

REALNETWORKS INC
Form 10-K
March 01, 2007

Table of Contents

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

Form 10-K

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2006**
- 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

(State of incorporation)

91-1628146

(I.R.S. Employer Identification Number)

2601 Elliott Avenue, Suite 1000

Seattle, Washington

(Address of principal executive offices)

98121

(Zip Code)

Registrant's telephone number, including area code:

(206) 674-2700

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, Par Value \$0.001 per share

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

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

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value of the Common Stock held by non-affiliates of the registrant was \$1,137,327,118 on June 30, 2006, based on the closing price of the Common Stock on that date, as reported on the Nasdaq Global Market.(1)

The number of shares of the registrant's Common Stock outstanding as of January 31, 2007 was 163,422,448.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement relating to the registrant's 2007 Annual Meeting of Shareholders to be held on or about May 25, 2007 are incorporated by reference into Part III of this Report.

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

	Page
<u>PART I</u>	
<u>Item 1.</u> <u>Business</u>	4
	12
<u>Item 1A.</u> <u>Risk Factors</u>	14
<u>Item 1B.</u> <u>Unresolved Staff Comments</u>	26
<u>Item 2.</u> <u>Properties</u>	26
<u>Item 3.</u> <u>Legal Proceedings</u>	27
<u>Item 4.</u> <u>Submission of Matters to a Vote of Security Holders</u>	27
<u>PART II</u>	
<u>Item 5.</u> <u>Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities</u>	28
<u>Item 6.</u> <u>Selected Financial Data</u>	29
<u>Item 7.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	30
<u>Item 7A.</u> <u>Quantitative and Qualitative Disclosures About Market Risk</u>	51
<u>Item 8.</u> <u>Financial Statements and Supplementary Data</u>	54
<u>Item 9.</u> <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	95
<u>Item 9A.</u> <u>Controls and Procedures</u>	95
<u>Item 9B.</u> <u>Other Information</u>	95
<u>PART III</u>	
<u>Item 10.</u> <u>Directors and Executive Officers of the Registrant</u>	96
<u>Item 11.</u> <u>Executive Compensation</u>	96
<u>Item 12.</u> <u>Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</u>	96
<u>Item 13.</u> <u>Certain Relationships and Related Transactions</u>	97
<u>Item 14.</u> <u>Principal Accountant Fees and Services</u>	97
<u>PART IV</u>	
<u>Item 15.</u> <u>Exhibits and Financial Statement Schedules</u>	97
<u>Exhibit Index</u>	98
<u>Signatures</u>	101
<u>EXHIBIT 10.11</u>	
<u>EXHIBIT 10.12</u>	
<u>EXHIBIT 21.1</u>	
<u>EXHIBIT 23.1</u>	
<u>EXHIBIT 31.1</u>	
<u>EXHIBIT 31.2</u>	
<u>EXHIBIT 32.1</u>	
<u>EXHIBIT 32.2</u>	

Table of Contents

PART I.

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

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

the effects of acquiring WiderThan, including our position as a technology services provider for leading wireless carriers;

plans, strategies and expected opportunities for growth, increased profitability and innovation in 2007 and future years;

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

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

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

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

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

our financial position and the availability of resources;

our expectations regarding acquisition activity in 2007 and our focus on the integration of completed acquisitions;

future competition;

the degree of seasonality in our revenue; and

our expectations as to the future calculation of our total subscriber count.

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 the section of Item 1 entitled Competition, in Item 1A entitled Risk Factors and in Item 3 entitled Legal Proceedings. RealNetworks undertakes no obligation to update publicly any forward-looking statements as a result of new information, future events or otherwise, unless required by law. Readers should, however, carefully review the risk factors included in other reports or documents filed by RealNetworks from time to time with the Securities and Exchange Commission, particularly the Quarterly Reports on Form 10-Q and any Current Reports on Form 8-K.

Table of Contents

Item 1. *Business*

Overview

RealNetworks, Inc. is a leading creator of digital media services and software. Consumers use our services and software, such as Rhapsody, RealArcade, and RealPlayer to find, play, purchase, and manage free and premium digital content, including music, games, and video. Broadcasters, cable and wireless communication companies, media companies and enterprises, such as Cingular Wireless LLC and Verizon Wireless in the U.S. and SK Telecom Co., Ltd. in the Republic of Korea (South Korea), use our digital media applications and services to create, secure and deliver digital media to PCs, MP3 players, mobile phones, and other consumer electronics devices and to provide entertainment services to their subscribers.

Our strategy is to continue to leverage our Internet and mobile media technology, business partnerships and worldwide user base to increase our sales of digital media products, services and advertising in order to build a long-term, sustainable and profitable business. We intend to continue our strategy of expanding our products and services beyond the PC to mobile devices and to create compelling digital media experiences on a variety of home theatre and other entertainment devices.

We were incorporated in 1994 in the State of Washington. Our common stock is listed on the Nasdaq Global Market under the symbol RNWK. We pioneered the development of technology for the transmission of digital media over the Internet. We also developed a suite of software and services for Internet media delivery for business customers, including RealServer and the Helix product portfolio. Through our acquisition of WiderThan Co. Ltd., in the fourth quarter of 2006, we are now a leader in the development of digital entertainment services for wireless carriers, such as ringback tones, music-on-demand, and video-on-demand services.

Consumer Products and Services

Music

We own and manage a comprehensive set of digital music products and services designed to provide consumers with broad access to digital music. Our goal is to enable consumers to access digital music content anytime, anywhere and from a variety of devices. Our music services include Rhapsody, a membership based music service offering unlimited access to a catalog of millions of tracks, RadioPass, our Internet radio subscription service, and RealMusic, an offering to consumers outside the U.S. of Internet radio, a la carte music downloads, music news, and other music content. We also operate Rhapsody.com, a free Web-based version of our digital music service which is monetized primarily through advertising related revenues, and the RealPlayer Music Store, which enables consumers to purchase and download individual digital music tracks.

Rhapsody. Our Rhapsody music service and jukebox software is the centerpiece of our music offerings. Our software allows consumers to manage their entire digital music collection in one application and subscribers to our Rhapsody Unlimited service receive legal, unlimited, streaming access to over three million tracks for a monthly fee. Our Rhapsody Unlimited service enables subscribers to stream songs on-demand to their PC, features significant editorial content and provides user-friendly ways for subscribers to explore, organize and listen to music. Rhapsody Unlimited subscribers can build and share playlists, create customized radio stations, and customize their own homepage within Rhapsody to receive recommendations, new release information and other content specific to their music tastes and listening history. Rhapsody Unlimited subscribers can also purchase most of the tracks available from the service at a discounted price and can use the Rhapsody jukebox software to download an unlimited number of songs to their

computer to listen offline as long as they remain subscribers.

We also offer Rhapsody To Go, a premium service that allows subscribers to transfer their music to portable devices. Rhapsody To Go subscribers receive all of the benefits of our Rhapsody Unlimited service, as well as the ability to transfer songs to compatible portable music devices. During the fourth quarter of 2006, we also introduced Rhapsody DNA, our proprietary software which facilitates the secure transfer of subscription based tracks to portable devices in a user friendly manner. In addition, we jointly launched with SanDisk Corp. the Sansa e200R Rhapsody line of MP3 players, which we believe enhances the portable music

Table of Contents

service experience. The Sansa e200R Rhapsody, utilizing Rhapsody DNA software, is integrated with our Rhapsody music service to facilitate the transfer of subscription tracks to the MP3 player. Consumers can also buy other MP3 players and subscribe to our Rhapsody To Go subscription service by utilizing Microsoft Corporation's PlaysForSure technology, which has been adopted by a number of MP3 player manufacturers.

Our Rhapsody music services are marketed through our family of websites, including Rhapsody.com, and we also distribute these services through a variety of third-party distribution channels, including broadband service providers (Comcast Corporation), music retailers (Best Buy), home entertainment hardware providers (Sonos) and MP3 manufacturers (SanDisk). We recently entered into a partnership with Best Buy to launch the Best Buy online music service powered by Rhapsody.

Rhapsody.com. We also make a free version of Rhapsody called Rhapsody.com available over the Internet. Rhapsody.com enables consumers, in the U.S., to listen to up to 25 songs per month for free utilizing their web browser without downloading a desktop software application. This service is offered as a marketing program for the premium version of Rhapsody and is also monetized through advertising related revenue. We also manage the Rollingstone.com website pursuant to a licensing agreement with Rolling Stone.

RadioPass. We offer consumers a subscription-based Internet radio product called RadioPass. RadioPass subscribers gain access to over 70 pre-programmed, ad-free, high fidelity digital music radio stations in addition to simulcasts of 3,200 worldwide broadcast stations for a monthly subscription fee. We also operate Rhapsody Radio, a version of our Internet radio service for distribution to customers via the PC and through certain wireless phone carriers. We have agreements with broadband service providers to provide our radio services on a wholesale basis in order to expose their customers to our online music services.

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

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

Media Software and Services

We provide technology that facilitates the delivery and consumption of digital media over the Internet.

RealPlayer. RealPlayer includes features and services that enable consumers to discover, play and manage audio and video programming on the Internet. RealPlayer plays many major digital media types and is compatible with over 100 portable music devices. RealPlayer is available to consumers as a free download from our Real.com website and also through bundling with third-party products.

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

Advertising and Third-Party Software. We market and sell advertising on our websites and client software. Our primary online presence consists of our Real.com family of websites. In addition, we distribute third-party software products to consumers who wish to download additional applications when downloading our software products.

Table of Contents

Games

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

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

We believe that PC and mobile games are appropriate for generating advertising based revenue and in 2006, we successfully launched more than a dozen casual downloadable games supported by in-game advertising on RealArcade and Gamehouse.com. We intend to continue to launch more ad supported games through our own family of websites as well as through third-party distribution channels.

PC Games. Our free client software, RealArcade, enables consumers to purchase games from our existing catalog of over 550 downloadable PC games and 180 online games across a variety of popular casual game genres, including puzzle, word, and arcade type games. RealArcade makes it easy for consumers to discover, manage and play downloadable PC games. All games are made available with a free trial and can be purchased on an individual basis or as part of our subscription services. In exchange for a monthly subscription fee, GamePass subscribers receive a credit to download one game each month from our game catalog and receive discounts for additional game purchases. Subscribers to FunPass have unlimited access to play over 100 downloadable games in exchange for a monthly subscription fee. FunPass was launched in the U.S. on GameHouse.com and in Europe on Zylom.com.

We have also been growing our PC games business internationally, through organic efforts and strategic acquisitions. In January 2006, we acquired Zylom Media Group B.V., a distributor and developer of casual online games in Europe, to strengthen our games business in Europe and in November 2006, we acquired Atrativa Latin America Ltda, a distributor of casual downloadable and online games in Latin America. During the third quarter of 2006, we launched a beta service in China focused primarily on multiplayer games.

Mobile Games. We develop and publish original content that consumers can purchase individually or packaged through a subscription mobile games service available through wireless network carriers in the U.S. and Europe. In 2005, we acquired Mr. Goodliving Ltd. to expand our catalog of mobile games. Under the Mr. Goodliving brand we have created a technology development platform, called EMERGE, that enables us to efficiently convert game content for use on over 300 mobile handsets.

Technology Products and Solutions

We develop and market software products and services that enable wireless carriers, cable companies and other media and communications companies to distribute digital media content to PCs, mobile phones, and other non-PC devices. In recent periods, our Technology Products and Solutions segment has increasingly focused on sales of application services to wireless carriers. We believe that the transition to an application service provider (ASP) business model will create a more stable, recurring, and scalable revenue stream compared to our traditional system software license

sales model. An example of this transition is the agreement we entered into in 2006 to operate Cingular's streaming video service in the U.S.

In October 2006, we increased our ASP service offerings through our acquisition of WiderThan Co., Ltd. WiderThan is a global leader for delivering integrated digital entertainment solutions to communications

Table of Contents

service providers. WiderThan's applications, content, and services enable wireless carriers to provide a broad range of mobile entertainment to their subscribers, including ringback tones, music-on-demand, mobile games, ringtones, messaging, and information services. WiderThan currently provides mobile entertainment solutions to more than 50 wireless carriers in over 25 countries, including SK Telecom in South Korea, Cingular, Sprint Nextel Corp., T-Mobile USA and Verizon in the U.S., Bharti Airtel Limited in India and Globe Telecom in the Philippines. WiderThan has a rich technology background and history of innovation, including assisting SK Telecom launch one of the world's first commercial ringback tone services in South Korea, as well as a leading, integrated mobile and on-line music-on-demand service. Prior to being acquired by RealNetworks, WiderThan was listed on the Nasdaq Global Market under the symbol WTHN and had over 470 employees with headquarters in Seoul, South Korea.

We believe that the combination of WiderThan's portfolio of digital entertainment services with our products and services will create a compelling suite of product offerings for mobile carriers and other communications services providers throughout the world. We also believe that WiderThan's technology platform and history of wireless innovation will assist our strategy of moving our content and services beyond the PC to multiple platforms.

Technology Products and Solutions that we market as application services are described below.

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

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

Video-On-Demand. In 2005, we launched our video-on-demand (VOD) carrier application service. Our VOD service allows wireless carriers and other telecom providers to enable their subscribers to view a wide range of video clips by downloading or streaming to video-enabled mobile phones that are equipped with approved digital rights management systems. Users typically pay for VOD services through monthly subscriptions and/or content download fees.

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

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

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

or term-based license plus annual fees for upgrades and support. Our Helix Server software is installed at more than 1,600 companies worldwide.

Table of Contents

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

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

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

See Notes to Consolidated Financial Statements – Segment Information (Note 17) for information regarding our reporting segments and geographic regions.

Research and Development

We devote a substantial portion of our resources to developing new products, enhancing existing products, expanding and improving our fundamental streaming technology, and strengthening our technological expertise in all our businesses. During the years ended December 31, 2006, 2005 and 2004, we expended 20%, 22%, and 20%, respectively, of our net revenue on research and development activities.

Customers and Seasonality

Our customers include consumers and businesses located throughout the world. Sales to customers outside the U.S., primarily in Asia and Europe, were 28%, 23%, and 24% of our net revenue during the years ended December 31, 2006, 2005, and 2004, respectively.

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

Sales, Marketing and Distribution

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

organizations around the world. We also have subsidiaries and offices in several countries that market and sell our products outside the U.S.

Consumer Products and Services Marketing

We market and sell our consumer products and services directly through our own websites (*www.real.com*, *www.rhapsody.com*, *www.realarcade.com*, *www.gamehouse.com*, *www.zylom.com*, etc.), our client software, and a variety of third-party distribution channels, such as broadband service providers, retailers, and other partners. Our websites and client software provide us with a low-cost, globally accessible sales channel that is generally

Table of Contents

available 24 hours per day, seven days per week. We also have an advertising sales force that markets and sells advertising on our websites and client software. We sell our international advertising inventory directly to clients and agencies in foreign markets and through third-party advertising representation firms.

Technology Products and Solutions Marketing

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

Customer Support

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

Competition

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

Consumer Products and Services

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

Our Rhapsody music subscription services and our RealPlayer Music Store face competition from traditional offline music distribution companies and from other online digital music services, including Apple Inc.'s iTunes music store and Napster, Inc.'s and Yahoo! Inc.'s music subscription services, as well as a wide variety of other competitors that are now offering digital music for sale over the Internet. Microsoft also offers premium music services in conjunction with its Zune product line, Windows Media Player and MSN services. We also expect increasing competition from media companies such as MTV and online retailers such as Amazon.com. Our music offerings also face substantial competition from the illegal use of free peer-to-peer services. The ongoing presence of these free services substantially impairs the marketability of legitimate services such as Rhapsody and the RealPlayer Music Store.

Our Rhapsody subscription services compete primarily on the basis of the overall quality and perceived value of the user experience and on the effectiveness of our distribution network and marketing programs. We believe that Rhapsody's subscription-based services offer customers a superior value compared to the purchase of individual digital music tracks through competing online music download sites. We also believe that

Table of Contents

Rhapsody's tools to search for and discover music, as well as its editorial content, organization of music and related artists, and overall ease of use differentiates Rhapsody from other online digital music services. As the market for purchasing music online grows, we expect that competition for subscribers and purchasers will become increasingly intense. In particular, Apple heavily markets and promotes its brand and digital music download services in order to drive sales of its higher margin hardware products. We expect that competing subscription services will continue to compete aggressively for new subscribers and that Apple will continue to spend significantly to market and promote its brand and the sale of downloadable music to further its business model. We also expect that other competitors will continue to spend heavily to promote their brands and to attract and retain consumers for their services. We further believe that our ability to compete in the digital music business has been negatively impacted by the historical lack of a compelling portable device solution for our music subscription services. We have attempted to address this competitive problem by introducing our Rhapsody DNA software and partnering with MP3 player manufacturers like SanDisk to develop the Sansa Rhapsody. Sales of our Rhapsody To Go subscription service will be increasingly dependent on the sales of our partner MP3 players and the sales efforts of our music retailer partners like Best Buy.

Our games business competes with a variety of distributors, publishers and developers of casual games for the PC and mobile wireless platforms. Our RealArcade service competes with other high volume distribution channels for downloadable games including Yahoo! Games, MSN Gamezone, Pogo.com, and Shockwave. We compete in this market primarily on the basis of the quality and convenience of our RealArcade service, the reach and quality of our distribution arrangements and the quality and breadth of our game catalog. Our GameHouse, Mr. Goodliving, and Zylom content development studios compete with other developers and publishers of downloadable PC and mobile games. Our development studios compete based on our ability to develop and publish high quality games that resonate with consumers, our effectiveness at building our brands and our ability to secure broad distribution relationships for our titles, including distribution of mobile titles through mobile carriers.

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

Technology Products and Solutions

We believe that the primary competitive factors in the media delivery market include:

the quality, reliability, price and licensing terms of the overall media delivery solution;

ubiquitous and easy consumer accessibility to media playback capability;

access to distribution channels necessary to achieve broad distribution and use of products;

the ability to license or develop, support, and distribute secure formats and digital rights management systems for digital media delivery, particularly music and video, which includes the ability to convince consumer electronics manufacturers to adopt our technology and the willingness of content providers to use our digital rights management technology;

the ability to license and support popular and emerging media formats for digital media delivery in a market where competitors may control the intellectual property rights for these formats;

scalability of streaming media and media delivery technology and cost per user;

Table of Contents

the ability to obtain any necessary patent rights underlying important streaming media and digital distribution technologies that gain market acceptance; and

compatibility with new and existing media formats, and with the user's existing network components and software systems.

Microsoft is a principal competitor in the development and distribution of digital media and media distribution technology. Microsoft currently competes with us in the market for digital media servers, players, encoders, digital rights management, codecs and other technology and services related to digital distribution of media. Microsoft's commitment to and presence in the media delivery industry is significant and we expect that Microsoft will continue to increase competition in the overall market for digital media and media distribution products and services.

Microsoft distributes its competing streaming media server, player, tools and digital rights management products by bundling them with its Windows operating systems, including Windows NT and Windows XP, at no additional cost or otherwise making them available free of charge. Microsoft's Windows Media Player competes with our media player products. We expect that by leveraging its monopoly position in operating systems and tying streaming of digital media into its operating systems and its Web browser, Microsoft will distribute substantially more copies of the Windows Media Player in the future than it has in the past and may be able to attract more users and content providers to use its streaming or digital media products.

The acquisition of the products and services of WiderThan introduces a number of new competitors to us. Specifically, through WiderThan, we now compete with a number of South Korean and international companies in specific areas of our business, including NMS Communications, Comverse Technology, and Huawei Technologies, in the RBT market; Alcatel Lucent, LM Ericsson Telephone Company, Openwave Systems, and Siemens in the MOD market; and Sybase 365, a division of Sybase, Inc., in the ICM market.

Intellectual Property

As of December 31, 2006, we had 50 U.S. patents, 15 patents in South Korea, and over 85 pending patent applications relating to various aspects of our technology. We are continuously preparing additional patent applications on other current and anticipated features of our technology in various jurisdictions across the world. As of December 31, 2006, we had 75 registered U.S. trademarks or service marks, 15 South Korea trademarks or service marks, and had applications pending for several more trademark or service marks in various jurisdictions across the world. We also have several unregistered trademarks. In addition, we have several foreign trademark registrations and pending applications. Many of our marks begin with the word "Real" (such as RealPlayer, RealAudio and RealVideo). We are aware of other companies that use "Real" in their marks alone or in combination with other words, and we do not expect to be able to prevent all third-party uses of the word "Real" for all goods and services.

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

Employees

At December 31, 2006, we had 1,594 full-time employees and 55 part-time employees, of which 1,013 were based in the Americas, 459 were based in Asia, and 177 were based in Europe. None of our employees are subject to a

collective bargaining agreement, and we believe that our relations with our employees are good.

Table of Contents**Position on Charitable Responsibility**

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

Available Information

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

Executive Officers of the Registrant

The executive officers of RealNetworks as of February 28, 2007 were as follows:

Name	Age	Position
Robert Glaser	45	Chairman of the Board and Chief Executive Officer
Michael Eggers	35	Senior Vice President, Chief Financial Officer and Treasurer
Savino (Sid) Ferrales	56	Senior Vice President Human Resources
John Giamatteo	40	President Technology Products and Solutions and International Operations
Robert Kimball	43	Senior Vice President, Legal and Business Affairs, General Counsel and Corporate Secretary
Philip W. O Neil	48	Senior Vice President Music
Dan Sheeran	40	Senior Vice President Corporate Partnerships and Business Development
Carla Stratfold	47	Senior Vice President Integration Program Office
Harold Zeitz	43	Senior Vice President Games and Media Software and Services

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

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

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

Table of Contents

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

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

PHILIP W. O'NEIL has served as Senior Vice President - Music of RealNetworks since February 2007. From 2000 to February 2006, Mr. O'Neil was employed by Vivendi Universal Games, the video game publishing unit of Vivendi Universal, a leading global media and entertainment company, most recently serving as Chief Operating Officer from March 2005 to February 2006. Prior to his appointment as Chief Operating Officer, Mr. O'Neil served as President and Chief Operating Officer, North America from May 2004 to March 2005, as Executive Vice President Sales and Marketing, North America from January 2004 to May 2004, as President and Founder, Partner Publishing Group from 2001 to December 2003, as Senior Vice President, Sales and Marketing from 2001 to January 2004, and as Senior Vice President, Sales North America from 2000 to 2001. Previously, Mr. O'Neil served in a variety of executive management roles within the consumer packaged goods sector. Mr. O'Neil holds a B.A. in English from California Polytechnic State University and is co-chair of the Dean's Advisory Board for the College of Liberal Arts and Sciences.

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

CARLA STRATFOLD has served as Senior Vice President, Integration Program Office of RealNetworks since October 2006. Ms. Stratfold joined RealNetworks in May 2001 and served as Senior Vice President, North American Sales of RealNetworks from May 2001 to October 2006. From December 1998 to March 2000, Ms. Stratfold served as Vice President of Business Development of BackWeb Technologies Ltd., a provider of Internet communication infrastructure software. Ms. Stratfold holds a B.S. in Political Science from Washington State University.

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

consumer marketing executive. Mr. Zeitz holds a B.A. in Economics from Northwestern University and an MBA from the Stanford Graduate School of Business.

Table of Contents

Item 1A. Risk Factors

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

Risks Related To Recent Development

Our recent acquisition of WiderThan could expose us to new risks, disrupt our business, and adversely impact our results of operations.

On November 27, 2006, we announced the final results of our tender offer for WiderThan Co., Ltd. pursuant to which we acquired approximately 99.7% of the outstanding common shares and American Depositary Shares of WiderThan. The integration of our acquisition of WiderThan may divert the attention of management and other key personnel from other core business operations, which could adversely impact our financial performance in the near term. Moreover, the integration of WiderThan's operations into the Company will require expansions to our system of internal controls over financial reporting. Any failure to successfully operate and integrate WiderThan could have an adverse effect on our results of operations.

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

With the acquisition of WiderThan, we generate a material portion of our revenue from operations in the Republic of Korea (South Korea). On a consolidated basis, in 2006 we derived 5% of our revenue from our operations in South Korea and expect that we will generate a significant portion of our revenue from South Korea in 2007. Operating in this market subjects us to risks that were not previously relevant to us, including risks associated with the general state of the economy in South Korea and the potential instability of the Democratic People's Republic of Korea (North Korea).

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

Risks Related to Our Consumer Products and Services Business

Future growth of our online consumer businesses may not keep pace with recently realized growth rates; any slowdown in growth would negatively impact our overall operating results.

Our Consumer Products and Services revenue and subscriber and user base have grown substantially in the past two years. A slowdown in the growth of our consumer businesses would have a negative impact on our total revenue and consolidated operating results. Moreover, these consumer businesses compete in new and rapidly evolving markets and face substantial competitive threats. Our prospects for future growth in these businesses must be considered in light of the risks, expenses and difficulties frequently encountered in new and fiercely competitive markets.

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

We are increasingly experiencing seasonality in our business, particularly with respect to the fourth quarter of our fiscal year. Our consumer businesses, which include advertising revenue, make up a large percentage of our revenue, and the fourth quarter has traditionally been the seasonally strongest quarter for internet advertising. In addition, as we have begun partnering more closely with device manufacturers for our

Table of Contents

consumer music services, we expect sales of these devices to follow typical consumer buying patterns with a majority of consumer electronics being sold in the fourth quarter. Finally, WiderThan's historical business has seen a concentration of system sales, deployments, and consulting revenue in the fourth quarter. These factors may result in increasing seasonality in our business and we cannot predict with accuracy how these factors will impact our quarterly financial results.

The success of our subscription services businesses depends upon our ability to add new subscribers and minimize subscriber churn.

Our operating results could be adversely impacted by subscriber churn. Internet subscription businesses are a relatively new media delivery model and we cannot predict with accuracy our long-term ability to retain subscribers or add new subscribers. Subscribers may cancel their subscriptions to our services for many reasons, including a perception that they do not use the services sufficiently or that the service does not provide enough value, a lack of attractive or exclusive content generally or as compared to competitive service offerings (including Internet piracy), or because customer service issues are not satisfactorily resolved. In recent periods, we have seen an increase in the number of gross customer cancellations of our subscription services due in part to an increasingly large subscriber base.

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

We must continue to obtain compelling digital media content for our video, music, and games services in order to maintain and increase usage, subscription service revenue, and overall customer satisfaction for these products. In some cases, we pay substantial fees to obtain premium content. For instance, we pay substantial royalty fees to music labels to license content. Moreover, our online music service offerings depend on music licenses from the major music labels and publishers, and the failure of any such parties to renew these licenses under terms that are acceptable to us would harm our ability to offer successful music subscription services and therefore our operating results. If we cannot obtain premium digital content for any of our digital content subscription services on commercially reasonable terms, or at all, our business will be harmed.

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

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

Our consumer businesses face substantial competitive challenges that may prevent us from being successful in those businesses.

Music. Our online music services face significant competition from traditional offline music distribution competitors and from other online digital music services, as well as piracy. Some of these competing online services have spent substantial amounts on marketing and have received significant media attention, including Apple's iTunes music download service, which it markets closely with its extremely popular iPod line of portable digital audio players. Microsoft has also begun offering premium music services in conjunction with

Table of Contents

its Windows Media Player and also now markets a portable music player and related download software and music service called Zune. We also expect increasing competition from online retailers such as Amazon.com. Our current music service offerings may not be able to compete effectively in this highly competitive market. Our online music services also face significant competition from free peer-to-peer services which allow consumers to directly access an expansive array of free content without securing licenses from content providers. Enforcement efforts have not effectively shut down these services and there can be no assurance that these services will ever be shut down. The ongoing presence of these free services substantially impairs the marketability of legitimate services like ours.

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

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

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

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

The success of our music services depend, in part, on interoperability with our customer's music playback hardware.

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

Table of Contents

Risks Related to Our Technology Products and Solutions Business

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

We believe that our traditional system software sales have been negatively impacted primarily by the competitive effects of Microsoft, which markets and often bundles its competing technology with its market leading operating systems and server software. In December 2003, we filed suit against Microsoft in U.S. District Court to redress what we believed were illegal, anticompetitive practices by Microsoft. In October 2005, we entered into a settlement agreement with Microsoft regarding these claims and we also entered into two commercial agreements related to our digital music and casual games businesses. Although the settlement agreement contains a substantial cash payment to us and a series of technology agreements between the two companies, Microsoft will continue to be an aggressive competitor with our traditional systems software business. We cannot be sure whether the portions of the settlement agreement designed to limit Microsoft's ability to leverage its market power will be effective and we cannot predict when, or if, we will experience increased demand for our system software products.

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

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

Contracts with our carrier customers subject us to significant risks that could negatively impact our revenue from application services.

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

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

Finally, many of our carrier contracts are short term and allow for early termination by the carrier with or without cause. These contracts are therefore subject to renegotiation of pricing or other key terms that could be adverse to our interests, and leave us vulnerable to non-renewal by the carriers. If our carrier contracts are

Table of Contents

terminated, not renewed, or renegotiated in a manner less favorable to us, our application services revenue would be negatively impacted.

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

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

The mobile entertainment market is highly competitive.

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

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

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

Our patents may not improve our business prospects.

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

Risks Related to Our Business in General

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

As a result of the rapidly changing markets in which we compete, our operating results may fluctuate from period-to-period. In past periods, our operating results have been affected by personnel reductions and related charges,

charges relating to losses on excess office facilities, and impairment charges for certain of our equity investments. Our operating results may be adversely affected by similar or other charges or events in future periods, which could cause the trading price of our stock to decline. Certain of our expense decisions (for example, research and development and sales and marketing efforts) are based on predictions regarding business and the markets in which we compete. To the extent that these predictions prove inaccurate, our revenue may not be sufficient to offset these expenditures, and our operating results may be harmed. In

Table of Contents

addition, we recently acquired the operations of WiderThan. We have limited experience managing these assets which may make it more difficult for us to accurately predict our operating results.

Our settlement agreement with Microsoft may not improve our business prospects.

In October 2005, we entered into a settlement agreement with Microsoft regarding claims of monopolistic activity which we had made against them. In connection with the settlement, we also entered into two commercial agreements with Microsoft related to our digital music and casual games businesses. The settlement agreement consists of a series of substantial cash payments to us and a series of technology agreements between the two companies. We cannot be sure that we will be able to apply the proceeds of the settlement in a way that will improve our operating results or otherwise increase the value of our shareholders' investments in our stock.

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

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

reduced prices, revenue and margins;

increased expenses in responding to competitors;

loss of current and potential customers, market share and market power;

lengthened sales cycles;

degradation of our stature and reputation in the market;

changes in our business and distribution and marketing strategies;

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

strained relationships with partners; and

pressure to prematurely release products or product enhancements.

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

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

The process of developing new, and enhancing existing, products and services is complex, costly and uncertain. Our business depends on providing products and services that are attractive to subscribers and consumers, which, in part, is subject to unpredictable and volatile factors beyond our control, including end-user preferences and competing products and services. Any failure by us to timely respond to or accurately anticipate consumers' changing needs and

emerging technological trends could significantly harm our current market share or result in the loss of market opportunities. In addition, we must make long-term investments, develop or obtain appropriate intellectual property and commit significant resources before knowing whether our predictions will accurately reflect consumer demand for our products and services. Therefore, our operating results could be negatively impacted.

Microsoft is one of our strongest competitors, and employs highly aggressive tactics against us.

Microsoft is one of our principal competitors in the development and distribution of digital media and media distribution technology. Microsoft's market power in related markets such as personal computer

Table of Contents

operating systems, office software suites and web browser software gives it unique advantages in the digital media markets. Despite the settlement of our antitrust litigation with Microsoft, we expect that Microsoft will continue to compete vigorously in the digital media markets in the future. Microsoft's dominant position in certain parts of the computer and software markets, and its aggressive activities have had, and in the future will likely continue to have, adverse effects on our business and operating results.

If our products are not able to support the most popular digital media formats, our business will be substantially impaired.

We may not be able to license technologies, like codecs or digital rights management technology, that obtain widespread consumer and developer use, which would harm consumer and developer acceptance of our products and services. In addition, our codecs and formats may not continue to be in demand or as desirable as other third-party codecs and formats, including codecs and formats created by Microsoft or industry standard formats created by MPEG.

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

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

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

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

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

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

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

As part of our business strategy, we have acquired technologies and businesses in the past, including as recently as November 2006, and expect that we will continue to do so in the future. The failure to adequately manage the costs and address the financial, legal and operational risks raised by acquisitions of technology and businesses could harm our business and prevent us from realizing the benefits of the acquisitions.

Table of Contents

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

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

difficulties and expenses in assimilating the operations, products, technology, information systems, and/or personnel of the acquired company;

retaining key management or employees of the acquired company;

entrance into unfamiliar markets, industry segments, or types of businesses;

operating and integrating acquired businesses in remote locations;

integrating and managing businesses based in countries in which we have little or no prior experience;

impairment of relationships with employees, affiliates, advertisers or content providers of our business or acquired business; and

assumption of known and unknown liabilities of the acquired company, including intellectual property claims.

Our strategic investments may not be successful and we may have to recognize expenses in our income statement in connection with these investments.

We have made, and in the future we may continue to make, strategic investments in other companies, including joint ventures. These investments often involve immature and unproven businesses and technologies and involve a high degree of risk. We could lose the entire amount of our investment. No assurance can be made that we will realize the anticipated benefits from any of our strategic investment.

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

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

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

Our ability to provide our products and services to our customers and operate our business depends on the continued operation of our information systems and networks. A significant or repeated reduction in the performance, reliability or availability of our information systems and network infrastructure could harm our ability to conduct our business, and harm our reputation and ability to attract and retain users, customers, advertisers and content providers. We have on occasion experienced system errors and failures that caused interruption in availability of products or content or an increase in response time. Problems with our systems and networks could result from our failure to adequately maintain and enhance these systems and networks,

Table of Contents

natural disasters and similar events, power failures, HVAC failures, intentional actions to disrupt our systems and networks and many other causes. The vulnerability of a large portion of our computer and communications infrastructure is enhanced because much of it is located at a single leased facility in Seattle, Washington, an area that is at heightened risk of earthquake, flood, and volcanic events. Many of our services do not currently have fully redundant systems or a formal disaster recovery plan, and we may not have adequate business interruption insurance to compensate us for losses that may occur from a system outage.

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

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

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

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

As part of our international expansion strategy, we intend to grow our business in The People's Republic of China (PRC). PRC government regulates our business in PRC through regulations and license requirements restricting (i) the scope of foreign investment in the Internet, retail and delivery sectors, (ii) Internet content and (iii) the sale of certain media products. In order to meet PRC local ownership and regulatory licensing requirements, our business in PRC is operated through a PRC subsidiary which acts in cooperation with PRC companies owned by nominee shareholders who are PRC nationals. Although we believe this structure complies with existing PRC laws, it involves unique risks. There are substantial uncertainties regarding the interpretation of PRC laws and regulations, and it is possible that PRC government will ultimately take a view contrary to ours. If any of our PRC entities were found to be in violation of existing or future PRC laws or regulations or if interpretations of those laws and regulations were to change, the business could be subject to fines and other financial penalties, have its licenses revoked or be forced to shut down entirely.

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

Our ability to compete partly depends on the superiority, uniqueness and value of our technology, including both internally developed technology, and technology licensed from third parties. To protect our proprietary rights, we rely

on a combination of patent, trademark, copyright and trade secret laws, confidentiality agreements with our employees and third parties, and protective contractual provisions. As disputes regarding the ownership of technologies and rights associated with streaming media, digital distribution, and online businesses are common and likely to arise in the future, we may be forced to litigate to enforce or defend our intellectual property rights or to determine the validity and scope of other parties' proprietary

Table of Contents

rights. Any such litigation would likely be costly, distract our management, and the existence and/or outcome of any such litigation could harm our business.

Despite our efforts to protect our proprietary rights, any of the following would likely reduce the value of our intellectual property:

our applications for patents and trademarks relating to our business may not be granted and, if granted, may be challenged or invalidated;

our efforts to protect our intellectual property rights may not be effective in preventing misappropriation of our technology;

our efforts may not prevent the development and design by others of products or technologies similar to, competitive with, or superior to those we develop; or

another party may obtain a blocking patent, thus requiring us to either obtain a license or design around the patent in order to continue to offer the contested feature or service in our products.

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

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

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

We account for employee stock options using the fair value method, which may have a material adverse affect on our results of operations.

On January 1, 2006, we adopted the provisions of, and started accounting for stock-based compensation in accordance with, the Financial Accounting Standards Board's Statement of Financial Accounting Standard (SFAS) No. 123R revised 2004, *Share Based Payment*, which requires a company to recognize, as an expense, the fair value of stock options and other stock-based compensation. We are required to record an expense for our stock-based compensation plans using the fair value method as described in SFAS 123R, which results in the recognition of significant and ongoing accounting charges, for which we recorded an expense of \$18.2 million during the year ended December 31, 2006, in our condensed consolidated statement of operations. Stock options are also a key part of the compensation packages that we offer our employees. If we are forced to curtail our broad-based option program due to these additional charges, it may become more difficult for us to attract and retain employees.

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

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

Table of Contents

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

The Internet Tax Freedom Act, or ITFA, which Congress extended until November 2007, among other things, imposed a moratorium on discriminatory taxes on electronic commerce. The imposition by state and local governments of various taxes upon Internet commerce could create administrative burdens for us and could decrease our future sales.

We may be subject to additional income tax assessments.

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

We donate a portion of our net income to charity.

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

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

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

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

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

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

Table of Contents

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

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

adopt a plan of merger;

authorize the sale, lease, exchange or mortgage of assets representing more than 50% of the book value of our assets prior to the transaction or on which our long-term business strategy is substantially dependent;

authorize our voluntary dissolution; or

take any action that has the effect of any of the above.

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

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

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

We are exposed to potential risks from recent legislation requiring companies to evaluate controls under Section 404 of the Sarbanes-Oxley Act of 2002.

We have evaluated our internal controls in order to allow management to report on, and our registered independent public accounting firm to attest to, our internal controls, as required by Section 404 of the Sarbanes-Oxley Act of 2002. We have performed the system and process evaluation and testing required in an effort to comply with the management certification and auditor attestation requirements of Section 404. The requirements and processes associated with Section 404 are relatively new and still evolving and we cannot be certain that the measures we have taken will be sufficient to meet the Section 404 requirements as changes occur to the guidance and our reporting environment or that we will be able to implement and maintain adequate controls over financial reporting processes and reporting in the future. Moreover, we cannot be certain that the costs associated with such measures will not exceed our estimates, which could impact our overall level of profitability. Any failure to meet the Section 404 requirements or to implement required new or improved controls, or difficulties or unanticipated costs encountered in their implementation, could cause investors to lose confidence in our reported financial information or could harm our financial results, which could have a negative effect on the trading price of our stock.

Table of Contents

Certain material weaknesses in internal controls of WiderThan were identified as of December 31, 2005; if we fail to remediate and maintain an effective system of internal controls at WiderThan we may be unable to accurately report our financial results or reduce our ability to prevent or detect fraud, and investor confidence may be affected.

In connection with the audit of WiderThan's 2005 financial statements, the management of WiderThan identified certain material weaknesses, as defined by the Public Company Accounting Oversight Board's Auditing Standard No. 2, as of December 31, 2005, as follows:

WiderThan did not retain accounting staff with sufficient depth and skill in the application of U.S. GAAP commensurate with the reporting requirements of a U.S. registrant;

WiderThan did not have effective controls over establishing and maintaining accounting policies related to revenue recognition; and

WiderThan did not maintain effective controls, including monitoring, over the financial close and reporting process. Specifically, WiderThan relied heavily on the use of spreadsheet programs during the financial close process and did not have adequately designed controls to ensure the completeness, accuracy, and restricted access to such spreadsheets.

In making its assessment of the effectiveness of internal control over financial reporting as of December 31, 2006 management has excluded WiderThan, as permitted by the SEC, because it was acquired on October 31, 2006. The assets and net revenue of WiderThan as of and for the twelve months ended December 31, 2006 were \$431.7 million and \$26.7 million, respectively, representing 33% and 7%, respectively, of our consolidated assets and net revenue as of and for the twelve months ended December 31, 2006.

We are in the process of integrating the finance operations of WiderThan into our finance department; however, there is no certainty that the identified material weaknesses will be remediated in a timely manner or controls will be implemented to prevent a material misstatement in the consolidated financial statements. Moreover, we cannot be certain that the costs associated with such measures will not exceed our estimates, which could impact our overall level of profitability. Any failure to remediate these material weaknesses could cause investors to lose confidence in our reported financial information or could harm our financial results.

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

The trading price of our common stock has been highly volatile. For example, during the 52-week period ended December 31, 2006, the price of our common stock ranged from \$7.20 to \$12.08 per share. Our stock price could be subject to wide fluctuations in response to factors such as actual or anticipated variations in quarterly operating results, changes in financial estimates, recommendations by securities analysts, changes in the competitive environment, as well as any of the other risk factors described above.

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

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

Item 1B. *Unresolved Staff Comments*

None.

Item 2. *Properties*

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

Table of Contents

We lease properties primarily in the following locations to house our research and development, sales and marketing, and general and administrative personnel:

Location	Area leased (sq. feet)	Monthly rent	Lease expiration
Seattle, Washington	264,000	\$ 468,000	September 2014, with an option to renew for two five-year periods
Seattle, Washington(1)	133,000	398,000	September 2010
Seoul, Republic of Korea	78,000	127,000	October 2008
Reston, Virginia	35,000	76,000	December 2011
Tokyo, Japan	6,700	39,000	March 2008
San Francisco, California	28,750	32,000	November 2007
New York, New York	15,000	30,000	February 2011
London, United Kingdom	4,540	20,000	May 2010
Seattle, Washington	11,300	17,000	July 2010
New York, New York	4,200	13,000	December 2009
Eindhoven, Netherlands	14,700	10,000	June 2011

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

We also lease various other smaller facilities in the U.S. and foreign countries primarily for our sales and marketing personnel. A majority of these leases are for a period of less than one year. We believe that our properties are in good condition, adequately maintained and suitable for the conduct of our business. For additional information regarding our obligations under leases, see Notes to Consolidated Financial Statements – Commitments and Contingencies (Note 15).

Item 3. Legal Proceedings

See Notes to Consolidated Financial Statements – Commitments and Contingencies (Note 15) for information regarding legal proceedings.

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

No matters were submitted to a vote of our shareholders during the fourth quarter of our fiscal year ended December 31, 2006.

Table of Contents**PART II.****Item 5. *Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities***

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

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

	Years Ended December 31,			
	2006		2005	
	High	Low	High	Low
First Quarter	\$ 8.60	\$ 7.20	\$ 7.08	\$ 5.42
Second Quarter	11.05	8.27	7.40	4.85
Third Quarter	11.20	9.12	5.95	4.65
Fourth Quarter	12.08	10.44	9.08	5.63

As of January 31, 2007, there were approximately 772 holders of record of our common stock. Most shares of our common stock are held by brokers and other institutions on behalf of shareholders. We have not paid any cash dividends. Payment of dividends in the future will depend on our continued earnings, financial condition, and other factors.

The information required by this item regarding equity compensation plans is incorporated by reference to the information set forth in Part III, Item 12 of this Form 10-K.

In August 2005, our Board of Directors authorized a share repurchase program for the repurchase of up to an aggregate of \$75.0 million of our outstanding common stock. In November 2005, our Board of Directors authorized a new share repurchase program for the repurchase of up to an aggregate of \$100.0 million of our outstanding common stock, which replaced the August 2005 repurchase program. During 2005, under both the August 2005 and November 2005 repurchase programs, we repurchased 8.6 million shares at an average cost of \$6.29 per share for an aggregate value of \$54.3 million. During the quarter ended March 31, 2006 we purchased 9.5 million shares at an average cost of \$8.09 per share for an aggregate value of \$77.0 million.

In April 2006, our Board of Directors authorized a new share repurchase program of up to an aggregate of \$100.0 million of our outstanding common stock. During the period from April 2006 to December 2006 we repurchased 2.3 million shares at an average cost of \$9.44 per share for an aggregate value of \$21.9 million. As of December 31, 2006, \$78.1 million remained authorized for repurchase under the April 2006 repurchase program.

Between October 1, 2006 and December 31, 2006, the Company has issued and sold unregistered securities as follows:

On December 29, 2006, the Company issued an aggregate of 2,170 shares of Common Stock to three non-employee directors as compensation for board service during the fourth quarter of 2006 pursuant to the RealNetworks, Inc. Director Compensation Stock Plan. The aggregate value of the shares was approximately \$23,740. The shares were issued in reliance on Section 4(2) under the Securities Act of 1933, as amended, on the basis that the transactions did not involve a public offering.

Table of Contents**Item 6. Selected Financial Data**

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

	2006	Years Ended December 31,			2002
		2005	2004	2003	
(In thousands, except per share data)					
Consolidated Statements of Operations Data:					
Net revenue	\$ 395,261	\$ 325,059	\$ 266,719	\$ 202,377	\$ 182,679
Cost of revenue	124,108	98,249	97,145	68,343	50,269
Gross profit	271,153	226,810	169,574	134,034	132,410
Operating expenses:					
Research and development	77,386	70,731	52,066	47,730	49,514
Sales and marketing	165,602	130,515	96,779	77,335	73,928
General and administrative	57,332	50,697	31,538	21,160	19,820
Loss on excess office facilities	738		866	7,098	17,207
Personnel reduction and related charges					3,595
Subtotal operating expenses	301,058	251,943	181,249	153,323	164,064
Antitrust litigation (benefit) expenses, net	(220,410)	(422,500)	11,048	1,574	
Total operating expenses (benefit)	80,648	(170,557)	192,297	154,897	164,064
Operating income (loss)	190,505	397,367	(22,723)	(20,863)	(31,654)
Other income (expenses), net	37,248	32,176	248	(444)	(727)
Income (loss) before income taxes	227,753	429,543	(22,475)	(21,307)	(32,381)
Income taxes	(82,537)	(117,198)	(522)	(144)	(5,972)
Net income (loss)	\$ 145,216	\$ 312,345	\$ (22,997)	\$ (21,451)	\$ (38,353)
Basic net income (loss) per share	\$ 0.90	\$ 1.84	\$ (0.14)	\$ (0.13)	\$ (0.24)
Diluted net income (loss) per share	\$ 0.81	\$ 1.70	\$ (0.14)	\$ (0.13)	\$ (0.24)
Shares used to compute basic net income (loss) per share	160,973	169,986	168,907	160,309	159,365
Shares used to compute diluted net income (loss) per share	179,281	184,161	168,907	160,309	159,365

As of December 31,

	2006	2005	2004	2003	2002
	(In thousands)				
Consolidated Balance Sheets Data:					
Cash, cash equivalents, and short-term investments	\$ 678,920	\$ 781,327	\$ 363,621	\$ 373,593	\$ 309,071
Working capital	584,125	710,804	287,599	310,679	248,400
Other intangible assets, net	105,109	7,337	8,383	1,065	848
Goodwill	309,122	123,330	119,217	97,477	60,077
Total assets	1,303,416	1,112,997	602,502	580,939	462,101
Convertible debt	100,000	100,000	100,000	100,000	
Shareholders' equity	969,766	841,733	380,805	366,486	349,765

Table of Contents

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

Overview

We are a leading creator of digital media services and software. Consumers use our services and software, such as Rhapsody, RealArcade, and RealPlayer to find, play, purchase, and manage free and premium digital content, including music, games, and video. Broadcasters, cable and wireless communication companies, media companies and enterprises, such as Cingular and Verizon in the U.S. and SK Telecom in Korea, use our digital media applications and services to create, secure and deliver digital media to PCs, mobile phones, portable music players and other consumer electronics devices and to provide entertainment services to their subscribers.

Our strategy is to continue to leverage our Internet and mobile media technology, business partnerships and worldwide user base to increase our sales of digital media products, services and advertising in order to build a sustainable and profitable global business. We intend to continue our strategy of expanding our products and services beyond the PC to mobile devices and to create compelling digital media experiences on a variety of entertainment devices. We also intend to use our strong cash position to continue to seek acquisition opportunities to further our strategic initiatives and to enhance our competitive position.

In the year ended December 31, 2006, we recorded the highest total annual revenue in our history due to the significant growth in our Consumer Products and Services segment and also due to the inclusion of the operating results from our 2006 acquisitions, primarily WiderThan which we acquired in October 2006. The growth in our consumer businesses, as compared to 2005, was driven primarily by increased revenue from our Games and Music businesses, including increased sales resulting from our acquisition of Zylom in January 2006, and distribution of third-party products. This growth was partially offset by a decline in revenue in our Media Software and Services business from 2005 to 2006, due primarily to a decline in our SuperPass subscription service, and a decline in third-party subscriptions.

In recent years, we have focused our efforts on growing our consumer businesses through both internal initiatives and strategic acquisitions of businesses and technologies. As a result of these efforts, we have increased the number of subscribers to our music and games subscription offerings and increased sales of our digital music and games content. Our Consumer Products and Services segment accounted for 82%, 86%, and 82% of our total revenue during the years ended December 31, 2006, 2005, and 2004, respectively. In addition, we have increased our focus on free-to-consumer products and services, such as our Rhapsody.com website and our introduction of downloadable games containing in-game advertising. These products and services generate advertising revenue and are also designed to increase the exposure of our paid digital music and games products and services to consumers.

Our Technology Products and Solutions revenue also grew substantially in 2006, increasing 61% from 2005. The increase was primarily driven by our acquisition of WiderThan in October 2006. WiderThan is a leader in delivering integrated digital entertainment solutions to communications service providers worldwide. WiderThan's applications, content, and services enable wireless carriers to provide a broad range of mobile entertainment to their subscribers, including ringback tones, music-on-demand, mobile games, ringtones, messaging, and information services. We expect our Technology Products and Solutions revenue to grow as a percentage of total revenue and in absolute dollars during 2007 as it will include a full year of the results of operations of WiderThan. We also believe that WiderThan's technology platform and history of wireless innovation will assist our strategy of moving our content and services beyond the PC to multiple platforms.

In October 2005, we entered into an agreement to settle all of our antitrust disputes worldwide with Microsoft. Upon settlement of the legal disputes, we also entered into two commercial agreements with Microsoft that provide for collaboration in digital music and casual games. Pursuant to these commercial agreements we have received payments of \$478.0 million in 2005 and \$221.9 million in 2006. Microsoft also paid us the remaining contractual payment of \$61.1 million in January 2007 for a total of \$761.0 million.

Table of Contents

We manage our business, and correspondingly report revenue, based on two operating segments: Consumer Products and Services and Technology Products and Solutions.

Consumer Products and Services segment primarily includes revenue from: digital media subscription services such as Rhapsody, RadioPass, GamePass and SuperPass; sales and distribution of third-party software and services; sales of digital content such as music and game downloads; sales of premium versions of our RealPlayer and related products; and advertising.

Technology Products and Solutions segment includes revenue from: sales of ringback tones, music-on-demand, video-on-demand, and messaging services; sales of our media delivery system software, including Helix system software and related authoring and publishing tools, both directly to customers and indirectly through original equipment manufacturer (OEM) channels; support and maintenance services that we sell to customers who purchase our software products; broadcast hosting services; and consulting services we offer to our customers.

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

	Years Ended December 31,		
	2006	2005	2004
Net revenue:			
License fees	22.9%	24.9%	26.9%
Service revenue	77.1	75.1	73.1
Total net revenue	100.0	100.0	100.0
Cost of revenue:			
License fees	9.4	10.4	10.6
Service revenue	22.0	19.8	24.0
Loss on content agreement			1.9
Total cost of revenue	31.4	30.2	36.5
Gross profit	68.6	69.8	63.5
Operating expenses:			
Research and development	19.6	21.8	19.5
Sales and marketing	41.9	40.2	36.3
General and administrative	14.5	15.6	11.8
Loss on excess office facilities	0.2		0.3
Subtotal operating expenses	76.2	77.6	67.9
Antitrust litigation (benefit) expenses, net	(55.8)	(130.0)	4.1
Total operating expenses (benefit)	20.4	(52.4)	72.0
Operating income (loss)	48.2	122.2	(8.5)
Other income, net	9.4	9.9	0.1

Income (loss) before income taxes	57.6	132.1	(8.4)
Income taxes	(20.9)	(36.1)	(0.2)
Net income (loss)	36.7%	96.0%	(8.6)%

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

Table of Contents

financial statements and the reported amounts of revenue and expenses during the reported period. Our critical accounting policies and estimates are as follows:

Revenue recognition;

Estimating music publishing rights and music royalty accruals;

Recoverability of deferred costs;

Estimating allowances for doubtful accounts and sales returns;

Estimating losses on excess office facilities;

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

Valuation of other intangible assets;

Valuation of goodwill;

Stock-based compensation;

Accounting for income taxes; and

Determining loss on purchase commitments.

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

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

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

We recognize revenue on a gross or net basis, in accordance with EITF Issue No. 99-19. In most arrangements, we contract directly with end user customers, are the primary obligor and carry all collectibility risk. In such

arrangements we report the revenue on a gross basis. In some cases, we utilize third-party distributors to sell products or services directly to end user customers and carry no collectibility risk. In such instances we report the revenue on a net basis.

We recognize revenue for our software products pursuant to the requirements of SOP No. 97-2, as amended by SOP No. 98-9. If we provide consulting services that are considered essential to the functionality of the software products, both the software product revenue and services revenue are recognized under contract accounting in accordance with the provisions of SOP No. 81-1. Revenue from these arrangements is either recognized under the percentage of completion method based on the ratio of direct labor hours incurred to total projected labor hours, or on the completed contract method based on customer specific arrangement.

Table of Contents

Revenue from software license agreements with original equipment manufacturers (OEM) is recognized when the OEM delivers its product incorporating our software to the end user.

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

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

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

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

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

Accrued Loss on Excess Office Facilities. We made significant estimates in determining the appropriate amount of accrued loss on excess office facilities. If we made different estimates, our loss on excess office facilities could be significantly different from that recorded, which could have a material impact on our operating results. We have revised our original estimate several times in the last five years, increasing the accrual for loss on excess office facilities each time. The first two revisions were the result of changes in the market for commercial real estate where

the excess office facilities are located. The third revision, which took place in 2003, resulted from adding an additional tenant at a sublease rate lower than the rate used in previous estimates. During the quarter ended September 30, 2004 we renegotiated the lease for our headquarters building and ceased using part of the building resulting in a charge to our statement of operations. The latest revision, during the quarter ended March 31, 2006, resulted from incremental increases in the building

Table of Contents

operating expenses which were greater than the amounts previously estimated as not recoverable. The significant factors we considered in making our estimates are discussed in the section entitled *Loss on Excess Office Facilities*.

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

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

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

- poor economic performance relative to historical or projected future operating results;
- significant negative industry, economic or company specific trends;
- changes in the manner of our use of the assets or the plans for our business; and
- loss of key personnel.

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

Stock-Based Compensation. We account for stock-based compensation in accordance with Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment*. Under the provisions of SFAS No. 123R, which we adopted as of January 1, 2006, stock-based compensation cost is estimated at the grant date based on the award's fair-value as calculated by the Black-Scholes option-pricing model and is recognized as expense over the requisite service period, which is the vesting period. The Black-Scholes model requires various highly judgmental assumptions including volatility and expected option life. If any of the assumptions used in the Black-Scholes model change significantly, stock-based compensation expense may differ materially in the future from the amounts recorded in our consolidated statement of operations. We are required to estimate forfeitures at the time of grant and revise those

estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. Prior to the adoption of SFAS No. 123R, we measured compensation expense for our employee stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board Opinion (APB) No. 25,

Table of Contents

Accounting for Stock Issued to Employees. Under APB No. 25, when the exercise price of the Company's employee stock options was equal to the market price of the underlying stock on the date of the grant, no compensation expense was recognized.

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

We must periodically assess the likelihood that our deferred tax assets will be recovered from future taxable income, and to the extent that recovery is not likely, 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. Factors we consider in making such an assessment include, but are not limited to: past performance and our expectation of future taxable income, macro-economic conditions and issues facing our industry, existing contracts, our ability to project future results and any appreciation of our investments and other assets.

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

As of December 31, 2006 we had not made a final determination to maintain WiderThan Americas, Inc., currently a wholly-owned subsidiary of WiderThan, as a direct subsidiary of WiderThan or as a direct subsidiary of RealNetworks, Inc. The determination of the final structure may impact the amount of deferred tax liability and goodwill, if the decision is made within a reasonable time from the date of acquisition. In general, if the decision is made after one year following the date of acquisition it may impact our income tax expense.

Determining Loss on Purchase Commitments. We may from time-to-time enter into purchase commitments that commit us to the purchase of certain products and services. We periodically evaluate, based on market conditions, product plans and other factors, the future benefit of these purchase commitments. If it is determined that the purchase commitments do not have a future benefit, then a reserve is established for the amount of the commitment in excess of the estimated future benefit. Significant judgments and estimates must be made to determine such reserves.

Table of Contents**Revenue by Segment**

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

	2006	Change	2005	Change	2004
Consumer products and services	\$ 322,772	15%	\$ 279,964	28%	\$ 218,343
Technology products and solutions	72,489	61	45,095	(7)	48,376
Total net revenue	\$ 395,261	22%	\$ 325,059	22%	\$ 266,719

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

	2006	2005	2004
Consumer products and services	82%	86%	82%
Technology products and solutions	18	14	18
Total net revenue	100%	100%	100%

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

Consumer Products and Services revenue increased 15% in 2006 due primarily to: (1) increased sales of individual games driven by our acquisition of Zylom and through RealArcade; (2) growth in subscribers and related revenue for our Rhapsody subscription service; (3) increased advertising revenue from our music websites; and (4) distribution of third-party products. Overall growth was partly offset by a decline in media software and services revenue. Additional factors contributing to the changes are discussed below in the sections included within Consumer Products and Services revenue. We believe the growth in our music and games subscription services is due in part to the continued shift in our marketing and promotional efforts to these services as well as product improvements and increasing consumer acceptance and adoption of digital media products and services. While revenue related to our Consumer Products and Services continues to grow, the rate of growth was slower compared to 28% growth from 2004 to 2005. We cannot predict with accuracy how these subscription offerings will perform in the future, at what rate digital media subscription service revenue and subscribers will grow, if at all, or the nature or potential impact of anticipated competition.

Consumer Products and Services revenue increased 28% in 2005 due primarily to: (1) growth in subscribers and related revenue for our subscription services, including Rhapsody, RadioPass, and GamePass; (2) increased sales of individual tracks through our Rhapsody music subscription services and our RealPlayer music store; and (3) increased sales of individual games.

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

Table of Contents

Technology Products and Solutions revenue increased 61% in 2006 due primarily to our acquisition of WiderThan during the fourth quarter of 2006 representing 7% of net revenue. We expect WiderThan to contribute significantly to the Technology Products and Solutions segment in future periods in terms of revenue and as a percentage of total segment revenue. We believe that sales of certain of our business software products will continue to be substantially affected by Microsoft's continuing practice of bundling its competing Windows Media Player and server software for free with its Windows operating system products. No assurance can be given when, or if, we will experience increased sales of our Technology Products and Solutions to customers in these markets.

Technology Products and Solutions revenue decreased 7% in 2005 due primarily to a decrease in the revenue recognized related to the expiration of a legacy system software agreement and a decrease in sales of our system software to mobile and wireless infrastructure companies. This decrease was partially offset by an increase in sales of our system software to OEM customers.

Consumer Products and Services Revenue

A further analysis of our consumer products and services revenue is as follows (dollars in thousands):

	2006	Change	2005	Change	2004
Music	\$ 123,033	21%	\$ 101,769	49%	\$ 68,190
Media software and services	113,503	(7)	121,918	5	115,618
Games	86,236	53	56,277	63	34,535
Total consumer products and services revenue	\$ 322,772	15%	\$ 279,964	28%	\$ 218,343

Music. Music revenue primarily includes revenue from: our Rhapsody and RadioPass subscription services; sales of digital music content through our Rhapsody service and our RealPlayer music store; and advertising from our music websites. Music revenue increased by 21% in 2006 due primarily to: (1) growth in subscribers to our Rhapsody subscription service; (2) continued growth in the online sale of individual tracks through our Rhapsody subscription service and through our RealPlayer Music Store; (3) increase in advertising revenue; and (4) the distribution of our radio products through broadband service providers. We believe the continued growth of our Music revenue during 2006 is due primarily to the broader acceptance of paid online music services and increased focus of our marketing efforts on our music offerings.

Music revenue increased 49% in 2005 due primarily to: (1) growth in subscribers to our Rhapsody and RadioPass subscription services; (2) the online sale of individual tracks through our Rhapsody subscription service and through our RealPlayer Music Store (sales through our RealPlayer Music Store began during the quarter ended March 31, 2004); and (3) the distribution of our radio products through broadband service providers.

Media Software and Services. Media Software and Services revenue primarily includes revenue from: our SuperPass and stand-alone premium video subscription services; RealPlayer Plus and related products; sales and distribution of third-party software products; and all advertising other than that related directly to our Music and Games businesses. Media Software and Services revenue decreased 7% in 2006 due primarily to a decline in revenue from: (1) SuperPass subscription service; and (2) stand-alone subscriptions. This decrease was partially offset by growth in distribution of third-party products and advertising revenue.

Media Software and Services revenue increased by 5% in 2005 due primarily to: (1) increased revenue related to advertising through our websites; and (2) an increase in revenue associated with new and expanded advertising and distribution relationships, including our agreement with Google to distribute a version of the Google toolbar.

Games. Games revenue primarily includes revenue from: the sale of individual games through our RealArcade service and our games related websites including GameHouse, Mr. Goodliving (acquired in May 2005) and Zylom (acquired in January 2006); our GamePass subscription service; and advertising through

Table of Contents

RealArcade and our games related websites. Games revenue increased 53% in 2006 due primarily to: (1) increased sales of individual games through our RealArcade service and our websites, including Zylom; (2) growth in the number of subscribers to our GamePass and FunPass subscription services and related revenue; and (3) increased advertising on our Games related web properties. Additionally, we believe the increased focus of our marketing efforts on our Games business and the addition of new game titles to our RealArcade and GamePass offerings contributed to the growth in our Games business.

Games revenue increased 63% in 2005 due primarily to: (1) growth in subscribers to our GamePass subscription service and price increases introduced during the quarter ended March 31, 2005; (2) increased revenue related to our GameHouse product offerings (acquired in January 2004); (3) increased revenue related to the sale of individual games through our RealArcade service and our websites; and (4) increased revenue from the sale of games for mobile phones.

Geographic Revenue

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

	2006	Change	2005	Change	2004
United States	\$ 283,433	13%	\$ 249,855	23%	\$ 202,574
Europe	62,270	39	44,867	12	40,222
Asia	46,291	66	27,916	30	21,439
Rest of the World	3,267	35	2,421	(3)	2,484
Total	\$ 395,261	22%	\$ 325,059	22%	\$ 266,719

Revenue generated in the U.S. increased 13% during 2006 due primarily to the growth of our Music and Games businesses and increased revenue from distribution of third-party products. See Consumer Products and Services Revenue *Games* and *Music* above for further discussion of the changes.

Revenue generated in the U.S. increased 23% in 2005 due primarily to the growth of our Music and Games businesses and increased revenue from distribution of third-party services. See Consumer Products and Services Revenue *Games* and *Music* above for further discussion of the changes.

Revenue generated in Europe increased 39% in 2006 due primarily to the continued growth of our games business driven primarily by additional revenue from our Mr. Goodliving and Zylom product offerings subsequent to our acquisitions in 2005 and 2006, respectively. This increase was partially offset by a decrease in subscribers to our SuperPass subscription service in Europe. Revenue generated in Asia and in the Rest of the World increased due primarily to our acquisition of WiderThan in October 2006. The increase in Asia and Rest of the World revenue for 2006 was partially offset by a decrease in revenue from our SuperPass subscription service due to a decrease in subscribers.

At December 31, 2006, accounts receivable from one international customer accounted for 25% of trade accounts receivable. No single customer accounted for more than 10% of trade accounts receivable at December 31, 2005. The increase in international accounts receivable as a percentage of trade accounts receivables primarily resulted from the acquisition of WiderThan.

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

Table of Contents**Revenue**

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

	2006	Change	2005	Change	2004
License fees	\$ 90,684	12%	\$ 80,785	13%	\$ 71,706
Service revenue	304,577	25	244,274	25	195,013
Total net revenue	\$ 395,261	22%	\$ 325,059	22%	\$ 266,719

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

	2006	2005	2004
License fees	23%	25%	27%
Service revenue	77	75	73
Total net revenue	100%	100%	100%

License Fees. License fees primarily include revenue from: sales of content such as game downloads and digital music tracks; sales of our media delivery system software; sales of premium versions of our RealPlayer Plus and related products; and sales of third-party products. License fees include revenue from both our Consumer Products and Services and Technology Products and Solutions segments. The 12% increase in license fees in 2006 was due primarily to an increase in revenue from the sale of individual games through our RealArcade service and our websites, including Zylom (acquired in January 2006). In addition, license fee revenue increased due to the sale of individual games for mobile phones, primarily through our Mr. Goodliving (acquired in May 2005) product offerings and the online sale of individual tracks through our Rhapsody music subscription service, and our RealPlayer Music Store. The increase in license fees revenue was partially offset by a decrease in sales of our system software. See Revenue by Segment Consumer Products and Services and Revenue by Segment Technology Products and Solutions above for further explanation of changes.

The 13% increase in license fees in 2005 was due primarily to: (1) increased revenue from the online sale of individual tracks through our Rhapsody music subscription service and our RealPlayer Music Store; (2) increased revenue related to the sale of individual games through our RealArcade service and our websites, including GameHouse; and (3) revenue from the sale of individual games for mobile phones. These increases were partially offset by a decrease in revenue related to the expiration of a legacy system software agreement in July 2005, a decrease in sales of our system software to mobile and wireless infrastructure companies, as well as decreased sales of certain of our premium and third-party consumer license products.

Service Revenue. Service revenue primarily includes revenue from: digital media subscription services such as SuperPass, Rhapsody, RadioPass, GamePass and stand-alone subscriptions; sales of our ringback tones, music-on-demand, video-on-demand, and messaging services that we sell to wireless carriers; support and maintenance services that we sell to customers who purchase our software products; broadcast hosting and consulting

services that we offer to our customers; distribution of third-party software; and advertising. Service revenue includes revenue from both our Consumer Products and Services and Technology Products and Solutions segments. The 25% increase in service revenue in 2006 was due primarily to an increase in revenue from: (1) the increase in the number of subscribers to certain of our music and games subscription services; (2) advertising through our web properties; (3) consulting services provided to certain of our corporate customers; (4) inclusion of revenue from WiderThan (acquired in October 2006); and (5) distribution of third-party products. These increases were partially offset by a decrease in revenue related to: (1) a decrease in the number of subscribers to our SuperPass subscription service; and (2) decreased sales of certain stand-alone subscription services. Our subscription services accounted for \$197.0 million and \$187.0 million of service revenue during 2006 and 2005, respectively. The increase in revenue related to our subscription services was primarily due to an increase in the number of subscribers to our Rhapsody and GamePass subscription services. These increases were partially offset by a decrease in revenue resulting from a decrease in the number of subscribers to our

Table of Contents

SuperPass and stand-alone subscription service. The increases in subscription revenue are discussed in more detail in Revenue by Segment – Consumer Products and Services – above.

The 25% increase in service revenue in 2005 was due primarily to: (1) growth in subscribers to our music and games subscription services; (2) increased revenue related to our SuperPass subscription service, due in part to a price increase in August 2004; (3) increases in the distribution of certain third-party services and the related revenue; and (4) growth in revenue related to advertising through our websites. These increases were partially offset by a decrease in revenue related to sales of stand-alone subscription services.

Deferred Revenue

Deferred revenue is comprised of unrecognized revenue related to unearned subscription services, support contracts, prepayments under OEM arrangements and other prepayments for which the earnings process has not been completed. Total deferred revenue at December 31, 2006 was \$27.6 million compared to \$25.3 million at December 31, 2005. The increase in deferred revenue was primarily due to the acquisition of WiderThan and an increase in prepayments for support and maintenance services related to certain of our server software products. This increase was partially offset by a decrease in the aggregate number of subscribers and the related prepayments for our SuperPass subscription service, a decrease in sales and related prepayments to standalone subscription services, and an overall decrease in prepayment receipts related to certain of our Technology Products and Solutions customers. The slower rate of prepayment receipts has been largely due to the decrease in the number of new contracts in our Technology Products and Solutions business segment in recent periods, which historically represented a significant portion of deferred revenue. We believe the decrease in the number of new contracts in our Technology Products and Solutions business segment results primarily from the conditions discussed in Revenue by Segment – Technology Products and Solutions – above.

Cost of Revenue by Segment

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

	2006	Change	2005	Change	2004
Consumer products and services	\$ 101,995	13%	\$ 90,104	7%	\$ 83,968
Technology products and solutions	22,113	172	8,145	(1)	8,239
Loss on content agreement				n/a	4,938
Total cost of revenue	\$ 124,108	26%	\$ 98,249	1%	\$ 97,145

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

	2006	2005	2004
Consumer products and services(1)	32%	32%	41%
Technology products and solutions	31	18	17
Total cost of revenue	31	30	36

- (1) Consumer Products and Services includes costs related to loss on content agreement during the year ended December 31, 2004.

Cost of Consumer Products and Services. Cost of Consumer Products and Services revenue consist primarily of cost of content and delivery of the content included in our digital media subscription service offerings; royalties paid on sales of games, music and other third-party products; amounts paid for licensed technology; costs of product media, duplication, manuals and packaging materials; hardware devices and accessories; and fees paid to third-party vendors for order fulfillment and support services. Cost of Consumer Products and Services increased 13% during 2006 due primarily to increased content and licensing costs related to increased sales of our music and games products and services. Cost of Consumer Products and Services revenue as a percentage of Consumer Products and Services revenue was 32% in both 2006 and 2005. Increased content and licensing costs related to increased sales of our music and games products and

Table of Contents

services were offset by lower royalties related to stand-alone subscriptions due to the decrease in related revenue and the discontinuation of certain content offerings.

Cost of Consumer Products and Services revenue increased 7% during 2005 due primarily to increased content and licensing costs related to increased sales of our music and games products and services. These increases were partially offset by decreases in costs related to: (1) the renegotiation of certain content agreements with more favorable terms and the discontinuation of certain content offerings related to our SuperPass subscription services; and (2) lower royalties related to stand-alone subscriptions due to the decrease in related revenue. Cost of Consumer Products and Services revenue decreased as a percentage of Consumer Products and Services revenue in 2005 to 32% from 38%, excluding loss on content agreement, in 2004 due to the application of certain fixed costs against a higher revenue base, the renegotiation of certain content agreements, lower royalties related to stand-alone subscriptions due to the decrease in related revenue, and the discontinuation of certain content offerings.

Cost of Technology Products and Solutions. Cost of Technology Products and Solutions revenue includes amounts paid for licensed technology, costs of product media, duplication, manuals, packaging materials, fees paid to third-party vendors for order fulfillment, cost of personnel providing support and consulting services, and expenses incurred in providing our streaming media hosting services. In 2006, cost of Technology Products and Solutions revenue increased 172% due primarily to the inclusion of costs of revenue of WiderThan. As a percentage of Technology Products and Solutions revenue, cost of Technology Products and Solutions increased to 31% in 2006 from 18% in 2005, due primarily to higher costs of revenue of WiderThan.

Cost of Technology Products and Solutions revenue decreased slightly in 2005 from 2004 due primarily to lower servicing costs, such as bandwidth, resulting from a decrease in related revenue. As a percentage of Technology Products and Solutions revenue, cost of Technology Products and Solutions revenue increased slightly to 18% in 2005 from 17% in 2004.

Cost of Revenue

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

	2006	Change	2005	Change	2004
License fees	\$ 37,089	10%	\$ 33,770	20%	\$ 28,206
Service revenue	87,019	35	64,479	1	64,001
Loss on content agreement				n/a	4,938
Total cost of revenue	\$ 124,108	26%	\$ 98,249	1%	\$ 97,145
As a percentage of total net revenue	31%		30%		36%

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

	2006	2005	2004
License fees(1)	41%	42%	46%
Service revenue	29	26	33

Total cost of revenue	31	30	36
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(1) Cost of license revenue includes costs related to loss on content agreement during the year ended December 31, 2004.

Cost of License Fees. Cost of license fees includes royalties paid on sales of games, music and other third-party products, amounts paid for licensed technology, amortization of acquired technology, costs of product media, duplication, manuals, packaging materials, and fees paid to third-party vendors for order fulfillment. Cost of license fees increased 10% due primarily to an increase in revenue and associated licensing costs related to games licensing. These increases were partially offset by a decrease in the amortization of

Table of Contents

other intangible assets related to the acquisition of GameHouse as these other intangibles are now fully amortized. Cost of license fees as a percentage of revenue decreased slightly to 41% in 2006 from 42% in 2005.

Cost of license fees increased in dollars and as a percentage of license fees to 42% in 2005 from 39%, excluding loss on content agreement, in 2004, due primarily to: (1) the online sale of individual tracks through our Rhapsody subscription service and RealPlayer Music Store; and (2) an increase in revenue and associated licensing costs related to games licensing. These increases were partially offset by a decrease in revenue associated with licensing related to third-party products.

Cost of Service Revenue. Cost of service revenue includes the cost of content and delivery of the content included in our digital media subscription and mobile service offerings, cost of in-house and contract personnel providing support, amortization of acquired technology, and consulting services, royalties, and expenses incurred in providing our streaming media hosting services. Content costs are expensed over the period the content is available to our subscription services customers. Cost of service revenue increased in dollars and as a percentage of service revenue, which increased to 29% in 2006 from 26% in 2005, due primarily to: (1) the costs of service revenue related to the acquisition of WiderThan; and (2) increased content costs related to our digital music subscription services. The increase in costs was partly offset by: (1) the discontinuation of certain content offerings related to our SuperPass subscription service; and (2) a decrease in sales and the discontinuation of certain stand-alone subscription services. The increase in cost of service revenue as a percentage of service revenue is due to higher costs associated with the WiderThan mobile service offerings and the amortization of technology capitalized in the acquisition of WiderThan.

Cost of service revenue increased slightly, but decreased as a percentage of service revenue to 26% in 2005 from 33% in 2004, due primarily to increased content costs related to our digital music subscription services. The increase in costs was largely offset by: (1) the discontinuation of certain content offerings related to our SuperPass subscription service; and (2) a decrease in sales and the discontinuation of certain stand-alone subscription services. The decrease in cost of service revenue as a percentage of service revenue is due to the application of certain fixed costs against a higher revenue base and the discontinuation of certain product offerings.

Our digital media subscription services, including Rhapsody, are a relatively new and growing portion of our business and, to date, have been characterized by higher costs of revenue than our other products and services, due primarily to the cost of licensing media content to provide these services. As a result, if our digital media subscription services continue to grow as a percentage of net revenue, our cost of service revenue may grow at an increased rate relative to net revenue, which may result in reductions in our gross margin percentages in the future.

Loss on Content Agreement. During the quarter ended March 31, 2004, we cancelled a content licensing agreement with PGA TOUR. Under the terms of the cancellation agreement, we gave up rights to use and ceased using PGA TOUR content in our products and services as of March 31, 2004. The expense represents the estimated fair value of payments to be made in accordance with the terms of the cancellation agreement. All payments under the cancellation agreement were made as of December 31, 2005.

Other segment and geographical information

Operating expenses of both Consumer Products and Services and Technology Products and Solutions include costs directly attributable to those segments and an allocation of general and administrative and other corporate overhead costs based on the relative head count of each segment.

Table of Contents

Reconciliation of segment operating income (loss) to income (loss) before income taxes for the year ended December 31, 2006 is as follows (in thousands):

	Consumer Products and Services	Technology Products and Solutions	Reconciling Amounts	Consolidated
Net revenue	\$ 322,772	\$ 72,489	\$	\$ 395,261
Cost of revenue	101,995	22,113		124,108
Gross profit	220,777	50,376		271,153
Loss on excess office facilities			738	738
Antitrust litigation income, net			(220,410)	(220,410)
Other operating expenses	242,385	57,935		300,320
Operating income (loss)	(21,608)	(7,559)	219,672	190,505
Other income, net			37,248	37,248
Income (loss) before income taxes	\$ (21,608)	\$ (7,559)	\$ 256,920	\$ 227,753

Reconciliation of segment operating income (loss) to income (loss) before income taxes for the year ended December 31, 2005 is as follows (in thousands):

	Consumer Products and Services	Technology Products and Solutions	Reconciling Amounts	Consolidated
Net revenue	\$ 279,964	\$ 45,095	\$	\$ 325,059
Cost of revenue	90,104	8,145		98,249
Gross profit	189,860	36,950		226,810
Antitrust litigation income, net			(422,500)	(422,500)
Other operating expenses	197,902	54,041		251,943
Operating income (loss)	(8,042)	(17,091)	422,500	397,367
Other income, net			32,176	32,176
Income (loss) before income taxes	\$ (8,042)	\$ (17,091)	\$ 454,676	\$ 429,543

Reconciliation of segment operating income (loss) to income (loss) before income taxes for the year ended December 31, 2004 is as follows (in thousands):

Consumer Products	Technology Products	Reconciling
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	and Services	and Solutions	Amounts	Consolidated
Net revenue	\$ 218,343	\$ 48,376	\$	\$ 266,719
Cost of revenue				