FORM S-1 · REGISTRATION STATEMENT

Realnetworks Inc

IPO priced 1997-11-21 · $12.50 a share · RNWK



From S1 Directory · www.s1directory.com/s1/realnetworks-inc/ · Source: https://www.sec.gov/Archives/edgar/data/1046327/000089102097001263/0000891020-97-001263.txt

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON SEPTEMBER 26, 1997 REGISTRATION NO. 333-

SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549

FORM S-1 REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

REALNETWORKS, INC. (EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

WASHINGTON	7371	91-1628146
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(PRIMARY STANDARD INDUSTRIAL CLASSIFICATION CODE NUMBER)	(I.R.S. EMPLOYER IDENTIFICATION NO.)

1111 THIRD AVENUE, SUITE 2900 SEATTLE, WASHINGTON 98101 (206) 674-2700 (ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER, INCLUDING AREA CODE, OF REGISTRANT'S PRINCIPAL EXECUTIVE OFFICES) ROBERT GLASER, CHIEF EXECUTIVE OFFICER 1111 THIRD AVENUE, SUITE 2900 SEATTLE, WASHINGTON 98101 (206) 674-2700 (NAME, ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER, INCLUDING AREA CODE, OF AGENT FOR SERVICE)

COPIES TO:

LAURA T. PUCKETT JOHN M. STEEL ALAN KOSLOW GRAHAM & JAMES LLP/RIDDELL WILLIAMS P.S. 1001 FOURTH AVENUE PLAZA, SUITE 4500 SEATTLE, WASHINGTON 98154	CHARLES J. KATZ, JR. SCOTT L. GELBAND PERKINS COIE 1201 THIRD AVENUE, 40TH FLOOR SEATTLE, WASHINGTON 98101-3099

APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO PUBLIC: AS SOON AS PRACTICABLE AFTER THIS REGISTRATION STATEMENT BECOMES EFFECTIVE.

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, CHECK THE FOLLOWING BOX: [ ] 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: [ ] _____ IF THIS FORM IS A POST-EFFECTIVE AMENDMENT FILED PURSUANT TO RULE 462(C) UNDER THE SECURITIES ACT, CHECK THE FOLLOWING BOX AND LIST THE SECURITIES ACT REGISTRATION STATEMENT NUMBER OF THE EARLIER EFFECTIVE REGISTRATION STATEMENT FOR THE SAME OFFERING: [ ] _____ IF DELIVERY OF THE PROSPECTUS IS EXPECTED TO BE MADE PURSUANT TO RULE 434, PLEASE CHECK THE FOLLOWING BOX: [ ]

CALCULATION OF REGISTRATION FEE

TITLE OF EACH CLASS OF SECURITIES TO BE REGISTERED	AMOUNT TO BE REGISTERED(1)	PROPOSED MAXIMUM OFFERING PRICE PER UNIT(2)	PROPOSED MAXIMUM AGGREGATE OFFERING PRICE(2)	AMOUNT OF REGISTRATION FEE
Common Stock, par value $.001 per share.....	shares	$	$34,500,000	$10,455

(1) INCLUDES SHARES THAT MAY BE PURCHASED BY THE UNDERWRITERS TO COVER OVER-ALLOTMENTS, IF ANY.

(2) ESTIMATED SOLELY FOR THE PURPOSE OF CALCULATING THE REGISTRATION FEE PURSUANT TO RULE 457(A).

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 THIS REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(A), MAY DETERMINE.

INFORMATION CONTAINED HEREIN IS SUBJECT TO COMPLETION OR AMENDMENT. A REGISTRATION STATEMENT RELATING TO THESE SECURITIES HAS BEEN FILED WITH THE SECURITIES AND EXCHANGE COMMISSION. THESE SECURITIES MAY NOT BE SOLD NOR MAY OFFERS TO BUY BE ACCEPTED PRIOR TO THE TIME THE REGISTRATION STATEMENT BECOMES EFFECTIVE. THIS PROSPECTUS SHALL NOT CONSTITUTE AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY NOR SHALL THERE BE ANY SALE OF THESE SECURITIES IN ANY STATE IN WHICH SUCH OFFER, SOLICITATION OR SALE WOULD BE UNLAWFUL PRIOR TO REGISTRATION OR QUALIFICATION UNDER THE SECURITIES LAWS OF ANY SUCH STATE.

SUBJECT TO COMPLETION, DATED SEPTEMBER 26, 1997

SHARES [REALNETWORKS LOGO] REALNETWORKS, INC. (FORMERLY "PROGRESSIVE NETWORKS, INC.")

COMMON STOCK (PAR VALUE $.001 PER SHARE)

All of the shares of Common Stock offered hereby are being sold by RealNetworks, Inc. Prior to the offering, there has been no public market for the Common Stock. It is currently estimated that the initial public offering price will be between $ and $ per share. For factors considered in determining the initial public offering price, see "Underwriting".

THE COMMON STOCK OFFERED HEREBY INVOLVES A HIGH DEGREE OF RISK. SEE "RISK FACTORS" BEGINNING ON PAGE 6.

APPLICATION HAS BEEN MADE FOR QUOTATION OF THE COMMON STOCK ON THE NASDAQ NATIONAL MARKET UNDER THE SYMBOL "RNWK".

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	INITIAL PUBLIC OFFERING PRICE	UNDERWRITING DISCOUNT(1)	PROCEEDS TO COMPANY(2)
Per Share.....	$	$	$
Total(3).....	$	$	$

(1) THE COMPANY HAS AGREED TO INDEMNIFY THE UNDERWRITERS AGAINST CERTAIN LIABILITIES, INCLUDING LIABILITIES UNDER THE SECURITIES ACT OF 1933, AS AMENDED. SEE "UNDERWRITING".

(2) BEFORE DEDUCTING ESTIMATED EXPENSES OF $ PAYABLE BY THE COMPANY.

(3) The Company has granted the Underwriters an option for 30 days to purchase up to an additional shares at the initial public offering price per share, less the underwriting discount, solely to cover over-allotments. If such option is exercised in full, the total initial public offering price, underwriting discount and proceeds to Company will be $, $ and $, respectively. See "Underwriting".

THE SHARES OFFERED HEREBY ARE OFFERED SEVERALLY BY THE UNDERWRITERS, AS SPECIFIED HEREIN, SUBJECT TO RECEIPT AND ACCEPTANCE BY THEM AND SUBJECT TO THEIR RIGHT TO REJECT ANY ORDER IN WHOLE OR IN PART. IT IS EXPECTED THAT CERTIFICATES FOR THE SHARES WILL BE READY FOR DELIVERY IN NEW YORK, NEW YORK ON OR ABOUT , 1997, AGAINST PAYMENT THEREFOR IN IMMEDIATELY AVAILABLE FUNDS.

GOLDMAN, SACHS & CO. MONTGOMERY SECURITIES ROBERTSON, STEPHENS & COMPANY THE DATE OF THIS PROSPECTUS IS , 1997.

[SCREEN-SHOTS OF WEB PAGES SUPERIMPOSED OVER COMPANY LOGO] CERTAIN PERSONS PARTICIPATING IN THE OFFERING MAY ENGAGE IN TRANSACTIONS THAT STABILIZE, MAINTAIN, OR OTHERWISE AFFECT THE PRICE OF THE COMMON STOCK OF THE COMPANY, INCLUDING OVER-ALLOTMENT, STABILIZING AND SHORT-COVERING TRANSACTIONS IN SUCH SECURITIES, AND THE IMPOSITION OF A PENALTY BID, IN CONNECTION WITH THE OFFERING. FOR A DESCRIPTION OF THESE ACTIVITIES, SEE "UNDERWRITING".

CD-ROM INSERTED HERE

THE CD-ROM CONTAINS THE REALPLAYER, WHICH IS AVAILABLE FOR DOWNLOAD FREE OF CHARGE FROM THE COMPANY'S WEB SITE. THE CD-ROM IS CONTAINED IN AN ENVELOPE BOUND INTO THE PROSPECTUS, WITH A CLEAR CIRCULAR WINDOW THAT ALLOWS THE TOP OF THE CD-ROM TO BE SEEN. THE CD-ROM IS LAMINATED WITH THE COMPANY'S LOGO AND THE REALPLAYER LOGO, AS WELL AS THE FOLLOWING LANGUAGE: "FOR WINDOWS 95, WINDOWS NT AND MACINTOSH."

Prospectus Summary

The following summary is qualified in its entirety by the more detailed information and Consolidated Financial Statements and Notes thereto appearing elsewhere in this Prospectus, including the information under "Risk Factors."

Unless otherwise indicated, all information in this Prospectus (i) assumes that the Underwriters' over-allotment option will not be exercised; (ii) reflects an amendment to the Company's Amended and Restated Articles of Incorporation (the "Articles") to change the Company's authorized capital stock to Common Stock, Special Common Stock and preferred stock effective on the closing of the offering; (iii) reflects the conversion of each outstanding share of the Company's Series A Common Stock, Series B Common Stock, Series C Common Stock, Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and Series D Preferred Stock into one share of Common Stock effective on closing of the offering; (iv) reflects the conversion of each outstanding share of the Company's Series E Preferred Stock, at the election of the holder, into one share of Common Stock, rather than Special Common Stock, on closing of the offering; and (v) assumes the issuance of shares of Common Stock reflecting exercise of outstanding warrants on closing of the offering, except as noted hereinafter. See "Description of Capital Stock."

The Company

RealNetworks is a leading provider of branded software products and services that enable the delivery of streaming media content over the Internet and intranets. Streaming technology enables the transmission and playback of continuous "streams" of multimedia content, such as audio and video, over the Internet and intranets and represents a significant advancement over earlier technologies. The Company's products and services include its RealAudio and RealVideo software system, an electronic commerce Web site designed to promote the proliferation of streaming media products and a network of advertising-supported content aggregation Web sites.

The Company believes that the emergence of rich multimedia capabilities, such as streaming audio and video, has significantly enhanced the effectiveness of the Web as a global mass communications medium. These enhanced multimedia capabilities, combined with the unique interactive properties of the Internet, are attracting a large and expanding audience, a growing number of advertisers and an increasing breadth and depth of content and online commercial applications. As the Web continues to evolve as a mass communications medium, the Company believes that an increasing amount of the types of content currently delivered through traditional media, such as radio and television, will be

delivered over the Internet. The Company believes that streaming media technology is essential to this evolution because it provides a more compelling user experience, allowing the Internet to compete more effectively with traditional media for audience share.

From its inception, the Company has strategically chosen to offer its RealPlayer software to individual users free of charge to promote the widespread adoption of its client software and to speed the acceptance of Internet multimedia. The Company believes that more than 18 million copies of its RealPlayer software have been downloaded and that over 200,000 copies of its premium client product, RealPlayer Plus, have been sold electronically in the product's first year of distribution. In addition, the Company believes that more than 55,000 hours per week of live audio and video content are broadcast over the Web using RealAudio and RealVideo technology, and that more than 150,000 Web pages use the Company's software. As a result of these activities and the Company's aggressive promotional programs, the Company believes that its "Real" brand has become one of the most widely recognized brands on the Internet. The Company's customers, including ABC Radio Net, Bloomberg Online, The Boeing Company, Dow Jones & Company, Inc., NBC Desktop, News Corporation, Starwave Corporation and 3Com Corporation, use its software products and services to deliver a broad range of streaming audio and video news, sports, entertainment and corporate information over the Internet and intranets.

The Company's objective is to be the leading streaming media company, providing software and services that enable the delivery of a broad range of multimedia content over the Internet and intranets, thereby facilitating the evolution of the Internet into a mass communications and commerce medium. The key elements of this strategy include the extension of the Company's technology leadership, a continued focus on product ubiquity and brand leadership, the continued development of its electronic commerce and content aggregation businesses, a focus on providing cross-platform product solutions that operate in a wide variety of bandwidth environments, and the strengthening and expansion of strategic relationships.

The Company was incorporated in Washington in February 1994. Unless the context otherwise requires, the term "Company" or "RealNetworks" refers to RealNetworks, Inc. and its subsidiaries: RealNetworks, SARL, RealNetworks, Limited and Progressive Networks Kabushiki Kaisha. Prior to September 26, 1997, the Company's name was "Progressive Networks, Inc." The Company's principal executive offices are located at 1111 Third Avenue, Suite 2900, Seattle, Washington 98101, and its telephone number is (206) 674-2700. Information contained on the Company's Web sites will not be deemed to be part of this Prospectus.

RealAudio(R), RealVideo(R), RealPlayer(TM), RealPlayer Plus(TM), EasyStart(TM), RealNetworks(TM), Real(TM), the Real logo, RealStore(TM), Film.com(TM), Daily Briefing(TM) and Timecast(TM) are registered and unregistered trademarks, service marks and trade names of the Company. This Prospectus also includes trademarks, service marks and trade names other than those identified in this paragraph, all of which are the property of their respective holders.

The Offering

Common Stock offered by the Company.....	shares
Common Stock to be outstanding after the offering:	
Common Stock.....	shares(1)
Special Common Stock.....	0 shares(1)
Use of proceeds.....	Working capital requirements and other general corporate purposes. See "Use of Proceeds."
Proposed Nasdaq National Market symbol.....	"RNWK"

(1) Excludes 13,400,000 shares of Common Stock reserved for issuance under the Company's 1995 Stock Option Plan, Amended and Restated 1996 Stock Option Plan and 1998 Employee Stock Purchase Plan. See "Management -- Benefit Plans." Also excludes up to 3,709,305 shares of Common Stock or Special Common Stock issuable on exercise of a warrant to purchase Series E Preferred Stock at an exercise price of $13.48 per share (the "Series E Warrant") that terminates on the closing of the offering. The holder of the Series E Preferred Stock may elect to receive Common Stock or Special Common Stock, or a combination thereof, upon conversion of the Series E Preferred Stock. The Special Common Stock may only be converted into Common Stock upon the prior written consent of the Company's Board of Directors. Assumes 3,338,374 shares of Series E Preferred Stock convert into an equal number of shares of Common Stock. See "Risk Factors -- Control by Mr. Glaser; Antitakeover Provisions," "-- Impact of Exercise of the Series E Warrant; Election by Microsoft to Receive Common Stock Or Special Common Stock" and "Description of Capital Stock -- Common Stock."

Summary Consolidated Financial Data (In Thousands, Except Per Share Data)

The following summary consolidated financial data should be read in conjunction with the Company's Consolidated Financial Statements and Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations," included elsewhere in this Prospectus. The summary consolidated financial data for the period from February 9, 1994 (inception) to December 31, 1994, for the years ended December 31, 1995 and 1996, and as of December 31, 1996, are derived from the Consolidated Financial Statements of the Company audited by KPMG Peat Marwick LLP, independent accountants. The summary consolidated financial data as of June 30, 1997 and for the six months ended June 30, 1996 and 1997 are derived from unaudited consolidated financial statements prepared by the Company on a basis consistent with the Company's audited Consolidated Financial Statements and, in the opinion of management, include all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation of the results for such periods. Operating results for the six months ended June 30, 1997 are not necessarily indicative of the results that may be expected for any other interim period or for the year ending December 31, 1997.

PERIOD FROM FEBRUARY 9, 1994 (INCEPTION) TO DECEMBER 31,	YEAR ENDED DECEMBER 31,	SIX MONTHS ENDED JUNE 30,

	1994	1995	1996	1996	1997
				(UNAUDITED)	
STATEMENT OF OPERATIONS DATA:					
Total net revenues	$ --	$ 1,812	$14,012	$ 4,244	$13,366
Total cost of revenues	--	62	2,185	395	3,054
Gross profit	--	1,750	11,827	3,849	10,312
Operating loss	(545)	(1,595)	(4,016)	(1,566)	(6,808)
Net loss	(545)	(1,501)	(3,789)	(1,449)	(6,372)
Pro forma net loss per share			$ ( )		$ ( )
Shares used to compute pro forma net loss per share(1)					

	DECEMBER 31,	JUNE 30, 1997	
	1996	ACTUAL	AS ADJUSTED(2)
		(UNAUDITED)	
BALANCE SHEET DATA:			
Cash, cash equivalents and short-term investments	$ 19,595	$11,496	$
Working capital	16,893	8,879	
Total assets	26,468	22,148	
Redeemable, convertible preferred stock	23,153	23,264	
Shareholders' equity (deficit)	(3,320)	(9,764)	

(1) For an explanation of the number of shares used to compute pro forma net loss per share, see Note 1 of Notes to Consolidated Financial Statements.

(2) As adjusted to give effect to the (i) issuance in July 1997 of 3,338,374 shares of Series E Preferred Stock at $8.99 per share; (ii) conversion of all outstanding shares of Series A Common Stock, Series B Common Stock, Series C Common Stock, Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and Series E Preferred Stock into Common Stock on closing of the offering; (iii) sale by the Company of the shares of Common Stock offered hereby at an assumed initial public offering price of $ per share (after deducting the underwriting discount and estimated expenses of the offering); and (iv) application of the estimated net proceeds of the offering. Excludes up to 3,709,305 shares of Common Stock or Special Common Stock (representing additional cash and shareholders' equity of up to $50,001,431) issuable on exercise of the Series E Warrant. See "Use of Proceeds," "Capitalization" and "Description of Capital Stock."

Risk Factors

In addition to the other information contained in this Prospectus, investors should consider carefully the following risk factors before making an investment decision concerning the Common Stock. This Prospectus contains forward-looking statements that involve risks and uncertainties. The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under "Risk Factors" and elsewhere in this Prospectus.

Limited Operating History; Accumulated Deficit and Anticipated Future Losses

The Company was incorporated in February 1994 and did not recognize any revenue until July 1995, when the Company began delivery of the commercial version of RealAudio Version 1.0. Accordingly, the Company has a limited operating history on which an evaluation of the Company and its prospects can be based. The Company's prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in early stages of development, particularly companies in rapidly evolving markets such as media delivery and electronic commerce over the Internet and intranets. The Company has incurred significant losses since its inception and expects to continue to incur substantial operating losses for the foreseeable future. As of June 30, 1997, the Company had an accumulated deficit of $12.4 million. To achieve and sustain profitability, the Company must, among other things, establish widespread market acceptance of its existing products, successfully develop new products and services, respond quickly and effectively to competitive, market and technological developments, expand sales and marketing operations, broaden customer support capabilities, control expenses and continue to attract and retain qualified personnel. In addition, market prices for the Company's products must attain a level at which the Company can generate revenues in excess of its anticipated operating and other expenses. There can be no assurance that the Company will achieve or sustain profitability. See "-- Unpredictability of Future Revenues; Potential Fluctuation in Quarterly Operating Results," "-- Competition; Relationship With Microsoft" and "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Overview."

Unpredictability of Future Revenues; Potential Fluctuation in Quarterly Operating Results

As a result of the Company's limited operating history and the emerging nature of the markets in which it competes, the Company is unable to forecast accurately its revenues. The Company expects to experience significant fluctuations in its future quarterly operating results due to a variety of factors, many of which are outside the Company's control, including (i) demand for the Company's products and services, (ii) introduction or enhancement of products and services by the Company and its competitors, (iii) market acceptance of new products and services of the Company and its competitors, (iv) price reductions by the Company or its competitors or changes in how products and services are priced (such as the Company's recent decision to distribute free of charge a version of its basic EasyStart Server, which previously sold for $295 to $995), (v) the mix of products and services sold by the Company and its competitors, (vi) the mix of distribution channels through which the Company's products are licensed and sold, (vii) the mix of international and North American revenues, (viii) costs of litigation and intellectual property protection, (ix) the growth in the use of the Internet, (x) the Company's ability to attract and retain qualified personnel, (xi) the amount and timing of operating costs and capital expenditures related to expansion of the Company's business, operations and

infrastructure, (xii) technical difficulties with respect to the use of the Company's products, (xiii) governmental regulations and (xiv) general economic conditions and economic conditions specifically related to the Internet. It is often difficult to forecast what the effect of such factors would be, or the effect that any such factors or any combination thereof would have, on the Company's results of operations for any given fiscal quarter. There can be no assurance that the Company will be able to achieve historical revenue levels or maintain its historical growth rate. The Company has used, and expects to continue to use, price promotions to increase trial, purchase and use of its products, as well as to increase the overall recognition of its brands. The effect of such promotions on revenues in a particular period may be significant and extremely difficult to forecast. Based on the foregoing, the Company believes that its quarterly revenues, expenses and operating results could vary significantly in the future, and that period-to-period comparisons should not be relied upon as indications of future performance.

Historically, the Company has received a significant portion of its revenues from a limited number of sales and license agreements. The Company believes that a customer's decision to purchase its server products or license its technology is relatively discretionary and, for large-scale users, generally involves a significant commitment of capital resources. Therefore, any downturn in the economy or in the business of potential customers could have a material adverse effect on the Company's revenues and quarterly results.

The Company generally makes available its software products in "beta" form to the public prior to finalizing product features, functionality and operability. This may cause certain customers to delay purchasing decisions until final versions of the products are available, which could have a material adverse effect on the Company's revenues and quarterly results.

The Company derives a significant portion of its revenues from the sale of technical support services and software upgrades to its installed customer base. There can be no assurance that a sufficient number of the Company's customers will continue to enter into support and upgrade contracts or will renew existing support and upgrade contracts, or that revenues therefrom will continue to be significant. The loss of a material portion of such revenues would likely have a material adverse effect on the Company's business, financial condition and results of operations.

Management has observed that revenues from advertising sales have tended to be higher in the second and fourth quarters, and retail sales have tended to be highest in the fourth quarter. The Company typically operates with little or no backlog. As a result, quarterly sales and operating results depend primarily on the volume and timing of orders received in the quarter, both of which are difficult to forecast. The Company typically recognizes a substantial portion of its revenues in the last month of each quarter.

As a result of the Company's limited operating history, the Company does not have relevant historical financial data for a significant number of periods on which to base planned operating expenses. The Company's expense levels are based in part on its expectations with regard to future revenues. The Company may be unable to adjust spending in a timely manner to compensate for any unexpected revenue shortfall. As a result, any significant shortfall in demand for the Company's products and

services relative to the Company's expectations would have an immediate material adverse effect on the Company's business, financial condition and results of operations. Due to the foregoing factors, it is likely that in some future quarters the Company's operating results will fall below the expectations of securities analysts and investors, which would likely have a material adverse effect on the trading price of the Common Stock. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Competition; Relationship with Microsoft

The market for software and services for the Internet and intranets is relatively new, constantly evolving and intensely competitive. The Company expects that competition will intensify in the future. Many of the Company's current and potential competitors have longer operating histories, greater name recognition and significantly greater financial, technical and marketing resources than the Company.

The Company engages primarily in the sale and licensing of audio and video streaming products and services, electronic commerce and Internet advertising. The Company's principal competitors in the development and distribution of audio and video streaming solutions include Microsoft Corporation ("Microsoft"), VXtreme, Inc. ("VXtreme"), VDOnet Corporation ("VDOnet"), Xing Technology Corporation ("Xing"), Precept Software, Inc. ("Precept"), Cubic VideoComm, Inc. ("Cubic"), Motorola, Inc. ("Motorola"), VivoActive Software, Inc. ("Vivo"), Vosaic LLC ("Vosaic") and Oracle Corporation ("Oracle"). The Company's RealAudio and RealVideo system also competes to a lesser degree with non-streaming audio and video delivery technologies such as AVI and Quicktime, and indirectly with delivery systems for multimedia content other than audio and video, such as Flash by Macromedia Inc. ("Macromedia") and Enliven by Narrative Communications Corp. ("Narrative"). Competitive factors in this market include the quality and reliability of software; features for creating, editing and adapting content; ease of use and interactive user features; scaleability and cost per user; and compatibility with the user's existing network components and software systems. To expand its user base and further enhance the user experience, the Company must continue to innovate and improve the performance of its RealAudio and RealVideo system. The Company is committed to the continued market penetration of its brand, products and services. The Company may, as a strategic response to changes in the competitive environment, implement pricing, licensing, service or marketing changes designed to extend its current brand and technology franchise. For example, the Company recently made a version of its EasyStart Server, which had previously sold for $295 to $995, available for download free of charge. Continued price concessions or the emergence of other pricing or distribution strategies by competitors may have a material adverse effect on the Company's business, financial condition and results of operations.

The Company derives significant revenues from sales of RealPlayer Plus, an enhanced version of its free player product. The Company's ability to continue to generate revenues from sales of RealPlayer Plus is in large part dependent on its ability to differentiate the features and functionality of RealPlayer Plus from its own and competitors' free and for sale player products. In addition, the demand for

RealPlayer Plus is in part contingent on the demand for and the volume of free player products in the market. The Company's failure to continue to differentiate RealPlayer Plus, or to stimulate demand for its free player or RealPlayer Plus, may have a material adverse effect on the Company's business, financial condition or results of operations.

The Company anticipates that consolidation will continue in the streaming media industry and related industries such as computer software, media and communications. Competitors may be acquired by, receive investments from or enter into other commercial relationships with, larger, well-established and well-financed companies. For instance, Microsoft recently acquired VXtreme, a direct competitor of the Company in the market for streaming media software. Microsoft also owns a minority interest in VDOnet, a direct competitor of the Company in the market for streaming video software. In addition, in June 1997 the Company and Microsoft entered into a strategic agreement pursuant to which Microsoft purchased a minority interest in the Company. See "-- Department of Justice Subpoena," "Business -- Microsoft Relationship" and "Certain Transactions."

In connection with the Microsoft agreement, the Company granted Microsoft a nonexclusive license to certain substantial elements of the source code of the Company's RealAudio/RealVideo Version 4.0 technology, including its basic RealPlayer and substantial elements of its EasyStart Server products, and related Company trademarks. Under the agreement, Microsoft may sublicense its rights to the RealAudio/RealVideo Version 4.0 technology to third parties under certain circumstances. The agreement also provides for substantial refunds to Microsoft under prescribed circumstances that are solely within the Company's control. The amount of these refunds diminishes over time. The Company may not assign its obligations under the agreement without Microsoft's consent. Microsoft is obligated to distribute the Company's RealPlayer Version 4.0 for a defined term as long as the Company's player supports certain Microsoft architectures. The Company also agreed to work with Microsoft and several other companies to author and promote the Active Streaming Format ("ASF") as a standard file format for streaming media. The agreement also requires the Company to provide Microsoft with engineering consultation services, certain error corrections, and certain technical support over a defined term. As a result of Microsoft's agreement with the Company, its acquisition of VXtreme and its investment in VDOnet, Microsoft will be able to augment substantially the functionality of NetShow, its own streaming media product, which could have a material adverse effect on the competitiveness of the Company's products. See "-- Impact of Evolving Standards," "-- Uncertain Protection of Intellectual Property; Risks Associated With Licensed Third-Party Technology" and "Business -- Microsoft Relationship."

Microsoft currently competes with the Company in the market for streaming media server and player software. The Company believes that Microsoft will compete more directly with the Company in the future. The Company also believes that Microsoft's commitment to and presence in the streaming media industry will dramatically increase competitive pressure in the overall market for streaming media software, leading to, among other things, increased pricing pressure and longer sales cycles. Such pressures may result in further price reductions in the Company's products and may also materially reduce the Company's market share. The Company believes that Microsoft will incorporate streaming media technology in its Web browser software and certain of its server software offerings, possibly at

no additional cost to the user. In addition, notwithstanding the Company's cooperation with Microsoft regarding ASF, Microsoft may promote technologies and standards not compatible with the Company's technology. Microsoft has a longer operating history, a larger installed base of customers and dramatically greater financial, distribution, marketing and technical resources than the Company. As a result, there can be no assurance that the Company will be able to compete effectively with Microsoft now or in the future, or that the Company's business, financial condition and results of operations will not be materially adversely affected. In addition, if considerable industry consolidation occurs, there can be no assurance that the Company will be able to continue to compete effectively. See "Business -- Sales, Marketing and Distribution" and "-- Microsoft Relationship."

The Company currently derives significant revenues from the electronic distribution of certain of its products. The Company recently opened its RealStore Web site, an online store for the sale of the Company's products, third-party streaming media tools and utilities, and intranet-based training products. The Company competes with a variety of Web sites, such as Buydirect.Com and Software.Net, which also offer software products for download. To compete successfully in the electronic commerce market, the Company must attract sufficient commercial traffic to its RealStore Web site by offering high-quality merchandise in a compelling, easy-to-purchase format. There can be no assurance that the Company will be able to compete successfully in this market, and any failure to do so could have a material adverse effect on the Company's business, financial condition and results of operations. See "Business -- Products and Services" and "-- Competition."

In the Internet advertising segment, the Company competes for Internet advertising revenues with a wide variety of Web sites and Internet service providers. While Internet advertising revenues across the industry continue to grow, the number of Web sites competing for such revenue is also growing rapidly. The Company's advertising sales force and infrastructure are still in early stages of development relative to the Company's competitors. There can be no assurance that advertisers will place advertising with the Company or that revenues derived from such advertising will be material. In addition, if the Company loses advertising customers, fails to attract new customers, is forced to reduce advertising rates or otherwise modify its rate structure to retain or attract customers, or loses Web site traffic, the Company's business, financial condition and results of operations may be materially adversely affected. See "Business -- Products and Services" and "-- Competition."

Department of Justice Subpoena

Shortly after the Company entered into its strategic agreement with Microsoft, Microsoft acquired VXtreme and announced that it would incorporate the VXtreme technology, which competes with the Company's technology licensed to Microsoft, into its NetShow product. In addition, Microsoft owns a minority interest in VDOnet, a direct competitor of the Company, and has selected VDOnet as a Microsoft Solution Provider for NetShow-based products. Microsoft's acquisitions, investments and agreements in the streaming media industry prompted a U.S. Department of Justice investigation into horizontal merger activities within the industry. In August 1997, the Department of Justice served several companies, including the Company and Microsoft, with subpoenas to produce certain

documents. The investigation, including interviews of Company officers by Department of Justice personnel and document production requests, is ongoing. The Company is cooperating fully with the Department of Justice's investigation. See "-- Competition; Relationship With Microsoft" and "Business -- Microsoft Relationship."

As a result of the investigation, it is possible that the Department of Justice will require certain actions by the Company, Microsoft or other companies in the streaming media industry that could have a material adverse effect on the Company's business, financial condition and results of operations. The Department of Justice could decide to take action that could materially and adversely affect the Company's current relationship with Microsoft or other companies, that affect Microsoft's obligations with respect to the distribution of the Company's products, result in certain penalties, require the Company to refund all or a portion of the license fee paid by Microsoft to the Company, require Microsoft to limit or divest certain of its acquisitions or investments in the streaming media industry, including its investment in the Company, and, if Microsoft were forced to rescind its agreement with the Company, place the Company at a significant competitive disadvantage within the industry. There can be no assurance that any such outcome would not have an immediate material adverse effect on the Company's business, financial condition and results of operations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources."

DEVELOPING MARKET; DEPENDENCE ON THE INTERNET AND INTRANETS AS MEDIUMS OF COMMERCE AND COMMUNICATIONS The market for the Company's streaming media products and services, especially the market for the Company's intranet products and services, has begun only recently to develop and is evolving rapidly, with continuing new developments in technology, product distribution methods, and marketing and licensing relationships. The development of a market for the Company's streaming media products also depends on increased use of the Internet and intranets for information, publication, distribution and commerce. Continued growth in the use of the Internet may depend on potential increases in available bandwidth or transmission speeds or on other technological improvements. In particular, the Company believes that continued growth in the market acceptance of streaming media, especially streaming video, depends on such developments. Changes in network infrastructure, transmission and content delivery methods and underlying software platforms, and the emergence of new Internet access devices such as TV set-top boxes could dramatically change the structure and competitive dynamic of the market for streaming media solutions. In particular, technological developments or strategic partnerships that accelerate the adoption of "high bandwidth" access technologies such as cable modems may have a material adverse impact on the Company's business. Critical issues concerning use of the Internet and intranets (including security, reliability, cost, ease of use and quality of service) remain unresolved and may affect the growth of and the degree to which business is conducted over the Internet and intranets. If the market for the Company's products and services fails to grow, develops more slowly than expected or becomes saturated with competing products or services, the Company's business, financial condition and results of operations will be materially adversely affected. See "-- Availability and Quality of Content" and "-- Online Commerce Security Risks."

Because electronic commerce on the Internet is relatively new and evolving, it is difficult to predict whether the Internet will be a viable commercial marketplace or whether the Internet or intranets will be viable mediums of communication. Although some sales of the Company's products and services will depend on growth of intranets, sales of the Company's products will continue to depend in large part on the emergence of the Internet as a viable commercial marketplace with a strong and reliable infrastructure. The Internet has experienced substantial growth in the number of users and amount of traffic, and there can be no assurance that its technological infrastructure will be able to support the demands placed on it by continued growth. Delays in the development or adoption of new technological standards and protocols, or increased governmental regulation, could also affect the degree of use of the Internet. In addition, developments in Internet infrastructure such as broadband Internet access may significantly affect the market for streaming media products. There can be no assurance that the infrastructure or complementary services necessary to make the Internet a viable commercial medium will be developed or, if developed, that the Internet will become a viable commercial medium for products and services such as those offered by the Company. See "Business -- Industry Background."

Evolving Business Model; Development of New Products and Other Revenue Sources

The Company's success depends in part on its ability to develop new products in a timely manner and provide new services that achieve rapid and broad market acceptance. There can be no assurance that the Company successfully can identify new product and service opportunities and develop and bring to market new products and services in a timely manner or that any such product innovations will achieve the market penetration or price stability necessary for profitability.

As the online medium continues to evolve, the Company plans to leverage its technology by developing complementary products and services as additional sources of revenue. Accordingly, the Company may change its business model to take advantage of new business opportunities, including business areas in which the Company does not have extensive experience. For example, the Company recently focused on, and will continue to devote significant resources to, the development of its electronic commerce business, as well as its advertising-supported content aggregation business, as extensions of its business model. There can be no assurance that the Company will develop successfully these or other business models.

In addition, the Company must continue to innovate and develop new versions of its software to remain competitive in the market for streaming media solutions. The Company's product and software development efforts inherently are difficult to manage and keep on schedule. The Company on occasion has experienced development delays and related cost overruns and there can be no assurance that it will not encounter such problems in the future. In addition, products as complex as those offered by the Company may contain undetected errors when first introduced or when new versions are released. There can be no assurance that errors will not occur in current or new products, the result of

which may be adverse publicity, loss of or delay in market acceptance, or claims by customers against the Company, any of which could have a material adverse effect on the Company's business, financial condition and results of operations.

Expansion of the Company's operations to take advantage of new opportunities and to sustain a leadership position in the market for streaming media software may require significant additional expenditures and may strain the Company's management, financial and operational resources. The lack of market acceptance of new products or services or the Company's inability to generate satisfactory revenues from such new products and services to offset their cost could have a material adverse effect on the Company's business, financial condition and results of operations. "Business -- Strategy."

Dependence on Key Personnel; Need for Additional Personnel

The Company's performance depends substantially on the continued services of its executive officers and key employees, in particular Mr. Glaser, the Company's Chairman of the Board and Chief Executive Officer. The loss of the services of Mr. Glaser or any of its other executive officers or key employees could have a material adverse effect on the Company's business, financial condition and results of operations. None of the Company's executive officers has a contract that guarantees employment. Other than a $2,000,000 life insurance policy on the life of Mr. Glaser, the Company does not maintain "key person" life insurance policies. Given the Company's early stage of development, the Company depends on its ability to attract, train and retain qualified personnel, specifically those with management, technical and product development skills. Competition for such personnel is intense, particularly in geographic areas recognized as high technology centers such as the Pacific Northwest. There can be no assurance that the Company will be able to attract, train or retain additional highly qualified technical and managerial personnel in the future, which could have a material adverse effect on the Company's business, financial condition and results of operations. See "Management."

Control by Mr. Glaser; Antitakeover Provisions

Immediately after the closing of the offering, Mr. Glaser, the Company's founder, will own 14,089,919 shares of the outstanding Common Stock, which will represent % of the outstanding Common Stock (approximately % if the Underwriters' over-allotment option is exercised in full) and % of the outstanding Common Stock if the Series E Warrant is exercised in full, (approximately % if the Underwriters' over-allotment option is also exercised in full). If the holder of the Series E Preferred Stock should instead elect to receive shares of Special Common Stock on conversion of the Series E Preferred Stock, and assuming the Series E Warrant is exercised in full for shares of Special Common Stock, Mr. Glaser will hold % of the outstanding voting rights (approximately % if the Underwriters' over-allotment option is exercised in full). Accordingly, Mr. Glaser will have significant influence over the election of directors and matters submitted to a vote of the Company's shareholders. Control by Mr. Glaser may discourage certain types of transactions involving an actual or potential change of

control of the Company, including transactions in which the holders of Common Stock might receive a premium for their shares over prevailing market prices. See "-- Impact of Exercise of the Series E Warrant; Election by Microsoft to Receive Common Stock or Special Common Stock" and "Principal Shareholders."

The Company's Articles provide that on closing of the offering, a Strategic Transactions Committee of the Board of Directors shall be created, which committee shall be comprised of three directors. Without the prior approval of such committee, and subject to certain limited exceptions, the Board of Directors shall not have the authority to (i) adopt a plan of merger, (ii) authorize the sale, lease, exchange or mortgage of (A) assets representing more than 50% of the book value of the Company's assets prior to the transaction or (B) any other asset or assets on which the long-term business strategy of the Company is substantially dependent, (iii) authorize the voluntary dissolution of the Company or (iv) take any action that has the effect of clauses (i) through (iii). The provisions with respect to the authority of the Strategic Transactions Committee may be amended only with the approval of 90% of the shares entitled to vote on an amendment to the Articles. In connection therewith, the Company entered into an agreement with Mr. Glaser (the "Glaser Agreement") providing him with a direct contractual right to require the Company to abide by and perform all terms of the Articles with respect to the Strategic Transactions Committee. The Glaser Agreement also provides that so long as Mr. Glaser owns a specified number of shares, the Company shall use its best efforts to cause Mr. Glaser to be nominated to, not removed from, and elected to, the Board of Directors. The Glaser Agreement could inhibit or deter a third party from attempting to acquire the Company. See "Description of Capital Stock" and "Management."

In addition, the Articles provide that on closing of the offering, Mr. Glaser shall serve, or shall appoint another officer of the Corporation who shall serve, as the Company's Policy Ombudsman, with the exclusive authority to adopt or change the editorial policies of the Company as reflected on the Company's Web sites or other communications or media where the Company has a significant editorial or media voice. See "Management -- Policy Ombudsman." These provisions, as well as those relating to a classified Board of Directors, the availability of "blank check" preferred stock and certain provisions of Washington corporate law and of the shareholder rights plan that the Company intends to adopt prior to closing of the offering, could have the effect of making it more difficult or more expensive for a third party to acquire, or of discouraging a third party from attempting to acquire, control of the Company. See "Description of Capital Stock."

UNCERTAIN PROTECTION OF INTELLECTUAL PROPERTY; RISKS ASSOCIATED WITH LICENSED THIRD-PARTY TECHNOLOGY The Company's success depends in part on its ability to protect its proprietary software and other intellectual property. To protect its proprietary rights, the Company relies generally on patent, copyright, trademark and trade secret laws, confidentiality agreements with employees and third parties, and license agreements with consultants, vendors and customers, although the Company has not signed such agreement in every case. Despite such protections, a third party could copy or otherwise obtain and use the Company's products or technology, or develop similar technology independently. There can be no assurance that the Company's agreements with employees, consultants and others who participate in product

development activities will not be breached, that the Company will have adequate remedies for any breach, or that the Company's trade secrets will not otherwise become known or independently developed by competitors.

The Company currently has two patents pending in the U.S. relating to its product architecture and technology and holds one patent entitled "Method and Apparatus for Recommending Selections Based on Preferences in a Multi-User System." There can be no assurance that any pending or future patent applications will be granted, that any existing or future patent will not be challenged, invalidated or circumvented, or that the rights granted under any patent that has issued or may issue will provide competitive advantages to the Company. Many of the Company's current and potential competitors dedicate substantially greater resources to protection and enforcement of intellectual property rights, especially patents. If a blocking patent has issued or issues in the future, the Company would need to either obtain a license or design around the patent. There can be no assurance that the Company would be able to obtain such a license on acceptable terms, if at all, or to design around the patent. The Company pursues the registration of certain of its trademarks and service marks in the U.S. and in certain other countries, although it has not secured registration of all its marks. A significant portion of the Company's marks begin with the word "Real" (such as RealAudio and RealVideo). The Company is aware of other companies that use "Real" in their marks alone or in combination with other words, and the Company does not expect to be able to prevent all third-party uses of the word "Real" for all goods and services. In addition, the laws of some foreign countries do not protect the Company's proprietary rights to the same extent as do the laws of the U.S., and effective patent, copyright, trademark and trade secret protection may not be available in jurisdictions. The Company licenses certain of its proprietary rights to third parties, and there can be no assurance that such licensees will not fail to abide by compliance and quality control guidelines with respect to such proprietary rights or take actions that would materially adversely affect the Company's business, financial condition and results of operations.

To license many of its products, the Company relies in part on "shrinkwrap" and "clickwrap" licenses that are not signed by the end user and, therefore, may be unenforceable under the laws of certain jurisdictions. As with other software products, the Company's products are susceptible to unauthorized copying and uses that may go undetected, and policing such unauthorized use is difficult. In general, there can be no assurance that the Company's efforts to protect its intellectual property rights through patent, copyright, trademark and trade secret laws will be effective to prevent misappropriation of its technology, or to prevent the development and design by others of products or technologies similar to or competitive with those developed by the Company, and the Company's failure or inability to protect its proprietary rights could materially adversely affect the Company's business, financial condition and results of operations.

The computer software market is characterized by frequent and substantial intellectual property litigation, which is often complex and expensive, and involves a significant diversion of resources and uncertainty of outcome. Litigation may be necessary in the future to enforce and protect the Company's intellectual property or to defend against a claim of infringement or invalidity. The Company has been and expects to continue to be subject to legal proceedings and claims from time to

time in the ordinary course of its business, including claims of alleged infringement of third-party proprietary rights by the Company and its licensees. The Company attempts to avoid infringing known proprietary rights of third parties in its product development efforts. However, the Company has not conducted and does not conduct comprehensive patent searches to determine whether the technology used in its products infringes patents held by third parties. In addition, it is difficult to proceed with certainty in a rapidly evolving technological environment in which there may be numerous patent applications pending, many of which are confidential when filed, with regard to similar technologies. If the Company were to discover that its products violate third-party proprietary rights, there can be no assurance that it would be able to obtain licenses to continue offering such products without substantial reengineering or that any effort to undertake such reengineering would be successful, that any such licenses would be available on commercially reasonable terms, if at all, or that litigation could be avoided or settled without substantial expense and damage awards. Any claims relating to the infringement of third-party proprietary rights, even if not meritorious, could result in the expenditure of significant financial and managerial resources and could result in injunctions preventing the Company from distributing certain products. Such claims could materially adversely affect the Company's business, financial condition and results of operations.

The Company also relies on certain technology that it licenses from third parties, including software that is integrated with internally developed software and used in the Company's products, to perform key functions. There can be no assurance that such third-party technology licenses will continue to be available to the Company on commercially reasonable terms. The loss of any of these technologies could have a material adverse effect on the Company's business, financial condition and results of operations. Moreover, although the Company is generally indemnified against claims that such third-party technology infringes the proprietary rights of others, such indemnification is not always available for all types of intellectual property rights (for example, patents may be excluded) and in some cases the scope of such indemnification is limited. Even if the Company receives broad indemnification, third-party indemnitors are not always well capitalized and may not be able to indemnify the Company in the event of infringement, resulting in substantial exposure to the Company. There can be no assurance that infringement or invalidity claims arising from the incorporation of third-party technology, and claims for indemnification from the Company's customers resulting from such claims, will not be asserted or prosecuted against the Company. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources in addition to potential product redevelopment costs and delays, all of which could materially adversely affect the Company's business, financial condition and results of operations. See "Business -- Intellectual Property."

Availability and Quality of Content

The availability of compelling content for the Internet and intranets is critical to the continued and increasing use and sales of the Company's RealAudio and RealVideo system. The willingness of content providers to offer and license content that appeals to end users and attracts advertisers is an important factor in promoting the continued and increasing use of the Company's products and services. There

can be no assurance that such content will continue to be available on acceptable terms, if at all. Historically, the Company has recognized increased revenues from sales of RealPlayer Plus in months in which the Company bundled compelling content. If the Company were unable to bundle compelling content, license desirable content on favorable terms, or otherwise offer content that is widely accepted by a broad market audience, the Company's business, financial condition and results of operations would likely be adversely affected. It is possible that associations that represent collectives of content owners may seek to and may successfully establish minimum royalties or other conditions that apply to the licensing or distribution of content over the Internet and that may limit the availability of such content or increase the cost to the Company to use such content. The imposition of any such mandatory royalty payments may increase the Company's cost of revenues significantly, which would have a material adverse effect on the Company's business, financial condition and results of operation. See "Business -- Products and Services -- Media Publishing Products and Services."

Management of Growth; Acquisition Risks

The Company's rapid growth has placed, and is expected to continue to place, a significant strain on the Company's managerial, technical, operational and financial resources. None of the Company's executive officers has had senior management experience in a public company in the position he or she currently holds. From August 31, 1996 to August 31, 1997, the Company grew from 149 employees to 276 employees, and the Company expects this rapid growth to continue. To manage its growth, the Company must implement and improve its operational and financial systems and expand, train and manage its workforce. The Company will also need to manage an increasing number of complex relationships with customers, marketing partners and other third parties. In addition, the Company may pursue the acquisition of new or complementary businesses, products or technologies, although it has no present understandings, commitments or agreements with respect to any material acquisitions or investments. Any such future acquisitions would be accompanied by the risks commonly encountered in acquisitions of companies. Such risks include, among other things, the difficulty of assimilating the operations and personnel of the acquired companies, the potential disruption of the Company's ongoing business, the inability of management to incorporate successfully acquired technology and rights into the Company's products, services and media offerings, additional expense associated with amortization of acquired intangible assets, the maintenance of uniform standards, controls, procedures and policies, and the potential impairment of relationships with employees, customers and strategic partners.

There can be no assurance that the Company's systems, procedures or controls will be adequate to support the Company's current or future operations or that the Company's management will be able to manage effectively the expansion and still achieve the rapid execution necessary to exploit fully the market for the Company's products and services. The Company's future operating results will also depend on its ability to expand its sales and marketing organizations, implement and manage new distribution channels to penetrate different and broader markets, including the market for intranet software products, and expand its support organization accordingly. If the Company were to fail to

manage its growth effectively, its business, financial condition and results of operations would be materially adversely affected. See "-- Dependence on Key Personnel; Need for Additional Personnel" and "-- Risk of Capacity Constraints; Reliance or Internally Developed Systems; System Development Risks."

Impact of Evolving Standards

The Company's current streaming media products are based on protocols designed around certain standards, and the Company's business, financial condition and results of operations would be materially adversely affected if any of the Company's competitors were to establish a competing technology as the de facto industry standard for streaming audio and video transmission. The Company and Netscape Communications Corporation ("Netscape") co-authored the Real Time Streaming Protocol ("RTSP"), a proposed protocol for standardizing the control and delivery of streaming media over the Internet. RTSP can be used with a broad range of data types and is intended to promote a greater level of interoperability among various streaming media solutions by providing a standard way for clients and servers from multiple vendors to stream multimedia content. RTSP is built on top of a number of other Internet standard protocols and is complementary with ASF, a file format for streaming media that does not specify a method of client-server interaction. RTSP provides the client-server specification necessary to stream ASF files (and many other file types) on the Internet. There can be no assurance that RTSP will be established as the de facto industry standard or, if so accepted, that existing competitors and new entrants would not be able to compete more effectively with the Company's products. See "-- Competition; Relationship With Microsoft" and "Business -- Technology."

RISK OF CAPACITY CONSTRAINTS; RELIANCE ON INTERNALLY DEVELOPED SYSTEMS; SYSTEM DEVELOPMENT RISKS The satisfactory performance, reliability and availability of the Company's Web sites, transaction-processing systems and network infrastructure are critical to the Company's reputation and ability to attract and retain customers and maintain adequate customer service. Any system interruptions that result in the unavailability of the Company's Web sites would adversely affect the Company's ability to conduct business. The Company's Web sites are complex and require considerable technical expertise to maintain. Personnel with technological expertise in this area are in great demand, and there can be no assurance that the Company can attract, train or retain such personnel. Many of the software systems used to support the Company's Web sites, including its electronic commerce operations, were developed internally. These systems will need to be enhanced over time or replaced with equivalent commercial products, either of which could entail considerable effort and expense.

The Company's ability to provide a consistent level of high-quality customer service depends in part on the efficient and uninterrupted operation of its computer and communications hardware systems. Substantially all of the Company's computer and communications hardware is located at a single leased facility in Seattle, Washington. The Company's systems and operations are vulnerable to damage or interruption from fire, flood, power loss, telecommunications failure, break-ins, earthquake and similar

events. Because the Company does not presently have fully redundant systems or a formal disaster recovery plan, there can be no assurance that a system failure would not have a material adverse effect on the Company's business, financial condition and results of operations. The Company's servers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays, loss of data or the inability to accept and fulfill customer orders. The occurrence of any of the foregoing risks could have a material adverse effect on the Company's business, financial condition and results of operations. See "Business -- Technology."

Online Commerce Security Risks

Online commerce and communications depend to a significant extent on the ability to conduct secure transmission of confidential information over public networks. The Company relies on encryption and authentication technology licensed from third parties to provide the security and authentication intended to effect secure transmission of confidential information, such as customer credit card numbers. There can be no assurance that the Company's efforts in this area or advances in computer capabilities, new discoveries in the field of cryptography, or other events or developments will not result in a compromise or breach of the algorithms used by the Company to protect customer transaction data. Any compromise of the Company's security could have a material adverse effect on the Company's business, financial condition and results of operations. A party who is able to circumvent the Company's security measures could misappropriate proprietary information or cause interruptions in the Company's operations. The Company may be required to expend significant capital and other resources to protect against such security breaches or to alleviate problems caused by such breaches. In addition, there can be no assurance that credit card companies will not restrict online credit card transactions in the future for reasons such as fraudulent credit card transactions or other risks associated with online commerce transactions, which restrictions could have a material adverse effect on the Company's business, financial condition and results of operations. To the extent that activities of the Company or third-party contractors involve the storage and transmission of proprietary information, security breaches could damage the Company's reputation and expose the Company to a risk of litigation and possible liability. There can be no assurance that the Company's security measures will prevent security breaches or that the failure to prevent such security breaches will not have a material adverse effect on the Company's business, financial condition and results of operations.

Risks Associated with International Expansion

For the year ended December 31, 1996 and the six months ended June 30, 1997, approximately 19% and 27%, respectively, of the Company's total net revenues were generated from sources outside the U.S. and Canada. As a result, the Company is subject to the risks of doing business abroad, including unexpected changes in regulatory requirements, export and import restrictions, tariffs and other trade barriers, difficulties in staffing and managing foreign operations, longer payment cycles, problems in collecting accounts receivable, potential adverse tax consequences, exchange rate fluctuations,

increased risks of piracy, limits on the Company's ability to enforce its intellectual property rights, discontinuity of network infrastructures, limits on repatriation of funds and political risks that may limit or disrupt international sales. Such limitations and interruptions could have a material adverse effect on the Company's business, financial condition and results of operations. In addition, operations of the Company's foreign subsidiaries are translated from local currency into U.S. dollars based on average monthly exchange rates. The Company currently does not hedge its foreign currency transactions and is therefore subject to the risk of changes in exchange rates. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business -- Sales, Marketing and Distribution."

Governmental Regulation and Legal Uncertainties

The Company currently is not subject to direct regulation by any governmental agency, other than laws and regulations generally applicable to businesses, although certain U.S. export controls and import controls of other countries, including controls on the use of encryption technologies, may apply to the Company's products. Due to the increasing popularity and use of the Internet, it is possible that a number of laws and regulations may be adopted in the U.S. and abroad with particular applicability to the Internet. It is possible that governments will enact legislation that may be applicable to the Company to regulate areas such as content, network security, encryption and the use of key escrow, data and privacy protection, electronic authentication or "digital" signatures, illegal and harmful content, access charges and retransmission activities. Moreover, the applicability to the Internet of existing laws governing issues such as property ownership, content, taxation, defamation and personal privacy is uncertain. The majority of such laws were adopted before the widespread use and commercialization of the Internet and, as a result, do not contemplate or address the unique issues of the Internet and related technologies. Any such export or import restrictions, new legislation or regulation or governmental enforcement of existing regulations may limit the growth of the Internet, increase the Company's cost of doing business or increase the Company's legal exposure, which could have a material adverse effect on the Company's business, financial condition and results of operations.

By distributing content over the Internet, the Company faces potential liability for claims based on the nature and content of the materials that it distributes, including claims for defamation, negligence or copyright, patent or trademark infringement, which claims have been brought, and sometimes successfully litigated, against Internet companies. The Company's general liability insurance may not cover potential claims of this type or may not be adequate to indemnify the Company for any liability that may be imposed. Any liability not covered by insurance or in excess of insurance coverage could have a material adverse effect on the Company's business, financial condition and results of operations. Although those sections of the Communications Decency Act of 1996 (the "CDA") that, among other things, proposed to impose criminal penalties on anyone distributing "indecent" material to minors over the Internet, were held to be unconstitutional by the U.S. Supreme Court, there can be no assurance that similar laws will not be proposed and adopted. While the Company does not currently distribute the types of materials that the CDA may have deemed illegal, the nature of such similar

legislation and the manner in which it may be interpreted and enforced cannot be fully determined and, therefore, legislation similar to the CDA could subject the Company to potential liability, which in turn could have an adverse effect on the Company's business, financial condition and results of operations. Such laws could also damage the growth of the Internet generally and decrease the demand for the Company's products and services, which could adversely affect the Company's business, financial condition and results of operations. See "Business -- Governmental Regulation" and "-- Intellectual Property."

Volatility of Stock Price

The Company believes that factors such as announcements of developments related to the Company's business, announcements of technological innovations, or new products or enhancements by the Company or its competitors, sales by competitors (including sales to the Company's customers), sales of the Common Stock into the public market (including sales by members of management), developments in the Company's relationships with its customers, partners, distributors and suppliers, shortfalls or changes in revenues, gross margins, earnings or losses or other financial results from analysts' expectations, regulatory developments, fluctuations in results of operations and conditions in the Company's market or the markets served by the Company's customers or the economy could cause the price of the Common Stock to fluctuate, perhaps substantially. In addition, in recent years the stock market in general, and the market for shares of small capitalization and technology stocks in particular, has experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. There can be no assurance that the market price of the Common Stock will not experience significant fluctuations in the future, including fluctuations that are unrelated to the Company's performance. Such fluctuations could materially adversely affect the market price of the Common Stock.

Sales and Other Taxes

The Company currently does not collect sales or similar taxes with respect to the sale of products, license of technology, or provision of services into states and countries other than states in which the Company has offices. However, one or more states or foreign countries may seek to impose sales or other tax obligations on companies that engage in online commerce within their jurisdictions. A successful assertion by one or more states or any foreign country that the Company should collect sales or other taxes on the sale of products, license of technology or provision of services, or remit payment of sales or other taxes for prior periods, could have a material adverse effect on the Company's business, financial condition and results of operations.

IMPACT OF EXERCISE OF THE SERIES E WARRANT; ELECTION BY MICROSOFT TO RECEIVE COMMON STOCK OR SPECIAL COMMON STOCK In connection with Microsoft's investment in the Company in July 1997, the Company issued the Series E Warrant. If it is not exercised, the Series E Warrant will terminate upon the earliest of (i) the closing of an initial public offering, (ii) completion of

a merger in which the Company is not the survivor, or the sale of substantially all the assets of the Company, (iii) Microsoft's breach of its agreement with the Company, which breach is not cured, or (iv) January 21, 2002. Microsoft may elect to convert the shares of Series E Preferred Stock issuable on exercise of the Series E Warrant into Common Stock or Special Common Stock or in part into each of such classes. If Microsoft elects to convert shares of Series E Preferred Stock into $15,000,000 or more of Common Stock, it may be required to make a filing under the Hart-Scott-Rodino Antitrust Improvements Act, and obtain approval from the U.S. Department of Justice and Federal Trade Commission before completing the conversion into Common Stock. If the Series E Warrant is exercised in full, Microsoft will own % of the Company's outstanding capital stock immediately after the offering. There can be no assurance that Microsoft will exercise any or all of the Series E Warrant. In addition, there can be no assurance that if the Series E Warrant is exercised for shares of Series E Preferred Stock, Microsoft will elect to take any particular percentage of Common Stock or Special Common Stock.

Because the Microsoft Warrant may be exercised at any time until the closing of the offering, it is impossible to predict with any certainty the ultimate impact that the exercise thereof would have on the Company's resulting capitalization, dilution per share to existing and new investors, liquidity and capital resources, percentage of shares beneficially owned by the Company's executive officers, directors and significant shareholders, and certain matters involving corporate control. See "-- Competition; Relationship With Microsoft," "-- Department of Justice Subpoena," "-- Control by Mr. Glaser; Antitakeover Provisions," "Capitalization," "Dilution," "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Business -- Microsoft Relationship," "Principal Shareholders" and "Description of Capital Stock."

No Specific Use of Proceeds

The Company has not designated any specific use for the net proceeds from the sale of the Common Stock offered hereby. The Company intends to use the net proceeds primarily for general corporate purposes, including working capital to fund anticipated operating losses and capital expenditures. Accordingly, management will have significant flexibility in applying the net proceeds of the offering. The failure of management to apply such funds effectively could have a material adverse effect on the Company's business, financial condition and results of operations. See "Use of Proceeds."

No Prior Market for Common Stock

Prior to the offering, there has been no public market for the Common Stock. The initial public offering price of the Common Stock will be determined by negotiations between the Company and the representatives of the Underwriters and may not be indicative of the market price of the Common Stock in the future. There can be no assurance that an active trading market will develop or be sustained after the offering. See "Underwriting" for a discussion of the factors considered in determining the initial public offering price.

POSSIBLE ADVERSE EFFECT ON MARKET PRICE OF COMMON STOCK OF SHARES ELIGIBLE FOR FUTURE SALE AFTER THE OFFERING

```
     On closing of the offering, the Company will have outstanding
shares of Common Stock (          shares if the Underwriters' over-allotment
option is exercised in full), of which           shares
```

offered hereby (shares if the Underwriters' over-allotment option is exercised in full) will be freely transferable in the public market without restriction or further registration under the Securities Act of 1933, as amended (the "Securities Act"), except to the extent such shares are held by affiliates of the Company. The remaining 26,935,621 shares of Common Stock (the "Restricted Shares") outstanding on completion of the Offering (assuming no exercise of options or warrants after September 24, 1997) were issued by the Company in reliance upon exemptions from the registration requirements of the Securities Act, and public sale thereof is restricted except to the extent they are registered under the Securities Act or sold in accordance with an exemption from such registration. The Company and the holders of 26,654,431 of these Restricted Shares have entered into lock-up agreements (the "Lock-Up Agreements") with the Underwriters not to sell, offer to sell or otherwise dispose of any shares of Common Stock owned of record or beneficially as of the date of this Prospectus, including securities convertible into or exercisable or exchangeable for shares of Common Stock as of such date, as well as any shares of Common Stock later acquired by reason of the conversion, exercise or exchange of such securities, for a period of 180 days after the date of this Prospectus without the prior written consent of the Underwriters, except that persons other than officers, directors and holders of 1% or more of the capital stock of the Company will be free to sell or otherwise dispose of up to 5,000 shares of Common Stock to the extent permissible under Rule 144 or Rule 701 under the Securities Act. Of the remaining 281,190 Restricted Shares, 11,947 shares will be eligible for immediate public sale under Rule 144 under the Securities Act as currently in effect and the remaining 269,243 shares of Common Stock will be eligible for public sale subject to compliance with Rule 144, unless earlier registered under the Securities Act. At September 24, 1997, options for 6,374,214 shares of Common Stock were outstanding, of which options for 1,708,455 shares may be exercised during the 180 days following the date of this Prospectus, which shares potentially will be eligible for public sale 90 days after the date of this Prospectus pursuant to Rule 701 under the Securities Act; of these shares, 1,312,863 are subject to Lock-Up Agreements. Warrants to purchase an additional 4,707,363 shares of Common Stock, including the Series E Warrant to purchase 3,709,305 shares, which may be exercised in whole or in part for shares of either Common Stock or Special Common Stock, will be exercisable prior to or on closing of the offering, and the shares issued upon exercise will be potentially eligible for public sale under Rule 144. All of these shares are subject to Lock-Up Agreements. The holders of an aggregate of 16,390,753 shares of Common Stock (including shares of Common Stock issuable upon exercise of outstanding warrants and assuming that the Series E Preferred Stock converts into Common Stock and the Series E Warrant is exercised in its entirety for shares of Common Stock) have the right to require the Company to register their shares for sale under the Securities Act beginning six months after the closing of the offering. Sales of substantial numbers of shares of Common Stock in the public market following the offering could have a material adverse effect on the market price for the Common Stock. See "Shares Eligible for Future Sale."

Donation of Net Income to Charity

The Company's philosophy includes a commitment to charitable responsibility. If sustained profitability is achieved, the Company intends to donate approximately 5% of its annual net income to charitable organizations. As a result, the Company's net income will be reduced by the amount of these charitable donations. See "Business -- Position on Charitable Responsibility" and "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Charitable Donations."

Absence of Dividends

The Company has never declared or paid cash dividends on its capital stock and does not anticipate paying any cash dividends in the foreseeable future. See "Dividend Policy."

Dilution

```
     Investors in Common Stock in the offering will experience immediate and
substantial dilution in the net tangible book value of their shares. Assuming an
initial public offering price of $          per share, dilution to new investors
would be $          per share. Additional dilution will occur upon exercise of
outstanding stock options and warrants. See "Dilution."
```

Use of Proceeds

```
     The net proceeds to the Company from the sale of the           shares of
Common Stock offered hereby at an assumed initial public offering price of
$          per share, after deducting the underwriting discount and estimated
offering expenses payable by the Company, are estimated to be $
($          if the Underwriters' over-allotment option is exercised in full).
```

The principal purposes of the offering are to increase the Company's equity capital, to create a public market for the Common Stock, to increase the visibility of the Company in the marketplace and to facilitate future access by the Company to public equity markets. The Company intends to use the net proceeds primarily for general corporate purposes, including working capital to fund anticipated operating losses and capital expenditures. The Company may, when the opportunity arises, use an unspecified portion of the net proceeds to acquire or invest in complementary businesses, products and technologies. The Company has no present understandings, commitments or agreements with respect to any material acquisition or investment. Pending use of the net proceeds for the above purposes, the Company intends to invest such funds in interest-bearing, investment-grade securities.

Dividend Policy

The Company has never declared or paid cash dividends on its capital stock. The Company currently anticipates that it will retain all of its future earnings, if any, for use in the expansion and operations of its business and, therefore, does not anticipate paying any cash dividends in the foreseeable future.

Capitalization

The following table sets forth the capitalization of the Company at June 30, 1997 and as adjusted to give effect to the (i) issuance in July 1997 of 3,338,374 shares of Series E Preferred Stock at $8.99 per share; (ii) conversion of all outstanding shares of Series A Common Stock, Series B Common Stock, Series C Common Stock, Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and Series E Preferred Stock into Common Stock on closing of the offering; (iii) sale by the Company of the shares of Common Stock offered hereby at an assumed initial public offering price of $ per share (after deducting the underwriting discount and estimated expenses of the offering); (iv) application of the estimated net proceeds of the offering; and (v) issuance of 998,058 shares of Common Stock reflecting exercise of outstanding warrants on the closing of the offering, except as noted below. See "Use of Proceeds" and Note 8 of Notes to Consolidated Financial Statements. The information set forth below is unaudited and should be read in conjunction with the Company's Consolidated Financial Statements and Notes thereto.

JUNE 30, 1997 ACTUAL AS ADJUSTED (IN THOUSANDS)

Note payable	$ 991	$
Redeemable, convertible preferred stock, par value $0.001 per share: 9,344,306 shares authorized; 8,345,016 shares issued and outstanding, actual; no shares issued and outstanding, as adjusted(1)	23,264	
Shareholders' equity (deficit):		
Convertible preferred stock, par value $0.001 per share: 13,713,439 shares authorized; 13,713,439 issued and outstanding, actual; no shares issued and outstanding, as adjusted(1)	932	
Preferred stock, undesignated, par value $0.001 per share: 6,942,255 shares authorized; no shares issued and outstanding	--	
Common stock, par value $0.001 per share: 50,000,000 shares authorized; 749,520 shares issued and outstanding, actual; shares issued and outstanding, as adjusted(2)	89	
Additional paid-in capital	1,579	
Foreign currency translation adjustment	8	
Accumulated deficit	(12,372)	
Total shareholders' equity (deficit)	(9,764)	
Total capitalization	$ 14,491	$

(1) At June 30, 1997, the Company had 30,000,000 shares of preferred stock authorized, of which 13,713,439 shares were designated Series A Preferred Stock, 3,059,701 shares were designated Series B Preferred Stock, 3,004,305 shares were designated Series C Preferred Stock and 3,280,300 shares were designated Series D Preferred Stock. On July 21, 1997, 7,127,242 shares were designated Series E Preferred Stock. On September 19, 1997, the numbers of shares of the Company's authorized preferred stock and common stock were increased to 60,000,000 and 300,000,000, respectively.

(2) Excludes (i) 6,336,486 shares of Common Stock issuable at a weighted average exercise price of $0.67 per share upon exercise of stock options outstanding at June 30, 1997, (ii) 4,896,723 shares of Common Stock reserved for future issuance under the Company's stock option plans, (iii) 1,000,000 shares of Common Stock reserved for issuance under the 1998 Employee Stock Purchase Plan, and (iv) up to 3,709,305 shares of Common Stock or Special Common Stock (representing additional cash and

shareholders' equity of up to $50,001,431) issuable on exercise of the Series E Warrant. See "Management -- Benefit Plans," "Certain Transactions," "Description of Capital Stock -- Warrants to Purchase Preferred Stock and Common Stock" and Note 7 of Notes to Consolidated Financial Statements.

Dilution

The pro forma net tangible book value of the Company at June 30, 1997, as adjusted to give effect to the (i) issuance in July 1997 of 3,338,374 shares of Series E Preferred Stock at $8.99 per share; (ii) conversion of all outstanding shares of Series A Common Stock, Series B Common Stock, Series C Common Stock, Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and Series E Preferred Stock into Common Stock upon closing of the offering; (iii) sale by the Company of the shares of Common Stock offered hereby at an assumed initial public offering price of $ per share, and the receipt by the Company of the estimated net proceeds therefrom, was approximately $, or $ per share of Common Stock; and (iv) exclusion of up to 3,709,305 shares of Common Stock or Special Common Stock (representing additional cash and shareholders' equity of up to $50,001,431 and tangible book value per share of $) issuable on exercise of the Series E Warrant. Pro forma net tangible book value per share represents total tangible assets of the Company less total liabilities divided by the aggregate number of shares of Common Stock and Special Common Stock outstanding after closing of the offering. After giving effect to the net proceeds from the sale of the shares of Common Stock offered hereby, the adjusted pro forma net tangible book value of the Company at June 30, 1997 would have been approximately $, or $ per share of Common Stock and Special Common Stock. This represents an immediate increase in the pro forma net tangible book value of $ per share of Common Stock and Special Common Stock to existing shareholders and an immediate dilution of $ per share to new investors. The following table illustrates this per share dilution:

Assumed initial public offering price per share	$
Pro forma net tangible book value per share before the offering	$
Increase per share attributable to new investors	
Adjusted pro forma net tangible book value per share after the offering	
Dilution per share to new investors	$

The following table summarizes on a pro forma basis at June 30, 1997, after giving effect to the offering, the difference between existing shareholders and investors in the offering with respect to the number of shares of Common Stock and Special Common Stock purchased from the Company, the total consideration paid and the average price paid per share.

	SHARES PURCHASED(1)(2)		TOTAL CONSIDERATION		
	NUMBER	PERCENT	AMOUNT	PERCENT	AVERAGE PRICE PER SHARE
Existing shareholders		. %	$	. %	$
New investors		.		.	
Total		100.0%	$	100.0%	

(1) The table is based on ownership at June 30, 1997, giving effect to (i) the issuance in July 1997 of 3,338,374 shares of Series E Preferred Stock and (ii) the conversion of all outstanding shares of Series A Common Stock, Series B Common Stock, Series C Common Stock, Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and Series E Preferred Stock into Common Stock, and assumes no exercise of the Underwriters' over-allotment option. Exercise of the over-allotment option in full would (i) reduce the proportion of shares held by existing shareholders to . % of the total number of shares outstanding after the offering and (ii) increase the number of shares held by investors in the offering to shares, or . % of the total number of shares.

(2) Excludes (i) 6,336,486 shares of Common Stock issuable at a weighted average exercise price of $0.67 per share upon exercise of stock options outstanding at June 30, 1997, (ii) 4,896,723 shares of Common Stock reserved for future issuance under the Company's stock option plans, (iii) 1,000,000 shares of Common Stock reserved for issuance under the 1998 Employee Stock Purchase Plan, and (iv) 998,058 shares of Common Stock issuable upon exercise of outstanding warrants, and (v) up to 3,709,305 shares of Common Stock or Special Common Stock (representing additional cash and shareholders' equity of up to $50,001,431) issuable on exercise of the Series E Warrant. See "Management -- Benefit Plans," "Certain Transactions," "Description of Capital Stock -- Warrants to Purchase Preferred Stock and Common Stock" and Note 7 of Notes to Consolidated Financial Statements.

Selected Consolidated Financial Data

The following selected consolidated financial data should be read in conjunction with the Company's Consolidated Financial Statements and Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations," included elsewhere in this Prospectus. The selected consolidated financial data as of December 31, 1994, and for the period from February 9, 1994 (inception) to December 31, 1994, and as of and for the years ended December 31, 1995 and 1996 are derived from the Consolidated Financial Statements of the Company audited by KPMG Peat Marwick LLP, independent accountants. The selected consolidated financial data as of June 30, 1997 and for the six months ended June 30, 1996 and 1997 are derived from unaudited consolidated financial statements prepared by the Company on a basis consistent with the Company's audited Consolidated Financial Statements and, in the opinion of management, include all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation of the results for such periods. Operating results for the six months ended June 30, 1997 are not necessarily indicative of the results that may be expected for any other interim period or for the year ending December 31, 1997.

	PERIOD FROM FEBRUARY 9, 1994 (INCEPTION) TO DECEMBER 31,	YEAR ENDED DECEMBER 31,		SIX MONTHS ENDED JUNE 30,
	1994	1995	1996	1996	1997
	(IN THOUSANDS, EXCEPT PER SHARE DATA)				

(UNAUDITED)					
STATEMENT OF OPERATIONS DATA:					
Net revenues:					
Software license fees	$ --	$ 1,782	$11,876	$ 3,768	$10,070
Advertising	--	--	1,016	170	1,107
Service revenues	--	30	1,120	306	2,189
Total net revenues	--	1,812	14,012	4,244	13,366
Cost of revenues:					
Software license fees	--	29	1,343	143	1,134
Advertising	--	--	288	105	308
Service revenues	--	33	554	147	1,612
Total cost of revenues	--	62	2,185	395	3,054
Gross profit	--	1,750	11,827	3,849	10,312
Operating expenses:					
Research and development	202	1,380	4,812	1,739	5,463
Selling and marketing	47	1,218	7,540	2,264	9,161
General and administrative	296	747	3,491	1,412	2,496
Total operating expenses	545	3,345	15,843	5,415	17,120
Operating loss	(545)	(1,595)	(4,016)	(1,566)	(6,808)
Net other income	--	94	227	117	436
Net loss	$ (545)	$(1,501)	$(3,789)	$(1,449)	$(6,372)
Pro forma net loss per share			$ ( )		$ ( )
Shares used to compute pro forma net loss per share(1)					

	DECEMBER 31,			JUNE 30,
	1994	1995	1996	1997
		(IN THOUSANDS)		
(UNAUDITED)				
BALANCE SHEET DATA:				
Cash, cash equivalents and short-term investments	$ --	$ 6,116	$19,595	$11,496
Working capital (deficit)	(49)	5,948	16,893	8,879
Total assets	64	7,574	26,468	22,148
Redeemable, convertible preferred stock	--	7,655	23,153	23,264
Shareholders' equity (deficit)	15	(1,111)	(3,320)	(9,764)

(1) For an explanation of the number of shares used to compute pro forma net loss per share, see Note 1 of Notes to Consolidated Financial Statements.

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of the financial condition and results of operations of the Company should be read in conjunction with the Consolidated Financial Statements and Notes thereto included elsewhere in this Prospectus. This discussion contains forward-looking statements that involve risks and uncertainties. The Company's actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth under "Risk Factors" and elsewhere in this Prospectus.

Overview

RealNetworks is a leading provider of branded software products and services that enable the delivery of streaming media content over the Internet and intranets. The Company's products and services include its RealAudio and RealVideo software system, an electronic commerce Web site designed to promote the proliferation of streaming media products and a network of advertising- supported content aggregation Web sites.

The Company was incorporated in February 1994 and did not recognize any revenue until July 1995, when the Company began delivery of the commercial version of RealAudio Version 1.0. From inception through December 31, 1995, the Company's operating activities related primarily to recruiting personnel, raising capital, purchasing operating assets, conducting research and development, building the RealAudio brand and establishing the market for streaming audio. During 1996, the Company continued to invest heavily in research and development, marketing, building domestic and international sales channels and general and administrative infrastructure. In August 1996, the Company began selling RealPlayer Plus, a premium version of its RealPlayer product. RealPlayer continues to be available for free download from the Company's Web sites. In February 1997, the Company released a beta version of its RealVideo product and since that time has worked to build the market for streaming video.

The Company has a limited operating history on which an evaluation of the Company and its prospects can be based. The Company's prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in early stages of development, particularly companies in rapidly evolving markets such as media delivery and electronic commerce over the Internet and intranets. To achieve and sustain profitability, the Company must, among other things, establish widespread market acceptance of its existing products, successfully develop new products and services, respond quickly and effectively to competitive, market and technological developments,

expand sales and marketing operations, broaden customer support capabilities, control expenses and continue to attract and retain qualified personnel. There can be no assurance that the Company will achieve or sustain profitability.

The Company has incurred significant losses since its inception, and as of June 30, 1997 had an accumulated deficit of $12,372,000. The Company believes that its success will depend largely on its ability to extend its technological leadership and continue to build its brand position. Accordingly, the Company intends to invest heavily in research and development and sales and marketing. The Company expects to continue to incur substantial operating losses for the foreseeable future. In view of the rapidly evolving nature of the Company's business and its limited operating history, the Company believes that period-to-period comparisons of its revenues and operating results, including its gross profit margin and operating expenses as a percentage of total net revenues, are not necessarily meaningful and should not be relied upon as indications of future performance. Although the Company has experienced significant percentage growth in total net revenues, it does not believe that its historical growth rates are sustainable or indicative of future growth. The Company has used, and expects to continue to use, price promotions to increase trial, purchase and use of its products, as well as to increase overall recognition of its brands. The effect of such promotions on revenues in a particular period may be significant and extremely difficult to forecast.

The following table sets forth certain financial data for the periods indicated as a percentage of total net revenues:

	YEAR ENDED DECEMBER 31,		SIX MONTHS ENDED JUNE 30,	
	1995	1996	1996	1997
Net revenues:				
Software license fees	98.4%	84.8%	88.8%	75.3%
Advertising	--	7.2	4.0	8.3
Service revenues	1.6	8.0	7.2	16.4
Total net revenues	100.0	100.0	100.0	100.0
Cost of revenues:				
Software license fees	1.6	9.6	3.4	8.5
Advertising	--	2.0	2.4	2.3
Service revenues	1.8	4.0	3.5	12.1
Total cost of revenues	3.4	15.6	9.3	22.9
Gross profit	96.6	84.4	90.7	77.1
Operating expenses:				
Research and development	76.2	34.3	41.0	40.9
Selling and marketing	67.2	53.8	53.3	68.5
General and administrative	41.2	24.9	33.3	18.7
Total operating expenses	184.6	113.0	127.6	128.1
Operating loss	(88.0)	(28.6)	(36.9)	(51.0)
Other income (expense):				
Interest income, net	5.2	2.1	3.5	3.3
Other expense	--	(0.5)	(0.7)	0.0
Net other income	5.2	1.6	2.8	3.3
Net loss	(82.8)%	(27.0)%	(34.1)%	(47.7)%

Results of Operations -- Six Months Ended June 30, 1996 and 1997

Revenues

The Company generates revenues primarily from three sources: software license fees, advertising and services. Software license fees are recognized upon delivery, net of allowances for estimated future returns, provided that no significant obligations of the Company remain and collection of the resulting receivable is deemed probable. Revenues from software license agreements with original equipment manufacturers ("OEM") are recognized when the OEM delivers its product incorporating the Company's software to the end user. In the case of prepayments from an OEM, the Company generally recognizes revenues based on the actual products sold by the OEM. If the Company anticipates providing ongoing support to the OEM in the form of future upgrades, enhancements or other services over the term of the contract, revenue generally is recognized on the straight-line method over the term of the contract. The Company recognizes revenues from software license agreements with value-added resellers ("VAR") upon delivery to the VAR, provided necessary conditions are met. If these conditions are not met, revenue is recognized upon redistribution by the VAR to the end user. Advertising revenues are recognized over the period in which the advertisement is displayed on one of the Company's Web pages. To the extent minimum guaranteed page impression deliveries are not met, the Company defers recognition of the corresponding advertising revenues until guaranteed page impression delivery levels are achieved. Service revenues include support and upgrade contracts, commissions from electronic sales of third-party products, consulting, content hosting and fees from user conferences. Support and upgrade revenues are recognized ratably over the term of the contract, which typically is 12 months. Payments for support and upgrade contracts are generally made in advance and are nonrefundable. Other service revenues are recognized when the service is performed.

Software License Fees. Software license fees were $3,768,000 and $10,070,000 for the six months ended June 30, 1996 and 1997, respectively. The increase was primarily due to growing market acceptance of the Company's server and player products, including the introduction of RealPlayer Plus in August 1996 and RealVideo in February 1997, successful product promotions and diversification of the Company's sales channels, including electronic distribution. Server product sales were $3,616,000 and $5,484,000 for the six months ended June 30, 1996 and 1997, respectively. Player product sales were $152,000 and $4,586,000 over the same respective periods. The Company began selling products electronically from its Web site in August 1996. Electronic sales of both server and player products for the six months ended June 30, 1997 were $3,934,000, or 39% of software license fees in the period. The Company has used price promotions to increase the trial, purchase and use of its software products. In February 1997, the Company reduced the prices of its server products. In July 1997, the Company made its EasyStart Server available to customers to download free of charge.

Advertising Revenues. Advertising revenues were $170,000 and $1,107,000 for the six months ended June 30, 1996 and 1997, respectively. The Company began selling advertising space on its Web sites in March 1996. Increased revenues in 1997 were due in large part to a full period of advertising sales and the Company's success in attracting a greater number of advertisers.

Service Revenues. Service revenues were $306,000 and $2,189,000 for the six months ended June 30, 1996 and 1997, respectively. Revenues from upgrade and support contracts were $306,000 and $1,473,000 for the six months ended June 30, 1996 and 1997, respectively. This increase was primarily due to a greater installed base of the Company's products. Service revenues for the six months ended June 30, 1997 also included fees of $498,000 related to the Company's first RealMedia conference.

International Revenues. International revenues were 19% and 27% of total net revenues for the six months ended June 30, 1996 and 1997, respectively. The increase in international revenues was due in part to the creation of the Company's three foreign subsidiaries. The Company incorporated its French and Japanese subsidiaries in November 1996 and its U.K. subsidiary in February 1997. Substantially all international revenue was generated in Europe and Asia. The functional currency of the Company's foreign subsidiaries is the local currency in the country in which the subsidiary is incorporated. Operations of the Company's foreign subsidiaries are translated from local currency into U.S. dollars based on average monthly exchange rates. The Company currently does not hedge its foreign currency transactions and is therefore subject to the risk of changes in exchange rates.

Cost of Revenues

Cost of Software License Fees. Cost of software license fees includes cost of product media, duplication, manuals, packaging materials, amounts paid for licensed technology and fees paid to third-party vendors for order fulfillment. Cost of software license fees was $143,000 and $1,134,000 for the six months ended June 30, 1996 and 1997, respectively, and 4% and 11%, respectively, of software license fees. The increase in absolute dollars was primarily due to higher sales volume. The increase in percentage terms was due to a shift in product mix toward lower-margin player products, a greater percentage of sales through indirect channels, and the utilization of a third-party order fulfillment agency.

Cost of Advertising Revenues. Cost of advertising revenues includes personnel associated with content creation and bandwidth expenses related to the Company's Web sites. Cost of advertising revenues was $105,000 and $308,000 for the six months ended June 30, 1996 and 1997, respectively, and 62% and 28%, respectively, of advertising revenues. The increase in absolute dollars was primarily due to increased head count associated with content creation and higher bandwidth expenses. The decrease in percentage terms was due to revenues growing at a faster rate than expenses.

Cost of Service Revenues. Cost of service revenues includes in-house and contract personnel providing services, bandwidth expenses for hosting services and user conference expenses. Cost of service revenues was $147,000 and $1,612,000 for the six months ended June 30, 1996 and 1997,

respectively, and 48% and 74%, respectively, of service revenues. The increase in absolute dollars was primarily due to increased staff and other costs associated with providing these services to a greater number of customers, and, in March 1997, the Company incurred $1,000,000 of costs associated with its RealMedia conference. No such costs were incurred in the comparable period in 1996. Excluding the effects of the RealMedia conference, cost of service revenues was 48% and 36% of service revenues for the six months ended June 30, 1996 and 1997, respectively. This decrease was primarily attributable to better utilization of service personnel associated with an increased customer base.

Gross margins may be affected by the mix of distribution channels used by the Company, the mix of products sold, the mix of product revenues versus service revenues and the mix of international versus U.S. and Canada revenues. The Company typically realizes higher gross margins on direct channel sales relative to indirect channels and higher gross margins on software license fees relative to service revenues. If sales through indirect channels increase as a percentage of total net revenues, or if, as the Company anticipates, service revenues increase as a percentage of total net revenues, the Company's gross margins will be adversely affected.

Operating Expenses

Research and Development. Research and development expenses consist primarily of salaries and consulting fees paid to support product development. To date, all research and development costs have been expensed as incurred because technological feasibility of the Company's products is established upon completion of a working model. To date, costs incurred between completion of a working model and general release of products have been insignificant. The Company believes that continued investment in research and development is critical to attaining its strategic objectives and, as a result, expects research and development expenses to increase significantly. Research and development expenses were $1,739,000 and $5,463,000 for the six months ended June 30, 1996 and 1997, respectively, and 41% of total net revenues for both periods. The increase in absolute dollars was due primarily to increases in internal development personnel, travel, and consulting expenses. Research and development expenses incurred for the six months ended June 30, 1997 were related primarily to enhancements to existing products and development of new technology and products.

Selling and Marketing. Selling and marketing expenses consist primarily of salaries, commissions, consulting fees paid, trade show expenses, advertising and cost of marketing collateral. The Company intends to continue its aggressive branding and marketing campaign and therefore expects selling and marketing expenses to increase significantly. Selling and marketing expenses were $2,264,000 and $9,161,000 for the six months ended June 30, 1996 and 1997, respectively, and 53% and 69%, respectively, of total net revenues. The increases were due in large part to growth in sales personnel, commissions and costs related to the continued development and implementation of the Company's branding and marketing campaigns. During the six months ended June 30, 1997, the Company also incurred approximately $694,000 in marketing expenses related to the launch of RealVideo.

General and Administrative. General and administrative expenses consist primarily of salaries and fees for professional services. The Company expects general and administrative expenses to increase as the Company expands its staff, incurs additional costs related to growth of its business, and becomes a publicly traded company. General and administrative expenses were $1,412,000 and $2,496,000 for the six months ended June 30, 1996 and 1997, respectively, and 33% and 19%, respectively, of total net revenues. The increase in absolute dollars was primarily a result of increased personnel and facility expenses necessary to support the Company's growth. The decrease in percentage terms was a result of revenues growing at a faster rate than expenses.

Net Other Income

Other income and expenses consist primarily of earnings on the Company's cash and cash equivalents and short-term investments. Net other income was $117,000 and $436,000 for the six months ended June 30, 1996 and 1997, respectively. The increase was due primarily to interest income resulting from additional invested cash and cash equivalents and short-term investments.

Income Taxes

The Company has had a net operating loss for each period since inception. As of June 30, 1997, the Company had approximately $7,800,000 of net operating loss carryforwards for federal income tax purposes that will expire in 2010 through 2012 if not utilized. See Note 4 of Notes to Consolidated Financial Statements.

Results of Operations -- Years Ended December 31, 1995 and 1996

Revenues

Software License Fees. Software license fees were $1,782,000 and $11,876,000 for 1995 and 1996, respectively. The Company first began recognizing revenues from software license fees in July 1995. The increase in software license fees in 1996 was primarily due to a full period of sales, growing market acceptance of the Company's products, the introduction of RealPlayer Plus in August 1996 and diversification of sales channels, including electronic distribution. All of the Company's software license fees in 1995 were from the sale of its server software. In 1996, server product sales were $8,188,000 and player product sales were $3,688,000.

Advertising Revenues. Advertising revenues were $1,016,000 for 1996. The Company began selling advertising space on its Web sites in March 1996, and, as a result no advertising revenues were generated in 1995.

Service Revenues. Service revenues were $30,000 and $1,120,000 for 1995 and 1996, respectively. The increase in service revenues in 1996 was primarily due to support and upgrade contracts associated with a larger installed base of the Company's products. Consulting, content hosting and user conference revenues were not significant in either period.

International Revenues. International revenues as a percentage of total net revenues were 15% and 19% for 1995 and 1996, respectively. Substantially all international revenues were generated in Europe and Asia.

Cost of Revenues

Cost of Software License Fees. Cost of software license fees was $29,000 and $1,343,000 for 1995 and 1996, respectively, and 2% and 11%, respectively, of software license fees. The increase in absolute dollars was primarily due to higher sales volume. The increase in percentage terms was due to a shift in product mix toward lower-margin player products, a greater percentage of sales through indirect channels, and the utilization of a third-party order fulfillment agency.

Cost of Advertising Revenues. Cost of advertising revenues was $288,000 for 1996, and was 28% of advertising revenues. Since the Company did not begin selling advertising until 1996, all content creation costs in 1995 were charged to research and development and selling and marketing expenses.

Cost of Service Revenues. Cost of service revenues was $33,000 and $554,000 for 1995 and 1996, respectively, and was 110% and 49%, respectively, of service revenues. The increase in absolute dollars was due primarily to increased staff and other costs associated with providing these services to a greater number of customers. The decrease in percentage terms was due to better utilization of service personnel associated with an increased customer base.

Operating Expenses

Research and Development. Research and development expenses were $1,380,000 and $4,812,000 for 1995 and 1996, respectively, and 76% and 34%, respectively, of total net revenues. The increase in absolute dollars was attributable primarily to increased personnel and related costs associated with enhancement of existing products and development of new products. The decrease in percentage terms was a result of revenues growing at a faster rate than research and development expenses.

Selling and Marketing. Selling and marketing expenses were $1,218,000 and $7,540,000 for 1995 and 1996, respectively, and 67% and 54%, respectively, of total net revenues. The increase in absolute dollars was due primarily to increased salaries, direct sales personnel, commissions, costs associated with international expansion and promotional expenses. The decrease in percentage terms was a result of revenues growing at a faster rate than selling and marketing expenses.

General and Administrative. General and administrative expenses were $747,000 and $3,491,000 for 1995 and 1996, respectively, and 41% and 25%, respectively of total net revenues. The increase in absolute dollars was primarily a result of increased salaries and related expenses associated with the hiring of additional personnel and increased facilities expenses. The decrease in percentage terms was a result of revenues growing at a faster rate than general and administrative expenses.

Net Other Income

Net other income was $94,000 and $227,000 for 1995 and 1996, respectively. The increase was due primarily to interest income resulting from higher invested cash and cash equivalents and short-term investments.

Income Taxes

The Company has had a net operating loss for each period since inception. As of December 31, 1996, the Company had approximately $2,700,000 of net operating loss carryforwards for federal income tax purposes that will expire in 2010 and 2011 if not utilized. See Note 4 of Notes to Consolidated Financial Statements.

Quarterly Results of Operations

The following table sets forth certain unaudited quarterly statement of operations data for the five quarters ended June 30, 1997. In the opinion of management, this information has been prepared substantially on the same basis as the audited Consolidated Financial Statements appearing elsewhere in this Prospectus, and all necessary adjustments, consisting only of normal recurring adjustments, have been included in the amounts stated below to present fairly the unaudited quarterly results. The quarterly data should be read in conjunction with the audited Consolidated Financial Statements of the Company and the Notes thereto appearing elsewhere in this Prospectus. The operating results for any quarter are not necessarily indicative of the operating results for any future period.

	QUARTER ENDED				
	JUNE 30, 1996	SEPT. 30, 1996	DEC. 31, 1996	MARCH 31, 1997	JUNE 30, 1997
	(IN THOUSANDS)				
Total net revenues	$ 2,479	$ 4,030	$ 5,738	$ 6,356	$ 7,010
Total cost of revenues	249	575	1,216	2,021	1,033
Gross profit	2,230	3,455	4,522	4,335	5,977
Operating expenses:					
Research and development	989	1,334	1,739	2,725	2,738
Selling and marketing	1,445	2,125	3,151	4,350	4,811
General and administrative	820	906	1,173	1,171	1,325
Total operating expenses	3,254	4,365	6,063	8,246	8,874
Operating loss	(1,024)	(910)	(1,541)	(3,911)	(2,897)
Net other income	68	43	67	205	231
Net loss	$ (956)	$ (867)	$(1,474)	$(3,706)	$(2,666)

	AS A PERCENTAGE OF TOTAL NET REVENUES				
	JUNE 30, 1996	SEPT. 30, 1996	DEC. 31, 1996	MARCH 31, 1997	JUNE 30, 1997
Total net revenues	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %
Total cost of revenues	10.0	14.3	21.2	31.8	14.7
Gross profit	90.0	85.7	78.8	68.2	85.3
Operating expenses:					
Research and development	39.9	33.1	30.3	42.9	39.1
Selling and marketing	58.3	52.7	54.9	68.4	68.6
General and administrative	33.1	22.5	20.5	18.4	18.9
Total operating expenses	131.3	108.3	105.7	129.7	126.6
Operating loss	(41.3)	(22.6)	(26.9)	(61.5)	(41.3)
Net other income	2.7	1.1	1.2	3.2	3.3
Net loss	(38.6)%	(21.5)%	(25.7)%	(58.3)%	(38.0)%

The Company's total net revenues have increased in all quarters presented as a result of increasing market acceptance of the Company's direct products, diversification of the Company's sales channels, including electronic distribution, expansion of the Company's direct sales efforts, and continued increases in its installed customer base. In the third quarter of 1996, the Company released RealPlayer Plus. During the first quarter of 1997, the Company released a beta version of RealVideo and began recognizing revenues upon the final release of RealVideo in the second quarter of 1997. The increases in total cost of revenues as a percentage of total net revenues in the third and fourth quarters of 1996 were due to a shift in product mix toward RealPlayer Plus products, a greater percentage of sales through indirect channels and the utilization of a third-party order fulfillment agency. In the first quarter of 1997, the Company held its first RealMedia conference and recognized revenues and cost of revenues of $498,000 and $1,000,000, respectively, which increased total cost of revenues as a percentage of total net revenues.

Operating expenses increased in each quarter reflecting increased spending on developing, selling, marketing and supporting the Company's products, as well as building the Company's market presence. Research and development expenses have increased as a result of continued enhancements to existing products and development of new products. Selling and marketing expenses increased as a result of increased sales personnel and commissions. In the first and second quarters of 1997, the Company increased marketing activities associated with the release of RealVideo. The trend of increasing general and administrative expenses is due primarily to additional personnel and facilities costs.

Factors Affecting Operating Results

As a result of the Company's limited operating history and the emerging nature of the markets in which it competes, the Company is unable to forecast accurately its revenues. The Company's expense levels are based in part on its expectations with regard to future revenues. The Company may be unable to adjust spending in a timely manner to compensate for any unexpected revenue shortfall. As a result, any significant shortfall in demand for the Company's products and services relative to the Company's expectations would have an immediate material adverse effect on the Company's business, financial condition and results of operations. Further, as a strategic response to changes in the competitive environment, the Company may from time to time implement pricing, service or marketing changes

that could have a material adverse effect on its business, financial condition and results of operations. See "Risk Factors -- Unpredictability of Future Revenues; Potential Fluctuation in Quarterly Operating Results," "-- Competition; Relationship With Microsoft" and "Business -- Competition."

The Company expects to experience significant fluctuations in its future quarterly operating results due to a variety of factors, many of which are outside the Company's control, including (i) demand for the Company's products and services, (ii) introduction or enhancement of products and services by the Company and its competitors, (iii) market acceptance of new products and services of the Company and its competitors, (iv) price reductions by the Company or its competitors or changes in how products and services are priced (such as the Company's recent decision to distribute free of charge a version of its basic EasyStart Server, which previously sold for $295 to $995), (v) the mix of products and services sold by the Company and its competitors, (vi) the mix of distribution channels through which the Company's products are licensed and sold, (vii) the mix of international and North American revenues, (viii) costs of litigation and intellectual property protection, (ix) the growth in the use of the Internet, (x) the Company's ability to attract and retain qualified personnel, (xi) the amount and timing of operating costs and capital expenditures related to expansion of the Company's business, operations and infrastructure, (xii) technical difficulties with respect to the use of the Company's products, (xiii) governmental regulations and (xiv) general economic conditions and economic conditions specifically related to the Internet. It is often difficult to forecast what the effect of such factors would be, or the effect that any such factors or any combination thereof would have on the Company's results of operations for any given fiscal quarter. The Company has used, and expects to continue to use, price promotions to increase trial, purchase and use of its products, as well as to increase the overall brand awareness of RealNetworks. The effect of such promotions on revenues in a particular period may be significant and extremely difficult to forecast. Based on the foregoing, the Company believes that its quarterly revenues, expenses and operating results could vary significantly in the future, and that period- to-period comparisons should not be relied upon as indications of future performance.

Management has observed that revenues from advertising sales have tended to be higher in the second and fourth quarters, and retail sales have tended to be highest in the fourth quarter. The Company typically operates with little or no backlog. As a result, quarterly sales and operating results depend primarily on the volume and timing of orders received in the quarter, both of which are difficult to forecast. The Company typically recognizes a substantial portion of its revenues in the last month of each quarter.

Due to the foregoing factors, it is likely that in some future quarters the Company's operating results will fall below the expectations of securities analysts and investors, which would likely have a material adverse affect on the trading price of the Common Stock.

Donation of Net Income to Charity

The Company's philosophy includes a commitment to charitable responsibility. If sustained profitability is achieved, the Company intends to donate approximately 5% of its annual net income to charitable organizations. As a result, the Company's net income will be reduced by the amount of these

charitable donations. See "Business -- Position on Charitable Responsibility."

Liquidity and Capital Resources

Since inception, the Company has financed its operations primarily through private sales of preferred stock and common stock and contributions of capital by the Company's founder. Net proceeds from these sales and contributions totaled $25,611,000.

Net cash used in operating activities was $1,240,000 and $635,000 in 1995 and 1996, respectively. Cash used in operating activities in 1995 was primarily attributable to a net loss of $1,501,000. For 1996, cash used in operating activities resulted primarily from a net loss of $3,789,000 and an increase of $2,608,000 in trade accounts receivable, largely offset by increases of $2,267,000 in deferred revenue, $2,220,000 in accounts payable and $822,000 in accrued expenses. Net cash used in operating activities was $5,658,000 for the six months ended June 30, 1997. This was attributable primarily to a net loss of $6,372,000, a decrease in accounts payable of $862,000 and an increase of $1,049,000 in trade accounts receivable, partially offset by increases of $801,000 in accrued expenses and $620,000 in deferred revenue.

Net cash used in investing activities of $3,660,000, $4,837,000, and $5,107,000 for the years ended December 31, 1995 and 1996 and the six months ended June 30, 1997, respectively, was primarily related to purchases of property and equipment and increases in short-term investments.

Cash provided by financing activities of $8,029,000 in 1995 consisted primarily of $7,405,000 in net proceeds from the issuance of Series B and C Preferred Stock and a capital contribution by the founder of $372,000. Cash provided by financing activities of $17,091,000 in 1996 was primarily from net proceeds of $17,047,000 from the issuance of Series D Preferred Stock. Cash flows provided by financing activities of $1,009,000 for the six months ended June 30, 1997 were primarily from $991,000 of proceeds from the issuance of a note payable.

As of June 30, 1997, the Company had $4,972,000 of cash and cash equivalents and $6,524,000 in short-term investments. As of June 30, 1997, the Company's principal commitments consisted of obligations outstanding under operating leases and a $991,000 note payable. Although the Company has no material commitments for capital expenditures, it anticipates a substantial increase in its capital expenditures and lease commitments consistent with anticipated growth in operations, infrastructure and personnel.

In October 1996, the Company established a $1,000,000 line of credit and a $1,500,000 term loan with Silicon Valley Bank. The line of credit and term loan bear interest at the prime rate plus 0.75% and 1.0% per annum, respectively. In December 1996, Silicon Valley Bank amended the agreements to waive the financial covenants applicable thereunder. There were no borrowings outstanding under the line of credit or the term loan as of December 31, 1996 and June 30, 1997.

Since inception, the Company has significantly increased its operating expenses. The Company currently anticipates that it will continue to experience significant growth in its operating expenses for the foreseeable future and that its operating expenses will be a material use of the Company's cash resources. The Company believes that the net proceeds from the offering, together with its current cash, cash equivalents and short-term investments, will be sufficient to meet its anticipated cash needs for working capital and capital expenditures for at least the next 12 months.

Recent Developments

In June 1997, the Company and Microsoft entered into a strategic agreement pursuant to which the Company granted Microsoft a nonexclusive license to certain substantial elements of the source code of the Company's RealAudio/RealVideo Version 4.0 technology, including its basic RealPlayer and substantial elements of its EasyStart Server products, and related Company trademarks. In July 1997, the Company received a $30,000,000 prepayment related to the license agreement. The agreement requires the Company to provide Microsoft with engineering consultation services, certain error corrections and certain technical support over a defined term. In connection with the agreement, Microsoft purchased a minority interest in the Company in the form of 3,338,374 shares of Series E Preferred Stock for $30,000,000, plus a warrant to purchase up to 3,709,305 shares of Series E Preferred Stock at an exercise price of $13.48 per share.

In August 1997, the U.S. Department of Justice commenced an investigation into horizontal merger activities within the streaming media industry. The Department of Justice served several companies, including the Company and Microsoft, with subpoenas to produce certain documents. As a result of the investigation, it is possible that the Department of Justice will require certain actions by the Company, Microsoft or other companies in the streaming media industry that could, among other things, affect Microsoft's obligations with respect to the distribution of the Company's products, require the Company to refund all or a portion of the license fee paid by Microsoft to the Company, require Microsoft to limit or divest certain of its acquisitions or investments in the streaming media industry, including its investment in the Company, and, if Microsoft were forced to rescind its agreement with the Company, place the Company at a significant competitive disadvantage within the industry. There can be no assurance that any such outcome would not have an immediate material adverse effect on the Company's business, financial condition and results of operations. See "Risk Factors -- Department of Justice Subpoena."

In September 1997, the Company terminated its line of credit and term loan with Silicon Valley Bank.

New Accounting Pronouncements

In February 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 128, Earnings Per Share ("Statement 128"). Statement 128 establishes standards for the computation, presentation and disclosure of earnings per share ("EPS"), replacing the presentation of the currently required Primary EPS with a presentation of Basic EPS. It

also requires dual presentation of Basic EPS and Diluted EPS on the face of the income statement for entities with complex capital structures. Basic EPS is based on the weighted average number of common shares outstanding during the period. Diluted EPS is based on the potential dilution that would occur upon exercise or conversion of securities into common stock using the treasury stock method. Statement 128 is effective for financial statements for periods ending after December 15, 1997, including interim periods; earlier application is not permitted. When adopted, the Company will be required to restate its EPS data for all prior periods presented. The Company does not expect the impact of the adoption of Statement 128 to be material to its reported EPS amounts.

In June 1997, the FASB issued SFAS No. 130, Reporting Comprehensive Income ("Statement 130"). Statement 130 establishes standards for reporting and disclosure of comprehensive income and its components (revenues, expenses, gains and losses) in a full set of general-purpose financial statements. Statement 130 is effective for fiscal years beginning after December 15, 1997. Reclassification of financial statements for earlier periods provided for comparative purposes is required. The Company has not determined the manner in which it will present the information required by Statement 130.

In June 1997, the FASB issued SFAS No. 131, Disclosure About Segments of an Enterprise and Related Information("Statement 131"). Statement 131 establishes standards for the way that public business enterprises report information about operating segments. It also establishes standards for related disclosures about products and services, geographic areas and major customers. Statement 131 is effective for financial statements for periods beginning after December 15, 1997. In the initial year of application, comparative information for earlier years is to be restated. The Company has not determined the manner in which it will present the information required by Statement 131.

Business

The Company

RealNetworks is a leading provider of branded software products and services that enable the delivery of streaming media content over the Internet and intranets. The Company's products and services include its RealAudio and RealVideo software system, an electronic commerce Web site designed to promote the proliferation of streaming media products and a network of advertising- supported content aggregation Web sites. As the Web continues to evolve as a mass communications medium, the Company believes that an increasing amount of the types of content currently delivered through traditional media, such as radio and television, will be delivered over the Internet. The Company believes that streaming media technology is essential to this transition because it enables a more compelling user experience, allowing the Internet to compete more effectively with traditional media for audience share.

From its inception, the Company has strategically chosen to offer its RealPlayer software to individual users free of charge to promote the widespread adoption of its client software and to speed the acceptance of Internet multimedia. The Company believes that more than 18 million copies of its

RealPlayer software have been downloaded and that over 200,000 copies of its premium client product, RealPlayer Plus, have been sold electronically in the product's first year of distribution. In addition, the Company believes that more than 55,000 hours per week of live audio and video content are broadcast over the Web using RealAudio and RealVideo technology, and that more than 150,000 Web pages use the Company's software. The Company's customers, including ABC Radio Net, Bloomberg Online, The Boeing Company, Dow Jones & Company, Inc. ("Dow Jones"), NBC Desktop, News Corporation ("News Corp."), Starwave Corporation ("Starwave") and 3Com Corporation ("3Com"), use its software products and services to deliver a broad range of streaming audio and video news, sports, entertainment and corporate information over the Internet and intranets.

Industry Background

The Internet has grown rapidly in recent years, driven by the development of the Web and graphically intuitive Web browsers, the proliferation of multimedia PCs, increasingly robust network architectures and the emergence of compelling Web-based content and commerce applications. The broad acceptance of the standard Internet Protocol ("IP") has also led to the emergence of intranets and the development of a wide range of non-PC devices that allow users to access the Internet and intranets. International Data Corporation ("IDC") estimates that the number of Web users worldwide will continue to grow rapidly from 28 million in 1996 to an estimated 175 million in 2001. In addition, users are spending an increasing amount of time on the Web. A recent study by the Georgia Institute of Technology indicates that 51% of total Internet users access the Internet for 10 or more hours per week as of April 1997, compared with 29% as of April 1995.

The development of the Web has contributed to the transition of the Internet from a text and e-mail-focused data-sharing network to a richer environment, capable of delivering graphical and interactive content. The Web has a number of features unavailable in traditional media and commerce channels that attract online users, content providers, advertisers and merchants. The relatively low barriers to publishing content on the Web have led to an explosion of Web-based content and the development of a large and diverse group of Web-based communication channels. As an interactive, searchable, user-controlled medium, the Web provides a highly engaging user experience and allows users to access this broad range of online content on demand and at their convenience. The narrow-casting capabilities of the Web enable content providers and advertisers to establish customized, personalized interactions with consumers.

The development of streaming media technology has further enhanced the graphical capabilities of the Internet and intranets. Streaming technology enables the transmission and playback of continuous "streams" of multimedia content, such as audio and video, and represents a significant advancement over earlier technologies. Prior to the advent of streaming technology, users could not initiate the playback of audio or video clips until such content was downloaded in its entirety, resulting in significant waiting times. As a result, live broadcasts of audio and video content over the Internet or intranets were not possible.

Market Opportunity

The Company believes that the emergence of rich multimedia capabilities, such as streaming audio and video, has significantly enhanced the effectiveness of the Web as a global mass communications medium and has accelerated the adoption of corporate intranets as a means to improve communications within enterprises. Many businesses and content providers now offer interactive audio, video and other multimedia content as a means of enriching and differentiating their Web sites. The Company believes that more than 55,000 hours per week of live audio and video content are broadcast over the Web using RealAudio and RealVideo technology, with a substantially greater amount of recorded media available on demand.

These enhanced multimedia capabilities, combined with the unique interactive properties of the Internet, are attracting a large and expanding audience, a growing number of advertisers and an increasing breadth and depth of content and online commercial applications. The market for Web advertising revenues is expected to grow from $180 million in 1996 to $2.9 billion in 2000, according to IDC. Overall usage growth, together with the Internet's unique interactive properties, has also led to a rapidly evolving online commerce opportunity. IDC estimates that worldwide revenues generated by Web-based commerce will grow from $2.6 billion in 1996 to $223 billion in 2001. As a result of the growth in business opportunities on the Internet, the market for software solutions that focus on the Internet and intranets is also growing rapidly. IDC estimates that Internet-focused software revenues will grow from $359 million in 1996 to $4.3 billion in 2000.

As the Web continues to evolve as a mass communications medium, the Company believes that an increasing amount of the types of content currently delivered through traditional media, such as radio and television, will be delivered over the Internet. The Company believes that streaming media technology is essential to this evolution because it provides a more compelling user experience, allowing the Internet to compete more effectively with traditional media for audience share.

The Company believes that to successfully capitalize on this opportunity, streaming media providers must address the following challenges:

DELIVER COMPELLING STREAMING MEDIA CONTENT IN BANDWIDTH CONSTRAINED ENVIRONMENTS. The Internet was designed to transmit discrete packets of data and is not inherently well suited to the delivery of continuous streams of multimedia data without additional software. In addition, bandwidth is limited in Internet and intranet environments, posing significant technological challenges for delivery of high-quality streaming audio and video content.

ENABLE BROAD-BASED ACCESS TO STREAMING MEDIA TECHNOLOGY. Online content providers, advertisers and merchants must make a significant investment to create and deliver streaming media content and need to reach a sufficiently large audience to generate an adequate return on such investment. As a result, content providers must consider the popularity and quality of a particular streaming media solution before committing resources to delivering content using that solution. The Company believes that Internet users prefer client software that has widespread market acceptance and is compatible with substantial amounts of encoded content.

DRIVE CONSUMER USAGE. The Company believes that consumer interest in streaming media content is driven in large part by the ability to locate and experience such content easily. As a result, the Company believes that the development of well-marketed, compelling Web sites that aggregate streaming media content is central to the continued growth of multimedia content on the Web.

The Company believes that a substantial opportunity exists to provide software solutions and content aggregation and delivery services that address these challenges and support the development of large and growing advertising and electronic commerce markets on the Web.

The Realnetworks Solution

RealNetworks enables and promotes the transmission of real-time streaming media content over the Internet and intranets. The Company provides an integrated suite of branded streaming media software products and services, including its RealAudio and RealVideo system, an electronic commerce Web site designed to promote the proliferation of streaming media products and a network of advertising-supported content aggregation Web sites. Each of the Company's products and services has been designed to address the technological and market development challenges that confront streaming media content providers.

STREAMING MEDIA TECHNOLOGY. RealNetworks has been a pioneer in the development of streaming technology and continues to offer leading streaming media software solutions. The Company's products use advanced compression and error-correction technologies to deliver acceptable performance even in bandwidth-constrained environments. The Company has won numerous awards for its technology, including a PC Magazine Editor's Choice award for streaming video in October 1997. The Company's software runs on a broad range of operating systems and hardware platforms, enabling content providers to reach a broad audience and enterprises to deliver intranet content in heterogeneous computing environments.

REALPLAYER UBIQUITY AND BRAND STRENGTH. From its inception, the Company has strategically chosen to offer its RealPlayer software to individual users free of charge to promote the widespread adoption of its client software and speed the acceptance of Internet multimedia. The Company estimates that more than 18 million copies of its RealPlayer software have been downloaded and that more than 150,000 Web pages use the Company's software. In addition, over 1,200 third-party developers have joined the Company's Real Developer Program. To continue the broad market adoption of its server products, the Company now offers its basic server free of charge to accelerate the delivery of RealAudio and RealVideo content. As a result of these activities and the Company's aggressive promotional programs, the Company believes that the "Real" brand has become one of the most widely recognized brands on the Internet.

ELECTRONIC COMMERCE DISTRIBUTION CHANNEL. The Company has pursued an electronic commerce distribution strategy designed to further accelerate product adoption and drive upgrade and cross-selling opportunities among its existing installed user base. The Company's online distribution efforts have resulted in electronic sales of over 200,000 copies of the Company's RealPlayer Plus in its

first year of distribution and the collection of a database of information of over 7 million names. Recently, the Company opened its RealStore Web site, an online store for the sale of the Company's products, third-party multimedia tools and utilities, and intranet-based training products. The Company believes that it will be able to continue to facilitate the adoption and growth of streaming media content by providing a concentrated marketplace and a low-cost distribution mechanism for emerging streaming media tools and their developers.

STREAMING MEDIA CONTENT AND AGGREGATION. The Company's advertising-supported Web sites, including Timecast, LiveConcerts.com, and Film.com, aggregate, organize and provide streaming media programming, in order to build consumer awareness and Web site traffic for streaming media content. According to I/Pro, the Company's network of Web sites attracted on average over 380,000 visitors and generated over two million page impressions per day. The Company's Daily Briefing and Destination Button services provide one-click access to a range of third-party programming. In addition to generating advertising revenues, these sites and services stimulate demand for and creation of streaming media content and the Company's RealAudio and RealVideo system.

Business Strategy

The Company's objective is to be the leading streaming media company, providing software and services that enable the delivery of a broad range of multimedia content over the Internet and intranets, thereby facilitating the evolution of the Internet into a mass communications and commerce medium. To achieve this objective, the Company's strategy includes the following key elements:

EXTEND TECHNOLOGY LEADERSHIP. The Company has established a reputation as a leader in streaming media technology and intends to continue to maintain its reputation for quality and innovation by expanding the features and breadth of its audio and video product offerings. The Company believes that the fundamental architecture of its products can also be expanded to support synchronized streaming of a wide variety of other time-based data types, such as MIDI, images, animation and multimedia presentations. As part of this strategy, the Company has devoted and will continue to commit significant resources to the development of technologies that increase the scaleability of streaming media solutions.

MAXIMIZE MARKET PENETRATION AND BRAND NAME RECOGNITION. The Company believes that it is the recognized leader in the streaming media technology and that its "Real" brand is one of the most widely recognized brand names on the Internet. Since its inception, the Company has sought to achieve rapid and broad adoption of its technologies and strong brand recognition. This strategy has been pursued through various means, such as offering the Company's RealPlayer to individual users free of charge over the Internet, bundling the Company's products with those of other major vendors and using multiple distribution channels, including both direct sales and indirect OEM and retail relationships. The Company has recently intensified its efforts to proliferate its streaming technology by offering its basic EasyStart Server free of charge and entering into a licensing and distribution agreement with Microsoft. The Company also intends to continue to promote the

adoption of industry standards that are either based on or compatible with its technologies. For example, the Company is one of the principal co-authors of RTSP, a proposed industry standard for the control and delivery of streaming media.

LEVERAGE MARKET POSITION TO EXPAND BUSINESS MODEL. Management believes that the Company's technology leadership, market position and brand name are significant assets that the Company can leverage to maintain and increase its market share and diversify its revenue base. The Company intends to leverage these assets as follows:

- GROW STREAMING MEDIA SOFTWARE BUSINESS. The Company intends to capitalize on the growth in demand for streaming media software by continuing to develop, market and support industry-leading products and services. The Company also plans to strengthen its marketing, sales and customer support efforts as the size of its market opportunity and customer base increases.

- EXPAND INTERNET COMMERCE BUSINESS. The Company's Web sites provide product information and fulfillment resources for streaming media content users and developers. The Company recently opened its RealStore Web site, an online store for the sale of the Company's products, third-party multimedia tools and utilities and intranet-based training products. The Company believes that it will be able to continue to facilitate the adoption and growth of streaming media content by providing a concentrated marketplace and a low-cost distribution mechanism for emerging streaming media tools and their developers.

- OFFER LEADING CONTENT AGGREGATION SITES FOR STREAMING MEDIA. The Company has developed a network of Web sites that aggregate links to third-party streaming media programming. The Company plans to continue building Web site traffic from these activities to increase Web site advertising revenues, increase visibility and sales of the Company's products, promote the use of streaming media content on the Internet or intranets and promote the Company's Internet commerce platform.

DEVELOP AND MARKET STREAMING MEDIA SOLUTIONS FOR A VARIETY OF PLATFORMS AND BANDWIDTHS. The Company's rapid growth is attributable in part to the wide acceptance of the streaming media solutions it has developed for PCs networked in low-bandwidth environments. However, significant efforts are underway to make the Internet available on a wider range of platforms, including non-PC Internet appliances, and over higher-speed connections, including cable modems. Accordingly, the Company has designed its solutions to add value in a range of bandwidth environments and to be flexible enough to port easily to new platforms. As a result, management believes that the Company is positioned to capitalize on possibly significant platform and bandwidth changes.

STRENGTHEN STRATEGIC RELATIONSHIPS. The Company has established strategic relationships with a variety of industry participants, including software and hardware vendors, entertainment companies, content publishers and broadcast media companies. The Company's relationship with Microsoft enables wider distribution of the Company's products and promotes interoperability among numerous streaming media technologies. In addition to its relationship with Microsoft, the Company has formed strategic distribution relationships with several other companies, including Starlight

Networks Inc. ("Starlight") and Macromedia, has formed a joint venture in Japan with NTT PC Communications, Inc. ("NTT"), Kokusai Denshin Denwa Co., Ltd. ("KDD") and Trans Cosmos, Inc. ("Trans Cosmos") and has entered into a pilot program with MCI Communications Corporation ("MCI") to distribute the RealNetwork broadcast service. The Company pursues strategic relationships for a variety of purposes, such as maximizing rapid penetration, validation and adoption of its technologies; aiding the development of compelling content to build consumer demand for streaming media over the Internet; and expanding the range of commercial activities based on its technology and brand name. The Company has also collaborated with other industry leaders for the purpose of developing software protocols for proposed adoption as industry standards. Although the Company has not engaged in significant joint technology development relationships to date, it anticipates that it may form third-party development relationships in the future as it seeks to expand the fundamental architecture of its technology and influence the direction of technological developments in the industry.

Products and Services

The Company develops and markets software products and services that enable the delivery of streaming audio and video content over the Internet and intranets. The Company also conducts electronic commerce and sells advertising through its Web sites, provides audio and video broadcast services to third parties, and provides various other services designed to promote widespread usage of the Company's technology.

Media System

The Company's streaming media system allows content providers to encode content such as live music, video or other multimedia programming into discrete data packets that can be broadcast to large numbers of simultaneous users.

EASYSTART SERVERS. The Company offers a basic EasyStart Server free of charge from its Web site. This product enables content providers to stream both audio and video to as many as 60 simultaneous users.

PROFESSIONAL SERVERS. The Professional Server is designed for use by commercial Web sites, including media content providers that distribute audio and/or video content over the Internet to a broad base of consumers. This server can be purchased for either audio-only or both audio and video broadcasting purposes. In addition to the basic streaming features of the EasyStart Server, the Professional Server offers advanced administrative features and the ability to reach a larger audience. Professional Server licenses start at $4,995 and are priced based on the number of streams licensed.

INTRANET SYSTEMS. The Intranet System is a Professional Server designed specifically for use in intranet applications. The Intranet System includes a site license for the RealPlayer. A 10-user Intranet System is available free of charge from the Company's Web site. Larger system licenses start at $6,995

and are priced according to the number of licensed users.

REALENCODERS. The Company's RealEncoders enable content providers to convert live or recorded audio and video programming into the Company's proprietary file format. This highly compressed file format increases the efficiency of limited-bandwidth transmissions and is readable by the Company's players. The RealEncoder is distributed free of charge from the Company's Web site.

REALNETWORK BROADCAST SERVICE. The Company operates the RealNetwork broadcast service, which uses the Company's splitter technology to broadcast content to thousands of simultaneous users through IP multicasting or traditional unicasting. In August 1997, the Company and MCI announced that they had commenced a pilot program in which the Company's technology will be incorporated into MCI's Internet backbone. The RealNetwork broadcast service will enable broadcasters to reach up to 50,000 users simultaneously by combining MCI's nationwide network of datalines and computer centers with the Company's streaming media and splitter technologies. Current content providers using the RealNetwork broadcast service include ABC News, Inc., Atlantic Recording Corporation, ESPN, Inc., and Major League Baseball teams, including the Los Angeles Dodgers and the Seattle Mariners. The Company often uses the RealNetwork broadcast service to host its own content. In select cases, the Company has and will continue to enter into relationships with content providers in which the providers' content is hosted on the RealNetwork broadcast service at the Company's expense in exchange for a share of the advertising or other revenue generated.

In May 1997, the Company entered into a joint venture with NTT, KDD and Trans Cosmos in Japan to establish J-Stream Co. Inc. ("J-Stream"), which, like the Company's RealNetwork broadcast service, streams audio and video content to users through IP multicasting or traditional unicasting. The Company supplies its RealAudio and RealVideo system and technical support for the operation of the J-Stream broadcast network. The Company holds a 24% interest in the joint venture.

CONSULTING. The Company provides a range of consulting services that principally relate to the creation and maintenance of streaming media networks based on the Company's technology. Commonly provided services include sound editing, video production assistance and network design.

Consumer Products and Electronic Commerce

The Company's player enables a user to listen to or view content from Web sites that use the Company's server products. The player decompresses and decodes audio and video packets transmitted by the server, reassembles them in the correct order, identifies and requests retransmission of any missing data packets, and then plays back the reassembled audio or video content for the user in real-time. The players can be easily installed and used by nontechnical computer users, even using dial-up modems over standard voice-grade telephone lines.

REALPLAYER. RealPlayer, the Company's standard player, can be downloaded free of charge from the Company's Web site and currently is distributed by a number of third parties in combination with their own products. RealPlayer offers basic functions such as play, stop, fast-forward, rewind and volume

adjustment, as well as the ability to program six Destination Buttons, which provide one-click access to preprogrammed audio and video content.

REALPLAYER PLUS. The RealPlayer Plus is an enhanced player that can be downloaded from the Company's Web site or purchased in a retail store for a suggested price of $29.95. RealPlayer Plus not only offers basic RealPlayer functions, but also features a scan function and 40 programmable buttons that allow users to preset favorite content. Customers who purchase a RealPlayer Plus also have access to special content available only to RealPlayer Plus users.

ELECTRONIC COMMERCE AND REALSTORE. Since August 1996, the Company has sold its products electronically. On September 8, 1997, it opened its RealStore Web site, an online store for the sale of the Company's products, third-party streaming media tools and utilities and intranet-based corporate training products. Through this distribution channel, the Company is able to offer a broad selection of products with little inventory risk or merchandising expense.

Media Publishing Products and Services

The Company's network of Web sites aggregates, organizes and provides streaming media programming through a variety of navigational and theme-oriented content sites. These sites derive revenues from the sale of advertising to third parties such as General Motors Corporation, International Business Machines Corporation, AT&T Corp. and Microsoft. The Company has been instrumental in pioneering new forms of Internet advertising, including in-stream advertising, in which streamed audio and video advertisements are inserted into selected programming.

In addition to its main Web site, the Company's network of Web sites includes:

Timecast, a guide to RealAudio and RealVideo content that offers programming information from and links to over 2,500 Web sites, including over 500 radio and television stations;

LiveConcerts.com, which, in cooperation with House of Blues, offers live streamed music concerts using the Company's products as well as access to services, including up-to-date concert schedules;

Film.com, which the Company began hosting in September 1997, provides in-depth information about, and streaming media clips of, movies, including reviews and previews; and Daily Briefing allows customers to design their own custom streaming media newscasts from over 35 short programs in the areas of news, sports, entertainment, weather and business/technology, and to receive the custom newscasts daily. Daily Briefing providers include NBC News, The Weather Channel, CBS/SportsLine, and Warner Bros.

Technology

The Company's client/server software system is designed to optimize the delivery of streaming media over the Internet, intranets or any IP-based network. The system is based on open industry standards and works with a broad range of operating systems, hardware platforms and media types.

Codecs

The Company's system uses multiple compression/decompression algorithms (or "codecs") to translate time-based data-intensive content such as audio and video data into discrete data packets and then broadcast (or "stream") the packets to the client (or "player"). The player then reassembles the packets in the correct order and plays back the streaming media content in real-time. The compression process enables the data to be streamed to the player even in very low bandwidth (14.4 kbps) or congested network environments by reducing the amount of data to be streamed.

Transmission Technology and Protocols

Neither of the two basic Internet transport protocols, User Datagram Protocol ("UDP") and Transport Control Protocol ("TCP"), was originally designed to handle the transmission of real-time content. UDP is able to transmit data packets efficiently and without delays, but is not generally robust enough to ensure delivery of all data packets. TCP generates robust and reliable transmissions, but is not designed for efficient and continuous real-time delivery of content. Higher level Internet protocols, such as File Transfer Protocol ("FTP") and Hypertext Transfer Protocol ("HTTP"), were designed originally for one-way continuous transmissions and as such do not efficiently allow the player to communicate back to the server to activate functions such as fast forward, pause and rewind or to select a particular portion of a clip for playing.

To address the inherent limitations of the Internet with respect to multimedia delivery, the Company has developed its own client/server software architecture based on advanced transmission technologies and protocols. Key elements of the Company's technology solution include:

- BUFFERING: Because the streaming of continuous, time-based content such as audio or video must occur in real-time and with minimal transmission loss, the Company's technology incorporates a time delay (or "buffering") feature that allows the player extra time to accumulate data packets and, if any are missing, request retransmission of particular packets. As a result, transmission and playback quality can be optimized, even in highly congested transmission environments.

- BIDIRECTIONAL COMMUNICATION: The Company's server and player communicate during transmission regarding the bandwidth and quality of the user's connection to optimize the transmission by using the system's bandwidth negotiation and dynamic connection management capabilities. For example, the system is able to detect the available bandwidth and the extent of packet loss and performance degradation.

- ERROR-MITIGATION: To the extent that buffering and packet retransmission efforts are insufficient to maintain acceptable quality of user experience, the Company's system draws on several techniques designed to mitigate performance degradation, including interpolation methods that "reconstruct" lost data packets based on approximations regarding adjacent or closely related data packets, UDP-based retransmission of lost packets and forward error correction.

- SMART NETWORKING: This feature allows a server to stream content to the player via unicasting or IP multicasting and automatically select the appropriate transmission protocol (UDP, TCP or HTTP) depending on current network conditions and the presence of firewalls or proxies.

- VIDEO-OPTIMIZED TRANSMISSION: Because video transmissions are more data-intensive than audio transmissions, the encoding of video streams for low bandwidth requires a higher compression ratio. In addition to standard compression techniques, the Company uses a technique known as interframe compression, which reduces unnecessary repetition of redundant background data in neighboring video frames, thereby reducing the number of data packets being transmitted. The system also incorporates "stream thinning" technology that responds to episodes of performance degradation by dynamically reducing the amount of video content being streamed to the user, thereby preserving bandwidth for audio packets to maintain the continuity of the audio stream, which is often more central to the user experience than video.

In addition to its core client/server technology, the Company has adopted RTSP, a proposed protocol for standardizing the control and delivery of streaming media over the Internet. RTSP is a unified standard for a broad range of media data types and is intended to promote a greater level of interoperability among various streaming media solutions. RTSP is built on top of a number of other Internet standard protocols such as HTTP, TCP/IP and Real Transport Protocol, and is complementary with ASF, a file format for streaming media that does not specify a method of client-server interaction. RTSP provides the client-server specification necessary to stream ASF files (and many other file types) on the Internet. RTSP was submitted to the IETF in October 1996 with the support of over 40 companies. See "-- Microsoft Relationship" and "Risk Factors -- Impact of Evolving Standards."

Networked Multimedia for Large-scale Delivery

The Company's splitter technology allows broadcasters to transmit large numbers of simultaneous streams. Traditionally, a standalone server sends a separate signal to each individual user, which is an inefficient use of network bandwidth because the same signal is often being distributed through many of the same links on the network.

The Company's splitter technology enables one "central" server to broadcast a signal to a set of servers distributed around a network, which servers then transmit the signal to the end user, thereby minimizing the use of the network backbone and improving signal quality. The Company uses this technology in its RealNetwork broadcasting service, as well as in its J-Stream joint venture in Japan. See "-- Business Strategy -- Strengthen Strategic Relationships" and "-- Products and Services -- Media System."

Research and Development

The Company devotes a substantial portion of its resources to developing new products and product features, expanding and improving its fundamental streaming technology, and strengthening its technological expertise. During the fiscal year ended December 31, 1996, and the six months ended June 30, 1997, the Company expended approximately 34% and 41%, respectively, of its total net revenues on research and development activities. The Company intends to continue to devote substantial resources toward research and development for the next several years. At August 31, 1997, the Company had 90 employees, or 32% of its workforce, engaged in research and development activities. The Company must hire additional skilled software engineers to further its research and development efforts. The Company's business, financial condition and results of operations could be adversely affected if it is not able to hire and retain the required number of engineers.

Sales, Marketing and Distribution

The Company believes that any individual or company that desires to transmit or receive streaming media content over the Internet or intranets is a potential Company customer. To reach as many customer segments as possible, the Company markets its products and services through several direct and indirect distribution channels, including over the Internet, through a direct sales force, through OEMs and VARs, and internationally through distributors and the J-Stream joint venture. As of August 31, 1997, the Company employed 98 sales and marketing personnel worldwide.

ELECTRONIC COMMERCE. The Company's Consumer and E-Commerce Divisions are responsible for electronic commerce sales and marketing of the Company's products as well as third-party multimedia development products sold on the Company's RealStore Web site. Substantially all of the Company's products may be downloaded directly from the Company's Web sites, with over 18 million product downloads to date. The Company sells third-party products on its RealStore Web site on a consignment basis and, accordingly, incurs no inventory risk with respect to such products. Electronic distribution provides the Company with a low-cost, globally accessible, 24-hour sales channel.

DIRECT SALES FORCE. The Company's direct sales force markets the Company's products and services primarily to corporate customers worldwide. The direct sales force is comprised of the Major Accounts, National Accounts and Telesales groups of the Company's Media Systems Division. The Major Accounts and National Accounts groups market and sell to corporate customers primarily interested in server products for commercial Internet Web sites or intranets. The Telesales group develops and pursues leads generated from inquiries on the Company's Web sites and from downloads of its EasyStart Server.

OEMS AND VARS. The Strategic Channels, OEM and Consulting groups of the Company's Media Systems Division market and establish indirect distribution agreements. The Company has entered into various distribution relationships with third parties pursuant to which the Company's products

are incorporated into, or bundled with, the third party's products for delivery by the third party to end users. Such third parties include Creative Labs, Inc., Apple Computer, Inc., Network Computer, Inc., WebTV Networks, Inc. and Microsoft.

ADVERTISING SALES. The Company's Advertising Sales group markets and sells advertising on the Company's Web sites and within media streams that the Company hosts on behalf of its corporate customers.

INTERNATIONAL SALES. The Company has three international subsidiaries that market and sell the Company's products outside the U.S. and Canada. The Company distributes its products internationally through a direct sales force and distribution arrangements.

MARKETING PROGRAMS. The Company participates in trade shows, conferences and seminars, provides product information through the Company's Web sites, promotes and co-promotes special events, places advertising for the Company's products and services in print and electronic media, and sponsors special programs for software developers, including its own conference. The Company's marketing programs are aimed at informing distributors and end users about the capabilities and benefits of the Company's products and services, increasing brand name awareness, stimulating demand across all market segments and encouraging independent software developers to develop products and applications that are compatible with the Company's products and technology.

Microsoft Relationship

In June 1997, the Company entered into a strategic agreement with Microsoft, pursuant to which the Company granted Microsoft a nonexclusive license to certain substantial elements of the source code of the Company's RealAudio/RealVideo Version 4.0 technology, including its basic RealPlayer and substantial elements of its EasyStart Server products, and related Company trademarks. Under the agreement, Microsoft may sublicense its rights to the RealAudio and RealVideo Version 4.0 technology to third parties under certain circumstances. The agreement also provides for substantial refunds to Microsoft under prescribed circumstances that are solely within the Company's control. The amount of these refunds diminishes over time. The Company may not assign its obligations under the agreement without Microsoft's consent. Microsoft is obligated to distribute the Company's RealPlayer Version 4.0 for a defined term as long as the Company's player supports certain Microsoft architectures. The Company also agreed to work with Microsoft and several other companies to author and promote ASF as a standard file format for streaming media. The agreement also requires the Company to provide Microsoft with engineering consultation services, certain error corrections and certain technical support over a defined term.

In connection with the agreement, Microsoft also purchased a minority interest in the Company. Microsoft currently offers its own streaming media product, NetShow. In addition, Microsoft recently acquired VXtreme, a direct competitor of the Company in the market for streaming media software. Microsoft also owns a minority interest in VDOnet, a direct competitor of the Company in the market for streaming video software. As a result of Microsoft's agreement with the Company, its acquisition of

VXtreme, and is investment in VDOnet, Microsoft will be able to augment substantially the functionality of NetShow, its streaming media product, which could have a material adverse effect on the competitiveness of the Company's products. See "Risk Factors -- Department of Justice Subpoena."

Microsoft currently competes with the Company in the market for streaming media server and player software. The Company believes that Microsoft will compete more directly with the Company in the future. The Company also believes that Microsoft's commitment to and presence in the streaming media industry will dramatically increase competitive pressure in the overall market for streaming media software, leading to, among other things, increased pricing pressure and longer sales cycles. Such pressures may result in further price reductions in the Company's products and may also materially reduce the Company's market share. The Company believes that Microsoft will incorporate streaming media technology in its Web browser software and certain of its server software offerings, possibly at no additional cost to the user. In addition, notwithstanding the Company's cooperation with Microsoft regarding ASF, Microsoft may promote technologies and standards not compatible with the Company's technology. Microsoft has a longer operating history, a larger installed base of customers and dramatically greater financial, distribution, marketing and technical resources than the Company. As a result, there can be no assurance that the Company will be able to compete effectively with Microsoft now or in the future, or that the Company's financial condition and results of operations will not be materially adversely affected. In addition, if considerable consolidation occurs, there can be no assurance that the Company will be able to continue to compete effectively.

Customers

Since the Company's inception, the following companies have paid $45,000 or more to the Company for the purchase of products or services or the license of technology: ABC Radio Net, Apple Computer, Inc., Bandai Digital Entertainment Corporation, Bloomberg L.P., Boeing-Inform, Cisco Systems, Inc., Creative Labs, Inc., Dow Jones, Forefront Graphics Corporation, Internet Canada, Merrill Lynch & Co. Inc, Microsoft, Multiple Zones, Muzak, Navio Communications, Inc., NBC Desktop, NetRadio Network, Network Computer Inc., News Corp., Prodigy Services Company, Starwave, Tele2 Danmark A/S, Teledanmark In, Telia Data AB, 3Com, United Technologies Corp., WavePhore, Inc. and WebTV Networks, Inc. The Company's customers consist primarily of resellers and users located in the U.S. and Canada and various foreign countries. Sales to customers outside the U.S. and Canada, primarily Asia and Europe, were approximately 15%, 19% and 27% of total net revenues in the years ended December 31, 1995 and 1996 and the six months ended June 30, 1997, respectively.

Customer Support

The Company's customers have a choice of support options depending on the level of service desired. The Company maintains a technical support hotline to answer inquiries and provides an online database of technical information. The Company's support staff also responds to e-mail inquiries. The Company tracks all support requests through a series of customer databases, including current status

reports and historical customer interaction logs. The Company uses customer feedback as a source of ideas for product improvements and enhancements. As of August 31, 1997, the Company employed 10 technical representatives to respond to customer requests for support.

Competition

The market for software and services for the Internet and intranets is relatively new, constantly evolving and intensely competitive. The Company expects that competition will intensify in the future. Many of the Company's current and potential competitors have longer operating histories, greater name recognition and significantly greater financial, technical and marketing resources than the Company. The Company's principal competitors in the development and distribution of audio and video streaming solutions include Microsoft, VXtreme, VDOnet, Xing, Precept, Cubic, Motorola, Vivo, Vosaic and Oracle. The Company's RealAudio and RealVideo system also competes to a lesser degree with non-streaming audio and video delivery technologies such as AVI and Quicktime, and indirectly with delivery systems for multimedia content other than audio and video, such as Flash by Macromedia and Enliven by Narrative. Competitive factors in this market include the quality and reliability of software; features for creating, editing and adapting content; ease of use and interactive user features; scaleability and cost per user; and compatibility with the user's existing network components and software systems. To expand its user base and further enhance the user experience, the Company must continue to innovate and improve the performance of its RealAudio and RealVideo system. The Company anticipates that consolidation will continue in the streaming media industry and related industries such as computer software, media and communications. Consequently, competitors may be acquired by, receive investments from or enter into other commercial relationships with, larger, well-established and well-financed companies. There can be no assurance that the Company can establish or sustain a leadership position in this market segment. See "-- Microsoft Relationship."

The Company is committed to the continued market penetration of its brand, products and services, which, as a strategic response to changes in the competitive environment, may require pricing, licensing, service or marketing changes intended to extend its current brand and technology franchise. By way of example, the Company recently decided to distribute free of charge a version of its EasyStart Server, which previously sold for $295 to $995. Continued price concessions or the emergence of other pricing or distribution strategies by competitors may have a material adverse effect on the Company's business, financial condition and results of operations.

The Company derives significant revenues from the electronic distribution of certain of its products. The Company recently opened its RealStore Web site, an online store for the sale of the Company's products, third-party streaming media tools and utilities and Internet-based training products. The Company competes with a variety of Web sites, such as Buydirect.Com and Sofware.Net, which also offer software products for download. To compete successfully in the electronic commerce market, the Company must attract sufficient commercial traffic to its RealStore Web site by offering high-quality

merchandise in a compelling, easy-to-purchase format. There can be no assurance that the Company will be able to compete successfully in this market, and any failure to do so could have a material adverse effect on the Company's business, financial condition and results of operations.

In the Internet advertising segment, the Company competes for Internet advertising revenues with a wide variety of Web sites and Internet service providers. While Internet advertising revenues across the industry continue to grow, the number of Web sites competing for such revenue is also growing rapidly. The Company's advertising sales force and infrastructure are still in early stages of development relative to the Company's competitors. There can be no assurance that advertisers will place advertising with the Company or that revenues derived from such advertising will be material. In addition, if the Company loses advertising customers, fails to attract new customers, is forced to reduce advertising rates or modify its rate structure to retain or attract customers, or loses Web site traffic, the Company's business, financial condition and results of operations may be materially adversely affected.

Position on Charitable Responsibility

Immediately subsequent to the offering, Mr. Glaser will contribute 5% of his Common Stock to charitable organizations. In addition, Mr. Jacobsen will also make a sizable contribution of his Common Stock to charitable organizations. The Company is strongly committed to charitable responsibility, as evidenced by its donations of software to charitable organizations. If sustained profitability is achieved, the Company intends to donate approximately 5% of its annual net income to charitable organizations. The Company hopes to encourage employee giving by using a portion of its intended contribution to match charitable donations made by employees. See "Risk Factors -- Position on Charitable Responsibility."

Governmental Regulation

The Company currently is not subject to direct regulation by any governmental agency, other than laws and regulations generally applicable to businesses, although certain U.S. export controls and import controls of other countries, including controls on the use of encryption technologies, may also apply to the Company's products. However, due to the increasing popularity and use of the Internet, it is possible that a number of laws and regulations may be adopted in the U.S. and abroad with particular applicability to the Internet. It is possible that governments will enact legislation that may be applicable to the Company in areas such as content, network security, encryption and the use of key escrow, data and privacy protection, electronic authentication or "digital" signatures, illegal and harmful content, access charges and retransmission activities. Moreover, the applicability to the Internet of existing laws governing issues such as property ownership, content, taxation, defamation and personal privacy is uncertain. The majority of such laws were adopted before the widespread use and commercialization of the Internet and, as a result, do not contemplate or address the unique issues of the Internet and related technologies. Any such export or import restrictions, new legislation or

regulation or governmental enforcement of existing regulations may limit the growth of the Internet, increase the Company's cost of doing business or increase the Company's legal exposure, which could have a material adverse effect on the Company's business, financial condition and results of operations.

By distributing content over the Internet, the Company faces potential liability for claims based on the nature and content of the materials that it distributes, including claims for defamation, negligence or copyright, patent or trademark infringement, which claims have been brought, and sometimes successfully litigated, against Internet companies. The Company's general liability insurance may not cover potential claims of this type or may not be adequate to indemnify the Company for any liability that may be imposed. Any liability not covered by insurance or in excess of insurance coverage could have a material adverse effect on the Company's business, financial condition and results of operations. Although those sections of the Communications Decency Act of 1996 ("CDA") that, among other things, proposed to impose criminal penalties on anyone distributing "indecent" material to minors over the Internet, were held to be unconstitutional by the U.S. Supreme Court, there can be no assurance that similar laws will not be proposed and adopted. While the Company does not currently distribute the types of materials that the CDA may have deemed illegal, the nature of such similar legislation and the manner in which it may be interpreted and enforced cannot be fully determined and, therefore, legislation similar to the CDA could subject the Company to potential liability, which in turn could have an adverse effect on the Company's business, financial condition and results of operations. Such laws could also damage the growth of the Internet generally and decrease the demand for the Company's products and services, which could adversely affect the Company's business, financial condition and results of operations.

Intellectual Property

The Company's success depends in part on its ability to protect its proprietary software and other intellectual property. To protect its proprietary rights, the Company relies generally on patent, copyright, trademark and trade secret laws, confidentiality agreements with employees and third parties, and license agreements with consultants, vendors and customers, although the Company has not signed such agreements in every case. Despite such protections, a third party could, without authorization, copy or otherwise obtain and use the Company's products or technology to develop similar technology independently. There can be no assurance that the Company's agreements with employees, consultants and others who participate in product development activities will not be breached, that the Company will have adequate remedies for any breach, or that the Company's trade secrets will not otherwise become known or independently developed by competitors.

The Company currently has two patents pending in the U.S. relating to its product architecture and technology and holds one patent entitled "Method and Apparatus for Recommending Selections Based on Preferences in a Multi-User System." There can be no assurance that any pending or future patent applications will be granted, that any existing or future patent will not be challenged, invalidated or circumvented, or that the rights granted under any patent that has issued or may issue will provide competitive advantages to the Company. Many of the Company's current and potential competitors

dedicate substantially greater resources to protection and enforcement of intellectual property rights, especially patents. If a blocking patent has issued or issues in the future, the Company would need either to obtain a license or design around the patent. There can be no assurance that the Company would be able to obtain such a license on acceptable terms, if at all, or to design around the patent. The Company pursues the registration of certain of its trademarks and service marks in the U.S. and in certain other countries, although it has not secured registration of all its marks. As of September 19, 1997, the Company had 9 registered U.S. trademarks or service marks, and had applications pending for an additional 26 U.S. trademarks. A significant portion of the Company's marks begin with the word "Real" (such as RealAudio and RealVideo). The Company is aware of other companies that use "Real" in their marks alone or in combination with other words, and the Company does not expect to be able to prevent all third-party uses of the word "Real" for all goods and services. In addition, the laws of some foreign countries do not protect the Company's proprietary rights to the same extent as do the laws of the U.S., and effective patent, copyright, trademark and trade secret protection may not be available in such jurisdictions. The Company licenses certain of its proprietary rights to third parties, and there can be no assurance that such licensees will not fail to abide by compliance and quality control guidelines with respect to such proprietary rights or take actions that would materially adversely affect the Company's business, financial condition and results of operations.

To license many of its products, the Company relies in part on "shrinkwrap" and "clickwrap" licenses that are not signed by the end user and, therefore, may be unenforceable under the laws of certain jurisdictions. As with other software products, the Company's products are susceptible to unauthorized copying and uses that may go undetected, and policing such unauthorized use is difficult. In general, there can be no assurance that the Company's efforts to protect its intellectual property rights through patent, copyright, trademark and trade secret laws will be effective to prevent misappropriation of its technology, or to prevent the development and design by others of products or technologies similar to or competitive with those developed by the Company, and the Company's failure or inability to protect its proprietary rights could materially adversely affect the Company's business, financial condition and results of operations.

The computer software market is characterized by frequent and substantial intellectual property litigation, which is often complex and expensive, and involves a significant diversion of resources and uncertainty of outcome. Litigation may be necessary in the future to enforce and protect the Company's intellectual property and trade secrets or to defend against a claim of infringement or invalidity. The Company has been and expects to continue to be subject to legal proceedings and claims from time to time in the ordinary course of its business, including claims of alleged infringement of third-party proprietary rights by the Company and its licensees. The Company attempts to avoid infringing known proprietary rights of third parties in its product development efforts. However, the Company has not conducted and does not conduct comprehensive patent searches to determine whether the technology used in its products infringes patents held by third parties. In addition, it is difficult to proceed with certainty in a rapidly evolving technological environment in which there may be numerous patent applications pending, many of which are confidential when filed, with regard to similar technologies. If the Company were to discover that its products violate third-party proprietary

rights, there can be no assurance that it would be able to obtain licenses to continue offering such products without substantial reengineering or that any effort to undertake such reengineering would be successful, that any such licenses would be available on commercially reasonable terms, if at all, or that litigation could be avoided or settled without substantial expense and damage awards. Any claims relating to the infringement of third-party proprietary rights, even if not meritorious, could result in the expenditure of significant financial and managerial resources and could result in injunctions preventing the Company from distributing certain products. Such claims could materially adversely affect the Company's business, financial condition and results of operations.

The Company also relies on certain technology that it licenses from third parties, including software that is integrated with internally developed software and used in the Company's products, to perform key functions. There can be no assurance that such third-party technology licenses will continue to be available to the Company on commercially reasonable terms. The loss of any of these technologies could have a material adverse effect on the Company's business, financial condition and results of operations. Moreover, although the Company is generally indemnified against claims that such third-party technology infringes the proprietary rights of others, such indemnification is not always available for all types of intellectual property rights (for example, patents may be excluded) and in some cases the scope of such indemnification is limited. Even if the Company receives broad indemnification, third-party indemnitors are not always well capitalized and may not be able to indemnify the Company in the event of infringement, resulting in substantial exposure to the Company. There can be no assurance that infringement or invalidity claims arising from the incorporation of third-party technology, and claims for indemnification from the Company's customers resulting from such claims, will not be asserted or prosecuted against the Company. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources in addition to potential product redevelopment costs and delays, all of which could materially adversely affect the Company's business, financial condition or results of operations. See "Risk Factors -- Uncertain Protection of Intellectual Property; Risks Associated with Licensed Third-Party Technology."

Employees

At August 31, 1997, the Company had 276 full-time employees and two part-time employees, 250 of whom were based at the Company's executive offices in Seattle, Washington, 21 of whom were based at the Company's offices in Japan, England or France and five of whom were salespersons based at other locations. None of the Company's employees is subject to a collective bargaining agreement, and the Company believes that its relations with its employees are good.

Facilities

The Company's executive offices are located in downtown Seattle, Washington in an office building in which, as of September 30, 1997, the Company leases an aggregate of 80,345 square feet at a current monthly rental of $122,411. The lease agreement terminates on April 30, 2001. The Company has an

option to extend the lease agreement for two additional five-year terms.

The Company anticipates that it will require additional space within the next 12 months, but that suitable additional space will be available on commercially reasonable terms, although there can be no assurance in this regard. The Company does not own any real estate.

Legal Proceedings

From time to time the Company has been, and expects to continue to be, subject to legal proceedings and claims in the ordinary course of its business, including claims of alleged infringement of third-party trademarks and other intellectual property rights by the Company and its licensees. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources. In August 1997, the Company was subpoenaed by the Department of Justice in connection with its investigation into horizontal merger activity in the streaming media industry. The investigation, including interviews by the Department of Justice of Company officers, and document production requests, is ongoing. As a result of the investigation, it is possible that the Department of Justice will require certain actions by the Company or other companies in the streaming media industry, which could have a material adverse effect on the Company's competitive position, and on its business, financial condition and results of operations. The Company is cooperating in the investigation. The Company is not aware of any other legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse effect on its business, financial condition or results of operations. See "Risk Factors -- Department of Justice Subpoena" and "-- Uncertain Protection of Intellectual Property; Risks Associated With Licensed Third-Party Technology."

Management

Directors, Executive Officers and Key Employees

The executive officers, directors and key employees of the Company as of September 26, 1997 are as follows:

Name Age Position

Robert Glaser(1).....	35	Chairman of the Board, Chief Executive Officer, Secretary and Treasurer
Bruce Jacobsen(2).....	37	President, Chief Operating Officer and Director
Mark Klebanoff.....	35	Chief Financial Officer
Len Jordan.....	31	Senior Vice President -- Media Systems
Phillip Barrett.....	44	Senior Vice President -- Media Systems
Maria Cantwell.....	38	Senior Vice President -- Consumer and E-Commerce
James Higa.....	39	Vice President -- Asia/Rest of World ("ROW")
John Atcheson.....	38	Vice President -- Media Publishing
James Wells.....	50	Vice President -- Sales
Kelly Jo MacArthur.....	33	Vice President and General Counsel

Erik Moris.....	38	Vice President -- Marketing
James Breyer(1)(2).....	36	Director
Mitchell Kapor(1)(2).....	46	Director

(1) Member of the Compensation Committee.

(2) Member of the Audit Committee.

Set forth below is certain information regarding the business experience during the past five years for each of the above-named persons.

ROBERT GLASER has served as Chairman of the Board, Chief Executive Officer and Treasurer of the Company since its inception in February 1994, and as Secretary since March 1995. On closing of the offering, he will also serve as the Company's Policy Ombudsman, with the exclusive authority to adopt or change the editorial policies of the Company as reflected on the Company's Web sites or other communications or media where the Company has a significant editorial or media voice. See "Description of Capital Stock -- Certain Voting and Other Matters." From 1983 to 1993, Mr. Glaser was employed at Microsoft, most recently as Vice President of multimedia and consumer systems, where he focused on the development of new businesses related to the convergence of the computer, consumer electronics and media industries. Mr. Glaser holds a B.A. and an M.A. in Economics and a B.S. in Computer Science from Yale University.

BRUCE JACOBSEN has served as President and Chief Operating Officer of the Company since February 1996 and as a Director since August 1997. From April 1995 to February 1996, Mr. Jacobsen was Chief Operating Officer of Dreamworks Interactive, a joint venture between Microsoft and Dreamworks SKG, a partnership among Steven Spielberg, Jeffery Katzenberg and David Geffen. From August 1986 to April 1995, Mr. Jacobsen was employed at Microsoft in a number of capacities, including General Manager of the Kids/Games business unit. Mr. Jacobsen graduated summa cum laude with Honors from Yale University and holds an M.B.A. from Stanford University.

MARK KLEBANOFF has served as Chief Financial Officer of the Company since June 1996. From May 1992 to June 1996, Mr. Klebanoff was Vice President of Finance and Operations of Industrial Systems, Inc., a client/server process information management software vendor, which merged with Aspen Technology, Inc. in 1995. From 1989 to 1992, Mr. Klebanoff worked in a number of general management capacities for the Japanese trading company Itochu Corporation. Mr. Klebanoff holds a B.A. from Yale University and a Masters degree from the Yale School of Management.

LEN JORDAN has served as Senior Vice President -- Media Systems of the Company since January 1997. From November 1993 to November 1996, Mr. Jordan was employed at Creative Multimedia, Inc., a developer and publisher of CD-ROM/Internet products in a number of capacities, most recently as President. From September 1989 to November 1993, Mr. Jordan was employed at Central Point Software, Inc., a utility software publisher. Mr. Jordan graduated magna cum laude from the Eccles School of Business at the University of Utah with B.S. degrees in Finance and Economics.

PHILLIP BARRETT has served as Senior Vice President -- Media Systems of the Company since January 1997, and from November 1994 to January 1997 as Vice President -- Software Development. From March 1986 to October 1994, Mr. Barrett was a Development Group Manager at Microsoft,

where he led development efforts for Windows 386, Windows 3.0 and Windows 3.1. Mr. Barrett holds an A.B. in Mathematics from Rutgers University and an M.S. in Computer Sciences from the University of Wisconsin, Madison.

MARIA CANTWELL has served as Senior Vice President -- Consumer and E-Commerce of the Company since July 1997. From April 1995 to July 1997, Ms. Cantwell served as Vice President -- Marketing of the Company. From February 1995 to April 1995, Ms. Cantwell was a consultant to the Company. From 1992 to January 1995, Ms. Cantwell served as a member of the 103rd Congress. Ms. Cantwell holds a B.A. in Public Administration from Miami University.

JAMES HIGA has served as Vice President -- Asia/ROW of the Company since September 1996. From January 1989 to August 1996, Mr. Higa was the Director for Asia/Pacific for NeXT Software, Inc. From 1986 to 1989, Mr. Higa served as Director of Product Marketing at Apple Japan, Inc. Mr. Higa holds a B.A. in Political Science from Stanford University.

JOHN ATCHESON has served as Vice President -- Media Publishing of the Company since January 1997. From March 1990 to May 1996, Mr. Atcheson was President and Chief Executive Officer of MNI Interactive, Inc., a developer and distributor of consumer interactive services. Mr. Atcheson holds a B.A. from Brown University and an M.B.A. from the Stanford Graduate School of Business.

JAMES WELLS has served as Vice President -- Sales of the Company since May 1995. From March 1994 to April 1995, Mr. Wells served as a consultant in sales, marketing and product strategy at Aldus Corporation, a developer and marketer of publishing software. From January 1991 to February 1994, Mr. Wells served in various senior sales and marketing positions with Apple Computer, Inc. Mr. Wells holds a B.S. in Engineering from Lamar University and an M.B.A. from the University of Delaware.

KELLY JO MACARTHUR has served as Vice President and General Counsel of the Company since October 1996. From January 1995 to March 1996, Ms. MacArthur served as General Counsel and Director of Business Affairs for Compton's NewMedia, Inc., which was acquired by Learning Co., Inc. in 1996. From July 1989 to December 1994, Ms. MacArthur was an attorney at Sidley & Austin. Ms. MacArthur graduated summa cum laude from the University of Illinois at Champaign-Urbana and holds a J.D. from Harvard Law School.

ERIK MORIS has served as Vice President -- Marketing of the Company since August 1997. From April 1997 to July 1997, Mr. Moris served as a Product Manager for the Company. From September 1996 to April 1997, Mr. Moris was a consultant to the Company. From May 1995 to August 1996, Mr. Moris was employed at Microsoft, where he managed advertising for the Windows 95 launch and was Group Manager for the Internet Platform and Tools Division. From 1985 to 1994, Mr. Moris was a Senior Vice President at McCann-Erickson Advertising. Mr. Moris holds a B.A. in Communications and Business from Western Washington University.

JAMES BREYER has been a Director of the Company since October 1995. Mr. Breyer has served as a Managing Partner of Accel Partners L.P. in Palo Alto/San Francisco since November 1995 and as a general partner from 1990 to 1995. At Accel Partners L.P., Mr. Breyer has sponsored investments in over a dozen companies that have completed public offerings or successful mergers. Previously, Mr.

Breyer was a management consultant at McKinsey & Company, and worked in product management and marketing at Apple Computer, Inc. and Hewlett-Packard Corporation. Mr. Breyer holds a B.S. from Stanford University and an M.B.A. from Harvard University, where he was named a Baker Scholar.

MITCHELL KAPOR has been a Director of the Company since October 1995. From 1990 to 1993, Mr. Kapor was President, from 1993 to 1995 he was Chairman and from 1995 to 1996 he was a director, of the Electronic Frontier Foundation, a nonprofit public Internet organization that he co-founded in 1990. Mr. Kapor designed Lotus 1-2-3, and founded Lotus Development Corporation in 1982 and served as its President and Chief Executive Officer from April 1982 to July 1986. Mr. Kapor holds a B.A. in Cybernetics from Yale University and an M.A. in Psychology from Beacon College.

Number, Term and Election of Directors

The Company's Articles provide that the number of directors shall be determined in the manner provided by the Company's Bylaws. The Bylaws provide that the number of directors shall not be less than one, with the precise number to be determined by resolution of the Board of Directors. The Board of Directors has determined that the number of directors shall be seven. Four directors currently serve on the Board, with three vacancies currently existing.

Prior to September 1997, each director was elected to serve until the next annual meeting of shareholders and the election and qualification of his or her successor or until his or her earlier resignation or removal. In September 1997, the Company established a classified Board of Directors with three classes (Class 1, Class 2 and Class 3), each class as nearly equal in number of directors as possible. Each of the current directors was elected in September 1997 to one of these three classes. Commencing with the annual shareholders meeting in 1998 and thereafter, each director shall serve for a term ending at the third annual meeting of shareholders following such director's election. Mr. Kapor was elected to Class 1 with a term expiring at the annual shareholders meeting in 1998; Messrs. Breyer and Jacobsen were elected to Class 2 with terms expiring at the annual shareholders meeting in 1999; and Mr. Glaser was elected to Class 3 with a term expiring at the annual shareholders meeting in 2000.

Contractual Arrangements

Pursuant to the terms of a Second Amended and Restated Investors' Rights Agreement (the "Investors' Rights Agreement"), the holders of Series B Preferred Stock are entitled to nominate one member to the Board of Directors, the holders of Series C Preferred Stock are entitled to nominate one member to the Board of Directors and the holders of Series E Preferred Stock are entitled to nominate one member to the Board of Directors. Mr. Kapor is the director nominated by the holders of the Series B Preferred Stock, Mr. Breyer is the director nominated by the holders of the Series C Preferred Stock, and the holders of the Series E Preferred Stock currently have not nominated a director. The right to nominate directors pursuant to the Investors' Rights Agreement will terminate on closing of the offering.

Under a voting agreement (the "Voting Agreement") entered into in September 1997 among the Company, Accel IV L.P. ("Accel IV") and Messrs. Jacobsen, Kapor and Glaser, each of Accel IV and Messrs. Jacobsen and Kapor have agreed, effective on closing of the offering, to vote all shares of stock of the Company owned by such shareholders to elect Mr. Glaser to the Board of Directors of the Company in each election in which he is a nominee. The obligations under the Voting Agreement terminate with respect to shares transferred by the parties thereto. The Voting Agreement terminates upon the death of Mr. Glaser.

Pursuant to the terms of the Glaser Agreement, the Company granted to Mr. Glaser a direct contractual right to require the Company to abide by and perform all terms of the Articles with respect to strategic transactions. The agreement also provides that so long as Mr. Glaser owns a specified number of shares, the Company shall use its best efforts to cause Mr. Glaser to be nominated to, not removed from, and elected to, the Board of Directors.

Compensation of Directors

Directors of the Company do not receive cash compensation for their services as directors or members of committees of the Board of Directors, but are reimbursed for their reasonable expenses incurred in attending Board of Directors meetings. The Company has not made option grants to outside directors, but intends to make such grants to outside directors.

Board Committees

The Company has established an Audit Committee, a Compensation Committee and a Strategy Committee. In addition, the Articles provide that, following the closing of the offering, the Company will establish a Strategic Transactions Committee. Following the closing of the offering, the Company also intends to establish a Nominating Committee.

The Audit Committee consists of Messrs. Breyer, Jacobsen and Kapor. The functions of the Audit Committee are to make recommendations to the Board of Directors regarding the selection of independent auditors, review the results and scope of the audit and other services provided by the Company's independent auditors and evaluate the Company's internal controls.

The Compensation Committee consists of Messrs. Breyer, Glaser and Kapor. The functions of the Compensation Committee are to review and approve the compensation and benefits for the Company's executive officers, administer the Company's stock option and stock purchase plans and make recommendations to the Board of Directors regarding such matters.

The Strategy Committee consists of Messrs. Breyer, Glaser, Jacobsen and Kapor. The functions of the Strategy Committee are to make recommendations to the Board of Directors regarding the overall strategic goals of the Company and review significant business transactions that affect the future strategic direction of the Company.

The Strategic Transactions Committee will be comprised of three directors, who shall initially be Messrs. Glaser, Breyer and Kapor. Without the prior approval of such committee, and subject to certain limited exceptions, the Board of Directors shall not have the authority to (i) adopt a plan of merger, (ii) authorize the sale, lease, exchange or mortgage of (A) assets representing more than 50% of the book value of the Company's assets prior to the transaction or (B) any other asset or assets on which the long-term business strategy of the Company is substantially dependent, (iii) authorize the Company's voluntary dissolution or (iv) take any action that has the effect of clauses (i) through (iii). Any vacancy on the Committee shall be filled by the remaining members of the Committee. If two members of the Committee remain and they are unable to agree on an individual to fill the vacancy, the vacancy may be filled by the member who holds or controls, directly or indirectly, the larger percentage of the outstanding shares of the Company's capital stock. The Committee, by vote of the Chairman of the Committee and one additional member, may limit the powers of the Committee or may terminate the Committee. The existence and powers of the Committee shall terminate when the members in the aggregate cease to hold or control, directly or indirectly, at least 10% of the outstanding shares of the Company's capital stock.

The Nominating Committee will be comprised of the Company's Chief Executive Officer and certain other directors of the Company. The function of the Nominating Committee will be to recommend persons for election to the Board of Directors.

Policy Ombudsman

Under the Articles, Mr. Glaser shall serve, or shall appoint another officer of the Company who shall serve, as the Company's Policy Ombudsman, with the exclusive authority to adopt or change the editorial policies of the Company as reflected on the Company's Web sites or other communications or media where the Company has a significant editorial or media voice. Upon the death, resignation or removal of Mr. Glaser as the Policy Ombudsman, the Chief Executive Officer shall serve or appoint another officer of the Company to serve as his or her successor.

Executive Compensation

The following table sets forth information concerning the compensation received for services rendered to the Company in all capacities during the year ended December 31, 1996 by the Company's Chief Executive Officer and by the other three executive officers of the Company whose salary and bonus exceeded $100,000 in 1996 (the "Named Executive Officers").

Summary Compensation Table

			LONG-TERM COMPENSATION AWARDS
	ANNUAL COMPENSATION		SECURITIES

NAME AND PRINCIPAL POSITION	SALARY($)(1)	BONUS($)	UNDERLYING OPTIONS(#)
Robert Glaser..... Chairman, Chief Executive Officer, Secretary and Treasurer	$100,000	$ --	--
Bruce Jacobsen..... President and Chief Operating Officer	118,158	--	1,176,367
James Wells..... Vice President -- Sales	90,000	23,625	--
Andrew Sharpless..... Senior Vice President	102,295	--	125,000(2)

(1) The current annual salaries for Messrs. Glaser, Jacobsen and Wells are $100,000, $135,000 and $90,000, respectively.

(2) Mr. Sharpless resigned as an officer of the Company effective August 2, 1996, after which time he served as a Vice President of the Company until February 1997, when he terminated his employment with the Company. Mr. Sharpless exercised this option with respect to 12,500 shares on April 8, 1997, after terminating his employment with the Company. The remainder of the shares subject to this option were unvested as of his termination date, and therefore were canceled.

The following table shows information concerning stock options granted to the Named Executive Officers in 1996 and reflects the conversion of Series B Common Stock and Series C Common Stock underlying such options into Common Stock on closing of the offering.

Option Grants in 1996

	INDIVIDUAL GRANTS				POTENTIAL REALIZABLE VALUE AT ASSUMED ANNUAL RATES OF STOCK APPRECIATION FOR OPTION TERM(3)	
NAME	NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED(#)(1)	% OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN 1996	EXERCISE PRICE ($/SHARE)(2)	EXPIRATION DATE	5%($)	10%($)
Robert Glaser.....	--	--	--	--	$ --	$ --
Bruce Jacobsen.....	1,176,367	31.2%	$ 0.20	2/16/2016	388,977	1,347,528
James Wells.....	--	--	--	--	--	--
Andrew Sharpless....	125,000	3.3%	$ 0.20	5/29/1997(4)	41,332	143,187

(1) All options granted to the Named Executive Officers in 1996 were nonqualified stock options that vest with respect to 20% of the shares on the first anniversary of the date of grant and thereafter at a rate of 10% for each six months of services rendered by the optionee to the Company, except for one option granted to Mr. Jacobsen on February 16, 1996 for the purchase of 470,544 shares of Common Stock, of which 50% vests one year from date of grant and 25% vests every six months thereafter.

(2) The exercise price of each option was the estimated fair market value of the underlying securities on the date of grant, as determined by the Board.

(3) Based on the estimated fair market value of the underlying securities on the date of grant and assumed appreciation over the original 20-year option term at the respective annual rates of stock appreciation shown. Potential gains are net of the exercise price but before taxes associated with the

exercise. The 5% and 10% assumed annual rates of compounded stock price appreciation are mandated by the rules of the Securities and Exchange Commission (the "Commission") and do not represent the Company's estimate of the future price of the Common Stock. Actual gains, if any, on stock option exercises depend on the future financial performance of the Company and overall market conditions. The actual value realized may be greater or less than the potential realizable value set forth in the table.

(4) Mr. Sharpless exercised this option with respect to 12,500 shares on April 8, 1997, after terminating his employment with the Company. The remainder of the shares subject to this option were unvested as of his termination date and therefore were canceled.

The following table sets forth information regarding option exercises, and the fiscal year-end values of stock options held, by each of the Named Executive Officers during the year ended December 31, 1996. The table reflects the conversion of Series B Common Stock and Series C Common Stock underlying such options into Common Stock on closing of the offering.

Aggregated Option Exercises in 1996 and Year End Option Values

NAME	SHARES ACQUIRED ON EXERCISE(#)(1)	VALUE REALIZED($) (MARKET PRICE AT EXERCISE LESS EXERCISE PRICE)	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT DECEMBER 31, 1996(#) EXERCISABLE/ UNEXERCISABLE(3)	VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS AT DECEMBER 31, 1996($) EXERCISABLE/ UNEXERCISABLE(4)
Robert Glaser.....	--	$ --	--/--	$ --/--
Bruce Jacobsen.....	--	--	--/1,176,367	--/941,094
James Wells.....	--	--	82,500/192,500	76,725/179,025
Andrew Sharpless(2)...	300,000	87,750	12,500/112,500 (5)	10,000/90,000

(1) Does not include options exercised in 1997.

(2) The fair market value of the underlying securities at the close of business on the dates of exercise of Mr. Sharpless' options to purchase 225,000 shares and 75,000 shares were estimated to be approximately $0.20 and $0.85 per share, respectively, as determined by the Company's Board of Directors.

(3) Does not include options granted in 1997.

(4) The fair market value of the underlying securities at the close of business on December 31, 1996 was estimated to be approximately $1.00 per share, as determined by the Company's Board of Directors.

(5) Mr. Sharpless exercised this option with respect to 12,500 shares on April 8, 1997, after terminating his employment with the Company. The remainder of the shares subject to this option were unvested as of his termination date, and therefore were canceled.

Limitation of Liability and Indemnification Matters

The Company's Articles limit the liability of the Company's directors to the full extent permitted by Washington law. The Washington Business Corporation Act (the "Washington Act") provides that a corporation's articles of incorporation may contain a provision eliminating or limiting the personal liability of directors for monetary damages for breach of their fiduciary duty as directors, except for liability for (i) acts or omissions that involve intentional misconduct or a knowing violation of law, (ii) unlawful payments of dividends or unlawful stock repurchases or redemptions as provided in Section 23B.08.310 of the Washington Act ("Washington Act") or (iii) any transaction from which the director derived an improper personal benefit. The Articles provide that the Company shall indemnify its directors and officers, and may indemnify its employees and agents, to the fullest extent permitted by law.

The Company has entered into agreements with its directors and executive officers that, among other things, indemnify them for certain expenses (including attorneys' fees), judgments, fines and settlement amounts incurred by such persons in any action or proceeding, including any action by or in the right of the Company, arising out of such person's services as a director or officer of the Company, any subsidiary of the Company or any other company or enterprise to which the person provides services at the request of the Company. The Company believes that these provisions and agreements are necessary to attract and retain qualified directors and officers. These agreements also provide officers with the same limitation of liability for monetary damages that the Washington Act and the Articles provide to directors.

Benefit Plans

1995 STOCK OPTION PLAN. The Company's 1995 Stock Option Plan (the "1995 Plan") was adopted by the Board of Directors, and approved by the Company's shareholders, in March 1995. The 1995 Plan provides for the grant of nonqualified options to purchase up to an aggregate of 3,600,000 shares of Common Stock to employees, officers, directors, consultants and independent contractors of the Company. As of June 30, 1997, options to purchase 2,122,545 shares of Common Stock were outstanding under the 1995 Plan, with exercise prices ranging from $0.07 to $1.00 per share, options to purchase 864,236 shares were available for grant and options to purchase 613,219 shares had been exercised. The Company has resolved to not grant any additional options under the 1995 Plan, and has amended its Amended and Restated 1996 Stock Option Plan to provide for an increase in the number of shares reserved for issuance thereunder. See "-- Amended and Restated 1996 Stock Option Plan."

The provisions of the 1995 Plan with respect to the administration of the 1995 Plan and options granted thereunder, the term and termination of options granted, including any provision regarding the acceleration of exercisability thereof, are as set forth below with respect to the Amended and Restated 1996 Stock Option Plan.

AMENDED AND RESTATED 1996 STOCK OPTION PLAN. The Company's Amended and Restated 1996 Stock Option Plan (the "1996 Plan") was originally adopted by the Board of Directors in February 1996, and will be approved by the Company's shareholders in October 1997. The 1996 Plan provides for the grant of incentive and non-qualified options to purchase up to an aggregate of 9,692,736 shares of Common Stock to employees, officers, directors, consultants and independent contractors of the Company or any of its affiliates (the "Initial Option Amount"). The Initial Option Amount can be increased to up to 11,233,209 shares after taking into account 1,540,473 shares of Common Stock subject to options outstanding under the 1995 Plan on September 24, 1997, to the extent that such options terminate without having been exercised in full. As of June 30, 1997, options to purchase 4,213,941 shares of Common Stock were outstanding under the 1996 Plan, with exercise prices ranging from $0.20 to $2.75 per share, options to purchase 1,456,956 shares of Common Stock were available for grant and options to purchase 129,103 shares of Common Stock had been exercised.

The 1996 Plan is administered by the Board of Directors, which has the authority to grant options and to specify the terms and conditions of each option so granted, including the number of shares covered by the option, the type of option, the exercise price and the vesting provisions.

Options granted under the 1996 Plan must be exercised within three months of the termination of the optionee's employment with, or service to, the Company, or within one year after the optionee's termination due to death or disability, but in no event later than the expiration of the option term. Options granted under the 1996 Plan are not transferable by the optionee except by will or the laws of descent and distribution and generally are exercisable during the optionee's lifetime only by the optionee.

In the event of a sale of all or substantially all of the Company's assets, a merger or reorganization in which the Company is not the surviving corporation, or the sale or other transfer of shares representing more than 50% of the combined voting power of the then outstanding securities of the Company (each, a "Terminating Event"), the Board may determine whether provision will be made for assumption of, or substitution for, the stock options granted under the 1996 Plan by the successor corporation. If, with respect to a Terminating Event that has been approved by the Board, the Board determines that no such assumption or substitution will be made, then all options will become fully vested, and each optionee will have the right to exercise any unexercised options prior to closing of the Terminating Event. All options not so exercised will expire upon closing of the Terminating Event.

1998 EMPLOYEE STOCK PURCHASE PLAN. The Company's 1998 Employee Stock Purchase Plan (the "ESPP"), which was adopted by the Board of Directors and approved by the Company's shareholders in September 1997, will become effective on January 1, 1998. The Company has reserved 1,000,000 shares of Common Stock for issuance under the ESPP. The ESPP is intended to qualify for favorable tax treatment under Section 423 of the Internal Revenue Code of 1986, as amended. The

ESPP will be implemented through a series of offering periods of six months' duration, with new offering periods commencing on January 1 and July 1 of each year. The ESPP will be administered by the Compensation Committee of the Board of Directors of the Company. Each eligible employee of the Company or of any majority-owned subsidiary of the Company who has been employed by the Company or such majority-owned subsidiary of the Company for at least 90 days will be eligible to participate in the ESPP if such employee is employed by the Company or any such subsidiary for more than 20 hours per week and more than five months per year. The ESPP permits eligible employees to purchase Common Stock through payroll deductions, which may not exceed 10% of their compensation, at a price equal to 85% of the lower of the fair market value of the Common Stock at the beginning or end of the offering period. Employees may terminate their participation in the ESPP any time during the offering period; provided, however, that employees may not change their level of participation in the ESPP at any time during the offering period. Participation in the ESPP terminates automatically on the employee's termination of employment with the Company.

401(k) PLAN. The Company maintains a 401(k) plan that covers all employees who satisfy certain eligibility requirements relating to minimum age, length of service and hours worked. Under the profit-sharing portion of the plan, the Company may make an annual contribution for the benefit of eligible employees in an amount determined by the Board of Directors. The Company has not made any such contribution to date and currently has no plans to do so. Under the 401(k) portion of the plan, eligible employees may make pretax elective contributions of up to 20% of their compensation, subject to maximum limits on contributions prescribed by law.

Certain Transactions

Sales of Preferred Stock

Since the Company's inception in February 1994, the Company has issued, in private placement transactions, shares of Preferred Stock as follows: (i) in April 1995, an aggregate of 2,686,567 shares of Series B Preferred Stock at $0.67 per share, (ii) in October 1995, an aggregate of 2,904,305 shares of Series C Preferred Stock at approximately $1.96 per share, (iii) in November 1996, an aggregate of 2,381,010 shares of Series D Preferred Stock at $7.53 per share and (iv) in July 1997, an aggregate of 3,338,374 shares of Series E Preferred Stock at $8.99 per share. In addition, in connection with these private placements, the Company issued warrants as follows: (i) in April 1995, a warrant to purchase up to 373,134 shares of Series B Preferred Stock at an exercise price of $0.67 per share, which warrant was exercised in October 1995, (ii) in October 1995, warrants to purchase up to 100,000 shares of Series C Preferred Stock at an exercise price of approximately $1.96 per share and warrants to purchase up to 183,755 shares of Series B Common Stock at an exercise price of approximately $0.20 per share, (iii) in November 1996, warrants to purchase up to 714,303 shares of Series D Preferred Stock at an exercise price of approximately $9.41 per share and (iv) in July 1997, warrants to purchase up to 3,709,305 shares of Series E Preferred Stock at an exercise price of $13.48 per share. In April 1995, in connection with the Company's Series B Preferred Stock financing, Mr. Glaser exchanged

10,000 shares of the capital stock of the Company for one share of Series A Common Stock and 13,713,439 shares of Series A Preferred Stock to reflect capital contributions made by Mr. Glaser of approximately $0.07 per share. The purchasers of the Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and Series E Preferred Stock and the accompanying warrants to purchase Series B Common Stock and Series C, Series D and Series E Preferred Stock included, among others, the following 5% shareholders, executive officers, directors and entities associated with directors:

PREFERRED STOCK NAME SERIES B SERIES C SERIES D SERIES E

Robert Glaser.....	287,313	50,825	39,841	
Mitchell Kapor.....	1,492,537	656,172	66,401	
Accel Entities(1).....		2,037,282	66,401	
Microsoft Corporation.....				3,338,374
Phillip Barrett.....	373,134			

	WARRANTS			
NAME	SERIES B COMMON STOCK(2)	SERIES C PREFERRED STOCK(2)	SERIES D PREFERRED STOCK	SERIES E PREFERRED STOCK(2)
Robert Glaser.....			11,952	
Mitchell Kapor.....	33,755		19,920	
Accel Entities(1).....	150,000	100,000	19,921	
Microsoft Corporation.....				3,709,305

(1) The "Accel Entities" include Accel IV L.P., Accel Investors '95 L.P., Accel Keiretsu L.P. and Ellmore C. Patterson Partners. James Breyer, a director of the Company, is affiliated with the Accel Entities. See "Principal Shareholders."

(2) These warrants terminate automatically on closing of the offering.

In addition, members of Mr. Glaser's immediate family purchased an aggregate of 223,881 shares of Series B Preferred Stock in April 1995, and an aggregate of 39,498 shares of Series C Preferred Stock in October 1995, in each case on the same terms as the other investors.

Pursuant to the terms of the Investors' Rights Agreement, the holders of Series B Preferred Stock are entitled to nominate one member to the Board of Directors, the holders of Series C Preferred Stock are entitled to nominate one member to the Board of Directors and the holders of Series E Preferred Stock are entitled to nominate one member to the Board of Directors. In addition, all holders of preferred stock hold preemptive rights to purchase their pro rata share of new securities issued by the Company. The rights to nominate directors and the preemptive rights will terminate on closing of the offering. In addition, the Investors' Rights Agreement provides registration rights obligating it, under certain circumstances, to effect a registration under the Securities Act of any common stock issued upon conversion of the Preferred Stock, and the Common Stock issued pursuant to the exercise of the Series B Common Stock warrants. See "Shares Eligible for Future Sale -- Registration Rights." All shares of Preferred Stock will be converted into an equivalent number of shares of Common Stock or Special Common Stock on closing of the offering.

The Company has entered into indemnification agreements with each of its executive officers and directors. See "Management -- Limitation of Liability and Indemnification Matters."

Microsoft Corporation

The Company and Microsoft entered into an agreement in June 1997 pursuant to which the Company granted Microsoft a nonexclusive license to certain substantial elements of the source code of the Company's core RealAudio/RealVideo Version 4.0 technology, including its basic RealPlayer and substantial elements of its EasyStart Server products. Under the agreement, Microsoft may sublicense its rights to the RealAudio and RealVideo Version 4.0 technology to third parties under certain conditions. The agreement also provides for substantial refunds to Microsoft under prescribed circumstances that are solely within the Company's control. The amount of these refunds diminishes over time. In addition, the Company may not assign the agreement without Microsoft's consent. Microsoft is obligated to distribute the Company's RealPlayer Version 4.0 for a defined term as long as the Company's player supports certain Microsoft architectures. The Company also agreed to work with Microsoft and several other companies to author and promote ASF as a standard file format for streaming media. The agreement also requires the Company to provide Microsoft with engineering consultation services, certain error corrections, and certain technical support over a defined term. In connection with the agreement, Microsoft purchased 3,338,374 shares of nonvoting Series E Preferred Stock at approximately $8.99 per share for approximately $30,000,000. Each share of Series E Preferred Stock is convertible at the option of Microsoft into either one share of Common Stock or one share of Special Common Stock. Microsoft also received a warrant to purchase 3,709,305 shares of Series E Preferred Stock at an exercise price of $13.48 per share. If exercised, each share of Series E Preferred Stock acquired upon exercise will be automatically converted, at the election of the holder, into either one share of Common Stock or one share of Special Common Stock. If Microsoft elects to convert shares of Series E Preferred Stock into $15,000,000 or more of Common Stock, it may be required to make a filing under the Hart-Scott-Rodino Antitrust Improvements Act and obtain approval from the Department of Justice and the Federal Trade Commission before completing the conversion into Common Stock. This warrant terminates on closing of the offering. In connection with its equity investment, Microsoft also granted a limited proxy to the Company. See "Risk Factors -- Competition; Relationship With Microsoft," "-- Department of Justice Subpoena," "Business -- Microsoft Relationship" and "Description of Capital Stock -- Certain Voting and Other Matters."

Japanese Joint Venture

Trans Cosmos is the beneficial owner of 1,381,142 shares of Common Stock of the Company. In May 1997, Trans Cosmos, the Company and two other parties entered into a joint venture agreement with respect to the establishment and management of J-Stream to operate an Internet streaming business in Japan. Trans Cosmos owns 28% of J-Stream and each of the Company and the other two parties own 24%. Trans Cosmos is responsible for managing J-Stream, and the Company supplies J-Stream with software and technology for streaming on Internet networks. Trans Cosmos contributed approximately

$1,165,000 for its 28% interest and the Company contributed approximately $998,000 for its 24% interest in J-Stream, Trans Cosmos loaned the Company the amount of the Company's contribution, and the Company may, under certain circumstances, tender its 24% interest to Trans Cosmos as repayment of the loan.

Changes to Capital Structure

In connection with the offering, the Board recommended, and the Company's shareholders approved, amendments to the Company's Articles that, among other things, reduced the number of series of authorized Common Stock from five to two: voting Common Stock and nonvoting Special Common Stock. A majority of the previously authorized series were owned by certain of the Company's directors and executive officers. The amendments to the Articles also establish the Strategic Transactions Committee and provide for a Policy Ombudsman with authority to determine certain matters related to editorial policies of the Company. See "Management -- Policy Ombudsman" and "Description of Capital Stock -- Certain Voting and Other Matters."

Trans Cosmos Relationship

The Company and Trans Cosmos are parties to a Master Distribution Agreement pursuant to which the Company granted Trans Cosmos a nonexclusive, nontransferable license to reproduce and distribute RealPlayer and RealPlayer Plus, and distribute the Company's server products, in Japan. Trans Cosmos is required to comply with certain marketing requirements, personnel commitments and specified minimum distribution requirements. Under the distribution agreement, Trans Cosmos paid the Company license fees of $820,000 in 1996, and approximately $467,000 from January 1, 1997 through August 31, 1997. The distribution agreement became effective on July 22, 1996 and terminated pursuant to the terms of the agreement on July 22, 1997; however, the Company and Trans Cosmos have continued to adhere to the terms of the agreement and are currently renegotiating the agreement.

Principal Shareholders

The following table sets forth certain information regarding the beneficial ownership of the Common Stock as of September 19, 1997, assuming the conversion of all shares of Series A Common Stock, Series B Common Stock, Series C Common Stock, Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock, Series D Preferred Stock and Series E Preferred Stock into Common Stock, and as adjusted to reflect the sale of shares of Common Stock in the offering for (i) each person known to the Company to own beneficially more than 5% of the Common Stock, (ii) each of the Company's directors, (iii) each of the Named Executive Officers and (iv) all executive officers and directors as a group.

	COMMON STOCK	
	NUMBER	

NAME	OF SHARES BENEFICIALLY OWNED(1)	PERCENT OWNERSHIP BEFORE OFFERING	PERCENT OWNERSHIP AFTER OFFERING(2)
Accel IV L.P.	2,373,604(3)	8.7%	%
c/o Accel Partners L.P. One Embarcadero Center Suite 3820 San Francisco, CA 94111			
Mitchell Kapor	2,258,785(4)	8.4	
Kapor Enterprises, Inc. 238 Main Street Cambridge, MA 02142			
Robert Glaser	14,101,871(5)	52.3	
c/o RealNetworks, Inc. 1111 Third Avenue Suite 2900 Seattle, WA 98101			
Microsoft Corporation	7,047,679**	23.0	
One Microsoft Way Redmond, WA 98052-6399			
Trans Cosmos USA, Inc.	1,381,142(6)	5.1	
4040 Lake Washington Blvd. N.E. Suite 205 Kirkland, WA 98033			
Bruce Jacobsen	492,073(7)	1.8	
James W. Breyer	2,373,604(8)	8.7	
James Wells	137,500(9)	*	*
Andrew Sharpless	312,500	1.2	
All directors and executive officers as a group (13 persons)(10)	20,255,867	73.2%	%

* Less than 1%.

** Includes 3,709,305 shares of Common Stock issuable on exercise of the Series E Warrant. The Series E Warrant has an exercise price of $13.48 per share and, if not exercised, will automatically terminate on closing of the offering. Excluding shares subject to the Series E Warrant, Microsoft currently owns 12.1% of the common stock. Assuming the Series E Warrant is not exercised prior to closing of the offering, Microsoft will own only % of the common stock immediately after closing. See "Risk Factors -- Competition; Relationship With Microsoft," "Business -- Microsoft Relationship" and "Description of Capital Stock -- Warrants to Purchase Preferred Stock and Common Stock."

(1) Beneficial ownership is determined in accordance with rules of the Commission and includes shares over which the beneficial owner exercises voting or investment power. Shares of Common Stock subject to options or warrants currently exercisable or exercisable within 60 days of September 19, 1997 are deemed outstanding for the purpose of computing the percentage ownership of the person holding the options or warrants, but are not deemed outstanding for the purpose of computing the percentage ownership of any other person. Except as indicated, and subject to community property laws where applicable, the Company believes, based on information provided by such persons, that the persons named in the table above have sole voting and investment power with respect to all shares of Common Stock shown as beneficially owned by them.

(2) In the event that Microsoft elects to exercise the Series E Warrant in its entirety for the purchase of shares of Common Stock, the resulting ownership percentages on the closing of the offering for the other shareholders listed in the table would be as follows: Accel IV L.P. -- %; Mr. Kapor -- %; Mr. Glaser -- %; Trans Cosmos USA, Inc. ("TCI") -- %; Mr. Jacobsen -- %; Mr. Breyer -- %; Mr. Wells -- %; Mr. Sharpless -- %; and all directors and executive officers as a group -- %.

(3) Includes 1,926,973 shares owned by Accel IV L.P., 39,970 shares owned by Accel Keiretsu L.P., 90,459 shares owned by Accel Investors '95 L.P. and 46,281 shares owned by Ellmore C. Patterson Partners (together the "Accel Group"). Also includes 247,247 shares, 5,129 shares, 11,607 shares, and 5,938 shares of Common Stock issuable on exercise of warrants owned by Accel IV L.P., Accel Keiretsu L.P., Accel Investors '95 L.P. and Ellmore C. Patterson Partners, respectively.

(4) Includes 53,675 shares of Common Stock issuable on exercise of warrants.

(5) Includes 11,952 shares of Common Stock issuable on exercise of a warrant.

(6) Includes 796,813 shares of Common Stock owned by Trans Cosmos USA, Inc. ("TCI") and 265,604 shares of Common Stock owned by Encompass Group, Inc., an affiliate of TCI ("Encompass"). Also includes 239,043 and 79,682 shares of Common Stock issuable on exercise of warrants owned by TCI and Encompass, respectively.

(7) Includes 292,073 shares of Common Stock issuable on exercise of options.

(8) Mr. Breyer may be deemed to be the beneficial owner of the 2,373,604 shares of Common Stock beneficially owned by the Accel Group because he is a general partner of Accel Partners L.P., which is the general partner of Accel IV L.P. Mr. Breyer disclaims beneficial ownership of these shares except to the extent of his pecuniary interest therein. See footnote (3) above.

(9) Includes 27,500 shares of Common Stock issuable on exercise of options.

(10) Does not include shares owned by Mr. Sharpless, who terminated his employment with the Company in February 1997. Includes an aggregate of 415,473 shares and 335,548 shares, respectively, of Common Stock issuable upon exercise of options and warrants.

Description of Capital Stock

The following description of the capital stock of the Company and certain provisions of the Articles and the Bylaws is a summary and is qualified in its entirety by reference to the provisions of the Articles and the Bylaws, copies of which have been filed with the Commission as exhibits to the Company's Registration Statement, of which this Prospectus forms a part. The descriptions of the Common Stock and preferred stock reflect an amendment to the Articles, which amendment will be effective prior to the closing of the offering.

The authorized capital stock of the Company consists of 300,000,000 shares of common stock and 60,000,000 shares of preferred stock.

Common Stock

Subject to the rights of the holders of any preferred stock that may be outstanding, each holder of Common Stock is entitled to one vote per share. Holders of Common Stock on the applicable record date are entitled to receive such dividends as may be declared by the Board of Directors out of funds legally available therefor and, in the event of liquidation, to share pro rata in any distribution of the Company's assets after payment or providing for the payment of liabilities and the liquidation preference of any outstanding preferred stock. Holders of Common Stock have no cumulative voting rights or preemptive rights to purchase or subscribe for any shares of Common Stock or other securities of the Company.

The Company has 7,047,679 authorized shares of Special Common Stock that have identical rights to the Common Stock, except that they have voting rights only to the extent provided by applicable law. The Special Common Stock may only be converted into common stock on the prior written consent of the Board of Directors.

Preferred Stock

The Company's Board of Directors has the authority to issue shares of preferred stock in one or more series and to fix and determine the relative rights and preferences of the shares constituting any series to be established, without any further vote or action by the shareholders. Any shares of preferred stock so issued may have priority over the Common Stock with respect to dividend or liquidation rights or both. On closing of the offering, no shares of preferred stock will be outstanding. The Company has no current intention to issue any shares of preferred stock.

Warrants to Purchase Preferred Stock and Common Stock

At August 30, 1997, the Company had outstanding warrants to purchase 183,755 shares of Series B Common Stock at an exercise price of approximately $0.20 per share, warrants to purchase 100,000 shares of Series C Preferred Stock at an exercise price of approximately $1.96 per share, warrants to purchase 714,303 shares of Series D Preferred Stock at an exercise price of approximately $9.41 per share and a warrant to purchase 3,709,305 shares of Series E Preferred Stock at an exercise price of $13.48 per share. The warrants to purchase shares of Series B Common Stock, Series C Preferred Stock and Series E Preferred Stock will expire on closing of the offering. The warrants to purchase shares of Series D Preferred Stock expire on November 27, 1998 and, following the offering, will be exercisable for an equivalent number of shares of Common Stock. All of the Company's outstanding warrants currently are exercisable.

Certain Voting and Other Matters

Holders of preferred stock or other capital stock hereafter issued by the Company may be entitled to vote in connection with certain mergers and share exchanges or certain proposals to sell substantially all of the Company's assets and for certain other actions and separate approval may be required to the extent class voting rights are accorded to the holders of other capital stock of the Company.

Amendments to the Articles must be approved by the Board of Directors and the holders of a majority of the outstanding shares of Common Stock in most instances.

Articles and Bylaws

Under the Articles, Mr. Glaser shall serve, or shall appoint another officer of the Company to serve, as the Company's Policy Ombudsman, with the exclusive authority to adopt or change the editorial policies of the Company as reflected on the Company's Web sites or other communications or media where the Company has a significant editorial or media voice. Upon the death, resignation or removal of Mr. Glaser as the Policy Ombudsman, the Chief Executive Officer shall serve or appoint another officer of the Company to serve as his or her successor. The provisions delineating the authority of the Policy Ombudsman may be amended only with the approval of 90% of the shares entitled to vote on an amendment to the Articles.

In addition, the Articles provide for a Strategic Transactions Committee comprised of three directors, who shall initially be Messrs. Glaser, Breyer and Kapor. Without the prior approval of such committee, and subject to certain limited exceptions, the Board of Directors shall not have the authority to (i) adopt a plan of merger, (ii) authorize the sale, lease, exchange or mortgage of (A) assets representing more than 50% of the book value of the Company's assets prior to the transaction or (B) any other asset or assets on which the long-term business strategy of the Company is substantially dependent, (iii) authorize the Company's voluntary dissolution or (iv) take any action that has the effect of clauses (i) through (iii). Any vacancy on the Committee shall be filled by the remaining members of the Committee. If two members of the Committee remain and they are unable to agree on an individual to fill the vacancy, such vacancy may be filled by the member who holds or controls, directly or indirectly, the larger percentage of the outstanding shares of the Company's capital stock. The Committee, by vote of the Chairman of the Committee and one additional member, may limit the powers of the Committee or may terminate the Committee. The existence and powers of the Committee shall terminate when the members in the aggregate cease to hold or control, directly or indirectly, at least 10% of the outstanding shares of the Company's capital stock. The provisions with respect to the authority of the Strategic Transactions Committee may be amended only with the approval of 90% of the shares entitled to vote on an amendment to the Articles.

Special meetings of the shareholders may be called only by the Board of Directors, the Chairman of the Board, the President or the holders of at least 25% of all votes entitled to be cast on any issues proposed to be considered at such special meeting. The Company's Bylaws provide that shareholders seeking to bring business before, or to nominate directors at, any meeting of shareholders must provide timely notice thereof in writing. To be timely, a shareholder's notice must be delivered to, or mailed and received at, the principal executive offices of the Company not less than 70 days prior to the date of the meeting, or the tenth day after notice of the meeting is first given to shareholders, whichever is later, if the meeting is an annual meeting or a special meeting at which directors are to be elected. The Bylaws also contain specific requirements for the form of a shareholder's notice. These provisions may preclude or deter some shareholders from bringing matters before the shareholders or from making nominations for directors.

Contractual Agreements

On July 21, 1997, the Company and Microsoft entered into a Limited Proxy and Voting Agreement (the "Proxy Agreement") that gives Mr. Glaser, or Mr. Jacobsen if Mr. Glaser is unable to act, an irrevocable proxy with respect to the future voting of Microsoft's shares of the Company's nonvoting capital stock. The Proxy Agreement does not apply to voting with respect to certain matters, such as certain amendments to the Articles in which the class of shares held by Microsoft is treated adversely or disproportionately relative to other classes. The Proxy Agreement terminates upon the earliest of (i) the date on which Microsoft no longer holds any nonvoting shares, (ii) the conversion of the Series E Preferred Stock into Common Stock and (iii) July 21, 2007.

Under the Voting Agreement entered into in September 1997 among the Company, Accel IV and Messrs. Jacobsen, Kapor and Glaser, each of Accel IV and Messrs. Jacobsen and Kapor have agreed, effective on closing of the offering, to vote all shares of their or its stock of the Company owned by such shareholders to elect Mr. Glaser to the Board of Directors of the Company in each election in which he is a nominee. The obligations under the Voting Agreement terminate with respect to shares transferred by the parties thereto. The Voting Agreement terminates upon the death of Mr. Glaser.

The Company, Mr. Glaser and certain holders of Series B Common Stock and Series C Common Stock (together, the "Shares") have entered into a Shareholders' Buy-Sell Agreement dated March 31, 1995 (the "Buy-Sell Agreement") that restricts the free transferability of Shares held by parties to the Buy-Sell Agreement. The Buy-Sell Agreement gives the Company and the parties to the Buy-Sell Agreement a right of first refusal with respect to another party's proposed transfer of Shares, other than transfers to the Company, to certain family members and to trusts that are created and administered for the exclusive benefit of certain family members. The Buy-Sell Agreement is terminable upon the written agreement of the Company and the holders of two-thirds of the Shares on the dissolution, bankruptcy or insolvency of the Company, or at such time as there is only one remaining party to the Buy-Sell Agreement.

Washington Antitakeover Statute

Washington law contains certain provisions that may have the effect of delaying, deterring or preventing a takeover or change in control of the Company. Chapter 23B.19 of the Washington Act prohibits the Company, with certain exceptions, from engaging in certain significant business transactions with an "acquiring person" (defined as a person who acquires 10% or more of the Company's voting securities without the prior approval of the Company's Board of Directors) for a period of five years after such acquisition. The prohibited transactions include, among others, a merger with, disposition of assets to, or issuance or redemption of stock to or from, the acquiring person, or otherwise allowing the acquiring person to receive any disproportionate benefit as a shareholder. The Company may not exempt itself from coverage of this statute. These statutory provisions may have the effect of delaying, deterring or preventing a change in control of the Company.

Shareholder Rights Plan

The Company currently is contemplating entering into a Shareholder Rights Plan (the "Rights Plan") by and between the Company and a rights agent to be selected by the Company that would be adopted prior to the closing of the offering. Under the proposed Rights Plan, the Board would declare and distribute to the shareholders of record of the Company as of the date selected by the Board a dividend of one right ("Right") for each outstanding share of Common Stock and Special Common Stock, if any. Shares of Common Stock issued in the offering (assuming no triggering event) would automatically receive the Rights. The Rights would not be exercisable or transferable separately from shares of Common Stock and Special Common Stock, if any, until the earlier of: (i) 10 days following a public announcement that a person or group has acquired, or obtained the right to acquire, beneficial ownership of a designated percentage of the outstanding shares of the Common Stock and (ii) 10 days following the commencement or announcement of an intention to make a tender or exchange offer that would result in an acquiring person or group beneficially owning a designated percentage of outstanding shares of Common Stock, unless the Board sets a later date (the earlier of such dates, the "Distribution Date"). The Board would have the option to redeem the Rights at a nominal cost or prevent the Rights from being triggered by designating offers for all outstanding Common Stock as a permitted offer. Prior to the Distribution Date, the Company would be able to amend or supplement the Rights Plan without the consent of any of the holders of the Rights. Following the Distribution Date, the Rights Plan could be amended to cure any ambiguity, to correct or supplement any inconsistent provision or any other provision so long as such amendment or supplement would not adversely affect the holders of the Rights (other than an acquiring person or group). The Rights would expire 10 years after the date of adoption of the Rights Plan by the Board unless earlier redeemed by the Company.

The Rights, when exercisable, would entitle their holders (other than those held by an acquiring person or group) to purchase a specified fraction of a share of preferred stock (subject to adjustment) or, in certain instances, other securities of the Company. In certain circumstances, if the Company, in a merger or consolidation, is not the surviving entity or disposes of more than 50% of the Company's assets or earnings power, the Rights would also entitle their holders (other than an acquiring person or group) to purchase the highest priority voting shares in the surviving entity or its affiliates having a market value of two times the exercise price of the Rights.

The Rights Plan is intended to encourage a potential acquiring person or group to negotiate directly with the Board, but may have certain antitakeover effects. The Rights Plan, if adopted, could significantly dilute the interests in the Company of an acquiring person or group. The Rights Plan could therefore have the effect of delaying, deterring or preventing a change in control of the Company.

Transfer Agent and Registrar

The transfer agent and registrar for the Common Stock is ChaseMellon Shareholder Services, Ridgefield Park, New Jersey.

Shares Eligible for Future Sale

Prior to this offering, there has been no public market for the Common Stock, and there can be no assurance that a significant public market for the Common Stock will be developed or be sustained after this offering. Sales of substantial amounts of Common Stock in the public market after this offering, or the possibility of such sales occurring, could adversely affect prevailing market prices for the Common Stock or the future ability of the Company to raise capital through an offering of equity securities.

On closing of the offering, the Company will have outstanding shares of Common Stock (shares if the Underwriters' over-allotment option is exercised in full), of which shares offered hereby (shares if the Underwriters' over-allotment option is exercised in full) will be freely transferable in the public market without restriction or further registration under the Securities Act unless purchased by "affiliates" of the Company as that term is defined in Rule 144 of the Securities Act (an "Affiliate"), which shares will be subjected to the resale limitations of Rule 144 adopted under the Securities Act. The remaining 26,935,621 shares outstanding on completion of the offering (assuming no exercise of options or warrants after September 24, 1997) and held by existing shareholders will be "Restricted Securities" as that term is defined under Rule 144 (the "Restricted Shares"). The Restricted Shares were issued in private transactions in reliance on exemptions from registration under the Securities Act. Restricted Shares may be sold in the public market only if registered or if they qualify for an exemption from registration under Rule 144 or 701 promulgated under the Securities Act, which rules are summarized below.

Pursuant to the Lock-Up Agreements, persons who hold approximately 26,654,431 shares of Common Stock, including all officers and directors and certain existing shareholders of the Company, have agreed with the representatives of the Underwriters that, for a period of 180 days following the date of this Prospectus, they will not sell, offer to sell or otherwise dispose of any shares of Common Stock owned of record or beneficially by such persons as of the date of this Prospectus, including securities convertible into or exercisable or exchangeable for Common Stock as of said date, as well as any shares of Common Stock later acquired by reason of the conversion, exercise or exchange of such securities, except that persons other than officers, directors and holders of 1% or more of the capital stock of the Company each will be free to sell or otherwise dispose of up to 5,000 shares of Common Stock to the extent permissible under Rule 144 or Rule 701. The Lock-Up Agreements may be released at any time as to all or any portion of the shares subject to such agreements at the sole discretion of Goldman, Sachs & Co. on behalf of the Underwriters.

Based on the provisions of the Lock-Up Agreements and the provisions of Rules 144 and 701 of the Securities Act, additional shares will be available for sale in the public market as follows:

(i) 11,947 shares will be available for immediate sale in the public market on the date of this Prospectus, (ii)268,243 shares issued upon exercise of options prior to September 24, 1997 not subject to Lock-Up Agreements will be eligible for sale in the public market in accordance with Rules 144 and 701 as soon as 90 days after the date of this Prospectus, (iii) 4,707,363 shares issuable upon the exercise of warrants (assuming all outstanding warrants are exercised) will not be available for sale until various dates after 180 days following the date of this Prospectus, (iv) 26,654,431 currently outstanding shares will be eligible for sale upon expiration of Lock-Up Agreements (of which 23,909,137 shares will be subject to certain volume, manner of sale and other limitations under Rule 144); and (v) 1,000 remaining shares will be eligible for sale pursuant to Rule 144 on the expiration of a one-year holding period. As of September 24, 1997, options for 6,374,214 shares of Common Stock were outstanding, of which options for 1,708,455 shares may be exercised during the 180 days following the date of the Prospectus, which shares potentially will be eligible for public sale 90 days after the date of this Prospectus pursuant to Rule 701 under the Securities Act; of these shares, 1,312,863 are subject to Lock-Up Agreements.

In general, Rule 144 provides that any person who has beneficially owned shares for at least one year, including an "affiliate" (as defined in Rule 144), is generally entitled to sell, within any three-month period, a number of shares that does not exceed the greater of 1% of the shares of Common Stock then outstanding (approximately shares immediately after the offering) or the reported average weekly trading volume of the Common Stock during the four calendar weeks immediately preceding the date on which notice of the sale is sent to the Commission. Sales under Rule 144 are subject to certain manner of sale restrictions, notice requirements and availability of current public information concerning the Company. A person who is not an affiliate of the Company, and who has not been an affiliate within three months prior to the sale, generally may sell shares without regard to the limitations of Rule 144 provided that the person has held such shares for a period of at least two years.

Any employee, director or officer of, or consultant to, the Company holding shares purchased pursuant to a written compensatory plan or contract (including options) entered into prior to the offering is entitled to rely on the resale provisions of Rule 701, which permit nonaffiliates to sell such shares without having to comply with the public information, holding period, volume limitation or notice requirements of Rule 144 and permit affiliates to sell their Rule 701 shares without having to comply with the holding period restrictions of Rule 144, in each case commencing 90 days after the date of this Prospectus.

Registration Rights

Pursuant to the Investors' Rights Agreement, which provides registration rights to certain holders of shares of the Company's capital stock, holders of 16,390,753 shares of Common Stock or their permitted transferees (assuming (i) exercise of all outstanding warrants to purchase shares of Common Stock, (ii) conversion of the Series E Preferred Stock into Common Stock and (iii) exercise of the Series E Warrant in its entirety for shares of Common Stock (collectively, the "Registrable Shares") have certain rights with respect to the registration of the Registrable Shares under the Securities Act. Under

the terms of the Investors' Rights Agreement, if the Company proposes to register any of its securities under the Securities Act for its own account or for the account of others, Registrable Shares may be included, subject to any limitation set by the underwriters on the number of shares included in such registration. Holders of not less than 30% of the Registrable Shares may also require the Company, not more than twice, to file a registration statement under the Securities Act, at the Company's expense, with respect to any Registrable Shares holders desire to include. In addition, Holders of Registrable Shares may require the Company to file up to three registration statements on Form S-3, at the expense of the holders, for public offerings of Registrable Shares, provided that the aggregate offering price for such registration is not less than $250,000. The Company is required to use its best efforts to effect all such registrations, subject to certain conditions and limitations.

Legal Matters

The validity of the Common Stock being offered hereby will be passed upon for the Company by Graham & James LLP/Riddell Williams P.S., Seattle, Washington. Certain legal matters in connection with the offering will be passed upon for the Underwriters by Perkins Coie, Seattle, Washington.

Experts

The consolidated balance sheets at December 31, 1995 and 1996 and the consolidated statements of operations, shareholders' equity (deficit) and cash flows for the period from February 9, 1994 (inception) to December 31, 1994, and for the years ended December 31, 1995 and 1996 included in this Prospectus and in the Registration Statement of which this Prospectus forms a part have been included herein in reliance on the report of KPMG Peat Marwick LLP, independent accountants, appearing elsewhere herein, and upon the authority of said firm as experts in accounting and auditing.

Additional Information

The Company has filed with the Commission a Registration Statement on Form S-1 (together with all amendments and exhibits thereto, the "Registration Statement") under the Securities Act with respect to the offer and sale of Common Stock pursuant to this Prospectus. This Prospectus, filed as a part of the Registration Statement, does not contain all the information set forth in the Registration Statement or the exhibits thereto in accordance with the rules and regulations of the Commission, and reference is hereby made to such omitted information. Statements made in this Prospectus concerning the contents of any contract, agreement or other document filed as an exhibit to the Registration Statement are summaries of the terms of such contracts, agreements or documents and are not necessarily complete. Reference is made to each such exhibit for a more complete description of the matters involved and such statements shall be deemed qualified in their entirety by such reference. The Registration Statement and the exhibits thereto filed with the Commission may be inspected, without charge, and copies may be obtained at prescribed rates, at the public reference facility maintained by

the Commission at Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549 and at the regional offices of the Commission located at 7 World Trade Center, 13th Floor, New York, New York 10048 and Citicorp Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661-2511. The Registration Statement and other information filed by the Company with the Commission are also available at the Web site maintained by the Commission on the World Wide Web at http://www.sec.gov. For further information pertaining to the Company and the Common Stock offered by this Prospectus, reference is made to the Registration Statement.

The Company intends to furnish its shareholders with annual reports containing consolidated financial statements audited by its independent accountants and quarterly reports for the first three quarters of each fiscal year containing unaudited consolidated financial statements.

Realnetworks, Inc. and Subsidiaries

Index to Consolidated Financial Statements

Report of KPMG Peat Marwick LLP, Independent Accountants..... F-2
Consolidated Balance Sheets as of December 31, 1995 and 1996 and June 30, 1997 (unaudited)..... F-3
Consolidated Statements of Operations for the period from February 9, 1994 (inception) to December 31, 1994, the years ended December 31, 1995 and 1996, and the six months ended June 30, 1996 and 1997 (unaudited)..... F-4
Consolidated Statements of Shareholders' Equity (Deficit) for the period from February 9, 1994 (inception) to December 31, 1994, the years ended December 31, 1995 and 1996, and the six months ended June 30, 1997 (unaudited)..... F-5
Consolidated Statements of Cash Flows for the period from February 9, 1994 (inception) to December 31, 1994, the years ended December 31, 1995 and 1996, and the six months ended June 30, 1996 and 1997 (unaudited)..... F-6
Notes to Consolidated Financial Statements..... F-7

Independent Auditors' Report

The Board of Directors RealNetworks, Inc.:

We have audited the accompanying consolidated balance sheets of RealNetworks, Inc. (formerly Progressive Networks, Inc.) and subsidiaries as of December 31, 1995 and 1996, and the related consolidated statements of operations, shareholders' equity (deficit) and cash flows for the period from February 9, 1994 (inception) to December 31, 1994, and the years ended December 31, 1995 and 1996. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing

the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of RealNetworks, Inc. and subsidiaries as of December 31, 1995 and 1996, and the results of their operations and their cash flows for the period from February 9, 1994 (inception) to December 31, 1994, and the years ended December 31, 1995 and 1996 in conformity with generally accepted accounting principles.

KPMG Peat Marwick LLP March 14, 1997 Seattle, Washington

Realnetworks, Inc. and Subsidiaries

Consolidated Balance Sheets

Assets

	DECEMBER 31,		JUNE 30,
	1995	1996	1997
(UNAUDITED)			
CURRENT ASSETS:			
Cash and cash equivalents	$ 3,129,394	$14,737,806	$ 4,971,916
Short-term investments	2,986,493	4,857,163	6,523,710
Trade accounts receivable, net of allowance for doubtful accounts and sales returns of $129,869 in 1995, $383,350 in 1996 and $581,219 in 1997	667,847	3,275,518	4,352,334
Other receivables	48,568	105,888	149,628
Inventory	3,218	60,543	80,270
Prepaid expenses and other current assets	143,328	491,348	457,428
Total current assets	6,978,848	23,528,266	16,535,286
Property and equipment, net	594,042	2,678,798	4,019,255
Investment in joint venture	--	--	998,208
Other assets	836	261,094	595,105
	$ 7,573,726	$26,468,158	$ 22,147,854
LIABILITIES AND SHAREHOLDERS' DEFICIT			
CURRENT LIABILITIES:			
Accounts payable	$ 185,368	$ 2,405,490	$ 1,557,017

Accrued compensation	49,981	346,011	784,484
Other accrued expenses	149,909	971,499	1,774,847
Deferred revenue	645,416	2,911,922	3,540,235
Total current liabilities	1,030,674	6,634,922	7,656,583
Note payable	--	--	991,268
Redeemable, convertible preferred stock, no par value. Authorized 9,344,306 shares; issued and outstanding 5,964,006 shares at December 31, 1995, and 8,345,016 shares at December 31, 1996 and June 30, 1997 (aggregate liquidation preference of $7,752,312 at December 31, 1995 and $34,645,820 at December 31, 1996 and June 30, 1997 and aggregate redemption value of $7,752,312 at December 31, 1995 and $25,681,317 at December 31, 1996 and June 30, 1997)	7,654,528	23,153,494	23,264,467
SHAREHOLDERS' DEFICIT:			
Convertible preferred stock, no par value. Authorized, issued and outstanding; 13,713,439 shares at December 31, 1995 and 1996, and June 30, 1997 (aggregate liquidation preference of $999,710 at December 31, 1995 and 1996, and June 30, 1997)	932,385	932,385	932,385
Preferred stock, undesignated series, no par value. Authorized 6,942,255 shares; no shares issued and outstanding	--	--	--
Common stock, no par value. Authorized 50,000,000 shares; issued and outstanding; 36,948 shares at December 31, 1995, 535,491 shares at December 31, 1996 and 749,520 shares at June 30, 1997	2,680	46,450	88,617
Additional paid-in capital	--	1,579,000	1,579,000
Foreign currency translation adjustment	--	(11,307)	7,886
Accumulated deficit	(2,046,541)	(5,866,786)	(12,372,352)
Total shareholders' deficit	(1,111,476)	(3,320,258)	(9,764,464)
Commitments and contingencies			
	$ 7,573,726	$26,468,158	$ 22,147,854

See accompanying notes to consolidated financial statements.

Realnetworks, Inc. and Subsidiaries

Consolidated Statements of Operations

	PERIOD FROM FEBRUARY 9, 1994

	(INCEPTION) TO DECEMBER 31,	YEAR ENDED DECEMBER 31,		SIX MONTHS ENDED JUNE 30,	
	1994	1995	1996	1996	1997
				(UNAUDITED)	(UNAUDITED)
NET REVENUES:					
Software license fees	$ --	$ 1,781,763	$11,875,945	$ 3,767,785	$10,070,075
Advertising	--	--	1,015,964	170,102	1,106,582
Service revenues	--	29,835	1,120,479	306,055	2,189,520
Total net revenues	--	1,811,598	14,012,388	4,243,942	13,366,177
COST OF REVENUES:					
Software license fees	--	29,194	1,342,942	142,984	1,134,446
Advertising	--	--	288,024	104,752	307,751
Service revenues	--	32,940	554,558	146,913	1,612,080
Total cost of revenues	--	62,134	2,185,524	394,649	3,054,277
Gross profit	--	1,749,464	11,826,864	3,849,293	10,311,900
OPERATING EXPENSES:					
Research and development	201,847	1,379,727	4,812,188	1,738,867	5,462,851
Selling and marketing	47,181	1,217,900	7,539,924	2,264,285	9,160,905
General and administrative	296,211	746,645	3,491,296	1,412,120	2,495,695
Total operating expenses	545,239	3,344,272	15,843,408	5,415,272	17,119,451
Operating loss	(545,239)	(1,594,808)	(4,016,544)	(1,565,979)	(6,807,551)
OTHER INCOME (EXPENSE):					
Interest income, net	--	93,506	296,427	147,505	437,249
Other expense	--	--	(69,128)	(30,620)	(1,484)
Net other income	--	93,506	227,299	116,885	435,765
Net loss	$ (545,239)	$(1,501,302)	$(3,789,245)	$(1,449,094)	$(6,371,786)
Pro forma net loss per share					
Shares used to compute pro forma net loss per share					

See accompanying notes to consolidated financial statements.

Realnetworks, Inc. and Subsidiaries

Consolidated Statements of Shareholders' Equity (Deficit)

	PREFERRED STOCK		COMMON STOCK		ADDITIONAL	CUMULATIVE	TOTAL SHAREHOLDERS'
	SHARES	AMOUNT	SHARES	AMOUNT	PAID-IN CAPITAL	TRANSLATION ADJUSTMENT	ACCUMULATED DEFICIT	EQUITY (DEFICIT)
Sale of common stock.....	--	$ --	10,000	$ 72,838	$ --	$ --	$ --	$ 72,838
Contribution of capital by founder.....	--	--	--	487,357	--	--	--	487,357
Net loss.....	--	--	--	--	--	--	(545,239)	(545,239)
Balances at December 31, 1994.....	--	--	10,000	560,195	--	--	(545,239)	14,956
Contribution of capital by founder.....	--	--	--	372,283	--	--	--	372,283
Exchange of common stock for Series A preferred stock.....	13,713,439	932,385	(9,999)	(932,385)	--	--	--	--
Exercise of common stock options.....	--	--	30,750	2,153	--	--	--	2,153
Issuance of common stock in exchange for services.....	--	--	6,197	434	--	--	--	434
Net loss.....	--	--	--	--	--	--	(1,501,302)	(1,501,302)
Balances at December 31, 1995.....	13,713,439	932,385	36,948	2,680	--	--	(2,046,541)	(1,111,476)
Exercise of common stock options.....	--	--	498,543	43,770	--	--	--	43,770
Issuance of preferred stock warrants.....	--	--	--	--	1,579,000	--	--	1,579,000
Translation adjustment...	--	--	--	--	--	(11,307)	--	(11,307)
Accretion of redemption value of redeemable, convertible preferred stock.....	--	--	--	--	--	--	(31,000)	(31,000)
Net loss.....	--	--	--	--	--	--	(3,789,245)	(3,789,245)
Balances at December 31, 1996.....	13,713,439	932,385	535,491	46,450	1,579,000	(11,307)	(5,866,786)	(3,320,258)
Exercise of common stock options (unaudited)....	--	--	213,029	40,167	--	--	--	40,167
Issuance of common stock in exchange for services (unaudited)...	--	--	1,000	2,000	--	--	--	2,000
Accretion of redemption value of redeemable, convertible preferred stock (unaudited).....	--	--	--	--	--	--	(133,780)	(133,780)
Translation adjustment (unaudited).....	--	--	--	--	--	19,193	--	19,193
Net loss (unaudited)...	--	--	--	--	--	--	(6,371,786)	(6,371,786)
Balances at June 30, 1997 (unaudited).....	13,713,439	$932,385	749,520	$ 88,617	$1,579,000	$ 7,886	$ (12,372,352)	$(9,764,464)

See accompanying notes to consolidated financial statements.

Realnetworks, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

	PERIOD FROM FEBRUARY 9, 1994 (INCEPTION) TO DECEMBER 31,	YEAR ENDED DECEMBER 31,		SIX MONTHS ENDED JUNE 30,
	1994	1995	1996	1996

1997

(UNAUDITED) (UNAUDITED)

Cash flows from operating activities:
Net loss..... $ (545,239) $(1,501,302) $ (3,789,245) $ (1,449,094) $ (6,371,786)
Adjustments to reconcile net loss to net cash used in operating activities:
Depreciation and amortization..... 5,295 93,265 699,087 162,468 841,432
Common stock issued in exchange for services..... -- 434 -- -- 2,000
Change in certain assets and liabilities:
Trade accounts receivable..... -- (667,847) (2,607,671) (1,122,513) (1,049,378)
Other receivables..... -- -- (57,320) 31,274 (43,740)
Inventory..... -- (3,218) (57,325) (17,114) (19,727)
Prepaid expenses and other current assets..... -- (143,328) (348,723) (234,271) 33,600
Other assets..... -- -- (78,298) 137 (44,881)
Accounts payable..... -- 185,368 2,220,292 641,150 (861,716)
Accrued compensation..... 15,817 34,164 296,030 123,752 435,002
Other accrued expenses..... 33,217 116,692 821,590 224,338 801,381
Deferred revenue..... -- 645,416 2,266,506 972,875 620,148
Net cash used in operating activities..... (490,910) (1,240,356) (635,077) (666,998) (5,657,665)
Cash flows from investing activities:
Purchases of property and equipment..... (67,542) (624,503) (2,783,994) (1,300,315) (2,162,479)
Purchases of short-term investments..... -- (3,035,061) (30,514,885) (11,077,977) (10,614,439)
Proceeds from sales and maturities of short-term investments..... -- -- 28,644,215 10,952,121 8,947,892
Investment in joint venture..... -- -- -- -- (998,208)
Increase in other assets..... (1,393) -- (181,960) (215,550) (279,267)
Net cash used in investing activities..... (68,935) (3,659,564) (4,836,624) (1,641,721) (5,106,501)
Cash flows from financing activities:
Proceeds from issuance of note payable... -- -- -- -- 991,268
Proceeds from sale of preferred stock and stock warrants, net..... -- 7,404,528 17,046,966 -- --
Offering costs..... -- -- -- -- (22,807)
Proceeds from exercise of preferred stock warrant..... -- 250,000 -- -- --

Proceeds from exercise of common stock options	--	2,153	43,770	20,410	40,167
Proceeds from sale of common stock	72,838	--	--	--	--
Contribution of capital by founder	487,357	372,283	--	--	--
Net cash provided by financing activities	560,195	8,028,964	17,090,736	20,410	1,008,628
Effect of exchange rate changes on cash	--	--	(10,623)	--	(10,352)
Net increase (decrease) in cash and cash equivalents	350	3,129,044	11,608,412	(2,288,309)	(9,765,890)
Cash and cash equivalents at beginning of period	--	350	3,129,394	3,129,394	14,737,806
Cash and cash equivalents at end of period	$ 350	$ 3,129,394	$ 14,737,806	$ 841,085	$ 4,971,916
Supplemental disclosure of cash flow information -- cash paid during the period for interest	$ --	$ 1,853	$ 4,430	$ --	$ 26,633
Supplemental disclosure of noncash financing and investing activities:					
Exchange of common stock for Series A preferred stock	$ --	$ 932,385	$ --	$ --	$ --
Accretion of redemption value of redeemable, convertible preferred stock	$ --	$ --	$ 31,000	$ --	$ 133,780

See accompanying notes to consolidated financial statements.

Realnetworks, Inc. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 1994, 1995 AND 1996, AND JUNE 30, 1996 AND 1997 (INFORMATION AS OF JUNE 30, 1997 AND FOR THE SIX MONTHS ENDED JUNE 30, 1996 AND 1997 IS UNAUDITED)

(1) Nature of Business and Summary of Significant Accounting Policies

(a) Nature of Business RealNetworks, Inc. (formerly Progressive Networks, Inc.) and subsidiaries (Company) is a leading provider of branded software products and services that enable the delivery of streaming media content over the Internet and intranets. Streaming technology enables the transmission and playback of continuous "streams" of multimedia content, such as audio and video, over the Internet and intranets. The Company's products and services include its RealAudio and RealVideo software system, an electronic commerce Web site and a network of advertising-supported content aggregation Web sites.

Inherent in the Company's business are various risks and uncertainties, including its limited operating history and the limited history of commerce on the Internet. The Company's success may depend in part upon the emergence of the Internet as a communication medium, the acceptance of the Company's technology by the marketplace and the Company's ability to generate license and advertising revenues from the use of its technology on the Internet.

(b) Basis of Presentation The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

(c) Cash Equivalents

The Company considers all short-term investments with a remaining contractual maturity at date of purchase of three months or less to be cash equivalents.

(d) Short-Term Investments Short-term investments consist principally of short-term investment-grade, interest-bearing debt securities.

The Company classifies its short-term investments as available-for-sale. Accordingly, these investments are carried at fair value. The fair value of such securities approximated cost, and there were no unrealized holding gains or losses at December 31, 1995 and 1996, and June 30, 1997. All short-term investments have contractual maturities of less than one year at December 31, 1996 and June 30, 1997.

(e) Inventory

Inventory is stated at the lower of cost or market, with cost determined on the first-in, first-out basis.

(f) Property and Equipment Property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally three years. Leasehold improvements are amortized over the lesser of the term of the lease or the estimated useful life of the asset.

(g) Investment in Joint Venture The Company accounts for its investment in joint venture using the equity method. Accordingly, the initial investment is recorded at cost. Subsequently, the carrying amount of the investment is increased or decreased to reflect the Company's share of income or losses of the joint venture and is reduced to reflect dividends received from the joint venture. The Company's share of income or losses of the joint venture is included in the Company's statements of operations.

(h) Research and Development Research and development costs are charged to operations as incurred. Statement of Financial Accounting Standards (SFAS) No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed, requires capitalization of certain software development costs subsequent to the establishment of technological feasibility.

Based on the Company's product development process, technological feasibility is established upon completion of a working model. Costs incurred by the Company between completion of the working model and the point at which the product is ready for general release have been insignificant.

(i) Revenue Recognition The Company recognizes revenue from software license fees upon delivery, net of an allowance for estimated returns, provided that no significant obligations remain on the Company's behalf and collection of the resulting receivable is deemed probable.

Revenue from software license agreements with original equipment manufacturers (OEM) is recognized when the OEM delivers its product incorporating the Company's software to the end user. In the case of prepayments received from an OEM, the Company generally recognizes revenue based on the actual products sold by the OEM. If the Company anticipates providing ongoing support to the OEM in the form of future upgrades, enhancements or other services over the term of the contract, revenue is generally recognized on the straight-line method over the term of the contract.

The Company recognizes revenue from software license agreements with value-added resellers (VAR) upon delivery to the VAR, provided necessary conditions are met. If these conditions are not met, revenue is recognized upon redistribution by the VAR to the end user.

Revenues from advertising appearing on the Company's World Wide Web (Web) sites are recognized on the straight-line method over the terms of the advertising contracts. The Company guarantees to certain advertising customers a minimum number of page impressions to be delivered to users of its Web sites for a specified period. To the extent guaranteed minimum page impression deliveries are not met, the Company defers recognition of the corresponding revenues until guaranteed page impression delivery levels are achieved. As of December 31, 1996 and June 30, 1997, no revenues had been deferred as a result of these guarantees.

Service revenue includes revenue from upgrade and support agreements, consulting, content hosting, and fees from user conferences. Service revenue from upgrade and support agreements is recognized ratably over the term of the related agreements. Other service revenue is recognized when the service is performed.

(j) Financial Instruments and Concentrations of Risk The Company's financial instruments consist of cash and cash equivalents, short-term investments, trade accounts receivable, accounts payable, accrued expenses, and note payable. The fair value of

these instruments approximates their financial statement carrying amount. The Company maintains substantially all of its cash and cash equivalents and short-term investments with two financial institutions. Management believes that the financial risks associated with such deposits are minimal. Credit is extended to customers based on an evaluation of their financial condition, and collateral is not required. The Company performs ongoing credit evaluations of its customers and maintains an allowance for potential credit losses. Substantially all of the Company's accounts receivable are derived from domestic sales.

The Company's customers consist primarily of resellers and end users located in the United States and various foreign countries. Revenues in the years ended December 31, 1995 and 1996 and the six months ended June 30, 1996 and 1997 by geographic region, as a percent of total net revenues, are as follows:

	DECEMBER 31,		JUNE 30,	
	1995	1996	1996	1997
United States and Canada	85%	81%	81%	73%
Europe	5%	7%	7%	12%
Asia	8%	7%	4%	10%
Other	2%	5%	8%	5%

One customer accounted for approximately 14% of total net revenues in 1995. No one customer accounted for more than 10% of total net revenues in 1996 and the six months ended June 30, 1996 and 1997.

(k) Advertising Expenses The Company expenses the cost of advertising and promoting its products as incurred. Such costs are included in selling and marketing expense and totaled approximately $68,000 and $665,000 during the years ended December 31, 1995 and 1996, respectively, and $96,000 and $560,000 during the six months ended June 30, 1996 and 1997, respectively.

(l) Income Taxes

The Company was an S corporation for federal income tax purposes from inception through April 8, 1995. Consequently, taxable income or loss of the Company through April 8, 1995 was attributed to the Company's shareholders. Effective April 8, 1995, the Company changed its election to utilize the provisions of subchapter S of the Internal Revenue Code of 1986, as amended, and elected to be taxed as a subchapter C corporation.

The Company utilizes the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in

which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in results of operations in the period that includes the enactment date.

Pro forma income tax information has not been provided for the period from inception to April 8, 1995. As a result of the operating losses recognized prior to April 8, 1995, any income tax benefit would

have been fully offset by the establishment of a valuation allowance for deferred tax assets had the Company been taxed as a subchapter C corporation.

(m) Foreign Currency Translation The functional currency of the Company's foreign subsidiaries is the local currency in the country in which the subsidiary is incorporated. Assets and liabilities of foreign operations are translated into U.S. dollars using rates of exchange in effect at the end of the reporting period. Income and expense accounts are translated into U.S. dollars using average rates of exchange. The net gain or loss resulting from translation is shown as a cumulative translation adjustment in shareholders' equity.

(n) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(o) Stock-Based Compensation The Company accounts for its stock option plans for employees in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. As such, compensation expense related to employee stock options would be recorded only if, on the date of grant, the fair value of the underlying stock exceeded the exercise price. On January 1, 1996, the Company adopted the disclosure-only requirements of SFAS No. 123, Accounting for Stock-Based Compensation, which allows entities to continue to apply the provisions of APB Opinion No. 25 for transactions with employees and provide pro forma net income and pro forma earnings per share disclosures for employee stock option grants made in 1995 and future years as if the fair-value-based method of accounting in SFAS No. 123 had been applied to these transactions.

(p) Impairment of Long-Lived Assets The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets held and used is measured by a comparison of the carrying

amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceed the fair value of the assets.

(q) Reclassifications Certain reclassifications have been made to the 1994 and 1995 consolidated financial statements to conform with the 1996 presentation.

(r) Unaudited Interim Financial Statements In the opinion of the Company's management, the June 30, 1996 and 1997 unaudited interim financial statements include all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation.

Realnetworks, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

(s) Pro Forma Net Loss Per Share Pro forma net loss per share is computed by dividing the sum of net loss plus accretion of redemption value of redeemable, convertible preferred stock by the weighted average number of shares of common stock and common stock equivalents outstanding during each period and the shares resulting from the conversion of all outstanding shares of preferred stock, including Series E preferred stock, which was issued in July 1997. Common stock equivalents include all warrants and stock options which would have a dilutive effect, applying the treasury stock method. Additionally, common and common equivalent shares issued during the twelve months immediately preceding the initial filing of the Company's initial public offering (IPO) have been included in the calculation of common and common equivalent shares as if they were outstanding for all periods presented, including loss years where the impact of the incremental shares is antidilutive, using the treasury stock method and an assumed initial public offering price of $ per share. Due to the significant impact of the assumed conversion of the preferred stock upon closing of the IPO, historical net loss per share is not meaningful and, therefore, is not presented.

The Company has not calculated pro forma net loss per share because information regarding the pricing of the shares of Common Stock under the contemplated IPO has not yet been determined.

(t) New Accounting Pronouncements In February 1997, the Financial Accounting Standards Board (FASB) issued SFAS No. 128, Earnings Per Share (Statement 128). Statement 128 establishes standards for the computation, presentation and disclosure of earnings per share (EPS), replacing the presentation of currently required Primary EPS with a presentation of Basic EPS. It also requires dual presentation of Basic EPS and Diluted EPS on the face of the income statement for entities with complex capital structures. Basic EPS is based on the weighted average number of common shares outstanding during the period. Diluted EPS is based on the potential dilution that would occur upon exercise or conversion of securities into common stock using the treasury stock method. Statement 128 is effective for periods ending after December 15, 1997, including interim periods; earlier application

is not permitted. When adopted, the Company will be required to restate its EPS data for all prior periods presented. The Company does not expect the impact of the adoption of Statement 128 to be material to its reported EPS amounts.

In June 1997, the FASB issued SFAS No. 130, Reporting Comprehensive Income (Statement 130). Statement 130 establishes standards for reporting and disclosure of comprehensive income and its components (revenues, expenses, gains and losses) in a full set of general-purpose financial statements. Statement 130 is effective for fiscal years beginning after December 15, 1997. Reclassification of financial statements for earlier periods provided for comparative purposes is required. The Company has not determined the manner in which it will present the information required by Statement 130.

In June 1997, the FASB issued SFAS No. 131, Disclosure About Segments of an Enterprise and Related Information (Statement 131). Statement 131 establishes standards for the way that public business enterprises report information about operating segments. It also establishes standards for related disclosures about products and services, geographic areas and major customers. Statement 131 is effective for periods beginning after December 15, 1997. In the initial year of application, comparative information for earlier years is to be restated. The Company has not determined the manner in which it will present the information required by Statement 131.

Realnetworks, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

(2) Property and Equipment

Property and equipment consist of the following:

	DECEMBER 31,		JUNE 30,
	1995	1996	1997 (UNAUDITED)
Computer equipment and software.....	$ 529,705	$ 2,210,799	$ 3,630,964
Furniture, fixtures and leasehold improvements.....	162,340	1,251,354	2,013,870
	692,045	3,462,153	5,644,834
Less accumulated depreciation and amortization.....	98,003	783,355	1,625,579
	$ 594,042	$ 2,678,798	$ 4,019,255

(3) Commitments

(a) Leases

The Company leases facilities under operating lease agreements expiring through April 2001. Future minimum lease payments under these leases as of December 31, 1996 are:

1997	$ 739,627
1998	764,056
1999	886,201
2000	886,201
2001	295,399
Total minimum lease payments	$ 3,571,484

Rent expense totaled approximately $76,000 and $610,000 for the years ended December 31, 1995 and 1996, respectively, and $257,000 and $826,000 for the six months ended June 30, 1996 and 1997, respectively.

In April 1996, the Company entered into operating lease agreements for additional corporate office space, with the lease term extending through April 2001. These leases can be terminated beginning October 1998 with nine months' advance written notice and contain options for two five-year renewals.

(b) Royalties

The Company has arrangements with several Internet content providers whereby it is committed to pay a percentage of certain advertising revenues generated from its Web sites. As of December 31, 1996 and June 30, 1997, royalties under these arrangements have not been significant.

(4) Income Taxes

The expected U.S. federal income tax benefit determined by applying the statutory U.S. federal income tax rate of 34% to pretax loss for the period from February 9, 1994 (inception) to December 31, 1994 and the years ended December 31, 1995 and 1996 differs from the U.S. federal income tax benefit in the consolidated financial statements due primarily to the increase in the valuation allowance for deferred tax assets.

The tax effects of temporary differences and tax loss and credit carryforwards that give rise to significant portions of federal deferred tax assets are comprised of the following:

	DECEMBER 31,		JUNE 30,
	1995	1996	1997 (UNAUDITED)
Deferred tax assets:			
Net operating loss carryforwards	$ 216,000	$ 918,000	$ 2,641,000
Deferred revenue	112,000	530,000	635,000
Allowances for doubtful accounts and sales returns	44,000	130,000	196,000
Start-up costs capitalized for tax purposes	84,000	70,000	53,000
Research and experimentation credit			

carryforwards	7,000	102,000	102,000
Other	30,000	78,000	269,000
Gross deferred tax assets	493,000	1,828,000	3,896,000
Less valuation allowance	493,000	1,828,000	3,896,000
Net deferred tax assets	$ --	$ --	$ --

The valuation allowance for deferred tax assets increased $493,000, $1,335,000, and $2,068,000 for the years ended December 31, 1995 and 1996 and the six months ended June 30, 1997, respectively.

At December 31, 1996 and June 30, 1997, the Company had available net operating loss carryforwards of approximately $2,700,000 and $7,800,000, respectively, expiring in 2010 through 2012 available to offset future U.S. federal taxable income, if any. In addition, the Company has research and experimentation tax credit carryforwards of approximately $102,000, expiring in 2010 and 2011, which are available to offset future income taxes, if any.

The utilization of tax net operating loss carryforwards may be limited under Internal Revenue Code Section 382 due to ownership changes that occurred during the year ended December 31, 1996 or changes in ownership that may occur if the Company raises additional equity.

(5) 401(k) RETIREMENT SAVINGS PLAN The Company has a 401(k) Retirement Savings Plan that covers all employees who have met certain employment requirements. Employees can contribute a portion of their salary to the maximum allowed by the federal tax guidelines.

(6) Bank Line of Credit and Term Loan and Note Payable

At December 31, 1996, and June 30, 1997, the Company had available a $1,000,000 domestic bank line of credit and a $1,500,000 bank term loan. The line of credit and term loan bear interest at the prime rate plus 0.75% and 1.0% per annum, respectively. There were no borrowings outstanding under the line of credit or the term loan as of December 31, 1996 and June 30, 1997.

At June 30, 1997, the Company had outstanding a note payable to one of its joint venture partners. The note is denominated in Japanese yen, bears interest at a rate not to exceed the Japanese Short Term Prime Rate (1.75% at June 30, 1997) and is secured by the Company's shares in the joint venture. Interest on the note is payable monthly and the principal is due in May 2000. The principal amount of the

note is 115,200,000 Japanese yen ($991,268 at June 30, 1997), and the Company may, under certain circumstances, tender its shares in the joint venture as repayment of the note.

(7) Shareholders' Equity

(a) Preferred Stock

The Company has authorized and issued convertible preferred stock and redeemable, convertible preferred stock as follows:

	SERIES	AUTHORIZED SHARES	ISSUED AND OUTSTANDING SHARES DECEMBER 31, 1995	1996	JUNE 30, 1997 (UNAUDITED)
Convertible preferred.....	A	13,713,439	13,713,439	13,713,439	13,713,439
Redeemable, convertible preferred.....	B	3,059,701	3,059,701	3,059,701	3,059,701
Redeemable, convertible preferred.....	C	3,004,305	2,904,305	2,904,305	2,904,305
Redeemable, convertible preferred.....	D	3,280,300	--	2,381,010	2,381,010

The following table summarizes activity of the Company's redeemable, convertible preferred stock for the years ended December 31, 1995 and 1996, and the six months ended June 30, 1997:

Price Description Per Share Shares Amount

Balances at December 31, 1994.....		--	$ --
Sale of Series B preferred stock, net of issuance costs of $40,000.....	$0.6700	2,686,567	1,760,000
Sale of Series C preferred stock, net of issuance costs of $57,784.....	1.9634	2,904,305	5,644,528
Exercise of warrants for Series B preferred stock.....	0.6700	373,134	250,000
Balances at December 31, 1995.....		5,964,006	7,654,528
Sale of Series D preferred stock, net of issuance costs and warrant value of $889,186 and $1,579,000, respectively.....	7.5300	2,381,010	15,467,966
Accretion of redemption value.....		--	31,000
Balances at December 31, 1996.....		8,345,016	23,153,494
Issuance costs related to sale of Series D preferred stock (unaudited).....		--	(22,807)
Accretion of redemption value (unaudited).....		--	133,780
Balances at June 30, 1997 (unaudited).....		8,345,016	$23,264,467

The rights, preferences and restrictions of the Series A, B, C and D preferred stock are as follows:

- Each of the Series B, C and D preferred stock are redeemable by the holder, on, or at any time after, December 31, 2002 with the written consent of at least two-thirds of the respective outstanding Series B, C and D shareholders. The stated redemption price at date of issuance was $0.67, $1.9634 and $7.53 per share for the Series B, C and D preferred stock, respectively, and is to be adjusted for inflation from the issuance date to the redemption date. Redemption payments would be made in three equal installments commencing on the initial redemption request date, and each year thereafter, for a period of two years. The Company accounts for the difference

between the carrying amount of redeemable preferred stock and the redemption amount by increasing the carrying amount for periodic accretion against accumulated deficit using the interest method, so that the carrying amount will equal the redemption amount at the redemption date.

- Each share of Series A, B, C and D preferred stock is convertible at the option of the holder at any time into one share of Series A common stock, subject to certain antidilution provisions. The holders of Series A preferred stock have the right, under certain circumstances, to convert one share of Series A preferred stock to one share of Series D common stock.

- Conversion of all Series A, B, C and D preferred stock is automatic upon the earlier of the closing of a public offering of the Company's common stock at a purchase price of not less than $13.554 per share with aggregate proceeds of not less than $20,000,000, or the affirmative vote or written consent of the holders of at least two-thirds of the then outstanding shares of Series D preferred stock.

- Series A, B, C and D preferred stock have a liquidation preference of $0.0729, $0.67, $1.9634 and $11.295 per share, respectively, plus all declared but unpaid dividends, if any. No dividends have been declared through December 31, 1996 and June 30, 1997.

- Series A, B, C and D preferred stock have the same voting rights as Series A common stock based upon the number of shares of Series A common stock into which they are convertible; however, Series A, B, C and D preferred stock have preferential treatment over all common stock with respect to any payment of dividends when and if declared by the board of directors and any distributions of assets upon liquidation.

Pursuant to the rules and regulations of the Securities and Exchange Commission, the Company has classified redeemable, convertible preferred stock outside of shareholders' deficit.

(b) Common Stock

Common stock at December 31, 1995 and 1996, and June 30, 1997, consists of the following:

		ISSUED AND OUTSTANDING SHARES DECEMBER 31,		
	AUTHORIZED SHARES	1995	1996	JUNE 30, 1997 (UNAUDITED)
Series A	30,000,000	1	1	1
Series B	10,000,000	2,400	463,018	297,727
Series C	9,999,999	34,547	72,472	451,792
Series D	1	--	--	--

At January 1, 1995, 10,000 shares of common stock were issued and outstanding. In April 1995, these 10,000 shares of common stock were exchanged for 13,713,439 shares of Series A preferred stock and one share of Series A common stock.

Series A and B common stock entitle the holder to fifteen votes for each share held. Series C common stock entitles the holder to one vote for each share held. Series B common stock is reserved for issuance to employees, directors or affiliates of directors. Each share of Series B common stock automatically converts to one share of Series C common stock upon termination of the holder's employment, or status as a director or an affiliate of a director.

Series D common stock shall have the right to elect one member of the board of directors, the "Policy Director." Such director shall have the authority to adopt or change editorial policies relating to the Company's Internet Web site publishing.

(c) Stock Warrants

In connection with the sale of Series B preferred stock, the Company issued a warrant to purchase 373,134 additional shares of Series B preferred stock at an exercise price of $0.67 per share. No separate value was assigned to the warrant as the value was not significant at the date of issuance. This warrant was exercised in 1995.

In connection with the sale of Series C preferred stock, the Company issued warrants to purchase up to 100,000 additional shares of Series C preferred stock at an exercise price of $1.9634 per share, and warrants to purchase up to 183,755 shares of Series B common stock at an exercise price of $0.20 per share. No separate value has been assigned to the warrants as the values were not significant at the date of issuance. These warrants vest on the earlier of January 26, 1997 or, if certain conditions are met, upon the closing of an IPO of the Company's common stock. These warrants expire on the earlier of the closing of an IPO by the Company with aggregate proceeds of not less than $10,000,000 and at not less than $4.00 per share or October 26, 2000. No warrants to purchase Series C preferred stock or Series B common stock have been exercised as of December 31, 1996 and June 30, 1997.

In connection with the sale of Series D preferred stock, the Company issued warrants to purchase up to 714,303 additional shares of Series D preferred stock at an exercise price of $9.4125 per share. The value of the warrants, $1,579,000, was recorded as additional paid-in capital. These warrants are exercisable at December 31, 1996, and expire on November 27, 1998. Upon a merger or consolidation in which the Company is not the survivor, the warrants are canceled and all rights granted shall terminate. If an event causing conversion of the Company's Series D preferred stock shall have occurred prior to the exercise of the warrants, then all warrants shall be exercisable for the number of shares of common stock of the Company into which the Series D preferred stock not purchased upon any prior exercise of the warrants would have been so converted.

(d) Stock Option Plans Under the Company's 1995 Stock Option Plan (1995 Plan), 3,600,000 shares of common stock are reserved for the issuance of stock options. Options generally vest over a period of one to five years from the date of grant, expire 20 years from the date of grant and terminate, to the extent not exercised, three months after the termination of employment. In 1996, the Company adopted the 1996 Stock Option Plan (1996 Plan). A total of 3,000,000 shares of common stock were reserved for issuance of stock options under the 1996 Plan as of December 31, 1996. In January 1997, the Company reserved an additional 2,800,000 shares of common stock for issuance under the 1996 Plan. The terms of the 1996 Plan are substantially similar to the terms of the 1995 Plan.

A summary of stock option activity under the 1995 Plan and the 1996 Plan is as follows:

		OUTSTANDING OPTIONS	
	SHARES AVAILABLE FOR GRANT	NUMBER OF SHARES	WEIGHTED AVERAGE EXERCISE PRICE
Balances at December 31, 1994.....	--	--	$ --
Plan introduction.....	3,600,000	--	--
Options granted.....	(3,313,214)	3,313,214	0.07
Options exercised.....	--	(30,750)	0.07
Options canceled.....	450,000	(450,000)	0.07
Balances at December 31, 1995.....	736,786	2,832,464	0.07
Plan introduction.....	3,000,000	--	--
Options granted.....	(3,766,364)	3,766,364	0.34
Options exercised.....	--	(498,543)	0.09
Options canceled.....	765,250	(765,250)	0.10
Balances at December 31, 1996.....	735,672	5,335,035	0.27
Plan amendment (unaudited).....	2,800,000	--	--
Options granted (unaudited).....	(1,581,430)	1,581,430	1.94
Options exercised (unaudited).....	--	(213,029)	0.19
Options canceled (unaudited).....	366,950	(366,950)	0.39
Balances at June 30, 1997 (unaudited).....	2,321,192	6,336,486	$ 0.67

The Company applies APB Opinion No. 25 in accounting for the 1995 Plan and the 1996 Plan, and no compensation cost has been recognized for its employee stock options in the consolidated financial statements. Had the Company determined compensation cost of employee stock options based on the fair value at the grant date for its stock options under SFAS No. 123, the Company's net loss would have been increased to the pro forma amounts indicated below:

Net loss:		
As reported.....	$(1,501,302)	$(3,789,245)
Pro forma.....	(1,510,513)	(3,865,415)
Net loss per share:		

```
As reported.................................                $
Pro forma...................................
```

The full impact of calculating compensation cost for stock options under SFAS No. 123 is not reflected in the pro forma net loss and net loss per share amounts presented above because compensation cost is recognized over the options' vesting period. The Company has not calculated pro forma net loss per share because information regarding the pricing of the shares of Common Stock under the contemplated IPO has not yet been determined.

The per share weighted-average fair value of stock options granted during 1995 and 1996 was $.01 and $.07, respectively, on the date of grant using the minimum value method with the following weighted average assumptions: 1995 -- expected dividend yield of 0%, risk-free interest rate of 5.9%, and an expected life of 3.5 years; 1996 -- expected dividend yield of 0%, risk-free interest rate of 6.1%, and an expected life of 4.5 years.

The following table summarizes information about stock options outstanding under the 1995 Plan and the 1996 Plan at December 31, 1996:

	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
EXERCISE PRICES	NUMBER OUTSTANDING	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE	WEIGHTED-AVERAGE EXERCISE PRICE
$ 0.07	1,786,695	18.33 years	$0.07	493,845	$0.07
0.20	2,825,995	19.25 years	0.20	58,543	0.20
0.85	322,000	19.66 years	0.85	3,750	0.85
1.00	400,345	19.82 years	1.00	5,045	1.00
	5,335,035	18.96 years	$0.27	561,183	$0.09

(8) Subsequent Events (Unaudited)

In July 1997, the Company amended its articles of incorporation to designate 7,047,679 shares of common stock as Series E common stock, designate 7,047,679 shares of preferred stock as Series E preferred stock, and reduce the number of shares designated as Series D preferred stock to 3,095,313.

In June 1997, the Company entered into a strategic agreement with Microsoft Corporation (Microsoft) pursuant to which the Company granted Microsoft a nonexclusive license to certain substantial elements of the source code of the Company's RealAudio/RealVideo Version 4.0 technology, including its basic RealPlayer and substantial elements of its EasyStart Server products, and related Company trademarks. Under the agreement, Microsoft may sublicense its rights to the RealAudio/RealVideo Version 4.0 technology to third parties under certain conditions. The agreement also provides for

substantial refunds to Microsoft under prescribed circumstances that are solely within the Company's control. The amount of these refunds diminishes over time. The Company may not assign its obligations under the agreement without Microsoft's consent. Microsoft is obligated to distribute the Company's RealPlayer Version 4.0 for a defined term as long as the Company's player supports certain Microsoft architectures. The Company also agreed to work with Microsoft and several other companies to author and promote the Active Streaming Format as a standard file format for streaming media. The agreement also requires the Company to provide Microsoft with engineering consultation services, certain error corrections, and certain technical support over a defined term. In July 1997, the Company delivered the specified source code in exchange for a license fee of $30,000,000. The Company will recognize revenue, commencing with delivery of the source code, over the three-year term of its ongoing obligations.

In connection with the agreement, Microsoft purchased a minority interest in the Company in the form of 3,338,374 shares of Series E preferred stock at a price of $8.99 per share. The Series E preferred stock is redeemable, at the option of the holder, on or at any time after December 31, 2002 at a redemption price of $8.99 per share and also has a liquidation preference of $8.99 per share plus any declared but unpaid dividends. Each share of Series E preferred stock is also convertible at the option of the holder at any time into either one share of Series A common stock or one share of Series E nonvoting common stock. Conversion of Series E preferred stock is automatic upon either the closing of a public offering of the Company's common stock at a purchase price of not less than $13.554 per share with aggregate proceeds of not less than $20,000,000, or the affirmative vote or written consent of the holders of at least two-thirds of the then outstanding shares of Series D preferred stock. The conversion rate is subject to certain antidilution provisions. In connection with the offering, the Company also issued warrants to purchase up to 3,709,305 shares of Series E preferred stock at an exercise price of $13.48

per share. The warrants are exercisable at any time through January 21, 2000 and will terminate automatically upon either completion of an IPO by the Company, or completion of a merger in which the Company is not a survivor.

In September 1997, the Company amended its articles of incorporation as follows:

- increased the number of authorized shares of common stock and preferred stock to 300,000,000 and 60,000,000, respectively;

- established par value of $0.001 per share for both common stock and preferred stock;

- changed the designation of series of common stock to:

Common Series Stock

A	207,047,679
B	30,000,000
C	30,000,000
D	1
E	7,047,679

- provided an alternative automatic conversion provision for all series of preferred stock such that conversion is automatic on the closing of a public offering of the Company's common stock with aggregate proceeds of not less than $20,000,000, provided that holders of at least two-thirds of the then outstanding Series D preferred stock have consented to such conversion;

- provided that on the closing of an offering as described above, the designations of Series A through D common stock terminate and Series A through D common stock convert into one class of common stock, with each share entitled to one vote;

- provided that on the closing of an offering as described above, the designation of Series E common stock terminates and Series E common stock converts into either common stock, with each share entitled to one vote, or Special Common Stock, with no voting rights except as required by applicable law; shares of Special Common Stock convert into shares of common stock solely with the prior written approval of the Company's Board of Directors; and - created, upon the closing of an offering as described above, a Strategic Transactions Committee of the Board of Directors, consisting of three members of the Board of Directors; without the prior approval of this committee, the Board of Directors is prohibited from (i) adopting a plan of merger; (ii) authorizing sales of (A) assets representing more than 50% of the Company's assets, or (B) any asset on which the long-term business strategy of the Company is substantially dependent; or (iii) authorizing the voluntary dissolution of the Company.

In September 1997, the Company adopted the 1998 Employee Stock Purchase Plan which will become effective January 1, 1998. The Company has reserved 1,000,000 shares of common stock for issuance under the plan.

In September 1997, the Company adopted the Amended and Restated 1996 Stock Option Plan which provides for the grant of incentive and nonqualified options to purchase up to an aggregate of 9,692,736 shares of common stock to employees, officers, directors, consultants and independent contractors of the Company. The amount of shares reserved can be increased up to 11,233,209 after taking into account 1,540,473 shares subject to options outstanding under the 1995 Plan to the extent such options terminate without having been exercised in full.

In September 1997, the Company terminated its line of credit and bank term loan.

Underwriting

Subject to the terms and conditions of the Underwriting Agreement, the Company has agreed to sell to each of the Underwriters named below, and each of such Underwriters, for whom Goldman, Sachs & Co., Montgomery Securities and Robertson, Stephens & Company are acting as representatives, has severally agreed to purchase from the Company, the respective number of shares of Common Stock set forth opposite its name below:

NUMBER OF SHARES OF COMMON UNDERWRITER STOCK Goldman, Sachs & Co..... Montgomery Securities..... Robertson, Stephens & Company.....

Total.....

Under the terms and conditions of the Underwriting Agreement, the Underwriters are committed to take and pay for all of the shares offered hereby, if any are taken.

The Underwriters propose to offer the shares of Common Stock in part directly to the public at the initial public offering price set forth on the cover page of this Prospectus and in part to certain securities dealers at such price less a concession of $ per share. The Underwriters may allow, and such dealers may reallow, a concession not in excess of $ per share to certain brokers and dealers. After the shares of Common Stock are released for sale to the public, the offering price and other selling terms may from time to time be varied by the representatives.

The Company has granted the Underwriters an option exercisable for 30 days after the date of this Prospectus to purchase up to an aggregate of additional shares of Common Stock to cover over-allotments, if any. If the Underwriters exercise their over-allotment option, the Underwriters have severally agreed, subject to certain conditions, to purchase approximately the same percentage thereof that the number of shares to be purchased by each of them, as shown in the foregoing table, bears to the shares of Common Stock offered.

As of the date of this Prospectus, The Goldman Sachs Group, L.P., an affiliate of Goldman, Sachs & Co., beneficially owns 66,401 shares, and a warrant to purchase 19,920 shares, of Series D Preferred Stock. These shares and the warrant were purchased on November 27, 1996 in reliance on the exemption from registration set forth in Section 4(2) of the Securities Act relating to sales by an issuer not involving a public offering.

The Company has agreed that, during the period beginning from the date of this Prospectus and continuing to and including the date 180 days after the date of this Prospectus, it will not offer, sell, contract to sell or otherwise dispose of any securities of the Company (other than pursuant to employee stock option plans existing, or on the conversion or exchange of convertible or exchangeable securities outstanding, on the date of this Prospectus) which are substantially similar to the Common Stock or which are convertible into or exchangeable for securities which are substantially similar to the Common Stock without the prior written consent of the representatives, except for the shares of Common Stock offered in connection with the offering.

In addition, the officers, directors and certain persons who prior to closing of the offering hold shares of capital stock of the Company (including but not limited to all holders of 1% or more of the Company's capital stock) have agreed that they will not offer, sell or otherwise dispose of any shares of Common Stock owned of record or beneficially as of the date of the Prospectus, including securities convertible into or exercisable or exchangeable for shares of Common Stock as of said date, as well as any shares of Common Stock later acquired by reason of the conversion, exercise or exchange of such securities, or enter into any swap or other transaction with respect to the shares that would transfer the economic consequences of ownership of the Common Stock to another person, for a period of 180 days following the date of this Prospectus, except that persons other than officers, directors and holders of 1% or more of the capital stock of the Company each will be free to sell or otherwise dispose of up to 5,000 shares of Common Stock to the extent permissible under Rule 144 or Rule 701.

At the request of the Company, the Underwriters have reserved up to shares of Common Stock for sale, at the initial public offering price, to employees of the Company and to certain distributors. The number of shares of Common Stock available for sale to the general public in the public offering will be reduced to the extent such persons purchase such reserved shares.

The representatives of the Underwriters have informed the Company that they do not expect sales to accounts over which the Underwriters exercise discretionary authority to exceed 5% of the total number of shares of Common Stock offered by them.

Prior to this offering, there has been no public market for the shares. The initial public offering price will be negotiated among the Company and the representatives. Among the factors to be considered in determining the initial public offering price of the Common Stock, in addition to prevailing market conditions, will be the Company's historical performance, estimates of the business potential and earnings prospects of the Company, an assessment of the Company's management and the consideration of the above factors in relation to market valuation of companies in related businesses.

In connection with the offering, the Underwriters may purchase and sell the Common Stock in the open market. These transactions may include over-allotment and stabilizing transactions and purchases to cover syndicate short positions created by the Underwriters in connection with the offering. Stabilizing transactions consist of certain bids or purchases for the purpose of preventing or retarding a decline in the market price of the Common Stock; and syndicate short positions created by the Underwriters involve the sale by the Underwriters of a greater number of shares of Common Stock than they are required to purchase from the Company in the offering. The Underwriters also may impose a penalty bid, whereby selling concessions allowed to syndicate members or other broker-dealers in respect of the securities sold in the offering for their account may be reclaimed by the syndicate if such shares of Common Stock are repurchased by the syndicate in stabilizing or covering transactions. These activities may stabilize, maintain or otherwise affect the market price of the Common Stock which may be higher than the price that might otherwise prevail in the open market; and these activities, if commenced, may be discontinued at any time. These transactions may be effected on the Nasdaq National Market in the over-the-counter market or otherwise.

The Common Stock will be available for quotation on the Nasdaq National Market under the symbol "RNWK." The Company has agreed to indemnify the several Underwriters against certain liabilities, including liabilities under the Securities Act.

[SCREEN-SHOTS OF WEB PAGES SUPERIMPOSED OVER COMPANY LOGO] NO PERSON HAS BEEN AUTHORIZED TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATIONS OTHER THAN THOSE CONTAINED IN THIS PROSPECTUS, AND, IF GIVEN OR MADE, SUCH INFORMATION OR REPRESENTATIONS MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED. THIS PROSPECTUS DOES NOT CONSTITUTE AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY ANY SECURITIES OTHER THAN THE SECURITIES TO WHICH IT RELATES OR AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY SUCH SECURITIES IN ANY CIRCUMSTANCES IN WHICH SUCH OFFER OR SOLICITATION IS UNLAWFUL. NEITHER THE DELIVERY OF THIS PROSPECTUS NOR ANY SALE MADE HEREUNDER SHALL, UNDER ANY CIRCUMSTANCES, CREATE ANY IMPLICATION THAT THERE HAS BEEN NO CHANGE IN THE AFFAIRS OF THE COMPANY SINCE THE DATE HEREOF OR THAT THE INFORMATION CONTAINED HEREIN IS CORRECT AS OF ANY TIME SUBSEQUENT TO ITS DATE.

Table of Contents

Page

Prospectus Summary..... 3
Risk Factors..... 6
Use of Proceeds..... 20
Dividend Policy..... 20
Capitalization..... 21
Dilution..... 22
Selected Consolidated Financial Data..... 23
Management's Discussion and Analysis of Financial Condition and Results of Operations..... 24
Business..... 34
Management..... 49
Certain Transactions..... 57
Principal Shareholders..... 60
Description of Capital Stock..... 62
Shares Eligible for Future Sale..... 65
Legal Matters..... 67
Experts..... 67
Additional Information..... 67
Index to Consolidated Financial Statements..... F-1
Underwriting..... U-1

THROUGH AND INCLUDING , 1997 (THE 25TH DAY AFTER THE DATE OF THIS PROSPECTUS), ALL DEALERS EFFECTING TRANSACTIONS IN THE COMMON STOCK, WHETHER OR NOT PARTICIPATING IN THIS DISTRIBUTION, MAY BE REQUIRED TO DELIVER A PROSPECTUS. THIS IS IN ADDITION TO THE OBLIGATION OF DEALERS TO DELIVER A PROSPECTUS WHEN ACTING AS

UNDERWRITERS AND WITH RESPECT TO THEIR UNSOLD
ALLOTMENTS OR SUBSCRIPTIONS.

Shares

Realnetworks, Inc. (Formerly "Progressive Networks, Inc.")

COMMON STOCK (PAR VALUE $.001 PER SHARE) [REALNETWORKS LOGO] GOLDMAN, SACHS & CO. MONTGOMERY SECURITIES ROBERTSON, STEPHENS & COMPANY

Representatives of the Underwriters

Part Ii

Information Not Required in Prospectus

*Item 13. Other Expenses of Issuance and Distribution**

Securities and Exchange Commission Registration Fee.....	$ 10,455
NASD Filing Fee.....	3,950
Nasdaq National Market Listing Fee.....	50,000
Legal Fees and Expenses.....	**
Accountants' Fees and Expenses.....	225,000
Blue Sky Filing and Counsel Fees and Expenses.....	5,000
Printing and Engraving Expenses.....	150,000
Transfer Agent and Registrar Fees.....	10,000
Directors' and Officers' Liability Insurance.....	200,000
Miscellaneous Expenses.....	**
Total.....	$ **

* All expenses other than the Securities and Exchange Commission Registration Fee, the NASD Filing Fee and the Nasdaq National Market Fee are estimated.

** To be provided by amendment.

Item 14. Indemnification of Directors and Officers

Sections 23B.08.500 through 23B.08.600 of the Washington Business Corporation Act (the "Washington Act") authorize a court to award, or a corporation's board of directors to grant, indemnification to directors and officers on terms sufficiently broad to permit indemnification under certain circumstances for liabilities arising under the Securities Act of 1933, as amended (the "Securities Act"). Article VI, Section 6.4, of the Registrant's Amended and Restated Articles of Incorporation (Exhibit 3.1 hereto) and Article X of the Registrant' Restated Bylaws (Exhibit 3.2 hereto)

provide for indemnification of the Registrant's directors, officers, employees and agents to the maximum extent permitted by Washington law. The Registrant has entered into agreements with all officers and directors to indemnify them against certain liabilities arising out of their service as officers and directors, as applicable, and to advance expenses to defend claims subject to indemnification. The directors and officers of the Registrant also may be indemnified against liability they may incur for serving in that capacity pursuant to a liability insurance policy maintained by the Registrant for such purpose.

Section 23B.08.320 of the Washington Act authorizes a corporation to limit a director's liability to the corporation or its shareholders for monetary damages for acts or omissions as a director, except in certain circumstances involving intentional misconduct, self-dealing or illegal corporate loans or distributions, or any transaction from which the director personally receives a benefit in money, property or services to which the director is not legally entitled. Article VI, Section 6.5, of the Registrant's Amended and Restated Articles of Incorporation contains provisions implementing, to the fullest extent permitted by Washington law, such limitations on a director's liability to the Registrant and its shareholders.

Reference is also made to the Form of Underwriting Agreement to be filed as Exhibit 1.1 to this Registration Statement for certain provisions regarding the indemnification of officers and directors of the Registrant by the Underwriters.

Item 15. Recent Sales of Unregistered Securities

Since September 1, 1994, the Registrant has issued and sold unregistered securities as follows:

(1) An aggregate of 2,686,567 shares of Series B Preferred Stock issued in April 1995 to investors. The aggregate consideration received for such shares was $1,800,000.

(2) An aggregate of 2,600 shares of Series B Common Stock issued in September 1995 to 26 employees in exchange for services, and 100 shares of Series C Common Stock issued in September 1995 to one individual in exchange for services.

(3) An aggregate of 2,904,305 shares of Series C Preferred Stock issued in October 1995 to investors. The aggregate consideration received for such shares was $5,702,312.

(4) An aggregate of 3,497 shares of Series C Common Stock issued in October 1995 to one individual in exchange for services.

(5) An aggregate of 2,381,010 shares of Series D Preferred Stock issued in November 1996 to investors. The aggregate consideration received for such shares was $17,929,005.

(6) An aggregate of 1,000 shares of Series C Common Stock issued in March 1997 to one individual in exchange for services.

(7) An aggregate of 3,338,374 shares of Series E Preferred Stock issued in July 1997 to one investor. The aggregate consideration received for such shares was $30,000,000.

(8) An aggregate of 1,531,594 shares of Series B Common Stock and Series C Common Stock issued to employees and consultants upon the exercise of options. The aggregate consideration received for such shares was $187,914.

(9) An aggregate of 373,134 shares of Series B Preferred Stock issued to an investor upon the exercise of warrants. The aggregate consideration received for such shares was $250,000.

No underwriters were engaged in connection with these issuances and sales, which were made in reliance upon the exemption from registration set forth in Section 4(2) of the Securities Act, relating to sales by an issuer not involving a public offering.

Item 16. Exhibits and Financial Statement Schedules

(A) Exhibits

Number Description

1.1*	Form of Underwriting Agreement
3.1	Amended and Restated Articles of Incorporation filed September 19, 1997
3.2	Articles of Amendment to the Amended and Restated Articles of Incorporation filed September 25, 1997
3.3	Form of Amended and Restated Articles of Incorporation
3.4	Bylaws
4.1*	Specimen Stock Certificate
5.1*	Opinion of Graham & James LLP/Riddell Williams P.S.
10.1	RealNetworks, Inc. 1995 Stock Option Plan
10.2	RealNetworks, Inc. Amended and Restated 1996 Stock Option Plan
10.3	Form of Stock Option Agreement
10.4	1998 Employee Stock Purchase Plan
10.5	Form of Warrant to Purchase Series D Preferred Stock
10.6	Warrant to Purchase Series E Preferred Stock dated July 21, 1997 between the Registrant and Microsoft Corporation
10.7	Lease Agreement dated March 4, 1996 by and between the Registrant as Lessee and Wright Runstad Properties L.P. as Lessor

Number Description

10.8	Sublease Agreement dated March, 1996 by and between the Registrant as Sublessee and Legent Corporation as Sublessor
10.9	Antenna Site License Agreement dated August 12, 1997 by and between the Registrant and Wright Runstad & Company
10.10**	Agreement between Microsoft Corporation and the Registrant on Media Streaming Technology dated June 17, 1997
10.11	Offer letter dated February 16, 1996 between the Registrant and Bruce Jacobsen
10.12	Offer letter dated May 2, 1995 between the Registrant and James Wells
10.13	Offer letter dated May 24, 1994 between the Registrant and Andrew Sharpless
10.14	Form of Director and Officer Indemnification Agreement
10.15	Limited Proxy and Voting Agreement dated July 21, 1997 by and between the Registrant and Microsoft Corporation
10.16	Shareholders' Buy-Sell Agreement dated March 31, 1995 by and among the Registrant, Robert Glaser and certain shareholders of the Registrant
10.17	Voting Agreement dated September 25, 1997 by and among the Registrant, Robert

	Glaser, Accel IV L.P., Mitchell Kapor and Bruce Jacobsen
10.18	Agreement dated September 26, 1997 by and between the Registrant and Robert Glaser
10.19	Second Amended and Restated Investors' Rights Agreement dated July 21, 1997 by and among the Registrant and certain shareholders of the Registrant
11.1*	Statement re: Computation of Pro Forma Net Loss Per Share
21.1	Subsidiaries of the Registrant
23.1	Consent of Graham & James LLP/Riddell Williams P.S. (included in its opinion to be filed as Exhibit 5.1 hereto)
23.2	Consent of KPMG Peat Marwick LLP
24.1	Power of Attorney (included on signature page)
27.1	Financial Data Schedule

* To be filed by amendment.

** Confidential treatment requested.

(b) FINANCIAL STATEMENT SCHEDULE Schedule II -- Valuation and Qualifying Accounts

Item 17. Undertakings

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the Registrant pursuant to the foregoing provisions, or otherwise, the Registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Registrant of expenses incurred or paid by a director, officer or controlling person of the Registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

The undersigned Registrant hereby undertakes to provide to the Underwriters, at the closing specified in the Underwriting Agreement, certificates in such denominations and registered in such names as required by the Underwriters to permit prompt delivery to each purchaser.

The undersigned Registrant hereby undertakes that:

(1) For purposes of determining any liability under the Securities Act, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the Registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be a part of this Registration Statement as of the time it was declared effective.

(2) For the purpose of determining any liability under the Securities Act, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

Signatures

Pursuant to the requirements of the Securities Act of 1933, the Registrant has duly caused this Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Seattle, State of Washington, on September 26, 1997.

Realnetworks, Inc.

By: /s/ ROBERT GLASER Robert Glaser Chief Executive Officer

Power of Attorney

Each person whose individual signature appears below hereby constitutes and appoints Robert Glaser and Bruce Jacobsen, and each of them, as his true and lawful attorney-in-fact, with full power of substitution, to execute in the name and on behalf of such person, individually and in each capacity stated below, and to file, any and all amendments to this Registration Statement, including any and all post-effective amendments, and any related registration statement that is to be effective upon filing pursuant to Rule 462(b) under the Securities Act of 1933.

Pursuant to the requirements of the Securities Act of 1933, this Registration Statement has been signed by the following persons in the capacities and on the dates indicated below:

Signature Title Date

/s/ ROBERT GLASER - ---------- Robert Glaser	Chairman of the Board, Chief Executive Officer, Secretary and Treasurer (Principal Executive Officer)	September 26, 1997
/s/ BRUCE JACOBSEN - ---------- Bruce Jacobsen	President, Chief Operating Officer and Director	September 26, 1997
/s/ MARK KLEBANOFF - ---------- Mark Klebanoff	Chief Financial Officer (Principal Financial and Accounting Officer)	September 26, 1997

/s/ JIM BREYER Director September 25, 1997 James Breyer /s/ MITCHELL KAPOR Director September 22, 1997 Mitchell Kapor

Schedule Ii -- Valuation and Qualifying Accounts

REALNETWORKS, INC. AND SUBSIDIARIES PERIOD FROM FEBRUARY 9, 1994 (INCEPTION) TO DECEMBER 31, 1994 AND THE YEARS ENDED DECEMBER 31, 1995 AND 1996

BALANCE AT BEGINNING	CHARGED TO COSTS AND	COSTS AND	BALANCE AT END OF

DESCRIPTION	OF PERIOD	EXPENSES	DEDUCTIONS(1)	PERIOD

Year ended December 31, 1996: Valuation accounts deducted from assets: Allowance for doubtful accounts receivable and sales returns..... $ 129,869 $ 563,046 $(309,565) $ 383,350 Valuation allowance for deferred tax assets..... 493,000 1,335,000 -- 1,828,000 Year ended December 31, 1995: Valuation accounts deducted from assets: Allowance for doubtful accounts receivable and sales returns..... -- 129,869 -- 129,869 Valuation allowance for deferred tax assets..... -- 493,000 -- 493,000 Period from February 9, 1994 (inception) to December 31, 1994: Valuation accounts deducted from assets: Allowance for doubtful accounts receivable and sales returns..... -- -- -- -- Valuation allowance for deferred tax assets..... -- -- -- -- (1) Represents amounts written off.

Exhibit Index

Exhibit Number Description

1.1*	Form of Underwriting Agreement.....
3.1	Amended and Restated Articles of Incorporation filed September 19, 1997.....
3.2	Articles of Amendment to the Amended and Restated Articles of Incorporation filed September 25, 1997.....
3.3	Form of Amended and Restated Articles of Incorporation.....
3.4	Bylaws.....
4.1*	Specimen Stock Certificate.....
5.1*	Opinion of Graham & James LLP/Riddell Williams P.S.....
10.1	RealNetworks, Inc. 1995 Stock Option Plan.....
10.2	RealNetworks, Inc. Amended and Restated 1996 Stock Option Plan.....
10.3	Form of Stock Option Agreement.....
10.4	1998 Employee Stock Purchase Plan.....
10.5	Form of Warrant to Purchase Series D Preferred Stock.....
10.6	Warrant to Purchase Series E Preferred Stock dated July 21, 1997 between the Registrant and Microsoft Corporation.....
10.7	Lease Agreement dated March 4, 1996 by and between the Registrant as Lessee and Wright Runstad Properties L.P. as Lessor.....
10.8	Sublease Agreement dated March, 1996 by and between the Registrant as Sublessee and Legent Corporation as Sublessor.....
10.9	Antenna Site License Agreement dated August 12, 1997 by and between the Registrant and Wright Runstad & Company.....
10.10**	Agreement between Microsoft Corporation and the Registrant on Media Streaming Technology dated June 17, 1997.....
10.11	Offer letter dated February 16, 1996 between the Registrant and Bruce Jacobsen.....
10.12	Offer letter dated May 2, 1995 between the Registrant and James Wells.....
10.13	Offer letter dated May 24, 1994 between the Registrant and Andrew Sharpless.....
10.14	Form of Director and Officer Indemnification Agreement.....
10.15	Limited Proxy and Voting Agreement dated July 21, 1997 by and between the Registrant and Microsoft Corporation.....
10.16	Shareholders' Buy-Sell Agreement dated March 31, 1995 by and among the Registrant, Robert Glaser and certain shareholders of the Registrant.....
10.17	Voting Agreement dated September 25, 1997 by and among the Registrant, Robert Glaser, Accel IV L.P., Mitchell Kapor and Bruce Jacobsen.....
10.18	Agreement dated September 26, 1997 by and between the Registrant and

	Robert Glaser.....	
10.19	Second Amended and Restated Investors' Rights Agreement dated July 21, 1997 by and among the Registrant and certain shareholders of the Registrant.....	
11.1*	Statement re: Computation of Pro Forma Net Loss Per Share.....	
21.1	Subsidiaries of the Registrant.....	
23.1	Consent of Graham & James LLP/Riddell Williams P.S. (included in its opinion to be filed as Exhibit 5.1 hereto).....	
23.2	Consent of KPMG Peat Marwick LLP.....	
24.1	Power of Attorney (included on signature page).....	
27.1	Financial Data Schedule.....	

* To be filed by amendment.

** Confidential treatment requested. </TEXT>