

REALNETWORKS INC  
Form 10-Q  
May 08, 2013

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 March 31, 2013

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)

2601 Elliott Avenue, Suite 1000 98121  
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 April 30, 2013 was 35,427,190.

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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, 2013	December 31, 2012
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 136,694	\$ 163,198
Short-term investments	123,894	108,216
Trade accounts receivable, net of allowances	28,718	30,754
Deferred costs, current portion	1,297	825
Deferred tax assets, current	2,759	2,869
Prepaid expenses and other current assets	13,266	17,002
Total current assets	306,628	322,864
Equipment, software, and leasehold improvements, at cost:		
Equipment and software	95,918	98,041
Leasehold improvements	22,705	22,767
Total equipment, software, and leasehold improvements, at cost	118,623	120,808
Less accumulated depreciation and amortization	92,020	91,492
Net equipment, software, and leasehold improvements	26,603	29,316
Restricted cash equivalents and investments	10,000	10,000
Equity method investment	16,710	19,204
Available for sale securities	38,608	34,334
Other assets	3,331	3,153
Deferred costs, non-current portion	802	531
Deferred tax assets, net, non-current portion	4,803	4,911
Other intangible assets, net	2,837	3,275
Goodwill	6,410	6,309
Total assets	\$416,732	\$433,897
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 16,910	\$ 19,013
Accrued and other current liabilities	51,847	57,530
Deferred revenue, current portion	8,846	8,675
Total current liabilities	77,603	85,218
Deferred revenue, non-current portion	169	169
Deferred rent	2,026	2,250
Deferred tax liabilities, net, non-current portion	432	432
Other long-term liabilities	2,417	3,100
Total liabilities	82,647	91,169
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, \$0.001 par value, no shares issued and outstanding:		
Series A: authorized 200 shares	—	—
Undesignated series: authorized 59,800 shares	—	—
Common stock, \$0.001 par value authorized 250,000 shares; issued and outstanding 35,380 shares in 2013 and 35,324 shares in 2012	35	35

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Additional paid-in capital	605,402	603,770	
Accumulated other comprehensive loss	(25,141	) (26,540	)
Retained deficit	(246,211	) (234,537	)
Total shareholders' equity	334,085	342,728	
Total liabilities and shareholders' equity	\$416,732	\$433,897	

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)

	Quarter Ended	
	March 31,	
	2013	2012
Net revenue (A)	\$56,793	\$66,964
Cost of revenue (B)	20,506	27,427
Gross profit	36,287	39,537
Sale of patents and other technology assets, net of costs (See Note 1)	—	(1,580 )
Operating expenses:		
Research and development	15,251	17,818
Sales and marketing	21,134	23,796
General and administrative	9,946	13,276
Restructuring and other charges	1,382	1,609
Total operating expenses	47,713	56,499
Operating income (loss)	(11,426 )	(18,542 )
Other income (expenses):		
Interest income, net	647	644
Equity in net loss of Rhapsody investment	(2,233 )	(368 )
Other income (expense), net	109	1,475
Total other income (expenses), net	(1,477 )	1,751
Income (loss) before income taxes	(12,903 )	(16,791 )
Income tax expense (benefit)	(1,229 )	224
Net income (loss)	\$(11,674 )	\$(17,015 )
Basic net income (loss) per share	\$(0.33 )	\$(0.49 )
Diluted net income (loss) per share	\$(0.33 )	\$(0.49 )
Shares used to compute basic net income (loss) per share	35,343	34,488
Shares used to compute diluted net income (loss) per share	35,343	34,488
Comprehensive income (loss):		
Unrealized investment holding gains	\$2,637	\$8,494
Foreign currency translation adjustments, net of reclassification adjustments	(1,238 )	(384 )
Total other comprehensive income (loss)	1,399	8,110
Net income (loss)	(11,674 )	(17,015 )
Comprehensive income (loss)	\$(10,275 )	\$(8,905 )
(A) Components of net revenue:		
License fees	\$12,829	\$14,956
Service revenue	43,964	52,008
	\$56,793	\$66,964
(B) Components of cost of revenue:		
License fees	\$2,154	\$3,272
Service revenue	18,352	24,155
	\$20,506	\$27,427

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Quarter Ended	
	March 31,	2012
	2013	
Cash flows from operating activities:		
Net income (loss)	\$(11,674	) \$(17,015
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,888	4,118
Stock-based compensation	2,038	2,343
Equity in net loss of Rhapsody	2,233	368
Deferred income taxes, net	(1,559	) (19
Realized translation gain	—	(1,611
Other	(75	) (3
Net change in certain operating assets and liabilities:		
Trade accounts receivable	1,554	1,394
Prepaid expenses and other assets	2,823	(2,738
Accounts payable	(1,784	) (894
Accrued and other liabilities	(5,177	) (3,185
Net cash provided by (used in) operating activities	(6,733	) (17,242
Cash flows from investing activities:		
Purchases of equipment, software, and leasehold improvements	(1,194	) (2,798
Purchases of short-term investments	(43,318	) (9,969
Proceeds from sales and maturities of short-term investments	27,640	5,027
Acquisitions of businesses	(700	) —
Net cash provided by (used in) investing activities	(17,572	) (7,740
Cash flows from financing activities:		
Proceeds from issuance of common stock (stock options and stock purchase plan)	20	675
Tax payments from shares withheld upon vesting of restricted stock	(166	) —
Payment of contingent consideration	(828	) —
Net cash provided by (used in) financing activities	(974	) 675
Effect of exchange rate changes on cash and cash equivalents	(1,225	) 1,306
Net increase (decrease) in cash and cash equivalents	(26,504	) (23,001
Cash and cash equivalents, beginning of period	163,198	106,333
Cash and cash equivalents, end of period	\$ 136,694	\$ 83,332
Supplemental disclosure of cash flow information:		
Cash received from income tax refunds	\$ 3,612	\$ 39
Cash paid for income taxes	\$ 725	\$ 517
Non-cash investing activities:		
Increase (decrease) in accrued purchases of equipment, software, and leasehold improvements	\$ 172	\$ 1,430

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, 2012 and 2011

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. RealNetwork's 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 for the quarter ended March 31, 2013 (10-Q or Report), RealNetworks, Inc. and Subsidiaries is referred to as "RealNetworks", the "Company", "we", "us", or "our".

Basis of Presentation. The unaudited condensed consolidated financial statements include the accounts of RealNetworks 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 three months ended March 31, 2013 are not necessarily indicative of the results that may be expected for any subsequent period or for the year ending December 31, 2013. 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, 2012 (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.

Reportable Segments. In the first quarter of 2013 we reorganized the management of our businesses and as a result, we changed our reportable segments. See Note 17, Segment Information, for details.

Accumulated Other Comprehensive Income (Loss). The components of accumulated other comprehensive income (loss) consisted of unrealized gains on investment securities and foreign currency translation adjustments, net of any applicable tax, as follows (in thousands):

	March 31, 2013	December 31, 2012
Unrealized gains on investments, net of tax effects of \$783 and \$(846) at March 31, 2013 and December 31, 2012, respectively	\$29,322	\$26,685
Foreign currency translation adjustments	(54,463	) (53,225
Accumulated other comprehensive income (loss)	\$(25,141	) \$(26,540

For the three months ended March 31, 2012 we liquidated the investment in certain of our foreign entities and recorded a net pre-tax gain of \$1.6 million in Other income (expense), net, in the consolidated statement of operations upon the reclassification of the same amount of cumulative foreign exchange translation adjustment from accumulated other comprehensive income (loss) on the balance sheet. The reclassification adjustment had no related income tax

expense or benefit. No reclassification adjustments related to foreign exchange translation amounts or unrealized gains on investments occurred in 2013. In the first quarter of 2013 we recorded an income tax benefit of \$1.6 million related to unrealized gains on

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investment securities, and recognized the corresponding amount as a reduction to accumulated other comprehensive income. There were no tax related adjustments to accumulated other comprehensive income in the first quarter of 2012.

2012 Sale of Patents and Other Technology Assets to Intel Corporation. In the second quarter of 2012, we completed the sale of certain patents, patent applications and related rights held by us, and certain of our assets relating to our next generation video codec technologies to Intel Corporation (Intel). Related to this transaction, within the first quarter of 2012 we incurred \$1.6 million of total direct costs.

Note 2. Recent Accounting Pronouncements

There have been no recent accounting pronouncements or changes in accounting pronouncements during the three months ended March 31, 2013 to be implemented that are of significance or potential significance to RealNetworks.

Note 3. 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):

	Quarter Ended	
	March 31,	2012
	2013	
Total stock-based compensation expense	\$2,038	\$2,343

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

	Quarter Ended		
	March 31,	2012	
	2013		
Expected dividend yield	0	% 0	%
Risk-free interest rate	0.57	% 0.69	%
Expected life (years)	3.7	3.8	
Volatility	48	% 58	%

The total stock-based compensation amounts for 2013 and 2012 disclosed above are recorded in their respective line items within operating expenses in the consolidated statement of operations. No stock-based compensation was capitalized as part of the cost of an asset as of March 31, 2013 or December 31, 2012. As of March 31, 2013, we had \$8.5 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 4. Rhapsody Joint Venture

RealNetworks initially formed in 2007 a joint venture with 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 account for our investment in Rhapsody using the equity method of accounting for investments.

As of March 31, 2013 we owned approximately 45% of the issued and outstanding stock of Rhapsody.

RealNetworks continues to provide certain operational transition services to Rhapsody. These transition services are expected to be completed in 2013, and are discussed further in Footnote 18, Related Party Transactions.

We recorded our share of losses in the operations of Rhapsody of \$2.2 million and \$0.4 million for the three months ended March 31, 2013 and 2012, respectively.

The carrying value of our Rhapsody investment was \$16.7 million as of March 31, 2013.

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

	Quarter Ended	
	March 31, 2013	2012
Net revenue	\$33,962	\$35,170
Gross profit	7,845	9,612
Net loss	(4,816	) (1,070

#### Note 5. Fair Value Measurements

We measure certain financial assets at fair value on a recurring basis, including cash equivalents, short-term investments, and equity investments of publicly traded companies. The fair value of these financial assets was determined based on three levels of inputs:

Level 1: Quoted prices in active markets for identical assets or liabilities

Level 2: Directly or indirectly observed inputs for the asset or liability, including 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

Level 3: Significant unobservable inputs that reflect our own estimates of assumptions that market participants would use

#### 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 March 31, 2013 and December 31, 2012, and indicates the fair value hierarchy of the valuation inputs utilized to determine such fair value (in thousands).

	Fair Value Measurements as of March 31, 2013			
	Total	Level 1	Level 2	Level 3
Cash equivalents:				
Money market funds	\$6,978	\$3	\$6,975	\$—
Corporate notes and bonds	79,502	—	79,502	—
Short-term investments:				
Corporate notes and bonds	88,766	—	88,766	—
U.S. government agency securities	35,128	34,402	726	—
Restricted cash equivalents and investments	10,000	—	10,000	—
Equity investments in publicly traded securities	38,608	38,608	—	—
Total	\$258,982	\$73,013	\$185,969	\$—
	Fair Value Measurements as of December 31, 2012			
	Total	Level 1	Level 2	Level 3
Cash equivalents:				
Money market funds	\$10,680	\$—	\$10,680	\$—
Corporate notes and bonds	81,235	—	81,235	—
Short-term investments:				
Corporate notes and bonds	65,502	—	65,502	—
U.S. government agency securities	42,714	42,113	601	—
Restricted cash equivalents and investments	10,000	—	10,000	—
Equity investments in publicly traded securities	34,334	34,334	—	—
Total	\$244,465	\$76,447	\$168,018	\$—

Our equity investments in publicly traded companies consisted of 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

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available for sale. The aggregate cost basis of these securities totaled \$8.6 million as of March 31, 2013 and \$8.6 million at December 31, 2012.

#### 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 three months ended March 31, 2013 and 2012, we did not record any impairments on those assets required to be measured at fair value on a non-recurring basis.

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

Cash and cash equivalents, short-term investments, and restricted cash equivalents and investments as of March 31, 2013, consisted of the following (in thousands):

	Amortized Cost	Estimated Fair Value
Cash and cash equivalents:		
Cash	\$50,214	\$50,214
Money market mutual funds	6,979	6,978
Corporate notes and bonds	79,505	79,502
Total cash and cash equivalents	136,698	136,694
Short-term investments:		
Corporate notes and bonds	88,693	88,766
U.S. government agency securities	35,111	35,128
Total short-term investments	123,804	123,894
Total cash, cash equivalents and short-term investments	\$260,502	\$260,588
Restricted cash equivalents and investments	\$10,000	\$10,000

Cash and cash equivalents, short-term investments, and restricted cash equivalents and investments as of December 31, 2012 consisted of the following (in thousands):

	Amortized Cost	Estimated Fair Value
Cash and cash equivalents:		
Cash	\$71,283	\$71,283
Money market mutual funds	10,680	10,680
Corporate notes and bonds	81,237	81,235
Total cash and cash equivalents	163,200	163,198
Short-term investments:		
Corporate notes and bonds	65,426	65,502
U.S. Government agency securities	42,693	42,714
Total short-term investments	108,119	108,216
Total cash, cash equivalents, and short-term investments	\$271,319	\$271,414
Restricted cash equivalents and investments	\$10,000	\$10,000

Substantially all of the restricted cash equivalents and investments amounts as of March 31, 2013, and December 31, 2012 relate to cash and investments pledged as collateral against a letter of credit in connection with lease agreements.

Realized gains or losses on sales of short-term investment securities for the quarters ended March 31, 2013 and 2012 were not significant. Gross unrealized gains and gross unrealized losses on short-term investment securities as of March 31, 2013 and December 31, 2012 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 March 31, 2013 (in thousands):

	Estimated Fair Value
Within one year	\$99,791
Between one year and five years	24,103
Total short-term investments	\$123,894

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, 2012	\$1,010	\$653	
Addition (reduction) to allowance	89	(33	)
Amounts written off	(12	) (8	)
Foreign currency translation	(25	) —	
Balances, March 31, 2013	\$1,062	\$612	

No one customer accounted for more than 10% of trade accounts receivable as of March 31, 2013. No one customer accounted for more than 10% of trade accounts receivable as of December 31, 2012.

One customer accounted for approximately 14%, or \$8.1 million, of consolidated revenue during the quarter ended March 31, 2013, in our RealPlayer Group and Games segments. No one customer accounted for more than 10% of consolidated revenue during the quarter ended March 31, 2012.

Note 8. Other Intangible Assets

Other intangible assets (in thousands):

	Gross Amount	Accumulated Amortization	Net
Customer relationships	\$29,875	\$27,861	\$2,014
Developed technology	24,539	23,718	821
Patents, trademarks and tradenames	3,439	3,439	—
Service contracts and other	5,369	5,367	2
Total other intangible assets, March 31, 2013	\$63,222	\$60,385	\$2,837

Note 9. Goodwill

Changes in goodwill (in thousands):

Balances, December 31, 2012	\$6,309
Increases due to current year acquisition	200
Effects of foreign currency translation	(99
Balances, March 31, 2013	\$6,410

Goodwill by the Company's segments (in thousands):

	March 31, 2013
RealPlayer Group	\$580
Mobile Entertainment Games	781 5,049
Total goodwill	\$6,410
Note 10. Accrued and Other Current Liabilities	
Accrued and other current liabilities (in thousands):	

	March 31, 2013	December 31, 2012
Royalties and other fulfillment costs	\$18,165	\$19,435
Employee compensation, commissions and benefits	11,128	13,368
Sales, VAT and other taxes payable	9,936	10,959
Deferred tax liabilities—current	3,744	3,894
Accrued loss on excess office facilities	2,460	2,463
Other	6,414	7,411
Total accrued and other current liabilities	\$51,847	\$57,530

Note 11. Restructuring Charges

Restructuring and other charges in 2013 and 2012 consist of costs associated with the ongoing reorganization of our business operations and focus on aligning our operating expenses with our revenue profile. The expense amounts in both years relate to severance costs due to workforce reductions.

In the third quarter of 2012 we announced we would be eliminating approximately 160 positions worldwide, beginning immediately and we expect it to be concluded by the end of the second quarter of 2013. For the quarter ended March 31, 2013 we recorded a total of \$1.4 million of restructuring charges for employee separation costs related to this action and for other actions taken in 2013.

Details of restructuring charges for the three months ended March 31, 2013 and 2012 are in the table below. The amount accrued at March 31, 2013 for employee separation includes costs for those employees who were separated in the quarter ended March 31, 2013 and are expected to be paid out in the quarter ended June 30, 2013. The amount accrued for contract assignment is expected to be paid out by the end of 2013.

Restructuring charges by type of cost (in thousands):

	Employee Separation Costs
Costs incurred and charged to expense for the three months ended March 31, 2013	\$1,382
Costs incurred and charged to expense for the three months ended March 31, 2012	\$1,609

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



	By Type of Cost		Total
	Employee Separation Costs	Contract Assignment Costs	
Accrued liability as of December 31, 2012	\$731	\$1,700	\$2,431
Costs incurred and charged to expense for the three months ended March 31, 2013	1,382	—	1,382
Cash payments	(1,199	)—	(1,199
Accrued liability as of March 31, 2013	\$914	\$1,700	\$2,614

#### Note 12. Loss on Excess Office Facilities

As a result of the reduction in use of RealNetworks' office space, primarily in the corporate headquarters in Seattle, Washington, and certain other locations, losses have been recognized representing rent and contractual operating expenses over the remaining life of the leases, and related write-downs of leasehold improvements to their estimated fair value.

Changes to the accrued loss on excess office facilities (in thousands):

Accrued loss December 31, 2012	\$4,213
Less amounts paid, net of sublease amounts	(642
Accrued loss March 31, 2013	3,571
Less current portion (included in Accrued and other current liabilities)	(2,460
Accrued loss, non-current portion (included in Other long term liabilities)	\$1,111

#### Note 13. Income Taxes

As of March 31, 2013, there have been no material changes to RealNetworks' uncertain tax positions disclosures as provided in Note 14 of the 10-K. We do not anticipate that our total unrecognized tax benefits will significantly change within the next twelve months.

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.

#### Note 14. 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):

	Quarter Ended	
	March 31, 2013	2012
Net income (loss) available to common shareholders	\$(11,674	) \$(17,015
Weighted average common shares outstanding used to compute basic EPS	35,343	34,488
Dilutive effect of stock based awards	—	—
Weighted average common shares outstanding used to compute diluted EPS	35,343	34,488
Basic EPS	\$(0.33	) \$(0.49
Diluted EPS	\$(0.33	) \$(0.49

During the quarters ended March 31, 2013, and March 31, 2012, 4.2 million and 5.9 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 15. Commitments and Contingencies

**Commitments.** See Note 19, Subsequent Event, for details on office lease commitments.

**Litigation.** On July 3, 2012, a lawsuit was filed against us by VoiceAge Corporation in the Supreme Court of the State of New York. VoiceAge asserts that we have breached our payment obligations under the terms of a patent license agreement between us and VoiceAge in respect of distribution of specified codec technology and is seeking a material amount of damages. We have removed the proceedings to New York federal court. Discovery commenced on January 4, 2013 and is scheduled to close on May 15, 2013. We dispute VoiceAge's allegations and the magnitude of the claimed damages, and, because we are in the early stages of this litigation and due to the uncertainties inherent in this matter, we are unable to estimate the range of possible loss that could result from this litigation.

On October 28, 2011 and November 1, 2011, respectively, two lawsuits were filed by Callertone Innovations, LLC in the U.S. District Court for the District of Delaware. The first lawsuit was against T-Mobile USA, Inc. and the second lawsuit was against MetroPCS Wireless, Inc. and MetroPCS Communications, Inc., which we collectively refer to as MetroPCS. The lawsuits allege that T-Mobile and MetroPCS, respectively, infringe Callertone's patents by providing ringback tone services. We agreed to indemnify each of T-Mobile and MetroPCS against the claims based on an indemnity that is claimed to be owed by us. The respective complaint was served on T-Mobile on January 16, 2012 and on MetroPCS on January 14, 2012. We filed our answers to each complaint on April 9, 2012. In each matter, we dispute the plaintiff's allegations regarding both the validity of its patents and its claims of infringement against T-Mobile and MetroPCS, respectively. Because we are in the early stages of this litigation and due to the uncertainties inherent in these matters, we are unable to estimate the range of possible loss that could result from this litigation.

On April 25, 2007, a lawsuit was filed by Greenville Communications, LLC in Greenville, Mississippi against a number of cell phone carriers, including our partners T-Mobile USA, Inc. and Alltel Corporation, alleging that they infringe its patents by providing ringback tone services. We agreed to indemnify T-Mobile and Alltel against the claims based on an indemnity that is claimed to be owed by us. On August 27, 2007, our motion to transfer this matter to the U.S. District Court for the District of New Jersey was granted. The parties briefed claims construction, but the case was subsequently stayed pending reexamination of the patents at issue. On December 10, 2009, the U.S. Patent and Trademark Office issued notice of its intent to issue reexamination certificates for the patents in suit. The District Court lifted the stay on the litigation on January 29, 2010 and discovery resumed. On September 28, 2011, the District Court held a claims construction hearing, and on May 10, 2012, the District Court issued a non-infringement judgment that was favorable to us and the other defendants. On December 4, 2012, Greenville appealed the claims construction order and the judgment, and the defendants filed a reply brief on January 28, 2013. Because we are in the early stages of the appeals process and due to the uncertainties inherent in this matter, we are unable to estimate the range of possible loss that could result from this litigation.

From time to time we are, and expect to continue to be, 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. These claims, including those described above, even if not meritorious, could force us to spend significant financial and managerial resources. We are not aware of any other legal proceedings or claims that we believe will have, individually or taken together, a material adverse effect on our business, prospects, financial condition or results of operations. However, we may incur substantial expenses in defending against third-party claims. 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 16. Guarantees

In the ordinary course of business, RealNetworks is subject to potential obligations for standard indemnification and warranty provisions that are contained within many of our customer license and service agreements, as described

below.

Warranty provisions contained within our customer license and service agreements are generally consistent with those prevalent in our industry. The duration of our product warranties generally does not exceed 90 days following delivery of our products. Nearly all of our carrier contracts obligate us to indemnify our carrier customer for certain liabilities that may be incurred by them.

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We do not maintain accruals for warranty-related obligations as we do not have a history of incurring such losses. We have, however, received claims for indemnification from certain of our carrier customers. See Note 15, Commitments and Contingencies, for a discussion of these indemnification claims.

As discussed in Note 1, Description of Business and Summary of Significant Accounting Policies, we sold certain patents and other technology assets 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 in the asset purchase agreement executed in connection with the transaction, and 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 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 17. Segment Information

In the first quarter of 2013 we reorganized the management of our businesses and as a result, we now report the following three 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; (2) Mobile Entertainment, which includes our SaaS services, systems integration, and professional services to mobile carriers, 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.

In addition, we now also allocate certain corporate expenses which are directly attributable to supporting the business to our reportable segments, rather than retaining those expenses in our corporate segment. 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 retained in aggregate in our corporate segment. In 2012, corporate segment expenses also included the sale of patent and other technology assets, net of costs. The historical financial information presented has been recast to reflect the new segments and the new corporate expense presentation.

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 interim Chief Executive Officer, Chief Financial Officer, President, Executive Vice President, General Counsel and certain Senior Vice Presidents. The CEOS reviews financial information presented on both a consolidated basis and on a business segment basis, accompanied by certain disaggregated information about products and services, geographical regions and corporate expenses for purposes of making decisions and assessing financial performance. 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 three months ended March 31, 2013 and 2012 (in thousands):

#### RealPlayer Group

	Quarter Ended	
	March 31,	
	2013	2012
Revenue	\$22,383	\$22,081
Cost of revenue	5,311	4,564
Gross profit	17,072	17,517
Operating expenses	16,206	15,975
Operating income (loss)	\$866	\$1,542



## Mobile Entertainment

	Quarter Ended March 31,	
	2013	2012
Revenue	\$20,495	\$25,775
Cost of revenue	10,832	15,478
Gross profit	9,663	10,297
Operating expenses	9,111	14,804
Operating income (loss)	\$552	\$(4,507)

## Games

	Quarter Ended March 31,	
	2013	2012
Revenue	\$13,915	\$19,108
Cost of revenue	3,800	6,713
Gross profit	10,115	12,395
Operating expenses	11,852	14,138
Operating income (loss)	\$(1,737)	\$(1,743)

## Corporate

	Quarter Ended March 31,	
	2013	2012
Cost of revenue	\$563	\$672
Sale of patents and other technology assets, net of costs	—	(1,580)
Operating expenses	10,544	11,582
Operating income (loss)	\$(11,107)	\$(13,834)

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

	Quarter Ended March 31,	
	2013	2012
United States	\$28,024	\$31,814
Europe	11,255	16,212
Rest of the world	17,514	18,938
Total net revenue	\$56,793	\$66,964

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

	March 31, 2013	December 31, 2012
United States	\$26,476	\$27,915
Europe	1,830	2,350
Rest of the world	7,544	8,635
Total long-lived assets	\$35,850	\$38,900

#### Note 18. Related Party Transactions

Transactions with Rhapsody. See Note 4, Rhapsody Joint Venture, for details on the 2010 restructuring transaction involving Rhapsody. Subsequent to the restructuring transaction, we are obligated to provide Rhapsody with certain support services. These support services are expected to be completed in 2013. The support services include information technology and limited operational support provided directly to Rhapsody. The amount of these and other support service costs were based on various measures depending on the service provided, including vendor fees, an allocation of fixed costs and time employees spend on providing services to Rhapsody. RealNetworks allocates the cost of providing these support services and records such allocation as a reduction to the related expense in the period for which it was incurred. During the quarters ended March 31, 2013 and 2012, we charged Rhapsody \$0.2 million and \$0.3 million, respectively, for the support services.

Transactions with LoEn Entertainment, Inc. In 2008, RealNetworks acquired approximately 11% of the outstanding shares of LoEn Entertainment, Inc. (LoEn). We paid market price for the common shares of LoEn, which are traded on the Korean Securities Dealers Automated Quotations. Our investment in LoEn is treated as an equity investment of a public company and is marked-to-market each period with resulting unrealized gains or losses recognized in accumulated other comprehensive income/loss. During the quarters ended March 31, 2013 and 2012 we recorded revenue from LoEn of \$4.6 million and \$3.9 million, respectively. Revenue consisted primarily of sales of application service provider services, which include sales of ringback tones, music-on-demand, video-on-demand, and inter-carrier messaging services. Associated with these transactions, we also recorded accounts receivable of \$1.8 million as of March 31, 2013. Accounts payable and cost of revenue associated with LoEn as of and for the periods ended March 31, 2013 and 2012 were nominal.

#### Note 19. Subsequent Event

On May 2, 2013, we entered into a new lease in a new location for our Seattle headquarters and concurrently entered into an amendment to our current headquarters office lease that provides for an early termination of such lease. We filed a current report on Form 8-K with the SEC on May 6, 2013 that provides details on these transactions.

The new Seattle building lease is for an initial term of 11 years for approximately 85,000 square feet of office space and is estimated to commence on August 15, 2013. We will pay approximately \$3.5 million in annual rent, which includes our pro rata share of certain real property taxes, operating expenses and common area maintenance expenses. We have the option to extend the lease for two additional five-year terms, with certain increases in base rent.

The amendment to our current headquarters office lease provides for an early termination of such lease effective in three stages, with the termination of a majority of the premises taking place on August 31, 2013. In connection with the early termination of the lease, we will pay the landlord a termination payment of approximately \$6.6 million in 2013. Prior to the execution of the amendment, the lease had been scheduled to expire in September 2014.

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:

- 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;
- the effect on our businesses of the sale of certain patent assets and next generation codec assets to Intel Corporation;
- plans, strategies and expected opportunities for future growth, increased profitability and innovation;
- the prospects for creation and growth of strategic partnerships and the resulting financial benefits from such partnerships;
- the expected financial position, performance, growth and profitability of, and investment in, our businesses and the availability of resources;
- our involvement in potential claims, legal proceedings and government investigations, the expected course and costs of existing claims, legal proceedings and government investigations, and the potential outcomes and effects of both existing and potential claims, legal proceedings and governmental investigations on our business, prospects, financial condition or results of operations;
- the expected benefits and other consequences from the 2010 restructuring of Rhapsody and from our other strategic initiatives;
- our expected introduction of new and enhanced products, services and technologies across our businesses;
- 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;
- 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

In the first quarter of 2013 we reorganized the management of our businesses and as a result, we now report the following 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. The Mobile Entertainment business primarily includes revenue from SaaS services, systems integration, and professional services to mobile carriers, and sales of technology licenses of our software products such as Helix. The Games business primarily includes revenue from 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.

In addition, we now also allocate certain corporate expenses which are directly attributable to supporting the business, including but not limited to a portion of finance, legal, human resources and headquarters facilities, to our reportable segments rather than retaining those expenses in our corporate segment. The allocation of these costs to the business units will increase accountability for financial and operational performance within each of our reportable segments. RealNetworks' most significant expenses relate to cost of revenue, compensating employees, and selling and marketing our products and services. The historical financial information presented has been recast to reflect the new segments and the new corporate expense presentation.

For the three months ended March 31, 2013, our consolidated revenue declined by \$10.2 million compared to the same period in 2012, due to a decline of \$5.3 million in Mobile Entertainment revenues and a decline of \$5.2 million Games revenue.

Our SaaS business within Mobile Entertainment continues to be impacted by the proliferation of smartphone applications and services, some of which do not depend on our carrier customers for distribution to consumers. In addition, we are still experiencing pricing pressure from carriers for our intercarrier messaging services. In our Games segment and in the general games market, consumer game play continues to shift from downloadable PC games to social networks and mobile devices. Since 2011, we have been focusing on developing social and mobile games and monetizing those game play experiences. However, the revenue we currently generate from social games is not a significant portion of our Games revenue.

We continue to focus on aligning our operating expenses with our revenue profile. The actions we initiated in the third quarter of 2012 to eliminate approximately 160 positions worldwide contributed significantly to the \$8.8 million decline in our total operating expenses for the three months ended March 31, 2013 compared to the same period in 2012.

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

	Quarter Ended March 31,		\$ Change	% Change	
	2013	2012			
Total revenue	\$56,793	\$66,964	\$(10,171)	(15)	)%
Cost of revenue	20,506	27,427	(6,921)	(25)	)%
Gross profit	36,287	39,537	(3,250)	(8)	)%
Gross margin	64	% 59	%		
Sale of patent assets and other technology assets, net of costs	—	(1,580)	) 1,580	—	%
Operating expenses	47,713	56,499	(8,786)	(16)	)%
Operating income (loss)	\$(11,426)	\$(18,542)	) \$7,116	38	)%

In the first quarter of 2013, our total consolidated revenue declined by \$10.2 million, compared with the year-earlier period. The reduction in revenue resulted from a decline of \$5.3 million in our Mobile Entertainment segment and a decline of \$5.2 million in our Games segment, due to the factors described above. Gross margin increased to 64%

from 59% for the year earlier quarter as a result of a higher proportion of lower margin revenue in the prior year, in addition to lower personnel and related costs in first quarter of 2013 that resulted from our ongoing work to align our operating expenses with our revenue profile.

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Operating expenses decreased by \$8.8 million in the quarter ended March 31, 2013, compared with the prior year primarily due to reductions in personnel and related costs that resulted from our ongoing work to align our operating expenses with our revenue profile.

The 2012 costs for the sale of patents and other technology assets of \$1.6 million related to certain direct expenses incurred for the sale transaction with Intel Corporation.

See “Segment Operating Results” below for more information and discussion regarding changes in the operating results for each of our reporting segments.

#### Segment Operating Results

##### RealPlayer Group

The RealPlayer Group segment primarily generates revenue and incurs costs from sales of RealPlayer and its 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.

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

	Quarter Ended March 31,		\$ Change	% Change	
	2013	2012			
Revenue	\$22,383	\$22,081	\$302	1	%
Cost of revenue	5,311	4,564	747	16	%
Gross profit	17,072	17,517	(445)	(3)	)%
Gross margin	76	% 79	%		
Operating expenses	16,206	15,975	231	1	%
Operating income (loss)	\$866	\$1,542	\$(676)	(44)	)%

Total RealPlayer Group revenue increased by \$0.3 million in the three months ended March 31, 2013, compared with the year-earlier period. This increase was primarily due to increased revenue related to the distribution of third-party software of \$2.5 million, in addition to higher revenue from our intellectual property licenses of \$0.8 million. Partially offsetting these increases was a decrease in our subscriptions revenue of \$2.7 million, primarily related to our SuperPass product.

Operating expenses increased \$0.2 million in the three months ended March 31, 2013, compared with the year-earlier period. Personnel and related costs increased \$1.0 million in the period ended March 31, 2013 due to investment in new product development; and marketing spend increased by \$1.4 million. Offsetting these increases was a decrease of \$2.4 million, resulting from estimated amounts recorded during the quarter ended March 31, 2012 associated with the then-pending investigation by the Washington State Attorney General's office. As disclosed in the 2012 10-K, this matter was resolved in the third quarter of 2012 in an amount totaling \$1.3 million.

##### Mobile Entertainment

The Mobile Entertainment segment primarily generates revenue and incurs costs from the sales of SaaS services, such as ringback tones, intercarrier messages, music on demand and video on demand; professional services and systems integration services to mobile carriers and mobile handset companies; and Helix software.

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

	Quarter Ended March 31,		\$ Change	% Change	
	2013	2012			
Revenue	\$20,495	\$25,775	\$(5,280)	(20)	)%
Cost of revenue	10,832	15,478	(4,646)	(30)	)%
Gross profit	9,663	10,297	(634)	(6)	)%
Gross margin	47	% 40	%		
Operating expenses	9,111	14,804	(5,693)	(38)	)%
Operating income (loss)	\$552	\$(4,507)	) \$5,059	112	%



Total Mobile Entertainment revenue decreased by \$5.3 million in the quarter ended March 31, 2013 compared with the year-earlier period, primarily due to reduced revenue from our SaaS offerings of \$4.8 million. The decline in SaaS revenue was due primarily to a \$2.7 million decline in our ringback tone and intercarrier messaging revenues, due to fewer ringback tone subscribers, in addition to pricing pressure from carriers on intercarrier messaging. Additional revenue declines of \$1.1 million were seen in other carrier application services.

Cost of revenue decreased during the three months ended March 31, 2013 by \$4.6 million compared with the year-earlier period. During the quarter, costs related to our SaaS offerings decreased by \$4.4 million due to the lower revenues and to lower personnel and related costs that resulted from our ongoing work to align our operating expenses with our revenue profile.

Operating expenses declined by \$5.7 million for three months ended March 31, 2013 compared with the year-earlier period, primarily due to reductions in personnel and related costs of \$5.0 million that resulted from our ongoing work to align our operating expenses with our revenue profile.

#### Games

The Games segment primarily generates revenue and incurs costs from the creation, distribution and sales of games licenses, online games subscription services, advertising on game sites and social network sites, games syndication services, and microtransactions from online and social games, and sales of mobile games.

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

	Quarter Ended March 31,		\$ Change	% Change	
	2013	2012			
Revenue	\$13,915	\$19,108	\$(5,193)	) (27	)%
Cost of revenue	3,800	6,713	(2,913)	) (43	)%
Gross profit	10,115	12,395	(2,280)	) (18	)%
Gross margin	73	% 65	%		
Operating expenses	11,852	14,138	(2,286)	) (16	)%
Operating income (loss)	\$(1,737)	) \$(1,743)	) \$6	—	%

Total Games revenue decreased by \$5.2 million in the quarter ended March 31, 2013, compared with the year-earlier period. Lower revenue from license sales and our subscription products contributed \$2.3 million and \$1.9 million, respectively, to the decline during the period.

Cost of revenue decreased by \$2.9 million in the three months ended March 31, 2013, compared with the year-earlier period. The decrease was due to the decrease in partner royalties expense, which has a direct correlation with the decrease in Games revenue. Gross margins increased during the quarter ended March 31, 2013 due to lower margin projects that occurred in the year-earlier period.

Operating expenses declined by \$2.3 million in the three months ended March 31, 2013, compared with the year-earlier period. The decreases were mainly due to reductions in marketing expense of \$1.0 million, in addition to reductions in personnel and related costs of \$1.7 million, resulting from our ongoing work to align our operating expenses with our revenue profile.

#### Corporate

We allocate certain corporate expenses which are directly attributable to supporting the business to our reportable segments, rather than retaining those expenses in our corporate segment. 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 retained in aggregate in our corporate segment.

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

	Quarter Ended March 31,		\$ Change	% Change	
	2013	2012			
Cost of revenue	\$563	\$672	\$(109	) (16	)%
Sale of patent and other technology assets, net of costs	—	(1,580	) 1,580	—	%
Operating expenses	10,544	11,582	(1,038	) (9	)%
Operating income (loss)	\$(11,107	) \$(13,834	) \$2,727	20	%

The 2012 costs for the sale of patents and other technology assets of \$1.6 million related to certain direct expenses incurred for the sale transaction with Intel Corporation.

Operating expenses decreased by \$1.0 million in the quarter ended March 31, 2013 compared with the year-earlier period, primarily due to reductions in personnel and related costs resulting from our ongoing work to align our operating expenses with our revenue profile.

#### 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):

	Quarter Ended March 31,		\$ Change	% Change	
	2013	2012			
Research and development	\$15,251	\$17,818	\$(2,567	) (14	)%
Sales and marketing	21,134	23,796	(2,662	) (11	)%
General and administrative	9,946	13,276	(3,330	) (25	)%
Restructuring and other charges	1,382	1,609	(227	) (14	)%
Total consolidated operating expenses	\$47,713	\$56,499	\$(8,786	) (16	)%

Research and development expenses decreased by \$2.6 million in the quarter ended March 31, 2013, compared with the year-earlier period. The decline was primarily due to a decrease in personnel and related costs of \$2.8 million resulting from our ongoing work to align our operating expenses with our revenue profile.

Sales and marketing expenses decreased by \$2.7 million in the quarter ended March 31, 2013, compared with the year-earlier period. The decline was primarily due to a decrease in personnel and related costs of \$2.8 million resulting from our ongoing work to align our operating expenses with our revenue profile.

General and administrative expenses decreased by \$3.3 million in the quarter ended March 31, 2013, compared with the year-earlier period. The decrease was primarily due to the first quarter of 2012 expense accrual of \$2.4 million for estimated amounts associated with the then-pending investigation by the Washington State Attorney General's office. As disclosed in the 2012 10-K, this matter was resolved in the third quarter of 2012 at an amount totaling \$1.3 million. Also contributing to the decrease for the quarter was a decrease in personnel and related costs of \$1.1 million.

Restructuring and other charges in 2013 and 2012 consist of costs associated with the ongoing reorganization of our business operations and focus on aligning our operating expenses with our revenue profile. The expense amounts in both years primarily relate to severance costs due to workforce reductions. For additional details on these charges see Note 11, Restructuring Charges.

#### Other Income (Expenses)

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

	Quarter Ended March 31,				
	2013	2012	\$ Change	% Change	%
Interest income, net	\$647	\$644	\$3	—	%
Equity in net loss of Rhapsody	(2,233	) (368	) (1,865	) (507	)%
Other income (expense), net	109	1,475	(1,366	) (93	)%
Total other income (expense), net	\$(1,477	) \$1,751	\$(3,228	) NM	

The decrease in Other income (expense), net, of \$3.2 million for the quarter ended March 31, 2013 was due to the increase in equity loss for our investment in Rhapsody and to the first quarter of 2012 recognition of a \$1.6 million cumulative foreign exchange translation gain from accumulated other comprehensive loss on the balance sheet related to the liquidation of an investment in one of our foreign entities.

We account for our investment in Rhapsody under the equity method of accounting for investments. The net carrying value of our investment in Rhapsody is not necessarily indicative of the underlying fair value of our investment.

#### Income Taxes

During the quarters ended March 31, 2013 and 2012, we recognized an income tax benefit of \$1.2 million and income tax expense of \$0.2 million, respectively, related to U.S. and foreign income taxes. The income tax benefit for the quarter ended March 31, 2013 and the change in income tax as a percentage of pre-tax loss compared with the prior year period was primarily the result of the current period income tax benefit of \$1.6 million related to the change in our valuation allowance as a result of unrealized gains on investment securities, recognized in other comprehensive income.

As of March 31, 2013, there have been no material changes to RealNetworks' uncertain tax positions as disclosed in Note 14 of the 2012 10-K. We do not anticipate that our total unrecognized tax benefits will significantly change within the next twelve months.

Excluding the \$1.6 million income tax benefit related to unrealized gain on investments securities, we recognized income tax expense due to income in our foreign jurisdictions as we have not benefitted from the losses in the U.S. in the first quarter of 2013. We generate income in a number of foreign jurisdictions, some of which have higher tax rates and some of which have 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 lower than anticipated in countries where we have lower statutory tax rates and higher than anticipated in countries where we have higher statutory tax rates. For the quarter ended March 31, 2013, 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 our tax expense for the first quarter of 2013 was minimal.

As of March 31, 2013, 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. 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 taxes. It is not practicable to determine the U.S. federal 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 U.S. 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.

#### Geographic Revenue

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





	Quarter Ended March 31,		\$ Change	% Change	
	2013	2012			
United States	\$28,024	\$31,814	\$(3,790)	) (12	)%
Europe	11,255	16,212	(4,957)	) (31	)%
Rest of world	17,514	18,938	(1,424)	) (8	)%
Total net revenue	\$56,793	\$66,964	\$(10,171)	) (15	)%

Revenue in the United States declined by \$3.8 million in the quarter ended March 31, 2013, compared with the year-earlier period. The decline was due primarily to reductions in revenue generated from our SaaS offerings of \$3.0 million, lower sales of games subscriptions and licenses of \$2.0 million, and lower sales of SuperPass subscriptions of \$1.5 million due to fewer subscribers. These declines were offset in part by an increase of \$2.3 million of revenue related to the distribution of third-party software.

Revenue in Europe declined by \$5.0 million in the quarter ended March 31, 2013, compared with the year-earlier period. The decrease was primarily due to lower revenue from our Games business of \$2.3 million and lower revenue from our RealPlayer Group of \$1.9 million.

Revenue in the rest of world decreased by \$1.4 million for the quarter ended March 31, 2013, compared with the year-earlier period. The decrease was primarily due to lower revenue from our SaaS services of \$1.2 million.

#### New Accounting Pronouncements

There have been no recent accounting pronouncements or changes in accounting pronouncements during the three months ended March 31, 2013 to be implemented that are of significance or potential significance to RealNetworks.

#### Liquidity and Capital Resources

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

	March 31, 2013	December 31, 2012
Working capital	\$229,025	\$237,646
Cash, cash equivalents, and short-term investments	260,588	271,414
Restricted cash equivalents and investments	10,000	10,000

The following summarizes cash flow activity (in thousands):

	Three Months Ended March 31,		
	2013	2012	
Cash provided by (used in) operating activities	\$(6,733)	\$(17,242)	)
Cash provided by (used in) investing activities	(17,572)	(7,740)	)
Cash provided by (used in) financing activities	(974)	675	)

Cash used in operating activities consisted of net income (loss) adjusted for certain non-cash items including depreciation, amortization, stock-based compensation, deferred income taxes, and the effect of changes in certain operating assets and liabilities.

The lower amount of cash used in operating activities for the three months ended March 31, 2013 compared to the same period in 2012 was primarily due to the lower operating loss for the three months ended March 31, 2013 of \$11.4 million compared with \$18.5 million for the prior year period, which was due in part to our cost reduction efforts. We also had a net decrease in cash of \$2.6 million for the three months ended March 31, 2013 related to changes in certain operating assets and liabilities, compared with a net decrease in cash of \$5.4 million for the three months ended March 31, 2012 related to changes in certain operating assets and liabilities.

For the three months ended March 31, 2013, cash used by investing activities of \$17.6 million was primarily due to purchases, net of sales and maturities, of short-term investments of \$15.7 million.



For the three months ended March 31, 2012, cash used in investing activities of \$7.7 million was due to purchases, net of sales and maturities, of short-term investments of \$4.9 million, and purchases of equipment, software and leasehold improvements of \$2.8 million.

Financing activities for the three months ended March 31, 2013 used cash totaling \$1.0 million primarily from the payment of the principal amount of contingent consideration of \$0.8 million related to an earlier period business acquisition.

Financing activities for the three months ended March 31, 2012, provided cash totaling \$0.7 million from the proceeds from the exercise of employee stock options and proceeds from sales of common stock under the employee stock purchase plan totaling \$0.7 million.

Except for certain expenditures related to our new leased Seattle headquarters building, we currently have no planned significant capital expenditures for the remainder of 2013 other than those in the ordinary course of business. Details of the new lease are provided below.

In the future, we may seek to raise additional funds through public or private equity financing, or through other sources such as credit facilities. The sale of additional equity securities could result in dilution to our shareholders. In addition, in the future, we may enter into cash or stock acquisition transactions or other strategic transactions that could reduce cash available to fund our operations or result in dilution to shareholders.

Our principal 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.

As disclosed in Note 19, Subsequent Event, on May 2, 2013, we entered into a new lease in a new location for our Seattle headquarters and concurrently entered into an amendment to our current headquarters office lease that provides for an early termination of such lease.

The new Seattle building lease is for an initial term of 11 years and is estimated to commence on August 15, 2013. We will pay approximately \$3.5 million in annual rent, which includes our pro rata share of certain real property taxes, operating expenses and common area maintenance expenses. We have the option to extend the lease for two additional five-year terms, with certain increases in base rent. The amendment to our current headquarters office lease provides for an early termination of such lease effective in three stages, with the termination of a majority of the premises taking place on August 31, 2013. In connection with the early termination of the lease, we will pay the landlord a termination payment of approximately \$6.6 million in 2013. Prior to the execution of the amendment, the lease had been scheduled to expire in September 2014.

As a result of our entry into the new lease and the termination of our old lease, we expect to save approximately \$7 million in annual facilities costs.

In our 2012 10-K we disclosed that we had future contractual obligations, nearly all of which related to office leases, that totaled \$26.3 million at December 31, 2012. As a result of the leasing transactions described above we estimate that our future contractual obligations now total approximately \$56 million.

The declaration and payment of any future dividends, as well as the amount thereof, are subject to the discretion of our board of directors and will depend upon our results of operations, financial condition, capital levels, cash requirements, future prospects and other factors deemed relevant by our board of directors. Accordingly, there can be no assurance that we will declare and pay any dividends in the future.

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 March 31, 2013, approximately \$39.4 million of the \$260.6 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. 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, RealNetworks currently has significant net operating losses and other tax attributes that could be used to offset most 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 March 31, 2013, 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. 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 taxes. It is not practicable to determine the U.S. federal 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.

#### 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 16, 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;

Estimating losses on excess office facilities;

Valuation of equity method investments;

Valuation of long-lived assets;

Valuation of goodwill;

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 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 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 owed related to our music publishing rights and music royalties for our domestic and international music services primarily incurred by Rhapsody which was separated from our operating results beginning April 1, 2010. Unsettled obligations incurred prior to April 1, 2010 remain our liability. 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 yet completed negotiations with regard to the royalty rate to be applied to the current or historic sales of our digital music offerings. Our estimates are based on contracted or statutory rates, when established, or management's best estimates based on facts and circumstances regarding the specific music services and agreements in similar geographies or with similar agencies. While we base our estimates on historical experience and on various other assumptions that management believes to be reasonable under the circumstances, actual results may differ materially from these estimates under different assumptions or conditions.

**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 additional impairments of deferred project costs. We cannot accurately predict the amount and timing of 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 in any accounting period. Material differences may result in the amount and timing of our revenue for any period if we were to make different judgments or utilize different estimates or actual future experience was different from the judgments and estimates.

Estimating Losses on Excess Office Facilities. We made significant estimates in determining the appropriate amount of accrued loss on excess office facilities. If we make different estimates, our loss on excess office facilities could be significantly different from that recorded, which could have a material impact on our operating results.



**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. Prior to 2010, most of our equity method investments were purchased with cash which was determined to be fair value. For the investment in Rhapsody as of March 31, 2010, we used multiple valuation models that were based on assumptions of future results, including operating and cash flow projections, to calculate the fair value since we contributed both cash and non-cash items in exchange for our interest. These models were based upon estimates and assumptions relating to 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 long-term operating plans, market and interest rate risk, and risk-commensurate discount rates and cost of capital. We evaluate impairment of an investment valued under the equity method only if events and circumstances warrant. An impairment charge would be recorded whenever a decline in value of an equity investment below its carrying amount is 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 Long-Lived Assets.** Long-lived assets consist primarily of property, plant and equipment, as well as amortizable intangible assets acquired in business combinations. Long-lived assets are amortized on a straight line basis over their estimated useful lives. We review 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 comparison of 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 impairment analysis of long-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 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 our business climate, among other factors, and their resulting impact on the estimates and assumptions relating to the value of our long-lived assets could result in the need to perform an impairment analysis in future interim 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.

**Valuation of Goodwill.** 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 cash flows of long-term operating plans, market and interest rate risk, and risk-commensurate discount rates and cost of capital.

Stock-Based Compensation. Stock-based compensation cost is measured 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. We use the Black-Scholes option-pricing model or other appropriate valuation models to determine the fair value of stock-based option awards. The fair value of restricted stock awards is based on the closing market price of our common stock on the award date. 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. We are required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest.

**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 the 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 changes 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 March 31, 2013, \$39.4 million of the \$260.6 million of cash, cash equivalents, and short-term investments was held by our foreign subsidiaries.

As of March 31, 2013, 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. 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 taxes. It is not practicable to determine the U.S. federal 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, Cash, Cash Equivalents, Short-Term Investments, Restricted Cash Equivalents and Investments

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 March 31, 2013. Based on our cash, cash equivalents, short-term investments, and restricted cash equivalents as of March 31, 2013, 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 March 31, 2013, 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 our 2012 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 March 31, 2013 would not result in more than a nominal amount of unrealized gain or loss.

#### 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 March 31, 2013. 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 March 31, 2013, our disclosure controls and procedures were effective.

##### (b) Changes in Internal Control over Financial Reporting

As described in Management's Report on Internal Control over Financial Reporting in Item 9A of our 2012 10-K filed with the SEC on March 18, 2013, we identified a material weakness in internal control over financial reporting related to our equity method investment balance in our investee's (Rhapsody) financial statements. In the 2012 10-K we corrected the immaterial errors in the equity method investment amount and additional paid-in capital presented in our consolidated balance sheets and consolidated statements of shareholders' equity for the periods ended December 31, 2011 and December 31, 2010.

During the first quarter of 2013, we designed and implemented a new control process that entails a detailed reconciliation of our equity method investment balance to the latest financial statement balances of our investee. As of the date of this 10-Q filing, management believes this material weakness has been remediated.

Other than the changes described above, there was no change 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 first quarter of 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

See Note 15, Commitments and Contingencies, to Condensed Consolidated Financial Statements included in Part I, Item 1 of this report for information regarding legal proceedings.

### 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.

We have recently 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 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 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 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.

Our 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. There is no guarantee that we will be able to create popular and successful products 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, such as the introduction in 2012 of Windows 8, we could face difficulties reaching our traditional customer base and other unknown distribution challenges. If we are unable to successfully develop and introduce new products and services, or 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.

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 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 is expected to be concluded by the end of the second quarter of 2013. There can be no assurance that our 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.

The mobile entertainment market is highly competitive and evolving rapidly.

The market for mobile entertainment services, including our ring back tones, music on demand and video 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 non-SaaS businesses also 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.

Our SuperPass subscription service faces competition from a broad variety of entertainment sources, including traditional media outlets and emerging Internet media sources. We expect this competition to continue to be intense as the market and business models for Internet video content mature and more competitors enter these new markets.

Competing services may be able to obtain better or more favorable access to compelling video content than us, may develop better offerings than us and may be able to leverage other assets or technologies to promote or distribute their offerings successfully. Our 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. If we are unable to compete successfully, including through the introduction of

compelling new products and services, our SuperPass and RealPlayer businesses 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 achieve 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 agreed to control the defense on behalf of three of our carrier customers related to pending patent infringement proceedings, and we are vigorously defending them. These pending proceedings or 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 relationship with a few customers, and any deterioration of these relationships could materially harm our business. 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. 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 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. Our relationship with SK Telecom may also be affected by the general state of the economy of South Korea. Failure to maintain our relationships with these customers could have a material negative impact on our revenue and operating results.

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 is important to our future prospects, including future 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. In addition, our revenue from the distribution of third party products is currently significantly dependent on a single customer contract. If that contract is not renewed or is terminated and cannot be replaced by another similar customer contract, our financial results would be harmed.

Our operating results are difficult to predict and may fluctuate, which may contribute to volatility in our stock price. The trading price for our common stock has been volatile, ranging from \$6.80 to \$10.00 per share during the 52-week period ended March 31, 2013. As a result of the rapidly changing markets in which we compete, our operating results may fluctuate from period-to-period, which may continue to contribute to the volatility of our stock price. In past periods, our operating results have been affected by personnel reductions and related restructuring charges, charges relating to losses on excess office facilities, and impairment charges for certain of our equity investments, goodwill and other long-lived assets. Our operating results may be adversely affected by similar or other charges or events in future periods, including, but not limited to:

- impairments of long-lived assets,
- integrating and operating newly acquired businesses and assets, and
- the general difficulty in forecasting our operating results and metrics, which could result in actual results that differ significantly from expected results.

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 continue to fluctuate.

Continued loss of revenue from some of our subscription services may harm our operating results.

Our operating results have been and could continue to be adversely impacted by the loss of subscription revenue. Subscribers may cancel their subscriptions to our services for many reasons, including a perception that they do not use the services sufficiently or that the service does not provide enough value, a lack of attractive or exclusive content generally or as compared with competitive service offerings, or because customer service issues are not satisfactorily resolved. Revenue from our SuperPass subscription service 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 cover taxation, user privacy, data collection and protection, copyrights, electronic contracts, sales procedures, automatic subscription renewals, credit card processing procedures, consumer protections, 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 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. On May 24, 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. For details on this action and the related costs we incurred in 2012, see Note 16, Commitments and Contingencies, in our 2012 10-K. While we have resolved this matter, we cannot provide assurances that the Washington AG or other governmental agencies will not bring future claims regarding our marketing or other consumer 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 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.

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. In July 2012, Rob Glaser, our founder, Chairman and initial chief executive officer, was appointed as interim chief executive officer, having stepped down as chief executive officer in 2010. A search committee has been formed in connection with the chief executive officer position. We cannot provide assurance that we will effectively manage this or any other executive-level transition, which may impact our ability to retain our remaining 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 involved a reduction 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.

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. On July 3, 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 are vigorously defending ourselves against these claims, the outcome of this lawsuit remains uncertain and could ultimately 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. We are also investigating or litigating other pending claims, some of which are described in Note 15, Commitments and Contingencies, in this 10-Q. In the event of a determination adverse to us, we may incur substantial monetary liability and/or be required to change our business practices. 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 interim Chief Executive Officer beneficially owns approximately 37% 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 interim Chief Executive Officer, beneficially owns approximately 37% 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

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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

(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 May 8, 2013.

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*	Offer Letter dated January 7, 2013 between RealNetworks, Inc. and Max Pellegrini
31.1	Certification of Robert Glaser, Chairman and interim 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 interim 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

\* Executive compensation plan or agreement

\*\* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.