

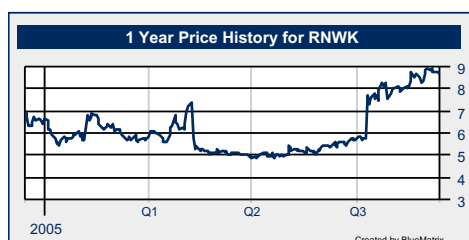
# RealNetworks, Inc.

December 14, 2005

*Dancing with a Bear's Hard Enough... And Now  
the Bear's Dancing with Others...*

NEUTRAL

RNWK - NASDAQ	\$8.69
52-WEEK RANGE	\$9.08-\$4.65
MARKET CAPITALIZATION	\$1,454.6mm
SHARES OUTSTANDING	167.4mm
FLOAT	117.1mm
BOOK VALUE/SHARE	\$2.30
DEBT/TOTAL CAP. (%)	17%
DIVIDEND/YIELD	NA/NM
AVG. DAILY VOLUME	2,521,353



RealNetworks is a leading distributor of digital media content on the Internet, including audio, video, and games. The company also provides a set of software and services enabling third parties' distribution of media over the Internet and to Internet-connected devices.

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**Investment Opinion: We are downgrading RealNetworks from Buy to Neutral.** Yesterday Microsoft announced it was launching a music service, competitive with Rhapsody, with Viacom. Microsoft is building the underlying "engine" making the company a competitor to RealNetworks sooner rather than later, in our opinion.

### We are downgrading RealNetworks from Buy to Neutral

**Microsoft to launch music service with Viacom.** Microsoft (MSFT, \$27.01, Not rated) announced yesterday it plans to launch a music service jointly with Viacom (VIA.B \$34.84, Not rated) called URGE. URGE will be bundled with the next version of the Windows media player (featured as prominently as RealNetwork's, Napster's [NAPS, \$3.44, No rated] and other services), will enable users to download individual tracks, and subscribe to a monthly offering--very much like the one provided by RealNetworks.

**Underlying download/subscription "engine" Microsoft's.** MTV indicated to us this morning the underlying technology for the upcoming service is being built by Microsoft. We believe this indicated Microsoft continues to be very interested in providing a service ultimately competitive with Rhapsody and is likely to learn "best practices" from Rhapsody off of its partnership on MSN.

**Rhapsody still featured as a premium on MSN.** Rhapsody will continue to have a premier positioning on Microsoft's MSN--as per the company's agreement announced on October 11 (see our notes of 10/11 and 10/12).

### We are lowering our estimates on RNWK as a result.

- **4Q.** We are lowering our revenue estimate from \$87 million to \$85 million (guidance: \$81-85 million; consensus: \$85 million) though leaving EPS estimate at \$1.46 (guidance: \$1.42-\$1.48; consensus: \$1.45).
- **2006.** We are lowering our revenue estimate from \$424 million to \$393 million (consensus: \$386 million) and EPS from \$1.07 to \$0.99 (consensus: \$1.00).

**Increased risk profile of investing in RealNetworks.** We believe this partnership is likely to increase the risk profile of investing in RealNetworks. Though the company benefited from the capital infusion from Microsoft, the partnership benefits seem much more limited after this announcement.

Fiscal Year	Earnings Per Share Estimates (US\$)										P/E	
	Dec	1Q (Mar)		2Q (Jun)		3Q (Sep)		4Q (Dec)		Year		
		Prior	Current	Prior	Current	Prior	Current	Prior	Current	Prior		Current
2003A	--	(0.02)	--	(0.06)	--	(0.02)	--	(0.03)	--	(0.13)	NM	
2004A	--	(0.06)	--	(0.03)	--	(0.04)	--	(0.01)	--	(0.14)	NM	
2005E	--	0.00A	--	0.03A	--	0.06A	--	1.46	--	1.55	5.6x	
2006E	0.20	0.19	0.27	0.26	0.30	0.28	0.31	0.28	1.07	0.99	8.8x	

GAAP EPS

See pages 3 - 4 for important disclosures

**Traffic declined 19% in October on y/y basis.** Per ComScore, RealNetwork's traffic declined during the month of October 19% over the same period a year ago--representing a steeper decline than 13% decline in September and 15% decline in August.

Our financial model follows.

### RealNetworks Income Statement (GAAP)

Figures in \$000 except per share data

FY December	Year	Q1	Q2	Q3A	Q4E	Year	Q1E	Q2E	Q3E	Q4E	Year
	2004	3/05	6/05	9/05	12/05	2005E	3/06	6/06	9/06	12/06	2006E
<b>Total revenues</b>	<b>266,719</b>	<b>76,572</b>	<b>82,686</b>	<b>82,233</b>	<b>85,358</b>	<b>326,849</b>	<b>93,485</b>	<b>94,991</b>	<b>99,538</b>	<b>105,260</b>	<b>393,274</b>
Cost of revenues	92,207	24,737	24,841	24,695	25,634	99,907	28,688	29,150	30,545	32,301	120,684
Loss on content agreement											
Gross profit	169,574	51,835	57,845	57,538	59,725	226,943	64,797	65,841	68,993	72,959	272,590
R & D	51,607	13,670	15,292	16,334	16,661	61,957	16,827	16,996	17,166	17,337	68,326
Sales & marketing	96,779	28,020	35,044	30,745	29,208	123,017	30,122	31,026	31,646	32,279	125,073
General & administrative	31,302	6,166	7,898	7,032	7,102	28,198	7,244	7,369	7,639	7,868	30,141
Goodwill amortization											
Antitrust litigation	11,048	3,744	4,650	3,531	(402,250)	(390,325)	(40,250)	(58,250)	(62,250)	(61,250)	(222,000)
Loss on excess office facilities	866										
Personnel reduction, restructuring, and related charges											
Stock-based compensation	695	36	48	25		109					
Non-recurring acquisition charges											
Other operating expenses	12,609	3,780	4,698	3,566	(402,250)	(390,216)	(40,250)	(58,250)	(62,250)	(61,250)	(222,000)
Total operating expenses	192,297	51,636	62,932	57,667	(349,279)	(177,044)	13,944	(2,839)	(5,799)	(3,765)	1,540
<b>Operating income</b>	<b>(22,723)</b>	<b>199</b>	<b>(5,087)</b>	<b>(129)</b>	<b>409,004</b>	<b>403,987</b>	<b>50,854</b>	<b>68,660</b>	<b>74,792</b>	<b>76,724</b>	<b>271,050</b>
Interest income	4,452	2,016	2,579	2,904	4,512	12,011	4,864	5,243	5,717	6,243	22,067
Equity in net loss of MusicNet	(4,351)	(1,066)	(2)			(1,068)					
Impairment of equity investments	(450)		7,590	11,740		19,330					
Other, net	(9)	(191)	(209)	124		(276)					
Total other income (expense), net	(368)	759	9,958	14,768	4,512	29,997	4,864	5,243	5,717	6,243	22,067
Pretax income	(23,081)	958	4,871	14,639	413,516	433,984	55,718	73,924	80,509	82,967	293,117
Taxes	522	144	162	3,457	144,730	148,493	19,501	25,873	28,178	29,039	102,591
Net income	(23,603)	814	4,709	11,182	268,785	285,490	36,216	48,050	52,331	53,929	190,526
<b>EPS (diluted)</b>	<b>(0.14)</b>	<b>0.00</b>	<b>0.03</b>	<b>0.06</b>	<b>1.46</b>	<b>1.55</b>	<b>0.19</b>	<b>0.26</b>	<b>0.28</b>	<b>0.28</b>	<b>0.99</b>
Shares (basic)	168,859	170,947	171,393	170,797	171,297	171,109	172,859	174,609	176,359	178,109	178,109
Shares	168,859	164,666	164,616	164,160	164,660	164,591	166,341	168,091	169,841	171,591	171,591
GAAP Net income (loss)	(23,603)	814	4,709	11,182	268,785	285,490	36,216	48,050	52,331	53,929	190,526
Interest income, net	(4,452)	(2,016)	(2,579)	(2,904)	(4,512)	(12,011)	(4,864)	(5,243)	(5,717)	(6,243)	(22,067)
Taxes	522	144	162	3,457	144,730	148,493	19,501	25,873	28,178	29,039	102,591
Depreciation, amortization and stock comp	15,338	3,666	4,092	4,220	2,370	14,348	(11,836)	2,436	2,471	2,508	(4,421)
<b>EBITDA</b>	<b>(12,195)</b>	<b>2,608</b>	<b>6,384</b>	<b>15,955</b>	<b>411,374</b>	<b>436,321</b>	<b>39,017</b>	<b>71,117</b>	<b>77,263</b>	<b>79,232</b>	<b>266,629</b>
Antitrust litigation	11,048	3,744	4,650	3,531	(402,250)	(390,325)	(40,250)	(58,250)	(62,250)	(61,250)	(222,000)
Loss on content agreement	4,938										
<b>EBITDA excluding antitrust litigation and</b>	<b>3,791</b>	<b>6,352</b>	<b>11,034</b>	<b>19,486</b>	<b>9,124</b>	<b>45,996</b>	<b>(1,233)</b>	<b>12,867</b>	<b>15,013</b>	<b>17,982</b>	<b>44,629</b>

Source: Company reports & Oppenheimer & Co. estimates.

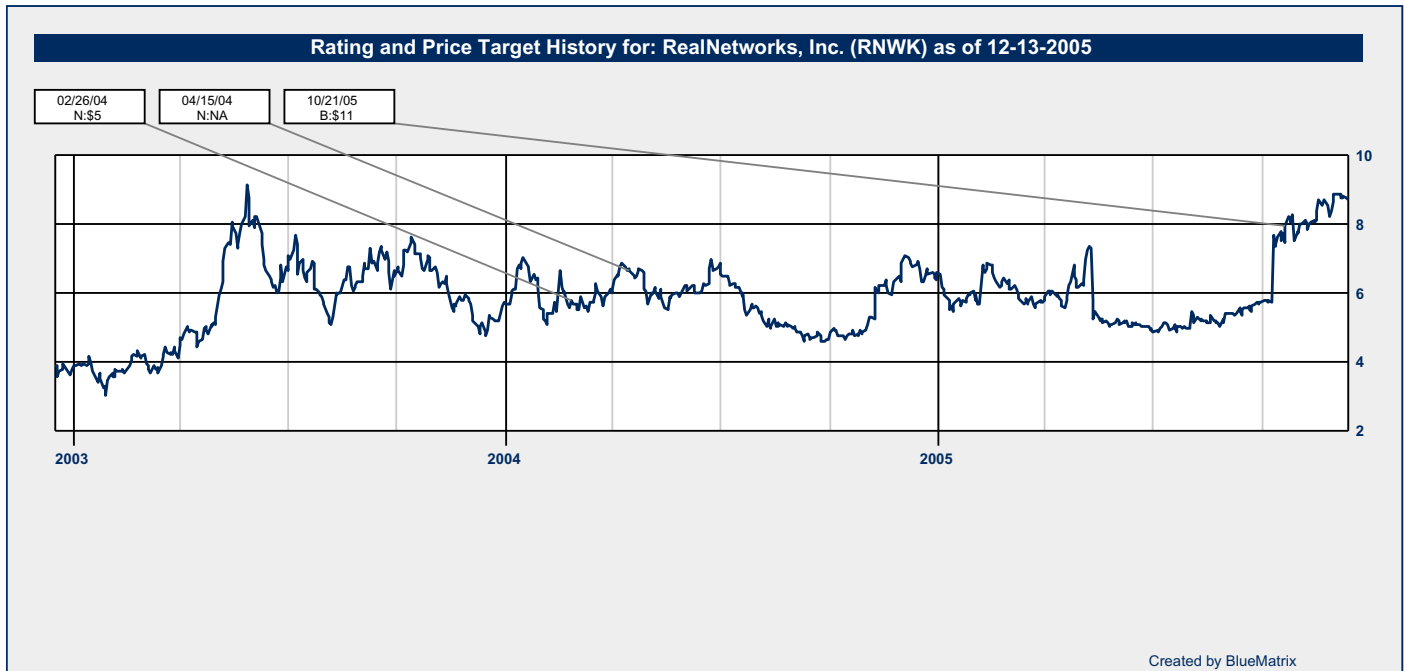
### Income Statement (GAAP) Analysis

FY December	Year	Q1	Q2	Q3A	Q4E	Year	Q1E	Q2E	Q3E	Q4E	Year
	2004	3/05	6/05	9/05	12/05	2005E	3/06	6/06	9/06	12/06	2006E
<b>Margin Analysis</b>											
Gross margin	63.6%	67.7%	70.0%	70.0%	70.0%	69.4%	69.3%	69.3%	69.3%	69.3%	69.3%
R & D % sales	19.3%	17.9%	18.5%	19.9%	19.5%	19.0%	18.0%	17.9%	17.2%	16.5%	17.4%
Sales & marketing	36.3%	36.6%	42.4%	37.4%	34.2%	37.6%	32.2%	32.7%	31.8%	30.7%	31.8%
General & administrative	11.7%	8.1%	9.6%	8.6%	8.3%	8.6%	7.7%	7.8%	7.7%	7.5%	7.7%
Operating margin	-8.5%	0.3%	-6.2%	-0.2%	479.2%	123.6%	54.4%	72.3%	75.1%	72.9%	68.9%
Pretax margin	-8.7%	1.3%	5.9%	17.8%	464.4%	132.8%	59.6%	77.8%	80.9%	78.8%	74.5%
Tax rate	-2.3%	15.0%	3.3%	23.6%	35.0%	34.2%	35.0%	35.0%	35.0%	35.0%	35.0%
Net margin	-8.8%	1.1%	5.7%	13.6%	314.9%	87.3%	38.7%	50.6%	52.6%	51.2%	48.4%
<b>Quarter-to-Quarter Growth</b>											
Total revenue		6%	8%	-1%	4%		10%	2%	5%	6%	
R&D		4%	12%	7%	2%		1%	1%	1%	1%	
Sales & marketing		5%	25%	-12%	-5%		3%	3%	2%	2%	
General & administrative		-22%	28%	-11%	1%		2%	2%	3%	3%	
Operating income		NMF	-2656%	NMF	NMF		-88%	35%	9%	3%	
Net income		NMF	479%	137%	2304%		-87%	33%	9%	3%	
EPS		NMF	478%	138%	2297%		-87%	31%	8%	2%	
<b>Year-to-Year Growth</b>											
Total revenue	32%	27%	26%	20%	18%	-23%	22%	15%	21%	23%	20%
R&D	7%	12%	16%	25%	27%	20%	23%	11%	5%	4%	10%
Sales & marketing	28%	26%	51%	24%	10%	-27%	8%	-11%	3%	11%	2%
General & administrative	49%	-10%	-8%	-12%	-10%	-10%	17%	-6%	9%	11%	7%
Operating income	NMF	NMF	NMF	NMF	NMF	NMF	25455%	NMF	NMF	-81%	-33%
Net income	NMF	NMF	NMF	NMF	NMF	NMF	4349%	920%	368%	-80%	-33%
EPS	NMF	NMF	NMF	NMF	NMF	NMF	4310%	903%	354%	-81%	-36%
<b>Metrics</b>											
Total subscribers (000)	1,550	1,850	2,000	2,200	2,430	2,430	2,628	2,825	3,048	3,295	3,295
Music subscribers (000)	700	975	1,150	1,300	1,450	1,450	1,613	1,775	1,938	2,100	2,100

Source: Company reports & Oppenheimer & Co. estimates.

## Important Disclosures and Certifications

Other companies mentioned in this report: VIA.B, VIA, NAPS, MSFT



All price targets displayed in the chart above are for a 12-month period. Prior to March 30, 2004, Oppenheimer & Co. Inc. used 6-, 12-, 12- to 18-, and 12- to 24-month price targets and ranges. For more information about target price histories, please write to Oppenheimer & Co. Inc., 125 Broad St., 16th Fl., New York, NY 10004, Attention: Research Disclosure.

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**Neutral** - anticipates that the shares will trade at or near their current price and generally in line with the leading market averages due to a perceived absence of strong dynamics that would cause volatility either to the upside or downside, and/or will perform less well than higher rated companies within its peer group. Our readers should be aware that when a rating change occurs to Neutral from Buy, aggressive trading accounts might decide to liquidate their positions to employ the funds elsewhere.

**Sell** - anticipates that the shares will depreciate 10% or more in price within the next 12 months, due to fundamental weakness perceived in the company or for valuation reasons, or are expected to perform significantly worse than equities within the peer group.

Distribution of Ratings/IB Services Firmwide and by Sector									
					TECHNOLOGY				
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			Count	Percent				Count	Percent
BUY [B]	147	51.40	15	10.20	BUY [B]	26	44.07	1	3.85
HOLD [N]	127	44.41	11	8.66	HOLD [N]	30	50.85	1	3.33
SELL [S]	12	4.20	1	8.33	SELL [S]	3	5.08	0	0.00

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