REALNETWORKS INC
Form 10-K
March 16, 2011
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year Ended December 31, 2010

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number 0-23137

RealNetworks, Inc.

(Exact name of registrant as specified in its charter)

Washington	**91-1628146**
(State of incorporation)	*(I.R.S. Employer Identification Number)*
2601 Elliott Avenue, Suite 1000 **Seattle, Washington**	**98121**
(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number, including area code:

(206) 674-2700

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, Par Value $0.001 per share	The NASDAQ Stock Market LLC
Preferred Share Purchase Rights	The NASDAQ Stock Market LLC

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 þ

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 þ

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

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

Indicate by check mark 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. þ

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

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

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

The aggregate market value of the Common Stock held by non-affiliates of the registrant was $278,119,195 on June 30, 2010, based on the closing price of the Common Stock on that date, as reported on the Nasdaq Global Select Market.(1)

The number of shares of the registrant s Common Stock outstanding as of March 14, 2011 was 136,360,266.

DOCUMENTS INCORPORATED BY REFERENCE

The registrant has incorporated by reference the information required by Part III of this Annual Report from its Proxy Statement relating to its 2011 Annual Meeting of Shareholders, to be filed within 120 days after the end of its fiscal year ended December 31, 2010.

(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.

Table of Contents

TABLE OF CONTENTS

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

- *future revenues, operating expenses, income and other taxes, tax benefits, net income (loss) per diluted share available to common shareholders, acquisition costs and related amortization, and other measures of results of operations;*
- *the effects of our past acquisitions and expectations for future acquisitions;*
- *plans, strategies and expected opportunities for future growth, increased profitability and innovation;*
- *the prospects for creation and growth of strategic partnerships and the resulting financial benefits from such partnerships;*
- *the expected financial position, performance, growth and profitability of our businesses and the availability of resources;*
- *our involvement in potential claims and legal proceedings, the expected course and costs of existing claims and legal proceedings, and the potential outcomes and effects of both existing and potential claims and legal proceedings on our business, prospects, financial condition or results of operations;*
- *our intention to separate our Games business;*
- *the expected benefits and other consequences from restructuring Rhapsody and from our other strategic initiatives;*
- *our expected introduction of new products and services across our businesses, including Unifi, a personal media cloud service we intend to launch in 2011;*
- *the effects of legislation, regulations, administrative proceedings, court rulings, settlement negotiations and other factors that may impact our businesses;*
- *the continuation and expected nature of certain customer relationships;*
- *impacts of competition and certain customer relationships on the future financial performance and growth of our businesses;*

the effects of U.S. and foreign income and other taxes on our business, prospects, financial condition or results of operations; and

the effect of economic and market conditions on our business, prospects, financial condition or results of operations.

These statements are not guarantees of future performance and actual actions or results may differ materially. These statements are subject to certain risks, uncertainties and assumptions that are difficult to predict, including those noted in the documents incorporated herein by reference. Particular attention should also be paid to the cautionary language included or referred to 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 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 creates innovative applications and services that make it easy to connect with and enjoy digital media. We intend to capitalize on the growth of mobile devices and computing by creating applications and services that simplify the way people connect with, use and enjoy their media in a mobile, multi-screen world that embraces a variety of technology and devices. We provide the digital media services and applications we create to consumers, mobile carriers and other businesses.

Consumers use our services and software to find, purchase, store, organize, play and manage music, games and video. Our consumer products and services include RealPlayer, a widely distributed media player; casual games for play on the Internet and social media sites and for purchase on personal computers and mobile phones; and SuperPass, a subscription service that provides access to a wide variety of digital media. In 2011 we will be launching Unifi, a personal Web-based service, that operates as a universal library for users of digital content, enabling consumers to organize, access and share their digital media from their Internet-connected devices. Network service providers, such as mobile carriers, use our products and services to create and deliver digital media and messaging services, such as ringback tones, music-on-demand, video-on-demand and intercarrier messaging, for their subscribers.

During 2010, we implemented a significant restructuring of our business. As part of these activities, effective March 31, 2010, we completed a restructuring of our Rhapsody joint venture, which we formed in 2007 with MTV Networks, a division of Viacom International Inc (MTVN). In connection with the restructuring, Rhapsody was converted from a limited liability company to a corporation, and our equity ownership in Rhapsody was reduced from 51% to approximately 47%. Because we no longer control Rhapsody following the restructuring, beginning April 1, 2010, Rhapsody s operating results are no longer consolidated with our consolidated financial statements.

As of July 1, 2010, we also reorganized the management of our businesses and product lines. Due to this reorganization, beginning with the third quarter of 2010, we manage our business and report segment revenue and profit (loss) in three segments: (1) Core Products, (2) Emerging Products and (3) Games. See additional information regarding these reporting segments under Segments below. We also report financial results from our former Music segment, which primarily includes financial results and operating performance of our Rhapsody joint venture, on a historical basis only. In addition, we report common corporate overhead expenses, including but not limited to finance, legal, headquarters facilities and stock compensation costs, in the aggregate as Corporate results. To be consistent with the new segments, we have reclassified corresponding items of segment information for prior periods, as set forth elsewhere in this report. During 2010, we also implemented other significant internal restructuring measures, including reductions in personnel and facilities and the discontinuance or de-emphasis of certain unprofitable products and services offerings, which together contributed to a significant reduction of our operating costs compared with the year ended December 31, 2009.

We have expressed our intent to separate our casual games business from the rest of our businesses and, during the year, we continued to make progress on that separation. No timetable has been set for the separation and we have not determined the optimal structure of the separated Games business, including whether we will retain control of the business or enter into a strategic transaction involving the business. In the meantime, we have focused our Games strategy on building our social games capabilities as well as stabilizing and building our online subscription and advertising-supported games businesses.

We were incorporated in 1994 in the State of Washington. Our common stock is listed on the Nasdaq Global Select Market under the symbol RNWK.

Segments

Core Products

Core Products, our largest segment by revenue, consists of the digital media services we provide to network service providers as software as a service (SaaS) offerings, sales of our Helix software used by enterprises to stream digital media, sales of Helix technology licenses for mobile handsets that allow playback of digital media,

Table of Contents

software integration and professional services provided to mobile carriers around the world as well as our SuperPass subscription service offering.

SaaS. We develop and provide a variety of SaaS services including ring-back tone (RBT), music-on-demand (MOD), video-on-demand (VOD) and messaging services principally sold to mobile carriers. Our Saas services generated the most revenue within our Core Products segment in 2010. In connection with our SaaS services, we also offer e-commerce services, including business intelligence, subscriber management and billing for our carrier customers. We have created a converged platform that allows us to operate both the technology for delivering digital media services and e-commerce storefront and editorial services functions for our customers. Our carrier customer base includes more than 90 mobile carriers worldwide in 2010.

Our RBT services enable callers to hear music instead of the traditional electronic ringing sound while waiting for the person they have called to answer. The RBT subscriber chooses the music heard by the subscriber s callers. Our RBT services enable subscribers to select from a variety of ringback content, including music, pre-recorded messages by celebrities and sound effects. Carriers generally offer our RBT service to their subscribers through monthly subscriptions or on a per-tone basis. In return for providing, operating and managing the RBT service for carrier customers, we generally enter into revenue-sharing arrangements based on monthly subscription fees, content download fees or a combination of such fees paid by subscribers.

Our MOD services allow carriers to offer their subscribers a wide range of songs for downloading or streaming to PCs, mobile phones and portable audio players. Users typically pay carriers for MOD service through monthly subscriptions or on a per-download basis, and we generally receive from the carriers a combination of a monthly fixed fee, a percentage of monthly subscription fees and a percentage of content download fees for providing the service.

Our VOD services allow carriers to offer their subscribers a wide range of videos 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 content download fees paid to the carriers, and we generally receive a combination of a monthly fixed fee, a percentage of monthly subscription fees and a percentage of content download fees for providing the service.

Our inter-carrier messaging (ICM) service routes and delivers short messaging service (SMS) messages between wireless carriers within the U.S. and internationally under the brand name Metcalf. We provide this service to carriers in partnership with Syniverse Holdings, Inc. The ICM service allows subscribers with any text-message capable handset to send and receive text messages to and from subscribers on other carrier 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 our revenue-sharing arrangement with Syniverse.

Software licensing. Our Helix server software allows companies and institutions to broadcast live and on-demand audio, video and other multimedia programming to large numbers of simultaneous users over the Internet. Carriers, media companies and other enterprises typically pay upfront fees for either a perpetual or term-based license plus annual fees for upgrades and support.

In addition, we have created enhanced versions of our media player and Helix server products for wireless applications and other devices, and we license them to a variety of mobile network operators and handset manufacturers on a worldwide basis. We have entered into agreements with companies including Motorola, Nokia, Qualcomm, and Sony Ericsson, to preinstall our mobile media player software on mobile phones.

Professional services and systems integration. We provide professional services and specialized technical support to customize and integrate our technology with our customers existing systems and technology. In recent years we have reduced our focus on our systems integration business because it has lower margins and does not generate recurring revenue. However, revenue from this business has been a significant contributor to Core Products revenue in the fourth quarter of each year for the past five years.

*SuperPas*s. SuperPass is a subscription service that provides consumers with access to a broad range of digital entertainment content for a monthly fee. In addition, our SuperPass subscription service includes exclusive live video feeds from the CBS television network s *Big Brother* program and a monthly allowance for games and music downloads.

Table of Contents

Emerging Products

Our emerging products business consists of RealPlayer and new products and services in development, including Unifi, which we began developing in 2010 and will be launching in 2011. In 2010, nearly all revenue in the segment was derived from product and services related to the RealPlayer.

RealPlayer. Our RealPlayer media player software includes features and services that enable consumers to discover, play, download, manage and edit digital video. Consumers can also use RealPlayer to stream audio and video, save CDs to their personal digital music libraries, burn CDs and transfer their audio and video content to portable devices. With the latest versions of our RealPlayer software, consumers can download and save their photos and web videos from thousands of websites, and transfer their photos and video content to and from portable devices. Consumers can also easily share photos and video links with their contacts on social networks and edit their own video content. RealPlayer is available to consumers as a free download from our Real.com and RealPlayer.com websites. A premium version of RealPlayer, which is available for purchase, includes enhanced functionality for creating CDs and DVDs, enhanced playback controls and additional media library features. We monetize RealPlayer primarily with revenue derived from sales of the premium version, and from distributing third-party software products, such as the Google toolbar and Google Chrome, to consumers who wish to download additional applications when downloading our software products.

In recent years, our RealPlayer strategy has focused on providing consumers with tools to manage their digital media content in a variety of formats across devices rather than creating a unique streaming platform and depending upon the adoption and use of the RealPlayer file format. As a result, RealPlayer s video downloading tools, for example, work on nearly any platform and play nearly all major digital media formats.

Unifi. Unifi is a personal media cloud service we will launch in 2011. This service will allow consumers to easily organize and access all of their personal digital media from any network-enabled device by automatically cataloging the photos, music and videos stored on users devices and through their social network and other third party service accounts. We plan to distribute this service by leveraging our worldwide user base established through our RealPlayer and casual games offerings as well as our relationships with our carrier customers.

Games

We own and operate a large casual games service, offering casual games via digital downloads, online subscription play, third-party portals, social networks and mobile devices. Casual games typically have simple graphics, rules and controls and are quick-to-learn. Casual games include board, card, puzzle, word and hidden-object games.

We develop, publish, license and distribute casual games. We have a large and diverse portfolio of original games developed by our in-house game studios, games developed by us from content we license from other intellectual property holders, and games licensed to us by third parties that we distribute to our customers. We also partner with external game developers who develop games for us on an outsourced basis, which gives those developers access to our large distribution network in exchange for distribution rights to their games. We distribute games principally in North America, Europe and Latin America through our GameHouse, Zylom and Atrativa websites and through websites owned or managed by third parties.

PC and Mobile Games. Consumers can play and purchase games from our catalog of online and downloadable PC games. We typically introduce new games by offering a free trial before purchase on an individual basis or as part of one of our subscription services. In addition to revenue from sales of games and subscriptions, we generate revenue from display advertising that is shown to consumers during online play. We have also adapted our games for play on more than 2,000 mobile handsets and launched several games for play on smartphones, including the iPhone.

Social Games. Game play on social networks is among the fastest growing trends in game play, and we have increased our focus on this segment. In 2010, we began developing and launched Fusion, a gaming platform that introduces social elements to game play to increase interactions and competition among players, such as leaderboards, cross-device play, microtransactions and chatrooms. In addition, we acquired a small social games company that we expect will help us develop, monetize and optimize social games and social game play experiences. We offer several of our casual games, including licensed brands UNO and Collapse, on Facebook and other social network platforms. We monetize social games largely through sales of advertising and microtransactions.

Music

Following the restructuring of our Rhapsody joint venture, we no longer operate our former Music business. Rhapsody continues to provide products and services that enable consumers to have unlimited access to digital music content anytime from a variety of devices. The Rhapsody subscription service offers conditional downloads and on-demand streaming services through unlimited access to a catalog of millions of music tracks. Rhapsody also operates an MP3 music store, where consumers can purchase and permanently download individual digital music tracks. Rhapsody generates revenue in the U.S. primarily through subscriptions to its music services, and sales of tracks and advertising.

Research and Development

We devote a substantial portion of our resources to developing new products, enhancing existing products, expanding and improving our fundamental technology, and strengthening our technological expertise in all our businesses. During the years ended December 31, 2010, 2009 and 2008, we expended 25%, 21% and 19%, respectively, of our 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 43%, 33% and 33% of our revenue during the years ended December 31, 2010, 2009 and 2008, respectively. No one customer accounted for more than 10% of our total revenue during the years ended December 31, 2010, 2009 and 2008.

We experience 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, our Core Products business typically has a concentration of system sales, deployment, and professional services 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 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, direct mail and email offers to qualified potential and existing customers, and providing product specific information through our websites. We also cross-market products and services offered by some of our businesses through the RealPlayer and Games marketing and distribution channels. We also have subsidiaries and offices in several countries that market and sell our products outside the U.S.

Our products and services are marketed through direct and indirect channels. We use public relations, trade shows, events and speaking opportunities to market our products and services. We also use a variety of online channels, including social media, to promote and sell our products and services directly.

Core Products. Our Core Products 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 the product and marketing divisions of our customers, we tailor our SaaS offerings to their strategic needs and the needs of their subscribers. A large network of distributors including hardware server companies, content aggregators, Internet service providers and other resellers, provide end users access to our Helix streaming technology.

Table of Contents

Emerging Products. We market and sell our RealPlayer services directly through our own websites such as Real.com and GameHouse.com, as well as indirectly through affiliate partnerships. We also have a global sales force that generates advertising revenue from our websites and free consumer applications such as RealPlayer.

Games. Our games are marketed directly from our websites and through third-party distribution channels, such as broadband service providers, search engines, online portals, mobile phone application stores, major social networks and content publishers.

Customer Support

Customer support is integral to the provision of nearly all of our consumer products and services. Consumers who purchase and use our consumer software products and services, including games and RealPlayer Plus, can get assistance via the Internet, email or telephone, depending on the product or service. For most of our consumer products, 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 or significantly greater resources than we do.

Core Products

SaaS. We compete with a large and diverse number of domestic and international companies in our SaaS business, and each of our SaaS offerings tends to face competitors specific to that product or service. The market for the SaaS services we offer has become increasingly competitive due in part to the proliferation of smartphones that has resulted in the introduction of a number of services and applications that are made available to consumers with no dependency on mobile carriers. We compete largely based on time-to-market, feature sets, ease of use, operational expertise, our ability to offer an integrated suite of entertainment services, customer care and price. Many of our SaaS services require a high degree of integration with carrier or service provider networks and thus require a high degree of operational expertise. In addition, our ability to enhance services with new features as the digital entertainment market evolves is critical to our competitive position, as is our knowledge of the consumer environment to which these services are targeted.

Software Licensing. We believe that the primary competitive factors in the digital-media delivery and licensing market include the quality, reliability, price and licensing terms of the overall media delivery solution, ubiquitous and easy consumer accessibility to media playback capability, broad distribution and use of products, and the ability to license and support popular and emerging media formats for digital media delivery. Our competitors in the market for digital media servers, players, encoders, digital rights management, codecs and other technology and services related to digital distribution of media include Adobe, Apple and Microsoft.

SuperPass. Our SuperPass subscription service faces competition from a large number of existing competitive alternatives and other emerging services and technologies. We face significant competition from emerging Internet media sources and established companies entering into the Internet media content market as well as broadband Internet service providers, many of which provide similar or alternative services for free or bundle these types of services with other offerings. In addition, our overall ability to sell SuperPass depends in part on the use of our formats on the Internet, which has declined in recent periods, and access to premium content on commercially acceptable terms.

Table of Contents

Emerging Products

RealPlayer. We expect competition for media player users to continue to be intense as the markets and business models for Internet video content mature and more competitors enter these markets. RealPlayer competes with alternative streaming media playback technologies such as Microsoft Windows Media Player and Adobe Flash and their related file formats, each of which has obtained very broad market penetration. Our video and photo transfer services within RealPlayer 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.

Games

Our Games business competes with a variety of distributors, publishers and developers of casual games for the PC and mobile platforms and for social networks. We compete in this market primarily on the basis of the quality and convenience of our services, the reach and quality of our distribution and the quality and breadth of our game catalog. In addition, the market for casual games has become increasingly price competitive in recent years. Our in-house content development studios compete with other developers and publishers of downloadable PC and mobile games. Our studios compete based on our ability to develop and publish high quality games that resonate with consumers, our effectiveness at building our brands, our ability to license and execute digital games based on popular third-party intellectual properties like Monopoly, Scrabble and UNO, and our ability to secure broad distribution relationships with major social networks and mobile carriers. Our family of websites serving the PC casual games market competes with other high volume distribution channels for downloadable, online and social games including Yahoo! Games, MSN Gamezone, Pogo.com, Big Fish Games, PopCap Games, Inc., and Amazon.com.

Intellectual Property

As of December 31, 2010, we had 86 U.S. patents, 72 South Korean patents, 37 patents in other countries and more than 200 pending patent applications worldwide 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, 2010, we had 52 registered U.S. trademarks or service marks, 30 registered 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. Many of our marks begin with the word Real (such as RealPlayer). 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.

Our ability to compete across our businesses partly depends on the superiority, uniqueness and value of our patent portfolio and other technology that we both develop and license 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. 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, 2010, we had 1,319 full-time employees and 209 part-time and contingent employees, of which 827 were based in the Americas, 457 were based in Asia, and 244 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.

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

Table of Contents

manages a substantial portion of 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.investor.realnetworks.com our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. However, the information found on our corporate website is not part of this or any other report.

Executive Officers of the Registrant

The table below lists the executive officers of RealNetworks as of March 1, 2011.

Name	Age	Position
Robert Kimball	47	President, Chief Executive Officer and Director
Michael Eggers	39	Senior Vice President, Finance, Chief Financial Officer and Treasurer
Tracy D. Daw	45	Chief Legal Officer and Corporate Secretary
Matt Hulett	40	Senior Vice President, Games Division
Michael Lunsford	43	Executive Vice President, Music, Media and Technology Solutions
Henry (Hank) Skorny	46	Senior Vice President and Chief Strategy Officer

ROBERT KIMBALL has served as President and Chief Executive Officer of RealNetworks since July 2010, and served as President and Acting Chief Executive Officer from January 2010 to July 2010. Mr. Kimball has also served as a director of RealNetworks since January 2010. Mr. Kimball joined RealNetworks in 1999 and has held various positions including Executive Vice President, Legal and Business Affairs, General Counsel and Corporate Secretary from January 2009 to January 2010 and Senior Vice President, Legal and Business Affairs, General Counsel and Corporate Secretary from January 2005 to January 2009. 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.

MICHAEL EGGERS has served as Senior Vice President, Chief Financial Officer and Treasurer of RealNetworks since February 2006. Mr. Eggers served as Vice President of Finance from September 2003 to February 2006. Mr. Eggers joined RealNetworks in 1997 as the Manager of Financial Reporting and has held various positions leading to his appointment as Vice President of Finance. Prior to RealNetworks, Mr. Eggers was employed by KPMG LLP 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.

TRACY D. DAW has served as Chief Legal Officer of RealNetworks since September 2010 and as Corporate Secretary since January 2010. Mr. Daw joined RealNetworks in 2000 and has held various positions with the Company, including Vice President, Corporate Development and Deputy General Counsel from January 2007 to September 2010 and Vice President, Corporate Development and Associate General Counsel from May 2006 to January 2007. Prior to joining RealNetworks, Mr. Daw was a partner in the law firm of Sidley & Austin in Chicago, Illinois. Mr. Daw holds a B.S. from Cornell University and a J.D. from the University of Michigan Law School.

MATT HULETT has served as the Senior Vice President of the Games Division of RealNetworks since July 2010 and served as Chief Revenue Officer of the Games Division from August 2009 to July 2010. From June 2006 to August 2009, Mr. Hulett was the Chairman and Chief Executive Officer of Mpire Corporation, a company engaged in online advertising optimization, and continues to serve as its Executive Chairman. From 2001 to 2005, Mr. Hulett was the President of the corporate travel division of Expedia, Inc., an online travel company. From 1999 to 2001, Mr. Hulett was President of Atom Entertainment, Inc., an online entertainment company. Mr. Hulett holds a B.A. degree in Marketing, Information Systems from the University of Washington.

Table of Contents

MICHAEL LUNSFORD has served as an Executive Vice President, Music, Media and Technology Solutions of RealNetworks since June 2010. Mr. Lunsford joined RealNetworks in 2008 and served as Executive Vice President, Technology Products and Solutions and Media Software and Services from January 2010 to June 2010 and Executive Vice President, Strategic Ventures from June 2008 to January 2010. From 1999 to December 2007, Mr. Lunsford was employed by Earthlink, Incorporated, a provider of communications services, serving as Executive Vice President from June 2007 to December 2007, as interim President and Chief Executive Officer from November 2006 to June 2007, as Executive Vice President and President, Access and Voice from September 2005 to November 2006, and as Executive Vice President, Marketing and Products from 2004 to September 2005. Mr. Lunsford holds an A.B. in Economics and an M.B.A. from the University of North Carolina.

HANK SKORNY has served as the Senior Vice President and Chief Strategy Officer of RealNetworks since January 2011. Mr. Skorny joined RealNetworks as a strategic advisor in January 2009 and served as Senior Vice President, Media Cloud Computing and Services from October 2009 to January 2011. From May 2007 to December 2008, Mr. Skorny was involved in various private investment and consulting activities for mobile technology companies. From 2005 to April 2007, Mr. Skorny served as President, Chief Executive Officer and director of Thumbspeed Inc., a developer and publisher of mobile applications that was acquired by OZ Communications Inc. in April 2007. Mr. Skorny served as Executive Vice President of OZ Communications Inc., a developer of mobile Internet solutions, from April 2007 to March 2008. From 2004 to 2005, Mr. Skorny served as Vice President of Product Management and Marketing of Infospace Mobile, Inc., a developer of mobile media and search applications and services. Mr. Skorny serves as Chairman of the Board of Directors of ZipWhip, Inc., a company engaged in the development of Internet messaging technology. Mr. Skorny studied at Drexel University.

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.

We need to successfully introduce new products and services to grow our businesses.

Our business is dependent upon the introduction of new products and services, which is subject to a number of risks. The process of developing new, and enhancing existing, products and services is complex, costly and uncertain. Providing products and services that are attractive and useful to subscribers and consumers is in part subject to unpredictable and volatile factors beyond our control, including end-user preferences and competing products and services. Any failure by us to timely respond to or accurately anticipate consumers changing needs 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, which may result in no return or a loss on our investments. Furthermore, new products and services may be subject to legal challenge. Responding to these potential claims may require us to enter into royalty and licensing agreements on unfavorable terms, require us to stop distributing or selling, or to redesign our products or services, or to pay damages. If we do not successfully introduce new products and services, our operating results may be materially harmed.

The mobile entertainment market is evolving rapidly and highly competitive.

The market for mobile entertainment services, including RBT, MOD and VOD solutions, is highly competitive and evolving rapidly, particularly with the growth in the use of smartphones. Increased use of smartphones has resulted in a proliferation of applications and services that compete with our SaaS services and, in many cases, are not dependent upon our carrier customers to make them available to subscribers. To maintain or enhance our competitive position, we may need to develop new SaaS services that enable our carrier customers to compete with the broad range of applications and other services available in the market. We face competition, and may face future competition, from major media companies, Internet portal companies, content aggregators, wireless software providers and other pure-play wireless entertainment publishers, some of which have greater financial resources than we do. In addition, the major music labels may demand more aggressive revenue sharing arrangements or impose an alternative business model less favorable to us. Furthermore, while most of our carrier customers do not offer internally developed services that compete with ours, if our carrier customers begin developing these services internally, we could be forced to lower our prices or increase the amount of service we provide in order to maintain our business with those carrier customers. Increased competition has in the past resulted in pricing pressure, forcing us to lower the selling price of our services. If we are unable to develop or provide services that compete effectively in the mobile entertainment market, our operating results and financial condition may be materially harmed.

Contracts with our carrier customers subject us to significant risks that could negatively impact our revenue or otherwise harm our operating results.

We derive a material portion of our revenue from our SaaS offerings we provide to carriers. Many of our SaaS contracts with carriers provide for revenue sharing arrangements, but we have little control over the pricing decisions of our carrier customers. Furthermore, most of these contracts do not provide for guaranteed minimum payments or usage levels. Because most of our carrier customer contracts are nonexclusive, it is possible that our mobile carrier customers could purchase similar services from third parties and cease to use our services in the future. As a result, our revenue derived under these agreements could be substantially reduced depending on the pricing and usage decisions of our carrier customers. In addition, some of our SaaS contracts require us to incur significant set-up costs prior to the launch of services with a carrier customer. These costs, particularly if combined with significant or sustained declines in revenue from our SaaS contracts, could result in impairments of deferred project costs in future periods, which would negatively impact our results of operations.

In addition, none of our SaaS contracts with carriers obligates our carrier customers to market or distribute any of our SaaS offerings. Despite the lack of marketing commitments, revenue related to our SaaS offerings is, to a large extent, dependent upon the marketing and promotion activities of our carrier customers. In addition, many of our carrier contracts are short term and allow for early termination by the carrier with or without cause. These contracts are therefore subject to renegotiation of pricing or other key terms that could be adverse to our interests and leave us vulnerable to non-renewal by the carriers. The loss of carrier customers, a reduction in marketing or promotion of our SaaS offerings, or the termination, non-renewal or renegotiation of contract terms that are less favorable to us would likely result in the loss of future revenues from our SaaS offerings.

Finally, certain of our carrier contracts obligate us to indemnify the carrier customer for certain liabilities and losses incurred by them, including liabilities resulting from third party claims for damages that arise out of the use of our technology. These indemnification terms provide us with certain procedural safeguards, including the right to control the defense of the indemnified party. Pursuant to these indemnifications obligations, we have agreed to control the defense on behalf of two of our carrier customers related to a pending patent infringement proceeding, and we are vigorously defending them. This pending proceeding or future claims against which we may be obligated to defend our carrier customers could result in payments that could materially harm our operating results.

A majority of the revenue that we generate in our Core Products business segment is dependent upon our relationship with a few customers, including SK Telecom and Verizon; any deterioration of these relationships could materially harm our business.

We generate a significant portion of our revenue from sales of our mobile entertainment services to a few of our mobile carrier customers, including SK Telecom, a leading wireless carrier in South Korea. In the near term, we expect that we will continue to generate a significant portion of our total revenue from these customers, particularly SK Telecom and Verizon. If these customers fail to market or distribute our services or terminate their business contracts with us, or if our relationships with these customers deteriorate in any significant way, we may be unable to replace the affected business arrangements with acceptable alternatives. Furthermore, our relationship with SK Telecom may be affected by the general state of the economy of South Korea. Failure to maintain our relationships with these customers could have a material negative impact on our revenue and operating results.

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

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

- reduced prices or margins,
- loss of current and potential customers, or partners and potential partners who provide content we distribute to our customers,
- changes to our products, services, technologies, licenses or business practices or strategies,
- lengthened sales cycles,
- industry-wide changes in content distribution to customers,
- pressure to prematurely release products or product enhancements, or
- degradation in our stature or reputation in the market.

In addition, we face the following competitive risks relating to our businesses:

Our SuperPass subscription service faces competition from a broad variety of entertainment sources, including traditional media outlets and emerging Internet media sources. We expect this competition to continue to be intense as the market and business models for Internet video content mature and more competitors enter these new markets. Competing services may be able to obtain better or more favorable access to compelling video content than us, may develop better offerings than us and may be able to leverage other assets or technologies to promote or distribute their offerings successfully. Our RealPlayer software services compete with alternative streaming media playback technologies and audio and video formats including Microsoft Windows Media Player and Adobe Flash and their related file formats, each of which has obtained very broad market penetration. In addition, our overall ability to sell subscription services depends in part on the use of RealNetworks formats on the Internet, and declines in the use of our formats have negatively affected, and are expected to continue to negatively affect, our subscription revenue and increase costs of obtaining new subscribers. If we are unable to compete successfully, including through the introduction of compelling new products and services, our SuperPass and RealPlayer businesses could continue to decline.

Our RealArcade, GameHouse, Zylom and Atrativa branded services compete with other online aggregators and distributors of online, downloadable and social casual PC games. Some of these competitors have high volume distribution channels and greater financial resources than we do. Our Games business also competes with many other smaller companies that may be able to adjust to market conditions, including responding effectively to the growing popularity of casual games on social networks, faster than us. We also face increasing price competition in the casual games market, and some of our competitors may compete on price more aggressively than us. 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 achieve growth in our revenue. Our development studios compete primarily with other developers of online, downloadable, mobile and social casual PC games and must continue to develop popular and high-quality game titles and to execute on opportunities to expand the play of our games on a variety of non-PC platforms, including social networks, to maintain our competitive position and help grow our Games business.

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

Maintaining and growing the distribution of digital media products through our websites and our other distribution channels is important to our future prospects, including future growth through the introduction of new products and services distributed through these channels. We cannot predict whether consumers will continue to download and use our digital media products consistent with past usage, which may reduce our ability to generate revenue from those products as well as result in lower than expected adoption of newly introduced products and services. Our inability to maintain continued high volume distribution of our digital media products could also hold back the growth and development of related revenue streams from these market segments, including the distribution of third-party products and sales of our subscription services, and therefore could harm our business and our prospects. Our revenue from the distribution of third-party products will also be negatively impacted if those products are not widely downloaded by consumers, including due to the relative market saturation of such products. In addition, our revenue from the distribution of third party products is currently significantly dependent on a single customer contract. If that contract is not renewed or terminated and cannot be replaced by another similar customer contract, our financial results would be harmed.

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

The trading price for our common stock has been volatile, ranging from $2.59 to $5.41 per share during the 52-week period ended December 31, 2010. As a result of the rapidly changing markets in which we compete, our operating results may fluctuate from period-to-period, which may continue to contribute to the volatility of our stock price. In past periods, our operating results have been affected by personnel reductions and related charges, charges relating to losses on excess office facilities, and impairment charges for certain of our equity investments, goodwill and other long-lived assets. Our operating results may be adversely affected by similar or other charges or events in future periods, including, but not limited to:

- impairments of long-lived assets,
- integrating and operating newly acquired businesses and assets,
- the seasonality of our business, which has experienced increased revenues in the fourth quarter of our fiscal year, and
- the general difficulty in forecasting our operating results and metrics, which could result in actual results that differ significantly from expected results.

Certain of our 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. Fluctuations in our operating results, particularly when experienced beyond what we expected, could cause the trading price of our stock to continue to fluctuate.

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

Our operating results could be adversely impacted by the loss of subscription revenue. Subscribers may cancel their subscriptions to our services for many reasons, including a perception that they do not use the services sufficiently or that the service does not provide enough value, a lack of attractive or exclusive content generally or as compared with competitive service offerings (including Internet piracy), or because customer service issues are not satisfactorily resolved. Revenue from our SuperPass subscription service has declined in recent periods due in part to our focus on other products and services we offer, and we expect this trend to continue. For the subscription services we offer, we must continue to obtain compelling digital media content for our video and games services in order to maintain and increase usage and overall customer satisfaction for these products. If we cannot obtain content for our subscription services on commercially reasonable terms, we may not offer the content to our consumers, which could negatively impact our operating results.

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

We are subject to regulations and laws specific to the marketing, sale and delivery of goods and services over the Internet. These laws and regulations cover taxation, user privacy, data collection and protection, copyrights, electronic contracts, sales procedures, automatic subscription renewals, credit card processing

Table of Contents

procedures, consumer protections, broadband Internet access and content restrictions. We cannot guarantee that we have been or will be fully compliant in every jurisdiction, as it is not entirely clear how existing laws and regulations governing issues such as privacy, taxation and consumer protection apply or will be enforced with respect to the Internet. Moreover, as Internet commerce continues to evolve, increasing regulation by federal, state and foreign agencies becomes more likely. The adoption of any laws or regulations that adversely affect our ability to market, sell, and deliver our products and services could decrease demand for our service offerings, resulting in lower revenue. Future regulations, or changes in laws and regulations or their existing interpretations or applications, could also hinder our operational flexibility, raise compliance costs or other costs of doing business and result in additional historical or future liabilities for us, resulting in adverse impacts on our business and our operating results.

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

Weaknesses in the national and global economy has resulted in recent years in a decline in overall consumer and corporate spending, declines in consumer and corporate access to credit, fluctuations in foreign exchange rates, declines in the value of assets and increased liquidity risks, all of which could materially impact our business, financial condition and results of operations. We provide digital entertainment services to consumers directly and indirectly through our carrier customers. Consumers may consider the purchase of our products and services to be a discretionary expenditure. As a result, consumers considering whether to purchase our products or services may be influenced by macroeconomic factors that affect consumer spending such as unemployment, conditions in the residential real estate and mortgage markets and access to credit when making a determination whether to commence, continue, or stop subscribing to or otherwise purchasing our products and services. In addition, businesses may reduce their advertising spending during adverse macroeconomic conditions, which would negatively impact the revenue we generate through sales of advertising on our websites and other properties. We have recorded impairments to our assets in 2008 and 2009 due in part to weakness in the global economy, and if there is a sustained period of significant weakness or uncertainty in the global economy, we may need to record additional impairments to our assets in future periods. If any of these risks are realized, we may experience a material adverse impact on our financial condition and results of operations.

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

We have been restructuring the operating and overhead costs of, and taking other measures to simplify, our business and operations. We have never before pursued initiatives to this extent and there is no assurance that our efforts will be successful. Our business and operations may be harmed to the extent there is customer or employee uncertainty surrounding the future direction of our product and service offerings and strategy for our businesses. Our restructuring activities have included implementing cost-cutting initiatives, which could materially impact our ability to compete in future periods. If we have not effectively re-aligned the cost structure of our remaining businesses or otherwise do not execute effectively on our strategic plans, our stock price may be adversely affected, and we and our shareholders will not realize the anticipated financial, operational and other benefits from such initiatives.

The restructuring of Rhapsody may not yield the anticipated benefits to us or to Rhapsody.

On March 31, 2010, we completed the restructuring transactions of our digital audio music service joint venture, Rhapsody America LLC (Rhapsody). As a result of the restructuring, we no longer have operational control over Rhapsody, and beginning April 1, 2010, Rhapsody s operating performance is no longer consolidated with our consolidated financial statements. We believe the restructuring will provide Rhapsody with the financial, intellectual property and other key assets and the operational flexibility to compete more effectively in the digital music market. Rhapsody s inability to operate and compete effectively as an independent company could adversely impact its financial condition and results of operations, which in turn would materially impact our reported net income (loss) in future periods. In addition, Rhapsody has generated losses since its inception, and the new structure may not alter this trend. If Rhapsody continues to incur losses, or if it otherwise experiences a significant decline in its business, we may incur a loss on our investment, which would have a material adverse effect on our financial condition and results of operations.

Table of Contents

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

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. In January 2010, Rob Glaser, our founder and the only Chief Executive Officer in our history, resigned as Chief Executive Officer. Although Mr. Glaser remains the Chairman of our Board of Directors, we have experienced our first transition at the Chief Executive Officer level. We cannot provide assurance that we will effectively manage this transition, particularly in light of our restructuring initiatives, which may impact our ability to retain our remaining key executive officers. The loss of the services of our 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. Our ability to attract and retain personnel may also be made more difficult by our restructuring initiatives. There can be no assurance that we will be able to attract and retain the key personnel necessary to sustain our business or support future growth.

Acquisitions 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 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.

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, amortization of acquired identifiable intangible assets and the incurrence of charges for the impairment of goodwill and other intangible assets, which are reflected in our operating expenses. New acquisitions and any potential additional future impairment of the value of purchased assets, including goodwill, could have a significant negative impact on our future operating results.

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;

16

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

diversion of management time and other resources from existing operations to integration activities for acquired businesses;

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

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

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

Our ability to compete across our businesses partly depends on the superiority, uniqueness and value of our patent portfolio and other 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. However, our efforts to protect our intellectual property rights may not assure our ownership rights in our intellectual property, protect or enhance the competitive position of our products and services or effectively prevent misappropriation of our technology. We also routinely receive challenges to our trademarks and other proprietary intellectual property that we are using in our business activities in China. As disputes regarding the validity and scope of patents or the ownership of technologies and rights associated with streaming media, digital distribution, and online businesses are common and likely to arise in the future, we may be forced to litigate to enforce or defend our patents and other intellectual property rights or to determine the validity and scope of other parties proprietary rights, enter into royalty or licensing agreements on unfavorable terms or redesign our product features and services. Any such dispute would likely be costly and distract our management, and the outcome of any such dispute could fail to improve our business prospects or otherwise harm our business.

From time to time we receive claims and inquiries from third parties alleging that our technology may infringe the third parties proprietary rights, especially patents. Third parties have also asserted and most likely will continue to assert claims against us alleging 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 Note 16, Commitments and Contingencies to Consolidated Financial Statements included in Part II, Item 8 of this report.

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

Our ability to provide our products and services to our customers and operate our business depends on the continued operation and security of our information systems and networks. A significant or repeated reduction in the performance, reliability, security or availability of our information systems and network infrastructure could harm our ability to conduct our business, and harm our reputation and ability to attract and retain users, customers, advertisers and content providers. We have on occasion experienced system errors and failures that caused interruption in availability of products or content or an increase in response time. Problems with our systems and networks could result from our failure to adequately maintain and enhance these systems and networks, natural disasters and similar events, power failures, HVAC failures, intentional actions to disrupt our systems and networks and many other causes. The vulnerability of a large portion of our computer and communications infrastructure is enhanced because much of it is located at 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.

The growth of our business is dependent in part on successfully managing 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, local economic

Table of Contents

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

We may be subject to market risk and legal liability in connection with 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.

Government regulation of the Internet and e-commerce is evolving, and changes in regulations that increase the taxes on the services we provide could materially harm our business and operating results.

As Internet commerce continues to evolve, increasing taxation by state, local or foreign tax authorities becomes more likely. For example, taxation of electronically delivered products and services or other charges imposed by government agencies may also be imposed. We believe we collect transactional taxes and are compliant and current in all jurisdictions where we believe we have a collection obligation for transaction taxes. Any regulation imposing greater taxes or other fees for products and services could result in a decline in the sale of products and services and the viability of those products and services, harming our business and operating results. A successful assertion by one or more states or foreign tax authorities that we should collect and remit sales or other taxes on the sale of our products or services could result in substantial liability for past sales.

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

We may be subject to additional income tax assessments.

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

Our Chairman of the Board beneficially owns more than 38% of our stock, which gives him significant control over certain major decisions on which our shareholders may vote or may discourage an acquisition of us, and any significant sales of stock by our Chairman could have a negative effect on our stock price.

Robert Glaser, our Chairman of the Board, beneficially owns more than 38% of our common stock. As a result, Mr. Glaser and his affiliates will have significant influence to:

- elect or defeat the election of our directors;
- amend or prevent amendment of our articles of incorporation or bylaws;

Table of Contents

- 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.

At our 2010 annual meeting of shareholders, Mr. Glaser withheld votes of his shares of our common stock with respect to the election of four of our directors, including three of our incumbent directors and Robert Kimball, our President and Chief Executive Officer. Although these four directors were re-elected, none of them received approval of a majority of the votes cast. The stock ownership of Mr. Glaser and his affiliates may discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of RealNetworks, which in turn could reduce our stock price or prevent our shareholders from realizing a premium over our stock price.

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

Our articles of incorporation provide for a strategic 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.

In addition, Mr. Glaser has special rights under our articles of incorporation to appoint or remove members of the strategic transaction committee at his discretion that could make it more difficult for RealNetworks to be sold or to complete another change of control transaction without Mr. Glaser s consent. RealNetworks has also entered into an agreement providing Mr. Glaser with certain contractual rights relating to the enforcement of our charter documents and Mr. Glaser s roles and authority within RealNetworks. These rights, together with Mr. Glaser s significant beneficial ownership, create unique potential for concentrated influence of Mr. Glaser over potentially material transactions involving RealNetworks.

We have adopted a shareholder rights plan, which was amended and restated in December 2008, which provides that shares of our common stock have associated preferred stock purchase rights. The exercise of these rights would make the acquisition of RealNetworks by a third-party more expensive to that party and has the effect of discouraging third parties from acquiring RealNetworks without the approval of our board of directors, which has the power to redeem these rights and prevent their exercise.

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

Item 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 that are utilized by all of our business segments, unless otherwise noted below, to house our research and development, sales and marketing, and general and administrative personnel:

Location	Area leased (sq. feet)	Lease expiration
Seattle, Washington	264,000	September 2014, with an option to renew for two five-year periods
Seoul, Republic of Korea(1)	62,000	October 2011
Reston, Virginia(1)	35,000	September 2012

(1) This facility is utilized only by our Core Products segment.

In addition, we lease smaller facilities with multi-year terms in the U.S. and foreign countries, some of which support the operations of all of our business segments while others are dedicated to a specific business segment. 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 other 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 Note 16 of Notes to Consolidated Financial Statements included in Item 8 of this report.

Item 3. ***Legal Proceedings***

See Note 16 of Notes to Consolidated Financial Statements included in Item 8 of this report for information regarding legal proceedings.

Item 4. ***Reserved***

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 Stock Market LLC 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, as reported on the Nasdaq Stock Market LLC. 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,			
	2010		2009	
	High	Low	High	Low
First Quarter	$ 5.41	$ 3.60	$ 3.84	$ 1.97
Second Quarter	4.95	3.15	3.12	2.23
Third Quarter	3.74	2.59	4.14	2.53
Fourth Quarter	4.31	2.93	4.48	3.21

As of January 31, 2011, there were approximately 662 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.

Table of Contents

Set forth below is a graph comparing the cumulative total return to shareholders on our common stock with the cumulative total return of the Nasdaq Composite Index and the Dow Jones U.S. Technology Index for the period beginning on December 31, 2005 and ended on December 31, 2010.

Comparison of 5 Year Cumulative Total Return Among RealNetworks, Inc.,

the NASDAQ Composite Index and the Dow Jones U.S. Technology Index

	December 31, 2005	December 31, 2006	December 31, 2007	December 31, 2008	December 31, 2009	December 31, 2010
RealNetworks, Inc.	$ 100	$ 140.98	$ 78.48	$ 45.49	$ 47.81	$ 54.12
NASDAQ Composite Index	$ 100	$ 111.74	$ 124.67	$ 73.77	$ 107.12	$ 125.93
Dow Jones U.S. Technology Index	$ 100	$ 110.10	$ 127.38	$ 72.78	$ 119.70	$ 134.76

The total return on our common stock and each index assumes the value of each investment was $100 on December 31, 2005, and that all dividends were reinvested, although dividends have not been declared on our common stock. Return information is historical and not necessarily indicative of future performance.

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.

	Years Ended December 31,				
	2010	**2009**	**2008**	**2007**	**2006**
	(In thousands, except per share data)				
Consolidated Statements of Operations Data:					
Net revenue	$ 401,733	$ 562,264	$ 604,810	$ 567,620	$ 395,261
Cost of revenue	144,723	222,142	233,244	213,491	124,108
Impairment of deferred costs and prepaid royalties			19,666		
Gross profit	257,010	340,122	351,900	354,129	271,153
Operating expenses:					
Research and development	100,955	119,448	113,680	102,731	77,386
Sales and marketing	118,543	165,856	211,922	209,412	165,602
Advertising with related party	1,065	33,292	44,213	24,360	
General and administrative	51,217	79,164	69,981	67,326	57,332
Impairment of goodwill and long-lived assets		175,583	192,676		
Restructuring and other charges	12,361	4,017	6,833	3,748	
Loss on excess office facilities	7,396				738
Subtotal operating expenses	291,537	577,360	639,305	407,577	301,058
Antitrust litigation (benefit) expenses, net				(60,747)	(220,410)
Total operating expenses (benefit)	291,537	577,360	639,305	346,830	80,648
Operating income (loss)	(34,527)	(237,238)	(287,405)	7,299	190,505
Other income, net	204	(2,470)	27,800	48,688	37,248
Income (loss) before income taxes	(34,323)	(239,708)	(259,605)	55,987	227,753
Income taxes	36,451	(3,321)	(25,828)	(27,456)	(82,537)
Net income (loss)	2,128	(243,029)	(285,433)	28,531	145,216
Net loss attributable to the noncontrolling interest in Rhapsody	2,910	26,265	41,555	19,784	
Net income (loss) attributable to common shareholders	$ 5,038	$ (216,764)	$ (243,878)	$ 48,315	$ 145,216
Basic net income (loss) per share available to common shareholders	$ 0.06	$ (1.64)	$ (1.74)	$ 0.32	$ 0.90
Diluted net income (loss) per share available to common shareholders	$ 0.06	$ (1.64)	$ (1.74)	$ 0.29	$ 0.81
Shares used to compute basic net income (loss) per share available to common shareholders	135,577	134,612	140,432	151,665	160,973
Shares used to compute diluted net income (loss) per share available to common shareholders	136,053	134,612	140,432	166,410	179,281

	2010	2009	As of December 31, 2008 (In thousands)	2007	2006
Consolidated Balance Sheets Data:					
Cash, cash equivalents, and short-term investments	$ 334,321	$ 384,900	$ 370,734	$ 556,629	$ 678,920
Working capital	286,315	278,198	266,990	351,066	584,125
Other intangible assets, net	6,952	10,650	18,727	107,677	105,109
Goodwill	4,960		175,264	353,153	309,122
Total assets	565,442	606,883	789,013	1,275,442	1,303,416
Convertible debt				100,000	100,000
Shareholders equity	412,745	375,811	553,558	875,104	969,766

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

Overview

We create innovative applications and services that make it easy to connect with and enjoy digital media. We pioneered the development of technology for streaming digital media over the Internet and have sustained our focus on creating and delivering digital media, technology, services and content such as music, games and video to consumers around the world. We distribute our products and services directly to consumers and also through mobile carriers, original equipment manufacturers and other communications companies who offer these products and services to their customers.

We are primarily focused on three key businesses: (1) our software as a service (SaaS) offerings of our Core Products segment (formerly referred to as our application service provider, or ASP, offerings), (2) our RealPlayer media player software and related businesses and (3) our casual games business. During 2010, we implemented a company-wide restructuring and simplification of our business that included a restructuring of our Rhapsody joint venture and a reorganization of our other businesses. As a result of these changes, we reduced overhead and other operating costs, discontinued certain unprofitable products and services offerings, and established new reporting segments, which are described further below. We have expressed our intent to separate our casual games business from the rest of our businesses and, during the year, we continued to make progress on that separation. No timetable has been set for the separation and we have not determined the optimal structure of the separated Games business, including whether we will retain control of the business or enter into another strategic transaction involving the business. In the meantime, we have focused our Games strategy on building our social games capabilities and revenue and stabilizing and building our online subscription and advertising-supported games businesses.

As of July 1, 2010, we reorganized the management of our businesses and product lines, and as a result, our operating results beginning with the third quarter of 2010 are reported in the following reporting segments: (1) Core Products, (2) Emerging Products, and (3) Games. We will continue to present financial results from our former Music segment on a historical basis only. The Music segment primarily included the financial results and operating performance of our Rhapsody joint venture, which was restructured as of March 31, 2010. As a result of the restructuring, Rhapsody s results are no longer consolidated with our financial statements for periods after March 31, 2010, as discussed in more detail in Note 3. Rhapsody Joint Venture to the Consolidated Financial Statements included within Part II, Item 8 of this report. In addition, we changed the allocation of corporate and shared overhead expenses as of July 1, 2010. Historically, we allocated common corporate overhead expenses to each business segment. Beginning in the third quarter of 2010, these shared expenses, as well as stock compensation costs, are reported in the aggregate as corporate expenses and not reflected in the financial and operating results of the business segments described above. The historical financial information presented has been adjusted to reflect the new segments and the new corporate expense presentation. More information about these new segments is included below under Segment Reporting.

Table of Contents

Summary of Results for the years ended December 31, 2010, 2009 and 2008

Consolidated results of operations for the years ended December 31, 2010, 2009 and 2008 are as follows (dollars in thousands):

	2010	2009	2008	2010-2009 Change	% Change	2009-2008 Change	% Change
Total revenue	$ 401,733	$ 562,264	$ 604,810	$ (160,531)	(29)%	$ (42,546)	(7)%
Cost of revenue	144,723	222,142	233,244	(77,419)	(35)%	(11,102)	(5)%
Impairment of deferred costs and prepaid royalties			19,666			(19,666)	(100)%
Gross profit	257,010	340,122	351,900	(83,112)	(24)%	(11,778)	(3)%
Gross margin	64%	60%	58%	4%		2%	
Total operating expenses	291,537	577,360	639,305	(285,823)	(50)%	(61,945)	(10)%
Operating loss	$ (34,527)	$ (237,238)	$ (287,405)	$ 202,711	85 %	$ 50,167	17 %

2010 compared with 2009

Revenue decreased by $160.5 million, or 29%, primarily due to the deconsolidation of Rhapsody on March 31, 2010, and declines in our Core Products and Games segments. Operating expenses improved due to a $175.6 million impairment of goodwill in 2009, lower expenses of $78.1 million associated with the deconsolidation of Rhapsody and cost reduction initiatives as part of our restructuring efforts in 2010.

2009 compared with 2008

Revenue decreased by $42.5 million, or 7%, primarily due to declines in the Core Products and Games segments. Operating loss improved due to an impairment of deferred costs and prepaid royalties of $19.7 million in 2008 resulting in an improvement in gross margins from 58% in 2008, to 60% in 2009. Also contributing to the improvement in operating loss were lower operating expenses of $61.9 million due to lower personnel and related costs of $18.7 million, reduced marketing expenses of $19.7 million and lower impairment expenses of $17.1 million.

Segment Reporting

Core Products

The Core Products segment primarily generates revenue and incurs costs from the sales of SaaS services, such as ringback tones, inter-carrier messages, music on demand and video on demand, professional services and system integration services to carriers and mobile handset companies, sales of licenses of our software products such as Helix for handsets, and consumer subscriptions such as SuperPass and international radio subscriptions. Core Products segment results of operations for the years ended December 31, 2010, 2009 and 2008 are as follows (dollars in thousands):

	2010	2009	2008	2010-2009 Change	% Change	2009-2008 Change	% Change
Total revenue	$ 212,845	$ 233,365	$ 262,681	$ (20,520)	(9)%	$ (29,316)	(11)%
Cost of revenue	83,733	81,774	93,784	1,959	2%	(12,010)	(13)%
Impairment of deferred costs and prepaid royalties			10,837			(10,837)	(100)%
Gross profit	129,112	151,591	158,060	(22,479)	(15)%	(6,469)	(4)%
Gross margin	61%	65%	60%	(4)%		5%	
Total operating expenses	86,217	138,502	260,728	(52,285)	(38)%	(122,226)	(47)%

Operating income (loss)	$ 42,895	$ 13,089	$ (102,668)	$ 29,806	228%	$ 115,757	113%

Table of Contents

2010 compared with 2009

Revenue decreased by $20.5 million, or 9%. SaaS revenue decreased by $14.6 million primarily due to the merger of certain carrier customers resulting in lower overall contract prices with these customers as well as a loss of total subscribers under management. In addition, revenue from system integration, a business that we have de-emphasized since 2008, decreased by $3.5 million.

Gross margin decreased primarily due to lower SaaS contract prices mentioned above, which had no corresponding decreases in cost of revenue. Operating expenses decreased by $52.3 million primarily due to impairments of long lived assets and goodwill of $50.5 million in 2009, with no similar impairments in 2010.

2009 compared with 2008

Revenue decreased by $29.3 million, or 11%. Consumer subscription revenue declined by $14.2 million primarily due to fewer subscribers to our SuperPass service as we continue to focus our marketing efforts on other products and services we offer that we believe have greater long term potential. In addition, we recorded lower revenue from our SaaS offerings of approximately $8.7 million and lower revenue from our Helix system licenses of approximately $7.5 million. These declines reflect the increase in the value of the U.S. dollar against the Korean won that negatively affected Core Products revenue in 2009 by approximately $11.3 million in the aggregate, including our Helix system licenses and SaaS services sales.

Gross margin improved due to an impairment of deferred costs and prepaid royalties of $10.8 million in 2008, with no similar impairment in 2009.

Operating expenses decreased by $122.2 million principally due to impairment of long lived assets and goodwill of $50.5 million in 2009 compared with $141.9 million in 2008. Lower personnel and related costs of approximately $11.6 million and professional service fees of $7.8 million reduced operating expenses further. In addition, marketing expenses decreased by $8.7 million, of which $6.2 million was from lower amortization of certain intangible assets capitalized from our acquisitions due to impairments recorded in the fourth quarter of 2008.

Emerging Products

The Emerging Products segment primarily generates revenue and incurs costs from sales of the RealPlayer and its related products, such as revenue from distribution of third party software products, advertising on RealPlayer websites and sales of RealPlayer Plus software licenses to consumers. Also included within the Emerging Products segment are the costs to build and develop new product offerings for consumers and corporate customers, including Unifi. Emerging Products segment results of operations for the years ended December 31, 2010, 2009 and 2008 are as follows (dollars in thousands):

	2010	2009	2008	2010-2009 Change	% Change	2009-2008 Change	% Change
Total revenue	$ 41,761	$ 45,207	$ 46,760	$ (3,446)	(8)%	$ (1,553)	(3)%
Cost of revenue	7,123	6,884	6,451	239	3%	433	7%
Impairment of deferred costs and prepaid royalties							
Gross profit	34,638	38,323	40,309	(3,685)	(10)%	(1,986)	(5)%
Gross margin	83%	85%	86%	(2)%		(1)%	
Total operating expenses	28,053	73,211	15,842	(45,158)	(62)%	57,369	362%
Operating income (loss)	$ 6,585	$ (34,888)	$ 24,467	$ 41,473	119%	$ (59,355)	(243)%

Table of Contents

2010 compared with 2009

Revenue decreased by $3.4 million, or 8%. Lower unit distribution of third-party software products, primarily due to increased market saturation of the software products we distribute, accounted for the majority of the decline. Gross margin did not change materially. Operating expenses declined by $45.2 million primarily due to impairments of long lived assets and goodwill of $46.8 million in 2009, with no similar impairments in 2010.

2009 compared with 2008

Revenue decreased by $1.6 million, or 3%, primarily due to lower advertising revenue. Gross margin did not change materially. Operating expenses increased by $57.4 million primarily due to impairments of long lived assets and goodwill of $46.8 million in 2009, with no similar impairments in 2008. Additionally, personnel and related costs increased by $6.9 million and professional service fees increased by $3.7 million due to investments related to projects and products under development.

Games

The Games segment primarily generates revenue and incurs costs from the creation, distribution and sales of games licenses, online games subscription services, advertising on game sites and social network sites, games syndication services and microtransactions from online and social games and sales of mobile games. Games segment results of operations for the years ended December 31, 2010, 2009 and 2008 are as follows (dollars in thousands):

	2010	2009	2008	2010-2009 Change	% Change	2009-2008 Change	% Change
Total revenue	$ 111,394	$ 122,824	$ 134,648	$ (11,430)	(9)%	$ (11,824)	(9)%
Cost of revenue	29,071	32,862	39,204	(3,791)	(12)%	(6,342)	(16)%
Impairment of deferred costs and prepaid royalties			7,829			(7,829)	(100)%
Gross profit	82,323	89,962	87,615	(7,639)	(8)%	2,347	3%
Gross margin	74%	73%	65%	1%		8%	
Total operating expenses	78,275	127,908	134,683	(49,633)	(39)%	(6,775)	(5)%
Operating income (loss)	$ 4,048	$ (37,946)	$ (47,068)	$ 41,994	111%	$ 9,122	19%

2010 compared with 2009

Revenue decreased by $11.4 million, or 9%. The decrease was primarily due to a decline in the number of games units sold combined with lower average selling prices due to continued competitive pressures, resulting in a decrease of $9.1 million. In addition, lower unit distribution of third party software products contributed $1.3 million of the decrease. Gross margin did not change materially. Operating expenses decreased by $49.6 million primarily due to impairment of long lived assets and goodwill of $41.2 million in 2009, with no similar impairments in 2010. Further contributing to the decline were reductions in personnel and related costs of $7.5 million and in marketing expenses of $1.9 million as part of our restructuring efforts in 2010.

2009 compared with 2008

Revenue decreased by $11.8 million, or 9%. Games sales decreased by $8.3 million primarily due to lower average sales prices for games sold on our websites in response to competitive pressures. Advertising revenue decreased by $4.7 million due to lower demand for online advertising. Gross margins improved due to an impairment of deferred costs and prepaid royalties of $7.8 million in 2008, with no similar impairment in 2009, and lower overall royalty costs. Operating expenses decreased by $6.8 million primarily due to lower impairments of long lived assets and goodwill of $4.6 million and a decrease in marketing expenses of $2.0 million.

27

Table of Contents

Music

Music segment results of operations for the years ended December 31, 2010, 2009 and 2008 are as follows (dollars in thousands):

	2010	2009	2008	2010-2009 Change	% Change	2009-2008 Change	% Change
Total revenue	$ 35,733	$ 160,868	$ 160,721	$ (125,135)	(78)%	$ 147	%
Cost of revenue	21,864	98,322	90,595	(76,458)	(78)%	7,727	9%
Impairment of deferred costs and prepaid royalties			1,000			(1,000)	(100)%
Gross profit	13,869	62,546	69,126	(48,677)	(78)%	(6,580)	(10)%
Gross Margin	39%	39%	43%	%		(4)%	
Total operating expenses	13,911	129,085	126,749	(115,174)	(89)%	2,336	2%
Operating income (loss)	$ (42)	$ (66,539)	$ (57,623)	$ 66,497	100%	$ (8,916)	(15)%

On March 31, 2010, we completed the restructuring of Rhapsody, which resulted in our ownership of Rhapsody s outstanding equity decreasing to approximately 47% and the loss of our operating control over Rhapsody. Since the restructuring was completed on the last day of the quarter ended March 31, 2010, our revenue and operating results for the first quarter includes results from Rhapsody s operations. Beginning with the second quarter of 2010, Rhapsody s revenue and other operating results are no longer consolidated within our financial statements and we are not recording any operating or other financial results for our Music segment. We now report our share of Rhapsody s income or losses as Equity in net loss of Rhapsody and other equity method investments in Other income. Our share of Rhapsody s losses for the nine-month period from April 1, 2010, to December 31, 2010, was $14.2 million.

Prior to April 1, 2010, our Music business was primarily operated through our Rhapsody joint venture. Music segment revenue and costs as reported in our financial statements primarily reflected sales of digital music content through Rhapsody s MP3 music store, the Rhapsody and international radio subscription services, and advertising on Rhapsody s music websites.

Summarized financial information for Rhapsody s results of operations for the nine-month period from April 1, 2010 to December 31, 2010, is presented below (dollars in thousands):

Total revenue	$ 91,279
Cost of revenue	65,577
Gross profit	25,702
Gross Margin	28%
Total operating expenses	56,435
Operating income (loss)	$ (30,733)

2010 compared with 2009

Revenue declined by $125.1 million in 2010 from 2009 due to the deconsolidation of Rhapsody on March 31, 2010. Rhapsody s revenue for the nine month period from April 1, 2010 to December 31, 2010 was lower than the revenue of our Music segment for the same period in 2009 due to lower average selling prices of Rhapsody s premium subscription service, partially offset by an increase in the number of subscribers.

Cost of revenue declined by $76.5 million in 2010 from 2009 due to the deconsolidation of Rhapsody on March 31, 2010. Rhapsody s gross margin for the nine-months period from April 1, 2010 to December 31, 2010 declined compared with the gross margin for our Music segment for the same period in 2009 due to lower average selling prices, without a corresponding decline in content costs and costs of providing its subscription services.

28

Table of Contents

Operating expenses declined by $115.2 million due to the deconsolidation of Rhapsody on March 31, 2010. Rhapsody s operating expenses for the period from April 1, 2010 to December 31, 2010 were less than the operating expenses of our Music segment for the same period in 2009 due primarily to $37.0 million in impairment charges associated with long lived assets and goodwill recorded in 2009.

2009 compared with 2008

Revenue was materially unchanged from 2008 with an increase in revenue from our subscription music services of $2.7 million, primarily driven by an increase in average number of subscribers during the year. The increase in subscription revenue was offset by a decline of $2.0 million in advertising revenue due to a reduction in demand for online advertising and in sponsorship revenue.

Cost of revenue increased by $7.7 million, while gross margin decreased. These changes were due to a change in revenue mix with an increase in lower margin revenue from the Rhapsody subscription service and a decrease in high margin revenue from advertising.

Operating expenses increased by $2.3 million primarily due to impairments of long lived assets and goodwill of $37.0 million in 2009, with no similar impairments in 2008. This increase was offset by reductions in personnel and related costs of $7.8 million and in marketing expenses of $10.4 million. In addition, advertising with related party, MTVN, declined by $10.9 million.

Corporate

Certain corporate-level activity is not allocated to our segments, including costs of: human resources, legal, finance, information technology, procurement activities, litigation, corporate headquarters, legal settlements and contingencies, stock compensation, losses on excess office facilities and employee severance costs. Corporate segment results of operations for the years ended December 31, 2010, 2009 and 2008 are as follows (dollars in thousands):

	2010	2009	2008	2010-2009 Change	% Change	2009-2008 Change	% Change
Cost of revenue	$ 2,932	$ 2,300	$ 3,209	$ 632	27%	$ (909)	(28)%
Total operating expenses	85,081	108,654	101,304	(23,573)	(22)%	7,350	7%
Operating loss	$ (88,013)	$ (110,954)	$ (104,513)	$ 22,941	21%	$ (6,441)	(6)%

2010 compared with 2009

Operating expenses decreased by $23.6 million, or 22%, due mainly to restructuring efforts and cost savings initiatives implemented throughout 2010. The decrease was due to lower personnel and related costs of $6.5 million and lower legal and other professional services expenses of $15.5 million, the majority of which related to litigation and settlement costs associated with a lawsuit relating to our proposed RealDVD product and an arbitration proceeding in 2009. In addition, stock compensation decreased $8.8 million primarily as a result of the deconsolidation of Rhapsody on March 31, 2010 and headcount reductions. These decreases in operating expenses were offset by an increase in restructuring costs of $15.7 million related to severance payments and loss on excess office facilities.

2009 compared with 2008

Operating expenses increased by $7.4 million, or 7%, primarily due to litigation and settlement costs associated with the RealDVD litigation and an arbitration proceeding in 2009.

Operating Expenses

Research and Development

Research and development expenses consist primarily of salaries and related costs of research and development personnel, expense associated with stock-based compensation, and consulting fees associated with

Table of Contents

product development. To date, all research and development costs have been expensed as incurred because technological feasibility for software products is generally not established until substantially all development is complete. Research and development costs and year-over-year changes are as follows (dollars in thousands):

	2010	2009	2008	2010-2009 Change	% Change	2009-2008 Change	% Change
Research and Development	$ 100,955	$ 119,448	$ 113,680	$ (18,493)	(15)%	$ 5,768	5%
As a percent of revenue	25%	21%	19%				

2010 compared with 2009

Research and development expenses, including non-cash stock-based compensation, decreased by $18.5 million, or 15%. The decrease was primarily due to the deconsolidation of Rhapsody on March 31, 2010, accounting for $9.3 million of the decrease. In addition, personnel and related costs, including non-cash stock-based compensation, decreased by approximately $11.2 million as a result of lower headcount from our cost reduction efforts. No other single factor contributed materially to these changes during the period. The increase in research and development expenses as a percentage of total revenue from 21% in 2009 to 25% in 2010 was due primarily to our decision to continue to invest in product development despite a decline in total revenue.

2009 compared with 2008

Research and development expenses, including non-cash stock-based compensation, increased by $5.8 million, or 5%. This increase was primarily due to an increase in research and development personnel and related costs of approximately $2.4 million as a result of an increase in average headcount. No other single factor contributed materially to these changes during the period. The increase in research and development expenses as a percentage of total revenue from 19% in 2008 to 21% in 2009 was due primarily to our decision to continue to invest in the development of our products despite a decline in total revenue.

Sales and Marketing

Sales and marketing expenses consist primarily of salaries and related costs for sales and marketing personnel, sales commissions, amortization of certain intangible assets capitalized in our acquisitions, credit card fees, subscriber acquisition costs, consulting fees, trade show expenses, advertising costs and costs of marketing collateral. Sales and marketing costs and year-over-year changes are as follows (dollars in thousands):

	2010	2009	2008	2010-2009 Change	% Change	2009-2008 Change	% Change
Sales and Marketing	$ 118,543	$ 165,856	$ 211,922	$ (47,313)	(29)%	$ (46,066)	(22)%
As a percent of revenue	30%	30%	35%				

2010 compared with 2009

Sales and marketing expenses, including non-cash stock-based compensation, decreased by $47.3 million, or 29%. The decrease was primarily due to the deconsolidation of Rhapsody on March 31, 2010, accounting for $31.9 million of the decrease. A reduction in personnel and related costs, including non-cash stock-based compensation, resulted in a decline of approximately $7.3 million, and a decrease in marketing and other professional services expenses reduced costs by an additional $7.1 million. No other single factor contributed materially to the decrease during the periods.

2009 compared with 2008

Sales and marketing expenses, including non-cash stock-based compensation, decreased by $46.1 million, or 22%. The decrease was primarily due to cost reduction efforts, including a decrease in sales and marketing headcount and marketing expenses and closing a number of office locations worldwide. The reduction in personnel and related costs resulted in approximately $19.0 million in savings, and the decrease in marketing and other professional services expenses reduced costs by an additional $16.7 million. Further contributing to the decrease were lower costs associated with the amortization of intangibles of approximately $7.8 million, due to

impairment costs recorded in the fourth quarter of 2008. The decrease in sales and marketing expenses as a percentage of total revenue from 35% in 2008 to 30% in 2009 is due to the reductions mentioned above exceeding the decline in revenue. No other single factor contributed materially to these changes during the period.

Advertising with Related Party

During 2010, 2009 and 2008, Rhapsody spent $1.1 million, $33.3 million, and $44.2 million, respectively, in advertising with MTVN. The 2010 expense reflects advertising Rhapsody spent with MTVN during the quarter ended March 31, 2010, prior to the restructuring of Rhapsody and the deconsolidation. After the deconsolidation and during the nine month period ended December 31, 2010, Rhapsody spent approximately $24.9 million in advertising with MTVN. Our share of these expenses after the deconsolidation is included within our share of Rhapsody s income or losses as Equity in net loss of Rhapsody and other equity method investments in Other income.

General and Administrative

General and administrative expenses consist primarily of salaries and related personnel costs, fees for professional and temporary services and contractor costs, stock-based compensation, and other general corporate costs. General and administrative costs and year-over-year changes are as follows (dollars in thousands):

	2010	2009	2008	2010-2009 Change	% Change	2009-2008 Change	% Change
General and Administrative	$ 51,217	$ 79,164	$ 69,981	$ (27,947)	(35)%	$ 9,183	13%
As a percent of revenue	13%	14%	12%				

2010 compared with 2009

General and administrative expenses, including non-cash stock-based compensation, decreased by $27.9 million, or 35%. The deconsolidation of Rhapsody on March 31, 2010 accounted for $4.7 million of the decrease. The remaining decrease was due to reduction in legal and other professional services expenses of approximately $15.0 million, the majority of which related to litigation and settlement costs associated with the RealDVD litigation and an arbitration proceeding in 2009, and a reduction in personnel and headcount-related costs, including non-cash stock-based compensation, from our continued cost cutting efforts of $6.4 million. No other single factor contributed materially to the decrease during the period.

2009 compared with 2008

General and administrative expenses, including non-cash stock-based compensation, increased by $9.2 million, or 13%. The increase was primarily due to increases in legal and other professional services expenses of approximately $14.0 million, partially offset by a reduction in personnel and related costs of approximately $2.1 million. Approximately $8.5 million of the increase in legal and professional fees was associated with the RealDVD litigation and an arbitration proceeding. No other single factor contributed materially to the increases during the periods.

Impairment of Deferred Costs and Prepaid Royalties

We assess the recovery of all deferred project costs and any royalty advances paid to content providers on a quarterly basis. As of December 31, 2008, we determined that the total estimated costs associated with certain projects exceeded the total estimated revenues expected to be recognized on those projects. As a result, we impaired approximately $10.8 million in deferred project costs. In addition, we assessed the recovery of recoupable royalty advances paid to certain content providers. As of December 31, 2008, we determined that approximately $8.8 million in royalty advances was not recoverable and therefore charged to expense. The total impairment of deferred costs and prepaid royalties was mentioned throughout the section above entitled Segment Reporting. See Note 7 of Notes to Consolidated Financial Statements included in Item 8 of this report for more information. No such charges existed in 2010 or 2009.

Table of Contents

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

Impairment of Goodwill and Long-Lived Assets

During the quarter ended June 30, 2009, we concluded that the implied fair value of goodwill was zero for each of our reporting units. As a result, we recorded impairments of $175.6 million, during the quarter ended June 30, 2009. No other impairments of goodwill and long-lived assets were recorded in 2009. No impairments were recognized in the year ended December 31, 2010.

As part of our annual goodwill impairment testing during the quarter ended December 31, 2008, we determined that the carrying value for two of our historical reporting units exceeded their respective fair values, indicating that goodwill within those reporting units was potentially impaired. We performed an analysis to determine the implied fair value of goodwill and recorded an impairment of goodwill of approximately $135.1 million as a result.

We determined that the net book value related to certain intangible assets exceeded the fair value attributable to such intangible assets as of December 31, 2008. As a result, we recorded charges of $57.6 million as impairments of long-lived assets within our consolidated statements of operations and comprehensive income in 2008. No such impairments were recognized in either 2010 or 2009.

Restructuring and Other Charges

During the years ended December 31, 2010, 2009 and 2008, we recorded restructuring and other charges of $12.4 million, $4.0 million and $6.8 million, respectively. A majority of these charges in 2010 and 2009 were severance charges resulting from workforce reductions.

Included in the charge for 2008 was $4.0 million in severance costs resulting from workforce reductions as well as a $2.8 million write-down related to capitalized transaction-related costs associated with our plan to separate our Games business from our company.

Loss on Excess Office Facilities

As part of our efforts to reorganize our business and operational structure, including the recent restructuring of Rhapsody, we reduced the use of our current office space in our headquarters in Seattle, as well as other offices in Europe and Asia. For the year ended December 31, 2010, the estimated loss on excess office facilities including the write-down of leasehold improvements was approximately $7.4 million. Our estimates are based upon many factors including projections of sublease rates and the time period required to locate tenants. Although we believe our estimates are reasonable, additional adjustments may result if our actual experience differs from our projections.

Table of Contents

Other Income, Net

Other income, net consists primarily of interest income on our cash, cash equivalents and short-term investments; gain related to the sale of certain of our equity investments; equity in net income (loss) of investments; gain from the sales of interest in and deconsolidation of Rhapsody; and impairment of certain equity investments. Other income, net and year-over-year changes are as follows (dollars in thousands):

	2010	Change	2009	Change	2008
Interest income, net	$ 2,417	(39)%	$ 3,969	(70)%	$ 13,453
Gain (loss) on sale of equity investments	(9)	(101)	688	228	210
Equity in net loss of Rhapsody and other equity method investments	(14,164)	978	(1,313)	89	(695)
Impairment of equity investments		(100)	(5,020)	n/a	
Gain on deconsolidation of Rhapsody	10,929	n/a		n/a	
Gain on sale of interest in Rhapsody		n/a		(100)	14,502
Other income (expenses)	1,031	(229)	(794)	(341)	330
Other income (expense), net	$ 204	108%	$ (2,470)	(109)%	$ 27,800

Other income (expense), net improved during 2010 due primarily to the gain on deconsolidation recognized as part of the separation with Rhapsody. This was partially offset by increases in our share of the net losses from our investment in Rhapsody and other equity method investments. Since March 31, 2010, we have not held a controlling interest in Rhapsody and we no longer consolidate Rhapsody s results with our own. We account for our ownership interest in Rhapsody as an equity method investment. Rhapsody s financial position as of March 31, 2010 and our operating results beginning April 1, 2010 are no longer consolidated with our consolidated financial statements.

Other income (expense), net decreased during 2009 due primarily to lower average interest rates from our investments, a lower average balance of cash and investments, an impairment of one of our equity method investments, and a change in late 2008 that resulted in no longer recording a gain on the sale of a noncontrolling interest in Rhapsody within our consolidated statement of operations. See Note 3 of Notes to Consolidated Financial Statements included in Item 8 of this report.

Income Taxes

During the years ended December 31, 2010, 2009, and 2008, we recognized an income tax benefit of $36.5 million, and income tax expenses of $3.3 million and $25.8 million, respectively, related to U.S. and foreign income taxes. The decrease of $39.8 million in income tax expense for the year ended December 31, 2009, resulting in an income tax benefit in 2010 was largely the result of a reversal in unrecognized tax benefits and the restructuring of Rhapsody. The decrease of $22.5 million in tax expense from 2008 to 2009 was primarily due to the smaller increase in valuation allowance in 2009 compared to 2008. We assess the likelihood that our deferred tax assets will be recovered. In making this assessment, many factors are considered including the current economic climate, our expectations of future taxable income, our ability to project such income, and the appreciation of our investments and other assets. As of December 31, 2010, we have a valuation allowance of $106.2 million. The net change in valuation allowance since December 31, 2009, was $5.1 million primarily due to the current economic environment in which we are not certain about our ability to recognize deferred tax assets.

At the end of the third quarter of 2010, we received a cash payment of approximately $30.0 million as the result of a refund of federal taxes we had previously paid. The refund resulted from an Internal Revenue Service (IRS) examination covering the periods from 2005 through 2007. The refund related primarily to allowed deductions and taxes on foreign sales associated with our 2005 antitrust settlement with Microsoft Corporation. We recorded the cash proceeds from the refund as an income tax benefit in our statement of operations and recognized other income tax benefits related to the examination, including the reversal of liabilities for uncertain tax positions.

Table of Contents

As of December 31, 2010 and December 31, 2009, gross unrecognized tax benefits were $14.0 million and $59.8 million, respectively. The decrease in unrecognized tax benefits resulted from a release of $57.2 million due to the closure of the IRS examination described above, offset by increases of $11.3 million due to transfer pricing risk in foreign jurisdictions and $0.1 million related to other prior year positions. The total amount of unrecognized tax benefits that would affect our effective tax rate if recognized is $11.0 million as of December 31, 2010 and $32.0 million as of December 31, 2009. We do not anticipate that our total unrecognized tax benefits will significantly change within the next twelve months. We estimate the impact of uncertain tax positions in accordance with FASB ASC 740 (previously FIN No. 48, *Accounting for Uncertainty in Income Taxes*), which clarifies the accounting for uncertainty in income taxes recognized in the financial statements. This pronouncement prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in our tax return.

We file numerous consolidated and separate income tax returns in the United States Federal, state, local, and foreign jurisdictions. With few exceptions, we are no longer subject to United States Federal income tax examinations for tax years before 2008 or state, local, or foreign income tax examinations for years before 1993. We are currently under audit by various states and foreign jurisdictions for certain tax years subsequent to 1993.

License Fees and Service Revenue

We also present our revenue based on License fees and Service revenue as set forth below (dollars in thousands):

	2010	2009	2008	2010-2009 Change	% Change	2009-2008 Change	% Change
License	$ 74,908	$ 100,996	$ 113,990	$ (26,088)	(26)%	$ (12,994)	(11)%
Service	326,825	461,268	490,820	(134,443)	(29)%	(29,552)	(6)%
Total Net Revenue	$ 401,733	$ 562,264	$ 604,810	$ (160,531)	(29)%	$ (42,546)	(7)%

License Fees. License fees primarily include revenue from sales of content such as game licenses, sales of our licenses of our system software products such as Helix for handsets, and sales of premium versions of our RealPlayer and related products. Prior to March 31, 2010, license fees also included the sales from digital music tracks from our Music segment. License fees include revenue from all of our reporting segments.

Service Revenue. Service revenue primarily includes revenue from sales of digital media subscription services such as SuperPass, GamePass and FunPass, sales of SaaS services, distribution of third party software, and advertising. Prior to March 31, 2010, service fees also included sales of the Rhapsody music subscription service from our Music segment. Service revenue includes revenue from all of our reporting segments.

2010 compared with 2009

License revenue declined by $26.1 million, or 26%. The deconsolidation of Rhapsody on March 31, 2010, accounted for $16.4 million of the decline. In addition, Games license sales declined by $9.1 million due to lower unit sales and a decline in average selling prices in response to continued competitive pressures.

Service revenue declined by $134.4 million, or 29%. The deconsolidation of Rhapsody on March 31, 2010, accounted for $107.5 million of the decline. SaaS revenue decreased by $14.6 million due to the merger of certain carrier customers resulting in lower overall contract prices with these customers and the loss of subscribers under management. Revenue from system integration, a business we have been de-emphasizing since 2008, declined by $3.5 million. Also contributing to the overall decline was lower unit distribution of third-party software products of approximately $3.6 million.

2009 compared with 2008

License revenue decreased by $13.0 million, or 11%. The decrease was primarily due to a reduction of $8.6 million from lower unit sales and the decline in average selling prices from our games in response to continued competitive pressures. In addition, our Helix license revenue declined by $4.3 million.

Table of Contents

Service revenue decreased by $29.6 million, or 6%. This decline was primarily due to a $14.2 million decrease in our consumer subscription service revenue as result of fewer SuperPass subscribers. We also had lower revenue from our SaaS offerings of approximately $8.7 million and sales of our Helix system services of approximately $3.7 million.

Cost of License Fees and Service Revenue

We also present our cost of revenue based on License fees and Service revenue as set forth below (dollars in thousands):

	2010	2009	2008	2010-2009 Change	% Change	2009-2008 Change	% Change
License	$ 21,451	$ 35,850	$ 50,097	$ (14,399)	(40)%	$ (14,247)	(28)%
Service	123,272	186,292	202,813	(63,020)	(34)%	(16,521)	(8)%
Total Cost of Revenue	$ 144,723	$ 222,142	$ 252,910	$ (77,419)	(35)%	$ (30,768)	(12)%

Cost of License Fees. Cost of license fees includes royalties paid on sales of games, amounts paid for licensed technology, amortization of acquired technology, and music royalties for periods prior to March 31, 2010.

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, fees for consulting services, and expenses incurred in providing our SaaS hosting services and cost of content for our Rhapsody service for periods prior to March 31, 2010. Content costs are expensed over the period the content is available to our subscription services customers.

2010 compared with 2009

Cost of license fees decreased by $14.4 million, or 40%. The decrease was primarily due to the deconsolidation of Rhapsody on March 31, 2010, resulting in a decrease of $11.8 million. In addition, games costs of license fees decreased by $3.5 million, due to lower unit sales and lower average selling prices for our games, resulting in lower royalty rates.

Cost of service revenue decreased by $63.0 million, or 34%. The decline was primarily due to the deconsolidation of Rhapsody on March 31, 2010, which decreased cost of service revenue by $64.7 million.

2009 compared with 2008

Cost of license fees decreased by $14.2 million, or 28%. We recorded $7.8 million in charges related to the impairment of certain prepaid license royalties in 2008. See Impairment of Deferred Costs and Prepaid Royalties below for more information. Games license costs declined by $3.8 million due to lower unit sales and lower average selling prices. Further, Music license costs declined by $1.6 million due to fewer tracks sales.

Cost of service revenue decreased by $16.5 million, or 8%. Core Products cost of service revenue decreased by $11.1 million due primarily to lower amortization of certain intangible assets capitalized from our acquisitions of $3.8 million and lower delivery and support costs of our SaaS services of $5.2 million. In addition, impairments of deferred project costs and impairments of certain prepaid royalties of $10.8 million and $1.0 million, respectively, were recorded in 2008. See the section Impairment of Deferred Costs and Prepaid Royalties below for further discussion of these impairments. Lower content costs related to our SuperPass subscription service resulted in an additional $2.8 million decrease in cost of service revenue. Partially offsetting these decreases was an increase in Music cost of service revenue of $9.3 million due to the higher number of subscribers for our Rhapsody service.

Table of Contents

Geographic Revenue

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

	2010	2009	2008	2010-2009 Change	% Change	2009-2008 Change	% Change
United States	$ 227,823	$ 374,283	$ 403,799	$ (146,460)	(39)%	$ (29,516)	(7)%
Europe	79,820	96,146	107,223	(16,326)	(17)%	(11,077)	(10)%
Rest of World	94,090	91,835	93,788	2,255	2%	(1,953)	(2)%
Total	$ 401,733	$ 562,264	$ 604,810	$ (160,531)	(29)%	$ (42,546)	(7)%

2010 compared with 2009

Revenue in the U.S. declined by $146.5 million, or 39%, primarily due to the deconsolidation of Rhapsody on March 31, 2010, which accounted for $116.7 million of the decrease. Core Products revenue in the U.S. declined by $19.8 million primarily due to the merger of certain carrier customers resulting in lower overall contract prices with these customers and a loss in total subscribers under management. Core Products revenue also declined in the U.S. due to fewer subscriptions to our SuperPass service resulting in a further decrease in revenue of $4.8 million. Revenue in the U.S. also decreased by $6.0 million due to a decline in sales of individual games. In addition, lower advertising revenue and lower revenue from the distribution of third-party software products contributed another $3.4 million to the overall decrease in revenue in the U.S.

Revenue in Europe decreased by $16.3 million, or 17%. The decrease was due to a decline in Helix licensing revenue of $8.3 million, lower unit distribution of third-party software products of $1.6 million, a decline in sales of individual games of $3.4 million and a decline in our international radio subscription revenue of $1.4 million. Foreign currency fluctuations of the U.S. dollar against the euro negatively affected 2010 revenue in Europe by approximately $3.9 million.

Revenue in the rest of world increased by $2.3 million, or 2%. This increase was primarily due to increased revenue from our MOD service in Korea of approximately $5.2 million. This increase was offset by a decrease in systems integration revenue, a business which we have de-emphasized since 2008, of $3.5 million. Foreign currency fluctuations of the U.S. dollar against the Korean won positively affected 2010 revenue in the rest of the world by approximately $4.6 million.

2009 compared with 2008

Revenue in the U.S. declined by $29.5 million, or 7%. This decrease was due primarily to a reduction in revenue generated from our SuperPass subscription service of approximately $11.9 million as well as in advertising and related revenue across our consumer businesses of approximately $9.3 million. The decline in revenue in the U.S. also resulted from decreases in the sales of our individual games and royalties received from our Helix system sales of approximately $8.0 million and $5.1 million, respectively. These decreases were partially offset by increases in Music subscription revenue of approximately $8.4 million.

Revenue in Europe decreased by $11.1 million, or 10%. The decrease was due primarily to a decline in revenue derived from minimum revenue guarantees associated with a SaaS customer contract of approximately $10.6 million during 2009. Foreign currency fluctuations of the U.S. dollar against the euro negatively affected 2009 revenue in Europe by approximately $3.5 million.

Revenue in the rest of world declined by $2.0 million, or 2%. This decrease was due primarily to reduced revenue from sales of Helix server licenses of approximately $2.8 million and from our SaaS offerings of approximately $3.1 million. These declines were partially offset by an increase in revenue generated from OEM licenses installed on mobile platforms of approximately $4.5 million. Foreign currency fluctuations of the U.S. dollar against the Korean won negatively affected 2009 revenue in the rest of the world by approximately $11.3 million.

Table of Contents

Liquidity and Capital Resources

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

	December 31,	
	2010	2009
Working capital	$ 286,315	$ 278,198
Cash, cash equivalents, and short-term investments	334,321	384,900
Restricted cash	10,000	13,700

Cash, cash equivalents, and short-term investments decreased from December 31, 2009, primarily due to $18.0 million in cash paid to Rhapsody in connection with the restructuring of our investment, $30.4 million in cash used to pay Rhapsody-related payables, capital expenditures of $12.9 million, and payment of the settlement obligation and related legal expenses of $5.5 million relating to the RealDVD litigation that was accrued in the quarter ended December 31, 2009, and $5.8 million, net of cash purchased, paid in connection with the acquisition of Backstage Technologies Incorporated (Backstage), a social games company based in Canada. These reductions were partially offset by the $30.0 million tax refund received in the quarter ended September 30, 2010.

The following summarizes cash flows (in thousands):

	Years Ended December 31,		
	2010	2009	2008
Cash (used in) provided by operating activities	$ (31,122)	$ (9,304)	$ (29,286)
Cash (used in) provided by investing activities	(17,525)	9,821	(113,218)
Cash (used in) provided by financing activities	3,939	39,492	(95,862)

Cash used in and provided by operating activities consisted of net income (loss) adjusted for certain non-cash items including depreciation, amortization, stock-based compensation, deferred income taxes, minority interest, gain on sales of interest in, and deconsolidation of, Rhapsody, impairment of goodwill and long-lived assets, accrued restructuring and other charges and the effect of changes in certain operating assets and liabilities, net of acquisitions.

Cash used in operating activities in the year ended December 31, 2010 was $31.1 million and consisted of net income of $2.1 million, adjustments for cash provided by non-cash items of $46.2 million and cash used in activities related to changes in certain operating assets and liabilities, net of acquisitions and deconsolidation of Rhapsody, of $79.4 million. Adjustments for cash provided by non-cash items primarily consisted of $23.4 million of depreciation and amortization expense, $14.2 million related to the equity in net losses recorded from our equity method investments, $5.7 million of non-cash expenses related to our loss on excess office facilities and $12.2 million of stock-based compensation.

Changes in certain operating assets and liabilities, net of acquisitions, in the year ended December 31, 2010, primarily consisted of uses of cash from the decrease in accrued and other liabilities of $67.6 million. These decreases were related to reductions in accrued royalties and other fulfillment costs, payment of the legal settlement and related legal expenses attributable to the RealDVD litigation, as well as a reduction in amounts payable to MTVN for related party advertising incurred during the quarter ended March 31, 2010 as compared to the quarter ended December 31, 2009.

Cash used in operating activities in the year ended December 31, 2009 was $9.3 million and consisted of a net loss of $243.0 million, adjustments for cash provided by non-cash items of $232.2 million and cash provided by activities related to changes in certain operating assets and liabilities, net of acquisitions, of $1.5 million. Adjustments for cash provided by non-cash items primarily consisted of $175.6 million of impairments of goodwill, $31.5 million of depreciation and amortization expense and $21.5 million of stock-based compensation.

Table of Contents

Changes in certain operating assets and liabilities, net of acquisitions, in the year ended December 31, 2009, primarily consisted of uses of cash from the decrease in accrued and other liabilities of $6.1 million primarily related to reductions in deferred revenue as well as a reduction in amounts payable to MTVN for related party advertising. A decrease in accounts payable of $4.9 million related to the timing of payments to vendors also contributed to the use of cash in 2009. These uses of cash were partially offset by a decrease in accounts receivable of $10.7 million related to the timing of customer collections.

Cash used in operating activities in the year ended December 31, 2008 was $29.3 million and consisted of a net loss of $285.4 million, adjustments for non-cash items provided by operations of $261.8 million and cash used in activities related to certain operating assets and liabilities, net of acquisitions, of $5.6 million. Adjustments for non-cash items primarily consisted of $46.0 million of depreciation and amortization expense, $23.5 million of stock-based compensation, $192.7 million of impairment of long-lived assets, $5.5 million of accrued restructuring and other charges and $11.6 million of deferred income taxes, partially offset by $14.5 million of gain on sale of interest in Rhapsody.

Changes in certain operating assets and liabilities, net of acquisitions, in the year ended December 31, 2008 primarily consisted of an increase of $5.0 million in prepaid expenses and other assets due primarily to increases in prepaid royalties, and a decrease in accounts payable of $13.7 million due primarily to a decrease in amounts due to third party content providers, partially offset by a decrease in accounts receivable of $9.5 million related to decreases in revenue associated with our systems integration business.

In the year ended December 31, 2010, investing activities used cash primarily for payments made in connection with the restructuring of Rhapsody of $18.0 million, purchases of equipment, software, and leasehold improvements of $12.9 million, as well as a $5.8 million payment of acquisition costs for Backstage, net of cash acquired. These uses of cash were partially offset by the repayment of temporary funding upon the deconsolidation of Rhapsody of approximately $5.9 million. Purchases, net of sales and maturities, of short-term investments provided cash of $9.6 million during 2010. In the year ended December 31, 2009, investing activities provided cash primarily from the sales and maturities, net of purchases, of short-term investments of approximately $29.9 million. Uses of cash during 2009 included the purchases of equipment, software and leasehold improvements of $16.8 million and the payment of acquisition costs of $3.3 million primarily related to the payment of anniversary and performance costs relating to the acquisition of Zylom, which were previously accrued. In the year ended December 31, 2008, investing activities used cash primarily for purchases of equipment, software, and leasehold improvements of $29.5 million and acquisition costs of $10.2 million, net of cash acquired from the acquisition of Trymedia, and the payment of anniversary and performance costs relating to the acquisition of Zylom, which were previously accrued. Purchases net of sales and maturities of short-term investments used cash of $57.8 million during 2008.

Financing activities in the year ended December 31, 2010 provided cash from the proceeds of sales of common stock under employee stock purchase plans and the exercise of stock options of $2.7 million. Financing activities provided cash from the proceeds of sales of interests in Rhapsody of $38.0 million as well as sales of common stock under our employee stock purchase plan and exercise of stock options of $1.5 million in the year ended December 31, 2009. Financing activities in 2008 used cash for the repurchase of our common stock of $50.2 million, in addition to payments on our convertible debt obligations of $100.0 million in 2008. These uses of cash were partially offset by the proceeds of sales of interests in Rhapsody of $44.6 million as well as sales of common stock under our employee stock purchase plan and exercise of stock options of $9.6 million.

Our Board of Directors has previously authorized share repurchase programs for the repurchase of our outstanding common stock, and all repurchases have been made pursuant to these authorized programs. During 2008, we repurchased 10.0 million shares for an aggregate payment of $50.2 million at an average cost of $5.04 per share. The purchases made through December 31, 2008 completed the authorized amount for all of the repurchase programs.

We currently have no planned significant capital expenditures for 2011 other than those in the ordinary course of business. In the future, we may seek to raise additional funds through public or private equity financing, or through other sources such as credit facilities. The sale of additional equity securities could result in dilution to our shareholders. In addition, in the future, we may enter into cash or stock acquisition transactions or other strategic transactions that could reduce cash available to fund our operations or result in dilution to shareholders.

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

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

We conduct our operations primarily in five functional currencies: the U.S. dollar, the Korean won, the Japanese yen, the British pound and the euro. Historically, neither fluctuations in foreign exchange rates nor changes in foreign economic conditions have had a significant impact on our financial condition or results of operations. We currently do not hedge the majority of our foreign currency exposures and are therefore subject to risk from exchange rate fluctuations. We invoice our international customers primarily in U.S. dollars, except in Korea, Japan, Germany, France and the United Kingdom, where we invoice our customers primarily in the respective local currencies. We are exposed to foreign exchange rate fluctuations as the financial results of foreign subsidiaries are translated into U.S. dollars in consolidation. Our exposure to foreign exchange rate fluctuations also arises from intercompany payables and receivables to and from our foreign subsidiaries.

At December 31, 2010, we had commitments to make the following payments:

Contractual Obligations	Total	Less than 1 Year	1-3 Years	3-5 Years	After 5 Years
			(In thousands)		
Office leases	$ 30,653	$ 9,963	$ 14,949	$ 5,588	$ 153
Other contractual obligations	1,172	996	176		
Total contractual cash obligations	$ 31,825	$ 10,959	$ 15,125	$ 5,588	$ 153

Other contractual obligations primarily relate to minimum contractual payments due to content and other service providers.

In addition to the amounts shown in the table above, $14.7 million of unrecognized tax benefits have been recorded as liabilities in accordance with FASB ASC 740 (previously FIN No. 48, *Accounting for Uncertainty in Income Taxes*), and we are uncertain as to if or when such amounts may be settled. We cannot make a reasonably reliable estimate of the amount and period of related future payments for such liability.

Off Balance Sheet Arrangements

Our only significant off-balance sheet arrangements relate to operating lease obligations for office facility leases and other contractual obligations related primarily to minimum contractual payments due to content and other service providers. Future annual minimum rental lease payments and other contractual obligations are included in the commitment schedule above.

Critical Accounting Policies and Estimates

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

Revenue recognition;

Estimating music publishing rights and music royalties;

Table of Contents

- Estimating recoverability of deferred costs;
- Estimating allowances for doubtful accounts and sales returns;
- Estimating losses on excess office facilities;
- Valuation of equity method investments;
- Valuation of available for sale securities;
- Valuation of long-lived assets;
- Valuation of goodwill;
- Stock-based compensation;
- Noncontrolling interest;
- Accounting for gains on sale of subsidiary stock; and
- Accounting for income taxes.

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

We recognize revenue on a gross or net basis. In most arrangements, we contract directly with end user customers, are the primary obligor and carry all collectability risk. In such arrangements, we recognize revenue on a gross basis. In some cases, we utilize third-party distributors to sell products or services directly to end user customers and carry no collectability risk. In such instances, we recognize revenue on a net basis.

In our direct to consumer business segments, we derive revenue through (1) subscriptions of SuperPass within our Core Products segment and subscriptions sold by our Games segment, (2) sales of content downloads, software and licenses offered by our Core Products, Emerging Products and Games segments and (3) the sale of advertising and the distribution of third-party products on our websites and in our games. Prior to April 1, 2010, our direct to consumer business also included the products and services offered by our Music segment, which was primarily sold by the Rhapsody joint venture. Beginning on April 1, 2010, revenue from the Rhapsody joint venture is no longer consolidated within our financial statements and we are no longer recording any operating or other financial results for the former Music segment.

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

We also generate revenue through business-to-business channels by providing services within our Core Products segment enabling mobile carriers to deliver audio and video content to their customers and by selling software licenses and products and related support and other services.

Revenue generated from services provided to mobile carriers that enable the delivery of audio and video content to their customers is recognized as the services are provided. Setup fees to build these services are recognized ratably upon launch of the service over the remaining expected term of the service.

A portion of the revenue related to the sale of software licenses and products and related support and other services is recorded as unearned due to undelivered elements including, in some cases, post-delivery support and the right to receive unspecified upgrades or enhancements on a when-and-if-available basis. The amount of revenue allocated to undelivered elements is based on the vendor specific objective evidence of fair value for those elements using the residual method or relative fair value method. Unearned revenue due to undelivered elements is recognized ratably on a straight-line basis over the related products contract term.

Table of Contents

Estimating Music Publishing Rights and Music Royalty Accruals. We must make estimates of amounts owed related to our music publishing rights and music royalties for our domestic and international music services primarily incurred by Rhapsody which was separated from our operating results beginning April 1, 2010. Unsettled obligations incurred prior to April 1, 2010 remain our liability. Material differences may impact the amount and timing of our expense for any period if management made different judgments or utilized different estimates. Under copyright law, we may be required to pay licensing fees for digital sound recordings and compositions we deliver. Copyright law generally does not specify the rate and terms of the licenses, which are determined by voluntary negotiations among the parties or, for certain compulsory licenses where voluntary negotiations are unsuccessful, by arbitration. There are certain geographies and agencies for which we have not yet completed negotiations with regard to the royalty rate to be applied to the current or historic sales of our digital music offerings. Our estimates are based on contracted or statutory rates, when established, or management s best estimates based on facts and circumstances regarding the specific music services and agreements in similar geographies or with similar agencies. While we base our estimates on historical experience and on various other assumptions that management believes to be reasonable under the circumstances, actual results may differ materially from these estimates under different assumptions or conditions.

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

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

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

Estimating Losses on Excess Office Facilities. We made significant estimates in determining the appropriate amount of accrued loss on excess office facilities. If we 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.

Valuation of Equity Method Investments. We use the equity method in circumstances where we have the ability to exert significant influence, but not control, over an investee or joint venture. We initially record our investment based on a fair value analysis of the investment. Prior to 2010, most of our equity method investments were purchased with cash which was determined to be fair value. For the investment in Rhapsody as of March 31, 2010, we used multiple valuation models that were based on assumptions of future results, including operating and cash flow projections, to calculate the fair value since we contributed both cash and non-cash items in exchange for our equity interest.

Table of Contents

We record our percentage interest in the investee or joint venture s income or loss under this method, which will increase or decrease the value of the investment. We record investee losses up to the aggregate amount of the investment.

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

Valuation of Available for Sale Securities. Our investments in publicly traded companies are accounted for as available-for-sale and are carried at current market value. We periodically evaluate whether any declines in fair value of our available for sale securities are other-than-temporary based on a review of qualitative and quantitative factors. For investments with publicly quoted market prices, these factors include the time period and extent by which its accounting basis exceeds its quoted market price. We consider additional factors to determine whether declines in fair value are other-than-temporary, such as the investee s financial condition, results of operations, and operating trends. The evaluation also considers publicly available information regarding the investee companies.

Valuation of Long-Lived Assets. Long-lived assets consist primarily of property, plant and equipment, as well as amortizable intangible assets acquired in business combinations. Long-lived assets are amortized on a straight line basis over their estimated useful lives. We review long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of such assets may not be recoverable. Recoverability of these assets is measured by comparison of their carrying amount to future undiscounted cash flows the assets are expected to generate. If long-lived assets are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the assets exceeds their fair market value. The impairment analysis of long-lived assets is based upon estimates and assumptions relating to our future revenue, cash flows, operating expenses, costs of capital and capital purchases. These estimates and assumptions are complex and subject to a significant degree of judgment with respect to certain factors including, but not limited to, the cash flows of our long-term operating plans, market and interest rate risk, and risk-commensurate discount rates and cost of capital. Significant or sustained declines in future revenue or cash flows, or adverse changes in our business climate, among other factors, and their resulting impact on the estimates and assumptions relating to the value of our long-lived assets could result in the need to perform an impairment analysis in future interim periods which could result in a significant impairment. While we believe our estimates and assumptions are reasonable, due to their complexity and subjectivity, these estimates and assumptions could vary period to period.

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. We consider a synthesis of the following important factors that 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;
- market and interest rate risk;
- changes in the manner of our use of the assets or the plans for our business; and
- loss of key personnel.

In addition, we perform a reconciliation of our market capitalization plus a reasonable control premium to the aggregated implied fair value of all of our reporting units.

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

Table of Contents

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.

The impairment analysis of goodwill is based upon estimates and assumptions relating to our future revenue, cash flows, operating expenses, costs of capital and capital purchases. These estimates and assumptions are complex and subject to a significant degree of judgment with respect to certain factors including, but not limited to, the cash flows of our long-term operating plans, market and interest rate risk, and risk-commensurate discount rates and cost of capital.

Stock-Based Compensation. 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 in our common stock price 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.

Noncontrolling Interests. We record noncontrolling interest expense (benefit) which reflects the portion of the earnings (losses) of majority-owned entities which are applicable to the noncontrolling interest partners in the consolidated statement of operations. Redeemable noncontrolling interests that are redeemable at either fair value or are based on a formula that is intended to approximate fair value follow our historical disclosure only policy for the redemption feature. Redeemable noncontrolling interests that are redeemable at either a fixed price or are based on a formula that is not akin to fair value are reflected as an adjustment to income attributable to common shareholders based on the difference between accretion as calculated using the terms of the redemption feature and the accretion entry for a hypothetical fair value redemption feature with the remaining amount of accretion to redemption value recorded directly to equity. Net loss attributable to the noncontrolling interest in Rhapsody is included within the consolidated statements of operations and comprehensive income (loss). We applied this accounting policy to the noncontrolling interest in Rhapsody that was held by MTVN for periods beginning when Rhapsody was formed in August 2007 through the quarter ended March 31, 2010. Due to the completion of the restructuring of Rhapsody on March 31, 2010, which resulted in our holding approximately 47% of the outstanding shares of capital stock of Rhapsody, this accounting policy will no longer apply with respect to our investment as we no longer consolidate Rhapsody and no longer report a noncontrolling interest.

Accounting for Gains on Sale of Subsidiary Stock. Effective January 1, 2009, we adopted Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment to ARB No. 51 (*SFAS 160) which was primarily codified into FASB ASC 810 *Consolidation* (ASC 810). Current guidance requires the difference between the carrying amount of the parent s investment in a subsidiary and the underlying net book value of the subsidiary after the issuance of stock by the subsidiary to be recorded as equity transactions. We elected to recognize any such gain in our consolidated statement of operations prior to January 1, 2009 as was allowable under generally accepted accounting principles in place at that time if certain recognition criteria were met. Due to the completion of the restructuring of Rhapsody on March 31, 2010, which resulted in our holding approximately 47% of the outstanding shares of capital stock of Rhapsody, this accounting policy will no longer apply with respect to our investment as we no longer consolidate Rhapsody and no longer report a noncontrolling interest.

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

Table of Contents

consequences of temporary differences between the financial reporting and tax basis of assets and liabilities and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities and operating loss and tax credit carryforwards are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences and operating loss and tax credit carryforwards are expected to be recovered or settled. We must make assumptions, judgments and estimates to determine current provision for income taxes, deferred tax assets and liabilities and any valuation allowance to be recorded against deferred tax assets. Our judgments, assumptions, and estimates relative to the current provision for income tax take into account current tax laws, our interpretation of current tax laws and possible outcomes of future audits conducted by foreign and domestic tax authorities. Changes in tax law or our interpretation of tax laws and future tax audits could significantly impact the amounts provided for income taxes in our consolidated financial statements.

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

We have not provided for U.S. deferred income taxes or withholding taxes on certain 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.

Recently Issued Accounting Standards

With the exception of those discussed below, there have been no recent accounting pronouncements or changes in accounting pronouncements during the year ended December 31, 2010, as compared to the recent accounting pronouncements described in our Annual Report on Form 10-K for the year ended December 31, 2009, that are of significance, or potential significance to us.

In September 2009, the FASB ratified Accounting Standards Update (ASU) 2009-13 (ASU 2009-13) (previously Emerging Issues Task Force (EITF) Issue No. 08-1, *Revenue Arrangements with Multiple Deliverables* (EITF 08-1)). ASU 2009-13 superseded EITF 00-21 and addresses criteria for separating the consideration in multiple-element arrangements. ASU 2009-13 will require companies to allocate the overall consideration to each deliverable by using a best estimate of the selling price of individual deliverables in the arrangement in the absence of vendor-specific objective evidence or other third-party evidence of the selling price. ASU 2009-13 was effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. We anticipate no material impact from the adoption of ASU 2009-13 on our consolidated results of operations and financial condition.

In September 2009, the FASB ratified ASU 2009-14 (ASU 2009-14) (previously EITF No. 09-3, *Certain Revenue Arrangements That Include Software Elements)*. ASU 2009-14 modifies the scope of Software Revenue Recognition to exclude (a) non-software components of tangible products and (b) software components of tangible products that are sold, licensed, or leased with tangible products when the software components and non-software components of the tangible product function together to deliver the tangible product s essential functionality. ASU 2009-14 was effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. We anticipate no material impact from the adoption of ASU 2009-14 on our consolidated results of operations and financial condition.

Table of Contents

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk***

The following discussion about our market risk involves forward-looking statements. All statements that do not relate to matters of historical fact should be considered forward-looking statements. Actual results could differ materially from those projected in any forward-looking statements.

Interest Rate Risk. Our exposure to interest rate risk from changes in market interest rates relates primarily to our short-term investment portfolio. We do not hold derivative financial instruments or equity investments in our short-term investment portfolio. Our short-term investments consist of high quality debt securities as specified in our investment policy. Investments in both fixed and floating rate instruments carry a degree of interest rate risk. The fair value of fixed rate securities may be adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Additionally, a declining rate environment creates reinvestment risk because as securities mature the proceeds are reinvested at a lower rate, generating less interest income. Due in part to these factors, our future interest income may be adversely impacted due to changes in interest rates. In addition, we may incur losses in principal if we are forced to sell securities that have declined in market value due to changes in interest rates. Because we have historically had the ability to hold our short-term investments until maturity, we would not expect our operating results or cash flows to be significantly impacted by a sudden change in market interest rates. There have been no material changes in our investment methodology regarding our cash equivalents and short-term investments during the year ended December 31, 2010. Based on our cash, cash equivalents, short-term investments, and restricted cash equivalents at December 31, 2010, a hypothetical 10% increase/decrease in interest rates would increase/decrease our annual interest income and cash flows by approximately $0.2 million.

The table below presents the amounts related to weighted average interest rates and contractual maturities of our short-term investment portfolio at December 31, 2010 (dollars in thousands):

	Weighted Average Interest Rate	Expected Maturity Dates 2011	2012	2013- 2022	Amortized Cost	Estimated Fair Value
Short-term investments:						
Corporate notes and bonds	1.60%	$ 59,626	$ 9,390	$ 7,141	$ 75,962	$ 76,157
U.S. government agency securities	0.68%	12,419	9,727		22,126	22,146
Total short-term investments	1.39%	$ 72,045	$ 19,117	$ 7,141	$ 98,088	$ 98,303

The table below presents the amounts related to weighted average interest rates and contractual maturities of our short-term investment portfolio at December 31, 2009 (dollars in thousands):

	Weighted Average Interest Rate	Expected Maturity Dates 2010	2011	2012- 2021	Amortized Cost	Estimated Fair Value
Short-term investments:						
Corporate notes and bonds	1.50%	$ 5,362	$ 56,506	$ 11,594	$ 72,731	$ 73,462
U.S. government agency securities	1.48%	22,094	3,776	8,538	34,560	34,408
Total short-term investments	1.49%	$ 27,456	$ 60,282	$ 20,132	$ 107,291	$ 107,870

Investment Risk. As of December 31, 2010, we had investments in voting capital stock of both publicly traded and privately-held technology companies for business and strategic purposes. Our investments in publicly traded companies are accounted for as available-for-sale, carried at current market value and are classified as long-term as they are strategic in nature. We periodically evaluate whether any declines in fair value of our investments are other-than-temporary based on a review of qualitative and quantitative factors. For investments with publicly quoted market prices, these factors include the time period and extent by which its accounting basis exceeds its quoted market price. We consider additional factors to determine whether declines in fair value are other-than-temporary, such as the investee s financial condition, results of operations, and operating trends. The

evaluation also considers publicly available information regarding the investee companies. For investments in private companies with no quoted market price, we consider similar qualitative and quantitative factors as well as the implied value from any recent rounds of financing completed by the investee. Based upon an evaluation of the facts and circumstances during the years ended December 31, 2010 and 2008, we determined that no additional other-than-temporary decline in fair value had occurred and therefore no impairment charges were recorded. We determined that the value of our initial investments in one of our equity method investments, Varia LLC, was impaired and recorded an impairment of $5.0 million in the year ended December 31, 2009.

Foreign Currency Risk. We conduct business internationally in several currencies. As such, we are exposed to adverse movements in foreign currency exchange rates.

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

Generally, our practice is to manage foreign currency risk for the majority of material short-term intercompany balances through the use of foreign currency forward contracts. These contracts require us to exchange currencies at rates agreed upon at the contract s inception. Because the impact of movements in currency exchange rates on forward contracts offsets the related impact on the short-term intercompany balances, these financial instruments help alleviate the risk that might otherwise result from certain changes in currency exchange rates. We do not designate our foreign exchange forward contracts related to short-term intercompany accounts as hedges and, accordingly, we adjust these instruments to fair value through results of operations. However, we may periodically hedge a portion of our foreign exchange exposures associated with material firmly committed transactions, long-term investments, highly predictable anticipated exposures and net investments in foreign subsidiaries. Some of our unhedged exposures are reconciled through our statement of operations on a mark-to-market basis each quarter, so to the extent we continue to experience adverse economic conditions, we may record losses related to such unhedged exposures in future periods that may have a material adverse effect on our financial condition and results of operations.

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

We have cash balances denominated in foreign currencies which are subject to foreign currency fluctuation risk. The majority of our foreign currency denominated cash is held in Korean won and euros. A hypothetical 10% increase or decrease in the Korean won and euro relative to the U.S. dollar from December 31, 2010 would result in an unrealized gain or loss of approximately $5.2 million.

Foreign currency transaction gains and losses were not material for the years ended December 31, 2010, 2009, and 2008.

Table of Contents

Item 8. ***Financial Statements and Supplementary Data***

REALNETWORKS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2010	December 31, 2009
	(In thousands, except per share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 236,018	$ 277,030
Short-term investments	98,303	107,870
Trade accounts receivable, net of allowances for doubtful accounts and sales returns of $2,568 in 2010 and $3,924 in 2009	48,324	60,937
Deferred costs, current portion	9,173	5,192
Related party receivable Rhapsody	351	
Prepaid expenses and other current assets	30,441	30,624
Total current assets	422,610	481,653
Equipment, software, and leasehold improvements, at cost:		
Equipment and software	144,623	151,951
Leasehold improvements	25,367	31,041
Total equipment, software, and leasehold improvements, at cost	169,990	182,992
Less accumulated depreciation and amortization	126,619	125,878
Net equipment, software, and leasehold improvements	43,371	57,114
Restricted cash equivalents and investments	10,000	13,700
Equity method investments	15,486	50
Available for sale securities	27,541	19,503
Other assets	3,316	4,030
Deferred costs, non-current portion	18,401	10,182
Deferred tax assets, net, non-current portion	12,805	10,001
Other intangible assets, net of accumulated amortization of $59,879 in 2010 and $67,478 in 2009	6,952	10,650
Goodwill	4,960	
Total assets	$ 565,442	$ 606,883
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 30,413	$ 32,703
Accrued and other liabilities	85,702	124,934
Deferred revenue, current portion	19,036	31,374
Related party payable MTVN		11,216
Accrued loss on excess office facilities, current portion	1,144	3,228
Total current liabilities	136,295	203,455
Deferred revenue, non-current portion	460	1,933
Accrued loss on excess office facilities, non-current portion	3,380	
Deferred rent	3,514	4,464
Deferred tax liabilities, net, non-current portion	1,049	961
Other long-term liabilities	7,999	13,006
Total liabilities	152,697	223,819
Redeemable noncontrolling interest in Rhapsody (see Note 3)		7,253
Commitments and contingencies		

Shareholders equity:		
Preferred stock, $0.001 par value, no shares issued and outstanding		
Series A: authorized 200 shares		
Undesignated series: authorized 59,800 shares		
Common stock, $0.001 par value authorized 1,000,000 shares; issued and outstanding 136,083 shares in 2010 and 135,057 shares in 2009	136	135
Additional paid-in capital	697,430	647,562
Sale of noncontrolling interest in Rhapsody		24,044
Accumulated other comprehensive loss	(32,543)	(38,614)
Retained deficit	(252,278)	(257,316)
Total shareholders equity	412,745	375,811
Total liabilities and shareholders equity	$ 565,442	$ 606,883

See accompanying notes to consolidated financial statements.

Table of Contents

REALNETWORKS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

	Years Ended December 31,		
	2010	2009	2008
	(In thousands, except per share data)		
Net revenue(A)	$ 401,733	$ 562,264	$ 604,810
Cost of revenue(B)	144,723	222,142	233,244
Impairment of deferred costs and prepaid royalties(B)			19,666
Gross profit	257,010	340,122	351,900
Operating expenses:			
Research and development	100,955	119,448	113,680
Sales and marketing	118,543	165,856	211,922
Advertising with related party	1,065	33,292	44,213
General and administrative	51,217	79,164	69,981
Impairment of goodwill and long-lived assets		175,583	192,676
Restructuring and other charges	12,361	4,017	6,833
Loss on excess office facilities	7,396		
Total operating expenses	291,537	577,360	639,305
Operating loss	(34,527)	(237,238)	(287,405)
Other income (expenses), net:			
Interest income, net	2,417	3,969	13,453
Gain (loss) on sale of equity investments	(9)	688	210
Equity in net loss of Rhapsody and other equity method investments	(14,164)	(1,313)	(695)
Impairment of equity investments		(5,020)	
Gain on deconsolidation of Rhapsody	10,929		
Gain on sale of interest in Rhapsody			14,502
Other income (expense)	1,031	(794)	330
Other income (expense), net	204	(2,470)	27,800
Loss before income taxes	(34,323)	(239,708)	(259,605)
Income taxes benefit (expense)	36,451	(3,321)	(25,828)
Net income (loss)	2,128	(243,029)	(285,433)
Net loss attributable to noncontrolling interest in Rhapsody prior to deconsolidation	2,910	26,265	41,555
Net income (loss) attributable to common shareholders	$ 5,038	$ (216,764)	$ (243,878)
Basic net income (loss) per share available to common shareholders	$ 0.06	$ (1.64)	$ (1.74)
Diluted net income (loss) per share available to common shareholders	$ 0.06	$ (1.64)	$ (1.74)
Shares used to compute basic net income (loss) per share available to common shareholders	135,577	134,612	140,432
Shares used to compute diluted net income (loss) per share available to common shareholders	136,053	134,612	140,432
Comprehensive income (loss):			
Net income (loss)	$ 2,128	$ (243,029)	$ (285,433)
Unrealized gain (loss) on investments:			
Unrealized holding gains (losses), net of tax	7,676	6,667	(2,320)

Foreign currency translation gains (losses)	(1,605)	3,448	(64,141)
Comprehensive income (loss)	$ 8,199	$ (232,914)	$ (351,894)
(A) Components of net revenue:			
License fees	$ 74,908	$ 100,996	$ 113,990
Service revenue	326,825	461,268	490,820
	$ 401,733	$ 562,264	$ 604,810
(B) Components of cost of revenue:			
License fees	$ 21,451	$ 35,850	$ 50,097
Service revenue	123,272	186,292	202,813
	$ 144,723	$ 222,142	$ 252,910

See accompanying notes to consolidated financial statements.

Table of Contents

REALNETWORKS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2010	2009	2008
		(In thousands)	
Cash flows from operating activities:			
Net income (loss)	$ 2,128	$ (243,029)	$ (285,433)
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Depreciation and amortization	23,401	31,454	45,968
Stock-based compensation	12,203	21,460	23,531
Deferred income tax expense	622	4,255	11,583
Impairment of equity investments		5,020	
Loss (gain) on disposal of equipment, software, and leasehold improvements	(41)	502	10
Excess tax benefit from stock option exercises	(48)	(15)	(127)
Accrued loss on excess office facilities	5,670	(3,982)	(3,490)
Loss (gain) on sale of equity investments	9	(688)	(210)
Equity in net loss of Rhapsody and other investments	14,164	1,313	695
Gain on deconsolidation of Rhapsody	(10,929)		
Gain on sale of interest in Rhapsody			(14,502)
Impairment of goodwill and long-lived assets		175,583	192,676
Accrued restructuring and other charges	652	(2,773)	5,524
Other	451	48	111
Changes in certain assets and liabilities, net of acquisitions and deconsolidation of Rhapsody:			
Trade accounts receivable	4,856	10,720	9,518
Prepaid expenses and other assets	(15,425)	1,789	(5,040)
Accounts payable	(1,202)	(4,879)	(13,709)
Accrued and other liabilities	(67,633)	(6,082)	3,609
Net cash used in operating activities	(31,122)	(9,304)	(29,286)
Cash flows from investing activities:			
Purchases of equipment, software, and leasehold improvements	(12,904)	(16,807)	(29,530)
Purchases of short-term investments	(116,831)	(143,273)	(251,887)
Proceeds from sales and maturities of short-term investments	126,398	173,169	194,053
Purchases of intangible and other assets			(2,839)
Decrease in restricted cash equivalents and investments, net	3,700	1,042	768
Proceeds from sale of equity investments		1,014	1,140
Purchases of equity investments		(2,000)	(14,731)
Sale of Exomi, net of cash received	49		
Payment in connection with the restructuring of Rhapsody	(18,000)		
Repayment of temporary funding on deconsolidation of Rhapsody	5,869		
Cash used in acquisitions, net of cash acquired	(5,806)	(3,324)	(10,192)
Net cash (used in) provided by investing activities	(17,525)	9,821	(113,218)
Cash flows from financing activities:			
Net proceeds from sales of common stock under employee stock purchase plan and exercise of stock options	2,678	1,455	9,570
Repayment of convertible debt			(100,000)
Net proceeds from sales of interest in Rhapsody	1,213	38,022	44,640
Excess tax benefit from stock option exercises	48	15	127
Repurchase of common stock			(50,199)

Net cash provided by (used in) financing activities	3,939	39,492	(95,862)
Effect of exchange rate changes on cash and cash equivalents	3,696	4,053	(5,363)
Net (decrease) increase in cash and cash equivalents	(41,012)	44,062	(243,729)
Cash and cash equivalents, beginning of year	277,030	232,968	476,697
Cash and cash equivalents, end of year	$ 236,018	$ 277,030	$ 232,968
Supplemental disclosure of cash flow information:			
Cash received from income tax refunds	$ 29,800	$ 7,888	$
Cash paid for income taxes	$ 4,905	$ 5,697	$ 12,110

See accompanying notes to consolidated financial statements.

49

Table of Contents

REALNETWORKS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY AND

NONCONTROLLING INTEREST

	Redeemable Noncontrolling Interest in Rhapsody America	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Sale of Noncontrolling Interest in Rhapsody America	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Deficit)	Total Shareholders Equity
					(In thousands)			
Balances, December 31, 2007	19,613	142,298	142	653,904		17,732	203,326	875,104
Common stock issued for exercise of stock options, employee stock purchase plan, and vesting of restricted shares		1,990	2	9,547				9,549
Common shares repurchased		(9,955)	(10)	(50,189)				(50,199)
Common shares awarded		6		21				21
Shares issued for director payments		15		110				110
Stock-based compensation				23,531				23,531
Unrealized loss on investments, net of income tax						(2,320)		(2,320)
Translation adjustment						(64,141)		(64,141)
Tax deficiency from stock option exercises				(1,600)				(1,600)
Sale of non-controlling interest in Rhapsody					7,381			7,381
Contributions and other transactions with owners	22,321							
Net loss	(41,555)						(243,878)	(243,878)
Balances, December 31, 2008	$ 378	134,354	$ 134	$ 635,324	$ 7,381	$ (48,729)	$ (40,552)	$ 553,558
Common stock issued for exercise of stock options, employee stock purchase plan, and vesting of restricted shares		688	1	1,166				1,167
Shares issued for director payments		15		48				48
Stock-based compensation				21,460				21,460
Unrealized gain on investments, net of income tax						6,667		6,667
Translation adjustment						3,448		3,448
Sale of non-controlling interest in Rhapsody								