

SECURITIES AND EXCHANGE COMMISSION

[Investment Company Act Release No. 27877; 812-13399]

RealNetworks, Inc.; Notice of Application

June 28, 2007

Agency: Securities and Exchange Commission (“Commission”).

Action: Notice of application under section 3(b)(2) of the Investment Company Act of 1940 (the “Act”).

Summary of Application: RealNetworks, Inc. (“RealNetworks”) seeks an order under section 3(b)(2) of the Act declaring it to be primarily engaged in a business other than that of investing, reinvesting, owning, holding or trading in securities. RealNetworks, directly and through its wholly-owned subsidiaries, creates digital media services and software.

Filing Date: The application was filed on June 22, 2007.

Hearing or Notification of Hearing: An order granting the requested relief will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission’s Secretary and serving applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on July 23, 2007, and should be accompanied by proof of service on applicants, in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer’s interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission’s Secretary.

Addresses: Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303. Applicant, 2601 Elliott Avenue, Suite 1000, Seattle, Washington 98121.

For Further Information Contact: Jaea F. Hahn, Senior Counsel, at (202) 551-6870, or Nadya B. Roytblat, Assistant Director, at (202) 551-6821 (Division of Investment Management, Office of Investment Company Regulation).

Supplementary Information: The following is a summary of the application. The complete application may be obtained for a fee at the Commission's Public Reference Desk, 100 F Street, NE, Washington, DC 20549-0102 (tel. 202-551-5850).

Applicant's Representations:

1. RealNetworks, a Washington corporation, is in the business of creating digital media services and software. Consumers use RealNetworks' services and software to discover, play, purchase and manage digital content, including music, games and video. Broadcasters, cable and wireless communications companies, media companies and enterprises use RealNetworks' products and services to create, secure and deliver digital media to personal computers, MP3 players, mobile phones and other consumer electronic devices and to provide entertainment services to their subscribers.

2. RealNetworks states that the market for software and services for media delivery over the Internet is relatively new, constantly changing and intensely competitive.

RealNetworks states that it requires substantial liquid capital to fund operations, fund research and development, license content and technology for its subscription service and software products, and fund acquisitions. Because of the pace of technological change in the industry sectors in which RealNetworks competes, RealNetworks needs to use cash to develop new products and fund capital expenditures, enhance its existing products and technology, and make strategic acquisitions. In addition, from time to time, RealNetworks also makes non-controlling investments in entities that complement or enhance RealNetworks' media delivery and digital

distribution business (“Strategic Investments”). RealNetworks seeks to preserve its capital and maintain liquidity, pending the use of such capital for its current and future operations, by investing in short-term investment grade and liquid fixed income and money market investments that earn competitive market returns and provide a low level of credit risk (“Capital Preservation Investments”). RealNetworks’ board of directors (“Board”) has approved a corporate investment policy establishing limits and guidelines governing its cash management investments, consistent with the goal of capital preservation (“Policy”). RealNetworks states that it does not invest in securities for short-term speculative purposes.

Applicant’s Legal Analysis:

1. RealNetworks seeks an order under section 3(b)(2) of the Act declaring that it is primarily engaged in a business other than that of investing, reinvesting, owning, holding or trading in securities, and therefore not an investment company as defined in the Act.

2. Under section 3(a)(1)(C) of the Act, an issuer is an investment company if it is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value in excess of 40 percent of the value of the issuer’s total assets (exclusive of Government securities and cash items) on an unconsolidated basis. Section 3(a)(2) of the Act defines “investment securities” to include all securities except Government securities, securities issued by employees’ securities companies, and securities issued by majority-owned subsidiaries of the owner which (a) are not investment companies, and (b) are not relying on the exclusions from the definition of investment company in section 3(c)(1) or 3(c)(7) of the Act. RealNetworks states that as of December 31, 2006, approximately 18% of its total assets (exclusive of

Government securities and cash items), on an unconsolidated basis, consisted of investment securities as defined in section 3(a)(2) of the Act.

3. Rule 3a-1 provides an exemption from the definition of investment company if no more than 45% of a company's total assets consist of, and not more than 45% of its net income over the last four quarters is derived from, securities other than Government securities, securities of majority-owned subsidiaries and primarily controlled companies. RealNetworks states that it cannot rely upon rule 3a-1 under the Act because the percentage of its total assets invested in securities fluctuates and may, from time to time, exceed 45% of its total assets.

4. Rule 3a-8 under the Act provides an exemption from the definition of investment company if, among other factors, a company's research and development expenses are a substantial percentage of its total expenses for the last four fiscal quarters combined. While Real Networks believes it could satisfy the other factors in the rule, RealNetworks' research and development expenses, as a percentage of its total expenses, fluctuate and may not account for a substantial percentage of its total expenses. For the last four fiscal quarters ended on December 31, 2006, RealNetworks' research and development expenses represented approximately 18% of its total expenses, including cost of goods sold. RealNetworks also states that as its revenues increase its research and development expenses as a percentage of its total expenses are expected to decline even if research and development expenses increase on an absolute basis because sales and marketing expense and cost of goods sold, which are closely related to revenues, are likely to increase faster than research and development expenses.

5. Section 3(b)(2) of the Act provides that, notwithstanding section 3(a)(1)(C) of the Act, the Commission may issue an order declaring an issuer to be primarily engaged in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in

securities either directly or through majority-owned subsidiaries or through controlled companies conducting similar types of businesses. RealNetworks requests an order under section 3(b)(2) of the Act declaring that it is primarily engaged in a business other than that of investing, reinvesting, owning, holding or trading in securities, and therefore not an investment company as defined in the Act.

6. In determining whether a company is primarily engaged in a non-investment company business under section 3(b)(2), the Commission considers: (a) the issuer's historical development; (b) its public representations of policy; (c) the activities of its officers and directors; (d) the nature of its present assets; and (e) the sources of its present income.<sup>1</sup>

a. **Historical Development.** RealNetworks states that since its inception in 1994 it has been developing and providing media delivery and digital distribution products and services for the Internet. Since its initial public offering in 1997, RealNetworks has used its revenue and raised cash to expand its operations into foreign countries, to expand its product and service lines, to license content and to acquire companies with complementary products or services.

b. **Public Representations of Policy.** RealNetworks states that it has never represented that it is involved in any business other than developing and providing branded software products and services that enable the creation, delivery and consumption of streaming media content. RealNetworks asserts that it has consistently stated in its annual reports to stockholders, press releases, filings with the Commission, marketing materials and website that it is a digital media technology and digital media distribution company. RealNetworks states that it generally does not make public representations regarding its investment securities except as required by its obligation to file periodic reports to comply with federal securities laws.

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<sup>1</sup> Tonopah Mining Company of Nevada, 26 SEC 426, 427 (1947).

RealNetworks further states that it has never emphasized either its investment income or the possibility of significant appreciation from its cash management investment strategies as a material factor in its business or future growth.

c. Activities of Officers and Directors. RealNetworks states that its directors and officers spend substantially all of their time managing RealNetworks core digital media technology and digital media distribution business. Other than establishing the Policy and receiving periodic reports on its implementation, the Board's involvement with RealNetworks' cash management investments is minimal. Applicant states that the Board is more actively involved in RealNetworks' Strategic Investments, but the amount of time dedicated to such matters is small relative to the amount of time dedicated to RealNetworks' direct ongoing business activities. Only three of RealNetworks' employees oversee the cash management process: RealNetworks' Treasurer is the only employee involved in the day-to-day management of cash management investments, and spends from 25-75% of his time doing so; one other member of the Treasurer's staff is involved in trade settlement and portfolio accounting, representing 15-20% of this person's time; and one member of the Treasurer's staff spends approximately 5% of his time on cash management in Korea. RealNetworks has approximately 1,500 employees worldwide.

d. Nature of Assets. RealNetworks states that as of December 31, 2006, its investment securities (as defined in Section 3(a)(2) of the Act) constituted approximately 18% of its total assets (excluding Government securities and cash items) on an unconsolidated basis. On a consolidated basis, that figure was 27%. RealNetworks states that in the future, the percentage of its total assets (other than Government securities and cash items) that will consist of investment securities other than Capital Preservation Investments will not exceed ten percent.

RealNetworks further states that a significant portion of its assets consist of intangible assets, such as intellectual property and goodwill, which, with limited exceptions, do not appear on its balance sheet and are not included in the value of RealNetworks total assets for purposes of determining its status under the Act. RealNetworks states that the asset tests used in connection with sections 3(a)(1)(C) and 3(b) of the Act therefore significantly understate the relative value of RealNetworks' non-investment security assets.

e. Sources of Income and Revenue. RealNetworks states that for the year ended December 31, 2005, it had net income of \$312.3 million, of which net investment income was \$33.9 million or approximately 11%. RealNetworks states that for the year ended December 31, 2006, it had net income of \$145.2 million, of which net investment income was \$37.4 million, or approximately 26%. RealNetworks states that its net investment income was 9% of its total revenue for each of its last two fiscal years. In the future, RealNetworks expects substantially all of its revenues to come from operations and less than 10% from investment securities. RealNetworks states that since substantially all of its revenue is attributable to its operations, rather than investments, RealNetworks' revenue supports a determination that RealNetworks is primarily engaged in a business other than that of investing, reinvesting, owning, holding or trading in securities.

7. RealNetworks thus asserts that it satisfies the standards for an order under section 3(b)(2) of the Act.

Applicant's Conditions:

RealNetworks agrees that any order granted pursuant to the application will be subject to the following conditions:

1. RealNetworks will continue to allocate and utilize its accumulated cash and investment securities for bona fide business purposes.
2. RealNetworks will refrain from investing or trading in securities for short-term speculative purposes.

For the Commission, by the Division of Investment Management, under delegated authority.

Florence E. Harmon  
Deputy Secretary