REALNETWORKS INC
Form 10-Q
August 02, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 30, 2018
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 1-37745

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

Washington	91-1628146
(State of incorporation)	(I.R.S. Employer Identification Number)
1501 First Avenue South, Suite 600 Seattle, Washington	98134
(Address of principal executive offices)	(Zip Code)

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

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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

The number of shares of the registrant’s Common Stock outstanding as of July 31, 2018 was 37,611,849.

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

	June 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$39,080	$ 51,196
Short-term investments	3,053	8,779
Trade accounts receivable, net of allowances of $660 and $937	13,127	12,689
Deferred costs, current portion	375	426
Prepaid expenses and other current assets	5,250	3,715
Current assets of discontinued operations	—	17,456
Total current assets	60,885	94,261
Equipment, software, and leasehold improvements, at cost:		
Equipment and software	41,793	46,417
Leasehold improvements	3,511	3,536
Total equipment, software, and leasehold improvements, at cost	45,304	49,953
Less accumulated depreciation and amortization	42,083	46,093
Net equipment, software, and leasehold improvements	3,221	3,860
Restricted cash equivalents	1,880	2,400
Other assets	5,844	5,588
Deferred costs, non-current portion	679	955
Deferred tax assets, net	1,036	1,047
Other intangible assets, net	215	325
Goodwill	17,120	13,060
Total assets	$90,880	$ 121,496
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$2,744	$ 3,785
Accrued and other current liabilities	12,261	12,365
Commitment to Napster	2,750	2,750
Deferred revenue, current portion	2,155	3,097
Current liabilities of discontinued operations	—	17,107
Total current liabilities	19,910	39,104
Deferred revenue, non-current portion	353	443
Deferred rent	1,023	982
Deferred tax liabilities, net	170	19
Other long-term liabilities	1,054	1,775
Total liabilities	22,510	42,323
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	—	—
	37	37

Common stock, $0.001 par value authorized 250,000 shares; issued and outstanding 37,612 shares in 2018 and 37,341 shares in 2017		
Additional paid-in capital	640,212	638,727
Accumulated other comprehensive loss	(60,752)	(59,547)
Retained deficit	(511,127)	(500,044)
Total shareholders’ equity	68,370	79,173
Total liabilities and shareholders’ equity	$90,880	$ 121,496

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Quarter Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net revenue (A)	$15,724	$21,605	$35,374	$41,296
Cost of revenue (B)	4,625	6,287	9,761	12,856
Gross profit	11,099	15,318	25,613	28,440
Operating expenses:				
Research and development	7,652	7,584	15,346	14,933
Sales and marketing	4,883	5,496	10,880	12,651
General and administrative	5,339	5,254	10,940	10,557
Restructuring and other charges	187	150	688	1,714
Lease exit and related benefit	(129)	—	(454)	—
Total operating expenses	17,932	18,484	37,400	39,855
Operating loss	(6,833)	(3,166)	(11,787)	(11,415)
Other income (expenses):				
Interest income, net	111	109	198	237
Equity in net loss of Napster investment	—	(349)	—	(1,097)
Other income (expense), net	(42)	(13)	(83)	(239)
Total other income (expenses), net	69	(253)	115	(1,099)
Loss from continuing operations before income taxes	(6,764)	(3,419)	(11,672)	(12,514)
Income tax expense	166	360	436	815
Net loss from continuing operations	(6,930)	(3,779)	$(12,108)	$(13,329)
Net income from discontinued operations, net of tax	—	393	—	519
Net loss	$(6,930)	$(3,386)	$(12,108)	$(12,810)
Net income (loss) per share - Basic:				
Continuing operations	$(0.18)	(0.10)	$(0.32)	(0.36)
Discontinued operations	—	0.01	—	0.01
Net loss per share - Basic	$(0.18)	$(0.09)	$(0.32)	$(0.35)
Net income (loss) per share - Diluted				
Continuing operations	$(0.18)	$(0.10)	$(0.32)	(0.36)
Discontinued operations	—	0.01	—	0.01
Net loss per share - Diluted	$(0.18)	$(0.09)	$(0.32)	$(0.35)
Shares used to compute basic net income (loss) per share	37,577	37,103	37,514	37,067
Shares used to compute diluted net income (loss) per share	37,577	37,103	37,514	37,067
Comprehensive income (loss):				
Unrealized investment holding gains, net of reclassification adjustments	$2	$6	$3	$10
Foreign currency translation adjustments, net of reclassification adjustments	(1,604)	646	(1,208)	1,240
Total other comprehensive income (loss)	(1,602)	652	(1,205)	1,250
Net loss	(6,930)	(3,386)	(12,108)	(12,810)
Comprehensive loss	$(8,532)	$(2,734)	$(13,313)	$(11,560)

(A) Components of net revenue:

License and product revenue	$4,529	$9,651	$11,943	$16,804
Service revenue	11,195	11,954	23,431	24,492

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	$15,724	$21,605	$35,374	$41,296
(B) Components of cost of revenue:				
License and product revenue	$1,465	$2,611	$3,220	$4,520
Service revenue	3,160	3,676	6,541	8,336
	$4,625	$6,287	$9,761	$12,856

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Six Months Ended June 30, 2018	2017
Cash flows from operating activities:		
Net loss	$(12,108)	$(12,810)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,231	1,757
Stock-based compensation	1,614	2,297
Equity in net loss of Napster	—	1,097
Deferred income taxes, net	(12)	(40)
Fair value of warrants granted in 2015 and 2017, net of subsequent mark to market adjustments in 2018 and 2017	50	(417)
Net change in certain operating assets and liabilities:		
Trade accounts receivable	16,960	(4,346)
Prepaid expenses and other assets	(1,633)	667
Accounts payable	(16,601)	(376)
Accrued and other liabilities	(2,231)	(1,775)
Net cash used in operating activities	(12,730)	(13,946)
Cash flows from investing activities:		
Purchases of equipment, software, and leasehold improvements	(580)	(417)
Purchases of short-term investments	—	(13,905)
Proceeds from sales and maturities of short-term investments	5,726	32,617
Acquisition, net of cash acquired	(4,192)	—
Advance to Napster	—	(1,500)
Net cash provided by investing activities	954	16,795
Cash flows from financing activities:		
Proceeds from issuance of common stock (stock options and stock purchase plan)	114	130
Tax payments from shares withheld upon vesting of restricted stock	(243)	(192)
Net cash used in financing activities	(129)	(62)
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(731)	1,347
Net increase (decrease) in cash, cash equivalents and restricted cash	(12,636)	4,134
Cash, cash equivalents and restricted cash, beginning of period	53,596	36,421
Cash, cash equivalents, and restricted cash end of period	$40,960	$40,555
Supplemental disclosure of cash flow information:		
Cash received from income tax refunds	$71	$323
Cash paid for income taxes	$503	$913
Non-cash investing activities:		
Increase (decrease) in accrued purchases of equipment, software, and leasehold improvements	$(112)	$32
Acquisition of intangible assets	$100	$—

See accompanying notes to unaudited condensed consolidated financial statements.

REALNETWORKS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Quarters and Six Months Ended June 30, 2018 and 2017
Note 1 Description of Business and Summary of Significant Accounting Policies
Description of Business. RealNetworks, Inc. and subsidiaries is a global provider of network-delivered digital media applications and services that make it easy to manage, play and share digital media. The Company also develops and markets software products and services that enable the creation, distribution and consumption of digital media, including audio and video.
Inherent in our business are various risks and uncertainties, including a limited history of certain of our product and service offerings. RealNetworks' success will depend on the acceptance of our technology, products and services and the ability to generate related revenue.
In this Quarterly Report on Form 10-Q (10-Q or Report), RealNetworks, Inc. and Subsidiaries is referred to as “RealNetworks”, the “Company”, “we”, “us”, or “our”.
Basis of Presentation. The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany balances and transactions have been eliminated in consolidation.
The unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal, recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations for the periods presented. Operating results for the quarter and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for any subsequent period or for the year ending December 31, 2018. Certain information and disclosures normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2017 (the 10-K).
Use of Estimates. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.
Note 2 Recent Accounting Pronouncements
Recently adopted accounting pronouncements
In May 2014, and subsequently updated and amended in 2015 and 2016, the Financial Accounting Standards Board (FASB) issued new revenue recognition guidance (Topic 606), which replaced most existing revenue recognition guidance in U.S. GAAP. The guidance requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. We adopted Topic 606 as of January 1, 2018 using the modified retrospective transition method. Refer to Note 3 Revenue Recognition for further details.
In November 2016, the FASB issued guidance on the classification and presentation of changes in restricted cash on the statement of cash flows. We adopted this guidance on January 1, 2018, and retroactively applied the changes to the Statement of Cash Flows for all periods presented. As a result, we no longer classify changes in restricted cash within the investing section of our Statement of Cash flows, and instead include restricted cash with unrestricted cash as a combined total. The impact of the adoption did not have a material impact on the Condensed Consolidated Financial Statements.
Recently issued accounting pronouncements not yet adopted
In February 2016, the FASB issued new guidance related to the accounting for leases. A major change in the new guidance is that lessees will be required to present right-of-use assets and lease liabilities on the balance sheet. The new guidance will be effective for us on January 1, 2019, including interim periods within 2019. We continue to evaluate the effect that the guidance will have on our consolidated financial statements and related disclosures. We expect that the guidance will result in a material change to our Consolidated Balance Sheet as a result of capitalizing

our operating leases.

In January 2017, the FASB issued new guidance simplifying the test for goodwill impairment. The new guidance eliminates Step 2 from the goodwill impairment test, instead requiring an entity to recognize a goodwill impairment charge for the amount by which the reporting unit's carrying amount exceeds the reporting unit's fair value. This guidance is effective for interim and annual goodwill impairment tests beginning on December 15, 2019, with early adoption permitted. We will be evaluating the impact of the guidance, but do not currently expect the adoption to have a material impact on our consolidated financial statements and related disclosures.

Note 3 Revenue Recognition

Adoption of New Revenue Standard

On January 1, 2018 we adopted the new revenue recognition standard by applying the modified retrospective approach to those contracts which were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under the new revenue recognition standard, while prior period amounts are not adjusted and continue to be reported under the accounting standards in effect for the prior periods.

We recorded a net decrease to opening retained deficit of $1.0 million as of January 1, 2018 due to the cumulative impact of adopting the new revenue recognition standard, with the impact primarily related to licensing of our RealPlayer product and full recognition of non-recurring engineering fees which were previously deferred and amortized over the life of the contract. The net impact to revenues as a result of adopting the new standard was a decrease of $1.1 million for the three months ended June 30, 2018 and an increase of $2.4 million for the six months ended June 30, 2018.

Performance Obligations

We generate all of our revenue through contracts with customers. Revenue is either recognized over time as the service is provided, or at a point in time when the product is transferred to the customer, depending on the contract type. Our performance obligations typically have an original duration of one year or less.

Our software licensing revenue stream generates revenue through the on-premises licensing of our codec technologies and integrated RealTimes platform. We recognize revenue upfront at the point in time when the software is made available to the customer. In cases where a sale or usage-based royalty is promised in exchange for a license of our codec technologies, revenue is recognized as the subsequent usage occurs for the contractual amount owed by the customer for that usage, as is allowed under the licensing of intellectual property section of Topic 606. Software licensing in our Mobile Services segment is invoiced on a monthly basis either based on usage of the respective product, or on a fixed fee basis. Our Consumer Media licensing is invoiced either quarterly or annually based on the usage of the respective product, or on a fixed fee basis. For each of these, the timing of payment generally does not vary significantly from the timing of invoice, however, certain of our long-term Consumer Media licensing contracts have extended payment schedules which may exceed one year.

Our subscription services revenue stream allows customers to use hosted software over the respective contract period without taking possession of the technology. The stream is primarily comprised of our intercarrier messaging service, ringback tones, PC-based games subscriptions and our RealPlayer and SuperPass services. Revenues related to subscription service products are recognized ratably over the contract period, or as we have the right to invoice as a practical expedient when that amount corresponds directly with the value to the customer of our performance completed to date. Consumer subscription products are paid in advance, typically on a monthly or quarterly basis. Subscription services offered to businesses are invoiced on a monthly basis, generally based upon the amount of usage for the previous month, and the timing of payment generally does not vary significantly from the timing of invoice.

Our product sales revenue stream includes purchases of mobile and wholesale games, as well as our RealPlayer product. Retail purchases are recognized and paid for at the point in time the product is made available to the end user. For games which are sold through third-party application storefronts, we evaluate the transaction for gross or net revenue recognition. As we typically are the primary obligor in our third-party transactions, we recognize revenues gross of any app store fees. We then receive monthly payments from the respective app store for all purchases within the respective month.

Other revenues consist primarily of advertising and the distribution of third-party products, which are recognized and paid on a cost per impression or cost per download basis.

Disaggregation of Revenue

The following table presents our disaggregated revenue by source and segment (in thousands):

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	Quarter Ended June 30, 2018			Six months ended June 30, 2018		
	Consumer Media	Mobile Services	Games	Consumer Media	Mobile Services	Games
Business Line						
Software License	$1,808	$ 469	$—	$5,145	$ 1,804	$ —
Subscription Services	1,225	6,250	2,689	2,510	13,619	5,382
Product Sales	299	—	1,953	639	—	4,355
Advertising and Other	552	—	479	1,073	—	847
Total	$3,884	$ 6,719	$5,121	9,367	15,423	10,584

The following table presents our disaggregated revenue by sales channel (in thousands):

	Quarter Ended June 30, 2018			Six months ended June 30, 2018		
	Consumer Media	Mobile Services	Games	Consumer Media	Mobile Services	Games
Sales Channel						
Business to Business	$2,360	$ 6,573	$836	$6,218	$15,103	$1,587
Direct to Consumer	1,524	146	4,285	3,149	320	8,997
Total	$3,884	$ 6,719	$5,121	$9,367	$15,423	$10,584

Contract Balances

The timing of revenue recognition may differ from the timing of invoicing to our customers. We record accounts receivable when the right to consideration becomes unconditional, except for the passage of time. For certain contracts, payment schedules may exceed one year; for those contracts we recognize a long-term receivable. As of June 30, 2018, our balance of long-term accounts receivable was $0.3 million, and is included in other long-term assets on our condensed consolidated balance sheets. During the quarter and six months ended June 30, 2018, we recorded no impairments to our contract assets.

We record deferred revenue when cash payments are received or due in advance of our completion of the underlying performance obligation. As of June 30, 2018 we had a deferred revenue balance of $2.5 million, a decrease of $1.0 million from December 31, 2017. The decrease is due primarily to our transition to Topic 606, with $0.8 million recorded to retained earnings on January 1, 2018. The decrease is further due to $0.2 million of revenues recognized which were included in the deferred balance at December 31, 2017.

Significant Estimates

For certain of our contracts, we recognize revenues using the sales- and usage-based exception as defined in the licensing guidance of Topic 606. For these contracts, we typically receive reporting of actual usage a quarter in arrears, and as such, we are required to estimate the current quarter's usage. To make these estimates, we utilize historical reporting information, as well as industry trends and interim reporting to quantify total quarterly usage. As actual usage information is received, we record a true-up in the following quarter to reflect any variance from our estimate. Our true-up on our first quarter estimates recorded in the second quarter of 2018 was not material to our condensed consolidated financial statements.

Practical Expedients

For those contracts for which we recognize revenue at the amount to which we have the right to invoice for service performed, we do not disclose the value of any unsatisfied performance obligations. We also do not disclose the remaining unsatisfied performance obligations which have an original duration of one year or less. Additionally, we immediately expense sales commissions when incurred as the amortization period would have been less than one year. These costs are recorded within sales and marketing expense.

Note 4 Stock-Based Compensation

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

	Quarter Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Total stock-based compensation expense	$457	$863	$1,614	$2,297

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

	Quarter Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Expected dividend yield	0 %	0 %	0 %	0 %
Risk-free interest rate	2.72%	1.62%	2.59%	1.76%
Expected life (years)	3.8	3.7	4.0	4.4
Volatility	35 %	34 %	35 %	35 %

The total stock-based compensation amounts for 2018 and 2017 disclosed above are recorded in their respective line items within operating expenses in the unaudited condensed consolidated statements of operations and comprehensive income (loss). Included in the expense for the six months ended June 30, 2018 and 2017 was stock compensation expense recorded in the first quarter of 2018 and 2017 related to our 2017 and 2016 incentive bonuses paid in fully vested restricted stock units, which were authorized and granted in the first quarter of 2018 and 2017, respectively.

As of June 30, 2018, $2.9 million of total unrecognized compensation cost, net of estimated forfeitures, related to stock awards. The unrecognized compensation cost is expected to be recognized over a weighted-average period of approximately 3.8 years.

Note 5 Napster Joint Venture

As of June 30, 2018 we owned approximately 42% of the issued and outstanding stock of Rhapsody International Inc., doing business as Napster, and account for our investment using the equity method of accounting.

Rhapsody America LLC was initially formed in 2007 as a joint venture between RealNetworks and MTV Networks, a division of Viacom International Inc. (MTVN), to own and operate a business-to-consumer digital audio music service originally branded as Rhapsody. The service was re-branded in 2016 as Napster. In this Note, we refer to the business as Napster, although the legal entity in which we hold our investment is Rhapsody International, Inc.

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

We recorded our share of losses of Napster of $0.0 million for the quarter and six months ended June 30, 2018; and $0.3 million and $1.1 million for the quarter and six months ended June 30, 2017. Because of the $10.0 million liquidation preference on the preferred stock we hold in Napster, under the equity method of accounting we did not record any share of Napster losses that would reduce our carrying value of Napster, which is impacted by Napster equity transactions, below $10.0 million, until Napster's book value was reduced below $10.0 million. This occurred in the first quarter of 2015. As of June 30, 2018, the carrying value of our Napster equity investment was zero, as we did not have any further commitment to provide future support to Napster, with the exception of the guaranty discussed below. Unless we commit to provide future financial support to Napster, we do not record any further share of Napster losses that would reduce our carrying value of Napster below zero; in accordance with GAAP, we currently track those suspended losses outside of our financial statements.

In December 2016, RealNetworks entered into an agreement to loan up to $5 million to Napster for general operating purposes, as did Napster's other 42% owner. Each entity fully funded its loan, providing $3.5 million each in December 2016 and the remaining $1.5 million each in January 2017. These loans are subordinate to senior creditors, and bear an interest rate of 10% per annum, which is added to the outstanding principal balance. At the time of signing the agreement we recognized previously suspended Napster losses, and, consequently, we did not record a receivable related to this loan.

As discussed in Note 4 to our 2017 Form 10-K, during November 2017, Napster entered into an amendment to its revolving credit facility. In conjunction with the amendment, both RealNetworks and Napster's other 42% owner entered into an arrangement to guarantee up to $2.75 million each of Napster's outstanding indebtedness on the credit facility. As a result of this guaranty, in December 2017 we recognized previously suspended Napster losses up to the full $2.75 million guaranty in our consolidated statement of operations. As of the date of this filing, RealNetworks has not been required to pay any amounts under the guaranty, and the amount is reflected on our condensed consolidated balance sheets as Commitment to Napster.

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

	Quarter Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net revenue	$36,239	$44,136	$76,529	$91,598
Gross profit	9,383	6,099	18,661	12,682
Operating income (loss)	3,895	(4,760)	10,310	(9,871)
Net income (loss)	2,134	(7,693)	6,582	(13,333)

Note 6 Fair Value Measurements

Items Measured at Fair Value on a Recurring Basis

The following table presents information about our financial assets that have been measured at fair value on a recurring basis as of June 30, 2018 and December 31, 2017, 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, 2018				Amortized Cost as of June 30, 2018
	Level 1	Level 2	Level 3	Total	
Cash and cash equivalents:					
Cash	$21,538	$—	$ —	$21,538	$ 21,538
Money market funds	17,542	—	—	17,542	17,542
Total cash and cash equivalents	39,080	—	—	39,080	39,080
Short-term investments:					
Corporate notes and bonds	—	3,053	—	3,053	3,049
Total short-term investments	—	3,053	—	3,053	3,049
Restricted cash equivalents	—	1,880	—	1,880	1,880
Warrants issued by Napster (included in Other assets)	—	—	939	939	—
Total	$39,080	$4,933	$ 939	$44,952	$ 44,009

	Fair Value Measurements as of December 31, 2017				Amortized Cost as of December 31, 2017
	Level 1	Level 2	Level 3	Total	
Cash and cash equivalents:					
Cash	$31,065	$—	$ —	$31,065	$ 31,065
Money market funds	20,131	—	—	20,131	20,131
Total cash and cash equivalents	51,196	—	—	51,196	51,196
Short-term investments:					
Corporate notes and bonds	—	8,779	—	8,779	8,779
Total short-term investments	—	8,779	—	8,779	8,779
Restricted cash equivalents	—	2,400	—	2,400	2,400
Warrants issued by Napster (included in Other assets)	—	—	989	989	—
Total	$51,196	$11,179	$ 989	$63,364	$ 62,375

Restricted cash equivalents as of June 30, 2018 and December 31, 2017 relates to cash pledged as collateral against letters of credit in connection with lease agreements.

Realized gains or losses on sales of short-term investment securities for the quarters and six months ended June 30, 2018 and 2017 were not significant. Gross unrealized gains and gross unrealized losses on short-term investment securities as of June 30, 2018 and December 31, 2017 were also not significant.

Investments with remaining contractual maturities of five years or less are classified as short-term because the investments are marketable and highly liquid, and we have the ability to utilize them for current operations.

Contractual maturities of short-term investments as of June 30, 2018 (in thousands):

	Estimated Fair Value
Within one year	$ 3,053
Between one year and five years	—
Total short-term investments	$ 3,053

In February 2015, Napster issued warrants to purchase Napster common shares to both RealNetworks and Napster's other 42% owner. The warrants were issued as compensation for past services provided by RealNetworks and the other 42% owner, and both warrants covered the same number of underlying shares, with a 10 year contractual term. The exercise price of the warrants was equal to the fair value of the underlying shares on the issuance date, and we used the Black-Scholes option-pricing model to calculate the fair value of the warrant, using an expected term of 5 years and expected volatility of 55%. On the date of issuance, we recognized and recorded the $1.2 million fair value of the warrant issued to RealNetworks within Other assets in the unaudited condensed consolidated balance sheets, and as an expense reduction within General and administrative expense in the unaudited condensed consolidated statements of operations. The warrants are free-standing derivatives and as such their fair value is determined each quarter using updated inputs in the Black-Scholes option-pricing model. At December 31, 2017 due to the management change and strategic shift undertaken by Napster, we determined that a change to the expected term was necessary. As a result, we extended the expected term by 3.25 years, resulting in a total expected term for the warrant of 8.25 years. During the six months ended June 30, 2018, the decrease in the fair value of the warrants was insignificant.

In February 2017, Napster issued additional warrants to purchase Napster common shares to both RealNetworks and Napster's other 42% owner. Consistent with the warrants issued in 2015, the 2017 warrants were issued as compensation for past services provided by RealNetworks and the other 42% owner, and both warrants covered the same number of underlying shares, with a 10 year contractual term. The exercise price of the warrants exceeded the fair value of the underlying shares on the issuance date, and we used the Black-Scholes option-pricing model to calculate the fair value of the warrant, using an expected term of 5 years and expected volatility of 55%, resulting in a recognized fair value of $0.5 million in Other assets in the unaudited condensed consolidated balance sheets, and as an expense reduction within general and administrative expense in the unaudited condensed consolidated statements of operations. At December 31, 2017, due to the management change and strategic shift undertaken by Napster, we determined that a change to the expected term was necessary. As a result, we extended the expected term by 1 year, resulting in a total expected term for the warrant of 6 years. During the six months ended June 30, 2018, the decrease in the fair value of the warrants was insignificant.

Items Measured at Fair Value on a Non-recurring Basis
Certain of our assets and liabilities are measured at estimated fair value on a non-recurring basis, using Level 3 inputs. These instruments are subject to fair value adjustments only in certain circumstances (for example, when there is evidence of impairment). During the six months ended June 30, 2018 and 2017, we did not record any impairments on those assets required to be measured at fair value on a non-recurring basis.

See Note 11, Lease Exit and Related Charges, for a discussion of the losses related to reductions in the use of RealNetworks' office space, which were recorded at the estimated fair value of remaining lease obligations, less expected sub-lease income.
Note 7 Other Intangible Assets
Other intangible assets (in thousands):

	June 30, 2018			December 31, 2017		
	Gross Amount	Accumulated Amortization	Net	Gross Amount	Accumulated Amortization	Net
Amortizing intangible assets:						
Customer relationships	$31,166	$ 31,025	$141	$32,286	$ 31,997	$289
Developed technology	24,598	24,598	—	25,177	25,177	—
Patents, trademarks and tradenames	3,792	3,792	—	3,932	3,896	36
Service contracts	5,548	5,474	74	5,576	5,576	—
Total	$65,104	$ 64,889	$215	$66,971	$ 66,646	$325

In conjunction with our acquisition of a Netherlands-based game development studio in the second quarter of 2018, we recorded $0.1 million in intangibles. Refer to Note 8 Goodwill for further details about the acquisition.

No impairments of other intangible assets were recognized in either of the six months ended June 30, 2018 or 2017.
Note 8 Goodwill
Changes in goodwill (in thousands):

Balance, December 31, 2017	$13,060
Increases due to current year acquisitions	4,367
Effects of foreign currency translation	(307)
Balance, June 30, 2018	$17,120

On April 16, 2018, in order to acquire a full workforce, we purchased 100% of the shares of a small, privately-held Netherlands-based game development studio for net cash consideration of $4.2 million. All tangible and intangible assets and liabilities recognized are reported within the Games segment. As a result of our preliminary purchase price allocation, we recorded $0.1 million of identifiable intangible assets relating to an existing customer contract. We also recorded goodwill of $4.4 million, representing the intangible assets that do not qualify for separate recognition for accounting purposes, primarily related to the assembled workforce and expected synergies in development of our Original Stories titles. The goodwill is not deductible for income tax purposes. We did not recognize significant revenue or loss before income taxes from this acquired business from the date of acquisition through June 30, 2018.

Goodwill by segment (in thousands):

	June 30, 2018
Consumer Media	$580
Mobile Services	2,106
Games	14,434
Total goodwill	$17,120

No impairment of goodwill was recognized in either of the six months ended June 30, 2018 or in 2017.

Note 9 Accrued and Other Current Liabilities

Accrued and other current liabilities (in thousands):

	June 30, 2018	December 31, 2017
Royalties and other fulfillment costs	$3,226	$ 2,965
Employee compensation, commissions and benefits	3,856	4,384
Sales, VAT and other taxes payable	1,495	1,782
Other	3,684	3,234
Total accrued and other current liabilities	$12,261	$ 12,365

Note 10 Restructuring Charges

Restructuring and other charges in 2018 and 2017 consist of costs associated with the ongoing reorganization of our business operations and our ongoing expense re-alignment efforts. The expense amounts in both years relate primarily to severance costs due to workforce reductions.

Restructuring charges are as follows (in thousands):

	Employee Separation Costs
Costs incurred and charged to expense for the six months ended June 30, 2018	$ 688
Costs incurred and charged to expense for the six months ended June 30, 2017	$ 1,714

Changes to the accrued restructuring liability (which is included in Accrued and other current liabilities) for 2018 (in thousands) are as follows:

	Employee Separation Costs
Accrued liability at December 31, 2017	$ 244
Costs incurred and charged to expense for the six months ended June 30, 2018	688
Cash payments	(638)
Accrued liability at June 30, 2018	$ 294

Note 11 Lease Exit and Related Charges

As a result of the reduction in use of RealNetworks' office space, lease exit and related charges have been recognized representing rent and contractual operating expenses over the remaining life of the leases, including estimates of sublease income expected to be received. In the first quarter of 2018, we renegotiated the lease for our Seattle headquarters, reducing our total leased space by 15%. Consequently, we recorded a reduction to our lease loss accrual to reflect our reduced future obligations. This reduction has also been recorded as a benefit of $0.3 million in our condensed consolidated statement of operations for the six months ended June 30, 2018. We continue to regularly evaluate the market for office space. If the market for such space changes further in future periods, we may have to revise our estimates which may result in future adjustments to expense for excess office facilities.

Changes to accrued lease exit and related charges (which is included in Accrued and other current liabilities) for 2018 (in thousands) are as follows:

Accrued loss at December 31, 2017	$2,058
Additions and adjustments to the lease loss accrual, including estimated sublease income	(454)
Less amounts paid, net of sublease amounts	(433)
Accrued loss at June 30, 2018	1,171
Less current portion (included in Accrued and other current liabilities)	(181)
Accrued loss, non-current portion (included in Other long term liabilities)	$990

Note 12 Shareholders' Equity

Accumulated Other Comprehensive Income (Loss)

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

	Quarter Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Investments				
Accumulated other comprehensive income (loss), beginning of period	$3	$(2)	$2	$(6)
Unrealized gains, net of tax effects of $1, $3, $1 and $5	2	6	3	10
Net current period other comprehensive income	2	6	3	10
Accumulated other comprehensive income balance, end of period	$5	$4	$5	$4
Foreign currency translation				
Accumulated other comprehensive loss, beginning of period	$(59,153)	$(61,045)	$(59,549)	$(61,639)
Translation adjustments	(1,604)	646	(1,208)	1,240
Net current period other comprehensive income (loss)	(1,604)	646	(1,208)	1,240
Accumulated other comprehensive loss balance, end of period	$(60,757)	$(60,399)	$(60,757)	$(60,399)
Total accumulated other comprehensive loss, end of period	$(60,752)	$(60,395)	$(60,752)	$(60,395)

Note 13 Income Taxes

As of June 30, 2018, there have been no material changes to RealNetworks' uncertain tax positions disclosures as provided in Note 14 of the 2017 10-K. We do not anticipate that the total amount of unrecognized tax benefits will significantly change within the next twelve months.

We file numerous consolidated and separate income tax returns in the U.S. including federal, state and local, as well as foreign jurisdictions. With few exceptions, we are no longer subject to U.S. federal income tax examinations for tax years before 2013 or state, local, or foreign income tax examinations for years before 1993. We are currently under audit by various states and foreign jurisdictions for certain tax years subsequent to 1993.

Note 14 Loss Per Share

Basic net loss per share (EPS) is computed by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted EPS is computed by dividing net loss by the weighted average number of common and dilutive potential common shares outstanding during the period. Basic and diluted EPS (in thousands, except per share amounts):

	Quarter Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net loss from continuing operations	$(6,930)	$(3,779)	$(12,108)	$(13,329)
Weighted average common shares outstanding used to compute basic EPS	37,577	37,103	37,514	37,067
Dilutive effect of stock based awards	—	—	—	—
Weighted average common shares outstanding used to compute diluted EPS	37,577	37,103	37,514	37,067
Basic EPS from continuing operations	$(0.18)	$(0.10)	$(0.32)	$(0.36)
Diluted EPS from continuing operations	$(0.18)	$(0.10)	$(0.32)	$(0.36)

During the quarter and six months ended June 30, 2018, 5.9 million and 6.0 million shares of common stock, respectively, of potentially issuable shares from stock awards were excluded from the calculation of diluted EPS because of their antidilutive effect.

During both the quarter and six months ended June 30, 2017, 5.2 million shares of common stock of potentially issuable shares from stock awards were excluded from the calculation of diluted EPS because of their antidilutive effect.

Note 15 Discontinued Operations

On December 31, 2017, our contract with our low-margin music on demand customer LOEN expired. The activity for this contract represented our only revenue source relating to music on demand services, and we did not renew the sole contract for this service, resulting in the abandonment of the related business. As the exit of the music on demand business represented a strategic shift, and the amounts were financially significant to our consolidated results, at December 31, 2017 we determined this business should be reported as a discontinued operation, and treated it as such beginning in our fourth quarter of 2017.

The following table summarizes the results of operations, which were recorded in our Mobile Services segment, relating to the discontinued operation (in thousands):

	Quarter Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net revenue	$—	$11,507	$—	$22,392
Cost of revenue	—	11,003	—	21,727
Gross profit	—	504	—	665
Income taxes	—	111	—	146
Income from discontinued operations, net of tax	$—	$393	$—	$519

The following table summarizes the remaining carrying amounts of major classes of assets and liabilities of the discontinued operation (in thousands). These assets and liabilities relate to final settlements of prior year activity between various parties. These balances were fully settled prior to the end of the second quarter of 2018.

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	June 30, 2018	December 31, 2017
Trade accounts receivable, net	$ —	$ 17,456
Total current assets of discontinued operations	—	17,456
Accounts payable	$ —	$ 15,836
Accrued and other current liabilities	—	1,271
Total current liabilities of discontinued operations	$ —	$ 17,107

The cash flows related to the discontinued operation have not been segregated, and are included in the Consolidated Statements of Cash Flows. For all periods presented, depreciation and amortization, capital expenditures and significant operating non-cash items from the discontinued operation were not material.

Note 16 Commitments and Contingencies

From time to time we are and may 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. Although we believe that resolving such claims, individually or in aggregate, will not have a material adverse impact on our business or financial condition, these matters are subject to inherent uncertainties. Such claims, even if not meritorious, could force us to expend significant financial and managerial resources. In addition, given the broad distribution of some of our consumer products, any individual claim related to those products could give rise to liabilities that may be material to us. In the event of a determination adverse to us, we may incur substantial monetary liability, and/or be required to change our business practices. Either of these could have a material adverse effect on our consolidated financial statements.

Note 17 Guarantees

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

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

Note 18 Segment Information

We manage our business and report revenue and operating income (loss) in three segments: (1) Consumer Media, which includes licensing of our codec technology and our PC-based RealPlayer products, including RealPlayer Plus and related products; (2) Mobile Services, which includes our subscription services and our integrated RealTimes platform which is sold to mobile carriers; and (3) Games, which includes all our games-related businesses, including sales of mobile games, sales of games licenses, games subscription services, advertising on games sites and social network sites, and microtransactions from online and social games.

We allocate to our reportable segments certain corporate expenses which are directly attributable to supporting our businesses, including but not limited to a portion of finance, legal, human resources and headquarters facilities. Remaining expenses, which are not directly attributable to supporting the business, are reported as corporate items. Also reported in our corporate segment are restructuring charges, lease exit and related charges, as well as stock-based compensation expense.

RealNetworks reports three reportable segments based on factors such as how we manage our operations and how our Chief Operating Decision Maker (CODM) reviews results. The CODM reviews financial information presented on both a

consolidated basis and on a business segment basis. The accounting policies used to derive segment results are the same as those described in Note 1, Description of Business and Summary of Significant Accounting Policies, in the 10-K.
Segment results for the quarters and six months ended June 30, 2018 and 2017 (in thousands):
Consumer Media

	Quarter Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenue	$3,884	$6,951	$9,367	$12,620
Cost of revenue	1,028	1,159	2,021	2,564
Gross profit	2,856	5,792	7,346	10,056
Operating expenses	3,439	3,730	7,357	7,740
Operating income (loss)	$(583)	$2,062	$(11)	$2,316

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Mobile Services

	Quarter Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenue	$6,719	$7,720	$15,423	$15,919
Cost of revenue	2,134	2,426	4,450	5,616
Gross profit	4,585	5,294	10,973	10,303
Operating expenses	6,969	6,705	14,335	14,824
Operating loss	$(2,384)	$(1,411)	$(3,362)	$(4,521)

Games

	Quarter Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenue	$5,121	$6,934	$10,584	$12,757
Cost of revenue	1,456	2,679	3,273	4,616
Gross profit	3,665	4,255	7,311	8,141
Operating expenses	5,095	5,090	10,012	10,037
Operating loss	$(1,430)	$(835)	$(2,701)	$(1,896)

Corporate

	Quarter Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Cost of revenue	$7	$23	$17	$60
Operating expenses	2,429	2,959	5,696	7,254
Operating loss	$(2,436)	$(2,982)	$(5,713)	$(7,314)

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

	Quarter Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
United States	$7,646	$10,889	$19,080	$20,629
Europe	3,010	3,205	6,035	6,399
Rest of the World	5,068	7,511	10,259	14,268
Total net revenue	$15,724	$21,605	$35,374	$41,296

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

	June 30, 2018	December 31, 2017
United States	$11,915	$ 12,236
Europe	7,287	3,437
Rest of the World	1,354	1,572
Total long-lived assets	$20,556	$ 17,245

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Note 19 Related Party Transactions

See Note 5, Napster Joint Venture, and Note 6, Fair Value Measurements, for details on transactions involving Napster.

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

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

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

These statements are not guarantees of future performance and actual actions or results may differ materially. These statements are subject to certain risks, uncertainties and assumptions that are difficult to predict, including those noted in the documents incorporated herein by reference. Particular attention should also be paid to the cautionary language in Item 1A of Part II "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 creates innovative applications and services that make it easy to connect with and enjoy digital media. We manage our business and report revenue and operating income (loss) in three segments: (1) Consumer Media, (2) Mobile Services, and (3) Games. See Note 18 Segment Information, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this Form 10-Q.

Within our Consumer Media segment revenue is primarily derived from the software licensing of our video compression, or codec, technology, including our latest technology, RealMedia High Definition, or RMHD. We also generate revenue from the sale of our PC-based RealPlayer products, including RealPlayer Plus and related products.

These products and services are delivered directly to consumers and through partners, such as OEMs and mobile device manufacturers.
Our Mobile Services business generates revenue primarily from the sale of subscription services, which includes our intercarrier messaging service and ringback tones, as well as through software licenses for the integration of our RealTimes platform and certain system implementations. We generate a significant portion of our revenue from sales within our Mobile

Services business to a few mobile carriers. The loss of these contracts, whether by termination or non-renewal or renegotiation of contract terms that are less favorable to us could result in the loss of future revenues and anticipated profits.
Our Games business, through the GameHouse and Zylom brands, derives revenue from product sales of mobile games, games licenses, games subscription services, and advertising on games sites and within our games.
We allocate to our reportable segments certain corporate expenses which are directly attributable to supporting our businesses, including but not limited to a portion of finance, IT, legal, human resources and headquarters facilities. Remaining expenses, which are not directly attributable to supporting the business, are reported as corporate items. These corporate items also include restructuring charges, lease exit and related charges, as well as stock compensation expense.
On December 31, 2017, our contract with LOEN Entertainment, Co, Ltd. (LOEN) for our music on demand services expired. As the profits generated from this business had significantly declined over time, we did not renew the sole contract for this service. Accordingly, we have reported the operating results and related assets and liabilities of this business as discontinued operations for all periods presented. Refer to Note 15 to our unaudited condensed consolidated financial statements for additional information on these discontinued operations. Unless otherwise noted, amounts and percentages for all periods discussed below reflect the results of operations and financial condition of our continuing operations.
As discussed in Note 3 Revenue Recognition, as a result of our transition to Topic 606, in the three months ended June 30, 2018, our net revenues were $1.1 million lower as compared to revenues which would have been recognized under previous accounting guidance. For the six months ended June 30, 2018 we accelerated the recognition of $2.4 million in revenues, the majority of which would have been recognized in future quarters of 2018 under previous accounting guidance.

As of June 30, 2018, we had $42.1 million in unrestricted cash, cash equivalents and short-term investments, compared to $60.0 million as of December 31, 2017. The 2018 decrease of cash, cash equivalents, and short-term investments was due to our ongoing cash flows used in operating activities and to the April 2018 acquisition of a game development studio, as discussed in Note 8 Goodwill.

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

	Quarter Ended June 30,				Six months ended June 30,			
	2018	2017	$ Change	% Change	2018	2017	$ Change	% Change
Total revenue	$15,724	$21,605	$(5,881)	(27)%	$35,374	$41,296	$(5,922)	(14)%
Cost of revenue	4,625	6,287	(1,662)	(26)%	9,761	12,856	(3,095)	(24)%
Gross profit	11,099	15,318	(4,219)	(28)%	25,613	28,440	(2,827)	(10)%
Gross margin	71%	71%			72%	69%		
Operating expenses	17,932	18,484	(552)	(3)%	37,400	39,855	(2,455)	(6)%
Operating loss	$(6,833)	$(3,166)	$(3,667)	(116)%	$(11,787)	$(11,415)	$(372)	(3)%

In the second quarter of 2018, our total consolidated revenue decreased $5.9 million as compared with the year-earlier period, due to decreases in revenue of $3.1 million in our Consumer Media segment, $1.8 million in our Games segment and $1.0 million in our Mobile Services segment. See below for further discussion around the fluctuations for each segment.
Cost of revenue decreased by $1.7 million for the quarter ended June 30, 2018, due primarily to declines of $1.2 million in our Games segment and $0.3 million in our Mobile Services segment.
Operating expenses decreased by $0.6 million in the quarter ended June 30, 2018 as compared with the year-earlier period, primarily due to reduced salaries, benefits and professional services costs of $0.3 million, and a benefit of $0.1 million to lease exit costs.

For the six months ended June 30, 2018, our total consolidated revenue decreased $5.9 million as compared to the prior year. The year over year decrease is due to lower revenues of $3.3 million in our Consumer Media segment, $2.2 million in our Games segment and $0.5 million in our Mobile Services segment. See below for further discussion around the fluctuations for each segment.

Cost of revenue decreased by $3.1 million in the six months ended June 30, 2018 as compared to the prior year period due to decreased costs in all three operating segments: $1.3 million in Games, $1.2 million in Mobile Services and $0.5 million in Consumer Media.

Operating expenses decreased by $2.5 million compared with the prior year primarily due to reduced restructuring costs of $1.0 million and a benefit of $0.5 million in lease exit and related charges following the renegotiation of certain leases. Also contributing to the overall decrease were reductions of $0.6 million in facilities and support services, $0.6 million in salaries, benefits, and professional services, and $0.4 million in marketing expense. These decreases were offset by certain benefits recorded in the first quarter of 2017, including: $0.5 million relating to the warrants we received from Napster and a $0.4 million release of previously accrued taxes.

Segment Operating Results

Consumer Media

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

	Quarter Ended June 30,				Six months ended June 30,			
	2018	2017	$ Change	% Change	2018	2017	$ Change	% Change
Revenue	$3,884	$6,951	$(3,067)	(44)%	$9,367	$12,620	$(3,253)	(26)%
Cost of revenue	1,028	1,159	(131)	(11)%	2,021	2,564	(543)	(21)%
Gross profit	2,856	5,792	(2,936)	(51)%	7,346	10,056	(2,710)	(27)%
Gross margin	74%	83%			78%	80%		
Operating expenses	3,439	3,730	(291)	(8)%	7,357	7,740	(383)	(5)%
Operating income (loss)	$(583)	$2,062	$(2,645)	(128)%	$(11)	$2,316	$(2,327)	(100)%

Total Consumer Media revenue for the quarter ended June 30, 2018 decreased $3.1 million as compared to the same quarter in 2017, due primarily to decreased software license revenues of $2.9 million, as well as a decrease in our subscription services revenues, described more fully below:

Software License

For our software license revenues, the $2.9 million decrease is primarily due to the timing of shipments by our customers. In the second quarter of 2017 we recognized revenue on certain large shipments, whereas in 2018 shipments have been more evenly distributed. The shift in timing resulted in a $2.3 million decrease to revenue compared to the prior year quarter. The variance was also impacted by the transition to Topic 606, which accelerated the recognition of certain codec technology revenues into the first quarter of 2018 which were previously recognized ratably.

Subscription Services

For our subscription services revenues, the decrease is primarily due to $0.3 million from continuing declines in our legacy subscription products.

Cost of revenue decreased by $0.1 million during the quarter ended June 30, 2018, compared with the year-earlier period. The decrease in cost of revenue was primarily due to lower bandwidth costs of $0.2 million, offset by increased professional services fees.

Operating expenses decreased $0.3 million as compared with the year-earlier period, due to reduced salaries, benefits and professional services fees, and to lower facilities and support services costs.

Total Consumer Media revenue for the six months ended June 30, 2018 decreased $3.3 million as compared to the prior year, due primarily to decreased software license revenues of $2.9 million, as well as a decrease in our subscription services revenues of $0.6 million, described more fully below. These decreases were offset in part by an increase in advertising and other revenues of $0.2 million.

Software License

For our software license revenues, the year over year decrease is partially due to the timing of shipments by our customers. In the second quarter of 2017 we recognized revenue on certain large shipments, whereas in 2018 shipments have been more evenly distributed. As a result of this shift in timing, we recorded $0.9 million less revenue during the six months ended June 30, 2018. The variance is also driven by the execution and recognition of large contract renewals in the first quarter of 2017.

Subscription Services

For our subscription services revenues, the decrease is primarily due to $0.6 million from continuing declines in our legacy subscription products.

Cost of revenue decreased by $0.5 million in the six months ended June 30, 2018 when compared to the prior-year period due to decreases of $0.4 million in bandwidth costs and $0.3 million in royalty costs. These decreases were offset by an increase of $0.3 million in salaries and benefits costs.

Operating expenses decreased $0.4 million in the six months ended June 30, 2018 as compared with the year-earlier period, due to reduced costs for facilities and support services of $0.3 million, and for salaries, benefits and professional services fees of $0.2 million.

Mobile Services

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

	Quarter Ended June 30,				Six months ended June 30,			
	2018	2017	$ Change	% Change	2018	2017	$ Change	% Change
Revenue	$6,719	$7,720	$(1,001)	(13)%	$15,423	$15,919	$(496)	(3)%
Cost of revenue	2,134	2,426	(292)	(12)%	4,450	5,616	(1,166)	(21)%
Gross profit	4,585	5,294	(709)	(13)%	10,973	10,303	670	7 %
Gross margin	68 %	69 %			71 %	65 %		
Operating expenses	6,969	6,705	264	4 %	14,335	14,824	(489)	(3)%
Operating loss	$(2,384)	$(1,411)	$(973)	(69)%	$(3,362)	$(4,521)	$1,159	26 %

Total Mobile Services revenue decreased by $1.0 million in the quarter ended June 30, 2018 compared with the prior-year period. The revenue decrease is due to declines of $0.8 million in our subscription services revenue stream and $0.2 million in our software license revenue stream, described more fully below:

Software license

For our software license revenues the decrease is primarily due to declines in our legacy integrated RealTimes product offered to mobile carriers.

Subscription services

For our subscription services, the $0.8 million decrease is primarily the result of a decrease of $0.5 million in our ringback tones business and a $0.3 million reduction in our intercarrier messaging service, driven primarily by one-time credits issued to certain carriers.

Cost of revenue decreased by $0.3 million in the quarter ended June 30, 2018 compared with the prior-year period, due primarily to reductions in bandwidth costs of $0.2 million.

Operating expenses increased by $0.3 million for the quarter ended June 30, 2018 compared with the year-earlier period primarily due to increased professional services fees and marketing spend relating to our growth initiatives.

Total Mobile Services revenue decreased by $0.5 million for the six months ended June 30, 2018 as compared to the prior-year period, as a decrease to our subscription services revenue stream of $1.0 million was offset by an increase in our software license revenue stream of $0.5 million, described more fully below:

Software license

For our software license revenues, the increase is primarily due to the recognition of $0.6 million in revenues generated by our integrated RealTimes products offered to mobile carriers due to our transition to Topic 606 in the first quarter of 2018.

Subscription service

For our subscription services, the $1.0 million decrease is primarily a result of a decrease in our ringback tones business, driven mostly by the recognition of $0.9 million in the first quarter of 2017 following the execution of a long-term contract with our partner in Brazil. Also contributing to the decrease is a $0.4 million reduction in our intercarrier messaging business. These decreases were offset by the recognition of $0.6 million in non-recurring engineering services relating to our ringback tones businesses, which was accelerated due to our transition to Topic 606 in the first quarter of 2018.

Cost of revenue decreased by $1.2 million for the six months ended June 30, 2018 when compared to the prior-year period, due primarily to lower bandwidth costs of $0.5 million, third-party customer service of $0.2 million, and salaries, professional services fees and benefits of $0.2 million.

Operating expenses decreased by $0.5 million in the six months ended June 30, 2018 as compared with the year-earlier period primarily due to a reduction in facilities and support services costs, and salaries, benefits and professional services fees totaling $0.3 million.

Games

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

	Quarter Ended June 30,				Six months ended June 30,			
	2018	2017	$ Change	% Change	2018	2017	$ Change	% Change
Revenue	$5,121	$6,934	$(1,813)	(26)%	$10,584	$12,757	$(2,173)	(17)%
Cost of revenue	1,456	2,679	(1,223)	(46)%	3,273	4,616	(1,343)	(29)%
Gross profit	3,665	4,255	(590)	(14)%	7,311	8,141	(830)	(10)%
Gross margin	72 %	61 %			69 %	64 %		
Operating expenses	5,095	5,090	5	— %	10,012	10,037	(25)	— %
Operating loss	$(1,430)	$(835)	$(595)	(71)%	$(2,701)	$(1,896)	$(805)	(42)%

Total Games revenue declined $1.8 million for the quarter ended June 30, 2018 as compared with the year-earlier period due primarily to a decrease of $2.1 million in our product sales revenue stream, offset by an increase of $0.3 million in our advertising and other revenue stream, described more fully below:

Product sales

For our product sales, the decrease is primarily due to the performance of certain of our Original Stories titles within the respective quarters, as our releases in the second quarter of 2017 had more comparative success than those titles released in the second quarter of 2018.

Advertising and other

Our advertising and other revenues increased $0.3 million as compared to the prior-year period as a result of new initiatives to offer in-game advertising within our mobile games.

Cost of revenue decreased $1.2 million in the quarter ended June 30, 2018 when compared with the prior-year period. Consistent with the decrease in revenue, we recorded decreased publisher royalties of $0.7 million and decreased app store fees of $0.5 million.

Operating expenses were flat in the quarter ended June 30, 2018, compared with the prior-year period as increased salaries and benefits costs, including our April acquisition of a Netherlands-based game development studio, were offset by decreased marketing fees.

Total Games revenue declined $2.2 million in the six months ended June 30, 2018 as compared with the prior-year period. The decrease is due primarily to a decrease of $2.5 million in our product sales revenue stream, offset by an increase of $0.6 million in our advertising and other revenue stream, described more fully below. The overall decrease was also impacted by a decrease of $0.2 million in our subscription services.

Product sales

For our product sales, the decrease of $2.5 million is due primarily to timing of launches and specific games launched within our Original Stories portfolio. As of the second quarter of 2018 we have published four Original Stories titles, compared to five titles in 2017, of which, our 2017 launches experienced more comparative success than those titles released in 2018.

Advertising and other

Our advertising and other revenues increased $0.6 million as compared to the prior-year period as a result of new initiatives to offer in-game advertising within our mobile games.

Cost of revenue decreased by $1.3 million in the six months ended June 30, 2018 as compared to the prior year period. Consistent with the decrease in revenue, we recorded decreased publisher royalties of $0.7 million and decreased app store fees of $0.7 million.

Operating expenses were flat in the six months ended June 30, 2018 when compared to the prior-year period, as an increase of $0.3 million in salaries and benefits costs were offset by decreased marketing fees.

Corporate

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

	Quarter Ended June 30,				Six months ended June 30,			
	2018	2017	$ Change	% Change	2018	2017	$ Change	% Change
Cost of revenue	$7	$23	$ (16)	70 %	$17	$60	$(43)	72 %
Operating expenses	2,429	2,959	(530)	(18)%	5,696	7,254	(1,558)	(21)%
Operating loss	$(2,436)	$(2,982)	$ 546	18 %	$(5,713)	$(7,314)	$ 1,601	22 %

Operating expenses decreased by $0.5 million in the quarter ended June 30, 2018 compared with the year-earlier period. The decrease was primarily due to $0.4 million lower salaries, benefits, professional services and facilities costs due to our ongoing cost reduction efforts.

Operating expenses decreased by $1.6 million in the six months ended June 30, 2018 when compared with the year-earlier period. The decrease was primarily due to lower restructuring costs and a benefit in lease exit and related charges due to the renegotiation of certain leases totaling $1.5 million. A decrease of $0.8 million in salaries, benefits, professional services and facilities costs due to our ongoing cost reduction efforts also reduced operating expenses compared to the prior year. These decreases were offset by certain benefits recorded in the first quarter of 2017: $0.5 million relating to the warrants received from Napster and a $0.4 million release of previously accrued taxes.

Consolidated Operating Expenses

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

	Quarter Ended June 30,				Six months ended June 30,			
	2018	2017	$ Change	% Change	2018	2017	$ Change	% Change
Research and development	$7,652	$7,584	$ 68	1 %	$15,346	$14,933	$413	3 %
Sales and marketing	4,883	5,496	(613)	(11)%	10,880	12,651	(1,771)	(14)%
General and administrative	5,339	5,254	85	2 %	10,940	10,557	383	4 %
Restructuring and other charges	187	150	37	25 %	688	1,714	(1,026)	(60)%
Lease exit and related charges	(129)	—	(129)	NM	(454)	—	(454)	NM
Total consolidated operating expenses	$17,932	$18,484	$ (552)	(3)%	$37,400	$39,855	$(2,455)	(6)%

Research and development expenses increased by $0.1 million in the quarter ended June 30, 2018 as compared with the year-earlier period, primarily due to an increase in salaries, benefits and professional services expense, reflecting our continued efforts towards our growth initiatives.

Research and development expenses increased by $0.4 million in the six months ended June 30, 2018 as compared with the prior year period, primarily due to an increase of $0.6 million in salaries, benefits and professional services expense, reflecting our continued efforts towards our growth initiatives.

Sales and marketing expenses decreased by $0.6 million in the quarter ended June 30, 2018 compared with the year-earlier period. The decrease was due to a $0.4 million reduction in salaries, benefits and professional service fees, and lower marketing expense and facilities and support services costs.

Sales and marketing expenses decreased by $1.8 million in the six months ended June 30, 2018 as compared with the prior year period. The decrease is comprised of a $1.0 million reduction in salaries, benefits and professional services fees, a $0.4 million reduction to marketing expense and a $0.3 million reduction in facilities and support services costs.

General and administrative expenses increased by $0.4 million in the six months ended June 30, 2018 as compared with the year-earlier period. In the first quarter of 2017 we recorded a benefit of $0.5 million relating to warrants we received from Napster and a benefit of $0.4 million from the release of previously accrued taxes. These benefits were offset in part by

decreases in 2018 compared with 2017 of $0.3 million in salaries, benefits and professional services costs and $0.3 million in facilities and support services as a result of our ongoing cost reduction efforts.
Restructuring and other charges and Lease exit and related charges consist of costs associated with the ongoing reorganization of our business operations and expense re-alignment efforts. Restructuring expense primarily relates to severance costs due to workforce reductions. For additional details on these charges see Note 10, Restructuring Charges and Note 11, Lease Exit and Related Charges.
Other Income (Expenses)
Other income (expenses), net was as follows (dollars in thousands):

	Quarter Ended June 30,			Six months ended June 30,		
	2018	2017	$ Change	2018	2017	$ Change
Interest income, net	$111	$109	$ 2	$198	$237	$(39)
Equity in net loss of Napster	—	(349)	349	—	(1,097)	1,097
Other income (expense), net	(42)	(13)	(29)	(83)	(239)	156
Total other income (expense), net	$69	$(253)	$ 322	$115	$(1,099)	$ 1,214

We account for our investment in Napster under the equity method of accounting, as described in Note 5, Napster Joint Venture. The net carrying value of our investment in Napster is not necessarily indicative of the underlying fair value of our investment.
Income Taxes
During the quarters ended June 30, 2018 and 2017, we recognized income tax expense of $0.2 million and $0.4 million, respectively, related to U.S. and foreign income taxes. During the six months ended June 30, 2018 and 2017, we recognized income tax expense of $0.4 million and $0.8 million, respectively, related to U.S. and foreign income taxes. The change in income tax expense during the quarter ended June 30, 2018 was largely the result of changes in our jurisdictional income.
As of June 30, 2018, there have been no material changes to RealNetworks’ uncertain tax positions disclosures as provided in Note 14 of the 2017 10-K. We do not anticipate that the total amount of unrecognized tax benefits will significantly change within the next twelve months.
The majority of our tax expense is due to income in our foreign jurisdictions and we have not benefitted from losses in the U.S. and certain foreign jurisdictions in the second quarter of 2018. We generate income in a number of foreign jurisdictions, some of which have higher or lower tax rates relative to the U.S. federal statutory rate. Our tax expense could fluctuate significantly on a quarterly basis to the extent income is less than anticipated in countries with lower statutory tax rates and more than anticipated in countries with higher statutory tax rates. For the quarter ended June 30, 2018, decreases in tax expense from income generated in foreign jurisdictions with lower tax rates in comparison to the U.S. federal statutory rate was offset by increases in tax expense from income generated in foreign jurisdictions having comparable, or higher tax rates in comparison to the U.S. federal statutory rate. The effect of differences in foreign tax rates on the Company's tax expense for the second quarter of 2018 was minimal.
On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act. The Company continues to analyze the impact of the Tax Cuts and Jobs Act on its financial statements, including the impact of the one-time deemed repatriation transition tax on previously untaxed accumulated and current earnings and profits of certain foreign subsidiaries and global intangible low-taxed income (GILTI) earned by controlled foreign corporations. As of June 30, 2018, the provisional amounts recorded in the financial statements for the period ending December 31, 2017 have not changed. However, the Company continues to evaluate the implications of tax reform and any additional impacts from the enactment of the Tax Cuts and Jobs Act will be recorded as they are identified during the measurement period as provided for in accordance with the SEC's SAB No. 118.
As of June 30, 2018, we have not provided for U.S. federal and state income taxes on certain undistributed earnings of our foreign subsidiaries, since such earnings are considered indefinitely reinvested outside the U.S. As part of the transition tax under the Tax Cuts and Jobs Act, the Company can now distribute, tax-free, earnings from our foreign

subsidiaries to the U.S. However, for certain earnings, foreign taxes may be imposed upon distribution. As such, the Company asserts that the undistributed earnings of its foreign subsidiaries will continue to be permanently reinvested in jurisdictions where foreign taxes would be assessed upon distribution to the U.S. It is not practicable to determine the foreign tax liability or benefit on such earnings due to the timing of such future distributions and the complexity of the computation if such earnings were not deemed to be permanently reinvested. If future events, including material changes in estimates of cash, working capital, and long-term investment requirements necessitate that these earnings be distributed, an additional provision for foreign taxes may be necessary.

We file numerous consolidated and separate income tax returns in the U.S., including federal, state and local returns, as well as in foreign jurisdictions. With few exceptions, we are no longer subject to United States federal income tax examinations for tax years prior to 2013 or state, local or foreign income tax examinations for years prior to 1993. We are currently under audit by various states and foreign jurisdictions for certain tax years subsequent to 1993.

New Accounting Pronouncements

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

Liquidity and Capital Resources

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

	June 30, 2018	December 31, 2017
Working capital	$40,975	$ 55,157
Cash, cash equivalents, and short-term investments	42,133	59,975
Restricted cash equivalents and investments	1,880	2,400

The 2018 decrease of cash, cash equivalents, and short-term investments from December 31, 2017 was due primarily to our ongoing negative cash flows used in operating activities, which totaled $12.7 million in the first six months of 2018, as well as our April purchase of a Netherlands-based game development studio.

The following summarizes cash flow activity (in thousands):

	Six months ended June 30,	
	2018	2017
Cash used in operating activities	$(12,730)	$(13,946)
Cash provided by investing activities	954	16,795
Cash provided used in financing activities	(129)	(62)

Cash used in operating activities consisted of net loss adjusted for certain non-cash items such as depreciation and amortization, stock-based compensation, equity in net loss of Napster, and the effect of changes in certain operating assets and liabilities.

Cash used in operating activities was $1.2 million less in the six months ended June 30, 2018 as compared to the same period in 2017. Cash used in operations was less due primarily to the net change in operating assets and liabilities during 2018 compared to 2017. In the current year, we used cash of $3.5 million from the net change in operating assets and liabilities while in 2017 the net change in operating assets and liabilities used $5.8 million.

For the six months ended June 30, 2018, cash provided by investing activities of $1.0 million was due to sales and maturities of short-term investments, which totaled $5.7 million. The maturities were offset by our purchase of a Netherlands-based game development studio in the second quarter of 2018 for net cash consideration of $4.2 million and by fixed asset purchases of $0.6 million.

For the six months ended June 30, 2017, cash provided by investing activities of $16.8 million was due to sales and maturities, net of purchases, of short-term investments, which totaled $18.7 million. The increase was offset in part by our advance paid to Napster of $1.5 million, as discussed further in Note 5 Napster Joint Venture, and fixed asset purchases of $0.4 million.

Cash used in financing activities for the six months ended June 30, 2018 was $0.1 million. This cash outflow was due to tax payments on shares withheld upon vesting of restricted stock, net of proceeds received from the employee stock purchase plan.
Cash used in financing activities for the six months ended June 30, 2017 was $0.1 million. This cash outflow was due mainly to tax payments on shares withheld upon vesting of restricted stock, net of proceeds received from the employee stock purchase plan.
Two customers in our Mobile Services segment accounted for 39% of trade accounts receivable as of June 30, 2018, with the customers individually accounting for 23% and 16%. At December 31, 2017, one customer in our Mobile Services segment accounted for 20% of trade accounts receivable.
One customer in our Mobile Services segment accounted for 12% of consolidated revenue or $1.8 million during the quarter ended June 30, 2018. No individual customer accounted for 10% or more of our consolidated revenue during the six months ended June 30, 2018. One customer in our Consumer Media segment accounted for 14% of consolidated revenue, or $3.1 million during the quarter ended June 30, 2017. No customer accounted for 10% or more of our consolidated revenue during the six months ended June 30, 2017.
While we currently have no planned significant capital expenditures for the remainder of 2018 other than those in the ordinary course of business, we do have contractual commitments for future payments related to office leases.
We believe that our current unrestricted cash, cash equivalents, and short-term investments will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next 12 months.
In the future, we may seek to raise additional funds through public or private equity financing, or through other sources such as credit facilities. Such sources of funding may or may not be available to us at commercially reasonable terms. The sale of additional equity securities could result in dilution to our shareholders. In addition, in the future, we may enter into cash or stock acquisition transactions or other strategic transactions that could reduce cash available to fund our operations or result in dilution to shareholders.
If Napster incurs losses, if it otherwise experiences a significant decline in its business or financial condition, or if we provide financial support to, or increase our investment in Napster, we could incur further losses on our investment, which could have an adverse effect on our financial condition, liquidity, and results of operations. For further information on Napster, please refer to Note 5 Napster Joint Venture.
Our cash equivalents and short-term investments consist of investment grade securities, as specified in our investment policy guidelines. The policy limits the amount of credit exposure to any one non-U.S. Government or non-U.S. Agency issue or issuer to a maximum of 5% of the total portfolio. These securities are subject to interest rate risk and will decrease in value if interest rates increase. Because we have historically had the ability to hold our fixed income investments until maturity, we do not expect our operating results or cash flows to be significantly affected by a sudden change in market interest rates in our securities portfolio.
We conduct our operations primarily in three functional currencies: the U.S. dollar, the euro and the Chinese yuan. We currently do not actively hedge our foreign currency exposures and are therefore subject to the risk of exchange rate fluctuations. We are exposed to foreign exchange rate fluctuations as the financial results of foreign subsidiaries are translated into U.S. dollars in consolidation. Our exposure to foreign exchange rate fluctuations also arises from intercompany payables and receivables to and from our foreign subsidiaries.
As of June 30, 2018, approximately $15.8 million of unrestricted cash, cash equivalents, and short-term investments was held by our foreign subsidiaries. While the Tax Act generally allows future repatriation of foreign funds without incurring additional U.S. taxes, certain funds may still be subject to foreign taxes. If these funds are needed for our operations in the U.S., we may be required to accrue and pay additional taxes, and incur additional costs, to repatriate these funds. However, our intent is to permanently reinvest these funds outside of the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations. We utilize a variety of tax planning and financing strategies in an effort to ensure that our worldwide cash is available in the locations in which it is needed. We do not expect restrictions or potential taxes on repatriation of amounts held outside of the U.S. to have a material effect on our overall liquidity, financial condition or results of operations.

Off-Balance Sheet Arrangements

We have operating lease obligations for office facility leases with future cash commitments that are not currently required under GAAP to be recorded on our consolidated balance sheet. Accordingly, these operating lease obligations constitute off-balance sheet arrangements. In addition, since we do not maintain accruals associated with certain guarantees, as discussed in Note 17, Guarantees, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this 10-Q, those guarantee obligations also constitute off-balance sheet arrangements.

Critical Accounting Policies and Estimates

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

- Revenue recognition;
- Estimating losses on excess office facilities;
- Valuation of equity method investments;
- Valuation of definite-lived assets and goodwill; and
- Accounting for income taxes.

Revenue Recognition. We recognize revenue from contracts with customers as control of the promised good or service is transferred. Please refer to Note 3 Revenue Recognition for further details regarding our recognition policies.

Estimating losses on excess office facilities. We make significant estimates in determining the appropriate amount of accrued loss on excess office facilities, including estimates of sublease income expected to be received. If we make different estimates, our loss on excess office facilities could be significantly different from that recorded, which could have a material impact on our operating results.

Valuation of Equity Method Investments. We use the equity method of accounting for investments in circumstances where we have the ability to exert significant influence, but not control, over an investee or joint venture. We record our percentage interest in the investee's recorded income or loss and changes in the investee's capital under this method, which will increase or decrease the reported value of our investment. See Note 5, Napster Joint Venture, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this 10-Q, for additional information. We initially record our investment based on a fair value analysis of the investment.

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

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

We test goodwill for impairment on an annual basis, in our fourth quarter, or more frequently if circumstances indicate reporting unit carrying values may exceed their fair values. As part of this test, we first perform a qualitative assessment to determine if the fair value of a reporting unit is more likely than not less than the reporting unit's carrying amount including goodwill. If this assessment indicates it is more likely than not, we then compare the carrying value of the reporting unit to the estimated fair value of the reporting unit. If the carrying value of the reporting unit exceeds the estimated fair value, we then calculate the implied estimated fair value of goodwill for the reporting unit and compare it to the carrying amount of goodwill for the reporting unit. If the carrying amount of goodwill exceeds the implied estimated fair value, an impairment charge to current operations is recorded to reduce the carrying value to implied estimated value.

The impairment analysis of definite-lived assets and 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. Significant or sustained declines in future revenue or cash flows, or adverse changes in our business climate, among other factors, and their resulting impact on the estimates and assumptions relating to the value of our definite-lived and goodwill assets could result in the need to perform an impairment analysis in future periods which could result in a significant impairment. While we believe our estimates and assumptions are reasonable, due to their complexity and subjectivity, these estimates and assumptions could vary from period to period. Changes in these estimates and assumptions could materially affect the estimate of future cash flows and related fair market values of these assets and result in significant impairments, which could have a material adverse effect on our financial condition or results of operations. For further discussion, please see the risk factor entitled, "Any impairment to our goodwill, and definite-lived assets could result in a significant charge to our earnings" under Item 1A Risk Factors.

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

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

As of June 30, 2018, $15.8 million of the $42.1 million of cash, cash equivalents, and short-term investments was held by our foreign subsidiaries.

As of June 30, 2018, we have not provided for foreign taxes on certain undistributed earnings of our foreign subsidiaries, since such earnings are considered indefinitely reinvested outside the U.S. As part of the transition tax under the Tax Cuts and Jobs Act, the Company can now distribute, tax-free, earnings from our foreign subsidiaries to the U.S. However, for certain earnings, foreign taxes may be imposed upon distribution. As such, the Company asserts that the undistributed earnings of its foreign subsidiaries will continue to be permanently reinvested in jurisdictions where foreign taxes would be assessed upon distribution to the U.S. It is not practicable to determine the foreign tax liability or benefit on such earnings due to the timing of such future distributions and the complexity of the computation if such earnings were not deemed to be permanently reinvested. If future events, including material changes in estimates of cash, working capital, and long-term investment requirements necessitate that these earnings be distributed, an additional provision for foreign taxes may be necessary.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Interest Rate Risk. Our exposure to interest rate risk from changes in market interest rates relates primarily to our short-term investment portfolio. Our short-term investments consist of investment grade debt securities as specified in our investment policy. Investments in both fixed and floating rate instruments carry a degree of interest rate risk. The fair value of fixed rate securities may be adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Additionally, a declining rate environment creates reinvestment risk because as securities mature the proceeds are reinvested at a lower rate, generating less interest income. See Note 6, Fair Value Measurements, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this Form 10-Q, for additional information. Due in part to these factors, our future interest income may be adversely impacted due to changes in interest rates. In addition, we may incur losses in principal if we are forced to sell securities that have declined in market value due to changes in interest rates. Because we have historically had the ability to hold our short-term investments until maturity, we would not expect our operating results or cash flows to be significantly impacted by a sudden change in market interest rates. There have been no material changes in our investment methodology regarding our cash equivalents and short-term investments during the quarter ended June 30, 2018. Based on our cash, cash equivalents, short-term investments, and restricted cash equivalents as of June 30, 2018, a hypothetical 10% increase/decrease in interest rates would not increase/decrease our annual interest income or cash flows by more than a nominal amount.

Investment Risk. As of June 30, 2018, we had an investment in the voting capital stock of a privately held technology company. See Note 1, Description of Business and Summary of Significant Accounting Policies - Equity Method Investments, and Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies and Estimates (Valuation of equity method investments) in our Form 10-K for details on our accounting treatment for this investment, including the analysis of other-than-temporary impairments.

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

Our exposure to foreign exchange rate fluctuations arise in part from: (1) translation of the financial results of foreign subsidiaries into U.S. dollars in consolidation; (2) the remeasurement of non-functional currency assets, liabilities and intercompany balances into U.S. dollars for financial reporting purposes; and (3) non-U.S. dollar denominated sales to foreign customers.

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 euros, Chinese yuan and Japanese yen. A hypothetical 10% increase or decrease in those currencies relative to the U.S. dollar as of June 30, 2018 would not result in a material impact on our financial position, results of operations or cash flows.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2018. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Based upon that evaluation, our chief executive officer and chief financial officer concluded that, as of June 30, 2018, our disclosure controls and procedures were effective.

(b) Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting (as such term is defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the second quarter of 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings
See Note 16, Commitments and Contingencies, to the unaudited condensed consolidated financial statements included in Item 1 of Part I of this Form 10-Q.
Item 1A. Risk Factors
You should carefully consider the risks described below together with all of the other information included in this Form 10-Q. The risks and uncertainties described below are not the only ones facing our company. Additional risks and uncertainties not presently known to us or that we presently deem less significant may also impair our business operations. If any of the following risks actually occurs, our business, financial condition or operating results, and the trading price of our common stock, could be materially harmed.
Our restructuring efforts and growth plans are ambitious and could be unsuccessful, which would have a material adverse effect on our business and financial results.
For the past several years, we have taken steps to reduce costs and increase profitability by restructuring our businesses and streamlining our operations. We have also developed new products and technologies and funded initiatives intended to create or support growth in our businesses and financial results. These restructuring efforts and growth initiatives have impacted all segments of our organization.
The simultaneous execution of all of these activities is complex and ambitious, thereby imposing increased pressure on our reduced human and capital resources, requiring us to allocate limited resources among our diverse business units. These efforts may cause uncertainty around the future direction of our product and service offerings and growth prospects.
Given the ambitious nature of our restructuring and streamlining efforts and our growth initiatives, there is substantial risk that we may be unsuccessful in managing the potential strain on our resources, our cash reserves may be insufficient to fully implement our plans, our growth initiatives may not gain adequate momentum, or the combination of our streamlining efforts and growth initiatives may not prove to be profitable. In any such case, our business would suffer, and our operational and financial results would be negatively impacted to a significant degree. Our stock price would suffer as a result.

We need to successfully monetize our new products and services in order to sustain and grow our businesses, and manage our cash resources.
In order to sustain our current level of business and to implement our growth plans, we must successfully monetize our new products and services, including through existing and new relationships with distribution partners. Our digital media products and services must be attractive and useful to subscribers and consumers, whether direct from us or through our distribution partners. The successful acceptance and monetization of these products and services, therefore, is subject to unpredictable and volatile factors beyond our control, including end-user preferences, competing products and services, the rapid pace of change in the market and the effectiveness of our distribution channels. Any failure by us to timely and accurately anticipate consumers’ changing needs and wants, emerging technological trends and data privacy norms, or changes in the competitive or regulatory landscape for our products and services could result in a failure to monetize our new products or the loss of market opportunities.
Moreover, in order to grow our businesses, we must make long-term investments, develop or obtain appropriate intellectual property and commit significant resources before knowing whether the products and services that we are developing or have introduced will meet the demands of a large enough group of consumers. We may not realize a sufficient return, or may experience losses, on these investments, thereby straining our limited cash resources and negatively affecting our ability to pursue other growth or strategic opportunities.
Sustaining and growing our businesses, and managing our cash resources, are subject to these risks inherent in developing, distributing and monetizing our new products and services. Our failure to manage these risks could negatively impact our financial results to a significant degree.
Furthermore, products and services may be subject to legal challenge. Responding to any such claims may require us to enter into royalty and licensing agreements on unfavorable terms, require us to stop distributing or selling, or to

redesign our products or services, or to pay damages, any of which could constrain our growth plans and cash resources.

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

Many of our current and potential competitors in our businesses have longer operating histories, greater name or brand recognition, more employees and significantly greater resources than we do. In addition, current and potential competitors may include relatively new businesses that develop or use innovative technologies, products or features that could disrupt the market for technologies, products or features we currently market or are seeking to develop. In attempting to compete with any or all of these competitors, we may experience some or all of 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 distribute our products and services or who provide content that we distribute to our customers,
- changes to our products, services, technologies, licenses or business practices or strategies,
- lengthened sales cycles,
- inability to meet demands for more rapid sales or development cycles,
- industry-wide changes in content distribution to customers or in trends in consumer consumption of digital media products and services,
- pressure to prematurely release products or product enhancements, or
- degradation in our stature or reputation in the market.

The market for our Mobile Services business is highly competitive and evolving rapidly. Increased use of smartphones has resulted in a proliferation of applications and services that compete with our SaaS services. For example, our ringback tones solution faces competition from alternative kinds of applications and services that carriers can deploy or offer to their subscribers, or that consumers can acquire independently of their carrier. Increased competition has in the past resulted in pricing pressure, forcing us to lower the selling price of our services. We expect this pricing pressure to continue to materially harm our operating results and financial condition.

Our Consumer Media technologies for media playback and production (RealPlayer, RealMedia VB and RealMedia HD) compete with alternative media playback technologies and audio and video content formats that have obtained broad market penetration. RealMedia VB and RealMedia HD are codecs, technology that enables compression and decompression of the media content in a (usually proprietary) format. We license our codec technology primarily to computer, smartphone and other mobile device manufacturers, and also to other partners that can support our efforts to build a strong ecosystem, like content providers and integrated circuit developers. To compete effectively, codec technologies must appeal to, and be adopted for use by, a wide range of parties: producers and providers of media content, consumers of media content, and device manufacturers who pre-load codec technologies into their devices. Promoting adoption of our codec technologies to a wide and diverse target market is a complex undertaking. Whether our current or future technologies and formats for producing, streaming or playing back media content, including related codec technology, will be widely and successfully adopted is highly uncertain. If we are unable to compete successfully, our Consumer Media business could continue to decline.

The branded services in our Games business compete with other developers, aggregators and distributors of mobile, online, and downloadable games. Our competitors vary in size and capabilities, which present us with a range of competitive factors and conditions to address. 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 more quickly or efficiently adjust to market conditions. We also face significant price competition in the casual games market, and some of our competitors may be able to offer games for free, or reduce prices more aggressively than us. We expect competition to continue to intensify in this market from these and other competitors. Our games development studios compete primarily with other developers of mobile, online, and downloadable games, and must continue to develop popular and high-quality game titles. Our Games business must also continue to execute on opportunities to expand the play of our games on a variety of non-PC platforms, including mobile, in order to maintain our competitive position and to grow the business.

The distribution and license of our technology products and services are governed by contracts with third parties, the terms of which subject us to significant risks that could negatively impact our revenue, expenses and assumption of liability related to such contracts.

In our Consumer Media and Mobile Services segments, we distribute and license most of our technology products and services pursuant to contracts with third parties, such as mobile carriers and their partners, online service providers, and OEMs and device manufacturers, many of whom may have stronger negotiating leverage due to their size and reach. These contracts govern the calculation of revenue generated and expenses incurred, how we recognize revenue and expenses in our financial statements, and the allocation of risk and liabilities arising from the product or service or distribution thereof. Terms impacting revenue, over which we may have limited if any control, may involve revenue sharing arrangements, end user pricing, usage levels, and exclusivity, all of which materially affect the level of revenue that we may realize from the relationship. Moreover, contract terms around marketing and promotion of our products and other expense allocation could result in us bearing higher expenses or achieving weaker performance than we had anticipated from the relationship.

In addition, although our contracts with third parties are typically for a fixed duration, they could be terminated early; and they may be renegotiated on less favorable terms or may not be renewed at all by the other party. We must, therefore, seek additional contracts with third parties on an ongoing basis to sustain and grow our business. We expect to face continuing and increased competition for the technology products and services we provide, and there is no assurance that the parties with which we currently have contracts will continue or extend current contracts on the same or more favorable terms, or that we will obtain alternative or additional contracts for our technology products and services. The loss of existing contracts, the failure to enter new contracts, or the deterioration of terms in our contracts with third parties could materially harm our operating results and financial condition.

Nearly all of our contracts in which we provide to another party services or rights to use our technology include some form of obligation by us to indemnify the other party 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. We have in the past incurred costs to defend and settle such claims. Claims against which we may be obligated to defend others pursuant to our contracts could in the future result in payments that could materially harm our business and financial results.

We may not be successful in maintaining revenue associated with the distribution of our legacy digital media products.

Maintaining and growing the distribution of digital media products through our websites and our other distribution channels has historically been an important revenue driver for our business, including growth through the introduction of new products and services distributed through these channels. Consumers are not downloading and using our digital media products consistent with past usage, so our ability to generate revenue from those products has been, and we expect will be continue to be, reduced, leading to lower than expected adoption of newly introduced products and services. This will also impair 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. Historically, most of our revenue from the distribution of third-party products was derived from a single contract, and the terms of this relationship have significantly deteriorated over the years. Our distribution revenue has been, and will continue to be, materially negatively impacted by these factors.

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

The trading price for our common stock has a history of volatility. As a result of the rapidly changing markets in which we compete, our operating results may fluctuate or continue to decline from period to period, which may contribute to further volatility or continued weakness of our stock price.

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

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

Any impairment to our goodwill and definite-lived assets could result in a significant charge to our earnings.
In accordance with accounting principles generally accepted in the United States ("GAAP"), we test goodwill for possible impairment on an annual basis or more frequently in the event of certain indications of possible impairment. We review definite-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of such assets may not be recoverable. These events or circumstances could include a significant change in the business climate, including a significant sustained decline in a reporting unit’s market value, changes in our operating plans and forecasts, legal factors, operating performance indicators, competition, sale or disposition of a significant portion of our business, a significant

sustained decline in our market capitalization and other factors. If we were to determine that an impairment had occurred, we would be required to record an impairment charge, which could have a significant negative, and unpredicted, impact on our financial results. The total carrying value of our goodwill and definite-lived assets as of June 30, 2018 was $21 million.

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

Government regulation of the Internet is evolving, and unfavorable developments could have an adverse effect on our operating results.
We are subject to regulations and laws specific to the marketing, sale and delivery of goods and services over the Internet. These laws and regulations, which continue to evolve, cover taxation, user privacy, data collection and protection, copyrights, electronic contracts, sales procedures, automatic subscription renewals, credit card processing procedures, consumer protections, digital games distribution, broadband Internet access and content restrictions. We cannot guarantee that we have been or will be fully compliant in every jurisdiction, as it is not entirely clear how existing laws and regulations governing issues such as privacy, taxation and consumer protection apply or will be enforced with respect to the products and services we sell through the Internet. Moreover, as Internet commerce continues to evolve, increasing regulation and/or enforcement efforts by federal, state and foreign agencies and the prospects for private litigation claims related to our data collection, privacy policies or other e-commerce practices become more likely. In addition, the adoption of any laws or regulations or the imposition of other legal requirements that adversely affect our ability to market, sell, and deliver our products and services could decrease our ability to offer or customer demand for our service offerings, resulting in lower revenue. For example, the European Union's General Data Protection Regulation (GDPR), effective in May 2018, created a variety of new compliance obligations, with significant penalties for noncompliance. We cannot provide assurance that the changes that we have adopted to our business practices will be compliant or that new compliance frameworks such as this will not have a negative impact on our financial results. Future regulations, or changes in laws and regulations or their existing interpretations or applications, could require us to further change our business practices, raise compliance costs or other costs of doing business and result in additional historical or future liabilities for us, resulting in adverse impacts on our business and our operating results.
As a consumer-facing business, we receive complaints from our customers regarding our consumer marketing efforts and our customer service practices. Some of these customers may also complain to government agencies, and from time to time, those agencies have made inquiries to us about these practices. In addition, we may receive complaints or inquiries directly from governmental agencies that have not been prompted by consumers. In May of 2012, we resolved an investigation and complaint filed against us by the Washington State Office of the Attorney General, or Washington AG, relating to our consumer marketing practices through the entry of a consent decree filed in King County, Washington Superior Court. While we resolved that matter, we cannot provide assurance that the Washington AG or other governmental agencies will not bring future claims regarding our marketing, or consumer services or other practices.

We face financial and operational risks associated with doing business in non-U.S. jurisdictions and operating a global business, that have in the past and could in the future have a material adverse impact on our business, financial condition and results of operations.

A significant portion of our revenue is derived from sales outside of the U.S. and most of our employees are located outside of the U.S. Consequently, our business and operations depend significantly on global and national economic conditions and on applicable trade regulations and tariffs. The growth of our business is also dependent in part on successfully managing our international operations. Our non-U.S. sales, purchases and operations are subject to risks inherent in conducting business abroad, many of which are outside our control, including the following:

- periodic local or geographic economic downturns and unstable political conditions;
- price and currency exchange controls;
- fluctuation in the relative values of currencies;
- difficulty in repatriating money, whether as a result of tax laws or otherwise;

- compliance with current and changing tax laws, and the coordination of compliance with U.S. tax laws and the laws of any of the jurisdictions in which we do business;
- difficulties protecting intellectual property;
- compliance with labor laws and other laws governing employees;
- local labor disputes;
- changes in trading policies, regulatory requirements, tariffs and other barriers, or the termination or renegotiation of existing trade agreements;
- impact of changes in immigration or other policies impacting our ability to attract, hire, and retain key talent; and
- difficulties in managing a global enterprise, including staffing, collecting accounts receivable, and managing suppliers, distributors and representatives.

Because consumers may consider the purchase of our digital entertainment products and services to be a discretionary expenditure, their decision whether to purchase our products and services may be influenced by macroeconomic factors that affect consumer spending such as unemployment, access to credit, negative financial news, and declines in income. In addition, mobile telecommunication carriers and other business partners may reduce their business or advertising spending with us or for our products and services they distribute to users in the face of adverse macroeconomic conditions, such as financial market volatility, government austerity programs, tight credit, and declines in asset values. We have in the past recorded material asset impairment charges due in part to weakness in the global economy, and we may need to record additional impairments to our assets in future periods in the event of renewed weakness and uncertainty in the global or a relevant national economy. Accordingly, any significant weakness in the national and/or global economy could materially impact our business, financial condition and results of operations in a negative manner.

Our international operations involve risks inherent in doing business globally, including difficulties in managing operations due to distance, language, and cultural differences, local economic conditions, different or conflicting laws and regulations, taxes, and exchange rate fluctuations. The functional currency of our foreign subsidiaries is typically 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, may result in lower reported revenue or net assets in future periods. 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.

Our business is conducted in accordance with existing international trade relationships, and trade laws and regulations. Changes in geopolitical relationships and laws or policies governing the terms of foreign trade could create uncertainty regarding our ability to operate and conduct commercial relationships in affected jurisdictions, which could have a material adverse effect on our business and financial results. Additionally, our global operations may also be adversely affected by political events, domestic or international terrorist events and hostilities or complications due to natural or human-caused disasters. These uncertainties could have a material adverse effect on the continuity of our business and our results of operations and financial condition.

Napster could continue to recognize losses, or we may modify our relationship with Napster in ways which could negatively impact our results of operations and financial condition or the perceived value of our common stock.

On March 31, 2010, we completed the restructuring of our digital audio music service joint venture, Rhapsody America LLC, now doing business under the Napster brand. As a result of the restructuring, we no longer have operational control over Napster and Napster’s operating performance is no longer consolidated with our consolidated financial statements. We disclose only limited strategic, business and financial information regarding Napster in our financial statements and disclosures, in accordance with GAAP. Napster has historically generated accounting losses since its inception, and we have recognized our share of such losses on our investment in its convertible preferred stock. We continue to track any additional losses incurred by Napster whether or not we recognize them, but in certain circumstances, which have occurred in the past and may occur again in the future, proper accounting treatment may cause us to recognize additional losses on our investment in Napster. Consequently, Napster's past or future performance may continue to have an adverse effect on our financial condition, results of operations, or perceived value. See Note 5. Napster Joint Venture, in this 10-Q, for further discussion of our relationship with Napster, including information about the accounting treatment related to the investment in Napster.

As a significant shareholder of Napster we have been in the past and may be in the future faced with a decision as to whether or not it is in the long term interest of RealNetworks to take certain actions with respect to Napster, such as extending a loan, making a further equity investment or providing an additional financial guarantee (as we did during the fourth quarter of 2017), any of which could reduce our available cash or liquidity, and any such action could result in the recognition of additional losses associated with our investment in Napster. The extent of any such potential action is likely to be influenced by whether Napster is able to secure and maintain adequate funding, experiences further declines in its operating results, or is unsuccessful in growing or improving its business or financial condition. Some or all of our decisions or actions related to Napster could have, or increase the risk to us of, an adverse effect on our financial condition, results of operations, liquidity or perceived value.

We depend on timely financial information from Napster in order to timely prepare and file our periodic SEC reports.
Given the current proportion of the outstanding equity of Napster that we hold, we need to receive Napster's unaudited quarterly financial statements and related information in order to timely prepare our quarterly consolidated financial statements and also to report certain of Napster's financial results, as may be required, in our quarterly reports on Form 10-Q. In addition, under certain circumstances, we may be required to include Napster's annual audited financial statements in our 10-K in future periods. As we no longer exert operational control over Napster, we cannot guarantee that Napster will deliver its financial statements and related information to us in a timely manner, or at all, or that the unaudited financial statement information provided by Napster will not contain inaccuracies that are material to our reported results. Any failure to timely obtain Napster's quarterly financial statements or to include its audited financial statements in our future 10-Ks, 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. See Note 5 Napster Joint Venture, for further information related to our investment in Napster.

The continued loss of key personnel, or difficulty recruiting and retaining them, could significantly harm our business or jeopardize our ability to meet our growth objectives.
Our success depends substantially on the contributions and abilities of certain key executives and employees. We have experienced a significant amount of executive-level turnover in the past several years, which has had and could continue to have a negative impact on our ability to retain key employees. We cannot provide assurance that we will effectively manage these recent or future executive-level transitions, which may impact our ability to retain key executives and employees and which could harm our business and operations to the extent there is customer or employee uncertainty arising from such transitions.
Our success is also substantially dependent upon our ability to identify, attract and retain highly skilled management, technical and sales personnel. Qualified individuals are in high demand and competition for such qualified personnel in our industry, particularly engineering talent, is extremely intense, and we may incur significant costs to attract or retain them. Changes in immigration or other policies in the U.S. or other jurisdictions that make it more difficult to hire and retain key talent, or to assign individuals to any of our locations as needed to meet business needs, could adversely affect our ability to attract key talent or deploy individuals as needed, and thereby adversely affect our business and financial results. In addition, our ability to attract and retain personnel has been and may continue to be made more difficult by the uncertainty created by our executive-level turnover and by our continued restructuring efforts, which have involved reductions in our workforce. There can be no assurance that we will be able to attract and retain the key personnel necessary to sustain our business or support future growth.

Acquisitions and divestitures involve costs and risks that could harm our business and impair our ability to realize potential benefits from these transactions.
As part of our business strategy, we have acquired and sold technologies and businesses in the past and expect that we will continue to do so in the future. The failure to adequately manage transaction costs and address the financial, legal and operational risks raised by acquisitions and divestitures of technology and businesses could harm our business and prevent us from realizing the benefits of these transactions. In addition, we may identify and acquire target companies, but those companies may not be complementary to our current operations and may not leverage our existing infrastructure or operational experience, which may increase the risks associated with completing acquisitions.
Transaction-related costs and financial risks related to completed and potential future purchase or sale transactions may harm our financial position, reported operating results, or stock price. Previous acquisitions have resulted in significant expenses, including amortization of purchased technology, amortization of acquired identifiable intangible assets and the incurrence of charges for the impairment of goodwill and other intangible assets, which are reflected in our operating expenses. New acquisitions and any potential additional future impairment of the value of purchased

assets, including goodwill, could have a significant negative impact on our future operating results. In compliance with GAAP, we evaluate these assets for impairment at least annually. Factors that may be considered a change in circumstances, indicating that our goodwill or definite-lived assets may not be recoverable, include reduced future revenue and cash flow estimates due to changes in our forecasts, and unfavorable changes to valuation multiples and discount rates due to changes in the market. If we were to conclude that any of these assets were impaired, we would have to recognize an impairment charge that could significantly impact our financial results.

Purchase and sale transactions also involve operational risks that could harm our existing operations or prevent realization of anticipated benefits from a transaction. These operational risks include:

- difficulties and expenses in assimilating the operations, products, technology, information systems, and/or personnel of the acquired company;
- retaining key management or employees of the acquired company;
- entrance into unfamiliar markets, industry segments, or types of businesses;
- operating, managing and integrating acquired businesses in remote locations or in countries in which we have little or no prior experience;
- diversion of management time and other resources from existing operations;
- impairment of relationships with employees, affiliates, advertisers or content providers of our business or acquired business; and
- assumption of known and unknown liabilities of the acquired company, including intellectual property claims.

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

Our ability to compete across our businesses partly depends on the superiority, uniqueness and value of our technology, including both internally developed technology and technology licensed from third parties. To protect our proprietary rights, we rely on a combination of patent, trademark, copyright and trade secret laws, confidentiality agreements with our employees and third parties, and protective contractual provisions. Our efforts to protect our intellectual property rights may not assure our ownership rights in our intellectual property, protect or enhance the competitive position of our products, services and technology, or effectively prevent misappropriation of our technology.

From time to time we receive claims and inquiries from third parties alleging that our technology used in our business may infringe the third parties' proprietary rights. These claims, even if not meritorious, could force us to make significant investments of time, attention and money in defense, and give rise to monetary damages, penalties or injunctive relief against us. We may be forced to litigate, to enforce or defend our patents, trademarks or other intellectual property rights, or to determine the validity and scope of other parties' proprietary rights in intellectual property. To resolve or avoid such disputes, we may also be forced to enter into royalty or licensing agreements on unfavorable terms or redesign our product features, services and technology to avoid actual or claimed infringement of misappropriation or technology. Any such dispute would likely be costly and distract our management, and the outcome of any such dispute (such as additional licensing arrangements or redesign efforts) could fail to improve our business prospects or otherwise harm our business or financial results.

Nearly all of our contracts by which we provide to another party services or rights to use our technology include some form of obligation by us to indemnify the other party 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. Also, in 2012 we sold most of our patents, including patents that covered streaming media, to Intel Corporation, in a contract by which we agreed to indemnify Intel for certain third-party infringement claims against these patents up to the purchase price we received in the sale. Claims against which we may be obligated to defend others pursuant to our contracts expose us to the same risks and adverse consequences described above regarding claims we may receive directly alleging that our trademarks or technology used in our business may infringe a third party's proprietary rights.

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 also routinely receive challenges to our trademarks and other proprietary intellectual property that we are using in our business activities. We are likely to continue to receive claims of third parties against us, alleging contract breaches, infringement of copyrights or patents, trademark rights, trade secret rights or other proprietary rights, or alleging unfair competition or violations of privacy rights.

We believe that our patent portfolio before the sale to Intel may have in the past discouraged third parties from bringing infringement or other claims against us relating to the use of our technologies in our business. Accordingly, we cannot predict whether the sale of these patent assets to Intel will result in additional infringement or other claims against us from third parties.

Our business and operating results will suffer and we may be subject to market risk and legal liability 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 and those of our service providers. A significant or repeated reduction in the performance, security or availability of our information systems and network infrastructure or that of our service providers could harm our ability to conduct our business, and harm our reputation and ability to attract and retain users, customers, advertisers and content providers. Many of our products are interactive Internet applications that by their very nature require communication between a client and server to operate.

We sell many of our products and services through online sales transactions directly with consumers, and their credit card information is collected and stored by our payment processors. The systems of our third party service providers may not prevent future improper access or disclosure of credit card information or personally identifiable information. We have an extensive privacy policy concerning the collection, use and disclosure of user data involved in interactions between our client, third party payment providers, and server products. A security breach that leads to disclosure of consumer account information, or any failure by us to comply with our posted privacy policy or existing or new privacy legislation, could harm our reputation, impact the market for our products and services, or subject us to litigation. 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, or the third party systems and networks that we utilize, could result from a failure to adequately maintain and enhance these systems and networks, natural disasters and similar events, power failures, intentional actions to disrupt systems and networks and many other causes. 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.

Changes in regulations applicable to the Internet and e-commerce that increase the taxes on the services we provide could materially harm our business and operating results.

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

In those countries where we have a tax obligation, we collect and remit 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.

Changes in accounting standards and subjective assumptions, estimates, and judgments by management related to complex accounting matters could significantly affect our financial results or financial condition.

We prepare our financial statements in conformity with GAAP. These accounting principles are subject to interpretation or changes by the Financial Accounting Standards Board ("FASB") and the SEC, and new accounting pronouncements and varying interpretations of accounting standards and practices have occurred in the past and are expected to occur in the future. Moreover, our financial statements require the application of judgments and estimates regarding a wide range of matters that are relevant to our business, such as revenue recognition, asset impairment and fair value determinations, stock-based compensation, equity method accounting, and intangible asset valuations. Changes in accounting standards or practices, or in our judgments and estimates underlying accounting standards and practices, could harm our operating results and/or financial condition. An example of a new accounting pronouncement is Accounting Standards Update ("ASU") 2014-09 related to revenue recognition. As discussed in Note 3 to the accompanying notes to the condensed consolidated financial statements, ASU 2014-09 changed the way we recognize revenue and impacted the timing of revenue recognition. In addition, subjective judgments and estimates are often necessary in our accounting for investments, such as Napster. Changes to existing accounting rules or to our judgments and estimates underlying those rules could materially impact our reported operating results and financial condition.

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

Our Chairman of the Board and Chief Executive Officer beneficially owns approximately 37% of our stock, which gives him significant control over certain major decisions on which our shareholders may vote or which may discourage an acquisition of us.
Robert Glaser, our Chairman of the Board and Chief Executive Officer, beneficially owns approximately 37% of our common stock. As a result, Mr. Glaser and his affiliates will have significant influence to:

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

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

Provisions of our charter documents, shareholder rights plan, and Washington law could discourage our acquisition by a third party.
Our articles of incorporation provide for a strategic transactions committee of the board of directors. Without the prior approval of this committee, and subject to certain limited exceptions, the board of directors does not have the authority to:

- adopt a plan of merger;
- authorize the sale, lease, exchange or mortgage of assets representing more than 50% of the book value of our assets prior to the transaction or on which our long-term business strategy is substantially dependent;
- authorize our voluntary dissolution; or
- take any action that has the effect of any of the above.

Mr. Glaser has special rights under our articles of incorporation to appoint or remove members of a strategic transactions committee at his discretion that could make it more difficult for RealNetworks to be sold or to complete another change of control transaction without Mr. Glaser's consent. RealNetworks has also entered into an agreement providing Mr. Glaser with certain contractual rights relating to the enforcement of our charter documents and Mr. Glaser's roles and authority within RealNetworks. These rights and his role as Chairman of the Board of Directors, together with Mr. Glaser's significant beneficial ownership, create unique potential for concentrated influence of Mr. Glaser over potentially material transactions involving RealNetworks and decisions regarding the future strategy and leadership of RealNetworks.
We have adopted a shareholder rights plan, which was amended and restated in December 2008, and amended in April 2016 and February 2018, 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 2. Unregistered Sales of Equity Securities and Use of Proceeds
(a) Not applicable
(b) Not applicable
(c) Not applicable
Item 3. Default Upon Senior Securities
None
Item 4. Mine Safety Disclosures
Not applicable
Item 5. Other Information
None.
Item 6. Exhibits
See Index to Exhibits below.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Form 10-Q Report to be signed on its behalf by the undersigned, thereunto duly authorized.

REALNETWORKS, INC.

By:	/s/ Cary Baker
	Cary Baker
Title:	Senior Vice President, Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)

Dated: August 2, 2018

INDEX TO EXHIBITS

Exhibit Number	Description
31.1	Certification of Robert Glaser, Chairman and Chief Executive Officer of RealNetworks, Inc., pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Cary Baker, Senior Vice President, Chief Financial Officer and Treasurer of RealNetworks, Inc., pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Robert Glaser, Chairman and Chief Executive Officer of RealNetworks, Inc., pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Cary Baker, Senior Vice President, Chief Financial Officer and Treasurer of RealNetworks, Inc., pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document