REALNETWORKS INC
Form 10-Q
November 08, 2018

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨

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

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

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

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

The number of shares of the registrant’s Common Stock outstanding as of October 31, 2018 was 37,655,047.

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REALNETWORKS, INC. AND SUBSIDIARIES
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	September 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 37,964	$ 51,196
Short-term investments	1,172	8,779
Trade accounts receivable, net of allowances of $577 and $937	13,090	12,689
Deferred costs, current portion	365	426
Prepaid expenses and other current assets	4,719	3,715
Current assets of discontinued operations	—	17,456
Total current assets	57,310	94,261
Equipment, software, and leasehold improvements, at cost:		
Equipment and software	40,016	46,417
Leasehold improvements	3,431	3,536
Total equipment, software, and leasehold improvements, at cost	43,447	49,953
Less accumulated depreciation and amortization	40,531	46,093
Net equipment, software, and leasehold improvements	2,916	3,860
Restricted cash equivalents	1,630	2,400
Other assets	5,723	5,588
Deferred costs, non-current portion	593	955
Deferred tax assets, net	1,019	1,047
Other intangible assets, net	120	325
Goodwill	17,060	13,060
Total assets	$ 86,371	$ 121,496
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable	$ 3,914	$ 3,785
Accrued and other current liabilities	11,916	12,365
Commitment to Napster	2,750	2,750
Deferred revenue, current portion	1,969	3,097
Current liabilities of discontinued operations	—	17,107
Total current liabilities	20,549	39,104
Deferred revenue, non-current portion	312	443
Deferred rent	953	982
Deferred tax liabilities, net	170	19
Other long-term liabilities	1,082	1,775
Total liabilities	23,066	42,323
Commitments and contingencies		
Shareholders’ equity:		
Preferred stock, $0.001 par value, no shares issued and outstanding:		
Series A: authorized 200 shares	—	—
Undesignated series: authorized 59,800 shares	—	—
	37	37

Common stock, $0.001 par value authorized 250,000 shares; issued and outstanding 37,652 shares in 2018 and 37,341 shares in 2017		
Additional paid-in capital	641,449	638,727
Accumulated other comprehensive loss	(61,077)	(59,547)
Retained deficit	(517,104)	(500,044)
Total shareholders’ equity	63,305	79,173
Total liabilities and shareholders’ equity	$ 86,371	$ 121,496

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net revenue (A)	$17,579	$18,557	$52,953	$59,853
Cost of revenue (B)	4,239	5,343	14,000	18,199
Gross profit	13,340	13,214	38,953	41,654
Operating expenses:				
Research and development	8,052	7,152	23,398	22,085
Sales and marketing	4,998	4,883	15,878	17,534
General and administrative	4,586	5,081	15,526	15,638
Restructuring and other charges	632	557	1,320	2,271
Lease exit and related benefit	—	—	(454)	—
Total operating expenses	18,268	17,673	55,668	57,528
Operating loss	(4,928)	(4,459)	(16,715)	(15,874)
Other income (expenses):				
Interest income, net	72	116	270	353
Equity in net loss of Napster investment	(737)	—	(737)	(1,097)
Other income (expenses), net	(112)	(50)	(195)	(289)
Total other income (expenses), net	(777)	66	(662)	(1,033)
Loss from continuing operations before income taxes	(5,705)	(4,393)	(17,377)	(16,907)
Income tax expense	272	139	708	954
Net loss from continuing operations	(5,977)	(4,532)	$(18,085)	$(17,861)
Net income from discontinued operations, net of tax	—	198	—	717
Net loss	$(5,977)	$(4,334)	$(18,085)	$(17,144)
Net income (loss) per share - Basic:				
Continuing operations	$(0.16)	$(0.12)	$(0.48)	$(0.48)
Discontinued operations	—	—	—	0.02
Net loss per share - Basic	$(0.16)	$(0.12)	$(0.48)	$(0.46)
Net income (loss) per share - Diluted				
Continuing operations	$(0.16)	$(0.12)	$(0.48)	$(0.48)
Discontinued operations	—	—	—	0.02
Net loss per share - Diluted	$(0.16)	$(0.12)	$(0.48)	$(0.46)
Shares used to compute basic net income (loss) per share	37,618	37,200	37,549	37,112
Shares used to compute diluted net income (loss) per share	37,618	37,200	37,549	37,112
Comprehensive income (loss):				
Unrealized investment holding gains (losses), net of reclassification adjustments	$(3)	$—	$—	$10
Foreign currency translation adjustments, net of reclassification adjustments	(322)	562	(1,530)	1,802
Total other comprehensive income (loss)	(325)	562	(1,530)	1,812
Net loss	(5,977)	(4,334)	(18,085)	(17,144)
Comprehensive loss	$(6,302)	$(3,772)	$(19,615)	$(15,332)

(A) Components of net revenue:				
License and product revenue	$5,827	$6,873	$17,770	$23,677
Service revenue	11,752	11,684	35,183	36,176

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	$17,579	$18,557	$52,953	$59,853
(B) Components of cost of revenue:				
License and product revenue	$1,523	$2,163	$4,743	$6,683
Service revenue	2,716	3,180	9,257	11,516
	$4,239	$5,343	$14,000	$18,199

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net loss	$(18,085)	$(17,144)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,738	2,402
Stock-based compensation	2,113	3,045
Equity in net loss of Napster	737	1,097
Deferred income taxes, net	5	(55)
Fair value of warrants granted in 2015 and 2017, net of subsequent mark to market adjustments in 2018 and 2017	78	(367)
Net change in certain operating assets and liabilities:		
Trade accounts receivable	16,754	(3,516)
Prepaid expenses and other assets	(979)	1,072
Accounts payable	(15,235)	(447)
Accrued and other liabilities	(2,754)	(3,630)
Net cash used in operating activities	(15,628)	(17,543)
Cash flows from investing activities:		
Purchases of equipment, software, and leasehold improvements	(698)	(541)
Purchases of short-term investments	—	(13,905)
Proceeds from sales and maturities of short-term investments	7,607	43,754
Acquisition, net of cash acquired	(4,192)	—
Advance to Napster	—	(1,500)
Net cash provided by investing activities	2,717	27,808
Cash flows from financing activities:		
Proceeds from issuance of common stock (stock options and stock purchase plan)	114	130
Tax payments from shares withheld upon vesting of restricted stock	(243)	(338)
Net cash used in financing activities	(129)	(208)
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(962)	1,519
Net increase (decrease) in cash, cash equivalents and restricted cash	(14,002)	11,576
Cash, cash equivalents and restricted cash, beginning of period	53,596	36,421
Cash, cash equivalents, and restricted cash end of period	$39,594	$47,997
Supplemental disclosure of cash flow information:		
Cash received from income tax refunds	$169	$419
Cash paid for income taxes	$862	$1,124
Non-cash investing activities:		
Increase (decrease) in accrued purchases of equipment, software, and leasehold improvements	$(92)	$42

See accompanying notes to unaudited condensed consolidated financial statements.

REALNETWORKS, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Quarters and Nine Months Ended September 30, 2018 and 2017

Note 1 Description of Business and Summary of Significant Accounting Policies

Description of Business. RealNetworks, Inc. and subsidiaries is a global provider of network-delivered digital media applications and services that make it easy to manage, play and share digital media. The Company also develops and markets software products and services that enable the creation, distribution and consumption of digital media, including audio and video.

Inherent in our business are various risks and uncertainties, including a limited history of certain of our product and service offerings. RealNetworks' success will depend on the acceptance of our technology, products and services and the ability to generate related revenue.

In this Quarterly Report on Form 10-Q (10-Q or Report), RealNetworks, Inc. and Subsidiaries is referred to as “RealNetworks”, the “Company”, “we”, “us”, or “our”.

Basis of Presentation. The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany balances and transactions have been eliminated in consolidation.

The unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal, recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations for the periods presented. Operating results for the quarter and nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for any subsequent period or for the year ending December 31, 2018. Certain information and disclosures normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2017 (the 10-K).

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

Note 2 Recent Accounting Pronouncements

Recently adopted accounting pronouncements

In May 2014, and subsequently updated and amended in 2015 and 2016, the Financial Accounting Standards Board (FASB) issued new revenue recognition guidance (Topic 606), which replaced most existing revenue recognition guidance in U.S. GAAP. The guidance requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. We adopted Topic 606 as of January 1, 2018 using the modified retrospective transition method. Refer to Note 3 Revenue Recognition for further details.

In November 2016, the FASB issued guidance on the classification and presentation of changes in restricted cash on the statement of cash flows. We adopted this guidance on January 1, 2018, and retroactively applied the changes to the Statement of Cash Flows for all periods presented. As a result, we no longer classify changes in restricted cash within the investing section of our Statement of Cash flows, and instead include restricted cash with unrestricted cash as a combined total. The impact of the adoption did not have a material impact on the Condensed Consolidated Financial Statements.

Recently issued accounting pronouncements not yet adopted

In February 2016, the FASB issued new guidance related to the accounting for leases. A major change in the new guidance is that lessees will be required to present right-of-use assets and lease liabilities on the balance sheet. Enhanced disclosures will also be required to give financial statement users the ability to assess the amount, timing and uncertainty of cash flows arising from leases. In July 2018 the FASB issued an alternative method that permits application of the new guidance at the beginning of the year of adoption. This is in addition to the method of applying the new guidance

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retrospectively to each prior reporting period presented. The new guidance will be effective for us on January 1, 2019, including interim periods within 2019. We continue to evaluate the effect that the guidance will have on our consolidated financial statements and related disclosures. We expect that the guidance will result in a material change to our Consolidated Balance Sheet as a result of capitalizing our operating leases.

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

In June 2018, the FASB issued new guidance related to the measurement and classification for share-based awards to non-employees. The new guidance essentially aligns the measurement and classification for these awards with that for share-based awards to employees. The new guidance will be effective for us on January 1, 2019, including interim periods within 2019, with early adoption permitted. We will be evaluating the impact of the guidance, but do not currently expect the adoption to have a material impact on our consolidated financial statements and related disclosures.

Note 3 Revenue Recognition

Adoption of New Revenue Standard

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

We recorded a net decrease to opening retained deficit of $1.0 million as of January 1, 2018 due to the cumulative impact of adopting the new revenue recognition standard, with the impact primarily related to licensing of our RealPlayer product and full recognition of non-recurring engineering fees which were previously deferred and amortized over the life of the contract. The net impact to revenues as a result of adopting the new standard was a decrease of $0.4 million for the three months ended September 30, 2018 and an increase of $2.0 million for the nine months ended September 30, 2018.

Performance Obligations

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

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

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

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

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

Disaggregation of Revenue

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

	Quarter Ended September 30, 2018			Nine months ended September 30, 2018		
	Consumer Media	Mobile Services	Games	Consumer Media	Mobile Services	Games
Business Line						
Software License	$2,746	$ 520	$—	$7,891	$2,324	$—
Subscription Services	1,232	6,828	2,744	3,742	20,447	8,126
Product Sales	281	—	2,280	920	—	6,635
Advertising and Other	474	—	474	1,547	—	1,321
Total	$4,733	$ 7,348	$5,498	$14,100	$22,771	$16,082

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

	Quarter Ended September 30, 2018			Nine months ended September 30, 2018		
	Consumer Media	Mobile Services	Games	Consumer Media	Mobile Services	Games
Sales Channel						
Business to Business	$3,220	$ 7,209	$806	$9,438	$22,312	$2,393
Direct to Consumer	1,513	139	4,692	4,662	459	13,689
Total	$4,733	$ 7,348	$5,498	$14,100	$22,771	$16,082

Contract Balances

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

We record deferred revenue when cash payments are received or due in advance of our completion of the underlying performance obligation. As of September 30, 2018 we had a deferred revenue balance of $2.3 million, a decrease of $1.3 million from December 31, 2017. The decrease is due primarily to our transition to Topic 606, with $0.8 million recorded to retained earnings on January 1, 2018. The decrease is further due to $0.2 million of revenues recognized which were included in the deferred balance at December 31, 2017.

Significant Estimates

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

Practical Expedients

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

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Note 4 Stock-Based Compensation

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

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Total stock-based compensation expense	$499	$748	$2,113	$3,045

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

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Expected dividend yield	0 %	0 %	0 %	0 %
Risk-free interest rate	2.78 %	1.61 %	2.69 %	1.71 %
Expected life (years)	3.8	3.7	3.9	4.2
Volatility	35 %	34 %	35 %	35 %

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

As of September 30, 2018, $3.3 million of total unrecognized compensation cost, net of estimated forfeitures, related to stock awards. The unrecognized compensation cost is expected to be recognized over a weighted-average period of approximately 3.8 years.

Note 5 Napster Joint Venture

As of September 30, 2018 we owned approximately 42% of the issued and outstanding stock of Rhapsody International Inc., doing business as Napster, and account for our investment using the equity method of accounting. Rhapsody America LLC was initially formed in 2007 as a joint venture between RealNetworks and MTV Networks, a division of Viacom International Inc. (MTVN), to own and operate a business-to-consumer digital audio music service originally branded as Rhapsody. The service was re-branded in 2016 as Napster. In this Note, we refer to the business as Napster, although the legal entity in which we hold our investment is Rhapsody International, Inc.

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

We recorded our share of losses of Napster of $0.7 million for the quarter and nine months ended September 30, 2018; and $0.0 million and $1.1 million for the quarter and nine months ended September 30, 2017. Because of the $10.0 million liquidation preference on the preferred stock we hold in Napster, under the equity method of accounting we did not record any share of Napster losses that would reduce our carrying value of Napster, which is impacted by

Napster equity transactions, below $10.0 million, until Napster's book value was reduced below $10.0 million. This occurred in the first quarter of 2015. As of September 30, 2018, the carrying value of our Napster equity investment was zero, as we did not have any further commitment to provide future support to Napster, with the exception of the guaranty discussed below. Unless we commit to provide future financial support to Napster, we do not record any further share of Napster losses that would reduce our carrying value of Napster below zero; in accordance with GAAP, we currently track those suspended losses outside of our financial statements.

In December 2016, RealNetworks entered into an agreement to loan up to $5.0 million to Napster for general operating purposes, as did Napster's other 42% owner. Each entity fully funded its loan, providing $3.5 million each in December 2016 and the remaining $1.5 million each in January 2017. These loans are subordinate to senior creditors, and bear an interest rate of 10% per annum, which is added to the outstanding principal balance. At the time of signing the agreement we recognized previously suspended Napster losses, and, consequently, we did not record a receivable related to this loan.

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

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

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net revenue	$34,814	$42,816	$111,343	$134,414
Gross profit	10,029	7,245	28,690	19,927
Operating income (loss)	4,142	179	14,452	(9,692)
Net income (loss)	2,768	(627)	9,350	(13,960)

Note 6 Fair Value Measurements

Items Measured at Fair Value on a Recurring Basis

The following table presents information about our financial assets that have been measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017, and indicates the fair value hierarchy of the valuation inputs utilized to determine such fair value (in thousands).

	Fair Value Measurements as of September 30, 2018				Amortized Cost as of September 30, 2018
	Level 1	Level 2	Level 3	Total	
Cash and cash equivalents:					
Cash	$26,472	$—	$ —	$26,472	$ 26,472
Money market funds	11,492	—	—	11,492	11,492
Total cash and cash equivalents	37,964	—	—	37,964	37,964
Short-term investments:					
Corporate notes and bonds	—	1,172	—	1,172	1,172
Total short-term investments	—	1,172	—	1,172	1,172
Restricted cash equivalents	—	1,630	—	1,630	1,630
Warrants issued by Napster (included in Other assets)	—	—	911	911	—
Total	$37,964	$2,802	$ 911	$41,677	$ 40,766

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

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

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

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

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

	Estimated Fair Value
Within one year	$ 1,172
Between one year and five years	—
Total short-term investments	$ 1,172

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

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

Items Measured at Fair Value on a Non-recurring Basis

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

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

Note 7 Other Intangible Assets

Other intangible assets (in thousands):

September 30, 2018	December 31, 2017