

REALNETWORKS INC  
Form 10-Q  
May 07, 2015

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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, 2015

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-23137

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

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

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

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

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

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

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

Large accelerated filer  Accelerated filer

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

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

The number of shares of the registrant's Common Stock outstanding as of April 30, 2015 was 36,106,018.

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TABLE OF CONTENTS

	Page
<u>Part I. Financial Information</u>	<u>3</u>
<u>Item 1. Financial Statements</u>	<u>3</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>16</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>27</u>
<u>Item 4. Controls and Procedures</u>	<u>27</u>
<u>Part II. Other Information</u>	<u>29</u>
<u>Item 1. Legal Proceedings</u>	<u>29</u>
<u>Item 1A. Risk Factors</u>	<u>29</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>38</u>
<u>Item 3. Default Upon Senior Securities</u>	<u>38</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>38</u>
<u>Item 5. Other Information</u>	<u>38</u>
<u>Item 6. Exhibits</u>	<u>38</u>
<u>Signature</u>	<u>39</u>
<u>Index to Exhibits</u>	<u>40</u>

## 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, 2015	December 31, 2014
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 102,994	\$ 103,253
Short-term investments	31,394	58,453
Trade accounts receivable, net of allowances	15,510	15,257
Deferred costs, current portion	314	702
Deferred tax assets, net, current portion	651	652
Prepaid expenses and other current assets	8,278	8,980
Total current assets	159,141	187,297
Equipment, software, and leasehold improvements, at cost:		
Equipment and software	71,840	74,100
Leasehold improvements	3,395	3,590
Total equipment, software, and leasehold improvements, at cost	75,235	77,690
Less accumulated depreciation and amortization	60,610	61,442
Net equipment, software, and leasehold improvements	14,625	16,248
Restricted cash equivalents and investments	3,000	3,000
Investment in and advances to Rhapsody	10,743	10,000
Available for sale securities	2,648	2,676
Other assets	3,761	2,299
Deferred costs, non-current portion	263	316
Deferred tax assets, net, non-current portion	899	999
Other intangible assets, net	9,700	10,109
Goodwill	16,839	17,355
Total assets	\$ 221,619	\$ 250,299
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 18,315	\$ 18,653
Accrued and other current liabilities	22,052	25,286
Deferred tax liabilities, net, current portion	1,576	1,628
Deferred revenue, current portion	3,857	5,301
Total current liabilities	45,800	50,868
Deferred revenue, non-current portion	173	235
Deferred rent	1,207	1,215
Deferred tax liabilities, net, non-current portion	690	702
Other long-term liabilities	448	81
Total liabilities	48,318	53,101
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	—	—

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Common stock, \$0.001 par value authorized 250,000 shares; issued and outstanding 36,106 shares in 2015 and 36,099 shares in 2014	36	36
Additional paid-in capital	621,007	617,756
Accumulated other comprehensive loss	(57,931	) (55,252 )
Retained deficit	(389,811	) (365,342 )
Total shareholders' equity	173,301	197,198
Total liabilities and shareholders' equity	\$221,619	\$250,299
See accompanying notes to unaudited condensed consolidated financial statements.		

3

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

(In thousands, except per share data)

	Quarters Ended	
	March 31,	
	2015	2014
Net revenue (A)	\$30,597	\$45,724
Cost of revenue (B)	16,547	18,786
Extinguishment of liability (See Note 9)	—	(10,580 )
Gross profit	14,050	37,518
Operating expenses:		
Research and development	12,379	14,059
Sales and marketing	12,837	21,723
General and administrative	7,283	9,317
Restructuring and other charges	485	1,216
Lease exit and related charges	78	79
Total operating expenses	33,062	46,394
Operating income (loss)	(19,012 )	(8,876 )
Other income (expenses):		
Interest income, net	200	136
Gain (loss) on sale of available for sale securities, net	299	2,371
Equity in net loss of Rhapsody	(6,180 )	(838 )
Other income (expense), net	443	(77 )
Total other income (expenses), net	(5,238 )	1,592
Income (loss) before income taxes	(24,250 )	(7,284 )
Income tax expense (benefit)	219	486
Net income (loss)	\$(24,469 )	\$(7,770 )
Basic net income (loss) per share	\$(0.68 )	\$(0.22 )
Diluted net income (loss) per share	\$(0.68 )	\$(0.22 )
Shares used to compute basic net income (loss) per share	36,104	35,840
Shares used to compute diluted net income (loss) per share	36,104	35,840
Comprehensive income (loss):		
Unrealized investment holding gains (losses), net of reclassification adjustments	\$(94 )	\$(3,575 )
Foreign currency translation adjustments, net of reclassification adjustments	(2,585 )	(25 )
Total other comprehensive income (loss)	(2,679 )	(3,600 )
Net income (loss)	(24,469 )	(7,770 )
Comprehensive income (loss)	\$(27,148 )	\$(11,370 )
(A) Components of net revenue:		
License fees	\$7,289	\$8,579
Service revenue	23,308	37,145
	\$30,597	\$45,724
(B) Components of cost of revenue:		
License fees	\$1,743	\$2,212
Service revenue	14,804	16,574
	\$16,547	\$18,786

See accompanying notes to unaudited condensed consolidated financial statements.



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

	Quarters Ended March 31,	
	2015	2014
Cash flows from operating activities:		
Net income (loss)	\$(24,469	) \$(7,770
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,503	2,983
Stock-based compensation	1,329	1,337
Equity in net loss of Rhapsody	6,180	838
Deferred income taxes, net	(77	) 10
Gain on sale of available for sale securities	(299	) (2,371
Realized translation gain	—	(48
Extinguishment of liability	—	(10,580
Fair value of warrants received	(1,155	) —
Net change in certain operating assets and liabilities:		
Trade accounts receivable	(654	) (818
Prepaid expenses and other assets	621	(1,426
Accounts payable	(62	) 1,435
Accrued and other liabilities	(4,011	) (2,100
Net cash provided by (used in) operating activities	(20,094	) (18,510
Cash flows from investing activities:		
Purchases of equipment, software, and leasehold improvements	(306	) (998
Proceeds from sale of available for sale securities	352	2,754
Purchases of short-term investments	(6,018	) (29,030
Proceeds from sales and maturities of short-term investments	33,077	25,589
Advance to Rhapsody	(5,000	) —
Net cash provided by (used in) investing activities	22,105	(1,685
Cash flows from financing activities:		
Proceeds from issuance of common stock (stock options and stock purchase plan)	6	210
Tax payments from shares withheld upon vesting of restricted stock	(7	) (60
Net cash provided by (used in) financing activities	(1	) 150
Effect of exchange rate changes on cash and cash equivalents	(2,269	) 86
Net increase (decrease) in cash and cash equivalents	(259	) (19,959
Cash and cash equivalents, beginning of period	103,253	151,235
Cash and cash equivalents, end of period	\$ 102,994	\$ 131,276
Supplemental disclosure of cash flow information:		
Cash received from income tax refunds	\$ 229	\$ 86
Cash paid for income taxes	\$ 229	\$ 621
Non-cash investing activities:		
Increase (decrease) in accrued purchases of equipment, software, and leasehold improvements	\$ 49	\$ 3
Acquisition of intangible assets	\$ 473	\$ —
See accompanying notes to unaudited condensed consolidated financial statements.		





REALNETWORKS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Quarters Ended March 31, 2015 and 2014

Note 1 Description of Business and Summary of Significant Accounting Policies

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

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

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

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

The unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal, recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations for the periods presented. Operating results for the quarter ended March 31, 2015 are not necessarily indicative of the results that may be expected for any subsequent period or for the year ending December 31, 2015.

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, 2014 (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.

Note 2 Recent Accounting Pronouncements

In August 2014, the Financial Accounting Standards Board (FASB) issued a new standard, "Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern". This standard provides guidance around management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures in certain circumstances. The new guidance is effective for all annual and interim periods ending after December 15, 2016. We are currently evaluating the impact, if any, the adoption of this standard will have on our consolidated financial statements.

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

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



Note 3 Stock-Based Compensation

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

	Quarters Ended	
	March 31, 2015	2014
Total stock-based compensation expense	\$1,329	\$1,337

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

	Quarters Ended		
	March 31, 2015	2014	
Expected dividend yield	0	% 0	%
Risk-free interest rate	1.20	% 1.10	%
Expected life (years)	4.2	3.8	
Volatility	37	% 40	%

The total stock-based compensation amounts for 2015 and 2014 disclosed above are recorded in their respective line items within operating expenses in the unaudited condensed consolidated statements of operations and comprehensive income (loss). As of March 31, 2015, \$13.5 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

As of March 31, 2015 we owned approximately 43% of the issued and outstanding stock of Rhapsody and account for our investment using the equity method of accounting.

Rhapsody was initially formed in 2007 as a joint venture between RealNetworks and MTV Networks, a division of Viacom International Inc. (MTVN), to own and operate a business-to-consumer digital audio music service known as Rhapsody.

Following certain restructuring transactions effective March 31, 2010, we began accounting for our investment in Rhapsody using the equity method of accounting. As part of the 2010 restructuring transactions, RealNetworks contributed \$18.0 million in cash, the Rhapsody brand and certain other assets, including content licenses, in exchange for shares of convertible preferred stock of Rhapsody, carrying a \$10.0 million preference upon certain liquidation events.

We recorded our share of losses of Rhapsody of \$6.2 million and \$0.8 million for the quarters ended March 31, 2015 and 2014, respectively. Because of the \$10.0 million liquidation preference on the preferred stock we hold in Rhapsody, under the equity method of accounting we do not record any share of Rhapsody losses that would reduce our carrying value of Rhapsody, which is impacted by Rhapsody equity transactions, below \$10.0 million, unless Rhapsody's book value is reduced below \$10.0 million. Because Rhapsody's book value declined below \$10.0 million in the first quarter of 2015, we reduced our investment in Rhapsody below the \$10.0 million liquidation preference and recorded \$6.2 million of our share of losses of Rhapsody. On the unaudited condensed consolidated balance sheet, Investment in and advances to Rhapsody of \$10.7 million includes the \$5.7 million carrying value of our Rhapsody equity investment.

In March 2015, RealNetworks extended a \$5.0 million loan to Rhapsody, as did the other 43% owner of Rhapsody. The loans have maturity dates of June 2018 or earlier if Rhapsody's certain loan to an external strategic partner is repaid on its due date of June 2015. The loans bear interest at the greater of prime plus 5.25% or 9% per annum, and interest accrues and is paid upon final maturity. In April 2015 RealNetworks and the other 43% owner of Rhapsody

each provided a \$5.0 million guaranty to Rhapsody's senior secured lender, related to the senior lender's loans to Rhapsody, which mature in April 2018. The guaranties will be released by the senior secured lender upon the June 2015 maturity of Rhapsody's loan to the external strategic partner, or no later than April 2018 if Rhapsody's loan to the external strategic partner is not repaid upon its due date.

7

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

	Quarters Ended	
	March 31, 2015	2014
Net revenue	\$46,324	\$42,003
Gross profit	8,090	9,121
Net loss	(8,924	) (1,630

Note 5 Fair Value Measurements

Items Measured at Fair Value on a Recurring Basis

The following table presents information about our financial assets that have been measured at fair value on a recurring basis as of March 31, 2015 and December 31, 2014, and indicates the fair value hierarchy of the valuation inputs utilized to determine such fair value (in thousands).

	Fair Value Measurements as of				Amortized Cost as of March 31, 2015
	March 31, 2015				
	Level 1	Level 2	Level 3	Total	
Cash and cash equivalents:					
Cash	\$26,642	\$—	\$—	\$26,642	\$26,642
Money market funds	9,370	—	—	9,370	9,370
Corporate notes and bonds	—	66,982	—	66,982	66,982
Total cash and cash equivalents	36,012	66,982	—	102,994	102,994
Short-term investments:					
Corporate notes and bonds	—	24,394	—	24,394	24,383
U.S. government agency securities	7,000	—	—	7,000	7,000
Total short-term investments	7,000	24,394	—	31,394	31,383
Restricted cash equivalents and investments	—	3,000	—	3,000	3,000
Equity investment in publicly traded securities	2,648	—	—	2,648	376
Warrant issued by Rhapsody (included in Other assets)	—	—	1,155	1,155	—
Total	\$45,660	\$94,376	\$1,155	\$141,191	\$137,753

	Fair Value Measurements as of				Amortized Cost as of December 31, 2014
	December 31, 2014				
	Level 1	Level 2	Level 3	Total	
Cash and cash equivalents:					
Cash	\$30,105	\$—	\$—	\$30,105	\$30,105
Money market funds	11,629	—	—	11,629	11,630
Corporate notes and bonds	—	61,519	—	61,519	61,520
Total cash and cash equivalents	41,734	61,519	—	103,253	103,255
Short-term investments:					
Corporate notes and bonds	—	51,453	—	51,453	51,438
U.S. government agency securities	7,000	—	—	7,000	7,000
Total short-term investments	7,000	51,453	—	58,453	58,438
Restricted cash equivalents and investments	—	3,000	—	3,000	3,000

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Equity investment in publicly traded securities	2,676	—	—	2,676	428
Total	\$51,410	\$115,972	\$—	\$167,382	\$165,121

8

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Restricted cash equivalents and investments amounts as of March 31, 2015, and December 31, 2014 relate to cash pledged as collateral against a letter of credit in connection with a lease agreement.

Realized gains or losses on sales of short-term investment securities for the quarters ended March 31, 2015 and 2014 were not significant. Gross unrealized gains and gross unrealized losses on short-term investment securities as of March 31, 2015 and December 31, 2014 were also 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, 2015 (in thousands):

	Estimated Fair Value
Within one year	\$27,809
Between one year and five years	3,585
Total short-term investments	\$31,394

Our equity investment in a publicly traded company as of March 31, 2015 and December 31, 2014 consisted of J-Stream Inc., a Japanese media services company. This equity investment is accounted for as available for sale. In March 2015 and 2014 we sold a portion of the J-Stream shares we held, resulting in cash proceeds of \$0.4 million and \$2.8 million, respectively, and a pre-tax gain of \$0.3 million and \$2.4 million respectively, reported in Other income (expense), net, in the unaudited condensed consolidated statements of operations and comprehensive income (loss). In February 2015, Rhapsody issued warrants to purchase Rhapsody common shares to each of RealNetworks and Rhapsody's one other 43% stockholder. The warrants were issued as compensation for past services provided by RealNetworks and the other 43% stockholder, and both warrants covered the same number of underlying shares. The exercise price of the warrants was equal to the fair value of the underlying shares on the issuance date, and we used the Black-Scholes option-pricing model to calculate the fair value of the warrant, using an expected term of 5 years and expected volatility of 55%. We recognized and recorded the \$1.2 million fair value of the warrant issued to RealNetworks within Other assets in the unaudited condensed consolidated balance sheets, and as an expense reduction within General and administrative expense in the unaudited condensed consolidated statements of operations and comprehensive income (loss).

#### 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, 2015 and 2014, we did not record any impairments on those assets required to be measured at fair value on a non-recurring basis.

#### Note 6 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, 2014	\$1,288	\$354
Addition (reduction) to allowance	65	15
Amounts written off	(34	) —
Foreign currency translation	(98	) (1
Balances, March 31, 2015	\$1,221	\$368

One customer accounted for 35% of trade accounts receivable as of March 31, 2015. One customer accounted for 21% and one other customer accounted for 15% of trade accounts receivable as of December 31, 2014.





One customer accounted for 17% of consolidated revenue, or \$5.3 million during the quarter ended March 31, 2015, and is reflected in our Mobile Entertainment segment.

Two customers each accounted for 17% of consolidated revenue during the quarter ended March 31, 2014. The revenue from one of these customers, which totaled \$7.6 million, is reflected in our RealPlayer Group and Games segments. The other customer, which accounted for \$7.8 million of consolidated revenue during the quarter ended March 31, 2014, is reflected in our Mobile Entertainment segment.

Note 7 Other Intangible Assets

Other intangible assets (in thousands):

	March 31, 2015			December 31, 2014		
	Gross Amount	Accumulated Amortization	Net	Gross Amount	Accumulated Amortization	Net
Amortizing intangible assets:						
Customer relationships	\$33,047	\$ 31,174	\$ 1,873	\$33,853	\$ 31,643	\$ 2,210
Developed technology	27,719	25,519	2,200	28,261	25,699	2,562
Patents, trademarks and tradenames	4,148	3,419	729	3,817	3,528	289
Service contracts	6,171	5,773	398	6,312	5,764	548
	71,085	65,885	5,200	72,243	66,634	5,609
Non-amortizing intangible assets:						
Trademarks and tradenames	4,500	—	4,500	4,500	—	4,500
Total	\$75,585	\$ 65,885	\$9,700	\$76,743	\$ 66,634	\$10,109

An asset purchase relating to our Games business was completed in the first quarter of 2015 and resulted in an intangible asset of \$0.5 million being recorded in the first quarter, the date the transaction closed. Cash for the transaction was subsequently paid in April 2015.

No impairments of other intangible assets were recognized in either of the three months ended March 31, 2015 or 2014.

Note 8 Goodwill

Changes in goodwill (in thousands):

Balance, December 31, 2014	\$17,355	
Effects of foreign currency translation	(516)	)
Balance, March 31, 2015	\$16,839	

Goodwill by segment (in thousands):

	March 31, 2015
RealPlayer Group	\$940
Mobile Entertainment	1,870
Games	14,029
Total goodwill	\$16,839

No impairment of goodwill was recognized in either of the three months ended March 31, 2015 or 2014.



## Note 9 Accrued and Other Current Liabilities

Accrued and other current liabilities (in thousands):

	March 31, 2015	December 31, 2014
Royalties and other fulfillment costs	\$4,341	\$4,868
Employee compensation, commissions and benefits	5,696	7,711
Sales, VAT and other taxes payable	5,508	5,896
Other	6,507	6,811
Total accrued and other current liabilities	\$22,052	\$25,286

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

## Note 10 Restructuring Charges

Restructuring and other charges in 2015 and 2014 consist of costs associated with the ongoing reorganization of our business operations and our ongoing expense re-alignment efforts. The expense amounts in both years relate primarily to severance costs due to workforce reductions and are classified as Employee Separation Costs in the table below.

Restructuring charges by type of cost, excluding non-cash charges (in thousands):

	Employee Separation Costs
Costs incurred and charged to expense for the three months ended March 31, 2015	\$485
Costs incurred and charged to expense for the three months ended March 31, 2014	\$1,216

Changes to the accrued restructuring liability (which is included in Accrued and other current liabilities) for 2015 (in thousands) are as follows:

	Employee Separation Costs
Accrued liability at December 31, 2014	\$449
Costs incurred and charged to expense for the three months ended March 31, 2015	485
Cash payments	(791)
Accrued liability at March 31, 2015	\$143

## Note 11 Lease Exit and Related Charges

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

Changes to accrued lease exit and related charges (which is included in Accrued and other current liabilities) for 2015 (in thousands) are as follows:

Accrued loss at December 31, 2014	\$234
Additions and adjustments to the lease loss accrual, including sublease income estimate revision	83
Less amounts paid, net of sublease amounts	(57)
Accrued loss at March 31, 2015	\$260

Note 12 Shareholders' Equity  
Accumulated Other Comprehensive Income (Loss)

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

	Quarters Ended March 31,	
	2015	2014
Investments		
Accumulated other comprehensive income (loss), beginning of period	\$2,252	\$6,397
Unrealized gains (losses), net of tax effects of \$116 and \$0 in 2015 and 2014	205	(1,204 )
Reclassification adjustments for losses (gains) included in other income (expense), net of tax effects of \$(1) and \$(4) in 2015 and 2014	(299 )	(2,371 )
Net current period other comprehensive income	(94 )	(3,575 )
Accumulated other comprehensive income (loss) balance, end of period	\$2,158	\$2,822
Foreign currency translation		
Accumulated other comprehensive income (loss), beginning of period	\$(57,504 )	\$(54,092 )
Translation adjustments	(2,585 )	23
Reclassification adjustments for losses (gains) included in other income (expense)	—	(48 )
Net current period other comprehensive income	(2,585 )	(25 )
Accumulated other comprehensive income (loss) balance, end of period	\$(60,089 )	\$(54,117 )
Total accumulated other comprehensive income (loss), end of period	\$(57,931 )	\$(51,295 )

Note 13 Income Taxes

As of March 31, 2015, there have been no material changes to RealNetworks' uncertain tax positions disclosures as provided in Note 14 of the 2014 10-K.

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

Note 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):

	Quarters Ended	
	March 31,	
	2015	2014
Net income (loss)	\$(24,469 )	\$(7,770 )
Weighted average common shares outstanding used to compute basic EPS	36,104	35,840
Dilutive effect of stock based awards	—	—
Weighted average common shares outstanding used to compute diluted EPS	36,104	35,840
Basic EPS	\$(0.68 )	\$(0.22 )
Diluted EPS	\$(0.68 )	\$(0.22 )

During the quarter ended March 31, 2015 and March 31, 2014, 6.3 million and 6.1 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

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

#### Note 16 Guarantees

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

See Note 4, Rhapsody Joint Venture, for a discussion of the \$5.0 million guaranty provided by RealNetworks related to a loan Rhapsody made to an external strategic partner in April 2015.

In relation to the patents and other technology assets we sold to Intel in the second quarter of 2012, we have specific obligations to indemnify Intel for breaches of the representations and warranties that we made and covenants that we agreed to in the asset purchase agreement for certain potential future intellectual property infringement claims brought by third parties against Intel. The amount of any potential liabilities related to our indemnification obligations to Intel will not be determined until a claim has been made, but we are obligated to indemnify Intel up to the amount of the gross purchase price that we received in the sale.

#### Note 17 Segment Information

We have three reportable segments: (1) RealPlayer Group, which includes our new RealPlayer Cloud product, our RealPlayer media player software and related products and our SuperPass service; (2) Mobile Entertainment, which includes our SaaS services, our LISTEN product, and the residual components of our Helix business; and (3) Games, which includes all our games-related businesses, including licenses, online games subscription services, advertising on games sites and social network sites, microtransactions from online and social games, and mobile games.

We allocate certain corporate expenses which are directly attributable to supporting the business to our reportable segments. These corporate expenses include but are not limited to a portion of finance, legal, human resources and headquarters facilities. Remaining expenses, which are not directly attributable to supporting the business, are reported as corporate items. Also reported in our corporate segment were restructuring charges as well as lease exit and related charges, and in 2014 the extinguishment of the liability associated with our historical music business.



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

Segment results for the quarters ended March 31, 2015 and 2014 (in thousands):

RealPlayer Group

	Quarters Ended March 31,	
	2015	2014
Revenue	\$8,013	\$15,215
Cost of revenue	4,112	3,518
Gross profit	3,901	11,697
Operating expenses	12,375	17,787
Operating income (loss)	\$(8,474)	\$(6,090)

Mobile Entertainment

	Quarters Ended March 31,	
	2015	2014
Revenue	\$14,480	\$19,913
Cost of revenue	9,506	11,950
Gross profit	4,974	7,963
Operating expenses	5,633	9,616
Operating income (loss)	\$(659)	\$(1,653)

Games

	Quarters Ended March 31,	
	2015	2014
Revenue	\$8,104	\$10,596
Cost of revenue	2,794	3,129
Gross profit	5,310	7,467
Operating expenses	8,683	9,766
Operating income (loss)	\$(3,373)	\$(2,299)

## Corporate

	Quarters Ended	
	March 31,	
	2015	2014
Cost of revenue	\$135	\$189
Extinguishment of liability	—	(10,580 )
Operating expenses	6,371	9,225
Operating income (loss)	\$(6,506 )	\$1,166

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

	Quarters Ended	
	March 31,	
	2015	2014
United States	\$12,349	\$20,428
Europe	4,163	8,412
Republic of Korea	6,324	10,294
Rest of the World	7,761	6,590
Total net revenue	\$30,597	\$45,724

Long-lived assets (which consist of equipment, software, leasehold improvements, other intangible assets, and goodwill) by geographic region (in thousands) are as follows:

	March 31,	December 31,
	2015	2014
United States	\$31,542	\$33,421
Europe	6,300	6,696
Republic of Korea	497	547
Rest of the World	2,825	3,048
Total long-lived assets	\$41,164	\$43,712

## Note 18 Related Party Transactions

See Note 4, Rhapsody Joint Venture, and Note 5, Fair Value Measurements, for details on transactions involving Rhapsody.



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

This Quarterly Report on Form 10-Q and the documents incorporated herein by reference contain forward-looking statements that have been made pursuant to the provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on current expectations, estimates, and projections about RealNetworks' industry, products, management's beliefs, and certain assumptions made by management. Words such as "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates," and similar expressions are intended to identify forward-looking statements. All statements contained in this report that do not relate to matters of historical fact should be considered forward-looking statements. Forward-looking statements include statements with respect to:

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

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

### Overview

We manage our business and report revenue and operating income (loss) in three segments: (1) RealPlayer Group, (2) Mobile Entertainment, and (3) Games. Within our RealPlayer Group, although our new RealPlayer Cloud service has begun to generate some revenue, this group's revenue is derived mainly from the sale of our RealPlayer media player software and related products. Our Mobile Entertainment business generates revenue primarily from the sale of its SaaS services, which include ringback tones, music on demand, and intercarrier messaging. Our Games business, through its Slingo, GameHouse and Zylom brands, derives revenue from sales of games licenses, online games subscription services, advertising on games sites and social networks, microtransactions within online and social games, and sales of mobile games.

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

and selling and marketing our products and services.

For the quarter ended March 31, 2015, our consolidated revenue declined by \$15.1 million compared to the same period in 2014, with revenue declines for the quarter of \$7.2 million in our RealPlayer Group, \$5.4 million in Mobile Entertainment and \$2.5 million in Games.

Revenue from our legacy products continues to decline as a result of certain ongoing changes in our businesses and market-driven factors. Our SaaS business within Mobile Entertainment continues to be negatively 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 continue to experience pricing pressure from carriers for our intercarrier messaging services and we have ceased investing in our Helix product. In our Games segment, our business continues to be challenged as consumer game play continues to shift from downloadable PC games to social networks and mobile devices. We have been focusing on developing social and mobile games and monetizing those game play experiences. In our RealPlayer Group segment, revenue is being negatively impacted as a result of our transition to a new third party distribution partner at significantly lower rates compared to our previous partner, lower distribution in our licensing business and our focus towards RealPlayer Cloud and away from our legacy products.

Over the past several quarters, we have developed a growth plan, implemented strategic initiatives, and executed certain restructuring efforts, all in an effort to grow our businesses, move towards profitability, and streamline our operations. In line with our growth plan, we continue to invest in each of our three business units, with a focus on RealPlayer Cloud. During the first half of 2014, we released RealPlayer Cloud worldwide and, currently, the product has over eleven million registered users. In our Mobile Entertainment business we continue our efforts to roll out our new LISTEN product through carriers. In our Games business, we launched Slingo Adventure worldwide on Facebook and on mobile platforms during the second half of 2014. We expect to continue to invest heavily in our growth initiatives, predominantly in further development and marketing efforts around RealPlayer Cloud. These investments have, and will likely continue to, negatively impacted our operating results.

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

	Quarters ended March 31,			
	2015	2014	\$ Change	% Change
Total revenue	\$30,597	\$45,724	\$(15,127)	(33)%
Cost of revenue	16,547	18,786	(2,239)	(12)%
Extinguishment of liability	—	(10,580)	10,580	100%
Gross profit	14,050	37,518	(23,468)	(63)%
Gross margin	46%	82%		
Operating expenses	33,062	46,394	(13,332)	(29)%
Operating income (loss)	\$(19,012)	\$(8,876)	\$(10,136)	(114)%

In the first quarter of 2015, our total consolidated revenue declined by \$15.1 million, compared with the year-earlier period. The reduction in revenue resulted from a decline of \$7.2 million in our RealPlayer Group, \$5.4 million in Mobile Entertainment and \$2.5 million in Games, due to the factors described above. Gross margin decreased to 46% from 82% during the quarter ended March 31, 2015, in large part due to the \$10.6 million in accrued royalty liabilities extinguished in the prior year as referenced below, but also due to lower margins realized by our RealPlayer Group, as described in more detail in Segment Operating Results below. Operating expenses decreased by \$13.3 million in the quarter ended March 31, 2015, compared with the prior year, primarily due to reduced marketing spend of \$5.3 million in line with the decrease in our RealPlayer group's third party distribution revenue and reductions in personnel and related costs of \$5.6 million.

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

#### Segment Operating Results

##### RealPlayer Group

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

	Quarters ended March 31,			
	2015	2014	\$ Change	% Change
Revenue	\$8,013	\$15,215	\$(7,202 )	(47 )%
Cost of revenue	4,112	3,518	594	17 %
Gross profit	3,901	11,697	(7,796 )	(67 )%
Gross margin	49 %	77 %		
Operating expenses	12,375	17,787	(5,412 )	(30 )%
Operating income (loss)	\$(8,474 )	\$(6,090 )	\$(2,384 )	(39 )%

Total RealPlayer Group revenue decreased by \$7.2 million in the quarter ended March 31, 2015, compared with the year-earlier period. This decrease was primarily a result of our transition to a new third party distribution arrangement, which began in the second quarter of 2014 and resulted in significantly lower rates which caused our third party distribution revenue to decrease by \$6.2 million quarter over quarter. Further contributing to the decline was lower revenue of RealPlayer Plus licenses of \$1.0 million due to our focus away from our RealPlayer product and towards RealPlayer Cloud development and monetization.

Cost of revenue increased by \$0.6 million during the quarter ended March 31, 2015, compared with the year-earlier period. This increase was primarily due to increased costs on development efforts related to RealPlayer Cloud product of \$1.0 million partially offset by a decrease in costs related to our RealPlayer legacy business.

Gross margin during the quarter ended March 31, 2015 declined primarily as a result of our transition to a new third party distribution arrangement at significantly lower rates compared to our previous partner.

Operating expenses decreased by \$5.4 million in the quarter ended March 31, 2015, compared with the year-earlier period primarily due to decreased marketing spend related to our third party distribution arrangements as discussed below under Sales and marketing expenses in our Consolidated Operating Expenses.

#### Mobile Entertainment

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

	Quarters ended March 31,			
	2015	2014	\$ Change	% Change
Revenue	\$14,480	\$19,913	\$(5,433 )	(27 )%
Cost of revenue	9,506	11,950	(2,444 )	(20 )%
Gross profit	4,974	7,963	(2,989 )	(38 )%
Gross margin	34 %	40 %		
Operating expenses	5,633	9,616	(3,983 )	(41 )%
Operating income (loss)	\$(659 )	\$(1,653 )	\$994	60 %

Total Mobile Entertainment revenue decreased by \$5.4 million in the quarter ended March 31, 2015, compared with the year-earlier period. This decrease was primarily due to a decrease in music on demand revenue of \$3.0 million, related to a temporary decline in our Korean music on demand revenue based on a change in attribution of the royalties, and a decrease of \$1.2 million in our ringback tones business due to slower growth in these areas.

Cost of revenue decreased by \$2.4 million in the quarter ended March 31, 2015, compared with the year-earlier period, primarily related to the decrease in label royalties related to our music on demand services.

Gross margin declined for the quarter ended March 31, 2015, due to a decline in higher margin revenues such as in our ringback tones business.

Operating expenses decreased by \$4.0 million for the quarter ended March 31, 2015, compared with the year-earlier period, primarily due to reductions in personnel and related costs of \$2.5 million and a decrease of \$0.7 million in marketing related expenses.

## Games

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

	Quarters ended March 31,			
	2015	2014	\$ Change	% Change
Revenue	\$8,104	\$10,596	\$(2,492 )	(24 )%
Cost of revenue	2,794	3,129	(335 )	(11 )%
Gross profit	5,310	7,467	(2,157 )	(29 )%
Gross margin	66	% 70		%
Operating expenses	8,683	9,766	(1,083 )	(11 )%
Operating income (loss)	\$(3,373 )	\$(2,299 )	\$(1,074 )	(47 )%

Total Games revenue decreased by \$2.5 million in the quarter ended March 31, 2015, compared with the year-earlier period. Lower revenue from our subscription products and advertising contributed \$1.7 million and \$0.6 million, respectively, to the overall decrease.

Cost of revenue decreased by \$0.3 million in the quarter ended March 31, 2015, compared with the year-earlier period, primarily due to a decline in our advertising business.

Gross margin declined during the quarter ended March 31, 2015 due primarily to a higher proportion of lower margin revenue in the current year.

Operating expenses declined by \$1.1 million in the quarter ended March 31, 2015, compared with the year-earlier period. The decrease was primarily due to reductions in personnel and related costs of \$0.8 million.

## Corporate

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

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

	Quarters ended March 31,			
	2015	2014	\$ Change	% Change
Cost of revenue	\$135	\$189	\$(54 )	(29 )%
Extinguishment of liability	—	(10,580 )	10,580	100 %
Operating expenses	6,371	9,225	(2,854 )	(31 )%
Operating income (loss)	\$(6,506 )	\$1,166	\$(7,672 )	(658 )%

Operating expenses decreased by \$2.9 million in the quarter ended March 31, 2015 compared with the year-earlier period. The decrease was primarily due to reduced personnel and related costs of \$1.9 million, of which \$1.2 million related to the non-cash benefit recorded in the first quarter of 2015 related to the warrants we received from Rhapsody, as discussed in Note 5, Fair Value Measurements, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this 10-Q. In addition to this decrease was lower restructuring costs of \$0.7 million. During the quarter ended March 31, 2014 certain accrued royalty liabilities of \$10.6 million associated with our historical music business, which had originally been recorded based on statutory rates, were extinguished.

## Consolidated Operating Expenses

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



	Quarters ended March 31,			
	2015	2014	\$ Change	% Change
Research and development	\$12,379	\$14,059	\$(1,680 )	(12 )%
Sales and marketing	12,837	21,723	(8,886 )	(41 )%
General and administrative	7,283	9,317	(2,034 )	(22 )%
Restructuring and other charges	485	1,216	(731 )	(60 )%
Lease exit and related charges	78	79	(1 )	(1 )%
Total consolidated operating expenses	\$33,062	\$46,394	\$(13,332)	(29 )%

Research and development expenses decreased by \$1.7 million in the quarter ended March 31, 2015, compared with the year-earlier period. The decrease was primarily due to reduced personnel and related costs of \$1.3 million.

Sales and marketing expenses decreased by \$8.9 million in the quarter ended March 31, 2015, compared with the year-earlier period. The decrease was primarily due to reduced marketing spend of \$5.4 million mainly related to our third party distribution business and \$2.8 million in reduced personnel and related costs.

General and administrative expenses decreased by \$2.0 million in the quarter ended March 31, 2015, compared with the year-earlier period. The decrease was due to the non-cash benefit of \$1.2 million recorded in the first quarter of 2015 related to the warrants we received from Rhapsody, as discussed in Note 5, Fair Value Measurements, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this 10-Q, and lower facilities expenses of \$0.3 million.

Restructuring and other charges and Lease exit and related charges consist of costs associated with the ongoing reorganization of our business operations and our ongoing expense re-alignment efforts. The restructuring expense amounts in both years are primarily related to severance costs due to workforce reductions. For additional details on these charges see Note 10, Restructuring Charges and Note 11, Lease Exit and Related Charges, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this 10-Q.

#### Other Income (Expenses)

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

	Quarters ended March 31,			
	2015	2014	\$ Change	% Change
Interest income, net	\$200	\$136	\$64	47 %
Gain (loss) on sale of available for sale securities, net	299	2,371	(2,072 )	(87 )%
Equity in net loss of Rhapsody	(6,180 )	(838 )	(5,342 )	(637 )%
Other income (expense), net	443	(77 )	520	675 %
Total other income (expense), net	\$(5,238 )	\$1,592	\$(6,830 )	(429 )%

As described further in Note 4, Rhapsody Joint Venture, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this 10-Q, we account for our investment in Rhapsody under the equity method of accounting. The net carrying value of our investment in Rhapsody is not necessarily indicative of the underlying fair value of our investment.

Gain (loss) on sale of available for sale securities, net, declined due to a smaller gain on the sale of available for sale securities. In 2014, we sold 700,000 shares of our J-Stream investment and realized a gain of \$2.4 million compared with a gain of \$0.3 million from the sale of 96,300 shares in 2015. See Note 5, Fair Value Measurements, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this 10-Q, for further discussion.

#### Income Taxes

During the quarters ended March 31, 2015 and 2014, we recognized income tax expense of \$0.2 million and \$0.5 million, respectively, related to U.S. and foreign income taxes.

The change in income tax expense during the quarter ended March 31, 2015 was largely the result of an income tax benefit related to unrealized gains on investment securities recognized in other comprehensive income during the quarter and changes in our jurisdictional income.

As of March 31, 2015, there have been no material changes to RealNetworks' uncertain tax positions disclosures as provided in Note 14 of the 2014 10-K.

The majority of our tax expense is due to income in our foreign jurisdictions and we have not benefitted from losses in the U.S. and certain foreign jurisdictions in the first quarter of 2015. We generate income in a number of foreign jurisdictions, some of which have higher or lower tax rates relative to the U.S. federal statutory rate. Our tax expense could fluctuate significantly on a quarterly basis to the extent income is less than anticipated in countries with lower statutory tax rates and more than anticipated in countries with higher statutory tax rates. For the quarter ended March 31, 2015, 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. The effect of differences in foreign tax rates on the Company's tax expense for the first quarter of 2015 is minimal.

As of March 31, 2015, we have not provided for U.S. federal and state income taxes on certain undistributed earnings of our foreign subsidiaries, since such earnings are considered indefinitely reinvested outside the U.S. or may be remitted tax-free to the U.S. If these amounts were distributed to the U.S., in the future in the form of dividends or otherwise, we could be subject to additional U.S. income and foreign withholding taxes. It is not practicable to determine the foreign withholding and U.S. income tax liability or benefit on such earnings due to the timing of such future distributions, the availability of foreign tax credits, and the complexity of the computation if such earnings were not deemed to be permanently reinvested. If future events, including material changes in estimates of cash, working capital, and long-term investment requirements necessitate that these earnings be distributed, an additional provision for U.S. income and foreign withholding taxes, net of foreign tax credits, may be necessary.

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

#### Geographic Revenue

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

	Quarters ended March 31,			
	2015	2014	\$ Change	% Change
United States	\$12,349	\$20,428	\$(8,079 )	(40 )%
Europe	4,163	8,412	(4,249 )	(51 )%
Republic of Korea	6,324	10,294	(3,970 )	(39 )%
Rest of world	7,761	6,590	1,171	18 %
Total net revenue	\$30,597	\$45,724	\$(15,127 )	(33 )%

Revenue in the United States declined by \$8.1 million in the quarter ended March 31, 2015 compared with the year-earlier period. The decline was due primarily to lower revenue generated from the distribution of third party software products of \$5.4 million, a decline in revenue generated from our SaaS offerings of \$1.2 million and lower revenue generated from each of our Games business and SuperPass subscription service of \$0.7 million each.

Revenue in Europe declined by \$4.2 million in the quarter ended March 31, 2015 compared with the year-earlier period. The decrease was primarily due to lower revenue from our Games business of \$1.5 million, a decline in our SaaS revenue of \$1.5 million, a decline in third party software distribution and advertising revenue of \$0.7 million and lower revenue from RealPlayer Plus licenses of \$0.3 million.

Revenue in Korea declined \$4.0 million in the quarter ended March 31, 2015 compared with the year-earlier period.

The decrease was primarily due to lower music on demand revenue of \$2.4 million, lower intellectual property license



revenue of \$1.2 million and lower revenue from our SaaS offerings (excluding music on demand) of \$0.4 million.

21

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Revenue in the rest of world increased by \$1.2 million in the quarter ended March 31, 2015 compared with the year-earlier period. The increase was primarily due to an increase in our intellectual property license revenue of \$1.5 million and an increase in our ring back tones business of \$0.4 million offset by lower revenue generated from our RealPlayer Plus licenses of \$0.3 million and the distribution of third party software products of \$0.2 million.

#### New Accounting Pronouncements

See Note 2, Recent Accounting Pronouncements, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this 10-Q.

#### Liquidity and Capital Resources

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

	March 31, 2015	December 31, 2014
Working capital	\$113,341	\$136,429
Cash, cash equivalents, and short-term investments	134,388	161,706
Restricted cash equivalents and investments	3,000	3,000

The 2015 decrease of cash, cash equivalents, and short-term investments from December 31, 2014 was due primarily to cash used in operating activities of \$20.1 million in the first three months of 2015 as well as the \$5 million loan made to Rhapsody in the first quarter of 2015, as described in more detail in Note 4, Rhapsody Joint Venture, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this 10-Q.

The following summarizes cash flow activity (in thousands):

	Three months ended March 31, 2015	2014
Cash provided by (used in) operating activities	\$(20,094)	\$(18,510)
Cash provided by (used in) investing activities	22,105	(1,685)
Cash provided by (used in) financing activities	(1)	150

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

Cash used in operating activities was \$1.6 million more in the three months ended March 31, 2015 as compared to the same period in 2014. While a slight increase from the prior year period, cash used in operating activities approximates the loss from operations as reported on the income statement in the periods presented, excluding the \$1.2 million non-cash benefit from the Rhapsody warrants issued to RealNetworks in 2015 and the \$10.6 million extinguishment of liability in 2014.

For the three months ended March 31, 2015, cash provided by investing activities of \$22.1 million was primarily due to sales and maturities, net of purchases, of short-term investments of \$27.1 million partially offset by purchases of equipment, software and leasehold improvements of \$0.3 million as well as the \$5.0 million advance made to Rhapsody in the first quarter of 2015, as described in more detail in Note 4, Rhapsody Joint Venture, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this 10-Q.

For the three months ended March 31, 2014, cash used for investing activities of \$1.7 million was primarily due to purchases, net of sales and maturities, of short-term investments of \$3.4 million, and purchases of equipment, software and leasehold improvements of \$1.0 million. Partially offsetting the cash used in investing activities was cash proceeds received from the sale of equity investments during the quarter of \$2.8 million.

Financing activities for the three months ended March 31, 2014 provided cash totaling \$0.2 million primarily from the issuance of common stock during the quarter.

We currently have no planned significant capital expenditures for the remainder of 2015 other than those in the ordinary course of business.



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

In the future, we may seek to raise additional funds through public or private equity financing, or through other sources such as credit facilities. Such sources of funding may or may not be available to us at commercially reasonable terms. The sale of additional equity securities could result in dilution to our shareholders. In addition, in the future, we may enter into cash or stock acquisition transactions or other strategic transactions that could reduce cash available to fund our operations or result in dilution to shareholders.

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

We conduct our operations primarily in five functional currencies: the U.S. dollar, the Korean won, the Japanese yen, the British pound and the euro. We currently do not hedge the majority of our foreign currency exposures and are therefore subject to the risk of exchange rate fluctuations. We 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, 2015, approximately \$22.4 million of the \$134.4 million of cash, cash equivalents, and short-term investments was held by our foreign subsidiaries. If these funds are needed for our operations in the U.S., we may be required to accrue and pay U.S. income and foreign withholding taxes to repatriate these funds. However, our intent is to permanently reinvest these funds outside of the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations. Additionally, the Company currently has significant net operating losses and other tax attributes that could be used to offset potential U.S. income tax that could result if these amounts were distributed to the U.S. We utilize a variety of tax planning and financing strategies in an effort to ensure that our worldwide cash is available in the locations in which it is needed. We do not expect restrictions or potential taxes on repatriation of amounts held outside of the U.S. to have a material effect on our overall liquidity, financial condition or results of operations.

#### 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, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this 10-Q, those guarantee obligations also constitute off-balance sheet arrangements.

#### Critical Accounting Policies and Estimates

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

- Revenue recognition;
- Estimating music publishing rights and music royalty accruals;
- Estimating recoverability of deferred costs;
- Estimating allowances for doubtful accounts and sales returns;
- Valuation of equity method investments;
- Valuation of definite-lived assets;
- Valuation of goodwill and indefinite-lived intangible assets;
- Stock-based compensation; and

Accounting for income taxes.

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

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

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

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

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

Non-software revenue arrangements containing multiple elements are divided into separate units of accounting, after being evaluated for specific criteria. If the criteria for separation are met, revenue is allocated to the individual units using the relative price method. If the criteria are not met, the elements are treated as one unit of accounting and revenue recognition is delayed until all elements have been delivered. In the case of revenue arrangements containing software, elements are divided into separate units of accounting only when vendor-specific objective evidence has been established. In cases where vendor-specific objective evidence has not been established, undelivered elements are combined into one unit of accounting and are not recognized in revenue until all elements have been delivered. **Estimating Music Publishing Rights and Music Royalty Accruals.** We have made estimates of amounts that may be owed related to music royalties for our historical domestic and international music services. 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 have delivered. 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. 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 have based 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.

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

**Estimating Recoverability of Deferred Costs.** We defer costs on projects for service revenue and system sales. Deferred costs consist primarily of direct and incremental costs to customize and install systems, as defined in individual customer contracts, including costs to acquire hardware and software from third parties and payroll costs for our employees and other third parties. We recognize such costs as a component of cost of revenue, the timing of which is dependent upon the revenue recognition policy by contract. For revenue recognized under the completed contract method, costs are deferred until the products are delivered, or upon completion of services or, where applicable, customer acceptance. For revenue recognized under the percentage of completion method, costs are recognized as products are delivered or services are provided in accordance with the percentage of completion calculation. For revenue recognized ratably over the term of the contract, costs are recognized ratably over the term of the contract, commencing on the date of revenue recognition. At each balance sheet date, we review deferred costs to

ensure they are ultimately recoverable. Any anticipated losses on uncompleted contracts are recognized when evidence indicates the estimated total cost of a contract exceeds its estimated total revenue.

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

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

**Valuation of Equity Method Investments.** We use the equity method of accounting for investments in circumstances where we have the ability to exert significant influence, but not control, over an investee or joint venture. We record our percentage interest in the investee's recorded income or loss and changes in the investee's capital under this method, which will increase or decrease the reported value of our investment. See Note 4, Rhapsody Joint Venture, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this 10-Q, for additional information. We initially record our investment based on a fair value analysis of the investment.

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

**Valuation of Definite-Lived Assets.** Definite-lived assets consist primarily of property, plant and equipment, as well as amortizable intangible assets acquired in business combinations. Definite-lived assets are amortized on a straight line basis over their estimated useful lives. We review definite-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of such assets may not be recoverable. Recoverability of these assets is measured by comparison of their carrying amount to future undiscounted cash flows the assets are expected to generate. If definite-lived assets are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the assets exceeds their fair market value.

The impairment analysis of definite-lived assets is based upon estimates and assumptions relating to our future revenue, cash flows, operating expenses, costs of capital and capital purchases. These estimates and assumptions are complex and subject to a significant degree of judgment with respect to certain factors including, but not limited to, the 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 definite-lived assets could result in the need to perform an impairment analysis in future periods which could result in a significant impairment. While we believe our estimates and assumptions are reasonable, due to their complexity and subjectivity, these estimates and assumptions could vary from period to period. Changes in these estimates and assumptions could materially affect the estimate of future undiscounted cash flows and related fair market values of these assets and result in significant impairments, which could have a material adverse effect on our financial condition or results of operations. For further discussion, please see the risk factor entitled, "Any impairment to our goodwill, indefinite-lived intangible assets or definite-lived assets could result in a significant charge to our earnings" under Item 1A Risk Factors.

**Valuation of Goodwill and Indefinite-Lived Intangible Assets.** We test goodwill for impairment on an annual basis, in our fourth quarter, or more frequently if circumstances indicate reporting unit carrying values may exceed their fair values. Circumstances that may indicate a reporting unit's carrying value exceeds its fair value include, but are not limited to: poor economic performance relative to historical or projected future operating results; significant negative industry, economic or company specific trends; changes in the manner of our use of the assets or the plans for our business; and loss of key personnel.



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.

We evaluate indefinite-lived intangible assets (primarily tradenames and trademarks) for impairment on an annual basis, in the fourth quarter, or more frequently if an event occurs or changes in circumstances indicate that impairment may exist. When evaluating indefinite-lived intangible assets for impairment, we may first perform a qualitative assessment to determine if the fair value of the intangible assets is more likely than not greater than its carrying amount. If we do not perform a qualitative assessment or if the fair value of the intangible assets is not more likely than not greater than its carrying amount, we estimate the fair value of the intangible assets. If the carrying amount of the intangible assets exceeds the estimated fair value, an impairment charge is recorded to reduce the carrying value to the estimated fair value. Significant judgments and estimates are required in assessing the fair value of the indefinite-lived intangible assets. These estimates and assumptions are complex and subject to a significant degree of judgment with respect to certain factors including, but not limited to, the 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 estimated at the grant date based on the award's fair value and is recognized as expense over the requisite service period, which is the vesting period. For stock options, the fair value is calculated using the Black-Scholes option-pricing model or other appropriate valuation models such as Monte Carlo simulation. 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 for new awards may differ materially in the future from the amounts recorded in our consolidated statement of operations. For all awards, we are required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting forfeitures.

**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 income tax expense and 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 and deferred provision for income taxes, deferred tax assets and liabilities and any valuation allowance to be recorded against deferred tax assets. Our judgments, assumptions, and estimates relative to the current provision for income tax take into account current tax laws, our interpretation of current tax laws and possible outcomes of future audits conducted by foreign and domestic tax authorities. Changes in tax law or our interpretation of tax laws and future tax audits could significantly impact the amounts provided for income taxes in our consolidated financial statements.

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

As of March 31, 2015, \$22.4 million of the \$134.4 million of cash, cash equivalents, and short-term investments was held by our foreign subsidiaries.

As of March 31, 2015, we have not provided for U.S. federal and state income taxes on certain undistributed earnings of our foreign subsidiaries, since such earnings are considered indefinitely reinvested outside the U.S. or may be remitted tax-free to the U.S. If these amounts were distributed to the U.S., in the form of dividends or otherwise, RealNetworks could be subject to additional U.S. income and foreign withholding taxes. It is not practicable to determine the foreign withholding and U.S. 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 5, Fair Value Measurements, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this 10-Q, 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, 2015. Based on our cash, cash equivalents, short-term investments, and restricted cash equivalents as of March 31, 2015, 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, 2015, we had investments in voting capital stock of both publicly traded and privately held technology companies for business and strategic purposes. See Note 1, Description of Business and Summary of Significant Accounting Policies - Valuation of Equity Method Investments, and Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies and Estimates (Valuation of equity method investments) in the 10-K for details on our accounting treatment for these investments, including the analysis of other-than-temporary impairments.

**Foreign Currency Risk.** We conduct business internationally in several currencies and thus are exposed to adverse movements in foreign currency exchange rates.

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

Where appropriate, we manage foreign currency risk for certain 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. To the extent we continue to experience adverse economic conditions, our unhedged exposures are impacted by movements in currency exchange rates and 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, 2015 would not result in a material impact on our financial position, results of operations or cash flows.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

27

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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, 2015. 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, 2015, our disclosure controls and procedures were effective.

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

There have been no changes in our internal control over financial reporting (as such term is defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the first quarter of 2015 that have materially affected, or are 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 the unaudited condensed consolidated financial statements included in Item 1 of Part I of this 10-Q.

### Item 1A. Risk Factors

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

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

Beginning in mid-2012, we have developed a growth plan that involved 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, either in a timely manner or at all, and our failure to do so would have a material adverse impact on our business and financial results.

We need to successfully introduce and monetize new products and services to sustain and grow our businesses. In order to sustain our current level of business and to implement our growth plan, we must successfully introduce and monetize new products and services. The process of developing new, and enhancing existing, products and services is complex, costly and uncertain, and is subject to a number of risks. Providing products and services that are attractive and useful to subscribers and consumers is in part subject to unpredictable and volatile factors beyond our control, including end-user preferences and competing products and services. Any failure by us to timely respond to or accurately anticipate consumers' changing needs, emerging technological trends or important changes in the market or competition for products and services that we introduce, or that we plan to introduce, could increase the current rate of decline in our market share or result in the loss of market opportunities. In addition, we must make long-term investments, develop or obtain appropriate intellectual property and commit significant resources before knowing whether the products and services that we are developing will meet the needs of a large enough group of consumers, which may result in no return or a loss on our investments.

During 2013 and 2014, each of our businesses introduced at least one new product or service. In early 2014, our RealPlayer business completed the global launch of RealPlayer Cloud, our integrated video player, storage and sharing app. In November 2013, our Mobile Entertainment business completed its European launch of LISTEN, an application and service for smartphone users featuring ringback tones and other services. LISTEN was launched with T-Mobile in the U.S. in April 2014. In August 2013, our Games business launched GameHouse Casino Plus with the Golden Dreams Sweepstakes feature and, in September 2014, launched Slingo Adventure. To date, we have not generated significant revenue from any of these new products and services. Over the past several quarters, we have invested heavily in the development of these and other new products and enhanced features for such products, and we expect to continue to invest heavily both in further development and in sales and marketing efforts aimed at monetizing these products and services. These investments have and are expected to continue to have a significant negative impact on our cash position and there can be no assurance that our efforts will generate any meaningful revenue or positive cash flow. If we are unable to generate sustained interest in these products and services, and therefore drive revenue growth, our financial results and cash position will be materially negatively impacted.

Furthermore, new products and services may be subject to legal challenge. Responding to any such 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 and our ability to grow our businesses.



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

Our legacy products and services also face continuing market challenges, including the rapid move to smartphones and tablets, and the introduction of new operating systems. We have historically distributed our legacy products and services 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 several years. There are many challenges involved in developing and marketing products and services for users of smartphones and tablets, and there is no guarantee that we will be able to transition or effectively monetize our legacy products and services to these devices. In addition, our consumer-based products and services have historically been distributed through desktop operating platforms. As new operating systems are introduced or updated for these platforms, we are likely to continue to face difficulties reaching our traditional customer base and other unknown distribution challenges. If we continue to have difficulty transitioning our legacy products and services for use on new devices or updated operating systems, then our revenues will continue to decline and our business could be significantly harmed.

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

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

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

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

- reduced prices or margins,

- loss of current and potential customers, or partners and potential partners who provide content we distribute to our customers,

- changes to our products, services, technologies, licenses or business practices or strategies,

- lengthened sales cycles,

- industry-wide changes in content distribution to customers or in trends in consumer consumption of digital media products and services,

- pressure to prematurely release products or product enhancements, or

- degradation in our stature or reputation in the market.

The market for mobile entertainment services, including our ringback tones and music on demand solutions, is highly competitive and evolving rapidly, particularly with the growth in the use of smartphones. Increased use of smartphones has resulted in a proliferation of applications and services that compete with our SaaS services and, in many cases, are not dependent upon our carrier customers to make them available to subscribers. Increased competition has in the past resulted in pricing pressure, forcing us to lower the selling price of our services. We expect this pricing pressure to continue to materially harm our operating results and financial condition.

Our recently launched RealPlayer Cloud product faces competition from other cloud service providers, including some that are firmly established in the marketplace and have access to extensive resources, as well as video sharing services, which include both well known and established companies and entrepreneurial startups. In addition, as we continue to develop this product and expand its reach, we expect to see growing competition from companies offering innovative features for engaging with users' video content. To be competitive, our RealPlayer Cloud product must provide sufficiently engaging and compelling features and our brand and corporate image must be deemed by consumers as sufficiently safe and secure for storing their digital content. Our RealPlayer software services compete with alternative streaming media playback technologies and audio and video formats which have obtained very broad market penetration. If we are unable to compete successfully, most notably through the development, marketing and monetization of RealPlayer Cloud, our RealPlayer business could continue to decline.

The branded services in our Games business compete with other online aggregators and distributors of online, downloadable and social casual PC games. Some of these competitors have high volume distribution channels and greater financial resources than we do. Our Games business also competes with many other smaller companies that may be able to adjust to market conditions, including responding effectively to the growing popularity of casual games on social networks, faster than us. We also face significant price competition in the casual games market, and some of our competitors may be able to lower prices more aggressively than us. We expect competition to continue to intensify in this market from these and other competitors. 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. If we are unable to slow recent revenue declines or achieve future growth in our revenue, particularly as we continue to invest in social and mobile games as the market for these games continues to rapidly evolve, revenue in our Games business will continue to decline and the business will suffer.

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. We may be required to 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 result in the loss of future revenues from our SaaS offerings.

Finally, nearly all of our carrier contracts obligate us to indemnify the carrier customer for certain liabilities and losses incurred by them, including liabilities resulting from third party claims for damages that arise out of the use of our technology. These indemnification terms provide us with certain procedural safeguards, including the right to control

the defense of the indemnified party. Pursuant to these indemnifications obligations, we have in the past agreed to control the defense on behalf of certain of our carrier customers related to patent infringement proceedings. In 2013, we settled two such litigation matters. Future claims against which we may be obligated to defend our carrier customers could result in payments that could materially harm our business and financial results.

A majority of the revenue that we generate in our Mobile Entertainment business segment is dependent upon our relationships with a few customers, and any deterioration of these relationships could materially harm our revenue. We generate a significant portion of our revenue from sales of our mobile entertainment services to a few of our mobile carrier customers, including SK Telecom, a leading wireless carrier in South Korea, and its affiliates. In the near term, we expect that we will continue to generate a significant portion of our total revenue from these customers. If these customers fail to market or distribute our services or terminate or fail to renew their business contracts with us, or if our relationships with these customers deteriorate in any significant way, we may be unable to replace the affected business arrangements with acceptable alternatives. Failure to maintain our relationships with these customers could have a material negative impact on our revenue and financial 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 has historically been important to our business, including growth through the introduction of new products and services distributed through these channels. It is unlikely that consumers will continue to download and use our digital media products consistent with past usage, so we expect that our ability to generate revenue from those products will be continue to be reduced, which could lead to lower than expected adoption of newly introduced products and services. Our inability to maintain continued high volume distribution of our digital media products could also hold back the growth and development of related revenue streams from these market segments, including the distribution of third-party products and sales of our subscription services, and therefore could harm our business and our prospects. Our revenue from the distribution of third-party products will also be negatively impacted if those products are not widely downloaded by consumers, including due to the relative market saturation of such products. Most of our revenue from the distribution of third-party products was historically derived from a single customer, however, that relationship ended during the third quarter of 2014, and we entered into an agreement with a new distribution partner. Our distribution revenue has been, and we expect will continue to be, materially negatively impacted by these factors.

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

The trading price for our common stock has a history of volatility. Although our recent stock price history shows more stability, with a range from \$6.00 to \$8.38 per share during the 52-week period ended March 31, 2015 it also shows continued weakness. As a result of the rapidly changing markets in which we compete, our operating results may fluctuate from period to period, which may contribute to volatility of our stock price.

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

Certain of our product and service investment decisions (for example, research and development and sales and marketing efforts) are based on predictions regarding business and the markets in which we compete. Fluctuations in our operating results, particularly when experienced beyond what we expected, could cause the trading price of our stock to fluctuate. Weakness in our operating performance is likely to cause continued weakness in our stock price.

Any impairment to our goodwill, indefinite-lived intangible assets and definite-lived assets could result in a significant charge to our earnings.

In accordance with accounting principles generally accepted in the United States, we are required to test goodwill and indefinite-lived intangible assets for possible impairment on an annual basis based upon a fair value approach, or more frequently in the event of certain indications of possible impairment. We review definite-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of such assets may not be recoverable. These events or circumstances could include a significant change in the business climate, including a significant

sustained decline in a reporting unit's market value, legal factors, operating performance indicators, competition, sale or disposition of a significant portion of our business, a significant sustained decline in our market capitalization and other factors. If we were to determine that an impairment had occurred, we would be required to record an impairment charge, which could have a significant negative, and unpredicted, impact on our financial results. The total carrying value of our goodwill, indefinite-lived intangible assets and definite-lived assets as of March 31, 2015 was \$41 million.

Continued loss of revenue from our subscription services may continue to harm our operating results. Our operating results have been and could continue to be adversely impacted by the loss of subscription revenue related to our legacy services and by the failure to generate revenue related to our new services. Subscribers may cancel their subscriptions to our services for many reasons, including a perception that they do not use the services sufficiently or that the service does not provide enough value, a lack of attractive or exclusive content generally or as compared with competitive service offerings, or because customer service issues are not satisfactorily resolved. Revenue from our SuperPass subscription service, for example, has declined in recent periods due to changes in consumer preferences and changes on our part to focus on other products and services we offer, and we expect these trends 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 effect on our operating results.

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

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

Global and national economic conditions have in the past and could in the future have a material adverse impact on our business, financial condition and results of operations.

Our business and operations depend significantly on global and national economic conditions. Because consumers may consider the purchase of our digital entertainment products and services to be a discretionary expenditure, their decision whether to purchase our products and services may be influenced by macroeconomic factors that affect consumer spending such as unemployment, access to credit, negative financial news, and declines in income. In addition, our carrier customers and business partners may reduce their business or advertising spending with us in the face of adverse macroeconomic conditions, such as financial market volatility, government austerity programs, tight credit, and declines in asset values.. We have in the past recorded material asset impairment charges due in part to

weakness in the global economy, and we may need to record additional impairments to our assets in future periods in the event of renewed weakness and uncertainty in the global or national economy. Accordingly, any significant weakness in the national and/or global economy could materially impact our business, financial condition and results of operations in a negative manner.



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

On March 31, 2010, we completed the restructuring of our digital audio music service joint venture, Rhapsody America LLC. As a result of the restructuring, we no longer have operational control over Rhapsody and Rhapsody's operating performance is no longer consolidated with our consolidated financial statements. Rhapsody has generated accounting losses since its inception and we have recognized losses on our investment in the convertible preferred stock of Rhapsody since the restructuring. If Rhapsody continues to incur losses, or if it otherwise experiences a significant decline in its business, we will incur further losses on our investment, which could have an adverse effect on our financial condition and results of operations. See Note 4, Rhapsody Joint Venture, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this 10-Q, for further discussion.

As described in more detail in Note 4, Rhapsody Joint Venture, in March 2015, RealNetworks extended a \$5.0 million loan to Rhapsody and provided a \$5.0 million guaranty to Rhapsody's senior secured lender. While we expect the loan to be repaid and the guaranty to be released, there can be no assurances that Rhapsody will be able to repay the loan or that the terms required for the release of the guaranty will occur.

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