

REALNETWORKS INC
Form 10-Q
August 09, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended June 30, 2011

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)

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Washington
(State of incorporation)

91-1628146
(I.R.S. Employer

Identification Number)

2601 Elliott Avenue, Suite 1000

Seattle, Washington
(Address of principal executive offices)

98121
(Zip Code)

(206) 674-2700

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer Accelerated filer

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

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

The number of shares of the registrant's Common Stock outstanding as of July 29, 2011 was 136,791,347.

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****REALNETWORKS, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except per share data)**

	June 30, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 236,730	\$ 236,018
Short-term investments	91,142	98,303
Trade accounts receivable, net of allowances for doubtful accounts and sales returns	46,011	48,324
Deferred costs, current portion	9,882	9,173
Related party receivable Rhapsody	527	351
Prepaid expenses and other current assets	24,845	30,441
Total current assets	409,137	422,610
Equipment, software, and leasehold improvements, at cost:		
Equipment and software	146,744	144,623
Leasehold improvements	25,454	25,367
Total equipment, software, and leasehold improvements, at cost	172,198	169,990
Less accumulated depreciation and amortization	131,193	126,619
Net equipment, software, and leasehold improvements	41,005	43,371
Restricted cash equivalents and investments	10,141	10,000
Equity method investments	11,397	15,486
Available for sale securities	26,150	27,541
Other assets	3,064	3,316
Deferred costs, non-current portion	16,443	18,401
Deferred tax assets, net, non-current portion	12,943	12,805
Other intangible assets, net	9,837	6,952
Goodwill	6,502	4,960
Total assets	\$ 546,619	\$ 565,442
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 22,194	\$ 30,413
Accrued and other liabilities	82,199	85,702
Deferred revenue, current portion	18,010	19,036
Accrued loss on excess office facilities, current portion	1,391	1,144
Total current liabilities	123,794	136,295
Deferred revenue, non-current portion	88	460
Accrued loss on excess office facilities, non-current portion	2,430	3,380
Deferred rent	3,032	3,514

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Deferred tax liabilities, net, non-current portion	2,015	1,049
Other long-term liabilities	11,231	7,999
Total liabilities	142,590	152,697
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, \$0.001 par value, no shares issued and outstanding:		
Series A: authorized 200 shares	0	0
Undesignated series: authorized 59,800 shares	0	0
Common stock, \$0.001 par value authorized 1,000,000 shares; issued and outstanding 136,783 shares in 2011 and 136,083 shares in 2010	137	136
Additional paid-in capital	705,344	697,430
Accumulated other comprehensive loss	(30,018)	(32,543)
Retained deficit	(271,434)	(252,278)
Total shareholders' equity	404,029	412,745
Total liabilities and shareholders' equity	\$ 546,619	\$ 565,442

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**REALNETWORKS, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****AND COMPREHENSIVE INCOME (LOSS)****(In thousands, except per share data)**

	Quarters Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
Net revenue (A)	\$ 83,752	\$ 88,884	\$ 171,053	\$ 217,484
Cost of revenue (B)	30,666	29,149	62,732	78,308
Gross profit	53,086	59,735	108,321	139,176
Operating expenses:				
Research and development	17,809	27,583	37,704	62,258
Sales and marketing	28,853	27,382	57,333	65,209
Advertising with related party	0	0	0	1,065
General and administrative	10,874	14,590	16,496	29,511
Restructuring and other charges	508	4,792	7,412	10,407
Loss (gain) on excess office facilities	(174)	7,082	(174)	7,082
Total operating expenses	57,870	81,429	118,771	175,532
Operating loss	(4,784)	(21,694)	(10,450)	(36,356)
Other income (expenses):				
Interest income, net	311	551	690	931
Equity in net loss of Rhapsody and other equity method investments	(1,018)	(5,427)	(4,299)	(5,427)
Loss on sale of equity investments, net	0	(50)	0	(50)
Gain on deconsolidation of Rhapsody	0	0	0	10,929
Other income (expense), net	(311)	994	(433)	1,093
Total other income (expenses), net	(1,018)	(3,932)	(4,042)	7,476
Loss before income taxes	(5,802)	(25,626)	(14,492)	(28,880)
Income tax benefit (expense)	(1,047)	(281)	(4,662)	3,291
Net loss	(6,849)	(25,907)	(19,154)	(25,589)
Net loss attributable to noncontrolling interest in Rhapsody				2,910
Net loss attributable to common shareholders	\$ (6,849)	\$ (25,907)	\$ (19,154)	\$ (22,679)
Basic net income (loss) per share available to common shareholders	\$ (0.05)	\$ (0.19)	\$ (0.14)	\$ (0.14)
Diluted net income (loss) per share available to common shareholders	\$ (0.05)	\$ (0.19)	\$ (0.14)	\$ (0.14)
Shares used to compute basic net income (loss) per share available to common shareholders	136,539	135,277	136,266	135,209
Shares used to compute diluted net income (loss) per share available to common shareholders	136,539	135,277	136,266	135,209
Comprehensive income (loss):				
Net loss	\$ (6,849)	\$ (25,907)	\$ (19,154)	\$ (25,589)

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Unrealized holding gains (losses) on short-term and equity, investments net of income taxes	5,679	(3,160)	(1,387)	(1,609)
Foreign currency translation gains (losses)	1,357	(4,743)	3,910	(6,354)
Comprehensive income (loss)	187	(33,810)	(16,631)	(33,552)
Net loss attributable to noncontrolling interest in Rhapsody	0	0	0	2,910
Comprehensive income (loss) attributable to common shareholders	\$ 187	\$ (33,810)	\$ (16,631)	\$ (30,642)
(A) Components of net revenue:				
License fees	\$ 16,817	\$ 16,644	\$ 35,232	\$ 40,816
Service revenue	66,935	72,240	135,821	176,668
	\$ 83,752	\$ 88,884	\$ 171,053	\$ 217,484
(B) Components of cost of revenue:				
License fees	\$ 4,800	\$ 5,668	\$ 10,046	\$ 13,217
Service revenue	25,866	23,481	52,686	65,091
	\$ 30,666	\$ 29,149	\$ 62,732	\$ 78,308

See accompanying notes to unaudited condensed consolidated financial statements.

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(in thousands)

	Six Months Ended June 30,	
	2011	2010
Cash flows from operating activities:		
Net loss	\$ (19,154)	\$ (25,589)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	8,116	13,973
Stock-based compensation	6,129	6,692
Loss (gain) on disposal of equipment, software, and leasehold improvements	85	(3)
Equity in net loss of Rhapsody and other investments	4,299	5,427
Loss on sale of equity investments, net	0	50
Excess tax benefit from stock option exercises	(57)	(18)
Gain on deconsolidation of Rhapsody	0	(10,929)
Accrued loss (gain) on excess office facilities	(174)	6,470
Deferred income taxes, net	(351)	(1,609)
Accrued restructuring and other charges	131	3,581
Other	62	22
Net change in certain operating assets and liabilities, net of acquisitions, disposals and deconsolidation of Rhapsody:		
Trade accounts receivable	3,661	7,649
Prepaid expenses and other assets	7,837	(7,336)
Accounts payable	(10,593)	(2,417)
Accrued and other liabilities	(5,481)	(52,300)
Net cash used in operating activities	(5,490)	(56,337)
Cash flows from investing activities:		
Purchases of equipment, software, and leasehold improvements	(3,134)	(9,507)
Purchases of short-term investments	(54,844)	(65,754)
Proceeds from sales and maturities of short-term investments	62,005	16,559
Decrease (increase) in restricted cash equivalents and investments, net	(141)	3,700
Payment in connection with the restructuring of Rhapsody	0	(18,000)
Payment of acquisition costs, net of cash acquired	(2,888)	0
Repayment of temporary funding upon deconsolidation of Rhapsody	0	5,869
Net cash provided by (used in) investing activities	998	(67,133)
Cash flows from financing activities:		
Net proceeds from sale of common stock under employee stock purchase plan and exercise of stock options	1,610	1,272
Excess tax benefit from stock option exercises	57	18
Net proceeds from sales of interest in Rhapsody	0	1,213
Net cash provided by financing activities	1,667	2,503
Effect of exchange rate changes on cash and cash equivalents	3,537	92
Net increase (decrease) in cash and cash equivalents	712	(120,875)
Cash and cash equivalents, beginning of period	236,018	277,030

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Cash and cash equivalents, end of period	\$ 236,730	\$ 156,155
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Supplemental disclosure of cash flow information:

Cash received from income tax refunds	\$ 3,534	\$ 131
Cash paid for income taxes	\$ 3,459	\$ 1,818

See accompanying notes to unaudited condensed consolidated financial statements.

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REALNETWORKS, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Quarters and Six Months Ended June 30, 2011 and 2010

Note 1. Summary of Significant Accounting Policies

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

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

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

On August 20, 2007, RealNetworks and MTV Networks, a division of Viacom International Inc. (MTVN), created Rhapsody America LLC (Rhapsody) to jointly own and operate a business-to-consumer digital audio music service. RealNetworks held a 51% interest in Rhapsody and Rhapsody's financial position and operating results were consolidated into RealNetworks' financial statements prior to March 31, 2010. MTVN's proportionate share of income (loss) was included in noncontrolling interest in Rhapsody in the unaudited condensed consolidated statements of operations and comprehensive income (loss). MTVN's proportionate share of equity was included in noncontrolling interest in Rhapsody in the unaudited condensed consolidated balance sheets. On March 31, 2010, the Company and MTVN restructured Rhapsody, and RealNetworks held approximately 47% of the outstanding shares of capital stock of Rhapsody after the restructuring. RealNetworks continues to own approximately 47% of the outstanding shares of capital stock as of June 30, 2011. Since March 31, 2010, RealNetworks has not held a controlling interest in Rhapsody and therefore, the Company has treated its ownership interest in Rhapsody as an equity method investment. Rhapsody's financial position as of March 31, 2010 and its operating results beginning April 1, 2010 are no longer consolidated with RealNetworks' consolidated financial statements.

The unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal, recurring adjustments that, in the opinion of the Company's management, are necessary for a fair presentation of the results of operations for the periods presented. Operating results for the quarter and six month period ended June 30, 2011 are not necessarily indicative of the results that may be expected for any subsequent period or for the year ending December 31, 2011. Certain information and disclosures normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC).

These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

Revenue Recognition. The Company recognizes 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 products or services are made available, digitally, to the end user.

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

In the Company's direct to consumer business, the Company derives revenue through (1) subscriptions of SuperPass within the Company's Core Products segment and subscriptions sold by the Company's Games segment, (2) sales of content downloads, software and licenses offered by the Company's Core Products, Emerging Products and Games segments and (3) the sale of advertising and the distribution of third-party products on its websites and in its games. Prior to April 1, 2010, the Company's direct to consumer business also included the products and services primarily sold by the Company's Rhapsody joint venture and included in the Company's Music segment. Beginning on April 1, 2010, revenue from the Company's Rhapsody joint venture is no longer consolidated within the Company's financial statements. The Company now reports its share of Rhapsody's net income or losses as Equity in net loss of Rhapsody and other equity method investments.

Consumer subscription products are paid in advance, typically for a 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 the Company's websites and from advertising and the distribution of third-party products included in the Company's products is recognized as revenue at the time of delivery.

The Company also generates revenue through business-to-business channels by providing services within the Company's 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. Revenue arrangements with multiple deliverables are divided into separate units and revenue is allocated using estimated selling prices if the Company does not have vendor-specific objective evidence or third-party evidence of the selling prices of the deliverables. Unearned revenue due to undelivered elements is recognized ratably on a straight-line basis over the related products' contract term.

Accounting for Gains on Sale of Subsidiary Stock. Effective January 1, 2009, the Company adopted Statement of Financial Accounting Standards No. 160, *Non-controlling Interests in Consolidated Financial Statements, an amendment to ARB No. 51* (SFAS 160) which was primarily codified into FASB ASC 810 *Consolidation* (ASC 810). Current guidance requires that the difference between the carrying amount of the parent's investment in a subsidiary and the underlying net book value be recorded as an equity transaction. The Company elected to recognize any such gain in its consolidated statements 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 the Company holding approximately 47% of the outstanding shares of capital stock of Rhapsody, this accounting policy no longer applies with respect to its investment as the Company no longer consolidates Rhapsody and no longer reports a noncontrolling interest.

Noncontrolling Interests. The Company records noncontrolling interest expense (benefit) which reflects the portion of the earnings (losses) of majority-owned entities which are applicable to the noncontrolling interest holders in the consolidated statements 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 the Company's 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). The Company applied this accounting policy to the noncontrolling interest in

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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 the Company holding approximately 47% of the outstanding shares of capital stock of Rhapsody, this accounting policy no longer applies with respect to the Company's investment as the Company no longer consolidates Rhapsody and no longer reports a noncontrolling interest.

Note 2. Recent Accounting Pronouncements

With the exception of those discussed below, there have been no recent accounting pronouncements or changes in accounting pronouncements during the six months ended June 30, 2011, to be implemented by the Company in future periods as compared to the recent accounting pronouncements described in the Company's Annual Report on Form 10-K for the year ended December 31, 2010, that are of significance, or potential significance to the Company.

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 supersedes EITF 00-21 and addresses criteria for separating the consideration in multiple-element arrangements. ASU 2009-13 requires 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.

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.

The Company elected to adopt ASU 2009-13 and ASU 2009-14 at the beginning of the first quarter of 2011 on a prospective basis. The Company did not have a significant change in units of accounting, allocation methodology, or timing of revenue recognition. As a result, the adoption of these accounting standards did not have a material impact on the Company's consolidated financial position, results of operations or financial condition.

Note 3. Stock-Based Compensation

Stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense over the requisite service period, which is the vesting period. The Company uses the Black-Scholes option-pricing model to determine the fair-value of stock-based awards. The Company recognizes compensation cost related to options granted on a straight-line basis over the applicable vesting period.

The expected term of the options represents the estimated period of time until exercise and is based on historical experience of similar awards, including the contractual terms, vesting schedules, and expectations of future employee behavior. Expected stock price volatility is based on a combination of historical volatility of the Company's stock for the related expected term and the implied volatility of its traded options. The risk-free interest rate is based on the implied yield available on U.S. Treasury zero-coupon issues with a term equivalent to the expected term of the stock options. Notwithstanding the special dividend described in Note 19, dividend yield is estimated at zero because the Company does not anticipate paying regular dividends in the foreseeable future.

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

	Quarters		Six Months	
	Ended June 30, 2011	2010	Ended June 30, 2011	2010
Expected dividend yield	0%	0%	0%	0%
Risk-free interest rate	1.57%	1.65%	1.73%	1.91%
Expected life (years)	4.0	4.0	4.0	4.0
Volatility	54%	62%	54%	62%

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

	Quarters		Six Months	
	Ended June 30, 2011	2010	Ended June 30, 2011	2010
Cost of revenue	\$ 234	\$ 228	\$ 522	\$ 459
Research and development	306	693	803	2,290
Sales and marketing	994	811	1,928	1,807
General and administrative	1,152	1,039	2,040	2,136
Restructuring and other charges	(10)	0	836	0
Total stock-based compensation expense	\$ 2,676	\$ 2,771	\$ 6,129	\$ 6,692

No stock-based compensation was capitalized as part of the cost of an asset during the quarters or six month periods ended June 30, 2011 or 2010. As of June 30, 2011, \$14.6 million of total unrecognized compensation cost, net of estimated forfeitures, related to stock options, is expected to be recognized over a weighted-average period of 2.9 years.

Note 4. Rhapsody Joint Venture***Restructuring of Rhapsody***

As described in Note 1. Summary of Significant Accounting Policies, the Company initially formed in August 2007 a joint venture with MTVN to own and operate a business-to-consumer digital audio music service known as Rhapsody. Prior to March 31, 2010, the Company held a 51% interest in Rhapsody and MTVN owned the remaining 49%. On March 31, 2010, restructuring transactions involving Rhapsody were completed, and Rhapsody was converted from a limited liability company to a corporation. Following the completion of the restructuring transactions, RealNetworks owned approximately 47%, MTVN owned approximately 47%, and two minority stockholders held slightly more than 5% of the outstanding shares of capital stock of Rhapsody.

As part of the March 31, 2010 restructuring, RealNetworks contributed \$18.0 million in cash, the Rhapsody brand and certain other assets, including content licenses, in exchange for shares of convertible preferred stock of Rhapsody, carrying a \$10.0 million preference upon certain liquidation events. RealNetworks' cash contribution included the repurchase of the international radio business that was previously contributed to Rhapsody by RealNetworks. MTVN contributed a \$33.0 million advertising commitment in exchange for shares of common stock of Rhapsody, and MTVN's previous obligation to provide advertising of approximately \$111 million as of December 31, 2009 was cancelled. In addition, the put and call rights held by RealNetworks and MTVN and MTVN's rights to receive a preferred return in connection with the exercise of RealNetworks' put right were terminated. RealNetworks is also providing certain operational transition services to Rhapsody. These transition services are expected to be completed in the first half of 2012. Rhapsody is governed by a board of directors with two directors appointed by each of the Company and MTVN and one independent director appointed by mutual agreement of the Company and MTVN.

Effective March 31, 2010, RealNetworks no longer has a controlling interest in Rhapsody and therefore, the operating results of Rhapsody are accounted for under the equity method of accounting for investments, and the Company's proportionate share of the income or loss is recognized as a component of Other income (expenses), net in the Company's condensed consolidated statements of operations in periods subsequent to March 31, 2010. As a result of the deconsolidation of Rhapsody's operations from the Company's financial statements, the Company no longer records any operating results for its Music segment for periods subsequent to March 31, 2010. The removal of these assets and liabilities and the creation of the initial equity method investment resulted in a one-time net gain of \$10.9 million recorded in Other income (expenses), net in the Company's unaudited condensed consolidated statements of operations for the quarter ended March 31, 2010, at which time the Company determined the fair value of its retained interest of approximately 47% to be approximately \$29.7 million as of March 31, 2010. The Company recorded its share of losses in the operations of Rhapsody of approximately \$1.0 million and \$4.3 million for the quarter and six months ended June 30, 2011, respectively, and \$5.4 million for the quarter and six months ended June 30, 2010. These losses reduced the carrying value of the investment to approximately \$11.2 million as of June 30, 2011.

As mentioned above, MTVN's preferred return rights were terminated in connection with the restructuring of Rhapsody. Prior to the restructuring, if the appraised value of Rhapsody at a redemption date was less than \$436.3 million, then the exercise price of the put right would have included a preferred return to MTVN. The Company previously elected to accrete any excess of the redemption value over the carrying amount of the noncontrolling interest as an adjustment to income attributable to common shareholders, and adjusted

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earnings per share for the current quarter's accretion of the difference between accretion as calculated using the terms of the redemption feature and the accretion entry for a hypothetical fair value redemption feature. Due to the termination of MTVN's preferred return rights at the completion of the restructuring, the Company decreased the noncontrolling interest that was on the unaudited condensed consolidated balance sheet at March 31, 2010, prior to the transaction above by \$10.4 million as part of the deconsolidation transactions, of which \$3.7 million was an adjustment to income attributable to common shareholders for the purposes of calculating earnings per share for the quarter ended March 31, 2010.

Noncontrolling interest rollforward

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

	Noncontrolling interest	Total Equity
Balances, December 31, 2009	\$ 7,253	\$ 375,811
Net loss	0	(25,589)
Net loss attributable to noncontrolling interest in Rhapsody	(2,910)	2,910
Contribution and other transactions with owners	616	619
Reversal of MTVN's accretion equity interest in Rhapsody	(6,736)	6,736
Reversal of MTVN's preferred return in Rhapsody	(3,700)	3,700
Deconsolidation	5,477	0
Unrealized holding losses on short-term and equity investments, net of taxes	0	(1,609)
Foreign currency translation losses	0	(6,354)
Stock-based transactions and compensation expense, net of taxes	0	7,861
Balances, June 30, 2010	\$ 0	\$ 364,085

Summarized financial information for Rhapsody for the period accounted for under the equity method (in thousands):

	Quarter Ended June 30, 2011	Six Months Ended June 30, 2011
Statements of Operations Data:		
Net revenue	\$ 30,985	\$ 63,472
Gross profit	9,793	19,238
Net loss	(2,165)	(9,146)

Note 5. Fair Value Measurements

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

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

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

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Level 3: Unobservable inputs that reflect the reporting entity's own assumptions

Table of Contents**Items Measured at Fair Value on a Recurring Basis**

The following table presents information about the Company's financial assets that have been measured at fair value on a recurring basis as of June 30, 2011, and December 31, 2010, and indicates the fair value hierarchy of the valuation inputs utilized to determine such fair value (in thousands).

	Fair Value Measurements as of			
	June 30, 2011			
	Total	Level 1	Level 2	Level 3
Cash equivalents:				
Money market funds	\$ 31,075	\$ 31,075	\$ 0	\$ 0
Corporate notes and bonds	126,398	126,398	0	0
U.S. government agency securities	4,200	4,200	0	0
Short-term investments:				
Corporate notes and bonds	52,564	52,564	0	0
U.S. government agency securities	38,578	38,578	0	0
Restricted cash equivalents and investments	10,141	10,141	0	0
Available for sale securities:				
Publicly traded investments	26,150	26,150	0	0
Total	\$ 289,106	\$ 289,106	\$ 0	\$ 0

	Fair Value Measurements as of			
	December 31, 2010			
	Total	Level 1	Level 2	Level 3
Cash equivalents:				
Money market funds	\$ 44,348	\$ 44,348	\$ 0	\$ 0
Corporate notes and bonds	120,984	120,984	0	0
U.S. Government agency securities	3,700	3,700	0	0
Short-term investments:				
Corporate notes and bonds	76,157	76,157	0	0
U.S. government agency securities	22,146	22,146	0	0
Restricted cash equivalents and investments	10,000	10,000	0	0
Available for sale securities:				
Publicly traded investments	27,541	27,541	0	0
Total	\$ 304,876	\$ 304,876	\$ 0	\$ 0

Investments in marketable securities classified as short-term investments and equity investments of public companies are measured at fair value using quoted market prices and are classified within Level 1 of the valuation hierarchy. The Company carries its equity investments in private companies at cost and no fair value is derived on a recurring basis. The Company has consistently applied these valuation techniques in all periods presented.

Items Measured at Fair Value on a Nonrecurring Basis

Certain assets and liabilities of the Company are measured at estimated fair value on a non-recurring basis. These instruments are subject to fair value adjustments only in certain circumstances (for example, when there is evidence of impairment). The Company performed a valuation using Level 3 inputs of its investment in the Rhapsody joint venture as of March 31, 2010. The Company performed the analysis as a result of the restructuring and related deconsolidation of Rhapsody, which is further described in Note 4, Rhapsody Joint Venture. The fair value analysis used multiple valuation models and was based on assumptions of future results made by management, including operating and cash flow projections.

Table of Contents**Note 6. Cash, Cash Equivalents, Short-Term Investments, Restricted Cash Equivalents and Investments**

Cash, cash equivalents, short-term investments, and restricted cash equivalents as of June 30, 2011, consist of the following (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Cash and cash equivalents:				
Cash	\$ 75,057	\$ 0	\$ 0	\$ 75,057
Money market mutual funds	31,075	0	0	31,075
Corporate notes and bonds	126,398	0	0	126,398
U.S. government agency securities	4,200	0	0	4,200
Total cash and cash equivalents	236,730	0	0	236,730
Short-term investments:				
Corporate notes and bonds	52,411	163	(10)	52,564
U.S. government agency securities	38,506	80	(8)	38,578
Total short-term investments	90,917	243	(18)	91,142
Total cash, cash equivalents and short-term investments	\$ 327,647	\$ 243	\$ (18)	\$ 327,872
Restricted cash equivalents and investments	\$ 10,141	\$ 0	\$ 0	\$ 10,141

Cash, cash equivalents, short-term investments, and restricted cash equivalents as of December 31, 2010 consist of the following (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Cash and cash equivalents:				
Cash	\$ 66,986	\$ 0	\$ 0	\$ 66,986
Money market mutual funds	44,348	0	0	44,348
Corporate notes and bonds	120,984	0	0	120,984
U.S. government agency securities	3,700	0	0	3,700
Total cash and cash equivalents	236,018	0	0	236,018
Short-term investments:				
Corporate notes and bonds	75,962	221	(26)	76,157
U.S. government agency securities	22,126	23	(3)	22,146
Total short-term investments	98,088	244	(29)	98,303
Total cash, cash equivalents and short-term investments	\$ 334,106	\$ 244	\$ (29)	\$ 334,321
Restricted cash equivalents and investments	\$ 10,000	\$ 0	\$ 0	\$ 10,000

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At June 30, 2011, and December 31, 2010, restricted cash equivalents and investments represent cash equivalents and short-term investments pledged as collateral against a letter of credit for a total of \$10.1 million in connection with lease agreements.

Realized gains or losses on sales of available-for-sale securities for the quarters and six month period ended June 30, 2011 and 2010, were not significant.

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

The contractual maturities of short-term investments at June 30, 2011, are as follows (in thousands):

	Amortized Cost	Estimated Fair Value
Within one year	\$ 38,860	\$ 38,915
Between one year and five years	52,057	52,227
Total short-term investments	\$ 90,917	\$ 91,142

Note 7. Allowance for Doubtful Accounts Receivable and Sales Returns

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

	Allowance For	
	Doubtful Accounts Receivable	Sales Returns
Balances, December 31, 2010	\$ 1,529	\$ 1,039
Additional charged to expenses	271	489
Amounts written off	(337)	(485)
 Balances, June 30, 2011	 \$ 1,463	 \$ 1,043

No customers accounted for 10% or more of trade accounts receivable as of June 30, 2011. As of December 31, 2010, one customer accounted for 15% of trade accounts receivable. No one customer accounted for more than 10% of total revenue during the quarters and six months ended June 30, 2011 and 2010.

Note 8. Available for Sale Securities

As of June 30, 2011 and December 31, 2010, the carrying value of the Company's equity investments in publicly traded companies consisted primarily of J-Stream Inc., a Japanese media services company, and LoEn Entertainment, Inc., a Korean digital music distribution company. These equity investments are accounted for as available for sale. Although the carrying value of the available for sale securities was \$26.2 million at June 30, 2011, there can be no assurance that any gain can be realized through the disposition of these shares.

Summary of available for sale securities is as follows (in thousands):

	June 30, 2011		December 31, 2010	
	Cost	Carrying Value	Cost	Carrying Value
Available for sale securities	\$ 10,765	\$ 26,150	\$ 10,765	\$ 27,541

Table of Contents**Note 9. Other Intangible Assets**

Other intangible assets consist of the following (in thousands):

	Gross Amount	Accumulated Amortization	Net
Customer relationships	\$ 31,610	\$ 25,381	\$ 6,229
Developed technology	29,870	26,485	3,385
Patents, trademarks and tradenames	5,495	5,434	61
Service contracts and other	6,339	6,177	162
Total other intangible assets, June 30, 2011	\$ 73,314	\$ 63,477	\$ 9,837
Total other intangible assets, December 31, 2010	\$ 66,831	\$ 59,879	\$ 6,952

Amortization expense related to other intangible assets during the quarter and six months ended June 30, 2011 was \$1.1 million and \$1.8 million, respectively. Amortization expense related to other intangible assets during the quarter and six months ended June 30, 2010 was \$1.2 million and \$2.5 million, respectively.

As of June 30, 2011, estimated future amortization of other intangible assets is as follows (in thousands):

2011 (remaining six months)	\$ 2,316
2012	4,183
2013	2,582
2014	418
2015	338
Total	\$ 9,837

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of such assets may not be recoverable. Recoverability of these assets is measured by comparing their carrying amount to future undiscounted cash flows the assets are expected to generate. If long-lived assets are considered to be impaired, the impairment to be recognized equals the amount by which the carrying value of the assets exceeds their fair market value. The Company did not record any impairment to long-lived assets during the quarter or six months ended June 30, 2011 or 2010.

Note 10. Goodwill

Changes in goodwill are as follows (in thousands):

Balances, December 31, 2010	\$ 4,960
Increases from acquisitions	1,385
Effects of foreign currency translation	157
Balances, June 30, 2011	\$ 6,502

Goodwill is assigned to the Company's segments as follows (in thousands):

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	June 30, 2011	December 31, 2010
Core products	\$ 805	\$ 0
Emerging products	580	0
Games	5,117	4,960
 Total goodwill	 \$ 6,502	 \$ 4,960

In accordance with ASC 350 Intangibles – Goodwill and Other, goodwill is required to be tested for impairment annually and also if there is an event or change in conditions that would more likely than not reduce the fair value of a reporting unit below its carrying value. The Company performs its annual goodwill impairment test during its fiscal fourth quarter. No impairments were recognized in the quarter or six months ended June 30, 2011.

Table of Contents**Note 11. Accrued and Other Liabilities**

Accrued and other liabilities consist of (in thousands):

	June 30, 2011	December 31, 2010
Royalties and other fulfillment costs	\$ 30,228	\$ 30,190
Employee compensation, commissions and benefits	14,325	19,353
Sales, VAT and other taxes payable	13,139	13,104
Deferred tax liabilities - current	12,248	12,162
Other	12,259	10,893
Total accrued and other liabilities	\$ 82,199	\$ 85,702

Note 12. Restructuring and Other Charges

Restructuring and other charges consist of costs associated with the realignment and reorganization of the Company's operations and primarily include separation costs for employees, including severance, and other benefits. Included in restructuring and other costs for the six-month period ended June 30, 2011 are separation costs of approximately \$2.8 million related to the resignation of the Company's Chief Executive Officer, of which approximately \$2.0 million was severance and \$0.8 million was non-cash charges related to accelerated vesting of stock options.

A summary of activity for accrued restructuring and other charges is as follows (in thousands):

Accrued restructuring and other charges, December 31, 2010	\$ 652
Plus additional restructuring and other charges	7,412
Less non-cash stock-based compensation charges included in restructuring and other charges	(836)
Less amounts paid	(6,947)
Accrued restructuring and other charges, June 30, 2011	\$ 281

Note 13. Loss on Excess Office Facilities

The Company completed a business and operational reorganization which led to the reduction of its use of office space in its corporate headquarters in Seattle, Washington and one of its offices in Europe. As a result, the Company recorded losses of \$7.4 million during the year ended December 31, 2010. These losses represented approximately \$5.5 million of rent and contractual operating expenses over the remaining life of the lease, and approximately \$1.6 million for the write-down of leasehold improvements to their estimated fair value. The Company regularly evaluates the market for office space. If the market for such space changes further in future periods, the Company may have to revise its estimates which may result in future gains or losses on excess office facilities.

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

Accrued loss on excess office facilities, December 31, 2010	\$ 4,524
Less amounts paid, net of sublease income	(529)
Current period accrued sublease income estimate revision	(174)
Accrued loss on excess office facilities, June 30, 2011	3,821
Less current portion	(1,391)

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Accrued loss on excess office facilities, non-current portion	\$ 2,430
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Table of Contents**Note 14. Earnings Per Share**

For periods beginning August 2007 through the quarter ended March 31, 2010, basic net income (loss) available to common shareholders per share is computed by dividing net income (loss) attributable to common shareholders adjusted for the impact of MTVN's preferred return in Rhapsody by the weighted average number of common shares outstanding during the period. Diluted net income (loss) available to common shareholders per share is computed by dividing net income (loss) attributable to common shareholders adjusted for the impact of MTVN's preferred return in Rhapsody by the weighted average number of common and dilutive potential common shares outstanding during the period. Basic and diluted net income (loss) per share available to common shareholders are calculated as follows (in thousands):

	Quarters Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Net income (loss) available to common shareholders:				
Net income (loss) attributable to common shareholders	\$ (6,849)	\$ (25,907)	\$ (19,154)	\$ (22,679)
Less termination of MTVN's preferred return in Rhapsody	0	0	0	3,700
Net income (loss) available to common shareholders	\$ (6,849)	\$ (25,907)	\$ (19,154)	\$ (18,979)
Shares used to compute diluted net income (loss) per share available to common shareholders:				
Weighted average common shares outstanding used to compute basic net income (loss) per share available to common shareholders	136,539	135,277	136,266	135,209
Dilutive stock options and restricted stock	0	0	0	0
Shares used to compute diluted net income (loss) per share available to common shareholders	136,539	135,277	136,266	135,209
Basic net income (loss) per share available to common shareholders	\$ (0.05)	\$ (0.19)	\$ (0.14)	\$ (0.14)
Diluted net income (loss) per share available to common shareholders	\$ (0.05)	\$ (0.19)	\$ (0.14)	\$ (0.14)

During the quarter and six months ended June 30, 2011, 16.1 million and 16.5 million shares of common stock, respectively, potentially issuable from stock options were excluded from the calculation of diluted net income per share because of their antidilutive effect. During the quarter and six months ended June 30, 2010, 18.4 million and 18.6 million shares of common stock, respectively, potentially issuable from stock options were excluded from the calculation of diluted net income per share because of their antidilutive effect.

Note 15. Commitments and Contingencies

Borrowing Arrangements. The Company's subsidiary, WiderThan, uses electronic promissory notes issued by a Korean domestic bank with an aggregate line of credit of up to \$2.3 million. The charged amounts are generally payable in the following month depending on the billing cycle and are included in accounts payable in the accompanying unaudited condensed consolidated balance sheets. In general, the term of the arrangement is one year, with renewal in April of each year. The arrangement may be renewed in writing by mutual agreement between WiderThan and the bank. WiderThan is not subject to any financial or other restrictive covenants under the terms of this arrangement. As of June 30, 2011, WiderThan had \$0.8 million outstanding on this promissory note and other guarantees.

Litigation. On April 25, 2007, a lawsuit was filed by Greenville Communications, LLC in Greenville, Mississippi against a number of cell phone carriers, including the Company's partners T-Mobile USA, Inc. and Alltel Corporation, alleging that they infringe its patents by providing ringback tone services. The Company agreed to indemnify T-Mobile and Alltel against the claims based on an indemnity that is claimed to be owed by the Company. On August 27, 2007, the Company's motion to transfer this matter to the U.S. District Court for the District of New Jersey was granted. The parties briefed claim construction, but the case was subsequently stayed pending reexamination of the patents at issue. On December 10, 2009, the U.S. Patent and Trademark Office issued notice of its intent to issue reexamination certificates for the patents in suit. The Court lifted the stay on the litigation on January 29, 2010 and

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discovery has resumed. The Company disputes the plaintiff's allegations regarding both the validity of its patents and its claims of infringement against the Company's partners. The Company is unable to provide meaningful quantification of how the final resolution of this litigation may impact its future consolidated financial position or results of operations.

The Company has also been involved in a proceeding in the U.S. District Court for the Southern District of New York to determine a royalty rate for the public performance of music contained in the American Society of Composers, Authors and Publishers (ASCAP) catalogue. In April 2008, the district court issued a preliminary ruling that sets forth, among other things, a methodology to be used to calculate the royalties owed to ASCAP and subsequently issued additional rulings. After working with ASCAP to make a final determination of amounts due under the court's rulings, the Company reached a partial agreement with ASCAP on January 12, 2009. The Company believes it has sufficiently accrued for expected royalties under the agreement, but the Company appealed some aspects of the court's rulings that underlie the agreement, arguing that the district court had adopted an improper formula for establishing royalty rates. ASCAP also appealed the district court's ruling, arguing that the district court should have ruled that all transmissions of content downloads constituted public performances. On September 28, 2010, the U.S. Court of Appeals for the Second Circuit issued an opinion substantially ruling in favor of each of the Company's positions that were on appeal. On the public performance issue, the Second Circuit ruled that delivering a download is neither a performance nor public, and therefore ASCAP is not entitled to any royalties for such downloads. The Second Circuit agreed with the Company that the formula adopted by the District Court for establishing royalties was unreasonable and unsupported, and directed the District Court to establish new rates that reflect the varying nature and scope of the Company's music use. These rates are relevant to the Company's operation of the Rhapsody music business prior to the completion of its restructuring at the end of the first quarter of 2010. The rates are also relevant to the ongoing business of Rhapsody in which the Company continues to hold an approximate 47% interest. The case has been remanded to the District Court in order to establish a new formula. Based on information currently known to management, the Company believes that the ultimate outcome of this proceeding will not have a material effect on the Company's financial position or results from operations.

From time to time the Company is, and expects to continue to be, subject to legal proceedings, governmental investigations, and claims in the ordinary course of business, including employment claims, contract-related claims, and claims of alleged infringement of third-party patents, trademarks and other intellectual property rights. These claims, including those described above, even if not meritorious, could force the Company to spend significant financial and managerial resources. The Company is not aware of any other legal proceedings or claims that the Company believes will have, individually or taken together, a material adverse effect on the Company's business, prospects, financial condition or results of operations. However, the Company may incur substantial expenses in defending against actual or potential third-party claims. In addition, given the broad distribution of some of our consumer products, any individual claim related to those products could give rise to liabilities that may be material to the Company. In the event of a determination adverse to the Company, the Company may incur substantial monetary liability and/or be required to change its business practices. Either of these could have a material adverse effect on the Company's financial position and results of operations.

Note 16. Segment Information

As of July 1, 2010, the Company reorganized the management of its product lines and businesses in order to more efficiently develop and sell its products, and more cost effectively manage its operations. Beginning in the quarter ended September 30, 2010, the Company's financial results reflect the new corporate reorganization with the following reporting segments: (1) Core Products, which includes financial results from existing and future software as a service offerings of ringback tones, music on demand, video on demand, storefront services and inter-carrier messaging; systems integration and professional services; Helix software and licenses for handsets; SuperPass; and the Company's international radio subscriptions; (2) Emerging Products, which includes financial results from RealPlayer, including distribution of third-party products, advertising and other revenue, and new products and services that will be introduced over time for consumers or enterprise customers; and (3) Games, which is unchanged and includes all games-related financial results, including game sales, subscriptions services, syndication services, advertising-supported games, and mobile and social games. In addition, the Company will continue to present financial results for its former Music segment on a historical basis only. The Music segment primarily includes financial results and operating performance of the Company's 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 the Company's financial statements for periods after March 31, 2010. The Company now reports its share of Rhapsody's income or losses as Equity in net loss of Rhapsody and other equity method investments in Other income (expenses), net. The Company has adjusted the financial information for periods prior to September 30, 2010, to reflect the segment reorganization to allow comparability between the periods.

Beginning with the third quarter of 2010, the Company also changed how it allocates corporate and shared overhead expenses. Historically, the Company allocated common corporate overhead expenses, including but not limited to finance, legal and headquarters

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facilities, to each business segment. Beginning in the quarter ended September 30, 2010, these shared expenses, as well as stock compensation costs, are shown in the aggregate as Corporate expenses and are not reflected in segment results for the business segments described in the preceding paragraph. Only direct business segment expenses, such as research and development, marketing and certain other business shared services are reflected in the associated business segment results. The changes in the allocation of corporate expenses are designed to help ensure that business segment results reflect only those items that are directly attributable to that segment's performance and that shared overhead expenses are centrally managed to promote focus on and accountability for the overall corporate cost structure.

The Company reports three ongoing reporting segments based on factors such as how the Company manages its operations and how its Chief Operating Decision Maker reviews results. The Company's Chief Operating Decision Maker is considered to be the Company's CEO Staff (CEOS), which includes the Company's Interim Chief Executive Officer, Chief Financial Officer, Chief Legal Officer and certain Senior Vice Presidents. The CEOS reviews financial information presented on both a consolidated basis and on a business segment basis, accompanied by disaggregated information about products and services, geographical regions and corporate expenses for purposes of making decisions and assessing financial performance. The CEOS reviews discrete financial information regarding profitability of the Company's Core Products, Emerging Products, Games, and, prior to April 1, 2010, Music segments and, therefore, the Company reports these as operating segments. The accounting policies used to derive segment results are generally the same as those described in Note 1, Summary of Business and Summary of Significant Accounting Policies.

Segment operating income (loss) for the quarters and six months ended June 30, 2011 and 2010, are as follows (in thousands):

Core Products

	Quarters Ended June 30,				Six Months Ended June 30,			
	2011	2010	\$ Change	% Change	2011	2010	\$ Change	% Change
Revenue	\$ 45,735	\$ 51,742	\$ (6,007)	(12)%	\$ 93,842	\$ 102,945	\$ (9,103)	(9)%
Cost of revenue	19,353	18,085	1,268	7	40,337	35,824	4,513	13
Gross profit	26,382	33,657	(7,275)	(22)	53,505	67,121	(13,616)	(20)
Operating expenses	19,174	22,508	(3,334)	(15)	38,560	46,594	(8,034)	(17)
Operating income (loss)	\$ 7,208	\$ 11,149	\$ (3,941)	(35)%	\$ 14,945	\$ 20,527	\$ (5,582)	(27)%

Emerging Products

	Quarters Ended June 30,				Six Months Ended June 30,			
	2011	2010	\$ Change	% Change	2011	2010	\$ Change	% Change
Revenue	\$ 12,717	\$ 8,997	\$ 3,720	41%	\$ 23,852	\$ 20,425	\$ 3,427	17%
Cost of revenue	2,978	3,404	(426)	(13)	4,518	4,868	(350)	(7)
Gross profit	9,739	5,593	4,146	74	19,334	15,557	3,777	24
Operating expenses	9,369	7,602	1,767	23	19,260	14,635	4,625	32
Operating income (loss)	\$ 370	\$ (2,009)	\$ 2,379	(118)%	\$ 74	\$ 922	\$ (848)	(92)%

Games

	Quarters Ended June 30,				Six Months Ended June 30,			
	2011	2010	\$ Change	% Change	2011	2010	\$ Change	% Change
Revenue	\$ 25,300	\$ 28,145	\$ (2,845)	(10)%	\$ 53,359	\$ 58,381	\$ (5,022)	(9)%
Cost of revenue	8,040	7,228	812	11	16,574	14,931	1,643	11

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Gross profit	17,260	20,917	(3,657)	(17)	36,785	43,450	(6,665)	(15)
Operating expenses	15,211	20,832	(5,621)	(27)	32,025	43,603	(11,578)	(27)
Operating income (loss)	\$ 2,049	\$ 85	\$ 1,964	NM	\$ 4,760	\$ (153)	\$ 4,913	NM

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	Quarters Ended June 30,				Six Months Ended June 30,			
	2011	2010	\$ Change	% Change	2011	2010	\$ Change	% Change
Revenue	\$ 0	\$ 0	\$ 0	0%	\$ 0	\$ 35,733	\$ (35,733)	(100)%
Cost of revenue	0	0	0	0	0	21,864	(21,864)	(100)
Gross profit	0	0	0	0	0	13,869	(13,869)	(100)
Operating expenses	0	0	0	0	0	13,911	(13,911)	(100)
Operating income (loss)	\$ 0	\$ 0	\$ 0	0%	\$ 0	\$ (42)	\$ 42	(100)%

Corporate

	Quarters Ended June 30,				Six Months Ended June 30,			
	2011	2010	\$ Change	% Change	2011	2010	\$ Change	% Change
Cost of revenue	\$ 295	\$ 432	\$ (137)	(32)%	\$ 1,303	\$ 821	\$ 482	59%
Operating expenses	14,116	30,487	(16,371)	(54)	28,926	56,789	(27,863)	(49)
Operating income (loss)	\$ (14,411)	\$ (30,919)	\$ 16,508	(53)%	\$ (30,229)	\$ (57,610)	\$ 27,381	(48)%

The Company's customers consist primarily of consumers and corporations located in the U.S., Europe and various foreign countries. Revenue by geographic region is as follows (in thousands):

	Quarters Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
United States	\$ 41,984	\$ 48,351	\$ 86,453	\$ 132,901
Europe	19,024	19,316	37,984	41,798
Rest of the world	22,744	21,217	46,616	42,785
Total net revenue	\$ 83,752	\$ 88,884	\$ 171,053	\$ 217,484

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

	June 30, 2011	December 31, 2010
United States	\$ 42,373	\$ 43,655
Republic of Korea	5,335	5,659
Europe	3,184	3,069
Rest of the world	6,452	2,900
Total long-lived assets	\$ 57,344	\$ 55,283

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Net assets including minority interest by geographic location are as follows (in thousands):

	June 30, 2011	December 31, 2010
United States	\$ 338,775	\$ 352,341
Republic of Korea	4,236	12,374
Europe	42,011	33,029
Rest of the world	19,007	15,001
Total net assets	\$ 404,029	\$ 412,745

Table of Contents**Note 17. Related Party Transactions**

Transactions with MTVN. As part of the initial formation of Rhapsody in 2007, MTVN contributed a \$230 million five-year note payable in partial consideration for acquiring MTVN's interest in the venture. In February 2009, RealNetworks and MTVN signed an amendment to the Rhapsody joint venture agreement which reduced the amount payable under the MTVN note to \$213.8 million over the original five-year term and on March 31, 2010, the note was cancelled in connection with the completion of the Rhapsody restructuring transactions. During the quarter ended March 31, 2010, Rhapsody received \$1.2 million in cash as note payments and spent \$1.1 million in advertising with MTVN. MTVN agreed to a new \$33.0 million marketing commitment as part of the restructuring transactions that were completed on March 31, 2010. RealNetworks no longer consolidates Rhapsody's financial position and results, and consequently these transactions are no longer considered related party transactions. See Note 4, Rhapsody Joint Venture, for more information on the restructuring transactions.

Transactions with Rhapsody. For periods between August 2007 and March 31, 2010, the Company also provided various support services, including items such as facilities, information technology systems, personnel support and some overhead charges associated with the support services, directly to Rhapsody. The allocation of these and other support service costs were based on various measures depending on the service provided, including employee headcount, time employees spent on providing services to Rhapsody, server usage or number of users of a service. The allocations of these costs were billed directly to Rhapsody. Prior to March 31, 2010, the Company treated these allocations as intercompany transactions and all such transactions were eliminated in consolidation. As of March 31, 2010, the Company no longer consolidates these transactions.

Following the restructuring transactions, the Company is obligated to provide Rhapsody with a reduced amount of support services. These support services are expected to be completed in the first half of 2012 unless earlier terminated by Rhapsody. The support services include information technology and limited operational support provided directly to Rhapsody. The amount charged for these and other support service costs were based on various measures depending on the service provided, including vendor fees, an allocation of fixed costs and time employees spend on providing services to Rhapsody. RealNetworks allocates the cost of providing these support services and records such allocation as a reduction to the related expense in the period for which it was incurred. During the quarter and six months ended June 30, 2011 the Company charged Rhapsody \$0.9 million and \$1.8 million, respectively, for the support services. At June 30, 2011, the Related Party Receivable Rhapsody of \$0.5 million included these charges.

Transactions with LoEn Entertainment, Inc. During the fourth quarter of 2008, the Company paid \$9.9 million to acquire approximately 11% of the outstanding shares of LoEn Entertainment, Inc. (LoEn). The Company paid market price for approximately 2.8 million common shares of LoEn which are traded on the Korean Securities Dealers Automated Quotations. The Company's investment in LoEn is treated as an available for sale investment of a public company and is marked-to-market each period with resulting gains/losses recognized in equity as unrealized holding gains/losses on investment. During the quarters ended June 30, 2011 and 2010, the Company recorded revenue from LoEn of approximately \$4.5 million and \$3.7 million, respectively. During the six month periods ended June 30, 2011 and 2010, the Company recorded revenue from LoEn of approximately \$8.6 million and \$7.4 million, respectively. This revenue consisted primarily of sales of application service provider services, which includes sales of ringback tones, music-on-demand, video-on-demand, and inter-carrier messaging services. Associated with these transactions, the Company also recorded accounts receivable of approximately \$2.3 million as of June 30, 2011. Accounts payable and cost of revenue balances associated with LoEn as of and for the quarters and six month periods ended June 30, 2011 and 2010, were nominal.

Note 18. Income Taxes

As of June 30, 2011, there have been no material changes to the Company's uncertain tax positions disclosures as provided in Note 15 to the Company's audited financial statements included in the Company's 2010 Annual Report on Form 10-K. The Company

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currently anticipates the closure of foreign income tax examinations in the next twelve months that may reduce total unrecognized tax benefits by an amount up to \$9.3 million as a result of the successful defense of the Company's positions, the settlement and payment of a liability, or a combination thereof.

The Company has 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, the Company 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. However, as the Company currently has significant net operating losses and other tax attributes that could be used to offset the potential U.S. income tax that could result if these amounts were distributed to the U.S., the Company does not anticipate a material U.S. tax impact on such earnings as of June 30, 2011.

The Company files numerous consolidated and separate income tax returns in the United States including federal, state and local, as well as foreign jurisdictions. With few exceptions, the Company is no longer subject to United States federal income tax examinations for tax years before 2006 or state, local, or foreign income tax examinations for years before 1993. RealNetworks, Inc. and/or subsidiaries are under audit by various states and foreign jurisdictions for certain tax years subsequent to 1993.

Note 19. Subsequent Event

On July 27, 2011, the Company's Board of Directors approved the payment of a special cash dividend of \$1.00 per common share and a one-for-four reverse stock split of the Company's common stock, as follows:

Special Dividend: The Board of Directors declared a special dividend of \$1.00 per share of its common stock, payable on August 23, 2011, to holders of record as of the close of business August 9, 2011. The aggregate amount of the special cash dividend will be approximately \$136.8 million.

Reverse Stock Split: The Board of Directors authorized a one-for-four reverse stock split of the Company's common stock, which is expected to become effective at the close of business on August 30, 2011. When the reverse stock split becomes effective, every four shares of issued and outstanding common stock will be automatically combined into one issued and outstanding share of common stock without any change in the par value per share. This will reduce the number of outstanding shares of common stock from approximately 136.8 million shares to approximately 34.2 million shares. Shareholders will be entitled to receive a cash payment in lieu of any fractional shares of common stock they would otherwise be entitled to receive as a result of the reverse stock split.

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

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

future revenues, operating expenses, income and other taxes, tax benefits, net income (loss) per diluted share available to common shareholders, acquisition costs and related amortization, and other measures of results of operations;

the effects of our past acquisitions and expectations for future acquisitions;

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, legal proceedings and governmental investigations on our business, prospects, financial condition or results of operations;

the expected benefits and other consequences from restructuring Rhapsody and from our other strategic initiatives;

our expected introduction of new and enhanced products, services and technologies across our businesses, including Unifi, a personal media cloud service we launched with one of our mobile-carrier customers in the latter part of the quarter ended June 30, 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

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

Overview

RealNetworks' mission is to 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 continued creating and delivering digital-media technology, services and content, such as music, games and video, around the world. We distribute our products and services directly to consumers and through mobile carriers, original equipment manufacturers and other communications companies who offer these products and services to their customers.

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We are primarily focused on the following three businesses: (1) our software as a service (SaaS) offerings; (2) our RealPlayer media player software and related businesses; and (3) our casual games business. Our major business initiatives include the continued development of our converged media platform, from which we deliver some of our SaaS services and which we intend to utilize increasingly in that business in the future; the development of social media capability within our games segment; and the development of Unifi, a personal cloud-media-management product that we introduced through one of our mobile-carrier customers in the second quarter of 2011 and expect to distribute through other mobile carriers and directly to consumers.

As of the quarter ended September 30, 2010, we report our results in the following reporting segments: (1) Core Products, (2) Emerging Products and (3) Games. We 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. In addition, we report common overhead expenses and stock compensation costs in the aggregate as corporate expenses and, therefore, these expenses are not reflected in the financial and operating results of our business segments. The historical financial information presented in this report has been adjusted to reflect the new segments and the new corporate expense presentation.

During 2010 and continuing into the first part of 2011, we implemented a significant restructuring of our business, which impacted our year-over-year results for the quarter and six months ended June 30, 2011. As part of these activities we restructured our Rhapsody joint venture, and as of March 31, 2010, no longer consolidate its results in our financial statements. 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 service offerings, while continuing to invest in our major business initiatives described above.

Condensed consolidated results of operations for the quarter and six month periods ended June 30, 2011 and 2010, are as follows (dollars in thousands):

	Quarters Ended June 30, 2011				Six Months Ended June 30, 2011			
	2011	2010	\$ Change	% Change	2011	2010	\$ Change	% Change
Revenue								
Core Products	\$ 45,735	\$ 51,742	\$ (6,007)	(12)%	\$ 93,842	\$ 102,945	\$ (9,103)	(9)%
Emerging Products	12,717	8,997	3,720	41	23,852	20,425	3,427	17
Games	25,300	28,145	(2,845)	(10)	53,359	58,381	(5,022)	(9)
Music	0	0	0	0	0	35,733	(35,733)	(100)
Total revenue	83,752	88,884	(5,132)	(6)	171,053	217,484	(46,431)	(21)
Cost of revenue	30,666	29,149	1,517	5	62,732	78,308	(15,576)	(20)
Gross profit	53,086	59,735	(6,649)	(11)	108,321	139,176	(30,855)	(22)
Gross margin	63%	67%			63%	64%		
Operating expenses	57,870	81,429	(23,559)	(29)	118,771	175,532	(56,761)	(32)
Operating loss	\$ (4,784)	\$ (21,694)	\$ 16,910	(78)%	\$ (10,450)	\$ (36,356)	\$ 25,906	(71)%

In the quarter ended June 30, 2011, our total consolidated revenue declined by \$5.1 million, compared with the year-earlier period. The reduction in revenue largely resulted from reduced SaaS services and subscription revenue, mainly from SuperPass, within our Core Products segment and a decline in Games revenue. These declines were partially offset by an increase in revenue from our Emerging Products segment. We reduced operating expenses by \$23.6 million in the quarter ended June 30, 2011, compared with the same period in 2010. The reduction in operating expenses was due principally to restructuring charges and loss on excess office facilities totaling \$11.9 million in the quarter ended June 30, 2010. The majority of the remaining decrease in operating expenses was due to lower personnel and related costs.

In the six months ended June 30, 2011, our total consolidated revenue declined by \$46.4 million, compared with the year-earlier period. The total reduction in revenue was largely a result of the deconsolidation of our Rhapsody joint venture as of March 31, 2010. We reduced operating expenses by \$56.8 million in the six months ended June 30, 2011, compared with the same period in 2010, principally through reduced personnel expenses, lower Rhapsody costs, lower restructuring charges and losses on excess office facilities, and an insurance settlement reimbursement of \$6.4 million related to previously settled litigation.

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See Segment Operating Results below for more information and discussion regarding changes in the operating results for each of our reporting segments for the quarter and six months ended June 30, 2011.

Segment Operating Results*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 quarter and six month ended June 30, 2011 and 2010, are as follows (dollars in thousands):

	Quarter Ended June 30,				Six Months Ended June 30,			
	2011	2010	\$ Change	% Change	2011	2010	\$ Change	% Change
Revenue	\$ 45,735	\$ 51,742	\$ (6,007)	(12)%	\$ 93,842	\$ 102,945	\$ (9,103)	(9)%
Cost of revenue	19,353	18,085	1,268	7	40,337	35,824	4,513	13
Gross profit	26,382	33,657	(7,275)	(22)	53,505	67,121	(13,616)	(20)
Gross margin	58%	65%			57%	65%		
Operating expenses	19,174	22,508	(3,334)	(15)	38,560	46,594	(8,034)	(17)
Operating income (loss)	\$ 7,208	\$ 11,149	\$ (3,941)	(35)%	\$ 14,945	\$ 20,527	\$ (5,582)	(27)%

Total Core Products revenue decreased by \$6.0 million in the quarter ended June 30, 2011, compared with the year-earlier period, primarily due to reduced service revenue from our SaaS offerings of \$2.2 million. The decline in SaaS revenue during the quarter was mainly due to lower intercarrier messaging contract prices, resulting in a decline of \$1.8 million. In addition, subscription revenue, mainly from SuperPass, declined by \$2.0 million, compared with the same period in 2010 resulting primarily from a decline in the number of subscribers. Further contributing to the decrease was a decline of \$1.2 million in technology license sales.

Total Core Products revenue decreased by \$9.1 million in the six months ended June 30, 2011, compared with the year-earlier period, primarily due to reduced service revenue from our SaaS offerings of \$5.3 million. The decline in SaaS revenue was mainly due to lower intercarrier messaging contract prices, resulting in a decline of \$4.2 million. In addition, subscription revenue, mainly from SuperPass, declined by \$2.0 million during the six months ended June 30, 2011, compared with the same period in 2010 due primarily to a decline in the number of subscribers.

Cost of revenue increased by \$1.3 million and \$4.5 million in the quarter and six months ended June 30, 2011, respectively, compared with the year-earlier periods principally due to increased costs associated with personnel working on the delivery of our SaaS services to an expanded customer base. Gross margins declined for the quarter and six months ended June 30, 2011, mainly due to declines in intercarrier messaging revenue and SuperPass revenue, which are higher margin services.

Operating expenses declined by \$3.3 million and \$8.0 million in the quarter and six months ended June 30, 2011, respectively, compared with the year-earlier periods, primarily due to reductions in personnel and related costs which resulted from our restructuring efforts.

Emerging Products

The Emerging Products segment primarily generates revenue and incurs costs from sales of RealPlayer and its related products, such as the distribution of third-party software products, advertising on RealPlayer websites, and sales of RealPlayerPlus software licenses to consumers. Also included within the Emerging Products segment is the cost to build and develop new product offerings for

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consumers and business customers, including Unifi. Emerging Products segment results of operations for the quarter and six months ended June 30, 2011 and 2010, are as follows (dollars in thousands):

	Quarters Ended June 30,				Six Months Ended June 30,			
	2011	2010	\$ Change	% Change	2011	2010	\$ Change	% Change
Revenue	\$ 12,717	\$ 8,997	\$ 3,720	41%	\$ 23,852	\$ 20,425	\$ 3,427	17%
Cost of revenue	2,978	3,404	(426)	(13)	4,518	4,868	(350)	(7)
Gross profit	9,739	5,593	4,146	74	19,334	15,557	3,777	24
Gross margin	77%	62%			81%	76%		
Operating expenses	9,369	7,602	1,767	23	19,260	14,635	4,625	32
Operating income (loss)	\$ 370	\$ (2,009)	\$ 2,379	(118)%	\$ 74	\$ 922	\$ (848)	(92)%

Total Emerging Products revenue increased by \$3.7 million in the quarter ended June 30, 2011, compared with the year-earlier period. Higher unit sales of our RealPlayer Plus software and higher distribution of third-party software products contributed approximately \$1.3 million and \$2.3 million, respectively, to the increase during the period. These increases were primarily attributable to our continued development of RealPlayer, specifically including our marketing efforts to optimize order paths and the distribution of third-party software.

Total Emerging Products revenue increased by \$3.4 million in the six months ended June 30, 2011, compared with the year-earlier period. Higher unit sales of our RealPlayer Plus software and higher distribution of third-party software products contributed approximately \$2.3 million and \$1.4 million, respectively, to the increase during the period. Gross margins increased for the quarter and six months ended June 30, 2011, mainly due to an increase in sales of RealPlayer Plus and distribution of third-party products which have higher margins. In addition, for the quarter ended June 30, 2010, there was a one-time expense for the rights to use certain technologies within our RealPlayer software in the amount of \$1.5 million.

Operating expenses increased by \$1.8 million and \$4.6 million in the quarter and six months ended June 30, 2011, respectively, compared with the year-earlier periods primarily due to increased marketing expense to drive the distribution of RealPlayer and related third-party software as well as continued development of Unifi. We have increased expenses associated with the development of Unifi and decreased expenses in other areas following our restructuring efforts.

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, microtransactions from online and social games, and sales of mobile games. Games segment results of operations for the quarter and six months ended June 30, 2011 and 2010, are as follows (dollars in thousands):

	Quarters Ended June 30,				Six Months Ended June 30,			
	2011	2010	\$ Change	% Change	2011	2010	\$ Change	% Change
Revenue	\$ 25,300	\$ 28,145	\$ (2,845)	(10)%	\$ 53,359	\$ 58,381	\$ (5,022)	(9)%
Cost of revenue	8,040	7,228	812	11	16,574	14,931	1,643	11
Gross profit	17,260	20,917	(3,657)	(17)	36,785	43,450	(6,665)	(15)
Gross margin	68%	74%			69%	74%		
Operating expenses	15,211	20,832	(5,621)	(27)	32,025	43,603	(11,578)	(27)
Operating income (loss)	\$ 2,049	\$ 85	\$ 1,964	2,311%	\$ 4,760	\$ (153)	\$ 4,913	2,311%

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Total Games revenue decreased by \$2.8 million in the quarter ended June 30, 2011, compared with the year-earlier period. Lower revenue from our subscription products and a decline in the distribution of third-party software contributed approximately \$1.4 million and \$1.0 million, respectively, to the decline during the period. The decline in subscription revenue was due to fewer subscribers compared with the year-earlier period. The decline in distribution of third party software was due to reduced traffic to our games properties.

Total Games revenue decreased by \$5.0 million in the six months ended June 30, 2011, compared with the year-earlier period. The decline was due to lower revenue from our subscription products of \$2.2 million as a result of fewer subscribers. In addition, distribution of third party software declined by \$1.7 million due to reduced traffic to our games properties. Further contributing to the decline was lower license revenue of \$1.3 million due to decreased unit sales of games.

Cost of revenue increased by \$1.6 million in the six months ended June 30, 2011, compared with the year-earlier period. The increase was due to higher costs associated with personnel who distribute and deliver our games products and services. Gross margins decreased for the quarter and six months ended June 30, 2011, as a result of higher personnel costs associated with the distribution and delivery of games products and services. Further contributing to the decline in gross margins was a revenue mix towards games with higher royalties.

Operating expenses declined by \$5.6 million and \$11.6 million in the quarter and six months ended June 30, 2011, respectively, compared with the year-earlier period. The decreases were primarily due to reductions in personnel and related costs of approximately \$2.5 million and \$5.2 million in the quarter and six months ended June 30, 2011, respectively. In addition, depreciation expense, related to our Games technology platform, decreased \$1.5 million and \$2.9 million in the quarter and six months ended June 30, 2011, respectively.

Music

Music segment results of operations for the quarter and six months ended June 30, 2011 and 2010, are as follows (dollars in thousands):

	\$35,733 Quarters Ended June 30,				\$35,733 Six Months Ended June 30,			
	2011	2010	\$ Change	% Change	2011	2010	\$ Change	% Change
Revenue	\$ 0	\$ 0	\$ 0	0	\$ 0	\$ 35,733	\$ (35,733)	(100)%
Cost of revenue	0	0	0	0	0	21,864	(21,864)	(100)
Gross profit	0	0	0	0	0	13,869	(13,869)	(100)
Gross margin						39%		
Operating expenses	0	0	0	0	0	13,911	(13,911)	(100)
Operating loss	\$ 0	\$ 0	\$ 0	0	\$ 0	\$ (42)	\$ 42	(100)%

On March 31, 2010, we completed the restructuring of Rhapsody, which resulted in our ownership interest of Rhapsody decreasing to approximately 47% and the loss of our operating control over Rhapsody. Our revenue for the first quarter of 2010 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 condensed consolidated 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 (expenses), net. Our share of Rhapsody's losses for the quarter and six months ended June 30, 2011 was \$1.0 million and \$4.3 million, respectively.

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Certain corporate-level activity is not allocated to our segments, including costs of the following: general and administrative functions and activities related to information technology, procurement activities, corporate headquarters, legal settlements and contingencies, stock compensation, losses on excess office facilities and employee severance costs. Corporate segment results of operations for the quarter and six months ended June 30, 2011 and 2010, are as follows (dollars in thousands):

	Quarters Ended June 30,				Six Months Ended June 30,			
	2011	2010	\$ Change	% Change	2011	2010	\$ Change	% Change
Cost of revenue	\$ 295	\$ 432	\$ (137)	(32)%	\$ 1,303	\$ 821	\$ 482	59%
Operating expenses	14,116	30,487	(16,371)	(54)	28,926	56,789	(27,863)	(49)
Operating income (loss)	\$ (14,411)	\$ (30,919)	\$ 16,508	(53)%	\$ (30,229)	\$ (57,610)	\$ 27,381	(48)%

Operating expenses decreased by \$16.4 million in the quarter ended June 30, 2011, compared with the year-earlier period. The decrease compared with the prior period was due to lower restructuring charges and loss of excess office facility charges related to our corporate headquarters in Seattle and our offices in Europe and Asia of \$11.5 million. Lower personnel costs of \$3.0 million as a result of our restructuring efforts also contributed to the decrease.

Operating expenses decreased by \$27.9 million in the six months ended June 30, 2011, compared with the year-earlier period. The decrease was due in part to lower restructuring charges and loss on excess office facilities of approximately \$10.3 million as well as a reduction in personnel and related costs of approximately \$7.0 million in the six months ended June 30, 2011, compared with the year-earlier period. The remaining decrease in operating expenses in the six months ended June 30, 2011 was due in part to a benefit from an insurance reimbursement of \$6.4 million related to previously settled litigation, which is accounted for as a reduction to operating expenses.

Consolidated Operating Expenses

Consolidated operating expenses consist primarily of salaries and related personnel costs including stock based compensation, consulting fees associated with product development, sales commissions, amortization of certain intangible assets capitalized in our acquisitions, professional service fees, advertising costs, restructuring and related charges, impairments of goodwill and losses on excess office facilities. 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. Operating expenses and changes for the quarters and six months ended June 30, 2011 and 2010, are as follows (dollars in thousands):

	Quarters Ended June 30,				Six Months Ended June 30,	
	2011	2010	\$ Change	% Change	2011	2010