since such earnings are considered indefinitely reinvested outside the U.S. or may be remitted tax-free to the U.S. If these amounts were distributed to the U.S., in the form of dividends or otherwise, RealNetworks could be subject to additional U.S. income and foreign withholding taxes. It is not practicable to determine the foreign withholding and U.S. income tax liability or benefit on such earnings due to the timing of such future distributions, the availability of foreign tax credits, and the complexity of the computation if such earnings were not deemed to be permanently reinvested. If future events, including material changes in estimates of cash, working capital, and long-term investment requirements necessitate that these earnings be distributed, an additional provision for U.S. income and foreign withholding taxes, net of foreign tax credits, may be necessary.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

The following discussion about our market risk involves forward-looking statements. All statements that do not relate to matters of historical fact should be considered forward-looking statements. Actual results could differ materially from those projected in any 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. Our short-term investments consist of investment grade 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. See Note 6, Fair Value Measurements for additional information. 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, 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 quarter ended September 30, 2014. Based on our cash, cash equivalents, short-term investments, and restricted cash equivalents as of September 30, 2014, a hypothetical 10% increase/decrease in interest rates would not increase/decrease our annual interest income or cash flows by more than a nominal amount.

**Investment Risk.** As of September 30, 2014, we had investments in voting capital stock of both publicly traded and privately held technology companies for business and strategic purposes. See Note 1, Description of Business and Summary of Significant Accounting Policies - Valuation of Equity Method Investments, and Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies and Estimates (Valuation of equity method investments) in the 10-K for details on our accounting treatment for these investments, including the analysis of other-than-temporary impairments.

**Foreign Currency Risk.** We conduct business internationally in several currencies and thus 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 remeasurement 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. We manage a portion of these risks 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. Some of our unhedged exposures are recorded in our statement of operations on a mark-to-market basis each quarter, so to the extent we continue to experience adverse economic conditions, we may record losses related to such unhedged exposures in future periods that may have a material adverse effect on our financial condition and results of operations.

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

We have cash balances denominated in foreign currencies which are subject to foreign currency fluctuation risk. The majority of our foreign currency denominated cash is held in Korean won and euros. A hypothetical 10% increase or decrease in the Korean won and euro relative to the U.S. dollar as of September 30, 2014 would not result in a material impact on our financial position, results of operations or cash flows.

#### Item 4. Controls and Procedures

##### (a) Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2014. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their

objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Based upon that evaluation, our chief executive officer and chief financial officer concluded that, as of September 30, 2014, our disclosure controls and procedures were effective.

(b) Changes in Internal Control over Financial Reporting

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There have been no changes in our internal control over financial reporting (as such term is defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the third quarter of 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

We have in the past and could in the future become subject to legal proceedings, governmental investigations and claims in the ordinary course of business, including employment claims, contract-related claims, and claims of alleged infringement of third-party patents, trademarks and other intellectual property rights. Such claims, even if not meritorious, could force us to expend significant financial and managerial resources. In addition, given the broad distribution of some of our consumer products, any individual claim related to those products could give rise to liabilities that may be material to us. In the event of a determination adverse to us, we may incur substantial monetary liability, and/or be required to change our business practices. Either of these could have a material adverse effect on our consolidated financial statements.

### Item 1A. Risk Factors

You should carefully consider the risks described below together with all of the other information included in this Form 10-Q. The risks and uncertainties described below are not the only ones facing our company. Additional risks and uncertainties not presently known to us or that we presently deem less significant may also impair our business operations. If any of the following risks actually occurs, our business, financial condition or operating results, and the trading price of our common stock, could be materially harmed.

Our business and financial results will be materially adversely impacted if we are unable to successfully implement our growth plan, strategic initiatives, and restructuring efforts.

Beginning in mid-2012, we have developed a growth plan that involves the launch of at least one major new product in each of our three business units. In tandem with our growth plan, we have embarked upon strategic initiatives intended to simplify and accelerate our operations, and restructuring efforts intended to streamline costs and bring more focus to our businesses. The simultaneous execution of all of these measures is ambitious and we have not attempted to pursue this level of transition in our history. We can provide no assurance that we will be successful in implementing our growth plan, strategic initiatives, and restructuring efforts, and our failure to do so would have a material adverse impact on our business and financial results.

We need to successfully introduce and monetize new products and services to sustain and grow our businesses. In order to sustain our current business and to implement our growth plan, we must successfully introduce and monetize new products and services. The process of developing new, and enhancing existing, products and services is complex, costly and uncertain, and is subject to a number of risks. Providing products and services that are attractive and useful to subscribers and consumers is in part 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, emerging technological trends or important changes in the market or competition for products and services that we introduce, or that we plan to introduce, 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 the products and services that we are developing will meet the needs of a large enough group of consumers, which may result in no return or a loss on our investments.

During 2013, each of our businesses introduced at least one new product or service. In November 2013, our Mobile Entertainment business completed its European launch of LISTEN, an application and service for smartphone users featuring ringback tones and other services. LISTEN was launched with T-Mobile in the U.S. in April 2014. In September 2013, our RealPlayer business completed the U.S. launch of RealPlayer Cloud, an integrated video player and cloud service. RealPlayer Cloud was launched globally in February 2014. In August 2013, our Games business launched GameHouse Casino Plus with the Golden Dreams Sweepstakes feature and, in September 2014, our Games business launched its newest game, Slingo Adventure. To date, we have not generated significant revenue from these recently launched products and services. Over the past several quarters, we have invested heavily in the development of these and other new products and enhanced features for such products, and we expect to continue to invest heavily



both in further development and in sales and marketing efforts aimed at monetizing these products and related services. There can be no assurance, however, that such efforts will generate significant revenue. If we are unable to generate sustained interest in these products and services, and therefore drive revenue growth, our financial results will be materially negatively impacted.

Furthermore, new products and services may be subject to legal challenge. 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 our products or services, or to pay damages, any of which could materially harm our operating results.

Our legacy products and services face new and continuing challenges, causing our revenues to suffer.

Our legacy products and services have historically been provided through desktop computers and feature phones, but the number of people who access similar products and services through smartphones and tablets has increased dramatically in the past few years. There are many challenges involved in developing and marketing products and services for users of smartphones and tablets, and there is no guarantee that we will be able to transition our legacy products and services to these devices or to effectively monetize popular and successful versions of these products and services for smartphones and tablets.

In addition, our consumer-based products and services have historically been distributed through desktop operating platforms. As new operating systems are introduced or updated for these platforms, we have faced, and could continue to face, difficulties reaching our traditional customer base and other unknown distribution challenges. If we have difficulty transitioning product and version releases that can easily be distributed through these new or updated operating systems and devices, then our business could be significantly harmed.

As we increasingly focus our development and sales and marketing efforts on our newly launched products and services, sales of our legacy products and services have suffered and will continue to suffer. For instance, while the efforts of our RealPlayer team are targeted more exclusively towards enhanced development and monetization of our new RealPlayer Cloud product, we have significantly reduced our marketing of SuperPass and have redirected our development resources away from RealPlayer Plus, both of which have resulted in declines in the number of subscribers of those legacy products.

Our restructuring efforts may not yield the anticipated benefits to our shareholders.

During 2012, we took steps to restructure and simplify our business and operations. In September 2012, we announced plans to divisionalize our business, which we implemented during the first quarter of 2013, and to significantly reduce operating expenses, in part through a reduction in our workforce that was substantially concluded by the end of the second quarter of 2013. In August 2014, we announced a further reduction in our workforce and related cost reductions. We continue to assess opportunities to further streamline our operations and make our businesses more efficient. There can be no assurance, however, that our past or future restructuring efforts will be successful. Our business and operations may be harmed to the extent there is customer or employee uncertainty surrounding the future direction of our product and service offerings and strategy for our businesses. Our restructuring activities have included implementing cost-cutting initiatives, which may not lead to future profitability and which could materially impact our ability to compete in future periods. If we are unable to effectively re-align the cost structure of our businesses or streamline and simplify our operations, our stock price may be adversely affected, and we and our shareholders will not realize the anticipated financial, operational and other benefits from such initiatives. Our businesses face substantial competitive challenges that may prevent us from being successful in those businesses, and may negatively impact future growth in those businesses.

Many of our current and potential competitors in our businesses have longer operating histories, greater name recognition, more employees and significantly greater resources than we do. To effectively compete in the markets for our products and services, we may experience the following consequences, any of which would adversely affect our operating results and the trading price of our stock:

- reduced prices or margins,
- loss of current and potential customers, or partners and potential partners who provide content we distribute to our customers,
- changes to our products, services, technologies, licenses or business practices or strategies,
- lengthened sales cycles,
- industry-wide changes in content distribution to customers or in trends in consumer consumption of digital media products and services,
- pressure to prematurely release products or product enhancements, or

degradation in our stature or reputation in the market.

The market for mobile entertainment services, including our ringback tones and music on demand solutions, is highly competitive and evolving rapidly, particularly with the growth in the use of smartphones. Increased use of smartphones has resulted in a proliferation of applications and services that compete with our SaaS services and, in many cases, are not dependent upon our carrier customers to make them available to subscribers. To maintain or enhance our competitive position, we need to develop new SaaS services that enable our carrier customers to compete with the broad range of applications and

other services available in the market. We face competition, and may face future competition, from major media companies, Internet portal companies, content aggregators, wireless software providers and other pure-play wireless entertainment publishers, some of which have greater financial resources than we do. Furthermore, while most of our carrier customers do not offer internally developed services that compete with ours, if our carrier customers begin developing these 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. Increased competition has in the past resulted in pricing pressure, forcing us to lower the selling price of our services. If we are unable to develop or provide services that compete effectively in the mobile entertainment market, our operating results and financial condition may be materially harmed.

Our legacy RealPlayer software services compete with alternative streaming media playback technologies and audio and video formats including Microsoft Windows Media Player and Adobe Flash and their related file formats, each of which has obtained very broad market penetration. In addition, our overall ability to sell subscription services depends in part on the use of our formats on the Internet, and declines in the use of our formats have negatively affected, and are expected to continue to negatively affect, our subscription revenue and increase costs of obtaining new subscribers. Our SuperPass subscription service, within our RealPlayer business unit, continues to face increasingly intense competition from a broad variety of entertainment sources, including traditional media outlets and Internet media sources. We expect that our recently launched RealPlayer Cloud product will face competition from other cloud service providers, including some that are firmly established in the marketplace and have access to extensive resources. If we are unable to compete successfully, including through the development, marketing and monetization of new or recently launched products and services, our RealPlayer business could continue to decline.

The branded services in our Games business compete with other online aggregators and distributors of online, downloadable and social casual PC games. Some of these competitors have high volume distribution channels and greater financial resources than we do. Our Games business also competes with many other smaller companies that may be able to adjust to market conditions, including responding effectively to the growing popularity of casual games on social networks, faster than us. We also face significant price competition in the casual games market, and some of our competitors may be able to lower prices more aggressively than us. We expect competition to continue to intensify in this market from these and other competitors. We cannot provide assurance that we will be able to slow recent revenue declines or achieve future growth in our revenue, particularly as we continue to invest in social and mobile games as the market for these games continues to rapidly evolve. Our games development studios compete primarily with other developers of online, downloadable, mobile and social casual PC games and must continue to develop popular and high-quality game titles. Our Games business must also continue to execute on opportunities to expand the play of our games on a variety of non-PC platforms, including social networks, in order to maintain our competitive position and to grow the business.

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 the SaaS offerings we provide to carriers. Many of our SaaS contracts with carriers 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 mobile carrier customers could purchase similar 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, some of our SaaS contracts require us to incur significant set-up costs prior to the launch of services with a carrier customer. For example, in the fourth quarter of 2011, we reduced our forecast for profitability associated with certain carrier customer contracts for which the total costs exceeded the total revenue we expect to recognize from these contracts, and as a result, we recorded impairment of deferred costs totaling \$20.0 million. There can be no assurance that we will not record additional impairments or other charges in future periods related to our carrier customer contracts, which would negatively impact our results of operations.

In addition, none of our SaaS contracts with carriers obligates our carrier customers to market or distribute any of our SaaS offerings. Despite the lack of marketing commitments, revenue related to our SaaS offerings is, to a large extent, dependent upon the marketing and promotion activities of our carrier customers. In addition, 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. The loss of carrier customers, a reduction in marketing or promotion of our SaaS offerings, or the termination, non-renewal or renegotiation of contract terms that are less favorable to us would likely result in the loss of future revenues from our SaaS offerings.

Finally, nearly all 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. Pursuant to these indemnifications obligations, we have in the past agreed to control the defense on behalf of certain of our carrier customers related to patent infringement proceedings. We have recently settled two such litigation matters. Future claims against which we may be obligated to defend our carrier customers could result in payments that could materially harm our business or our consolidated financial statements. A majority of the revenue that we generate in our Mobile Entertainment business segment is dependent upon our relationships with a few customers, and any deterioration of these relationships could materially harm our revenue. We generate a significant portion of our revenue from sales of our mobile entertainment services to a few of our mobile carrier customers, including SK Telecom, a leading wireless carrier in South Korea, and its affiliates. In the near term, we expect that we will continue to generate a significant portion of our total revenue from these customers. If these customers fail to market or distribute our services or terminate or fail to renew their business contracts with us, or if our relationships with these customers deteriorate in any significant way, we may be unable to replace the affected business arrangements with acceptable alternatives. Failure to maintain our relationships with these customers could have a material negative impact on our revenue.

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

Maintaining and growing the distribution of digital media products through our websites and our other distribution channels has historically been important to our business, including growth through the introduction of new products and services distributed through these channels. We cannot predict whether consumers will continue to download and use our digital media products consistent with past usage, which may reduce our ability to generate revenue from those products as well as result in lower than expected adoption of newly introduced products and services. Our inability to maintain continued high volume distribution of our digital media products could also hold back the growth and development of related revenue streams from these market segments, including the distribution of third-party products and sales of our subscription services, and therefore could harm our business and our prospects. Our revenue from the distribution of third-party products will also be negatively impacted if those products are not widely downloaded by consumers, including due to the relative market saturation of such products. Most of our revenue from the distribution of third-party products was historically derived from a single customer, however that relationship ended during the third quarter of 2014, and we entered into an agreement with a new distribution partner. We anticipate that our distribution revenue will be materially negatively impacted by this change.

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

The trading price for our common stock has a history of volatility. Although our recent stock price history shows more stability, with a range from \$6.94 to \$8.85 per share during the 52-week period ended September 30, 2014, it also shows continued weakness. As a result of the rapidly changing markets in which we compete, our operating results may fluctuate from period to period, which may contribute to volatility of our stock price.

In past periods, our operating results have been affected by personnel reductions and related restructuring charges, lease exit and related charges, and impairment charges for certain of our equity investments, goodwill and other long-lived assets. In addition to these factors, the general difficulty in forecasting our operating results and metrics could result in actual results that differ significantly from expected results, causing volatility and continued weakness in our stock price.

Certain of our product and service investment decisions (for example, research and development and sales and marketing efforts) are based on predictions regarding business and the markets in which we compete. Fluctuations in our operating results, particularly when experienced beyond what we expected, could cause the trading price of our stock to fluctuate. Weakness in our operating performance, is likely to cause continued weakness in our stock price. Any impairment to our goodwill, indefinite-lived intangible assets and definite-lived assets could result in a significant charge to our earnings.

In accordance with accounting principles generally accepted in the United States, we are required to test goodwill and indefinite-lived intangible assets for possible impairment on an annual basis based upon a fair value approach, or more

frequently in the event of certain indications of possible impairment. We review definite-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of such assets may not be recoverable. These events or circumstances could include a significant change in the business climate, including a significant sustained decline in a reporting unit's market value, legal factors, operating performance indicators, competition, sale or disposition of a significant portion of

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our business, a significant sustained decline in our market capitalization and other factors. If we were to determine that an impairment had occurred, we would be required to record an impairment charge, which could have a significant negative, and unpredicted, impact on our financial results. The total carrying value of our goodwill, indefinite-lived intangible assets and definite-lived assets as of September 30, 2014 was \$47 million.

Continued loss of revenue from some of our subscription services may continue to harm our operating results. Our operating results have been and could continue to be adversely impacted by the loss of subscription revenue related to our legacy services and by the failure to generate revenue related to our new services. 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 with competitive service offerings, or because customer service issues are not satisfactorily resolved. Revenue from our SuperPass subscription service, for example, has declined in recent periods due in part to our focus on other products and services we offer, and we expect this trend to continue. For the subscription services we offer, we must continue to obtain compelling digital media content for our video and games services in order to maintain and increase usage and overall customer satisfaction for these products. Our operating results may be negatively impacted if we cannot obtain content for our subscription services on commercially reasonable terms.

Government regulation of the Internet is evolving, and unfavorable developments could have an adverse affect on our operating results.

We are subject to regulations and laws specific to the marketing, sale and delivery of goods and services over the Internet. These laws and regulations, which continue to evolve, cover taxation, user privacy, data collection and protection, copyrights, electronic contracts, sales procedures, automatic subscription renewals, credit card processing procedures, consumer protections, digital games distribution, broadband Internet access and content restrictions. We cannot guarantee that we have been or will be fully compliant in every jurisdiction, as it is not entirely clear how existing laws and regulations governing issues such as privacy, taxation and consumer protection apply or will be enforced with respect to the products and services we sell through the Internet. Moreover, as Internet commerce continues to evolve, increasing regulation and/or enforcement efforts by federal, state and foreign agencies and the prospects for private litigation claims related to our data collection, privacy policies or other e-commerce practices become more likely. In addition, the adoption of any laws or regulations or the imposition of other legal requirements that adversely affect our ability to market, sell, and deliver our products and services could decrease our ability to offer or customer demand for our service offerings, resulting in lower revenue. Future regulations, or changes in laws and regulations or their existing interpretations or applications, could also require us to change our business practices, raise compliance costs or other costs of doing business and result in additional historical or future liabilities for us, resulting in adverse impacts on our business and our operating results.

As a consumer-facing business, we receive complaints from our customers regarding our consumer marketing efforts and our customer service practices. Some of these customers may also complain to government agencies, and from time to time, those agencies have made inquiries to us about these practices. In addition, we may receive complaints or inquiries directly from governmental agencies that have not been prompted by consumers. In May of 2012, we resolved an investigation and complaint filed against us by the Washington State Office of the Attorney General, or Washington AG, relating to our consumer marketing practices through the entry of a consent decree filed in King County, Washington Superior Court. While we resolved that matter, we cannot provide assurance that the Washington AG or other governmental agencies will not bring future claims regarding our marketing, or consumer services or other practices.

Uncertainty and adverse conditions in the economy could have a material adverse impact on our business, financial condition and results of operations.

The ongoing weakness in the national and global economy has resulted in declines in overall consumer and corporate spending, declines in consumer and corporate access to credit, fluctuations in foreign exchange rates, declines in the value of assets and increased liquidity risks, all of which could materially impact our business, financial condition and results of operations. We provide digital entertainment services to consumers directly and indirectly through our carrier customers. Consumers may consider the purchase of our products and services to be a discretionary



expenditure. As a result, consumers considering whether to purchase our products or services may be influenced by macroeconomic factors that affect consumer spending such as unemployment, conditions in the residential real estate and mortgage markets and access to credit when making a determination whether to commence, continue, or stop subscribing to or otherwise purchasing our products and services. In addition, businesses may reduce their advertising spending during adverse macroeconomic conditions, which would negatively impact the revenue we generate through sales of advertising on our websites and other properties. We have recorded material asset impairment charges in recent years due in part to weakness in the global economy, and if the ongoing

significant weakness and uncertainty in the global economy continues, we may need to record additional impairments to our assets in future periods. If any of these risks are realized, we may experience a material adverse impact on our financial condition and results of operations.

Rhapsody could continue to recognize losses, which would negatively impact our results of operations and financial condition.

On March 31, 2010, we completed the restructuring of our digital audio music service joint venture, Rhapsody America LLC. As a result of the restructuring, we no longer have operational control over Rhapsody and Rhapsody's operating performance is no longer consolidated with our consolidated financial statements. Rhapsody has generated accounting losses since its inception and we have recognized losses on our investment in the convertible preferred stock of Rhapsody since the restructuring. If Rhapsody continues to incur losses, or if it otherwise experiences a significant decline in its business, we may incur further losses on our investment, which could have an adverse effect on our financial condition and results of operations. See Note 5, Rhapsody Joint Venture, for details on the liquidation preference on our convertible preferred investment.

Given the current proportion of the outstanding equity of Rhapsody that we hold, we need to receive Rhapsody's unaudited quarterly financial statements and related information in order to timely prepare our quarterly consolidated financial statements and also to report certain of Rhapsody's financial results, as may be required, in our quarterly reports on Form 10-Q. In addition, we may be required to include Rhapsody's annual audited financial statements in our annual report on Form 10-K in future periods. As we no longer exert operational control over Rhapsody, we cannot guarantee that Rhapsody will deliver its financial statements and related information to us in a timely manner, or at all, or that the unaudited financial statement information provided by Rhapsody will not contain inaccuracies that are material to our reported results. Any failure to timely obtain Rhapsody's quarterly financial statements or to include its audited financial statements in our future annual reports on Form 10-K, if required, could cause our reports to be filed in an untimely manner, which would preclude us from utilizing certain registration statements and could negatively impact our stock price.

The loss of key personnel, or difficulty recruiting and retaining them, could significantly harm our business or jeopardize our ability to meet our growth objectives.

Our success depends substantially on the contributions and abilities of certain key executives and employees. We have experienced a significant amount of executive-level turnover in the past several years, which has had and could continue to have a negative impact on our ability to retain key employees. Rob Glaser, our founder, Chairman and initial chief executive officer, resigned as chief executive officer in 2010, was appointed as interim chief executive officer in July 2012, and was named permanent chief executive officer in July 2014. In addition, each member of our executive team is either new to RealNetworks or new to his executive position as of 2012, 2013 or 2014. We cannot provide assurance that we will effectively manage these executive-level transitions, which may impact our ability to retain key executives and employees and which could harm our business and operations to the extent there is customer or employee uncertainty arising from such transitions.

Our success is also substantially dependent upon our ability to identify, attract and retain highly skilled management, technical and sales personnel. Qualified individuals are in high demand and competition for such qualified personnel in our industry, particularly engineering talent, is intense, and we may incur significant costs to attract or retain them. Our ability to attract and retain personnel may also be made more difficult by the uncertainty created by our recent executive-level turnover and by our restructuring efforts, which have involved reductions in our workforce. 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.

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

As part of our business strategy, we have acquired and sold technologies and businesses in the past and expect that we will continue to do so in the future. The failure to adequately manage transaction costs and address the financial, legal and operational risks raised by acquisitions and divestitures of technology and businesses could harm our business and prevent us from realizing the benefits of these transactions. In addition, we may identify and acquire target companies, but those companies may not be complementary to our current operations and may not leverage our existing

infrastructure or operational experience, which may increase the risks associated with completing acquisitions. Transaction-related costs and financial risks related to completed and potential future purchase or sale transactions may harm our financial position, reported operating results, or stock price. Previous acquisitions have resulted in significant expenses, including amortization of purchased technology, amortization of acquired identifiable intangible assets and the incurrence of charges for the impairment of goodwill and other intangible assets, which are reflected in our operating expenses. New acquisitions and any potential additional future impairment of the value of purchased assets, including goodwill, could have a significant negative impact on our future operating results. For example, in 2013 we acquired Slingo, Inc. pursuant to

which we recorded \$8.0 million of intangible assets and \$9.9 million in goodwill, and Muzicall Limited pursuant to which we recorded \$5.4 million of intangible assets and \$1.3 million in goodwill. In compliance with accounting principles generally accepted in the United States, we evaluate these assets for impairment at least annually. Factors that may be considered a change in circumstances, indicating that our goodwill, indefinite-lived intangible assets or definite-lived assets may not be recoverable, include reduced future revenue and cash flow estimates due to changes in our forecasts, and unfavorable changes to valuation multiples and discount rates due to changes in the market. If we were to conclude that any of these assets were impaired, we would have to recognize an impairment charge that could significantly impact our financial results.

Purchase and sale transactions also involve operational risks that could harm our existing operations or prevent realization of anticipated benefits from a transaction. 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, managing and integrating acquired businesses in remote locations or in countries in which we have little or no prior experience;
- diversion of management time and other resources from existing operations;
- 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 may be unable to adequately protect our proprietary rights or leverage our technology assets, and may face risks associated with third-party claims relating to intellectual property rights associated with our products and services. Our ability to compete across our businesses 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. 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. We also routinely receive challenges to our trademarks and other proprietary intellectual property that we are using in our business activities in China. Disputes regarding the validity and scope of patents or the ownership of technologies and rights associated with streaming media, digital distribution, and online businesses are common and likely to arise in the future. While we sold to Intel Corporation in 2012 most of our patents, including patents that covered streaming media, we agreed to indemnify Intel for certain third-party infringement claims against these patents up to the purchase price we received in the sale. We may also be forced to litigate to enforce or defend our patents and other 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 fail to improve our business prospects or otherwise 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 contract breaches, infringement of copyrights, trademark rights, trade secret rights or other proprietary rights, or alleging unfair competition or violations of privacy rights. These claims, even if not meritorious, could force us to spend significant financial and managerial resources. Given the broad distribution of some of our consumer products, any individual claim related to those products could give rise to liabilities that may be material to us. For example, in July 2012, VoiceAge Corporation brought a lawsuit against us alleging breach of our obligation to pay them licensing fees under our patent license agreement with VoiceAge and seeking a material amount in damages. While we settled the dispute with VoiceAge in the fourth quarter of 2013, similar future lawsuits could result in significant legal expenses, monetary damages, penalties or injunctive relief against us that could have a material adverse impact on our future consolidated financial statements. In addition, in 2012 we sold substantially all

of our patent assets to Intel. We believe that our patent portfolio may have in the past discouraged third parties from bringing infringement or other claims against us relating to the use of our technologies in our business. Accordingly, we cannot predict whether the sale of these patent assets to Intel will result in additional infringement or other claims against us from third parties.

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 and security of our information systems and networks. A significant or repeated reduction in the performance,

reliability, security 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 two leased facilities 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.

The growth of our business is dependent in part on successfully managing our international operations.

Our international operations involve risks inherent in doing business globally, including difficulties in managing operations due to distance, language, and cultural differences, local economic conditions, different or conflicting laws and regulations, taxes, and exchange rate fluctuations. The functional currency of our foreign subsidiaries is the local currency of the country in which each subsidiary operates. We translate our subsidiaries' revenues into U.S. dollars in our financial statements, and continued volatility in foreign exchange rates, particularly if the U.S. dollar strengthens against the euro or the Korean won, may result in lower reported revenue or net assets in future periods. Our foreign currency exchange risk management program reduces, but does not eliminate, the impact of currency exchange rate movements. If we do not effectively manage any of the risks inherent in running our international businesses, our operating results and financial condition could be harmed.

We may be subject to market risk and legal liability in connection with our data collection and data security capabilities.

Many of our products are interactive Internet applications that by their very nature require communication between a client and server to operate. For example, to provide better consumer experiences and to operate effectively, our products send information, including personally identifiable information, to our servers. In addition, we sell many of our products and services through online sales transactions directly with consumers, through which we collect and store credit card information. In connection with our direct sales to consumers, we may be the victim of fraudulent transactions, including credit card fraud, which presents a risk to our revenue and potentially disrupts service to our consumers. While we take measures to protect our consumer data, we have experienced unauthorized access to our consumer data in the past, and it is possible that our security controls over consumer data may not prevent future improper access or disclosure of credit card information or personally identifiable information. We have an extensive privacy policy concerning the collection, use and disclosure of user data involved in interactions between our client and server products. A security breach that leads to disclosure of consumer account information (including personally identifiable information) or any failure by us to comply with our posted privacy policy or existing or new legislation regarding privacy issues could harm our reputation, impact the market for our products and services, subject us to litigation, and require us to expend significant resources to mitigate the breach of security, comply with breach notification laws or address related matters. In addition, we will also need to maintain compliance with the Payment Card Industry, or PCI, compliance standard for data security, which we recently achieved, in connection with our use of credit card services for payment. If we fail to maintain the PCI compliance standards we may be subject to substantial monetary penalties and we could lose the ability to accept credit card payments for transactions with our customers. Any of these consequences could materially harm our business or our consolidated financial statements. Changes in regulations applicable to the Internet and e-commerce that increase the taxes on the services we provide could materially harm our business and operating results.

As Internet commerce continues to evolve, increasing taxation by state, local or foreign tax authorities becomes more likely. For example, taxation of electronically delivered products and services or other charges imposed by government agencies may also be imposed. We believe we collect transactional taxes and are compliant and current in all jurisdictions where we believe we have a collection obligation for transaction taxes. Any regulation imposing greater taxes or other fees for products and services could result in a decline in the sale of products and services and

the viability of those products and services, harming our business and operating results. A successful assertion by one or more states or foreign tax authorities that we should collect and remit sales or other taxes on the sale of our products or services could result in substantial liability for past sales.

In those countries where we have taxable presence, we collect value added tax, or VAT, on sales of “electronically supplied services” provided to European Union residents. The collection and remittance of VAT subjects us to additional currency fluctuation risks.

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.

Our Chairman of the Board and Chief Executive Officer beneficially owns approximately 36% of our stock, which gives him significant control over certain major decisions on which our shareholders may vote or may discourage an acquisition of us.

Robert Glaser, our Chairman of the Board and Chief Executive Officer, beneficially owns approximately 36% of our common stock. As a result, Mr. Glaser and his affiliates 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.

The stock ownership of Mr. Glaser and his affiliates 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 transactions 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.

Mr. Glaser has special rights under our articles of incorporation to appoint or remove members of the strategic transactions committee at his discretion that could make it more difficult for RealNetworks to be sold or to complete another change of control transaction without Mr. Glaser's consent. 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. These rights and his role as Chairman of the Board of Directors, together with Mr. Glaser's significant beneficial ownership, create unique potential for concentrated influence of Mr. Glaser over potentially material transactions involving RealNetworks and decisions regarding the future strategy and leadership of RealNetworks.

We have adopted a shareholder rights plan, which was amended and restated in December 2008, which 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, 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.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds



- (a) Not applicable
- (b) Not applicable

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(c) Not applicable

Item 3. Default Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

Item 6. Exhibits

See Index to Exhibits below.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, on November 5, 2014.

REALNETWORKS, INC.

By: /s/ Tim M. Wan  
Tim M. Wan  
Title: Chief Financial Officer and Treasurer  
(Principal Financial and Accounting Officer)

INDEX TO EXHIBITS

Exhibit Number	Description
10.1	RealNetworks, Inc. 2005 Stock Incentive Plan, as amended and restated effective July 24, 2014
10.2	Offer Letter dated July 24, 2014 between RealNetworks, Inc. and Robert Glaser
31.1	Certification of Robert Glaser, Chairman and Chief Executive Officer of RealNetworks, Inc., pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Tim M. Wan, Chief Financial Officer and Treasurer of RealNetworks, Inc., pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Robert Glaser, Chairman and Chief Executive Officer of RealNetworks, Inc., pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Tim M. Wan, Chief Financial Officer and Treasurer of RealNetworks, Inc., pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document