Before the
Copyright Royalty Judges
Library of Congress
Washington, D.C.

In the Matter of Mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding	Docket No. 2006-3 CRB DPRA

The Written Rebuttal Testimony of Dan Sheeran

DiMA Trial Ex. 11

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REBUTTAL TESTIMONY OF DAN SHEERAN

1. My name is Dan Sheeran, and I am Senior Vice President of Business Development at RealNetworks, Inc. ("Real"). I submit this testimony in connection with the Rebuttal Case of the Digital Music Association ("DiMA") in the above-captioned proceeding for setting rates and terms for the making and distribution of digital phonorecord deliveries ("DPDs").

2. I received an MBA from the Kellogg School at Northwestern University, and a Bachelor of Science from Georgetown University.

3. I am responsible for structuring major corporate relationships, such as distribution partnerships, joint ventures, and licensing arrangements, for the company, with particular emphasis on its Music business. My prior position at Real was SVP of Music, during which time I had operating responsibility for all aspects of our music business worldwide.

4. Due to my responsibilities in my current and former roles, I have familiarity with Real's current product offerings and its efforts to enhance existing offerings and develop new ones. I am also familiar with the cost components and

associated considerations that drive our decisions regarding which products to offer, and how to price them. I am also generally familiar with the products and prices of other companies providing digital music services.

5. I have reviewed the rates and terms proposal submitted by the Copyright Owners in this proceeding. As I explain in greater detail below, their proposals for rates and terms for the Section 115 "mechanical" license would be highly disruptive to the digital music distribution industry and to consumers of digital music.

6. Before addressing the impact of the Copyright Owners' proposed rates and terms, I would like to provide context regarding the business environment in which these services are being offered today. Real Networks has invested more than $100 million in developing and expanding this business. For background, supplemental tables to the FY 2007 Real Networks Income Statement are attached to my written testimony at Tab A. We offer services that include permanent downloads, limited downloads and interactive and non-interactive streaming. The operating costs of these businesses are very high for several reasons. First, the royalty payments we incur and/or accrue account for more than half of our revenue. Second, we face high legal and technical costs in order to clear licenses, obtain physical copies of music, prepare the music for delivery, store it and deliver it to end users. Third, we must market our services in an environment where many consumers know that it is easy to illegally download all the music they want.

7. The impact of these three factors is clear: in 2007 our music business achieved $149 million in revenue but had an operating loss of $60 million. There are very few companies that are willing to incur losses like this over an extended period of

time. Therefore, it is not surprising that so many companies that have attempted to offer consumer-paid legal music services have had to sell or shut down these services in recent years. A partial list of such companies includes Yahoo, AOL, MTV Networks, MusicNow, Virgin Media, MusicMatch, and Listen.com. Based on my knowledge and understanding of the industry, I believe these companies, and the few of us who are still in the business, have collectively lost many hundreds of millions of dollars. Increasing our costs will not only make these existing economics even more difficult, it also will make it harder for those of us who remain to continue to invest in innovations like new portable devices, new distribution channels, or creative marketing.

8. In the meantime, many companies that pay nothing to copyright holders have launched, gained widespread consumer adoption, and then sold out at huge profits for their founders. As a result, many analysts claim that the only companies who should continue to invest in legal, consumer-paid digital music services are those who are willing to sell music as a loss leader for some other business, such as selling music devices. At Real, we continue to believe that it is possible to create a successful digital music business, but not if our cost structure becomes even worse.

I. <u>**The Copyright Owners' Proposal for Permanent Downloads Would Be Highly Disruptive**</u>

9. For permanent downloads, the Copyright Owners have proposed a fixed royalty rate of 15 cents per track (or 2.9 cents per minute of playing time), adjusted periodically for inflation as measured by the CPI. This proposal would effectively impose a minimum rate of 15 cents per track on permanent downloads. That would be an

increase of 5.9 cents per track from the current mechanical royalty fee – an increase of more than fifty percent.

10. I expect that Real and other digital music providers would ultimately bear the full cost of this, or any, increase in the mechanical royalty rate. Although we often sublicense works from labels rather than license directly from the publishers, based on my experience with labels and their ability to extract high rates and minimum fees from us, I am very confident that they would pass through any increase in the mechanical royalty rate.

11. We, in turn, would not be able to pass on the extra cost to the consumer for three reasons. First, the easy availability of illegal downloads places a cap on what many consumers are willing to pay. Second, in the physical retail world, the leading music retailer (Wal-Mart) is seeking to push album prices down to as low as $10 for the top hits and $5 for budget product. Information related to this development is attached at Tab B. In the digital world, this will have significant downward pressure on prices. Third, the move among the music labels to no longer require the use of digital rights management on permanent downloads will enable anyone to sell tracks that play on an iPod (the leading digital music device). As a result, there is likely going to be price competition as providers attempt to capture market share in serving the millions of iPod users.

12. The Copyright Owners' proposed rate for permanent downloads is also disruptive because it would be adjusted in the future based on changes to the CPI. The proposal implies that this approach would keep the mechanical rate insulated from

inflation. However, in order for the price adjustments to move with the CPI without the extra cost being borne by the service providers, retail prices would need to be able to move in conjunction with the CPI, which they have not ever done.

II. The Copyright Owners' Proposal for Limited Downloads Would Be Highly Disruptive

13. The Copyright Owners have proposed a complex, three-tiered mechanical royalty rate for limited downloads. In any particular instance, the actual payment due would be equal to the greatest of the three tiers.

a. The first tier calls for a payment of 15 percent of revenue. The Copyright Owners propose that for "music-only" services, the revenue base includes any and all consideration "from the sale of any product or service directly related to a music service." For services that offer more than just music to consumers, or for services for which there is not a separate fee for the music component, the Copyright Owners suggest that the revenue base should "capture all revenue that is fairly attributable to music," but they suggest no mechanism or formula for doing so.

b. The Copyright Owners' proposed second tier for rates for limited downloads would require payment of one-third of the total content costs paid for mechanical rights to musical compositions and rights to sound recordings.

c. The Copyright Owners' proposed third tier is the greater of $0.0033 per use or $0.00064 per minute of playing time or fraction thereof, adjusted periodically for inflation as measured by the CPI.

14. While DiMA fully endorses adopting a percentage-of-revenue methodology, the rates proposed by the Copyright Owners are unreasonably high and the structure of their proposal would be unduly disruptive for three reasons.

15. First, the 15 percent rate proposed in the first tier is too high compared to the more reasonable rate proposed by DiMA. Limited download services already pay well over half of revenue to copyright holders today. Moreover, these services face particularly high customer service costs because of the technical problems that can occur when the consumer is moving music from their PC to their portable device. Increasing our costs in this area could easily tip the balance for certain service providers to no longer offer limited download services. Bearing in mind the extremely challenging economic situation already faced by providers, as set forth in the introduction above, this change would accelerate the process of market exit -- and Real would have to seriously consider its options in this regard as well.

16. Second, the rates proposed by the Copyright Owners are well in excess of the reasonable expectations of digital music services that have been operating for years. Like other digital music companies, RealNetworks has been accruing for several years to ensure we have reserves sufficient to cover past royalty payments once the rates for these services is established. As a general matter, we have been accruing between 8-10% of subscription revenue to cover *total* royalty payments to publishers -- that is, mechanical

payments *and* public performance payments -- for these services. Based on information available to me in the ordinary course of my business activities, I believe this is a common accrual practice for other similar music services. We adopt accrual rates as a very conservative estimate that would likely be much higher than the amounts actually needed, preparing for the worst case scenario. Jumping to 15% *for mechanicals alone* would be incredibly disruptive.

17. Third, the Copyright Owners' proposed minimum would limit the ability of music services to respond to competition and develop new or modified or upgraded offerings and business models. For example, some companies are exploring the possibility of bundling music downloads and/or services into the price of other services or products (such as a cell phone subscription or a music player). These bundled plans could result in a substantial increase in the number of digital music consumers, but the providers of such bundles would require a relatively low price per unit. This is the way the cable television industry successfully penetrated the mass market, for example. Rather than requiring consumers to sign up for each cable network a la carte, they bundled together many channels by getting their suppliers to give them a low cost per channel. However, by creating or further reinforcing an artificial price floor, the proposed minima eliminates providers' ability to experiment with such models and otherwise adjust price in response to the market.

III. <u>The Copyright Owners' Proposal for Interactive Streaming Would Be Highly Disruptive</u>

18. The Copyright Owners also propose rates and terms for so-called "interactive streaming." I believe their proposal is unreasonable for several reasons. To

begin with, their definition of "interactive" ("a digital delivery of a sound recording of a musical work, using streaming technology, in response to an end user's request") is so vague as to make it impossible to determine what is "interactive" and what is not (any stream could be an "interactive" stream).

19. Indeed, the definition of "interactive streaming" could be interpreted to include 30-second clips that are used to promote sales of permanent or limited downloads. This could be massively expensive and complicated to implement and involve untold numbers of companies who have been operating in good faith and never been given notice about the potential for publishing liability for these activities.

20. Most importantly, Real *already pays* songwriters and publishers to publicly perform musical works through streaming. The performing rights organizations (ASCAP, BMI and SESAC) generally take the position that rates for streaming should be higher when users have more control over the music service (*e.g.*, "on demand" or "interactive"). Thus, the Copyright Owners are already being paid for the use of their works and no additional payment should be required. This is confirmed by the fact that no mechanical payments are being sought for "non-interactive" streaming, which involves making exactly the same sort of copies on end-users' machines. The fair price for all copies made to facilitate streaming is zero, because the Copyright Owners are fully compensated for this activity through the royalties paid to the performance rights organizations.

21. Certainly, any royalty imposed on interactive streaming should take into account public performance royalty payments already made to the same copyright

owners. Moreover, it would be massively disruptive as the Copyright Owners propose to assess a per-unit "penny" royalty on copies made in streaming, since the number and type of copies made vary widely depending on applicable technology and it would be incredibly expensive to track and account for such copies on an individual basis.

IV. <u>Failure to Specifically Include Rights And Payments For All Copies To Make And Distribute Digital Phonorecord Deliveries Would Be Highly Disruptive</u>

22. DiMA's license proposal expressly provides that a compulsory license under 17 U.S.C. § 115 extends to the making of, and the license fee for making and distributing a permanent digital phonorecord delivery or a limited digital phonorecord delivery includes all payments required to provide, all reproductions necessary to engage in activities covered by the license, including but not limited to: (a) the making of reproductions by and for end users; (b) reproductions on servers; and (c) incidental reproductions made in the normal course of engaging in such activities, including masters and cached, network, and buffer reproductions.

23. The rate for the reproduction or distribution of phonorecords that are part of a transmission that constitutes a digital phonorecord delivery should be zero, because those copies are necessary and part of the distribution of licensed digital phonorecord deliveries. There is no independent value that exists as a result of these copies; the copies exist only to facilitate activities for which copyright owners are already compensated, namely (a) licensed digital phonorecord deliveries or (b) public performances. Moreover, such incidental copies are made any time any data or media is transmitted over the internet, and any attempt to track and/or assess a royalty on these copies would be practically impossible.

24. The Copyright Owners' failure to expressly provide the same level of clarity is a fatal flaw. A license to make and distribute digital phonorecord deliveries without coverage of all copies that are necessary and part of the distribution is unusable and practically worthless.

V. <u>DiMA's Revised Proposal</u>

25. I am aware that DiMA has filed revised proposed rates and terms. I am familiar with the revised proposal, and I support it. Two aspects of the revised proposal merit further explanation here.

26. First, DiMA has revised its proposed revenue definition to provide additional specificity about which revenues should be included in the revenue base and how the mechanical royalty rate would be calculated from these revenues. The following examples illustrate how DiMA's proposed rates would be applied to this revenue base.

a. <u>Scenario one: Permanent download</u>. A customer purchases a permanent download for 89 cents. The applicable receipts from the sale are 89 cents. The mechanical royalty owed would be $0.89 x 6% = $0.0534.

b. <u>Scenario two: Permanent download sold with advertising</u>. A customer purchases a permanent download for 50 cents. During the download of the track, an advertisement is played to the customer. The digital music distributor obtains revenues of 50 cents from the advertising, after agency and sales commissions have been paid. The applicable receipts for the sale are the 50 cents paid in consideration for the track plus the 50 cents of revenue attributable from the advertising, or one dollar. The mechanical royalty owed would be \$1.00 x 6% = \$0.06.

c. <u>Scenario three: Playback of a particular track through subscription service.</u> A customer purchases a one-month subscription to a limited download service that costs \$11.99 per month. The service calculates the ratio of the number of times the customer plays track "A" compared to the customer's number of total plays (of all songs) during the month. Assume the customer listened to song "A" 10 times, and had 100 plays in total during the month. Thus, the ratio would be:

$$\frac{\text{Plays of Song "A"}}{\text{Total Plays}} = \frac{10}{100} \quad \frac{1}{10}$$

The service then multiplies this ratio by the price of the subscription service for the month to determine the applicable receipts from the customer's plays of song "A": 1/10 x \$11.99 = \$1.199. Last, the service multiplies the applicable receipts for song "A" by the mechanical royalty rate: \$1.199 x 5.9% = \$0.070741

d. <u>Scenario four: Playback of limited download "A" though subscription service with advertising.</u> A customer purchases a one-month subscription to a limited download service for \$5.99. When the customer plays a song, an advertisement is automatically played, from which the limited download service receives revenues. During the month, the digital subscription service obtains revenues of \$0.10 attributable to this advertising. The service calculates the ratio of the number of times the customer plays track “A” compared to the customer’s number of total plays (of all songs) during the month. Assume the customer listened to song “A” 10 times, and had 100 plays in total during the month. Thus, the ratio would be:

$$\frac{\text{Plays of Song “A”}}{\text{Total Plays}} = \frac{10}{100} \quad \frac{1}{10}$$

The service then multiplies this ratio by the price of the subscription service for the month plus the advertising revenues attributable to the advertising to determine the applicable receipts from the customer’s plays of song “A”: 1/10 x ($5.99 + $0.10) = $0.609. Last, the service multiplies the applicable receipts for song “A” by the mechanical royalty rate: $0.609 x 5.9% = $0.035931.

27. Of course, the revised revenue definition may not envision each and every new product offering that may be developed in the future. I do not think it would be possible to create a definition that could anticipate every new technological or business innovation. DiMA’s definition establishes the revenue base and rate calculation methodology for the business models that exist or are reasonably foreseeable today.

28. Second, as noted above, DiMA has included proposed minima. The point of the minima is to provide some protection for copyright owners without imposing unreasonable costs on digital music services or preventing services from expanding or entering into the marketplace. The proposed minima also recognize that business models are evolving and that both subscription and “non”-subscription offerings may develop more over the next five years. DiMA’s proposed minima specifically recognizes that the

minima must be lower for permanent downloads that are sold as part of a bundle, to accommodate the industry-standard practice of providing a discounted "album" price (i.e. in a service where permanent downloads sell for $0.99, an album with 15 tracks might sell for $9.99).

a. Permanent download. For permanent downloads, the minimum would be 4.8 cents per song sold as a single or 3.3 cents per song sold as part of a bundle.

b. Limited download. For limited downloads, the minimum would depend on whether the download was played by a "subscriber" or not.

   i. Where the delivery is to a subscriber then the minimum will be 13.5 cents per-subscriber-per-month times a fraction, (A) the numerator of which shall be the number of playbacks of all phonorecords of the licensed work and (B) the denominator of which shall be the total number of playbacks of all phonorecords of all licensed works.

   ii. Where the delivery is not to a subscriber then the minimum will be $0.00129 per playback.

   A "playback" will be any play of greater than 30 seconds by an end user during an accounting period of a phonorecord of the licensed work distributed by limited digital phonorecord delivery. A "subscriber" is a natural person who receives a limited digital phonorecord delivery for private and noncommercial use as part of a subscription offered by the licensee; pays a regular fee in order to access the subscription; and gains access to, and is able to playback the limited digital phonorecord delivery only while, such regular fee is paid and controlled by digital rights management technology. It is critical to differentiate between "subscribers" and other users because business models without subscribers cannot pay minimum fees based on recurring subscription revenues.

29. DiMA's proposed minima provide protection for songwriters but do not unfairly or unreasonably impede the ability of music services to make products available in a competitive market.

VII. Conclusion

30. For the foregoing reasons, the Copyright Owners' proposed rates and terms would be unduly disruptive. The Court should adopt DiMA's proposed rates and terms instead.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge, information and belief:

Dan Sheeran

Dan Sheeran

April 4th, 2008

Date

A

RealNetworks, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
(Unaudited)

	Quarters Ended December 31, 2007	Quarters Ended December 31, 2006	Years Ended December 31, 2007	Years Ended December 31, 2006
	(in thousands, except per share data)			
Net revenue	$ 156,882	$ 125,574	$ 567,620	$ 395,261
Cost of revenue	61,705	42,320	213,491	124,108
Gross profit	95,177	83,254	354,129	271,153
Operating expenses:				
Research and development	27,719	22,259	102,731	77,386
Sales and marketing	56,819	53,998	209,412	165,602
Advertising with related party (A)	16,613	-	24,360	-
General and administrative	16,159	15,746	67,326	57,332
Restructuring charge	3,748	-	3,748	-
Loss on excess office facilities (B)	-	-	-	738
Subtotal operating expenses	121,058	92,003	407,577	301,058
Antitrust litigation benefit, net (C)	-	(60,856)	(60,747)	(220,410)
Total operating expenses	121,058	31,147	346,830	80,648
Operating (loss) income	(25,881)	52,107	7,299	190,505
Other income (expenses):				
Interest and other, net	6,417	9,644	30,874	37,622
Gain (loss) on sale of equity investments	(34)	-	98	2,286
Equity in net income (loss) of investments	(308)	326	(440)	326
Impairment of equity investments	-	(3,116)	-	(3,116)
Minority interest in Rhapsody America (D)	13,318	-	19,784	-
Gain on initial formation of Rhapsody America (E)	-	-	3,866	-
Gain on sale of interest in Rhapsody America (F)	8,464	-	12,544	-
Other income	756	(302)	1,746	130
Other income, net	28,613	6,552	68,472	37,248
Income before income taxes	2,732	58,659	75,771	227,753
Income taxes	(47)	(19,357)	(27,456)	(82,537)
Net income	$ 2,685	$ 39,302	$ 48,315	$ 145,216
Basic net income per share	$ 0.02	$ 0.24	$ 0.32	$ 0.90
Diluted net income per share	$ 0.02	$ 0.22	$ 0.29	$ 0.81
Shares used to compute basic net income per share	144,387	162,130	151,665	160,973
Shares used to compute diluted net income per share	157,626	180,919	166,409	179,281

(A) Consists of advertising purchased by Rhapsody America from MTV Networks (MTVN). MTVN has a 49% ownership interest in Rhapsody America.

(B) The loss on unoccupied excess office facilities represents an increase in the estimate of loss from building operating costs that are not expected to be recovered.

(C) Consists of amounts received under the Settlement and Commercial agreements with Microsoft, net of certain legal fees, personnel costs, public relations and other professional service fees incurred related to antitrust complaints against Microsoft, including proceedings in the European Union.

(D) Minority interest reflects MTVN's 49% ownership interest in the losses of Rhapsody America.

(E) Consists of gains realized from MTVN's asset contributions to Rhapsody America.

(F) Consists of gains realized from MTVN's note payments to Rhapsody America.

RealNetworks, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(Unaudited)

	December 31, 2007	December 31, 2006
	(in thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 476,697	$ 525,232
Short-term investments	79,932	153,688
Trade accounts receivable, net	84,674	65,751
Deferred costs, current portion	6,408	1,643
Deferred tax assets, net, current portion	-	891
Prepaid expenses and other current assets	26,492	21,990
Total current assets	674,203	769,195
Equipment, software, and leasehold improvements, at cost:		
Equipment and software	109,621	83,587
Leasehold improvements	30,632	29,665
Total equipment, software, and leasehold improvements	140,253	113,252
Less accumulated depreciation and amortization	83,756	65,509
Net equipment, software, and leasehold improvements	56,497	47,743
Restricted cash equivalents	15,509	17,300
Equity investments	9,976	22,649
Other assets	10,161	5,148
Deferred tax assets, net, non-current portion	40,913	27,150
Other intangible assets, net	107,677	105,109
Goodwill	353,153	309,122
Total assets	$ 1,268,089	$ 1,303,416
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 56,160	$ 52,097
Accrued and other liabilities	106,783	104,328
Deferred revenue, current portion	39,564	24,137
Related party payable (A)	17,241	-
Convertible debt, current portion	100,000	-
Accrued loss on excess office facilities, current portion	3,389	4,508
Total current liabilities	323,137	185,070
Deferred revenue, non-current portion	2,663	3,440
Accrued loss on excess office facilities, non-current portion	7,311	9,993
Deferred rent	4,518	4,331
Deferred tax liabilities, net, non-current portion	22,060	27,076
Convertible debt, non-current portion	-	100,000
Other long-term liabilities	13,683	3,740
Total liabilities	373,372	333,650
Minority interest (B)	19,613	-
Shareholders' equity	875,104	969,766
Total liabilities and shareholders' equity	$ 1,268,089	$ 1,303,416

(A) Related party payable reflects amounts owed to MTVN.

(B) Minority interest reflects MTVN's 49% ownership in the net assets of Rhapsody America.

RealNetworks, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Years Ended December 31, 2007	2006
	(in thousands)	
Cash flows from operating activities:		
Net income	$ 48,315	$ 145,216
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	45,225	20,980
Stock-based compensation	23,918	18,151
Loss on disposal of equipment, software, and leasehold improvements	302	276
Equity in net loss of investments	440	(326)
Gain on sale of equity investments	(98)	(2,286)
Impairment of equity investments	-	3,116
Excess tax benefit from stock option exercises	(562)	(39,183)
Accrued loss on excess office facilities	(3,801)	(3,515)
Deferred income taxes	(15,052)	54,986
Minority interest in Rhapsody America	(19,784)	-
Gain on sale of interest in Rhapsody America	(16,410)	-
Other	95	97
Net change in certain assets and liabilities, net of acquisitions	1,162	(26,592)
Net cash provided by operating activities	63,750	170,920
Cash flows from investing activities:		
Purchases of equipment, software, and leasehold improvements	(26,658)	(13,808)
Purchases of short-term investments	(133,427)	(204,841)
Proceeds from sales and maturities of short-term investments	207,183	180,973
Purchases of intangible assets	(2,796)	-
Proceeds from the sales of equity investments	1,615	2,286
Purchase of equity investments	(1,656)	(834)
Decrease in restricted cash equivalents	1,805	-
Cash used in acquisitions, net of cash acquired	(45,599)	(257,841)
Net cash provided by (used in) investing activities	467	(294,065)
Cash flows from financing activities:		
Net proceeds from sales of common stock under employee stock purchase plan and exercise of stock options	15,894	54,929
Net proceeds from sales of interest in Rhapsody America	48,716	-
Excess tax benefit from stock option exercises	562	39,183
Repurchase of common stock	(178,792)	(98,876)
Net cash used in financing activities	(113,620)	(4,764)
Effect of exchange rate changes on cash	868	1,170
Net decrease in cash and cash equivalents	(48,535)	(126,739)
Cash and cash equivalents, beginning of period	525,232	651,971
Cash and cash equivalents, end of period	$ 476,697	$ 525,232

RealNetworks, Inc. and Subsidiaries
Supplemental Financial Information
(Unaudited)

	2007 Q4	2007 Q3	2007 Q2	2007 Q1	2006 Q4	2006 Q3	2006 Q2	2006 Q1
	(in thousands)							
Net Revenue by Line of Business:								
Consumer products and services (A)	$ 96,998	$ 91,824	$ 87,115	$ 85,040	$ 88,022	$ 82,497	$ 77,442	$ 74,811
Technology products and solutions (B)	59,884	53,271	49,056	44,432	37,552	11,179	11,967	11,791
Total net revenue	$156,882	$ 145,095	$ 136,171	$ 129,472	$ 125,574	$ 93,676	$ 89,409	$ 86,602
Consumer Products and Services:								
Subscriptions (C)	$ 54,784	$ 55,551	$ 51,091	$ 51,490	$ 50,835	$ 50,878	$ 47,452	$ 47,832
Media properties (D)	20,438	16,071	17,748	15,932	18,815	13,883	11,546	9,484
E-commerce and other (E)	21,776	20,202	18,276	17,618	18,372	17,736	18,444	17,495
Total consumer products and services revenue	$ 96,998	$ 91,824	$ 87,115	$ 85,040	$ 88,022	$ 82,497	$ 77,442	$ 74,811
Consumer Products and Services:								
Music (F)	$ 40,540	$ 37,658	$ 36,801	$ 34,127	$ 33,623	$ 30,375	$ 30,118	$ 28,918
Media software and services (G)	25,572	25,346	25,419	27,011	30,513	29,586	26,127	27,277
Games (H)	30,886	28,820	24,895	23,902	23,886	22,536	21,197	18,616
Total consumer products and services revenue	$ 96,998	$ 91,824	$ 87,115	$ 85,040	$ 88,022	$ 82,497	$ 77,442	$ 74,811
Net Revenue by Geography:								
United States	$ 96,806	$ 91,281	$ 88,035	$ 84,554	$ 81,758	$ 69,433	$ 66,542	$ 65,700
Rest of world	60,076	53,814	48,136	44,918	43,816	24,243	22,867	20,902
Total net revenue	$156,882	$ 145,095	$ 136,171	$ 129,472	$ 125,574	$ 93,676	$ 89,409	$ 86,602
Subscribers (presented as greater than) *:								
Total subscribers (I)	30,200	29,250	26,150	24,550	22,700	2,450	2,400	2,400
Technology products and solutions application services subscribers (J)	27,600	26,600	23,600	21,900	20,200			
Music subscribers:								
Consumer music subscribers (K)	1,900	1,925	1,850	1,875	1,725	1,650	1,625	1,575
Technology products and solutions application services music subscribers (L)	825	825	825	800	800			
Total Music Subscribers**	2,725	2,750	2,675	2,675	2,525	1,650	1,625	1,575

*Beginning the quarter ended December 31, 2006, total subscribers reflect the inclusion of subscribers related to wireless carrier application subscription services. Total music subscribers includes subscribers from our technology products and solutions application subscription services, such as music-on-demand, as well as our consumer music services, such as Rhapsody and Premium Radio. Although music-on-demand subscribers are included in the technology products and solutions application services subscribers and total music subscribers, these subscribers are only counted once as part of our total subscribers.

** Prior periods have been changed to reflect current period presentation. Totals may not equal due to rounding convention.

(A) Revenue is derived from consumer digital media subscription services, RealPlayer Plus and related products, sales and distribution of third party software products, content such as games and music and advertising.

(B) Revenue is derived from carrier application services such as ringback tones and music-on-demand, media delivery system software, support and maintenance services, broadcast hosting services and consulting services.

(C) Revenue is derived from consumer digital media subscription services including: SuperPass, RadioPass, Rhapsody, GamePass and stand-alone subscriptions.

(D) Revenue is derived from advertising and through the distribution of third party products.

(E) Revenue is derived from RealPlayer Plus and related products, sales of third party software products, and content such as games and music.

(F) Revenue is derived from Rhapsody and RadioPass subscription services and sales of music content, advertising generated from our music and music related websites and the distribution of third party products.

(G) Revenue is derived from SuperPass subscriptions, RealPlayer Plus and related products, stand-alone subscription services, sales and distribution of third-party software products and advertising related to our non-game and non-music related web properties.

(H) Revenue is derived from GamePass subscription service, sales of games, advertising generated from our games and game-related websites and the distribution of third-party products.

(I) Total subscribers include technology products and solutions application services and consumer subscription services including: ringback tones, music-on-demand, video-on-demand, Rhapsody, Rhapsody-to-Go, RadioPass, SuperPass, GamePass, and stand-alone subscriptions.

(J) Technology products and solutions application service subscribers include: ringback tones, music-on-demand and video-on-demand.

(K) Consumer music subscribers include: Rhapsody, Rhapsody-to-Go, premium radio, and music-on-demand.

(L) Technology products and solutions application services music subscribers include subscribers from application services including music-on-demand.

RealNetworks, Inc. and Subsidiaries
Supplemental Financial Information
(Unaudited)

Reconciliation of GAAP net income to adjusted net income is as follows

	Quarters Ended							
	December 31, 2007	September 30, 2007	June 30, 2007	March 31, 2007	December 31, 2006	September 30, 2006	June 30, 2006	March 31, 2006
	(in thousands, except per share data)							
Net income in accordance with GAAP	$ 2,685	$ 4,342	$ 1,327	$ 39,961	$ 39,302	$ 42,153	$ 38,878	$ 24,883
Stock-based compensation	6,627	5,984	5,622	5,685	5,819	5,021	3,673	3,638
Loss (gain) on equity investments	34	-	(132)	-	3,116	-	(2,286)	-
Conversion of WiderThan stock options to a cash equivalent	190	413	614	845	641	-	-	-
Acquisitions related intangible asset amortization* (net of minority interest effect)	6,639	5,583	5,311	5,312	3,530	569	445	727
Gain on initial formation of Rhapsody America	-	(3,866)	-	-	-	-	-	-
Expenses (benefit) related to antitrust litigation:								
Income	-	-	-	(61,000)	(61,000)	(62,000)	(58,000)	(40,000)
Expenses	179	201	202	471	1,026	1,000	997	971
Charitable contributions	-	-	-	1,921	2,009	1,889	1,805	1,225
Tax impact of above pro forma items*	(3,568)	(3,187)	(3,858)	20,051	18,428	20,370	19,569	12,446
Change in income tax valuation allowance	83	(255)	(143)	(2,805)	(2,662)	-	-	-
Adjusted net income	$ 12,869	$ 9,215	$ 8,943	$ 10,441	$ 10,209	$ 9,002	$ 5,081	$ 3,890
GAAP basic net income per share	$ 0.02	$ 0.03	$ 0.01	$ 0.25	$ 0.24	$ 0.26	$ 0.24	$ 0.15
GAAP diluted net income per share	$ 0.02	$ 0.03	$ 0.01	$ 0.22	$ 0.22	$ 0.24	$ 0.22	$ 0.14
Adjusted basic net income per share*	$ 0.09	$ 0.06	$ 0.06	$ 0.06	$ 0.06	$ 0.06	$ 0.03	$ 0.02
Adjusted diluted net income per share*	$ 0.08	$ 0.06	$ 0.05	$ 0.06	$ 0.06	$ 0.05	$ 0.03	$ 0.02
Shares used to compute basic net income per share	144,387	149,667	153,880	161,350	162,130	160,578	159,938	160,887
Shares used to compute diluted net income per share	157,626	163,094	169,033	178,053	180,919	178,913	177,337	176,923

Reconciliation of GAAP net income to adjusted EBITDA is as follows

	Quarters Ended							
	December 31, 2007	September 30, 2007	June 30, 2007	March 31, 2007	December 31, 2006	September 30, 2006	June 30, 2006	March 31, 2006
	(in thousands)							
Net income in accordance with GAAP	$ 2,685	$ 4,342	$ 1,327	$ 39,961	$ 39,302	$ 42,153	$ 38,878	$ 24,883
Interest income, net	(6,417)	(7,290)	(8,065)	(9,102)	(9,644)	(10,618)	(9,381)	(7,979)
Stock-based compensation	6,627	5,984	5,622	5,685	5,819	5,021	3,673	3,638
Loss (gain) on equity investments	34	-	(132)	-	3,116	-	(2,286)	-
Conversion of WiderThan stock options to a cash equivalent	190	413	614	845	641	-	-	-
Depreciation and amortization	5,703	6,210	5,661	4,621	4,970	3,692	3,522	3,525
Acquisitions related intangible asset amortization* (net of minority interest effect)	6,639	5,583	5,311	5,312	3,530	569	445	727
Gain on initial formation of Rhapsody America	-	(3,866)	-	-	-	-	-	
Expenses (benefit) related to antitrust litigation:								
Income	-	-	-	(61,000)	(61,000)	(62,000)	(58,000)	(40,000)
Expenses	179	201	202	471	1,026	1,000	997	971
Charitable contributions	-	-	-	1,921	2,009	1,889	1,805	1,225
Income taxes	47	2,012	2,178	23,219	19,357	25,908	22,521	14,751
Adjusted EBITDA	$ 15,687	$ 13,589	$ 12,718	$ 11,933	$ 9,126	$ 7,614	$ 2,174	$ 1,741

* 2006 results have been restated to include acquisition related intangible asset amortization and related tax impact to conform to the pro forma presentation for 2007.

RealNetworks, Inc. and Subsidiaries
Segment Results of Operations
(Unaudited)

	Quarter Ended December 31, 2007				
	Music [A]	Consumer [B]	TPS [C]	Other	Grand Total
			(in thousands)		
Net revenue	$ 40,540	$ 56,458	$ 59,884	$ -	$ 156,882
Cost of revenue	21,892	10,950	28,863	-	61,705
Gross profit	18,648	45,508	31,021	-	95,177
Gross margin	46%	81%	52%	-	61%
Operating expenses:					
Advertising with related party	16,613	-	-	-	16,613
Restructuring charge	-	-	-	3,748	3,748
Other operating expenses	28,817	38,246	33,489	145	100,697
Total operating expenses	45,430	38,246	33,489	3,893	121,058
Income (loss) from operations	(26,782)	7,262	(2,468)	(3,893)	(25,881)
Other income (expenses):					
Interest income, net	-	-	-	6,417	6,417
Minority interest	13,318	-	-	-	13,318
Gain on initial formation of Rhapsody America	-	-	-	-	-
Gain on sale of interest in Rhapsody America	8,464	-	-	-	8,464
Other income	-	-	-	414	414
Other income, net	21,782	-	-	6,831	28,613
Income (loss) before income taxes	$ (5,000)	$ 7,262	$ (2,468)	$ 2,938	$ 2,732

Reconciliation of segment GAAP income before taxes to segment adjusted EBITDA is as follows:

Income (loss) before income taxes	$ (5,000)	$ 7,262	$ (2,468)	$ 2,938	$ 2,732
Interest income, net	-	-	-	(6,417)	(6,417)
Stock-based compensation	1,296	2,283	3,048	-	6,627
Conversion of WiderThan stock options to a cash equivalent	-	-	190	-	190
Acquisition related intangible amortizatior[D]	384	911	5,344	-	6,639
Loss (gain) on equity investments	-	-	-	34	34
Gain on initial formation of Rhapsody America	-	-	-	-	-
Depreciation and amortization	1,187	1,928	2,588	-	5,703
Expenses (benefit) related to antitrust litigation:					
Income	-	-	-	-	-
Expenses	-	-	-	179	179
Charitable contributions	-	-	-	-	-
Adjusted EBITDA	$ (2,133)	$ 12,384	$ 8,702	$ (3,266)	$ 15,687

	Year Ended December 31, 2007				
	Music [A]	Consumer [B]	TPS [C]	Other	Grand Total
			(in thousands)		
Net revenue	$ 149,126	$ 211,851	$ 206,643	$ -	$ 567,620
Cost of revenue	81,462	39,840	92,189	-	213,491
Gross profit	67,664	172,011	114,454	-	354,129
Gross margin	45%	81%	55%	-	62%
Operating expenses:					
Advertising with related party	24,360	-	-	-	24,360
Restructuring charge	-	-	-	3,748	3,748
Other operating expenses	103,482	142,749	130,551	(58,060)	318,722
Total operating expenses	127,842	142,749	130,551	(54,312)	346,830
Income (loss) from operations	(60,178)	29,262	(16,097)	54,312	7,299
Other income (expenses):					
Interest income, net	-	-	-	30,874	30,874
Minority interest	19,784	-	-	-	19,784
Gain on initial formation of Rhapsody America	3,866	-	-	-	3,866
Gain on sale of interest in Rhapsody America	12,544	-	-	-	12,544
Other income	-	-	-	1,404	1,404
Other income, net	36,194	-	-	32,278	68,472
Income (loss) before income taxes	$ (23,984)	$ 29,262	$ (16,097)	$ 86,590	$ 75,771

Reconciliation of segment GAAP income before taxes to segment adjusted EBITDA is as follows:

Income (loss) before income taxes	$ (23,984)	$ 29,262	$ (16,097)	$ 86,590	$ 75,771
Interest income, net	-	-	-	(30,874)	(30,874)
Stock-based compensation	4,595	9,048	10,275	-	23,918
Conversion of WiderThan stock options to a cash equivalent	-	-	2,062	-	2,062
Acquisition related intangible amortizatior[D]	601	2,633	19,611	-	22,845
Loss (gain) on equity investments	-	-	-	(98)	(98)
Gain on initial formation of Rhapsody America	(3,866)	-	-	-	(3,866)
Depreciation and amortization	4,894	6,384	10,917	-	22,195
Expenses (benefit) related to antitrust litigation:					
Income	-	-	-	(61,000)	(61,000)
Expenses	-	-	-	1,053	1,053
Charitable contributions	-	-	-	1,921	1,921
Adjusted EBITDA	$ (17,760)	$ 47,327	$ 26,768	$ (2,408)	$ 53,927

Note: Cost of revenue and operating expenses of the segments shown above include costs directly attributable to those segments and an allocation of general and administrative and other common or shared costs.

(A) The Music segment primarily includes revenue and related costs from: Rhapsody America's Rhapsody and RadioPass subscription services; sales of digital music content through the Rhapsody service and the RealPlayer music store; and advertising from music websites.

(B) The Consumer segment primarily includes revenue and related costs from: the sale of individual games through our RealArcade service and our Games related websites including GameHouse, Mr. Goodliving, Zylom (acquired in January 2006), and Atrativa (acquired in Novemb 2006); our GamePass and FunPass subscription service; our SuperPass and stand-alone premium video subscription services; RealPlayer Plus and related products; sales and distribution of third-party software products; and all advertising other than that related directly to our Music businesses.

(C) TPS comprises our Technology Products and Services segment which includes revenue and related costs from: sales of ringback tone, music-on-demand, video-on-demand, messaging, and information services; sales of media delivery system software, including Helix system software and related authoring and publishing tools, both directly to customers and indirectly through original equipment manufacturer (OEM) channels; support and maintenance services sold to customers who purchase software products; broadcast hosting services; and consulting and professional services that are offered to customers.

(D) Net of minority interest effect within our Music segment.

RealNetworks, Inc. and Subsidiaries
Supplemental Financial Information
(Unaudited)

	Quarter Ended December 31, 2007					
	As Reported	Stock-Based Compensation	Acquisitions Related Intangible Asset Amortization (A)	WiderThan Options Converted to a Cash Equivalent	Antitrust Litigation Related	Adjusted
	(in thousands)					
Expenses in accordance with GAAP						
Cost of revenue	$ 61,705	$ (249)	$ (2,479)	$ (15)	$ -	$ 58,962
Operating expenses:						
Research and development	$ 27,719	$ (2,161)	$ -	$ (40)	$ -	$ 25,518
Sales and marketing	56,819	(2,388)	(4,160)	(135)	-	50,136
Advertising with related party	16,613	-	-	-	-	16,613
General and administrative	16,159	(1,829)	-	-	(179)	14,151
Restructuring charge	3,748	-	-	-	-	3,748
Total adjusted operating expenses, net	$ 121,058	$ (6,378)	$ (4,160)	$ (175)	$ (179)	$ 110,166

	Quarter Ended December 31, 2006				
	As Reported	Stock-Based Compensation	Acquisitions Related Intangible Asset Amortization (B)	Antitrust Litigation Related	Adjusted
	(in thousands)				
Expenses in accordance with GAAP					
Cost of revenue (B)	$ 42,320	$ (108)	$ (1,391)	$ -	$ 40,821
Operating expenses:					
Research and development	$ 22,259	$ (1,946)	$ -	$ -	$ 20,313
Sales and Marketing (B)	53,998	(2,440)	(2,139)	-	49,419
General and administrative	15,746	(1,325)	-	(2,891)	11,530
Antitrust litigation benefit, net	(60,856)	-	-	60,856	-
Total adjusted operating expenses, net (B)	$ 31,147	$ (5,711)	$ (2,139)	$ 57,965	$ 81,262

	Year Ended December 31, 2007					
	As Reported	Stock-Based Compensation	Acquisitions Related Intangible Asset Amortization (A)	WiderThan Options Converted to a Cash Equivalent	Antitrust Litigation Related	Adjusted
	(in thousands)					
Expenses in accordance with GAAP						
Cost of revenue	$ 213,491	$ (769)	$ (8,572)	$ (324)	$ -	$ 203,826
Operating expenses:						
Research and development	$ 102,731	$ (7,314)	$ -	$ (398)	$ -	$ 95,019
Sales and marketing	209,412	(9,373)	(14,273)	(973)	-	184,793
Advertising with related party	24,360	-	-	-	-	24,360
General and administrative	67,326	(4,633)	-	(368)	(2,542)	59,783
Restructuring charge	3,748	-	-	-	-	3,748
Antitrust litigation benefit, net	(60,747)	-	-	-	60,747	-
Total adjusted operating expenses, net	$ 346,830	$ (21,320)	$ (14,273)	$ (1,739)	$ 58,205	$ 367,703

	Year Ended December 31, 2006				
	As Reported	Stock-Based Compensation	Acquisitions Related Intangible Asset Amortization (B)	Antitrust Litigation Related	Adjusted
	(in thousands)				
Expenses in accordance with GAAP					
Cost of revenue (B)	$ 124,108	$ (257)	$ (2,201)	$ -	$ 121,650
Operating expenses:					
Research and development	$ 77,386	$ (6,512)	$ -	$ -	$ 70,874
Sales and Marketing (B)	165,602	(7,152)	(3,070)	-	155,380
General and administrative	57,332	(4,230)	-	(10,332)	42,770
Loss on excess office facilities	738	-	-	-	738
Antitrust litigation benefit, net	(220,410)	-	-	220,410	-
Total adjusted operating expenses, net (B)	$ 80,648	$ (17,894)	$ (3,070)	$ 210,078	$ 269,762

(A) - Net of minority interest effect within our Music segment.
(B) - 2006 results have been restated to include acquisition related intangible asset amortization to conform to the pro forma presentation for 2007.

RealNetworks, Inc. and Subsidiaries
Supplemental Financial Information
(Unaudited)

A reconciliation of GAAP net income guidance for the quarter ending March 31, 2008 and the full year ending December 31, 2008 to EBITDA guidance is as follows:

	Quarter Ending March 31, 2008		Year Ending December 31, 2008	
	Low	High	Low	High
	(in millions)			
Net income in accordance with GAAP	$ (13.2)	$ 2.4	$ (14.0)	$ (5.0)
Interest income, net & Other	(4.5)	(4.8)	(13.0)	(14.0)
Stock-based compensation and conversion of WiderThan stock options to a cash equivalent	5.8	7.3	24.0	30.0
Depreciation and amortization, including acquisitions related intangible asset amortization* (net of minority interest effect)	13.4	12.2	56.0	51.0
Income taxes	7.5	(5.1)	8.0	11.0
Total EBITDA	$ 9.0	$ 12.0	$ 61.0	$ 73.0

B

Wal-Mart Demands CD-Price Cut

Struggling labels stand to lose tens of millions of dollars

By Steve Knopper

WAL-MART, THE NATION'S largest music retailer, has threatened to stop selling CDs entirely if the major record labels don't drastically slash prices, according to music-industry sources. The superstore has insisted that the labels lower wholesale prices enough that the chain can profitably sell hits for $10 to $12, popular catalog titles for $7 to $9 and budget albums for as little as $5. (Most albums at Wal-Mart currently go for $13.99; some special promotions are priced at $9.72.)

After a fifteen percent decrease in album sales last year and another twelve percent so far in 2008, labels may have no choice but to agree to the terms – even though the new pricing structure will cost them "tens of millions in profit margins" a year, according to a label source. (Wal-Mart denied threatening to stop selling music.) "It's a death spiral, without question," says Jim Caparro, chairman of the Entertainment Distribution Company, which manufactures and distributes CDs for Universal Music Group, the largest of the four majors. "However, you could look at it another way and take the view that seventy percent of something is better than 100 percent of nothing."

Wal-Mart, which draws 127 million consumers a week into its stores, accounts for sixteen percent of domestic music sales. The store is powerful enough that it can bypass the record industry entirely, as it did with the Eagles' *Long Road Out of Eden*, which sold 2.6 million copies exclusively through Wal-Mart, according to Nielsen SoundScan, becoming 2007's third-biggest-selling album. (Wal-Mart has signed a similar deal with Journey, who are releasing a three-disc set, *Revelation*, on June 3rd.)

The chain, which has traditionally used music as a "loss leader" to draw consumers into stores, has reduced shelf space by twenty percent in recent years, leaving even the largest locations with a catalog of only 4,000 or so titles. Label sources say the chain could reduce music space another twenty percent in 2008 to make more room for DVDs and video games. (Wal-Mart declined to comment on future cuts.)

"The price discussion in music is not new," says Jeff Maas, Wal-Mart's home-entertainment-merchandise manager. In 2004, the chain unsuccessfully leaned on label executives to reduce their wholesale CD prices in an attempt to drop consumer prices from about $13.88 to $10. "The labels price things based on what they believe they can get – a pricing philosophy a lot of industries have," a Wal-Mart senior vice president, Gary Severson, told ROLLING STONE at the time. "But we like to price things as cheaply as we possibly can, rather than charge as much as we can get. It's a big difference in philosophy."

But the struggling labels have far less leverage than they did four years ago – and several major-label sources predict Wal-Mart will get its way, which would mean new prices in mid-May. And another source says word of Wal-Mart's proposal has already prompted other top retailers to demand similar decreases – a recipe for unsustainable label profit margins. "We'd probably have to fire another couple of thousand employees and get down to a handful here," says a major-label source. "And that wouldn't work."

According to a new survey by the NPD Group, a consumer-research firm, the spending on music declined from $44 to $40 per person in 2007, a decrease of ten percent, as 1 million people dropped out of the CD-buying market. And while an astonishing forty-eight percent of teenagers bought no CDs last year, Apple's iTunes store became the nation's number-two music retailer in February. (Apple has sold more than 4 billion songs since it opened in April 2003 and has 50 million customers.)

All of this is bad news for the struggling record biz, which is now facing its biggest outlet cutting prices and shelf space, and its second-biggest client selling digital downloads for a low-profit 99 cents apiece. "That's the real underlying problem of the industry: The kids have stopped buying records," says Russ Solomon, founder of the now-defunct Tower Records and owner of the Sacramento store R5 Records and Video. "Just reducing [CD prices] to $10 doesn't solve that problem."

UNDER PRESSURE

1. Wal-Mart is insisting that labels drop prices to as little as $5, or the store will stop selling CDs.
2. The chain is such a music-biz powerhouse that the Eagles sold 2.6 million copies of their 2007 disc at Wal-Mart.

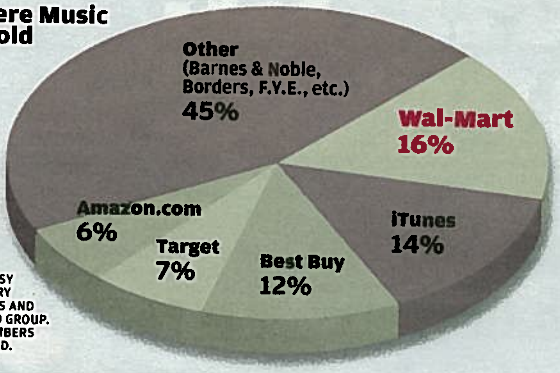
The New Music Market

Wal-Mart – the nation's top music retailer – is demanding that most CDs sell for $10 or less, potentially costing labels tens of millions of dollars a year. It's not the only bad news for the biz: iTunes (which specializes in low-profit 99-cent downloads) is now the number-two store, as CDs have increasingly become a niche product for older fans.

CD, Digital Sales By Age

AGE	% BUY CDS	% BUY DIGITAL
13-17	10	14
18-25	15	21
26-35	19	27
36-50	32	32
51+	25	5

Where Music Is Sold



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