REALNETWORKS INC
Form 10-Q
May 11, 2009

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended March 31, 2009

OR

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

For the transition period from to

Commission file number 0-23137

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

Washington	**91-1628146**
(State of incorporation)	*(I.R.S. Employer Identification Number)*
2601 Elliott Avenue, Suite 1000 **Seattle, Washington**	**98121**
(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 þ No o

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 o No o

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

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

The number of shares of the registrant s Common Stock outstanding as of April 30, 2009 was 134,420,761.

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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)

	March 31, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 211,709	$ 232,968
Short-term investments	164,785	137,766
Trade accounts receivable, net of allowances for doubtful accounts and sales returns	61,837	70,201
Deferred costs, current portion	6,948	4,026
Prepaid expenses and other current assets	31,004	34,599
Total current assets	476,283	479,560
Equipment, software, and leasehold improvements, at cost:		
Equipment and software	138,004	135,788
Leasehold improvements	30,758	30,719
Total equipment, software, and leasehold improvements, at cost	168,762	166,507
Less accumulated depreciation and amortization	107,913	103,500
Net equipment, software, and leasehold improvements	60,849	63,007
Restricted cash equivalents and investments	14,767	14,742
Equity investments	18,754	18,582
Other assets	3,992	3,775
Deferred costs, non-current portion	6,854	6,120
Deferred tax assets, net, non-current portion	8,980	9,236
Other intangible assets, net	15,747	18,727
Goodwill	170,618	175,264
Total assets	$ 776,844	$ 789,013
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 48,540	$ 36,575
Accrued and other liabilities	111,679	118,688
Deferred revenue, current portion	39,421	39,835
Related party payable	7,598	13,155
Accrued loss on excess office facilities, current portion	4,251	4,317
Total current liabilities	211,489	212,570
Deferred revenue, non-current portion	2,087	1,961
Accrued loss on excess office facilities, non-current portion	1,909	2,893

Deferred rent	4,589	4,614
Deferred tax liabilities, net, non-current portion	866	1,379
Other long-term liabilities	11,521	11,660
Total liabilities	232,461	235,077
Noncontrolling interest in Rhapsody America	5,427	378
Shareholders equity:		
Preferred stock, $0.001 par value, no shares issued and outstanding:		
Series A: authorized 200 shares		
Undesignated series: authorized 59,800 shares		
Common stock, $0.001 par value authorized 1,000,000 shares; issued and outstanding 134,414 shares in 2009 and 134,354 shares in 2008	134	134
Additional paid-in capital	650,050	642,705
Accumulated other comprehensive loss	(58,540)	(48,729)
Retained deficit	(52,688)	(40,552)
Total shareholders equity	538,956	553,558
Total liabilities and shareholders equity	$ 776,844	$ 789,013

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 March 31,	
	2009	2008
Net revenue (A)	$ 140,773	$ 147,563
Cost of revenue (B)	56,021	55,393
Gross profit	84,752	92,170
Operating expenses:		
Research and development	28,559	25,006
Sales and marketing	43,685	53,596
Advertising with related party	7,423	7,340
General and administrative	22,831	17,084
Restructuring and other charges	794	686
Total operating expenses, net	103,292	103,712
Operating loss	(18,540)	(11,542)
Other income (expenses):		
Interest income, net	1,183	4,958
Equity in net loss of investments	(655)	(91)
Gain on sale of equity investments, net	137	
Gain on sale of interest in Rhapsody America		3,726
Other income, net	855	768
Other income, net	1,520	9,361
Loss before income taxes	(17,020)	(2,181)
Income taxes	(1,549)	(4,008)
Net loss	(18,569)	(6,189)
Net loss attributable to noncontrolling interest in Rhapsody America	6,433	8,615
Net income (loss) attributable to common shareholders	$ (12,136)	$ 2,426
Basic net income (loss) per share available to common shareholders	$ (0.10)	$ 0.02
Diluted net income (loss) per share available to common shareholders	$ (0.10)	$ 0.02
Shares used to compute basic net income (loss) per share available to common shareholders	134,380	142,491
Shares used to compute diluted net income (loss) per share available to common shareholders	134,380	154,736

Comprehensive income (loss):		
Net loss	$ (18,569)	$ (6,189)
Unrealized holding losses on short-term and equity investments, net of income taxes	(1,822)	(434)
Foreign currency translation gains (losses)	(7,989)	(8,062)
Comprehensive loss	(28,380)	(14,685)
Comprehensive loss attributable to noncontrolling interest	6,433	8,615
Comprehensive loss attributable to common shareholders	$ (21,947)	$ (6,070)
(A) Components of net revenue:		
License fees	$ 26,179	$ 25,755
Service revenue	114,594	121,808
	$ 140,773	$ 147,563
(B) Components of cost of revenue:		
License fees	$ 9,246	$ 9,388
Service revenue	46,775	46,005
	$ 56,021	$ 55,393

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)

	Quarters Ended March 31, 2009	Quarters Ended March 31, 2008
Cash flows from operating activities:		
Net (loss) income attributable to common shareholders	$ (12,136)	$ 2,426
Adjustments to reconcile net income (loss) attributable to common shareholders to net cash provided by (used in) operating activities:		
Depreciation and amortization	7,776	12,971
Stock-based compensation	5,222	5,489
(Gain) loss on disposal of equipment, software, and leasehold improvements	(33)	75
Equity in net loss of investments	655	91
Gain on sale of equity investments, net	(137)	
Excess tax benefit from stock option exercises	(9)	(50)
Accrued loss on excess office facilities	(1,050)	(841)
Deferred income taxes	(212)	(939)
Noncontrolling interest	(6,433)	(8,615)
Gain on sale of interest in Rhapsody America		(3,726)
Accrued restructuring and other charges	(2,951)	
Other	10	32
Net change in certain operating assets and liabilities, net of acquisitions:		
Trade accounts receivable	7,121	12,084
Prepaid expenses and other assets	76	(30)
Accounts payable	12,990	(8,440)
Accrued and other liabilities	(6,928)	(21,816)
Net cash provided by (used in) operating activities	3,961	(11,289)
Cash flows from investing activities:		
Purchases of equipment, software, and leasehold improvements	(3,042)	(7,203)
Purchases of short-term investments	(52,415)	(49,798)
Proceeds from sales and maturities of short-term investments	25,396	68,838
Decrease in restricted cash equivalents and investments, net	(25)	(9)
Payment of acquisition costs, net of cash acquired	(3,154)	(6,011)
Purchase of equity investments	(2,000)	
Proceeds from sales of equity investments	137	350
Net cash provided by (used in) investing activities	(35,103)	6,167
Cash flows from financing activities:		
Net proceeds from sale of common stock under employee stock purchase plan and exercise of stock options	12	1,072
Excess tax benefit from stock option exercises	9	50
Net proceeds from sales of interest in Rhapsody America	12,667	7,406
Net cash provided by financing activities	12,688	8,528

Effect of exchange rate changes on cash and cash equivalents	(2,805)	(1,366)
Net increase (decrease) in cash and cash equivalents	(21,259)	2,040
Cash and cash equivalents, beginning of period	232,968	476,697
Cash and cash equivalents, end of period	$ 211,709	$ 478,737
Supplemental disclosure of cash flow information:		
Cash received from income tax refunds	$ 651	$
Cash paid for income taxes	$ 2,006	$ 1,336

See accompanying notes to unaudited condensed consolidated financial statements.

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REALNETWORKS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Quarters Ended March 31, 2009 and 2008

Note 1. Summary of Significant Accounting Policies

Description of Business. RealNetworks, Inc. and subsidiaries (RealNetworks or Company) is a leading global provider of network-delivered digital media products and services. 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 the Company s business are various risks and uncertainties, including limited history of certain of its product and service offerings and its limited history of offering premium subscription services on the Internet. The Company s success will depend on the acceptance of the Company s technology, products and services and the ability to generate related revenue.

Basis of Presentation. The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned and majority-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications have been made to 2008 amounts to conform to the current year presentation.

On August 20, 2007, RealNetworks and MTV Networks, a division of Viacom International Inc. (MTVN), created Rhapsody America LLC (Rhapsody America) to jointly own and operate a business-to-consumer digital audio music service. RealNetworks held a 51% interest in Rhapsody America as of March 31, 2009. Rhapsody America s financial position and operating results have been consolidated into RealNetworks financial statements since its formation in August 2007. The noncontrolling interest s proportionate share of income (loss) is included in noncontrolling interest in Rhapsody America in the unaudited condensed consolidated statements of operations and comprehensive income (loss). MTVN s proportionate share of equity is included in noncontrolling interest in Rhapsody America in the unaudited condensed consolidated balance sheets.

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 ended March 31, 2009 are not necessarily indicative of the results that may be expected for any subsequent quarter or for the year ending December 31, 2009. Certain information and disclosures normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America 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 the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

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

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

The Company recognizes revenue under the residual method for multiple element software arrangements when vendor specific objective evidence (VSOE) exists for all of the undelivered elements of the arrangement, but does not exist for one or more of the delivered elements in the arrangement, under SOP No. 97-2. Under the residual method, at the outset of the arrangement with a customer, the Company defers revenue for the fair value of the arrangement s undelivered elements such as post contract support (PCS), and recognizes revenue for the remainder of the arrangement fee attributable to the elements initially delivered, such as software licenses. VSOE for PCS is established on standard products for which no installation or customization is required based upon

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amount charged when PCS is sold separately. For multiple element software arrangements involving significant production, modification or customization of the software, which are accounted for in accordance with the provisions of SOP No. 81-1, VSOE for PCS is established if customers have an optional renewal rate specified in the arrangement and the rate is substantive.

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

The Company recognizes revenue on a gross or net basis in accordance with EITF Issue No. 99-19. In most arrangements, the Company contracts directly with end user customers, is the primary obligor and carries all collectibility risk. In such arrangements the Company reports revenue on a gross basis. In some cases, the Company utilizes third-party distributors to sell products or services directly to end user customers and carries no collectibility risk. In such instances the Company reports revenue on a net basis.

Revenue generated from advertising on the Company s websites and from advertising included in its products is recognized as revenue as the delivery of the advertising occurs.

Accounting for Gains on Sale of Subsidiary Stock. Effective January 1, 2009, the Company adopted Statement of Financial Accounting Standards No. 160, *Non-controlling Interests in Consolidated Financial Statements, an amendment to ARB No. 51* (SFAS 160) which requires the difference between the carrying amount of the parent s investment in a subsidiary and the underlying net book value to be recorded as an equity transaction. Prior to the adoption of SFAS 160, the Company elected to recognize any such gain in the consolidated statement of operations in accordance with SAB 51.

Noncontrolling Interests. The Company records noncontrolling interest expense (benefit) which reflects the portion of the earnings (losses) of majority-owned entities which are applicable to the noncontrolling interest partners in accordance with Accounting Research Bulletin No. 51, *Consolidated Financial Statements* (ARB 51), SFAS 160, and EITF Topic No. D-98, *Classification and Measurement of Redeemable Securities* (EITF D-98). Redeemable noncontrolling interests that are redeemable at either fair value or are based on a formula that is intended to approximate fair value follow the Company s historical disclosure only policy for the redemption feature, and the current redemption amount of the redeemable noncontrolling interests is disclosed in Note 4. Redeemable noncontrolling interests that are redeemable at either a fixed price or are based on a formula that is not akin to fair value are reflected as an adjustment to income (loss) attributable to common shareholders based on the difference between accretion as calculated using the terms of the redemption feature and the accretion entry for a hypothetical fair value redemption feature with the remaining amount of accretion to redemption value recorded directly to equity. Noncontrolling interest expense (benefit) is included within the condensed consolidated statements of operations and comprehensive income (loss) for the quarters ended March 31, 2009 and 2008.

As of March 31, 2009 and December 31, 2008, the Company s noncontrolling interests solely related to redeemable noncontrolling interests in Rhapsody America. See Note 4 for further discussion of the redeemable noncontrolling interest treatment.

Note 2. Recent Accounting Pronouncements

With the exception of those discussed below, there have been no recent accounting pronouncements or changes in accounting pronouncements during the quarter ended March 31, 2009, as compared to the recent accounting pronouncements described in the Company s Annual Report on Form 10-K for the year ended December 31, 2008, that are of significance, or potential significance to the Company.

Adopted Accounting Pronouncements

Effective January 1, 2009, the Company adopted SFAS No. 141 (revised 2007), *Business Combinations* (SFAS 141(R)). Under SFAS 141(R), an entity is required to recognize the assets acquired, liabilities assumed, contractual contingencies, and contingent consideration at their fair value on the acquisition date. It further requires that acquisition-related costs be recognized separately from the acquisition and expensed as incurred; that restructuring costs generally be expensed in periods subsequent to the acquisition date; and that changes in accounting for deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period be recognized as a component of provision for taxes. In addition, acquired in-process research and development is capitalized as an intangible asset and amortized over its estimated useful life. SFAS 141(R) is effective on a prospective basis for all business combinations for which the acquisition date is on or after January 1, 2009, with the exception of the accounting for valuation allowances on deferred taxes and acquired contingencies under SFAS 109. With the adoption of SFAS 141(R), any tax related adjustments associated with acquisitions that closed prior to January 1, 2009 will be recorded through income tax expense, whereas the previous accounting treatment would require any adjustment to be recognized through goodwill. The adoption of SFAS 141(R) had no impact on the Company s consolidated financial statements as of and for the quarter ended March 31, 2009.

Effective January 1, 2009, the Company adopted, FASB Staff Position (FSP) No. 142-3, *Determination of the Useful Life of Intangible Assets* (FSP No. 142-3) that amends the factors considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under Statement of Financial Accounting Standards No. 142 *Goodwill and Other Intangible Assets* (SFAS 142). FSP No. 142-3 requires a consistent approach between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of an asset under SFAS No. 141(R). The FSP also requires enhanced disclosures when an intangible asset s expected future cash flows are affected by an entity s intent and/or ability to renew or extend the arrangement. The adoption did not have a material impact on the Company s consolidated results of operations or financial condition as of and for the quarter ended March 31, 2009.

Effective January 1, 2009, the Company implemented Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment to ARB No. 51* (SFAS 160). This standard changed the accounting for and reporting of noncontrolling interest (previously called minority interest) in the consolidated financial statements. Upon adoption, certain prior period amounts have been reclassified to conform to the current period financial statement presentation. These reclassifications have no effect on the Company s previously reported financial position or results of operations. Refer to Note 4, Rhapsody America, and Note 13, Earnings per Share, of this report for additional information on the adoption of SFAS 160.

Effective January 1, 2009, the Company adopted FSP APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)* (FSP 14-1). FSP 14-1 specifies that the liability and equity components of convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) be separately accounted for in a manner that reflects an issuer s nonconvertible debt borrowing rate and requires retrospective application for all periods presented. The adoption did not have a material impact on the Company s consolidated results of operations or financial condition for all periods presented.

Note 3. Stock-Based Compensation

The Company accounts for stock-based compensation in accordance with SFAS No. 123R revised 2004, *Share-Based Payment* (SFAS 123R). Under the fair value provisions of the statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which is the vesting period. The Company uses the Black-Scholes option-pricing model to determine the fair-value of stock-based awards under SFAS 123R. The Company recognizes compensation cost related to options granted on a straight-line basis over the applicable vesting period.

The expected term of the options represents the estimated period of time until exercise and is based on historical experience of similar awards, including the contractual terms, vesting schedules, and expectations of future employee behavior. Expected stock price volatility is based on a combination of historical volatility of the Company s stock for the related expected term and the implied volatility of its traded options. The risk-free interest rate is based on the implied yield available on U.S. Treasury zero-coupon issues with a term equivalent to the expected term of the stock options. The Company has not paid dividends in the past.

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

	Quarters Ended March 31,	
	2009	**2008**
Expected dividend yield	0%	0%
Risk-free interest rate	1.60%	2.45%

Expected life (years)	4.2	4.2
Volatility	63%	45%

Recognized stock-based compensation expense is as follows (in thousands):

	Quarters Ended March 31,	
	2009	**2008**
Cost of revenue	$ 630	$ 234
Research and development	1,824	1,913
Sales and marketing	1,066	1,908
General and administrative	1,702	1,434
Total stock-based compensation expense	$ 5,222	$ 5,489

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No stock-based compensation was capitalized as part of the cost of an asset during the quarters ended March 31, 2009 or 2008. As of March 31, 2009, $30.7 million of total unrecognized compensation cost, net of estimated forfeitures, related to stock options, is expected to be recognized over a weighted-average period of 2.3 years.

Note 4. Rhapsody America

Formation

On August 20, 2007, RealNetworks and MTVN created Rhapsody America to jointly own and operate a business-to-consumer digital audio music service. Under the Rhapsody America venture agreements:

RealNetworks contributed its Rhapsody service subscribers, RadioPass subscribers, cash, contracts, revenue from existing Rhapsody subscribers, marketing materials, player hardware, rhapsody.com and related URLs, certain liabilities, and distribution arrangements in exchange for a 51% equity interest in Rhapsody America. RealNetworks also licensed certain assets to Rhapsody America, including Rhapsody content, Rhapsody technology, the Rhapsody brands and related materials.

MTVN contributed its URGE service subscribers, cash, contracts, marketing materials, and revenue from existing URGE subscribers, certain liabilities, plus the note payable described below, in exchange for a 49% equity interest in Rhapsody America. MTVN has also licensed certain assets to Rhapsody America, including URGE content, brands and related materials.

In addition to the assets described above, MTVN also contributed a $230 million five-year note payable in consideration for acquiring MTVN s interest in the venture. In February 2009, RealNetworks and MTVN signed an amendment to the Rhapsody America venture agreement to true-up the original fair values contributed to the venture. The amendment reduced the MTVN note payable from $230.0 million to $213.8 million over the same five-year term. Rhapsody America must use the proceeds from the note solely to purchase advertising from MTVN. As MTVN makes payments on the note, Rhapsody America records equity and RealNetworks realizes an immediate appreciation in the carrying value of the Company s interests in the venture.

Effective January 1, 2009, the Company adopted SFAS 160 which requires the appreciation of gains on the sale of non-controlling interest to be recorded as an equity transaction. Prior to the adoption of SFAS 160, the Company elected to recognize any such gain in the consolidated statement of operations in accordance with SAB 51. MTVN made payments of $7.2 million during the quarter ended March 31, 2008. As a result, RealNetworks realized and recorded gains in the condensed consolidated statements of operations of $3.7 million, as all of the SAB 51 gain criteria were met. During the quarter ended March 31, 2009, MTVN made payments of $7.7 million for which the sale of ownership interests in Rhapsody America have been reflected as an equity transaction and $3.9 million has been recorded directly to shareholders equity. As of March 31, 2009, $77.1 million in payments have been made on the note since the formation of Rhapsody America.

Call/Put Rights

Pursuant to the terms of the Rhapsody America limited liability company agreement, RealNetworks has the right to purchase from MTVN, and MTVN has a right to require RealNetworks to purchase, MTVN s interest in Rhapsody America. The Company has evaluated the terms of the call and put rights under applicable accounting literature, including SFAS No. 133, A*ccounting for Derivatives and Hedging Activities*, and SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*, and concluded that neither of these rights represent freestanding financial instruments or derivatives that should be accounted for separately.

These call and put rights are exercisable upon the occurrence of certain events any time after January 1, 2011 and during certain periods in each of 2012, 2013 and 2014 and every two years thereafter, and are not exercisable any time prior to January 1, 2011. If MTVN exercises its put right, RealNetworks has the right to pay a portion of the purchase price for MTVN s interest in cash and shares of RealNetworks capital stock, subject to certain maximum amounts, with the balance (if any) to be paid with a note. If RealNetworks exercises its call right, MTVN has the right to demand payment of part of the purchase price for its membership interest in shares of RealNetworks capital stock. If a portion of the purchase price for MTVN s interest is payable in shares of RealNetworks capital stock, such shares could consist of RealNetworks common stock representing up to 15% of the outstanding shares of

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RealNetworks common stock immediately prior to the transaction, and shares of our non-voting stock representing up to an additional 4.9% of the outstanding shares of RealNetworks common stock immediately prior to the transaction, representing a maximum total of 19.9% of RealNetworks capital stock. If RealNetworks pays a portion of the purchase price for MTVN s membership interest in shares of RealNetworks common stock and non-voting stock, RealNetworks other shareholders voting and economic interests in RealNetworks could be diluted, and MTVN will become one of RealNetworks significant shareholders.

The redemption prices of MTVN s interest in Rhapsody America under both the call and put rights are calculated based on the provisions within the limited liability agreement, as amended, are impacted by the total appraised value of Rhapsody America and assume repayment of the $213.8 million five-year note payable from MTVN. Once the call right becomes exercisable, the redemption price of MTVN s interest in Rhapsody America under the call right will be equal to the greater of $213.8 million or the appraised value of MTVN s interest in Rhapsody America at the redemption date.

Once the put right becomes exercisable, the redemption price of MTVN s interest in Rhapsody America under the put right will be based on a formula that is dependent on the appraised value of Rhapsody America. If the appraised value of Rhapsody America at that time is equal to or greater than $436.3 million, the implied fair value of the venture at its inception, then the exercise price of the put is equal to the appraised value. If the appraised value of Rhapsody America at the redemption date is less than $436.3 million, then the exercise price of the put includes a preferred return due to MTVN.

For the period from August 20, 2007 (inception of the venture) through September 30, 2008, the Company determined that the value of the Rhapsody America venture had not declined from its initial implied fair value and assessed the probability that the put would include a preferred return as remote. The formula that determined that put redemption amount was considered to approximate fair value for this period. However, beginning with the fourth quarter of 2008, the current appraised value of Rhapsody America was determined to have declined to the point where the Company has determined that the likelihood of the put triggering the preferred return when exercisable was no longer remote and considered the put formula to no longer approximate fair value. Beginning with the fourth quarter of 2008, the Company has accounted for the noncontrolling interest as having a fixed price redemption feature.

The hypothetical current redemption price of MTVN s interest in Rhapsody America under the put right at March 31, 2009 before consideration of the remaining payments due on the note was approximately $81.4 million. The current redemption price has been adjusted under the formula in the limited liability agreement for the remaining outstanding amounts due of $136.7 million on the note payable as of March 31, 2009. The Company has elected to accrete any excess of the redemption value over the carrying amount as an adjustment to income attributable to common shareholders and has adjusted earnings per share for the current quarter s accretion of the difference between accretion as calculated using the terms of the redemption feature and the accretion entry for a hypothetical fair value redemption feature. For the quarter ended March 31, 2009, the Company increased the noncontrolling interest on the Condensed Consolidated Balance Sheets by $1.4 million which was an adjustment to income attributable to common shareholders for the purposes of calculating earnings per share. See Note 13, Earnings Per Share, for more information on this item. For 2008, this amount was nominal to the consolidated financial statements.

Noncontrolling interest rollforward

Activity in noncontrolling interest and equity attributable to common shareholders is as follows (in thousands):

	Noncontrolling interest	Total Equity
Balances, December 31, 2007	$ 19,613	$ 875,104
Net income (loss)	(8,615)	2,426
Contribution and other transactions with owners	3,680	
Unrealized holding losses on short-term and equity investments net of taxes		(434)
Foreign currency translation losses		(8,062)
Stock-based transactions and compensation expense, net of taxes		6,677

Balances, March 31, 2008	$	14,678	$	875,711

	Noncontrolling interest		Total Equity	
Balances, December 31, 2008	$	378	$	553,558
Net loss		(6,433)		(12,136)
Contribution and other transactions with owners		10,048		3,732
Accretion of MTVN s preferred return in Rhapsody America		1,434		(1,434)
Unrealized holding losses on short-term and equity investments, net of taxes				(1,822)
Foreign currency translation losses				(7,989)
Stock-based transactions and compensation expense, net of taxes				5,047
Balances, March 31, 2009	$	5,427	$	538,956

Note 5. Fair Value Measurements

Effective January 1, 2008, the Company implemented SFAS No. 157, *Fair Value Measurement* (SFAS 157), for its financial assets and liabilities that are re-measured and reported at fair value at each reporting period, and non-financial assets and liabilities that are re-measured and reported at fair value at least annually. Effective the quarter ended March 31, 2009, the Company implemented SFAS 157 for our nonfinancial assets and liabilities that are remeasured at fair value on a non-recurring basis. The adoption of SFAS 157 for our nonfinancial assets and liabilities that are remeasured at fair value on a non-recurring basis did not impact our financial position or results of operations as of and for the quarter ended March 31, 2009; however, SFAS 157 could have an impact in future periods. In addition, we may have additional disclosure requirements in the event we complete an acquisition or incur impairment of our assets in future periods.

SFAS No. 157 establishes a hierarchy that prioritizes fair value measurements based on the types of inputs used for the various valuation techniques (market approach, income approach and cost approach). The levels of the hierarchy are described below:

Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; these include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active

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Level 3: Unobservable inputs that reflect the reporting entity s own assumptions
The following table presents information about the Company s financial assets that have been measured at fair value (in thousands) as of March 31, 2009 and December 31, 2008 and indicates the fair value hierarchy of the valuation inputs utilized to determine such fair value.

	Fair Value Measurements as of March 31, 2009			
	Total	Level 1	Level 2	Level 3
Cash equivalents				
Money market funds	$ 121,966	$ 121,966	$	$
Short-term investments				
Corporate notes and bonds	79,941	79,941		
U.S. government agency securities	84,844	84,844		
Equity investments				
Publicly traded investments	12,745	12,745		
Total	$ 299,496	$ 299,496	$	$

	Fair Value Measurements as of December 31, 2008			
	Total	Level 1	Level 2	Level 3
		(In thousands)		
Cash equivalents				
Money market funds	$ 157,063	$ 157,063	$	$
U.S. government agency securities	4,292	4,292		
Short-term investments				
U.S. government agency securities	84,330	84,330		
Corporate notes and bonds	53,436	53,436		
Equity investments				
Publicly traded investments	13,903	13,903		
Total	$ 313,024	$ 313,024	$	$

Investments in marketable securities classified as short-term investments and equity investments of public companies are measured at fair value using quoted market prices and are classified within Level 1 of the valuation hierarchy. The Company carries its equity investments in private companies at cost and are excluded from the provisions of SFAS 157. The Company has consistently applied these valuation techniques in all periods presented.

Note 6. Cash, Cash Equivalents, Trading Securities, Short-Term Investments, and Restricted Cash Equivalents and Investments

Cash, cash equivalents, trading securities, short-term investments, and restricted cash equivalents and investments as of March 31, 2009 consist of the following (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated

								Fair Value
Cash and cash equivalents:								
Cash	$	89,743	$		$		$	89,743
Money market mutual funds		122,003		5		(42)		121,966
Total cash and cash equivalents:		211,746		5		(42)		211,709
Short-term investments:								
Corporate notes and bonds		81,392		423		(1,874)		79,941
U.S. Government agency securities		84,508		336				84,844
Total short-term investments:		165,900		759		(1,874)		164,785
Total cash, cash equivalents and short-term investments	$	377,646	$	764	$	(1,916)	$	376,494
Restricted cash equivalents and investments	$	14,767	$		$		$	14,767

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Cash, cash equivalents, short-term investments, and restricted cash equivalents as of December 31, 2008 consist of the following (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Cash and cash equivalents:				
Cash	$ 71,613	$	$	$ 71,613
Money market mutual funds	156,803	260		157,063
U.S. government agency securities	4,203	89		4,292
Total cash and cash equivalents	232,619	349		232,968
Short-term investments:				
Corporate notes and bonds	54,685	154	(1,403)	53,436
U.S. Government agency securities	83,920	410		84,330
Total short-term investments	138,605	564	(1,403)	137,766
Total cash, cash equivalents, and short-term investments	$ 371,224	$ 913	$ (1,403)	$ 370,734
Restricted cash equivalents	$ 14,742	$	$	$ 14,742

At March 31, 2009 and December 31, 2008, restricted cash equivalents and investments represent cash equivalents and short-term investments pledged as collateral against two letters of credit for a total of $14.8 million and $14.7 million, respectively, in connection with two lease agreements.

Realized gains or losses on sales of available-for-sale securities for the quarters ended March 31, 2009 and 2008 were not significant.

Changes in estimated fair values of short-term investments are primarily related to changes in interest rates and are considered to be temporary in nature.

The contractual maturities of available-for-sale investments at March 31, 2009 are as follows (in thousands):

	Amortized Cost	Estimated Fair Value
Within one year	$ 87,220	$ 87,449
Between one year and five years	78,680	77,336
Total available-for-sale investments	$ 165,900	$ 164,785

Note 7. Allowance for Doubtful Accounts Receivable and Sales Returns

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

	Allowance For	
	Doubtful Accounts Receivable	Sales Returns
Balances, December 31, 2008	$ 3,532	$ 1,099

Additions charged to expenses	260	510
Amounts written off	(1,747)	(490)
Balances, March 31, 2009	$ 2,045	$ 1,119

One customer accounted for 29% of trade accounts receivable as of March 31, 2009. As of December 31, 2008, the same customer accounted for 20% of trade accounts receivable. No one customer accounted for more than 10% of total revenue during the quarters ended March 31, 2009 and 2008.

Note 8. Equity Investments

As of March 31, 2009 and December 31, 2008, the carrying value of equity investments in publicly traded companies primarily relates to J-Stream Inc., a Japanese media services company, and LoEn Entertainment, Inc., a Korean digital music distribution company. These equity investments are accounted for as available-for-sale. The market for these investments is relatively limited and the share price is volatile. Although the carrying value of the total equity investments was $18.8 million at March 31, 2009, there can be no assurance that any gain can be realized through the disposition of these shares.

Summary of equity investments is as follows (in thousands):

	March 31, 2009		December 31, 2008	
	Cost	Carrying Value	Cost	Carrying Value
Publicly traded investments	$ 10,765	$ 12,745	$ 10,765	$ 13,903
Privately held investments	7,364	6,009	5,695	4,679
Total equity investments	$ 18,129	$ 18,754	$ 16,460	$ 18,582

Note 9. Other Intangible Assets

Other intangible assets at March 31, 2009 consist of the following (in thousands):

	Gross Amount	Accumulated Amortization	Net
Customer relationships	$ 32,315	$ 21,612	$ 10,703
Developed technology	27,724	23,845	3,879
Patents, trademarks and tradenames	6,175	5,962	213
Service contracts and other	5,715	4,763	952
Total other intangible assets	$ 71,929	$ 56,182	$ 15,747

Other intangible assets at December 31, 2008 consist of the following (in thousands):

	Gross Amount	Accumulated Amortization	Net
Customer relationships	$ 34,004	$ 21,705	$ 12,299
Developed technology	28,673	23,849	4,824
Patents, trademarks and tradenames	8,556	7,176	1,380
Service contracts and other	3,711	3,487	224
Total other intangible assets	$ 74,944	$ 56,217	$ 18,727

Amortization expense related to other intangible assets during the quarter ended March 31, 2009 was $2.3 million. Amortization expense related to other intangible assets during the quarter March 31, 2008 was $6.7 million.

As of March 31, 2009, estimated future amortization of other intangible assets is as follows (in thousands):

2009 (remaining nine months)	$ 6,134
2010	4,156
2011	2,040
2012	1,783
2013	1,420
Thereafter	214
Total	$ 15,747

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144), the Company reviews long-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 comparing their carrying amount to future undiscounted cash flows the assets are expected to generate. If long-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 Company did not record any impairments during the quarters ended March 31, 2009 or 2008.

The impairment analysis of long-lived assets is based upon estimates and assumptions relating to the Company s 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 cash flows of our long-term operating plans, 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 the Company s business climate, among other factors, and their resulting impact on the estimates and assumptions relating to the value of the Company s long-lived assets could result in the need to perform an impairment analysis under SFAS 144 in future periods which could result in a significant impairment.

Note 10. Goodwill

Changes in goodwill are as follows (in thousands):

Balance, December 31, 2008	$ 175,264
Effects of foreign currency translation	(4,646)
Balance, March 31, 2009	$ 170,618

In accordance with SFAS 142, goodwill is required to be tested for impairment annually and if an event or conditions change that would more likely than not reduce the fair value of a reporting unit below its carrying value. The Company performs its annual goodwill impairment test during its fiscal fourth quarter.

A two step process is used to test for goodwill impairment under SFAS 142. The first step is to determine if there is an indication of impairment by comparing the estimated fair value of each reporting unit to its carrying value including existing goodwill. Goodwill is considered impaired if the carrying value of a reporting unit exceeds the estimated fair value. Upon an indication of impairment from the first step, a second step is performed to determine the amount of the impairment. This involves calculating the implied fair value of goodwill by allocating the fair value of the reporting unit to all assets and liabilities other than goodwill and comparing it to the carrying amount of goodwill. The Company has four reporting units: Music, Technology Products and Solutions, Games, and Media Software and Services.

To estimate the fair value of the reporting units for step one, the Company utilized a combination of income and market approaches. The income approach, specifically a discounted cash flow methodology, included assumptions and estimates for, among others, forecasted revenues, gross profit margins, operating profit margins, working capital cash flow, growth rates and long term discount rates, all of which require significant judgments by management.

During the quarter ended March 31, 2009, the Company considered whether a triggering event had occurred during the quarter ended March 31, 2009 in assessing whether an interim impairment analysis of goodwill was warranted. The Company noted a significant decline in its market capitalization during the quarter ended March 31, 2009, resulting in the Company s market capitalization falling below its carrying value before adjusting for a reasonable control premium. The Company also noted, more broadly, a continuation of macroeconomic instability in general as well as continued illiquidity in the overall credit market. While these factors alone might be compelling indicators of impairment, the Company noted no other circumstances or indicators during the quarter that its goodwill might be impaired. Specifically, the company noted that there were no adverse changes in its business climate (including the introduction of unanticipated competition) or the existence or timing of resolution of new or existing legal factors during the quarter that might be indicative of a goodwill impairment. Further, the Company lost no key personnel during the quarter nor was it adversely affected by any regulatory actions related to its business or industry. Finally, the Company s actual results of operations for the quarter ended March 31, 2009 and outlook for the remainder of 2009 were materially in line with the operating projections used in the Company s recent goodwill impairment analysis, completed during the quarter ended December 31, 2008. As a result, and in light of all factors considered, the Company concluded that an interim impairment analysis of goodwill as of March 31, 2009 was not warranted.

The impairment analysis of goodwill is based upon estimates and assumptions relating to the Company s 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 cash flows of our long-term operating plans, market and interest rate risk, and risk-commensurate discount rates and cost of capital. Significant and sustained declines in the Company s stock price and market capitalization, a significant decline in its expected future cash flows or a significant adverse change in the Company s business climate, among other factors, and their resulting impact on the estimates and assumptions relating to the value of the Company s goodwill could result in the need to perform an impairment analysis under SFAS 142 in future interim periods which could result in a significant impairment.

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Note 11. Accrued and Other Liabilities

Accrued and other liabilities consist of (in thousands):

	March 31, 2009	December 31, 2008
Royalties and other fulfillment costs	$ 50,444	$ 55,247
Employee compensation, commissions and benefits	19,534	21,679
Sales, VAT and other taxes payable	17,272	16,801
Legal fees and contingent legal fees	7,601	3,290
Other	16,828	21,671
Total	$ 111,679	$ 118,688

Note 12. Loss on Excess Office Facilities

The accrued loss of $6.2 million for estimated future losses on excess office facilities located near the Company s corporate headquarters in Seattle Washington at March 31, 2009, is shown net of expected future sublease income of $4.5 million, which was committed under sublease contracts at the time of the estimate. The Company regularly evaluates the market for office space in the cities where it has operations. If the market for such space declines further in future periods, the Company may have to revise its estimates further, which may result in additional losses on excess office facilities.

A summary of activity for accrued loss on excess office facilities is as follows (in thousands):

Accrued loss on excess office facilities, December 31, 2008	$ 7,210
Less amounts amortized from the accrued loss on excess office facilities	(1,050)
Accrued loss on excess office facilities, March 31, 2009	6,160
Less current portion	(4,251)
Accrued loss on excess office facilities, non-current portion	$ 1,909

Note 13. Earnings Per Share

Basic net income (loss) available to common shareholders per share is computed by dividing net income (loss) attributable to common shareholders less any accretion from MTVN s preferred return in Rhapsody America by the weighted average number of common shares outstanding during the period. Diluted net income (loss) available to common shareholders per share is computed by dividing net income (loss) attributable to common shareholders less any accretion from MTVN s preferred return in Rhapsody America by the weighted average number of common and dilutive potential common shares outstanding during the period. Share count used to compute basic and diluted net income available to common share holders per share is calculated as follows (in thousands):

	Quarters Ended March 31, 2009	Quarters Ended March 31, 2008
Net income (loss) available to common shareholders:		
Net income (loss) attributable to common shareholders	$ (12,136)	$ 2,426
Less accretion of MTVN s preferred return in Rhapsody America	(1,434)	
Net income (loss) available to common shareholders	$ (13,570)	$ 2,426

Weighted average common shares outstanding used to compute basic net income (loss) per share available to common shareholders	134,380	142,491
Dilutive potential common shares:		
Stock options and restricted stock		1,495
Convertible debt		10,750
Shares used to compute diluted net income (loss) per share available to common shareholders	134,380	154,736
Basic net income (loss) per share available to common shareholders	$ (0.10)	$ 0.02
Diluted net income (loss) per share available to common shareholders	$ (0.10)	$ 0.02

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During the quarters ended March 31, 2009 and 2008, 39.3 million and 36.8 million shares of common stock, respectively, potentially issuable from stock options were excluded from the calculation of diluted net income per share because of their antidilutive effect.

Note 14. Commitments and Contingencies

Borrowing Arrangements. The Company s subsidiary, WiderThan, has entered into lines of credit with two Korean domestic banks with an aggregate maximum available limit of $1.5 million at interest rates of approximately 2.9% over the rate earned on the underlying deposits. WiderThan has entered into a separate line of credit with a Korean domestic bank with maximum available limit of $0.7 million bearing interest at 7.3%. During the quarter ended March 31, 2009, the Company did not draw on these lines of credit and there were no balances outstanding as of March 31, 2009 or December 31, 2008.

The Company s subsidiary, WiderThan, uses corporate charge cards issued by a Korean domestic bank with an aggregate line of credit of up to $3.7 million. The charged amounts are generally payable in the following month depending on the billing cycle and are included in accounts payable in the accompanying unaudited condensed consolidated balance sheets. In general, the term of the arrangement is one year, with automatic renewal in April of each year. The arrangement may be terminated in writing by mutual agreement between the bank and the Company. The Company is not subject to any financial or other restrictive covenants under the terms of this arrangement.

The Company s subsidiary, WiderThan, has a letter of credit of up to $5.0 million with a Korean domestic bank for importing goods, with one-year maturity (renewable every April), which bears interest at 2.5% over the London Inter-Bank Offer Rate (LIBOR). Borrowings under this letter of credit are collateralized by import documents and goods being imported under such documentation. To the extent that the Company has any outstanding balance, the Company is subject to standard covenants and notice requirements under the terms of this facility, such as covenants to consult with the lender prior to engaging in certain events, which include, among others, mergers and acquisitions or sale of material assets or to furnish certain financial and other information. The Company is not, however, subject to any financial covenant requirements or other restrictive covenants that restrict the Company s ability to utilize this facility or to obtain financing elsewhere. During the quarter ended March 31, 2009, the Company did not draw on the letter of credit and there was no balance outstanding as of March 31, 2009 or December 31, 2008.

The Company s subsidiary, WiderThan, has purchase guarantees amounting to $0.7 million from Seoul Guarantee Insurance which guarantees payments for one year under certain supply contracts the Company has with a customer in Korea.

Litigation. On September 30, 2008, the Company filed a declaratory action against Disney Enterprises, Inc., Paramount Pictures Corp., Sony Pictures Entertainment, Inc., Twentieth Century Fox Film Corp., NBC Universal, Inc., Warner Bros. Entertainment, Inc., Viacom, Inc. and the DVD Copy Control Association (DVD CCA) in the Northern District of California relating to the Company s RealDVD product, which, among other things, allows consumers to securely store DVD content on their hard drives. On the same day, various movie studios filed suit against the Company in the Central District of California. The Company s suit asks the court to find that the RealDVD product does not breach the license agreement that the Company entered into with the DVD CCA. The movie studios suit alleges that by offering the RealDVD product, RealNetworks has violated the Digital Millennium Copyright Act. The DVD CCA has filed a counterclaim against the Company alleging that the Company breached its license with the DVD CCA by developing RealDVD. The movie studios suit was subsequently transferred to the Northern District of California. On October 3, 2008, the movie studios obtained a temporary restraining order (TRO) requiring the Company to cease distribution of its RealDVD product. The TRO was extended on October 7, 2008. In April and May 2009, the Court is holding a preliminary injunction hearing to address the movie studios claim that RealDVD should not be sold pending a final judicial determination of the underlying claims between the parties and closing arguments are currently scheduled for late May 2009. The Company believes that RealDVD complies with the law, and the Company intends to vigorously defend the preliminary injunction request and, if necessary, pursue its declaratory judgment action.

In June 2008, the Company initiated an arbitration action in Seattle, Washington against VeriSign, Inc., to seek resolution of disputes regarding the proper interpretation of an Alliance Agreement entered into between the parties dating back to 2001. VeriSign asserted various counterclaims against the Company, including claims that the

Company breached the Alliance Agreement and tortiously interfered with VeriSign s proposed sale of certain business units. On May 7, 2009, the Arbitrator issued a ruling denying the Company s claims for relief and granting VeriSign s claims, including VeriSign s claim that the Company tortiously interfered with VeriSign s proposed sale of certain business units. The Arbitrator did not determine any damages award as part of the ruling. A hearing to address potential damages is currently scheduled for May 27, 2009. While VeriSign may seek monetary damages that could be material to the Company s financial results, the Company believes that a limitation of liability clause applies to any potential monetary damages claim that limits any such damages to an amount that would not have a material impact on the Company s financial results. No assurance can be made as to the final outcome of the disputes until all rulings are final and all avenues of review have been exhausted. The Company intends to continue to defend itself vigorously with respect to this matter.

On April 25, 2007, a lawsuit was filed by Greenville Communications, LLC in Greenville, Mississippi against a number of cell phone carriers, including the Company s partners T-Mobile USA, Inc. and Alltel Corporation, alleging that they infringe its patents by providing ringback tone services. The Company agreed to indemnify T-Mobile and Alltel against the claims based on an indemnity that is claimed to be owed by Real s subsidiary, WiderThan. On August 27, 2007, the Company s motion to transfer this matter to the District of New Jersey was granted. The parties have briefed claim construction, but the case has been stayed pending reexamination of the patents at issue. The Company disputes the plaintiff s allegations regarding both the validity of its patents and its claims of infringement against the Company s partners.

In April 2007, the Copyright Royalty Board (CRB) issued a decision setting new royalty rates for the use of sound recordings in Internet radio from 2006 through 2010. These rates are still under appeal. Additionally, in a separate proceeding, the CRB held hearings to determine mechanical royalty rates associated with the statutory license for digital phonorecord deliveries, including tethered downloads. These rates have also been subject to industry-wide settlement negotiations. A partial settlement was reached with respect to on-demand streaming and tethered downloads between the Digital Media Association (DiMA), the Recording Industry Association of America (RIAA) and the National Music Publishers Association (NMPA), among others. This settlement was published by the CRB in an administrative judicial proceeding supervised by the U.S. Copyright Office. This settlement, with some modifications, is part of the CRB s final determination as published in the Federal Register, but it may be appealed. In addition, the U.S. Copyright Office has raised legal challenges to the CRB s final determination, creating some uncertainty as to the applicability of the settlement terms set forth in CRB s final determination. Finally, the Company has been involved in a proceeding in the Southern District of New York to determine a royalty rate for the public performance of music contained in the American Society of Composers, Authors and Publishers (ASCAP) catalogue. In April 2008, the district court issued a preliminary ruling that sets forth, among other things, a methodology to be used to calculate the royalties owed to ASCAP and subsequently issued additional rulings. After working with ASCAP to make a final determination of amounts due under the court s rulings, the Company reached a partial agreement with ASCAP on January 12, 2009. The Company believes it has sufficiently accrued for expected royalties under the agreement, but the Company plans to appeal some aspects of the court s rulings that underlie the agreement, and the rulings remain subject to appeal and challenge by other participants.

In June 2003, a lawsuit was filed against the Company and Listen.com, Inc. (Listen) in federal district court for the Northern District of Illinois by Friskit, Inc. (Friskit), alleging that certain features of the Company s and Listen s products and services willfully infringe certain patents relating to searching and streaming media files. In July , 2007, the court granted the Company s motion for summary judgment and invalidated all claims on grounds of obviousness. On January 12, 2009, the Federal Circuit affirmed the District Court s dismissal of the suit and invalidation of all asserted claims.

From time to time the Company is, and expects to continue to be, subject to legal proceedings and claims in the ordinary course of its business, including employment claims, contract-related claims, and claims of alleged infringement of third-party patents, trademarks and other intellectual property rights. These claims, including those described above, even if not meritorious, could force the Company to spend significant financial and managerial resources. The Company is not aware of any other legal proceedings or claims that the Company believes will have, individually or taken together, a material adverse effect on the Company s business, prospects, financial condition or results of operations. However, the Company may incur substantial expenses in defending against third-party claims and certain pending claims are moving closer to trial. The Company expects that its potential costs of defending these claims may increase as the disputes move into the trial phase of the proceedings. In the event of a determination adverse to the Company, the Company may incur substantial monetary liability, and/or be required to change its business practices. Either of these could have a material adverse effect on the Company s financial position and results of operations.

Note 15. Segment Information

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131), establishes standards for the way in which public companies disclose certain information about operating segments in their financial reports. The Company reports four segments consistent with SFAS 131, based on factors such as how the Company manages its operations and how its Chief Operating Decision Maker reviews results. The Company s Chief Operating Decision Maker is considered to be the Company s CEO Staff (CEOS), which includes the Company s Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Executive Vice Presidents and Senior Vice Presidents. The CEOS reviews financial information presented on both a consolidated basis and on a business segment basis, accompanied by disaggregated information about products and services and geographical regions for purposes of making decisions and assessing financial performance. The CEOS reviews discrete financial information regarding profitability of the Company s Music, Games, Media Software and Services and Technology Products and Solutions segments and, therefore, the Company reports these as operating segments as defined by SFAS 131. The accounting policies used to derive segment results are generally the same as those described in Note 1.

The Music segment includes the operations of Rhapsody America as well as the aspects of the Company s music business not included as part of Rhapsody America. The revenue and costs from these businesses include: digital music subscription services such as Rhapsody and RadioPass and sales of digital music content and advertising. These products and services are sold and provided primarily through the Internet, and the Company charges customers credit cards at the time of sale. Billing periods for subscription services typically occur monthly, quarterly or annually, depending on the service purchased.

The Games segment primarily includes revenue from the sale of individual games on the Company s websites RealArcade.com, GameHouse.com and Zylom.com; the sale of games subscription services; advertising through the Company s games websites; the sale of games through syndication on partner sites; and sales of games through wireless carriers.

The Media Software and Services segment primarily includes revenue from sales of the Company s SuperPass premium subscription service; sales of RealPlayer Plus and related products; sales and distribution of third-party software products; and all advertising other than that related directly to the Company s Music and Games businesses.

The Technology Products and Solutions segment includes revenue and costs from: sales of ringback tone, music-on-demand, video-on-demand, messaging, and information services; sales of media delivery system software and licenses, including Helix system software and related authoring and publishing tools, both directly to customers and indirectly through original equipment manufacturer channels; support and maintenance services sold to customers who purchase software products; sales of broadcast hosting services; and consulting and professional services that are sold to customers. These products and services are primarily sold to corporate customers.

Amounts that are not included within the above segment descriptions are shown below as Reconciling Amounts. Included within these amounts are items such as interest income and net antitrust litigation benefit.

Segment income (loss) before income taxes for the quarter ended March 31, 2009 is as follows (in thousands):

	Music	Games	Media Software and Services	Technology Products and Solutions	Reconciling Amounts	Consolidated
Net revenue	$ 44,053	$ 32,823	$ 20,318	$ 43,579	$	$ 140,773
Cost of revenue	27,300	8,564	3,707	16,450		56,021
Gross profit	16,753	24,259	16,611	27,129		84,752
Operating expenses	29,817	27,151	19,949	26,337	38	103,292
Operating income (loss)	(13,064)	(2,892)	(3,338)	792	(38)	(18,540)
Total non-operating income, net					1,520	1,520
Income (loss) before income taxes	(13,064)	(2,892)	(3,338)	792	1,482	(17,020)
Income taxes					(1,549)	(1,549)
Net income (loss)	(13,064)	(2,892)	(3,338)	792	(67)	(18,569)
Net income (loss) attributable to noncontrolling interest in Rhapsody America	6,433					6,433
Net income (loss) attributable to common shareholders	$ (6,631)	$ (2,892)	$ (3,338)	$ 792	$ (67)	$ (12,136)

Segment income (loss) before income taxes for the quarter ended March 31, 2008 is as follows (in thousands):

Media

	Software	Technology Products	Reconciling
Music			