REALNETWORKS INC
Form S-3/A
November 18, 2003

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As filed with the Securities and Exchange Commission on November 18, 2003
Registration No. 333-108777

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Amendment No. 1 to

Form S-3
REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

REALNETWORKS, INC.
(Exact name of Registrant as specified in its charter)

Washington	**2601 Elliott Avenue, Suite 1000**	**91-1628146**
(State or other jurisdiction of incorporation or organization)	**Seattle, Washington 98121** **(206) 674-2700**	*(I.R.S. Employer Identification Number)*

(Address, including zip code, and telephone number, including area code, of Registrant s principal executive offices)

Robert Kimball

Vice President, Legal and Business Affairs,
General Counsel and Corporate Secretary
RealNetworks, Inc.
2601 Elliott Avenue, Suite 1000
Seattle, Washington 98121
(206) 674-2700
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Patrick J. Schultheis, Esq.
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5300 Carillon Point
Kirkland, Washington 98033-7356
(425) 576-5800

Approximate date of commencement of proposed sale to the public: From time to time after the effective date of this Registration Statement.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. o

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. þ

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered	Proposed Maximum Offering Price Per Share(1)	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee
Zero Coupon Convertible Subordinated Notes due July 1, 2010	$100,000,000	100%	$100,000,000	$8,090(2)
Common stock, $0.001 par value per share(3)	10,756,500(4)	(4)	(4)	(5)

(1) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(c) of the Securities Act of 1933, as amended.

(2) Previously Paid.

(3) Includes preferred stock purchase rights which, prior to the occurrence of certain events, will not be exercisable or evidenced separately from the common stock.

(4) Includes 10,756,500 shares of common stock, and associated preferred stock purchase rights, issuable upon conversion of the notes registered hereby at a conversion rate of 107.5650 shares per $1,000 principal amount of notes. Pursuant to Rule 416 under the Securities Act, such number of shares of common stock registered hereby shall include an indeterminate number of shares of common stock that may be issued in connection with a stock split, stock dividend, recapitalization or similar event.

(5) Pursuant to Rule 457(i), there is no additional filing fee with respect to the shares of common stock issuable upon conversion of the notes because no additional consideration will be received in connection with the exercise of the conversion privilege.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933 OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

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The information in this prospectus is not complete and may be changed. These securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED NOVEMBER 18, 2003

$100,000,000

(aggregate principal amount)

RealNetworks, Inc.

Zero Coupon Convertible Subordinated Notes due July 1, 2010

and
10,756,500 Shares of Common Stock Issuable upon Conversion of the Notes

We issued the notes in a private placement on June 17, 2003. This prospectus will be used by selling securityholders to resell their notes and the common stock issuable upon conversion of their notes. We will not receive any proceeds from this offering.

The notes will mature on July 1, 2010. As described in more detail beginning on page 33 of this prospectus, you may convert the notes into shares of our common stock at any time before the close of business on the date of their maturity unless we have previously repurchased the notes, if:

- on any date on or prior to December 31, 2007, the closing sales price of our common stock for at least 20 trading days in the period of the 30 consecutive trading days ending on the date immediately prior to the eleventh trading day of the following fiscal quarter was more than 110% of the then current conversion price of the notes;

- on any date after December 31, 2007, the closing sales price of our common stock is more than 110% of the then current conversion price of the notes;

- on or after July 1, 2008, we elect to call the notes for redemption;

- specified corporate transactions involving the distribution to all or substantially all of our holders of common stock of rights, options, warrants, cash, assets, debt securities or capital stock should occur;

- we become a party to a consolidation, merger or sale of all or substantially all of our assets, which consolidation, merger or sale constitutes a change in control transaction, as described in this prospectus; and

- subject to the exceptions described in this prospectus, during the five business day period after any five consecutive trading-day period in which the average trading prices for the notes for such five trading-day period was less than 95% of the product of the closing sale price of our shares of common stock on a given day and the then current conversion rate for the notes during that period.

The conversion rate is 107.5650 shares of common stock per each $1,000 principal amount of notes, subject to adjustment in certain circumstances. This is equivalent to a conversion price of approximately $9.30 per share.

The notes are subordinated to our existing and future senior indebtedness and effectively subordinated to all indebtedness and all liabilities of our subsidiaries. As of September 30, 2003, we had no outstanding senior debt, and the aggregate amount of indebtedness and other liabilities of our subsidiaries was approximately $10.8 million (excluding intercompany liabilities).

The interest rate on the notes is zero. The notes do not accrete interest.

On or after July 1, 2008, we may redeem the notes in whole or in part at the redemption prices set forth in this prospectus.

On July 1, 2008, or in the event of a change in control transaction, as described in this prospectus, you may require us to repurchase any notes held by you at the repurchase prices set forth in this prospectus.

The notes are not listed on any securities exchange or included in any automated quotation system. Our common stock is quoted on The Nasdaq National Market under the symbol RNWK. The closing sale price of our common stock on November 14, 2003 was $6.01 per share.

These securities involve a high degree of risk. See Risk Factors beginning on page 6.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

This prospectus is dated November , 2003

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You should rely only on the information contained in this document or to which we have referred you. We have not authorized anyone to provide you with information that is different. This document may only be used where it is legal to sell these securities. You should not assume that the information contained in or incorporated by reference in this prospectus is accurate as of any date other than the date on the front of this prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

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SUMMARY

The following summary is qualified in its entirety by the more detailed information, including our consolidated financial statements and related notes, included in this prospectus and incorporated in this prospectus by reference. You should carefully consider the information set forth in the section entitled Risk Factors. Unless the context otherwise requires, the terms RealNetworks, we, us and our refer to RealNetworks, Inc., a Washington corporation.

RealNetworks, Inc.

We are a leading global provider of network-delivered digital media services and the technology that enables digital media creation, distribution and consumption. Our company is at the center of the intersection between technology and digital content.

Our strategy is to drive the creation of a market for subscription-based digital audio and video content online, and we are positioned to benefit from this market in three primary ways: (1) as an electronic retailer of digital content to consumers; (2) as a business-to-business services provider to third parties who wish to distribute their content to consumers over digital networks; and (3) as a supplier of the underlying technology used by content owners and network operators to create and distribute digital content. We have helped to create a large ecosystem of consumers, network operators and content owners who use our products and services to create, send and receive both free and paid content. We believe that we can leverage this ecosystem to successfully compete in the market for digital content and related technology.

Consumers use our RealOne Player to play, create and manage their digital media, rip and burn CDs, tune in to Internet radio and play streaming and on-demand audio and video. Since our inception, there have been more than 300 million unique registered users worldwide of our RealOne Player and its predecessor, the RealPlayer. RealOne Player users can subscribe to our RealOne subscription services, which offer subscribers a package of premium software and services and access to premium content. We offer a variety of subscription service offerings to consumers under our RealOne brand, including RealOne SuperPass, which provides consumers access to online sports, news, music and entertainment programming from brand-name media companies, and RealOne RadioPass, a subscription radio service. In addition, a subscription to one of our RealOne services includes a premium version of our RealOne Player software, offering playback of over 50 media types, advanced CD burning and other features designed to enhance the user experience for digital media. RealOne Player users can also subscribe to one of the subscription products we offer that feature the content of our content partners, including CNN, Major League Baseball Advanced Media and NASCAR.com. At September 30, 2003, our subscription offerings had over one million paying subscribers. We believe this represents one of the largest paid media subscription businesses on the Internet.

Our ecosystem also includes content owners and network operators who use our products to create and distribute free and paid digital content, as well as other technology companies who license our technology in order to integrate digital media into their products. The technology platform that we use for our products and that we license to other companies is called Helix. The Helix platform is designed to deliver digital media in any major media format over Internet protocol-enabled networks to media-enabled devices. Helix supports all of the major server and device operating systems, and it enables content providers to deliver high quality digital audio and video content to consumers with high levels of scalability, reliability and flexibility. We have made the core Helix technology available in source code to a community of developers the Helix Community to help increase the speed, creativity and innovation in development on our platform. We have also entered into agreements with leading manufacturers of semi-conductors, servers, personal computers, and wireless and personal music devices, as well as other consumer electronic devices, to incorporate our streaming and downloadable media technology in their products. We believe that this will enable even more rapid adoption of our Helix technologies.

The size of our worldwide user base provides us with an ability to pool consumer demand on a very large scale. Accordingly, we have developed a variety of products and services to connect content providers, broadcasters and advertisers with that user base, including our RealOne subscription services. Our strategy is to continue to leverage our Internet media technology and our worldwide user base to create industry-leading products, services and businesses at the intersection of digital technology and digital media.

We were incorporated in the State of Washington in 1994. Our principal executive offices are located at 2601 Elliott Avenue, Suite 1000, Seattle, Washington 98121 and our telephone number at that location is (206) 674-2700. Our website is *www.realnetworks.com*. The information on our website is not incorporated into this prospectus.

RealNetworks is registered in the U.S. Patent and Trademark Office and in other countries as a trademark of RealNetworks, Inc. Other trademarks of RealNetworks, Inc. used herein include RealOne, RealAudio, RealVideo, RealPlayer, RealOne SuperPass, RealOne MusicPass, RealOne RadioPass, and RealJukebox. All other trademarks, service marks, registered trademarks, or registered service marks in this prospectus that are not the property of RealNetworks, Inc. are the property of their respective owners.

The Offering

Securities offered	$100,000,000 principal amount of Zero Coupon Convertible Subordinated Notes due July 1, 2010, and shares of common stock issuable upon conversion of the notes.
Interest	Interest on the notes will be zero.
Conversion	Unless we have previously redeemed, purchased or repurchased the notes, you will have the right, at your option, to convert your notes, in whole or in part, into shares of our common stock prior to maturity, subject to adjustments described herein, at a rate of 107.5650 shares of common stock per $1,000 principal amount of notes (which is equivalent to a conversion price of approximately $9.30 per share), as follows: you will have such conversion right in a conversion period (as defined in this prospectus) on any date on or prior to December 31, 2007, if the closing sale price of our common stock for at least 20 trading days in the period of the 30 consecutive trading days ending on the first day of such conversion period was more than 110% of the then current conversion price of the notes; if, on any date after December 31, 2007, the closing sale price of our common stock is more than 110% of the then current conversion price of the notes, then you will have such conversion right at all times thereafter; you will have the right to convert the notes until the close of business on the business day prior to the redemption date if we elect to call the notes for redemption on or after July 1, 2008; if we distribute to all or substantially all holders of our common stock rights, options or warrants entitling them to purchase common stock at less than the closing sale price of our common stock on the day preceding the declaration for such distribution; if we distribute to all or substantially all holders of our common stock cash, assets, debt securities or capital stock, which distribution has a per share value as determined by our board of directors exceeding 10% of the closing sale price of our common stock on the day preceding the declaration for such distribution; or

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	if we become a party to a consolidation, merger or sale of all or substantially all of our assets that constitutes a change in control transaction as defined in Description of the Notes Repurchase at Option of Holders Upon a Change in Control.
	You may also convert your notes into shares of our common stock for the five business day period after any five consecutive trading-day period in which the average trading prices for the notes for such five trading-day period was less than 95% of the average conversion value (as defined in this prospectus) for the notes during that period; provided, however, if, at the time of the conversion, the closing sale price of shares of our common stock is greater than the then current conversion price on the notes and less than or equal to 110% of the then current conversion price on the notes and you surrender your notes for conversion, you will receive, at our option, cash, common stock or a combination of cash and common stock with a value equal to the principal amount of your notes on such conversion date. If we elect to pay you in common stock or in a combination of cash and common stock, our common stock will be valued at 100% of the average closing sale price for the five trading days ending on the third trading day preceding the conversion date.
	The conversion rate is subject to adjustment upon certain events. See Description of the Notes Conversion Rights.
Subordination	The notes are subordinated to our present and future senior debt, as that term is defined in Description of the Notes Subordination. The notes are also effectively subordinated in right of payment to all indebtedness and other liabilities of our subsidiaries. As of September 30, 2003, we had no outstanding senior debt, and the aggregate amount of indebtedness and other liabilities of our subsidiaries was approximately $10.8 million (excluding intercompany liabilities). The indenture under which the notes were issued does not restrict the incurrence of senior debt by us or the incurrence of indebtedness or liabilities by us or any of our subsidiaries. See Description of the Notes Subordination.
Optional redemption by RealNetworks	On or after July 1, 2008, we have the option to redeem all or a portion of the notes at 100% of the principal amount of the notes. See Description of the Notes Optional Redemption by RealNetworks.
Purchase of the notes at the option of the holder	You may require us to purchase all or a portion of your notes in cash on July 1, 2008, at 100% of the principal amount of the notes. See Description of the Notes Purchase of Notes at the Option of the Holder.
Repurchase at the option of the holders upon a change in control	Upon a change in control, as that term is defined in Description of the Notes Repurchase at Option of Holders Upon a Change in Control, you will have the right, subject to conditions and restrictions, to require us to repurchase some or all of your notes at a price equal to 100% of the principal amount. The repurchase price

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	is payable in cash or, at our option, subject to certain circumstances, in shares of our common stock valued at 95% of the average closing sales prices of the common stock for the five trading days preceding and including the third trading day prior to the repurchase date. See Description of the Notes Repurchase at Option of Holders Upon a Change in Control.
Use of proceeds	We will not receive any of the proceeds from the sale by any selling securityholder of the notes or the underlying common stock into which the notes may be converted.
Events of default	The following are events of default under the indenture for the notes: we fail to pay the principal of any note when due; we fail to pay liquidated damages on any note when due, and such failure continues for 30 days; we fail to provide the notice that we are required to give in the event of a change in control; we fail to perform any other covenant in the indenture and that failure continues for 60 days after written notice to us by the trustee or the holders of at least 25% in aggregate principal amount of outstanding notes; we or any of our significant subsidiaries, as defined in the indenture, fail to pay when due, either at its maturity or upon acceleration, any indebtedness under any bonds, debentures, notes or other evidences of indebtedness for money borrowed by us or such subsidiary, or any guarantee thereof, in excess of $25 million if the indebtedness is not discharged, or the acceleration is not annulled, within 30 days after written notice by the trustee or the holders of at least 25% in aggregate principal amount of the outstanding notes; and events of bankruptcy, insolvency or reorganization involving us or any significant subsidiary. See Description of the Notes Events of Default.

Risk Factors

You should read the Risk Factors section, beginning on page 6 of this prospectus, so that you understand the risks associated with an investment in the securities offered with this prospectus.

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Ratio of Earnings to Fixed Charges

The ratio of earnings to fixed charges for each of the periods indicated is as follows:

	Nine Months Ended September 30,		Fiscal Year Ended December 31,				
	2002	**2003**	**1998**	**1999**	**2000**	**2001**	**2002**
Ratio of earnings to fixed charges	N/A	N/A	N/A	1.73	N/A	N/A	N/A
Deficiency of earnings to fixed charges (in 000 s)	$(29,941)	(15,996)	(19,953)	N/A	(107,155)	(78,821)	(32,381)

These computations include us and our consolidated subsidiaries. Ratio of earnings to fixed charges is computed by dividing:

earnings before taxes adjusted for fixed charges by,

fixed charges, which includes interest expense, plus the portion of interest expense under operating leases deemed by us to be representative of the interest factor, plus amortization of debt issuance costs.

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RISK FACTORS

In addition to the other information contained in or incorporated by reference into this prospectus, you should carefully consider the following risk factors before making an investment in the notes or the common stock issuable upon conversion of the notes. If any of the events or circumstances described in the following risks actually occur, our business, financial condition or results of operations could suffer, and the trading price of our common stock and the notes offered by this prospectus could decline. The risks outlined below address many of the risks RealNetworks faces, but it is not an exhaustive list of all of our risks.

Keep these risk factors in mind when you read forward-looking statements elsewhere in this prospectus and in the documents incorporated by reference into this prospectus. These are statements that relate to our expectations for future events and time periods. Generally, the words, anticipates, expects, intends, plans, believes, seeks, estimates and similar expressions are intended to identify forward-looking stateme Forward-looking statements involve risks and uncertainties, and future events and circumstances could differ significantly from those anticipated in the forward-looking statements.

Risks Related to Our Business

We have a relatively limited operating history, which makes it difficult to evaluate our business.

We were incorporated in February 1994 and have a relatively limited operating history, particularly in our consumer subscription businesses. We have limited financial results on which you can assess our future success. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by growing companies in new and rapidly evolving markets, such as the markets for online consumer subscription services and digital media software in which we operate.

To address the risks and uncertainties faced by our business, we must meet many challenges including:

- establishing and maintaining broad market acceptance of our products and services and converting that acceptance into direct and indirect sources of revenue;
- establishing and maintaining adoption of our technology on a wide variety of platforms and devices;
- establishing and maintaining our brand name;
- timely and successfully developing new products, product features and services and increasing the functionality and features of existing products and services;
- developing subscription services products that result in high degrees of consumer satisfaction and high levels of consumer usage;
- successfully responding to competition from Microsoft, Yahoo!, Apple and others, including competition from emerging technologies and solutions; and
- developing and maintaining strategic relationships to enhance the distribution, features, content and utility of our products and services.

Our business strategy may be unsuccessful and we may be unable to address the risks we face in a cost-effective manner, if at all. If we are unable to successfully address these risks our business will be harmed.

We have a history of losses.

We have incurred significant losses since our inception. As of September 30, 2003, we had an accumulated deficit of $274 million. We had net losses for the quarter and nine months ended September 30, 2003 and the years ended December 31, 2002, 2001 and 2000, and we may not generate sufficient revenue to be profitable on a quarterly or annual basis in the future. We devote significant resources to developing, enhancing, selling, marketing and obtaining content for our products and services. As a result, we will need to generate significant revenue to be profitable in the future.

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Our operating results are likely to fluctuate significantly, which may cause our stock price to fluctuate.

As a result of our relatively brief operating history and the rapidly changing and uncertain nature of the markets in which we compete, our quarterly and annual revenue and operating results are likely to fluctuate from period-to-period, and period-to-period comparisons may not be meaningful. These fluctuations are caused by a number of factors, many of which are beyond our control. In past periods, our operating results have been affected by personnel reductions and related charges, charges relating to losses on excess office facilities, and impairment charges for certain of our equity investments. No assurance can be given that our operating results will not be affected by similar charges in future periods. Our future operating results could fall below the expectations of public market analysts or investors, which would likely significantly reduce the market price of our common stock. Fluctuations in our operating results will likely increase the volatility of our stock price.

Our research and development and sales and marketing efforts, and other business expenditures generally, are partially based on predictions regarding certain developments for media delivery and digital media distribution and on the consumption of online consumer subscription services. To the extent that these predictions prove inaccurate, our revenue may not be sufficient to offset these expenditures, and our operating results may be harmed.

Our revenue may be harmed if general economic conditions do not improve.

The difficult macroeconomic environment and Microsoft s bundling practices have impacted sales to customers in a variety of market segments, including customers in the corporate enterprise, broadcast hosting, Internet content provider, non-PC device manufacturer, systems software, telecommunication and original equipment manufacturer markets. No assurance can be given as to when, or if, we will experience increased demand for our systems software products from customers in these markets. In the event that a substantial number of our current or potential customers experience financial difficulties in the future or elect to use Microsoft s bundled products, the rate of adoption of our products may be slowed, our ability to increase or maintain sales to such customers will be adversely affected and our ability to generate revenue from these companies will also be adversely impacted.

Our consumer subscription services are a new business model for us and we believe these services represent a discretionary spending item for many consumers. Accordingly, the development of these services could be negatively impacted by a general decline in consumer spending levels or other changes in consumer habits caused by macroeconomic conditions, which would harm our business and our business prospects.

Our acquisition of Listen.Com may not be successful.

On August 4, 2003, we closed our acquisition of Listen.Com. The acquisition may not be successful and will not achieve its anticipated benefits unless we successfully integrate Listen.Com s operations with those of RealNetworks in a timely manner. Prior to the acquisition, RealNetworks and Listen.Com operated independently, each with its own business, business culture, markets, customers, employees and systems. Integrating the operations associated with Listen.Com will be a complex, time-consuming and expensive process that may result in revenue disruption, loss of key employees, customer uncertainty, and other operational difficulties if not completed in a timely and efficient manner. The operations associated with Listen.Com will remain in San Francisco after the closing. This will be our first experience operating and integrating a substantial acquired business in a remote location. The geographic separation could increase the operational risks described below under the caption Potential acquisitions involve risks that we may not adequately address and, in particular, may make it more difficult to retain the employees of Listen.Com. If we are not successful in retaining the key Listen.Com employees or in addressing any other problems encountered in connection with the acquisition, our business could be harmed.

Anticipated losses from our Listen.Com acquisition may harm our business.

We expect that the operations of Listen.Com will initially increase our operating losses. The level of additional operating losses is subject to risk and uncertainty. These additional operating losses could adversely affect our ability to achieve profitability in any given fiscal period, which could result in a decrease in our stock price. If the operating losses continue for a significant period of time, or are significant in magnitude, such losses could harm our financial position, reported operating results or stock price. Our estimate of the operating losses we are likely to incur is based on Listen.Com s past performance and anticipated future performance. Factors that might contribute to the operating losses continuing for a long period of time, or being significant, include Listen.Com s ability to renew existing music licenses with the major music labels on commercially reasonable terms, or at all, rates of subscriber retention, pressure from competitors, including pricing pressure, the development of the market for online music subscription services, both domestically and internationally, and others factors described under the caption Our online music services initiatives may not be successful, including our acquisition of Listen.Com.

There are a number of risks associated with our recently announced Helix initiative.

In July 2002, we announced the introduction of Helix, a combination of technology and a new licensing model designed to create an open, comprehensive platform and development community to enable the creation of digital media products and applications for multiple formats, operating systems and devices. Under the new licensing model, Helix community members can access, use and modify RealNetworks source code. This enables a large group of developers to extend the Helix technology to other platforms, fix software bugs and create their own applications using the Helix platform.

There are a number of risks associated with our Helix initiative, including risks associated with open source and community source technology licensing, development and business models and the risks typically associated with the introduction of new products and technologies. There can be no assurance that the industry will adopt the Helix Platform or the Helix Community, or that third parties will develop and introduce technologies or products based on them. Further, there can be no assurance that new or existing customers will license the Helix Universal Server. While we have invested substantial resources in the development of these initiatives and products, there can be no assurance that they will be accepted by the market, that we will derive substantial revenue from such initiatives and products or that the introduction of Helix and the Helix Universal Server will not adversely affect our sales.

Our subscription services may not be successful.

Members of one of our RealOne subscription services gain access to premium subscription content and are able to take advantage of certain enhanced features of the RealOne Player. These subscription services are a relatively new business model for delivering media over the Internet and represent a new and rapidly evolving business model for us. It is too early to predict whether consumers will accept in significant numbers our subscription services or whether the services will otherwise be financially viable. To date, costs of our subscription services as a percentage of subscription services revenue are significantly higher than such costs represented in our business historically, and we expect this trend will continue to negatively impact our overall gross margins as we grow our consumer subscription business and it becomes a larger portion of our overall revenue. Our subscription services compete with both traditional and online entertainment service providers. We anticipate that we will face increasing competition for online subscription service revenue from a wide range of companies, including Time Warner s AOL subsidiary, Microsoft and Yahoo!, which offer subscription services that compete with the offerings of certain of our subscription services, and from broadband Internet service providers. In addition, Apple s recently released iTunes digital music store provides additional competition for our music offerings. Many of our competitors have significantly more resources than us, including access to content, and some of our competitors may be able to leverage their experience in providing subscription or similar services to customers in other businesses to the sale of digital media subscriptions.

We must continue to obtain premium digital content in order to maintain and increase subscriptions and subscription service revenue and overall customer satisfaction. It is too early to predict whether our subscription business will require highly popular content to increase or maintain subscriptions, and, if so, whether we will be able to obtain such content on a consistent basis, or on commercially acceptable terms. To date, a limited amount of premium digital content has been made available for delivery over the Internet that can only be accessed through a for-pay service and not for free. If we are unable to obtain premium digital content on commercially reasonable terms, or at all, or if we do not successfully market our subscription services to our end users and other potential subscribers, our business could be harmed. In addition, if the adoption of broadband services is slower than anticipated it may impact the desirability of our services as users encounter content over slower connections, which degrade the quality of the user experience. In the future, increased competition for subscription services may make it more difficult to secure content licenses under reasonable terms.

If we do not continue to add subscribers to our subscription services or if we experience excessive rates of subscriber churn, our revenue and business will be harmed.

Our subscription services have become an increasingly important source of our total revenue. We believe the subscription business represents a major growth opportunity for us and also creates substantial risks. Subscribers may cancel their subscriptions to our subscription services for many reasons, including a perception that they do not use the subscription services sufficiently or that the service does not provide enough value, a lack of attractive or exclusive content generally or as compared to competitive service offerings, or because customer service issues are not satisfactorily resolved. In order to increase our number of subscribers and subscription revenue, we must continue to add new subscribers each quarter while minimizing the rate of loss of existing subscribers. Because the Internet subscription content business is a relatively new media delivery model and a relatively new business for us, we cannot predict with accuracy our long-term ability to retain subscribers or add new subscribers. If our marketing and promotional activities fail to add significant numbers of new subscribers or if too many of our subscribers cancel their memberships, our revenue and business will suffer. In addition, if the costs of such marketing and promotional activities increase in order to add new subscribers, our margins and operating results will suffer. Our subscription revenue and subscriber base have grown on a percentage basis in the early phases of the development of our subscription business. If our subscription revenue and subscriber base continue to grow, the percentage growth rates we have experienced to date are unlikely to be sustainable.

Many of our subscribers subscribe to our premium subscription service products, some of which are seasonal or periodic in nature, such as our Major League Baseball and CBS Big Brother offerings. We have limited experience with these types of offerings and cannot predict how the seasonal or periodic nature of these offerings or our experimentation with new content offerings will impact our subscriber growth rates, future subscriber retention levels or our quarterly financial results. In addition, our contract with Major League Baseball Advanced Media is due to expire in the fourth quarter of 2003. Failure to renew the contract will result in the loss of subscribers to MLB subscription offerings and a corresponding loss of revenue. Accordingly, we anticipate that subscriber levels for our various subscription service offerings will fluctuate as we develop this business and experiment with new types of content offerings. No assurance can be given that subscribers to our seasonal or periodic offerings will renew their subscriptions for future offerings. In addition, no assurance can be given that the gross margins associated with these offerings will be consistent with our historical gross margins or our gross margins for our other subscription products, such as RealOne SuperPass.

Our online music services initiatives, including our acquisition of Listen.Com, may not be successful.

In 2001, we announced the formation of a joint venture called MusicNet with several leading media companies to create a technology platform for online music subscription services. We also entered into an agreement with MusicNet to license the MusicNet platform and service for sale to our own customers. In December 2001, we began offering the RealOne MusicPass subscription service, a for-pay music subscription service based on the MusicNet platform. We recently replaced that offering with an online music subscription service using Listen.Com s technology and marketed as RealOne RHAPSODY, as discussed further below. The business models, technologies and market for online music subscription services are new and unproven and no assurance can be given that our online music initiatives will be successful.

In addition, we record in our statement of operations our equity share in MusicNet s net income (loss), which was a loss of $1.1 million and $4.3 million for the quarter and nine months ended September 30, 2003, respectively. We anticipate that MusicNet will continue to incur losses in the foreseeable future and will need additional funding. No assurance can be made that MusicNet will ever contribute net income to our statement of operations, that losses recorded from MusicNet will not increase in the future, or that our investment in MusicNet will not be written down in future periods. MusicNet also is a licensee of our technology and has used our digital music architecture to build its technology platform. If MusicNet is not successful and other online music subscription services do not license our technology, our business and business prospects could be harmed. The Antitrust Division of the U.S. Department of Justice and certain European antitrust regulatory authorities have commenced investigations into music licensing and other business practices related to online music businesses, including the business of MusicNet. If the business of MusicNet is harmed or materially modified as a result of these investigations, our financial results and business prospects could be harmed.

On August 4, 2003, we closed our acquisition of Listen.Com, and acquired Listen.Com s music subscription service, RHAPSODY. We are now offering RealOne RHAPSODY, our music subscription service using Listen.Com s technology, as our primary music subscription service offering through our Web sites and distribution channels. We are also continuing to distribute the RHAPSODY music service through Listen.Com s distribution channels. However, our ability to provide this music service will be dependent on music licenses from the major music labels. While we have received consent to transfer Listen.Com s existing music licenses with the major music labels, no assurance can be given that these labels will renew the licenses upon their expiration or that such renewals will be on terms that are commercially viable. Many of these licenses are due to expire and will need to be renewed in early 2004. Due to the increasing importance of our music services to our overall revenues, the failure of the major music labels to renew these licenses under terms that are acceptable to us will harm our ability to offer successful music subscription services and would harm our operating results.

Our online music offerings may not be able to successfully compete with other online music services or traditional music distribution channels.

Our music subscription services face competition from traditional offline music distribution competitors and from other new online music services, including Apple s iTunes music service and a service launched by Roxio under the brand name Napster, each of which has received significant initial media exposure and each of which is spending substantial marketing dollars to promote its service. We expect that the market for online music services will become increasingly competitive and will attract additional competitors that may be able to devote significantly greater resources to the development of their online music services. Competing services may be able to obtain more or better music content, may be able to license such content on more favorable terms than us, or may develop better offerings than us, which could harm the ability of our music subscription services to compete effectively in the marketplace.

Our music subscription services also face significant competition from free peer-to-peer services, such as KaZaA and Morpheus, which allow consumers to directly access an expansive array of free content without securing licenses from content providers. Although several of these free services have been found to be illegally violating copyright laws, enforcement efforts to date have not effectively shut down these services, and there can be no assurance that these services will ever be shut down. The ongoing presence of these free services, even if they are subsequently found to be illegal, substantially impairs the marketability of legitimate services like ours.

We may be unable to successfully compete with Microsoft and other companies in the media delivery market.

The market for software and services for media delivery over the Internet is relatively new and constantly changing. We expect that competition will continue to intensify. Increased competition has and could continue to hurt our business and the trading price of our stock. Increased competition may also result in price reductions, reduced margins, loss of customers, and a change in our business and marketing strategies, any of which could harm our business.

Many of our current and potential competitors have longer operating histories, greater name recognition, more employees and significantly greater financial, technical, marketing, public relations and distribution resources than we do. In addition, new competitors with potentially unique or more desirable products or

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services may enter the market at any time. The competitive environment may require us to make changes in our products, pricing, licensing, services or marketing to maintain and extend our current brand and technology franchise. Price concessions or the emergence of other pricing, licensing and distribution strategies or technology solutions of competitors may reduce our revenue, margins or market share, any of which will harm our business. Other changes we have to make in response to competition could cause us to expend significant financial and other resources, disrupt our operations, strain relationships with partners, or release products and enhancements before they are thoroughly tested, any of which could harm our operating results and stock price.

Microsoft is a principal competitor in the development and distribution of digital media and media distribution technology. Microsoft currently competes with us in the market for digital media servers, players, encoders, digital rights management, codecs and other technology and services related to digital distribution of media. Microsoft s commitment to and presence in the media delivery industry has increased. Microsoft recently announced the settlement of antitrust litigation with Time Warner in which Microsoft reportedly paid Time Warner $750 million and the two companies agreed to collaborate on long-term digital media initiatives, an announcement which may or may not have an impact on our existing relationship with AOL or on our business generally. We expect that Microsoft will continue to increase competitive pressure in the overall market for digital media and media distribution.

Microsoft distributes its competing streaming media server, player, tools and digital rights management products by bundling them with its Windows operating systems and servers at no additional cost or otherwise making them available free of charge. Microsoft s practices have caused, and may continue to cause, pricing pressure on our revenue generating products and services and affect usage of our competing products and formats. Microsoft s practices have led in some cases, and could continue to lead to, longer sales cycles, decreased sales, loss of existing and potential customers and reduced market share. In addition, we believe that Microsoft has used and may continue to use its monopoly position in the computer industry and its financial resources to secure preferential or exclusive distribution, use bundling contracts for its media delivery technologies and products with third parties, such as ISPs, content delivery networks, content providers, entertainment and media companies, VARs and OEMs, including third parties with whom we have relationships. Microsoft has also invested significant money in, has provided substantial financial incentives to, or offered or conditioned placement on or through the Windows operating system, the Internet Explorer Web browser and Microsoft s MSN service to, certain of our current and potential customers and content suppliers. We expect this trend to continue, which may cause those customers to stop using or reduce their use of our products and services and which may cause those content suppliers to withhold desirable media content from us or end users of our products and services. Such arrangements, together with Microsoft s aggressive competitive tactics, leveraging its operating system, and marketing of its Windows operating systems, server products and digital media products, may reduce our share of the streaming media and digital distribution markets. While courts have ruled that several of Microsoft s practices violated relevant laws related to illegal maintenance of monopoly power, court remedies to date have had little or no impact. There can be no assurance that there will be future court remedies against Microsoft s illegal actions, or if there are any such future remedies, there can be no assurance that these remedies will be effective in curtailing these activities.

Microsoft s Windows Media Player competes with our media player products. Certain versions of the Windows Media Player are available for download from Microsoft s Web site for free, and the Windows Media Player is bundled with Microsoft s Windows XP operating system and the Windows 98, Windows 2000 and Windows ME operating systems, the Internet Explorer Web browser, and Microsoft s MSN service. Windows XP, a significant focus of which is digital media delivery, gives very prominent and persistent placement to Microsoft s Windows Media Player, Windows Media Guide, music services, and other media delivery services in the operating system and on the end user s desktop. In some cases, the Windows Media Player may override default playback settings set by end users or by our software. New versions of Internet Explorer and MSN Explorer also prominently feature and promote Windows Media. We expect that by leveraging its monopoly position in operating systems and tying streaming or digital media into its operating systems and its Web browser, Microsoft will distribute substantially more copies of the Windows Media Player in the future than it has in the past and may be able to attract more users and content providers to use its streaming or digital media products. In addition, Microsoft does not document or expose all of the interfaces that would allow our products to take full advantage of the features and functionality of Windows XP that it makes available to the Windows Media Player. In light of Microsoft s efforts and dominant position in operating systems, our market position may be difficult to sustain. The ubiquitous distribution of Windows Media Player with Microsoft s Windows operating systems may make it less likely that Internet content providers would use our technology. We may have to use additional resources, personnel and capital to effectively counter Microsoft s competitive tactics and use of its operating system monopoly.

Microsoft s Windows Media Player also competes with the personal music management features of the RealOne Player. Microsoft has made strategic investments in other digital distribution technologies that compete with the RealOne Player. The Windows Media Player supports the Windows Media format, but not our media formats. Microsoft also licenses various Windows Media Technology applications, a platform for authoring, delivering and playing digital media intended to compete with our system software products, and supports and promotes other third party products competitive to our products. In addition, Microsoft provides servers that support Windows Media Technologies at no additional cost to customers who purchase its Windows servers, whereas we offer versions of our competitive servers for sale. Microsoft bundles its Windows Media Server product with its server operating systems. In some cases, Microsoft has conditioned use of the Windows Media Digital Rights Management and security technologies supported by Windows XP to support for Windows Media formats and use of Windows Media Player and servers.

We compete with Microsoft, Sony Corporation and others in the market for digital rights management technologies. Sony s acquisition of digital rights management patents from Intertrust in conjunction with Philips Electronics indicates that Sony may increase its focus on competing with us in the market for digital rights management technology. We expect Microsoft, Sony and other competitors to devote significantly greater resources to product development in the music management and digital media categories in the future. Microsoft has bundled its digital rights management technology with Windows and provides it at no charge. Microsoft is likely to use its operating system monopoly leverage to win market share for its digital rights management technologies.

Microsoft also competes with us to attract broadcasters and owners of high quality or popular content to promote and deliver such content in Microsoft s formats, in some cases on an exclusive or preferential basis. While we have rights to play back certain content in Microsoft formats through our player products under a limited set of conditions, we may not secure necessary rights from Microsoft to enable our products to play back all such content or content in Microsoft s newest formats, or such rights may not be available to us on commercially reasonable terms. Our player products may be disadvantaged if they cannot play content in Windows Media formats or content that is secured by the Windows Media Digital Rights Management technology, or if such content providers do not also make their content available in our media formats using digital rights management systems supported by us. In some cases, we believe Microsoft uses its financial resources and monopoly leverage to obtain rights to such content, and to provide incentives to content providers to prepare their content in Microsoft s formats. If content providers use Microsoft s digital media technology rather than ours, it may harm our ability to sell subscription services, players and Helix technology. Microsoft s commitment to and presence in the media delivery industry has increased and we believe that Microsoft will continue to increase competitive pressure in the overall market for streaming media and media distribution.

Microsoft has aggressively marketed and licensed its Windows Media technology to consumer electronics companies, a number of which have built support for Windows Media in their products. If Microsoft is successful in spreading Windows Media technology to non-PC devices in part through leveraging its operating system monopoly and we are not, it could harm our business.

In addition to Microsoft, we face competition from other companies that develop and market streaming media products. For example, Apple Computer offers the QuickTime streaming media technology and other technology based on MPEG-4 standards. Apple also offers competitive music management software and hardware. Apple has recently begun to devote significant resources to developing and marketing digital media products and we expect they will continue to do so to enable them to compete vigorously with us in the

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marketplace. Apple has also enlisted the open source code development community to assist its development of competitive products. Companies such as Time Warner and Yahoo! and many smaller competitors also offer various products that compete with our player products and content subscription services. In connection with the deployment of our system software in AOL s Internet service, we also licensed our technology to AOL for use with its own Internet service media player application. Such licensing may impact the number of end users of our player products if AOL users only use AOL applications. As more companies enter the market with products that compete with our servers, players and tools, the competitive landscape could change rapidly to our disadvantage. If our player products and formats do not continue to achieve a high level of consumer adoption and usage, our revenue and business could be harmed.

We may be unable to successfully compete in other parts of our business.

Media Hosting and Delivery. Our media hosting and delivery service, the Real Broadcast Network, competes with a variety of companies that provide streaming media hosting and broadcast services. These companies include Akamai, Yahoo! Broadcast Services and other emerging broadcast networks. Some of these competitors have cost or other advantages over our services and offer other services that the Real Broadcast Network does not offer, such as creating corporate intranet portals or hosting in media formats not supported by the Real Broadcast Network. We may not establish or sustain our competitive position in this market segment. In recent periods, many of the customers of the Real Broadcast Network have reduced their usage of our media hosting services. Some of our media hosting competitors are also customers on whom we rely to help drive product download traffic to our Web sites through their broadcast events. We also sell servers and tools to companies that compete with the Real Broadcast Network. If our relationship with these companies becomes more competitive, such companies may reduce their level of usage and purchases of our products or services.

Web Site Destinations, Content and Advertising. Our Web sites and the Real.com Network compete for user traffic and Internet advertising revenue with a wide variety of Web sites, Internet portals and ISPs. We cannot be certain that advertisers will place advertising with us or that revenue derived from such advertising will be meaningful. Advertising revenue does not currently represent a large percentage of our revenues and we cannot predict if our advertising revenues can be sustained or will increase in future periods.

We may not be successful in the market for downloadable media and personal music management systems.

The market for products that enable the downloading of media and that provide a personal music management system is relatively new and still evolving. We may be unable to develop a revenue model or sufficient demand to take advantage of this market opportunity. We cannot predict whether consumers will adopt the RealOne Player as their primary application to play, record, download and manage their digital music. There are a number of competitive products on the market that offer certain of the music management features currently offered by the RealOne Player. Given the size and importance of the general market for music distribution, competitors will likely release additional products that directly compete with the RealOne Player, which could harm our business. Our competitors may develop new features and technology not available in the RealOne Player, including advanced codecs and digital rights management technology, which could harm our business.

The RealOne Player also faces competition from the emergence of widespread peer-to-peer file sharing services and programs such as KaZaA and Morpheus, and a variety of other similar services that allow computer users to connect with each other and to copy many types of program files, including music and other media, from one another s hard drives. These services allow consumers to directly access an expansive array of content without relying on content providers to make the content available for streaming or digital download, and without relying on products such as the RealOne Player to be able to play, record and store such content. Our inability to achieve widespread acceptance for our digital music architecture or widespread distribution of our player products could hold back the development of revenue streams from these market segments, including digital music content, and therefore could harm the prospects for our business.

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We must also provide digital rights management solutions and other security mechanisms in order to address concerns of content providers, and we cannot be certain that we can develop, license or acquire such solutions, or that content licensors or consumers will accept them. In addition, consumers may be unwilling to accept the use of digital rights management technologies that limit their use of content, especially with large amounts of free content readily available. In connection with the continued development of our products, particularly with respect to the adaptation of our products on non-PC devices, we may need to license other digital rights management solutions to support our products. No assurance can be given that such solutions will be available to us, or, if they will be available to us at reasonable rates or upon reasonable terms, which could harm the development of our products and our business.

Our industry is experiencing consolidation that may intensify competition.

The Internet and media distribution industries are undergoing substantial change which has resulted in increasing consolidation and a proliferation of strategic transactions. As a result, we are increasingly competing with larger competitors that have substantially greater resources than we do. We expect this consolidation and strategic partnering to continue. Acquisitions or strategic relationships could harm us in a number of ways. For example:

- competitors could acquire or enter into relationships with companies with which we have strategic relationships and discontinue our relationship, resulting in the loss of distribution opportunities for our products and services or the loss of certain enhancements or value-added features to our products and services;
- competitors could obtain exclusive access to desirable multimedia content and prevent that content from being available in our formats, thus decreasing the use of our products and services and hurting our ability to attract advertisers to our Web sites and product offerings;
- suppliers of important or emerging technologies could be acquired by a competitor or other company which could prevent us from being able to utilize such technologies in our offerings, and disadvantage our offerings relative to those of competitors;
- a competitor could be acquired by a party with significant resources and experience that could increase the ability of the competitor to compete with our products and services; and
- other companies with related interests could combine to form new, formidable competition, which could preclude us from obtaining access to certain markets or content, or which could dramatically change the market for our products and services.

Any of these events could put us at a competitive disadvantage which could cause us to lose customers, revenue and market share. They could also force us to expend greater resources to meet new or additional competitive threats, which could also harm our operating results.

We rely on content provided by third parties to increase market acceptance of our products and services.

If third parties do not develop or offer compelling content to be delivered over the Internet, or grant necessary licenses to us or our customers to distribute or perform such content, our business will be harmed and our products and services may not achieve or sustain broad market acceptance. We rely on third-party content providers, such as radio and television stations, record labels, media companies, game developers, Web sites and other companies, to develop and offer content in our formats that can be delivered using our server products and played back using our player products. We also rely entirely on third-party content for the programming and content offerings that comprise our RealOne and stand-alone subscription services and our RHAPSODY subscription music service offering acquired in the Listen.Com acquisition. In some cases, we pay substantial fees to obtain content for these services. In order to provide compelling subscription services, we must be able to offer unique content and programming to our customers. We face competition in the market for subscription content services from a variety of companies, including larger competitors such as Time Warner, Microsoft and Yahoo!, who may have greater access to content or the ability to pay substantially higher fees to content providers. We cannot guarantee that third-party content providers will

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continue to rely on our technology or offer compelling content in our formats, nor can we guarantee that we will be able to secure licenses to their content or that such licenses will be available at commercially reasonable rates, to encourage and sustain broad market acceptance of our products and services. The failure to do so would harm our business and our business prospects.

While we have a number of short-term agreements with third parties to provide content from their Web sites in our formats, most third parties are not obligated to develop or offer content using our technology. In addition, some third parties have entered into and may in the future enter into agreements with our competitors, principally Microsoft, to develop or offer all or a substantial portion of their content in our competitors formats and using their digital rights management technology. This may prevent such content from being playable through our products. Microsoft has substantially more resources than us that may enable it to secure preferential and even exclusive relationships with content providers, including preferential placement on or through the Windows Operating System, Internet Explorer or MSN. There could be less demand for and use of our products if Microsoft or another competitor were to secure preferential or exclusive relationships with the leading content providers, Web sites or broadcasters.

Our success also depends on the availability of third-party content, especially music, that current users of our player products can lawfully and easily access, record and play back. Our products may not achieve or sustain market acceptance if third parties are unwilling to offer their content for free download, streaming or purchase by users of our player products. We believe that current concerns regarding the secure distribution of music over the Internet, and the difficulties and costs associated with obtaining necessary or desirable licensing rights have contributed to the delay in market acceptance of our music subscription products and may continue to do so in the future.

We may not successfully develop new products and services.

Our growth depends on our ability to continue to develop leading edge media delivery and digital distribution products and services. Our business and operating results would be harmed if we fail to develop products and services that achieve widespread market acceptance or that fail to generate significant revenue or gross profits to offset our development and operating costs. We may not timely and successfully identify, develop and market new product and service opportunities. If we introduce new products and services, they may not attain broad market acceptance or contribute meaningfully to our revenue or profitability. Competitive or technological developments may require us to make substantial, unanticipated investments in new products and technologies, and we may not have sufficient resources to make these investments. If we are unable to be a technological leader in our market our business is likely to be harmed. In addition, with the recent introduction of our Helix initiative, we no longer exercise control over many aspects of the development of the open source technology that comprises our Helix initiative and accordingly, there can be no assurance that the industry will adopt the Helix Platform or the Helix Community, or that third parties will develop and introduce technologies or products based on them.

Because the markets for our products and services are changing rapidly, we must develop new offerings quickly. We have experienced development delays and cost overruns in our development efforts in the past and we may encounter such problems in the future. Delays and cost overruns could affect our ability to respond to technological changes, evolving industry standards, competitive developments or customer requirements. Our products also may contain undetected errors that could cause increased development costs, loss of revenue, adverse publicity, reduced market acceptance of our products or services or lawsuits by customers.

The RealOne Player supports a variety of audio formats, including RealAudio, MP3, Windows Media Audio, Apple QuickTime and MPEG-4. Support for some formats, including Windows Media Audio and Apple QuickTime, requires the user to have additional third party software installed. However, technical formats and consumer preferences evolve very rapidly, and we may be unable to adequately address consumer preferences or fulfill the market demand to the extent it exists. We may be unable to license technologies, like codecs, that obtain widespread consumer and developer use which would harm consumer and developer acceptance of our products and services. In addition, our codecs and formats may not continue to be in

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demand or as desirable as other third party codecs and formats, including industry standard codecs and formats created by MPEG, become more readily available.

We depend on key personnel who may not continue to work for us.

Our success substantially depends on the continued employment of certain executive officers and key employees, particularly Robert Glaser, our founder, Chairman of the Board and Chief Executive Officer. The loss of the services of Mr. Glaser or other key executive officers or employees could harm our business. If any of these individuals were to leave RealNetworks, we could face high costs and substantial difficulty in hiring qualified successors and could experience a loss in productivity while any such successor obtains the necessary training and experience. We do not maintain key person life insurance policies. If we do not succeed in retaining and motivating existing personnel, our business could be harmed.

Our failure to attract, train or retain highly qualified personnel could harm our business.

Our success also depends on our ability to attract, train or retain qualified personnel in all areas, especially those with management and product development skills. In particular, we must hire and retain experienced management personnel to help us continue to grow and manage our business, and skilled software engineers to further our research and development efforts. At times, we have experienced difficulties in hiring personnel with the proper training or experience, particularly in technical and media areas. Competition for qualified personnel is intense, particularly in high-technology centers such as the Pacific Northwest, where our corporate headquarters are located. If we do not succeed in attracting new personnel or in retaining and motivating our current personnel, our business could be harmed.

Potential acquisitions involve risks we may not adequately address.

As part of our business strategy, we have acquired technologies and businesses in the past, and expect that we will to continue to do so in the future. The failure to adequately address the financial, legal and operational risks raised by acquisitions of technology and businesses could harm our business. Acquisition or business combination transactions are accompanied by a number of significant risks. Financial risks related to acquisitions may harm our financial position, reported operating results or stock price, and include:

- potentially dilutive issuances of equity securities;
- use of cash resources;
- the incurrence of debt and contingent liabilities;
- large write-offs and difficulties in assessment of the relative percentages of in-process research and development expense that can be immediately written off as compared to the amount which must be amortized over the appropriate life of the asset; and
- amortization expenses related to other intangible assets.

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

- difficulties in assimilating the operations, products, technology, information systems or personnel of the acquired company;
- subsequent loss of key employees of the acquired company;
- diversion of management s attention from other business concerns and the potential disruption of our ongoing business;
- the difficulty of incorporating acquired technology or content and rights into our products and services and unanticipated expenses related to such incorporation;
- impairment of relationships with our employees, affiliates, advertisers and content providers;

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inability to maintain uniform standards, controls, procedures and policies;