Dolby Laboratories, Inc.
Form 10-Q
August 08, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended June 29, 2012

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: 001-32431

DOLBY LABORATORIES, INC.
(Exact name of registrant as specified in its charter)

Delaware	90-0199783
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
100 Potrero Avenue San Francisco, CA	94103-4813
(Address of principal executive offices)	(Zip Code)

(415) 558-0200
(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 Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

On July 19, 2012 the registrant had 47,612,218 shares of Class A common stock, par value $0.001 per share, and 57,098,489 shares of Class B common stock, par value $0.001 per share, outstanding.

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PART I – FINANCIAL INFORMATION
ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DOLBY LABORATORIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)
(unaudited)

	September 30, 2011	June 29, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$551,512	$670,408
Short-term investments	391,281	322,399
Accounts receivable, net of allowance of $2,466 at September 30, 2011 and $1,876 at June 29, 2012	61,815	46,034
Inventories	26,244	12,760
Deferred taxes	90,869	89,983
Prepaid expenses and other current assets	36,877	27,447
Total current assets	1,158,598	1,169,031
Long-term investments	272,797	295,950
Property, plant and equipment, net	117,107	140,127
Intangible assets, net	51,573	42,115
Goodwill	263,260	263,536
Deferred taxes	14,779	22,157
Other non-current assets	6,273	20,639
Total assets	$1,884,387	$1,953,555
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$10,887	$12,596
Accrued liabilities	117,035	111,596
Income taxes payable	4,762	3,147
Deferred revenue	26,701	25,099
Total current liabilities	159,385	152,438
Long-term deferred revenue	15,526	16,878
Deferred taxes	671	615
Other non-current liabilities	23,455	32,562
Total liabilities	199,037	202,493
Stockholders' equity:		
Class A common stock, $0.001 par value, one vote per share, 500,000,000 shares authorized: 51,860,546 shares issued and outstanding at September 30, 2011 and 48,143,047 at June 29, 2012	52	48
Class B common stock, $0.001 par value, ten votes per share, 500,000,000 shares authorized: 57,559,554 shares issued and outstanding at September 30, 2011 and 57,098,489 at June 29, 2012	58	57
Additional paid-in capital	210,681	64,969
Retained earnings	1,445,189	1,657,997
Accumulated other comprehensive income	7,533	5,897
Total stockholders' equity – Dolby Laboratories, Inc.	1,663,513	1,728,968
Controlling interest	21,837	22,094
Total stockholders' equity	1,685,350	1,751,062

Total liabilities and stockholders' equity	$1,884,387	$1,953,555

See accompanying notes to unaudited condensed consolidated financial statements

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DOLBY LABORATORIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(unaudited)

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	July 1, 2011	June 29, 2012	July 1, 2011	June 29, 2012
Revenue:				
Licensing	$181,790	$178,436	$584,593	$603,409
Products	28,395	22,132	100,769	75,760
Services	8,814	7,304	26,375	22,340
Total revenue	218,999	207,872	711,737	701,509
Cost of revenue:				
Cost of licensing	4,095	2,892	13,827	9,523
Cost of products	20,320	14,529	62,549	46,052
Cost of services	3,518	3,610	9,153	9,458
Total cost of revenue	27,933	21,031	85,529	65,033
Gross margin	191,066	186,841	626,208	636,476
Operating expenses:				
Research and development	34,086	35,123	90,812	102,185
Sales and marketing	36,726	46,819	112,488	133,029
General and administrative	32,397	36,859	104,594	109,605
Restructuring charges / (credits), net	(48)	(85)	737	1,193
Total operating expenses	103,161	118,716	308,631	346,012
Operating income	87,905	68,125	317,577	290,464
Interest income	1,670	1,513	5,237	4,664
Interest expense	690	(26)	322	(57)
Other income, net	186	709	875	969
Income before income taxes	90,451	70,321	324,011	296,040
Provision for income taxes	(28,404)	(18,915)	(92,717)	(82,951)
Net income including controlling interest	62,047	51,406	231,294	213,089
Less: net (income) / loss attributable to controlling interest	(299)	123	(1,098)	(281)
Net income attributable to Dolby Laboratories, Inc.	$61,748	$51,529	$230,196	$212,808
Earnings per share attributable to Dolby Laboratories, Inc.:				
Basic	$0.55	$0.48	$2.06	$1.97
Diluted	$0.55	$0.48	$2.03	$1.96
Weighted-average shares outstanding:				
Basic	111,494	106,328	111,893	107,876
Diluted	112,349	107,202	113,165	108,493
Related party rent expense included in general and administrative expenses	$343	$343	$1,029	$1,029
Related party rent expense included in net income attributable to controlling interest	$748	$732	$2,056	$2,118

See accompanying notes to unaudited condensed consolidated financial statements

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DOLBY LABORATORIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Fiscal Year-to-Date Ended	
	July 1, 2011	June 29, 2012
Operating activities:		
Net income including controlling interest	$231,294	$213,089
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	33,975	31,189
Stock-based compensation	32,916	34,243
Amortization of premium on investments	12,375	13,280
Excess tax benefit from exercise of stock options	(12,643)	(941)
Provision for doubtful accounts	828	449
Deferred income taxes	1,573	(7,075)
Payment on litigation settlement	(3,000)	—
Other non-cash items affecting net income	175	38
Changes in operating assets and liabilities:		
Accounts receivable	14,065	15,359
Inventories	4,927	5,275
Prepaid expenses and other assets	(6,718)	582
Accounts payable and other liabilities	(27,394)	874
Income taxes, net	6,386	6,857
Deferred revenue	5,400	(221)
Net cash provided by operating activities	294,159	312,998
Investing activities:		
Purchases of available-for-sale securities	(454,795)	(431,894)
Proceeds from sales of available-for-sale securities	169,419	261,520
Proceeds from maturities of available-for-sale securities	176,200	202,915
Purchases of property, plant and equipment	(30,334)	(50,225)
Acquisitions, net of cash acquired	(3,350)	(575)
Purchases of intangible assets	—	(350)
Proceeds from sales of property, plant and equipment and assets held for sale	3,077	988
Net cash used in investing activities	(139,783)	(17,621)
Financing activities:		
Proceeds from issuance of common stock, net of shares withheld for taxes	22,920	12,816
Repurchase of common stock	(142,500)	(189,959)
Excess tax benefit from exercise of stock options	12,643	941
Net cash used in financing activities	(106,937)	(176,202)
Effect of foreign exchange rate changes on cash and cash equivalents	1,304	(279)
Net increase in cash and cash equivalents	48,743	118,896
Cash and cash equivalents at beginning of period	545,861	551,512
Cash and cash equivalents at end of period	$594,604	$670,408
Supplemental disclosure:		
Cash paid for income taxes	$84,689	$83,185
Cash paid for interest	242	8

See accompanying notes to unaudited condensed consolidated financial statements

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DOLBY LABORATORIES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation

Unaudited Interim Financial Statements

We have prepared the accompanying unaudited condensed consolidated financial statements in accordance with accounting principles generally accepted in the U.S. ("GAAP"), and with Securities and Exchange Commission ("SEC") rules and regulations, which allow for certain information and footnote disclosures that are normally included in annual financial statements prepared in accordance with GAAP to be condensed or omitted. In our opinion, these condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements for the fiscal year ended September 30, 2011 and include all adjustments necessary for fair presentation. The accompanying condensed consolidated financial statements should be read in conjunction with our consolidated financial statements for the fiscal year ended September 30, 2011, which are included in our Annual Report on Form 10-K, as amended, filed with the SEC.

The results for the fiscal quarter and fiscal year-to-date period ended June 29, 2012 are not necessarily indicative of the results to be expected for any subsequent quarterly or annual financial period, including the fiscal year ending September 28, 2012.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of Dolby Laboratories and our wholly owned subsidiaries. In addition, we have consolidated the financial results of jointly owned affiliated companies in which our principal stockholder has a controlling interest. We report these controlling interests as a separate line item in our condensed consolidated statements of operations as net income attributable to controlling interest and in our condensed consolidated balance sheets as controlling interest. We eliminate all intercompany accounts and transactions upon consolidation.

Use of Estimates

The preparation of the consolidated financial statements in accordance with GAAP requires management to make certain estimates and assumptions that affect the amounts reported and disclosed in our consolidated financial statements and accompanying notes. Significant items subject to such estimates and assumptions include estimated selling prices for elements sold in multiple-element revenue arrangements, valuation allowances for accounts receivable, carrying values of inventories and certain property, plant and equipment, goodwill, intangible assets, stock-based compensation, fair values of investments, accrued expenses, including liabilities for unrecognized tax benefits, and deferred income tax assets. Actual results could differ from our estimates.

Fiscal Year

Our fiscal year is a 52 or 53 week period ending on the last Friday in September. The fiscal periods presented herein include the 13 week periods ended July 1, 2011 and June 29, 2012, and the 40 week period ended July 1, 2011 and the 39 week period ended June 29, 2012. Our fiscal year ended September 30, 2011 (fiscal 2011) consisted of 53 weeks, while our fiscal year ending September 28, 2012 (fiscal 2012) consists of 52 weeks.

Reclassifications

We have reclassified certain prior period amounts within our condensed consolidated financial statements and accompanying notes to conform to our current period presentation. These reclassifications did not affect total revenue, operating income, or net income.

2. Summary of Significant Accounting Policies

Recently Issued Accounting Standards

In June 2011 the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income, ("ASU 2011-05"). This new accounting standard: (1) eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity, (2) requires the consecutive presentation of the statement of net income and other comprehensive income, and (3) requires an entity to present reclassification adjustments on the face of the financial statements from other comprehensive income to net income. This new standard does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income, nor does it affect

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how earnings per share is calculated or presented. ASU 2011-05 is required to be applied retrospectively and is effective for fiscal years and interim periods within those years beginning after December 15, 2011, with early adoption permitted. In December 2011 the FASB issued ASU No. 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. This update temporarily defers the effective date of the requirement for presentation of reclassification adjustments, as described above. ASU 2011-05 will be effective for our fiscal year beginning September 29, 2012. As this new standard only requires enhanced disclosure, the adoption of ASU 2011-05 will not impact our financial position or results of operations.

In September 2011 the FASB issued ASU No. 2011-08, Goodwill and Other (Topic 350): Testing Goodwill for Impairment, (“ASU 2011-08”). This new accounting standard simplifies goodwill impairment tests and states that a qualitative assessment may be performed to determine whether further impairment testing is necessary. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. We adopted the provisions of this accounting standard for the goodwill impairment test that was performed in the third quarter of fiscal 2012. The adoption of ASU 2011-08 did not have a material impact on our condensed consolidated financial statements.

Other than the adoption of the standard described above, there have been no material changes to our significant accounting policies as compared to those described in our Annual Report on Form 10-K, as amended, for the fiscal year ended September 30, 2011.

3. Composition of Certain Financial Statement Captions

Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and investments consist of the following:

	September 30, 2011	June 29, 2012
	(in thousands)	
Cash and cash equivalents:		
Cash	$394,474	$491,857
Cash equivalents:		
Money market funds	142,038	128,001
U.S. agency securities	15,000	—
Commercial paper	—	41,550
Municipal debt securities	—	9,000
Total cash and cash equivalents	551,512	670,408
Short-term investments:		
U.S. agency securities	8,074	9,048
Commercial paper	—	5,197
Corporate bonds	52,645	77,166
Municipal debt securities	330,562	230,988
Total short-term investments	391,281	322,399
Long-term investments:		
U.S. agency securities	6,845	15,018
Corporate bonds	124,313	93,275
Municipal debt securities	141,639	187,657
Total long-term investments	272,797	295,950
Total cash, cash equivalents, and investments	$1,215,590	$1,288,757

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Our investment portfolio, which is recorded as cash equivalents, short-term investments, and long-term investments, consists of the following:

	September 30, 2011			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
Money market funds	$142,038	$—	$—	$142,038
U.S. agency securities	29,858	65	(4)	29,919
Corporate bonds	177,129	316	(487)	176,958
Municipal debt securities	471,005	1,251	(55)	472,201
Cash equivalents and investments	$820,030	$1,632	$(546)	$821,116

	June 29, 2012			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
Money market funds	$128,001	$—	$—	$128,001
U.S. agency securities	24,046	25	(5)	24,066
Commercial paper	46,747	—	—	46,747
Corporate bonds	169,980	518	(57)	170,441
Municipal debt securities	427,175	612	(142)	427,645
Cash equivalents and investments	$795,949	$1,155	$(204)	$796,900

We have classified all of our investments listed in the tables above as available-for-sale securities recorded at fair market value in our condensed consolidated balance sheets, with unrealized gains and losses reported as a component of accumulated other comprehensive income. Upon sale, amounts of gains and losses reclassified into earnings are determined based on specific identification of the securities sold.

The following tables show the gross unrealized losses and the fair value for those available-for-sale securities that were in an unrealized loss position:

	September 30, 2011					
	Less than 12 months		12 months or greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in thousands)					
U.S. agency securities	$3,997	$(4)	$—	$—	$3,997	$(4)
Corporate bonds	87,613	(487)	—	—	87,613	(487)
Municipal debt securities	79,466	(52)	2,081	(3)	81,547	(55)
Total	$171,076	$(543)	$2,081	$(3)	$173,157	$(546)

	June 29, 2012					
	Less than 12 months		12 months or greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in thousands)					
U.S. agency securities	$3,998	$(5)	$—	$—	$3,998	$(5)

Corporate bonds	$38,757	$(56)	$2,061	$(1)	$40,818	$(57)
Municipal debt securities	207,419	(141)	2,500	(1)	209,919	(142)
Total	$250,174	$(202)	$4,561	$(2)	$254,735	$(204)

The unrealized losses on our available-for-sale securities were primarily a result of unfavorable changes in interest rates subsequent to the initial purchase of these securities. As of June 29, 2012, we owned 93 securities that were in an unrealized loss position. We do not intend to sell, nor do we believe we will need to sell, these securities before we recover the associated

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unrealized losses. We do not consider any portion of the unrealized losses at September 30, 2011 or June 29, 2012 to be an other-than-temporary impairment, nor do we consider any of the unrealized losses to be credit losses.
The following table summarizes the amortized cost and estimated fair value of short-term and long-term available-for-sale investments based on stated maturities:

	June 29, 2012	
	Amortized Cost	Fair Value
	(in thousands)	
Due within 1 year	$321,958	$322,399
Due in 1 to 2 years	169,046	169,453
Due in 2 to 3 years	126,394	126,497
Total	$617,398	$618,349

Inventories
Inventories are stated at the lower of cost (first-in, first-out) or market and consist of the following:

	September 30, 2011	June 29, 2012
	(in thousands)	
Raw materials	$10,821	$4,803
Work in process	2,942	153
Finished goods	12,481	7,804
Inventories	$26,244	$12,760

The primary driver of the decrease in inventories from September 30, 2011 to June 29, 2012 is an effort to reduce overall inventory levels in connection with the restructuring of our manufacturing operations and to match inventory levels with anticipated demand for products.

Additionally, $8.2 million of raw materials inventory is included within other non-current assets in our condensed consolidated balance sheet as of June 29, 2012. This inventory was purchased in bulk in fiscal 2012 to obtain a significant volume discount, and is expected to be consumed over a period that exceeds 12 months. We have reviewed anticipated consumption rates of this inventory and do not believe there to be material risk of obsolescence prior to the ultimate sale of the inventory. As a result no valuation reserve has been recorded as of June 29, 2012. All inventory was classified as current as of September 30, 2011.

Prepaid Expenses and Other Current Assets
Prepaid expenses and other current assets consist of the following:

	September 30, 2011	June 29, 2012
	(in thousands)	
Prepaid assets	$9,365	$9,200
Other current assets	19,683	14,352
Income tax receivable	7,829	3,895
Prepaid expenses and other current assets	$36,877	$27,447

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Property, Plant and Equipment

Property, plant and equipment are recorded at cost and consist of the following:

	September 30, 2011	June 29, 2012
	(in thousands)	
Land	$12,778	$12,592
Buildings	26,623	26,824
Leasehold improvements	44,021	66,323
Machinery and equipment	20,845	26,286
Computer systems and software	71,220	83,877
Furniture and fixtures	10,537	12,907
Products provided under operating leases	1,060	—
	187,084	228,809
Less: accumulated depreciation	(69,977)	(88,682)
Property, plant and equipment, net	$117,107	$140,127

Depreciation expense for our property, plant and equipment is included in cost of products, cost of services, research and development expenses, sales and marketing expenses, and general and administrative expenses in our condensed consolidated statements of operations.

In June 2012, we announced plans to purchase an approximately 354,000 square-foot building in San Francisco for approximately $109.8 million. As of June 29, 2012, we had pledged $5.5 million towards the purchase of the building, which is classified within other non-current assets in our condensed consolidated balance sheet and within purchases of property, plant and equipment in our condensed consolidated statements of cash flows. After making certain improvements to the property to prepare the building for our use, we intend to use the space as our new worldwide headquarters.

Goodwill and Intangible Assets

The following table outlines changes to the carrying amount of goodwill:

	(in thousands)
Balance at September 30, 2011	$263,260
Translation adjustments	276
Balance at June 29, 2012	$263,536

Intangible assets consist of the following:

	September 30, 2011			June 29, 2012		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Intangible assets subject to amortization:	(in thousands)					
Acquired patents and technology	$61,611	$(32,146)	$29,465	$61,783	$(38,093)	$23,690
Customer relationships	30,748	(12,821)	17,927	30,749	(15,203)	15,546
Customer contracts	6,063	(6,063)	—	—	—	—
Other intangibles	20,308	(16,127)	4,181	20,307	(17,428)	2,879
Total	$118,730	$(67,157)	$51,573	$112,839	$(70,724)	$42,115

Amortization expense for our intangible assets is included in cost of licensing, cost of products, research and development expenses, and sales and marketing expenses in our condensed consolidated statements of operations.

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As of June 29, 2012, our expected amortization expense in future periods is as follows:

Fiscal Year	Amortization Expense (in thousands)
Remainder of 2012	$2,989
2013	11,943
2014	10,299
2015	7,843
2016	5,675
Thereafter	3,366
Total	$42,115

Accrued Liabilities

Accrued liabilities consist of the following:

	September 30, 2011	June 29, 2012
	(in thousands)	
Amounts payable to joint licensing program partners	$42,502	$47,054
Accrued compensation and benefits	41,168	35,679
Accrued customer refunds and deposits	10,849	10,169
Other accrued liabilities	22,516	18,694
Accrued liabilities	$117,035	$111,596

Other Non-Current Liabilities

Other non-current liabilities consist of the following:

	September 30, 2011	June 29, 2012
	(in thousands)	
Supplemental retirement plan obligations	$1,811	$1,932
Non-current tax liabilities	13,070	20,349
Other liabilities	8,574	10,281
Other non-current liabilities	$23,455	$32,562

See Note 7 “Income Taxes” for additional information related to tax liabilities.

Revenue from Material Customer

In the fiscal quarters ended July 1, 2011 and June 29, 2012, revenue from one customer was $28.7 million and $30.2 million, respectively, or 13% and 15% of revenue for each quarter, respectively. In the fiscal year-to-date periods ended July 1, 2011 and June 29, 2012, the same customer accounted for $95.0 million and $99.4 million, respectively, or 13% and 14% of total revenue for each period, respectively.

4. Fair Value Measurements

Fair value is the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants at the measurement date. We minimize the use of unobservable inputs and use observable market data, if available, when determining fair value. We classify our inputs to measure fair value using the following three-level hierarchy:

Level 1:	Quoted prices in active markets at the measurement date for identical assets and liabilities.
Level 2:	Prices may be based upon quoted prices in active markets or inputs not quoted on active markets but are corroborated by market data.

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Level 3: Unobservable inputs are used when little or no market data is available and reflect management's estimates of assumptions that market participants would use in pricing the asset or liability.

Financial assets and liabilities carried at fair value are classified below:

	September 30, 2011			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Investments held in supplemental retirement plan (1)	$1,891	$—	$—	$1,891
Money market funds (2)	142,038	—	—	142,038
Corporate bonds (3)	—	176,958	—	176,958
Municipal debt securities (3)	—	472,201	—	472,201
U.S. agency securities (2), (3)	29,919	—	—	29,919
Total	$173,848	$649,159	$—	$823,007

(1) These assets are included within prepaid expenses and other current assets and within other non-current assets.
(2) These assets are included within cash and cash equivalents.
(3) These assets are included within short-term investments and within long-term investments.

	September 30, 2011			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Liabilities:				
Investments held in supplemental retirement plan (1)	$1,891	$—	$—	$1,891
Total	$1,891	$—	$—	$1,891

(1) These liabilities are included within accrued liabilities and within other non-current liabilities.

	June 29, 2012			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets:				
Investments held in supplemental retirement plan (1)	$2,030	$—	$—	$2,030
Money market funds (2)	128,001	—	—	128,001
Commercial paper (2), (3)	—	46,747	—	46,747
Corporate bonds (4)	—	170,441	—	170,441
Municipal debt securities (2), (4)	—	427,645	—	427,645
U.S. agency securities (4)	24,066	—	—	24,066
Total	$154,097	$644,833	$—	$798,930

(1) These assets are included within prepaid expenses and other current assets and within other non-current assets.
(2) These assets are included within cash and cash equivalents.
(3) These assets are included within short-term investments.
(4) These assets are included within short-term investments and within long-term investments.

	June 29, 2012			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Liabilities:				
Investments held in supplemental retirement plan (1)	$2,030	$—	$—	$2,030
Total	$2,030	$—	$—	$2,030

(1) These liabilities are included within accrued liabilities and within other non-current liabilities.

We base the fair value of our Level 1 financial instruments, which are traded in active markets, using quoted market prices for identical instruments. Our Level 1 financial instruments include money market funds, U.S. agency securities, U.S. government bonds, and mutual fund investments held in our supplemental retirement plan.

We obtain the fair value of our Level 2 financial instruments from a professional pricing service, which may use quoted market prices for identical or comparable instruments, or model driven valuations using observable market data or inputs

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corroborated by observable market data.

To validate the fair value determination provided by our primary pricing service, we perform quality controls over values received which include comparing our pricing service provider's assessment of the fair values of our investment securities against the fair values of our investment securities obtained from another independent source, reviewing the pricing movement in the context of overall market trends, and reviewing trading information from our investment managers. In addition, we assess the inputs and methods used in determining the fair value in order to determine the classification of securities in the fair value hierarchy.

We did not own any Level 3 financial assets or liabilities as of September 30, 2011 or June 29, 2012.

5. Stock-Based Compensation

We have adopted compensation plans that provide for grants of stock-based awards as a form of compensation to employees, officers, and directors. We have issued stock-based awards in the form of stock options, restricted stock units, stock appreciation rights, and shares issued under our employee stock purchase plan ("ESPP").

We recognize stock-based compensation expense net of estimated forfeitures. Stock-based compensation expense included in our condensed consolidated statements of operations was as follows:

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	July 1, 2011	June 29, 2012	July 1, 2011	June 29, 2012
	(in thousands)			
Stock-based compensation expense:				
Stock options	$5,930	$5,047	$18,957	$17,101
Restricted stock units	4,805	5,235	13,526	16,379
Employee stock purchase plan	227	442	593	667
Stock appreciation rights	(46)	17	(160)	96
Total stock-based compensation expense	$10,916	$10,741	$32,916	$34,243

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	July 1, 2011	June 29, 2012	July 1, 2011	June 29, 2012
	(in thousands)			
Stock-based compensation expense was classified as follows:				
Cost of products	$169	$158	$483	$504
Cost of services	47	57	129	174
Research and development	2,632	2,668	7,566	8,300
Sales and marketing	3,429	3,820	9,792	11,538
General and administrative	4,639	4,038	14,946	13,727
Total stock-based compensation expense	$10,916	$10,741	$32,916	$34,243

As of June 29, 2012, total unrecognized stock-based compensation expense associated with employee stock options expected to vest was $57.9 million, which is expected to be recognized over a weighted-average period of approximately 2.7 years. As of June 29, 2012, total unrecognized stock-based compensation expense associated with restricted stock units expected to vest was $57.2 million, which is expected to be recognized over a weighted-average period of approximately 3.0 years.

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The following table summarizes information about stock options issued to officers, directors, and employees under our 2000 Stock Incentive Plan and 2005 Stock Plan:

	Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Stock options outstanding at September 30, 2011	5,801	$45.19		
Grants	2,380	32.81		
Exercises	(410)	26.90		
Forfeitures and cancellations	(444)	50.95		
Stock options outstanding at June 29, 2012	7,327	$41.84	7.7	$44,813
Stock options vested and expected to vest at June 29, 2012	6,993	$41.67	7.6	$43,322
Stock options exercisable at June 29, 2012	3,372	$41.67	6.2	$22,565

Aggregate intrinsic value is based on the closing price of our common stock on June 29, 2012 of $41.30 and excludes the impact of stock options that were not in-the-money.

We use the Black-Scholes option pricing model to determine the fair value of employee stock options at the date of grant. The fair value of our stock-based awards was estimated using the following weighted-average assumptions:

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	July 1, 2011	June 29, 2012	July 1, 2011	June 29, 2012
Expected life (in years)	4.40	4.53	4.40	4.53
Risk-free interest rate	1.3%	0.6%	1.5%	0.7%
Expected stock price volatility	40.0%	41.5%	41.4%	44.0%
Dividend yield	—	—	—	—

See Note 12, Subsequent Events, for discussion of the Employee Stock Option Exchange Program (the "Exchange Program") which launched on July 16, 2012.

The following table summarizes information about restricted stock units issued to officers, directors, and employees under our 2005 Stock Plan:

	Shares (in thousands)	Weighted Average Fair Value
Non-vested at September 30, 2011	946	$53.71
Granted	1,242	33.31
Vested	(365)	50.81
Forfeitures and cancellations	(94)	47.77
Non-vested at June 29, 2012	1,729	$39.90

Employee Stock Purchase Plan. Until May 2012, our ESPP allowed eligible employees to have up to 10 percent of their eligible compensation withheld and used to purchase Class A common stock, subject to a maximum of $25,000 worth of stock purchased in a calendar year or no more than 1,000 shares in an offering period, whichever is less. The plan provided for a discount equal to 15 percent of the closing price on the New York Stock Exchange on the last day of the purchase period. This plan was amended as of the purchase date of May 15, 2012, as described below.

Amended Employee Stock Purchase Plan. During the first quarter of fiscal 2012, the compensation committee of our board of directors amended the ESPP to provide for overlapping one-year offering periods composed of successive six-month purchase periods, with a look back feature to the Company's stock price at the commencement of a one-year offering period. The amended plan also includes an automatic reset feature that provides for an offering period to be reset and recommenced to a new lower-priced offering if the offering price of a new offering period is less than that of the immediately preceding offering period. The amendment is effective for the ESPP offering period which commenced in May 2012. We do not expect adoption of

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the amendment to the ESPP to have a material impact on our results of operations.

6. Restructuring

In the fourth quarter of fiscal 2011, we informed approximately 55 employees of our plans to reorganize certain aspects of our business under a strategic restructuring program. As a result we recognized total estimated severance and other associated costs for affected employees of $2.5 million and $0.4 million in fiscal 2011 and the fiscal year-to-date period ended June 29, 2012, respectively. In addition, we recognized $0.4 million in facilities and contract termination costs during the fiscal year-to-date period ended June 29, 2012. We also recognized $0.2 million and $0.4 million in fixed asset write-off costs related to this restructuring program in fiscal 2011 and during the fiscal year-to-date period ended June 29, 2012, respectively. We expect to recognize no additional expense related to this restructuring program. These expenses are being recognized in restructuring charges, net, in our condensed consolidated statements of operations.

Changes in our restructuring accruals, which are included within accrued liabilities in our condensed consolidated balance sheets, were as follows:

	Severance	Facilities and contract termination costs	Fixed assets write-off	Other associated costs	Total
	(in thousands)				
Balance at September 30, 2011	$2,250	$ —	$—	$120	$2,370
Restructuring charges	318	352	424	99	1,193
Cash payments	(2,545)	(147)	—	(201)	(2,893)
Non-cash charges	4	114	(424)	(16)	(322)
Balance at June 29, 2012	$27	$ 319	$—	$2	$348

7. Income Taxes

Our effective tax rate is based on a projection of our annual fiscal year results. Our effective tax rate was 31% and 27% for the fiscal quarters ended July 1, 2011 and June 29, 2012, respectively, and 29% and 28% for the fiscal year-to-date periods ended July 1, 2011 and June 29, 2012, respectively.

Our estimated fiscal year 2012 tax provision reflects additional benefits from our election to indefinitely reinvest a portion of our undistributed earnings in a foreign subsidiary. We also benefited from a reduction in the current year state apportionment percentage. These benefits were partially offset by the expiration of the federal research and development tax credits, effective from the first quarter of fiscal 2012, which resulted in an increase to our effective tax rate.

In the fiscal year-to-date period ended April 1, 2011, we completed the restructuring of our international operations, which resulted in the release of a deferred tax liability of $11.0 million related to the amortization of an intangible asset from a prior year acquisition, thereby lowering our effective tax rate for that period.

As of June 29, 2012, the total amount of gross unrecognized tax benefits was $15.4 million, of which $9.0 million, if recognized, would reduce our effective tax rate. Our liability for unrecognized tax benefits is classified within other non-current liabilities in our condensed consolidated balance sheets.

Withholding Tax. We recognize licensing revenue gross of withholding taxes, which our licensees remit directly to their local tax authorities. We reduce our income tax provision for withholding taxes in various jurisdictions for allowable foreign tax credits. Withholding tax remittances were $7.6 million and $7.6 million in the fiscal quarters ended July 1, 2011 and June 29, 2012, respectively. Withholding tax remittances were $23.4 million and $29.1 million in the fiscal year-to-date periods ended July 1, 2011 and June 29, 2012, respectively.

8. Legal Proceedings

We are involved in various legal proceedings from time to time arising from the normal course of business activities, including claims of alleged infringement of intellectual property rights, commercial, employment, and other matters. In our opinion, resolution of these proceedings is not expected to have a material adverse effect on our operating results or financial condition. However, it is possible that an unfavorable resolution of one or more such proceedings could materially affect our future operating results or financial condition in a particular period. There has been no material change in the status of legal proceedings since our fiscal year ended September 30, 2011.

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9. Commitments and Contingencies

The following table presents a summary of our contractual obligations and commitments as of June 29, 2012:

	Payments Due By Fiscal Period						
	Remainder of 2012	2013	2014	2015	2016	Thereafter	Total
	(in thousands)						
Naming and other rights (1)	$7,250	$—	$7,341	$7,432	$7,525	$134,034	$163,582
Operating leases (2)	3,561	13,737	10,750	7,583	5,925	9,653	51,209
Purchase obligations (3)	1,288	3,832	607	105	—	—	5,832
Total	$12,099	$17,569	$18,698	$15,120	$13,450	$143,687	$220,623

(1) In April 2012, we entered into an agreement for naming rights and related benefits with respect to the Dolby Theatre in Hollywood, California, the location of the Academy Awards®. In exchange for these rights and other benefits, we will make one annual payment in the first year of the contract and subsequently, semi-annual payments over the term. Our payment obligations are conditioned in part on the Academy Awards® being held and broadcast from the Dolby Theatre. The term of the agreement is 20 years.

(2) Operating lease payments include future minimum rental commitments, including those payable to our principal stockholder and portions attributable to the controlling interests in our wholly owned subsidiaries, for non-cancelable operating leases of office space as of June 29, 2012.

(3) Our purchase obligations consist of agreements to purchase goods and services, entered into in the ordinary course of business. These represent non-cancelable commitments for which a penalty would be imposed if the agreement was canceled for any reason other than an event of default as described by the agreement.

We are party to certain contractual agreements under which we have agreed to provide indemnifications of varying scope and duration to the other party relating to our licensed intellectual property. Historically, we have made no payments for these indemnification obligations and no amounts have been accrued in our condensed consolidated financial statements with respect to these obligations. Due to their varying terms and conditions, we are unable to make a reasonable estimate of the maximum potential amount we could be required to pay.

See Note 12, Subsequent Events, for discussion of additional cash commitments and transactions subsequent to June 29, 2012.

10. Stockholders' Equity

Common Stock Repurchase Program

In November 2009 we announced a stock repurchase program, providing for the repurchase of up to $250.0 million of our Class A common stock. Our board of directors approved an additional $300.0 million for our stock repurchase program in July 2010, $250.0 million in July 2011, and $100.0 million in February 2012, for a total authorization of up to $900.0 million in stock repurchases. Stock repurchases under this program may be made through open market transactions, negotiated purchases, or otherwise, at times and in amounts that we consider appropriate. The timing of repurchases and the number of shares repurchased depend upon a variety of factors including price, regulatory requirements, the rate of dilution from our equity compensation programs, and other market conditions. We may limit, suspend, or terminate the stock repurchase program at any time without prior notice. This program does not have a specified expiration date. Shares repurchased under the program will be returned to the status of authorized but unissued shares of Class A common stock. As of June 29, 2012, the remaining authorization to purchase additional shares is $276.5 million.

Stock repurchase activity under the stock repurchase program during the fiscal year-to-date period ended June 29, 2012 is summarized as follows:

	Shares Repurchased	Cost (in thousands)	Average Price Paid

		(1)	per Share (2)
Repurchase activity for the fiscal quarter ended December 30, 2011	885,969	$26,068	$29.41
Repurchase activity for the fiscal quarter ended March 30, 2012	1,575,891	$60,081	$38.11
Repurchase activity for the fiscal quarter ended June 29, 2012	2,545,699	$103,810	$40.76
Total	5,007,559	$189,959	

(1) Cost of share repurchases includes the price paid per share and applicable commissions.
(2) Excludes commission costs.

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Comprehensive Income

The components of comprehensive income were as follows:

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	July 1, 2011	June 29, 2012	July 1, 2011	June 29, 2012
	(in thousands)			
Net income including controlling interest	$62,047	$51,406	$231,294	$213,089
Other comprehensive income:				
Foreign currency translation adjustment, net of tax	1,191	(3,117)	4,535	(1,560)
Unrealized losses on available-for-sale securities, net of tax	342	(279)	(314)	(87)
Comprehensive income	63,580	48,010	235,515	211,442
Less: comprehensive (income) / loss attributable to controlling interest	(292)	286	(1,225)	(270)
Comprehensive income attributable to Dolby Laboratories, Inc.	$63,288	$48,296	$234,290	$211,172

Accumulated Other Comprehensive Income

Accumulated other comprehensive income consists of the following:

	September 30, 2011	June 29, 2012
	(in thousands)	
Accumulated foreign currency translation gains, net of tax of ($2,653) at September 30, 2011 and ($3,284) at June 29, 2012	$6,834	5,285
Accumulated unrealized gains on available-for-sale securities, net of tax of ($387) at September 30, 2011 and ($339) at June 29, 2012	699	612
Total accumulated other comprehensive income	$7,533	5,897

Stockholders' Equity and Controlling Interest

The following tables present the changes in total stockholders' equity attributable to Dolby Laboratories, Inc. and the controlling interest:

	Dolby Laboratories, Inc.	Controlling Interest	Total
	(in thousands)		
Balance at September 24, 2010	$1,473,737	$20,942	$1,494,679
Net income	230,196	1,098	231,294
Translation adjustments, net of taxes of ($149)	4,408	127	4,535
Unrealized losses on available-for-sale securities, net of taxes of $197	(314)	—	(314)
Stock-based compensation expense	33,020	—	33,020
Repurchase of common stock	(142,500)	—	(142,500)
Tax benefit from the exercise of stock options and vesting of restricted stock units	12,232	—	12,232
Common stock issued under employee stock plans, net of shares withheld for taxes	22,920	—	22,920
Balance at July 1, 2011	$1,633,699	$22,167	$1,655,866

	Dolby Laboratories, Inc.	Controlling Interest	Total
	(in thousands)		

Balance at September 30, 2011	$1,663,513	$21,837	$1,685,350
Net income	212,808	281	213,089
Distributions to controlling interest	—	(13)	(13)
Translation adjustments, net of taxes of ($631)	(1,549)	(11)	(1,560)
Unrealized losses on available-for-sale securities, net of taxes of $48	(87)	—	(87)
Stock-based compensation expense	34,059	—	34,059
Repurchase of common stock	(189,959)	—	(189,959)
Tax benefit from the exercise of stock options and vesting of restricted stock units	(2,633)	—	(2,633)
Common stock issued under employee stock plans, net of shares withheld for taxes	12,816	—	12,816
Balance at June 29, 2012	$1,728,968	$22,094	$1,751,062

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11. Earnings Per Share

We compute basic earnings per share by dividing net income attributable to Dolby Laboratories, Inc. by the weighted-average number of shares of Class A and Class B common stock outstanding during the period. For diluted earnings per share, we divide net income attributable to Dolby Laboratories, Inc. by the sum of the weighted-average number of shares of Class A and Class B common stock outstanding and the potential number of dilutive shares of Class A and Class B common stock outstanding during the period.

The following table sets forth the computation of basic and diluted earnings per share attributable to Dolby Laboratories, Inc.:

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	July 1, 2011	June 29, 2012	July 1, 2011	June 29, 2012
	(in thousands, except per share amounts)			
Numerator:				
Net income attributable to Dolby Laboratories, Inc.	$61,748	$51,529	$230,196	$212,808
Denominator:				
Weighted-average shares outstanding - basic	111,494	106,328	111,893	107,876
Potential common shares from options to purchase Class A and Class B common stock	757	577	1,076	496
Potential common shares from restricted stock units	98	297	196	121
Weighted-average shares outstanding - diluted	112,349	107,202	113,165	108,493
Net income per share attributable to Dolby Laboratories, Inc. - basic	$0.55	$0.48	$2.06	$1.97
Net income per share attributable to Dolby Laboratories, Inc. - diluted	$0.55	$0.48	$2.03	$1.96
Anti-dilutive options excluded from calculation	3,563	5,636	3,043	6,318
Anti-dilutive restricted stock units excluded from calculation	384	426	471	1,657

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12. Subsequent Events

In June 2012, we announced plans to purchase an approximately 354,000 square-foot building in San Francisco for approximately $109.8 million. As of June 29, 2012, we had pledged $5.5 million towards the purchase of the building, which is classified within other non-current assets in our condensed consolidated balance sheet and within purchases of property, plant and equipment in our condensed consolidated statements of cash flows. The purchase was completed on July 9, 2012 and settled in cash, and as such, no debt resulted from this transaction.

At our Annual Meeting of Stockholders, held on February 7, 2012, our stockholders approved an Employee Stock Option Exchange Program (the "Exchange Program") to permit eligible employees to exchange, on a grant-by-grant basis, eligible outstanding options that are significantly “underwater” (that is, the option's exercise price was greater than the quoted market price at the time the Exchange Program was launched) for a lesser number of restricted stock units, to be granted under our 2005 Stock Plan. The Exchange Program offer period began on July 16, 2012 and is expected to end on August 10, 2012, unless we extend the offer period. The Exchange Program is open to all employees and executive officers in eligible countries. However, non-employee members of our board of directors are not eligible to participate. Options eligible for the Exchange Program are those options that were granted prior to July 16, 2011, and that have exercise prices per share that are greater than $45.83, which approximates the 52-week high of our per share stock price as of the start of this offer.

On July 19, 2012, we acquired all outstanding shares of IMM Sound, S.A., a privately held company based in Barcelona, Spain, that develops and markets immersive 3D sound for the digital film industry. We believe that this technology complements our newly released Atmos technology. The aggregate purchase price, including acquisition-related costs, was approximately €21.5 million, or approximately $26.8 million. We will account for the business combination under the purchase method of accounting in the fourth quarter of fiscal 2012.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our interim condensed consolidated financial statements and the related notes that appear elsewhere in this Quarterly Report on Form 10-Q. These discussions contain forward-looking statements reflecting our current expectations, which involve risks and uncertainties. In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “potential,” “continue,” or the negative of these terms or comparable terminology. Forward-looking statements include, but are not limited to: statements regarding the extent and timing of future licensing, products, and services revenue levels and mix, expenses, margins, net income per diluted share, income taxes, tax benefits, acquisition costs and related amortization, and other elements of results of operations; our expectations regarding demand and acceptance for our technologies; growth opportunities and trends in the markets in which we operate; our plans, strategies, and expected opportunities; the deployment of and demand for our products and for products incorporating our technologies; and future competition. Actual results may differ materially from those discussed in these forward-looking statements due to a number of factors, including the risks set forth in Part II, Item 1A, “Risk Factors,” of this Quarterly Report on Form 10-Q and elsewhere in this filing. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of these forward-looking statements. We are under no duty to update any of the forward-looking statements after the date of this Quarterly Report on Form 10-Q to conform our prior statements to new developments or actual results.

Overview

Dolby Laboratories has been a leading solutions provider to the entertainment industry for more than 45 years. We provide products, services, and technologies to capture, distribute, and play back entertainment content that gives consumers a premium entertainment experience, regardless of how or where they choose to enjoy it. Our core strengths range from our expertise in digital signal processing and compression technology to our long history of providing products, tools, and technologies to participants in the entertainment industry at each stage in the content creation, distribution, and playback process. We provide products and services that enable content creators and distributors to produce, encode, and transmit content with our premium audio technologies, and we license decoding technologies to the manufacturers of entertainment devices to ensure that content is ultimately experienced as the creator and distributor intended.

Throughout our history, we have introduced numerous innovations that have significantly improved the quality of audio entertainment, such as noise reduction for the recording and cinema industries and surround sound for cinema and home

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entertainment. Today, we continue to derive the vast majority of our revenue from our audio technologies.
Looking forward, we see a number of industry trends that create opportunities for the continued growth of our audio business, including the ongoing global transition from analog to digital television and consumers' increasing use of portable electronic devices, such as tablets and smartphones, to play back digital content. Our portfolio of technologies and solutions optimize the audio experience for portable devices to provide consumers with a rich, clear, and immersive sound, despite the bandwidth limitations of online and cellular networks.
We also see opportunities to apply our core strengths in areas beyond audio. For example, we believe that significant improvements can be made in the technology currently used to deliver and play back premium video, and we have identified solutions that may substantially improve the video experience. Similarly, we believe we can apply our existing audio technologies to improve the clarity and quality of voice communications in areas such as multi-party teleconferencing.

Business Model

We generate the majority of our revenue by licensing technologies to original equipment manufacturers ("OEM") of consumer entertainment ("CE") products and to software vendors. We also generate revenue by selling products and related services to creators and distributors of entertainment content.
We participate in the global entertainment industry in three principal ways:

- We offer products, services, and technologies to creators and distributors of entertainment content, such as motion picture, television, and music recording studios, television broadcasters, satellite and cable operators, and increasingly, Internet content streaming and download service providers. These content creators and distributors use our products, services, and technologies to encode and transmit content, creating rich, clear, and immersive audio experiences for consumers upon playback.
- We license technologies, such as Dolby Digital, Dolby Digital Plus, and Dolby Pulse, to OEMs and software vendors for incorporation into their CE and other products, so that consumers can play back audio content with our technologies in the rich, clear, and immersive manner the creators intended.
- We work directly with standards-setting organizations in the entertainment and technology industries, as well as governments and other regulatory bodies, to promote adoption of our technologies in their standards. As a result, our technologies are included in virtually all DVD players, Blu-ray Disc players, audio/video receivers, and personal computer ("PC") DVD software players.

We license our technologies to OEMs and software vendors in 46 countries, and our licensees distribute products incorporating our technologies throughout the world. We sell our products and provide services in approximately 80 countries. In fiscal 2010, 2011, and the fiscal year-to-date period ended June 29, 2012, revenue from outside of the U.S. was 66%, 68%, and 67% of our total revenue, respectively. Geographic data for our licensing revenue is based on the location of our licensees' headquarters. Products revenue is based on the destination to which we ship our products, while services revenue is based on the location where services are performed.

Opportunities, Challenges, and Risks

Our licensing and products markets are characterized by rapid technological changes, new and improved product introductions, changing customer demands, evolving industry standards, changing licensee needs, and product obsolescence. We believe that these changes present us with opportunities to provide realistic and immersive audio experiences to consumers through new and emerging delivery channels. As described below, our licensing revenue is subject to uncertainties and trends relating to technology and market growth, as well as the mix of CE products sold that incorporate our technologies. Our licensing business also could be affected by adverse general economic conditions, because many of the products in which our technologies are incorporated are discretionary goods. Furthermore, our products business is subject to intense competition and uncertainties relating to the transition to digital cinema and purchasing decisions by our cinema customers. We expect recent declines in our 3D revenue to continue, as the market for 3D products becomes increasingly saturated.

Licensing

Licensing revenue constitutes the majority of our total revenue, representing 77%, 83%, and 86% of total revenue in fiscal 2010, 2011, and the fiscal year-to-date period ended June 29, 2012, respectively.
As consumers are presented with more options for receiving content, competition across delivery channels has intensified. We see this reflected in the composition of our licensing revenue, driven by a shift away from optical disc based

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products. Optical disc based revenue is generated from the sale of technology solutions that enable DVD or Blu-ray Disc playback functionality. Optical disc based revenue includes the Windows 7 operating system, independent PC DVD software players, DVD, and Blu-ray Disc technologies included in consumer products. However, most of these products can receive content over mobile or online networks, as well as from optical discs, and we have increased our technology penetration into these other distribution channels. Non-optical disc based revenue is generated from the sale of technology solutions other than those used to enable DVD or Blu-ray Disc playback functionality. Non-optical disc based revenue includes licensing revenue derived from products such as TVs, set-top boxes, and mobile devices, as well as our post processing technologies on a range of devices. We remain focused on delivering the products, tools, and technologies needed to ensure a high quality audio experience from any device.

Looking forward, we expect continued growth in the proportion of our licensing revenue we derive from non-optical disc sources. This will be driven partly by the maturity of optical disc as a method for delivering content, but also by the significant opportunities presented by digital broadcast and online distribution, as well as the inclusion of our technologies in the Windows 8 operating system to enable the playback of online content. We also see significant opportunities to offer encode/decode solutions in video and voice that leverage our expertise in signal processing, compression, and the capture and playback of content.

Our licensing revenue comes from the following markets and primarily from the inclusion of our technologies in the products indicated for each market:

- Broadcast market: primarily televisions and set-top boxes
- PC market: primarily DVD software players and Microsoft Windows operating systems
- CE market: primarily DVD and Blu-ray Disc players and recorders, audio/video receivers, and home-theater-in-a-box systems
- Other markets:
  Mobile – primarily cell phones and other mobile devices
  Gaming – primarily video game consoles
  Licensing services – primarily administration of joint licensing programs
  Automotive – primarily in-car DVD players

The entertainment industry is in transition. The growth of the Internet, and the related shift by consumers toward online entertainment content, has resulted in a global trend toward an array of online content streaming and download services. Today content is captured, delivered, and played back in more ways than ever before. Content creators and distributors are increasingly focused on delivering content across a multitude of media and devices with varying bandwidth and performance requirements, including PCs, connected TVs, set-top boxes, gaming consoles, connected Blu-ray Disc players, and a variety of mobile devices. Many of these mobile devices are increasingly designed to capture and distribute content through improved camera and WiFi technologies, as well as to play back rich entertainment experiences. This increasingly complex array of devices, with capability for both creating and playing back content, presents a challenge for content creators and device manufacturers seeking consistent audio quality. We believe this challenge provides an opportunity similar to that of digital broadcast, whereby we can provide solutions to optimize the audio experience across the online and portable device ecosystem.

In the area of content creation and delivery, our technologies are included in DVD, Blu-ray Disc, and certain broadcast standards, and we are working to extend our technologies to online delivery services. Online content aggregators, including Netflix, Amazon, VUDU, Apple, HBO GO, Samsung's Acetrax, and the Roxio Now platform, use our technologies to encode video and audio content. Leading music services such as Rhapsody and Omnifone use our audio encoding tools to deliver a rich music experience to their subscribers. In the second quarter of fiscal 2012, HBO adopted Dolby Digital Plus in its HBO GO service, for content delivered to select connected TVs. HBO will also offer Dolby Digital Plus in its HBO GO service, for content delivered to Blu-ray Disc players. In addition, Samsung is expected to offer Dolby Digital Plus surround sound audio through the Acetrax Video on Demand application during fiscal 2012.

Our broadcast market is driven by demand for our technologies in televisions and set-top boxes and represented approximately 27%, 31%, and 34% of our licensing revenue in fiscal 2010, 2011, and the fiscal year-to-date period ended June 29, 2012, respectively. Higher attach rates in the first three quarters of fiscal 2012 drove increased revenue from both televisions and set-top boxes, relative to the same period in the prior year. We view the broadcast market as an area for potential continued growth, primarily in geographic markets outside of the U.S. We also view broadcast services, such as terrestrial broadcast or IPTV services, which operate under bandwidth constraints, as another area of opportunity for Dolby Digital Plus, HE AAC, and Dolby Pulse. These technologies enable the delivery of high quality audio content at reduced bit rates, thereby conserving bandwidth. We may not, however, be able to extend our current success in the broadcast market to these new opportunities.

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Our PC market represented approximately 36%, 30%, and 28% of our licensing revenue in fiscal 2010, 2011, and the fiscal year-to-date period ended June 29, 2012, respectively. Our technologies are incorporated in the majority of PCs sold today, primarily because of the inclusion of DVD and Blu-ray Disc playback in the majority of PCs and the inclusion of Dolby technologies in the DVD and Blu-ray Disc standards.

Historically, we have licensed our technologies to a range of PC licensees, including independent software vendors (“ISV”), PC OEMs, and operating system providers, and the release of new versions of major PC operating systems has often resulted in changes in the mix of our PC licensees. In 2007, Microsoft introduced its Windows Vista operating system, which included our technologies to enable DVD audio playback in two of its editions. In fiscal 2009, Microsoft released its current operating system, Windows 7, which includes our technologies within four editions. As a result, since 2007 the mix of our PC licensing revenue from operating systems has increased relative to that from OEMs and ISVs. We currently license our audio codec technologies directly to OEMs such as Apple, Toshiba, and Sony to support optical disc playback on PCs, and we license our PC Entertainment Experience (“PCEE”) technologies to multiple PC OEMs through our PCEE licensing program.

In May 2012, we entered into an agreement with Microsoft under which Dolby Digital Plus 5.1 channel decoding and Dolby Digital two-channel encoding will be included in all PCs and tablets licensed to run the Windows 8 operating system. Under the arrangement, OEMs generally will be required to directly license and pay us a base royalty rate for the right to use the Dolby technologies included in Windows 8 installed on PCs and tablets for online and file-based content. OEMs will pay a higher per-unit royalty for Windows 8 PCs that also include optical disc playback functionality, which will be implemented by ISV applications. This higher rate is consistent with historical rates paid for the inclusion of Dolby disc playback software. We expect the majority of PCs to continue to ship with optical disc drives when Windows 8 is released and to include optical disc playback functionality.

We believe the Microsoft Windows 8 arrangement provides an easier way for OEMs to enable playback with our technologies of content delivered by online services and video in local files on the device. Given the anticipated release date of Windows 8, we do not expect any such change to have a material financial impact in fiscal 2012, as we expect that Microsoft will continue to license its Windows 7 operating systems with our technologies at least until the release of Windows 8. The ultimate financial impact of these licensing arrangements for Windows 8 on our licensing revenue is uncertain and will depend on several factors, including:

- The extent and rate at which Windows 8 is adopted in the marketplace;
- The extent to which OEMs include optical disc playback in Windows 8 devices;
- The extent to which earlier versions of Microsoft operating systems, including Windows 7, continue to be licensed after the release of Windows 8;
- Our ability to establish and extend licensing relationships directly with PC OEMs and ISVs;
- The rate at which entertainment content shifts from optical disc media to online media, thus reducing the need for PCs to have optical disc drives and DVD and Blu-ray Disc software players; and
- Our ability to extend the adoption of our technologies to online and mobile platforms.

In the short term, revenue from our PC market remains dependent on several factors, including underlying PC unit shipment growth and the extent to which our technologies are included in operating systems and ISV media applications. We continue to face risks relating to:

- Purchasing trends away from traditional PCs and toward computing devices without optical disc drives, such as ultrabooks and tablets, which may not include our technologies;
- The prevalence of PC software that includes our technologies on an unauthorized and infringing basis, for which we receive no royalty payments; and
- Continued decreasing inclusion of ISV media applications by PC OEMs in their Windows 7-based PCs, as Windows 7 already incorporates DVD playback software.

Our CE market is driven primarily by revenue attributable to sales of DVD and Blu-ray Disc players and recorders and represented approximately 22%, 21%, and 19% of licensing revenue in fiscal 2010, 2011, and the fiscal year-to-date period ended June 29, 2012, respectively. Blu-ray Disc players continue to represent an important source of revenue within our CE market, as these players are required to include Dolby Digital technology for primary audio content and our Dolby Digital Plus technology for secondary audio content. In addition, our Dolby TrueHD technology is an optional audio standard for Blu-ray Disc. Sales of DVD players are declining, as a result of the maturity of the DVD platform and a shift to Blu-ray Disc players and other connected devices capable of delivering content; however, our revenue from sales of Blu-ray Disc players in recent quarters is decreasing and has not offset this decline. In the fiscal year-to-date period ended June 29, 2012, we continued to see reductions in reported units of DVD and Blu-ray Disc players incorporating our technologies.

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Revenue generated from our other markets includes revenue attributable to mobile, gaming, licensing services, and automotive, and represented approximately 15%, 18%, and 19% of licensing revenue in fiscal 2010, 2011, and the fiscal year-to-date period ended June 29, 2012, respectively. Mobile revenue is primarily driven by demand for the Dolby Digital Plus, AAC, Dolby Mobile, and Dolby Digital. We view the mobile device market as an area of opportunity for us to increase revenue; however, actual results may differ from our expectations. Revenue attributable to gaming and automotive is primarily driven by sales of video game consoles and in-car entertainment systems, respectively, that incorporate our Dolby Digital, Dolby Digital Plus, AAC, and Dolby TrueHD technologies. Licensing services revenue, from administration of joint licensing programs, is primarily driven by demand for standards-based audio compression technologies for broadcast, PC, CE, and mobile products.

Consumer entertainment products throughout the world incorporate our technologies. We expect that sales of such products incorporating our technologies in emerging economies such as Brazil, China, India, and Russia, will increase in the future as consumers in these markets acquire more disposable income with which to purchase entertainment products. However, events in these economies or in the world economy in general may contradict these expectations. Moreover, we expect that OEMs in lower-cost manufacturing countries, including China, will increase production in response to this demand and that traditional OEMs will continue to shift their manufacturing operations to these lower-cost manufacturing countries. There are substantial risks associated with doing business in such countries, including OEMs failing to report or underreporting shipments of products incorporating our technologies, that have affected and will continue to affect our operating results.

Revenue from Microsoft represented approximately 15% of our total revenue in the third quarter of fiscal 2012 and 14% in the fiscal year-to-date period ended June 29, 2012, and included licensing revenue from our PC, CE, and other markets.

Products

Products revenue is driven primarily by sales of equipment to cinema operators and broadcasters and represented 20%, 14%, and 11% of our total revenue in fiscal 2010, 2011, and the fiscal year-to-date period ended June 29, 2012, respectively.

Our cinema products represented approximately 90%, 87%, and 86% of total products revenue in fiscal 2010, 2011, and the fiscal year-to-date period ended June 29, 2012, respectively. Sales of our cinema products tend to fluctuate based on underlying trends in the cinema industry, including the popularity of individual movies, as cinema owners often purchase equipment to meet expected box office demand.

The cinema industry is transitioning from traditional film to digital cinema, and we estimate that the industry is more than halfway through this transition. Digital cinema offers motion picture studios a means to save costs in printing and distributing movies, combat piracy, and enable repeated movie playback without degradation in image and audio quality. Our cinema products include our Dolby Digital Cinema screen server and central library server, for the storage and playback of digital content, and our digital audio processor, which provides audio control for our digital cinema servers. We expect that most cinema owners who are either constructing new theaters or upgrading existing theaters will choose digital cinema products over traditional film cinema products. However, our competitive position in the digital cinema market is not as strong as our position in the traditional film cinema market. For example, digital cinema specifications are based on open standards which, unlike traditional cinema standards, do not include our proprietary audio technologies. Furthermore, we are facing more pricing and other competitive pressures for our digital cinema products than we experience for our traditional film cinema products.

Digital cinema standards are defined by the Digital Cinema Initiative (“DCI”) specifications, and we have developed software for our currently available digital cinema server that is DCI compliant. This software was made commercially available during fiscal 2012. We do not have significant contractual provisions arising from the sale of products relating to DCI compliance that would require additional performance from us other than making the software update available to our customers.

Several of our competitors have introduced digital cinema products that support the playback of high frame rate content and also support presentation of movies with higher resolution “4K” digital cinema projectors. We are developing a 4K and high frame rate solution and expect to make it available in calendar 2012. If we are unable to provide such a solution with a market competitive feature set, price, and compliance with DCI specifications, our results of operations could be adversely affected.

Our digital 3D products provide 3D image capabilities when combined with a digital cinema projector and server. Our cinema products revenue has been negatively impacted by declines in unit shipments for 3D products, as the market for 3D cinema equipment has become increasingly competitive. We also believe the decrease in revenue from our 3D products reflects the increasing saturation of 3D enabled screens within the cinema industry.

Our traditional film cinema products are used primarily to read, decode, and play back film soundtracks, to calibrate

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cinema sound systems, and to enable soundtracks encoded in digital audio formats to be played back on analog cinema audio systems. As investment by the cinema industry in digital cinema has increased, revenue from our traditional film cinema products has declined, and we expect this decline to continue.

Our broadcast products represented approximately 9%, 10%, and 11% of products revenue in fiscal 2010, 2011, and the fiscal year-to-date period ended June 29, 2012, respectively. Our broadcast products are used to encode, transmit, and decode multiple channels of high quality audio content for DTV and HDTV program production and broadcast distribution and to measure the subjective loudness of audio content within broadcast programming.

In fiscal 2011, we began selling our Professional Reference Monitor product, a flat-panel video reference display for video professionals. These video professionals use the monitor for color critical tasks, such as calibrating color accuracy to professional reference standards. Our Professional Reference Monitor uses our dynamic range imaging technologies, which enhance contrast and extend brightness and dynamic range, while reducing power consumption in LED backlit LCD televisions. We do not anticipate generating significant revenue from this product in fiscal 2012.

Services

Services revenue represented approximately 3% of total revenue in each of fiscal 2010, 2011, and the fiscal year-to-date period ended June 29, 2012. The level of our services revenue is primarily tied to activity in the cinema industry, and in particular, to the number of movies being produced and distributed by studios and independent filmmakers. Several factors influence the number of movies produced in a given fiscal period, including strikes and work stoppages within the cinema industry, as well as tax incentive arrangements provided by many governments to promote local filmmaking. Services revenue is also impacted by the transition to digital cinema in some regions.

Other

We are party to an agreement under which we obtained naming rights and related benefits with respect to the Dolby Theatre in Hollywood, California. Under the agreement, we will make one annual payment in the first year of the contract and subsequently, semi-annual payments over the term, which will be recorded as marketing expenses. Our payment obligations are conditioned in part on the Academy Awards® being held and broadcast from the Dolby Theatre. For additional details, see Note 9 “Commitments and Contingencies” to our condensed consolidated financial statements. In addition to these contractual obligations, we anticipate that we will continue to incur increased marketing expenses associated with promoting our products, technologies, and brand at the Dolby Theatre.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based on our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. (“GAAP”), and pursuant to Securities and Exchange Commission (“SEC”) rules and regulations. GAAP and SEC rules and regulations require us to use accounting policies and make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies as of the date of the financial statements, and the reported amounts of revenue and expenses during a fiscal period. The SEC considers an accounting policy or estimate to be critical if it is both important to a company’s financial condition and/or results of operations and requires significant judgment on the part of management in its application. On a regular basis, we evaluate our assumptions, judgment, and estimates. We have discussed the selection and development of the critical accounting policies and estimates with the audit committee of our board of directors. Other than the early adoption of ASU 2011-08, there have been no material changes to our critical accounting policies and estimates from those described in our Annual Report on Form 10-K, as amended, for the fiscal year ended September 30, 2011. Although we believe that our judgments and estimates are appropriate and correct, actual results may differ from these estimates.

We consider the following to be critical accounting policies and estimates because we believe they are both important to the portrayal of our financial condition and results of operations and require management judgments about matters that are uncertain. If actual results or events differ materially, our reported financial condition and results of operation for future periods could be materially affected. See Part II, Item 1A “Risk Factors” for further information on the potential risks to our future results of operations.

Revenue Recognition

We enter into revenue arrangements with our customers to license technologies, trademarks, and know-how and to sell products and services. We recognize revenue when all of the following criteria are met: persuasive evidence of an arrangement

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exists, delivery has occurred or services have been rendered, the seller's price to the buyer is fixed or determinable, and collectibility is probable. Judgment is required to assess whether collectibility is probable. We determine collectibility based on an evaluation of our customer's recent payment history, the existence of a standby letter of credit between the customer's financial institution and our financial institution, and other factors. Some of our revenue arrangements include multiple elements, such as hardware, software, maintenance, and other services.

We evaluate each element in a multiple element ("ME") arrangement to determine whether it represents a separate unit of accounting. An element constitutes a separate unit of accounting when it has standalone value and delivery of an undelivered element is both probable and within our control. When these criteria are not met, the delivered and undelivered elements are combined and the arrangement fees are allocated to this combined single unit.

If the unit separation criteria are met, we account for each element within a ME arrangement (such as hardware, software, maintenance, and other services) separately, and we allocate fees from the arrangement based on the relative selling price of each element. For some arrangements, customers receive certain elements over a period of time, after delivery of the initial product. These elements may include support and maintenance and/or the right to receive upgrades. Revenue allocated to the undelivered element is recognized either over its estimated service period or when the upgrade is delivered. We do not recognize revenue that is contingent upon the future delivery of products or services or upon future performance obligations. We recognize revenue for delivered elements only when we have completed all contractual obligations.

We determine our best estimate of the selling price for an individual element within a ME revenue arrangement using the same methods used to determine the selling price of an element sold on a standalone basis. If we sell the element on a standalone basis, we estimate the selling price by considering actual sales prices. Otherwise, we estimate the selling price by considering internal factors such as pricing practices and margin objectives. Consideration is also given to market conditions such as competitor pricing strategies, customer demands, and industry technology lifecycles. Management applies judgment to establish margin objectives, pricing strategies, and technology lifecycles.

Revenue recognition for transactions which involve software, such as fees we earn from integrated software vendors, requires judgment, including whether a software arrangement includes multiple elements, and if so, whether vendor specific objective evidence ("VSOE") of fair value exists for those elements. For some of our ME arrangements, customers receive certain elements of the arrangement over a period of time or after delivery of the initial software. These elements may include support and maintenance. The fair values of these elements are recognized over the estimated period for which these elements will be delivered, which is sometimes the estimated life of the software. If we do not have VSOE of fair value for any undelivered element included in these ME arrangements for software, we defer revenue until all elements are delivered and/or services have been performed, or until we have VSOE of fair value for all remaining undelivered elements. If the undelivered element is support and we do not have fair value for the support element, revenue for the entire arrangement is bundled and recognized ratably over the support period.

For ME arrangements containing both software and hardware, we allocate the arrangement fees to each element based on its relative selling price, which we establish using a selling price hierarchy. We determine the selling price of each element based on its VSOE, if available, third-party evidence ("TPE"), if VSOE is not available, or estimated selling price ("ESP"), if neither VSOE nor TPE is available.

We account for our digital cinema server sales as ME arrangements that may include up to three separate units, or elements, of accounting. The first element consists of our digital cinema server hardware and the accompanying software, which is essential to the functionality of the hardware. This element is typically delivered at the time of sale. The second element is the right to receive support and maintenance, which is included with the purchase of the hardware element and is typically delivered over a service period subsequent to the initial sale. The third element is the right to receive specified upgrades, which is included with the purchase of the hardware element and is typically delivered when a specified upgrade is available, subsequent to the initial sale. The application of the revenue accounting standards to our digital cinema server sales typically results in the allocation of a substantial majority of the arrangement fees to the delivered hardware element based on its ESP, relative to the VSOE or ESP of the other elements, which we recognize as revenue at the time of sale. A small portion of the arrangement fees is allocated to the undelivered support and maintenance element, and in some cases to the undelivered specified upgrade element, based on the VSOE or ESP of each element. The portion of the arrangement fees allocated to the support and maintenance element is recognized as revenue ratably over the estimated service period and the portion of the arrangement fees allocated to specified upgrades is recognized as revenue upon delivery of the upgrade.

Goodwill, Intangible Assets, and Long-Lived Assets

We test goodwill for impairment annually during our third fiscal quarter and whenever events or changes in circumstances indicate that the carrying amount may be impaired. In September 2011, the FASB issued ASU 2011-08 which amends the rules for testing goodwill for impairment. We adopted the provisions of ASU 2011-08 for our annual goodwill

impairment test performed in the third quarter of fiscal 2012.
In performing the qualitative assessments, we consider events and circumstances, including but not limited to, macroeconomic conditions, industry and market considerations, cost factors, overall financial performance, changes in management or key personnel, changes in strategy, changes in customers, changes in the composition or carrying amount of a reporting unit's net assets and changes in the price of our common stock. If, after assessing the totality of events or circumstances, we determine that it is more likely than not that the fair value of a reporting unit is greater than its carrying amount, then the two-step goodwill impairment test is not performed.
If the two-step goodwill test is performed, we evaluate and test our goodwill for impairment at a reporting-unit level using expected future cash flows to be generated by the reporting unit. If the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the calculated fair value of the goodwill. A reporting unit is an operating segment or one level below. Our operating segments are aligned with the management principles of our business.
We completed our annual goodwill impairment assessment in the fiscal quarter ended June 29, 2012. At the time of our annual goodwill impairment test for fiscal 2012, we had two reporting units: Via, which corresponds to our wholly owned subsidiary and has no assigned goodwill, and Dolby Entertainment Technology ("DET"), with goodwill of $263.5 million. We determined, after assessing the totality of the events and circumstances described above, that it is more likely than not that the fair value of each reporting unit is greater than its carrying amount. Accordingly there was no indication of impairment and the two-step goodwill impairment test was not performed. We did not recognize any goodwill impairment losses in fiscal 2010, 2011, or the year-to-date period ended June 29, 2012.
Intangible assets with definite lives are amortized over their estimated useful lives. Our intangible assets principally consist of acquired technology, patents, trademarks, customer relationships, and contracts, which are amortized on a straight-line basis over their useful lives ranging from two to fifteen years.
We review long-lived assets, including intangible assets, for impairment whenever events or a change in circumstances indicate an asset’s carrying value may not be recoverable. Recoverability of an asset is measured by comparing its carrying value to the total future undiscounted cash flows that the asset is expected to generate. If we determine that the carrying value of an asset is not recoverable, an impairment loss is recorded in the amount by which the carrying value of the asset exceeds its estimated fair value.
Accounting for Income Taxes
We make estimates and judgments that affect our accounting for income taxes, including estimates of actual tax exposure and assessment of temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences, including the timing of the recognition of stock-based compensation expense, result in deferred tax assets and liabilities, which are included in our condensed consolidated balance sheets. We assess the likelihood that our deferred tax assets will be recovered from future taxable income, and to the extent that we believe recovery is not likely, we establish a valuation allowance.
Our policy is to recognize a tax benefit from an uncertain tax position only if it is more likely than not that the tax position is sustainable upon examination by tax authorities. We include interest and penalties related to gross unrecognized tax benefits within our provision for income taxes. When accrued interest and penalties do not ultimately become payable, amounts accrued are reduced in the period that such determination is made and are reflected as a reduction of the overall income tax provision.
Significant judgment is required in determining the provision for income taxes, the deferred tax asset and liability balances, the valuation allowance against our deferred tax assets, and the reserve resulting from uncertain tax positions. Our financial position and results of operations may be materially affected if actual results differ significantly from these estimates or if the estimates are adjusted in future periods.
Valuation and Classification of Investments
Fair value is the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants at the measurement date.
We classify our financial assets and liabilities measured at fair value using a three-level hierarchy that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be

used when available. Observable inputs are those that reflect the assumptions market participants would use in pricing the investment that are based on market data obtained from sources independent of the reporting entity, such as market quoted prices. GAAP

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establishes a three-level hierarchy prioritizing the inputs used in measuring fair value as follows: the fair value hierarchy gives the highest priority to quoted prices in active markets that are accessible by us at the measurement date for identical investments, described as Level 1, and the lowest priority to valuation techniques using unobservable inputs, described as Level 3. We obtain the fair value of our Level 2 financial instruments from a professional pricing service, which may use quoted market prices for identical or comparable instruments. Fair value from this professional pricing source can also be based on pricing models whereby all significant inputs, including maturity dates, issue dates, settlement dates, benchmark yields, reported trades, broker-dealer quotes, issuer spreads, benchmark securities, bids, offers, and other market related data, are observable or can be derived from or corroborated by observable market data for substantially the full term of the asset.

The degree to which estimates and judgment are used in determining fair value, is generally dependent upon the market pricing information available for the investments, the availability of observable inputs, the frequency of trading in the investments and the investment's complexity. If different judgments regarding inputs were made, we could potentially reach different conclusions regarding the fair value of our investments.

Stock-Based Compensation

We determine the expense for all stock-based compensation awards by estimating their fair value and recognizing that value as an expense, on a ratable basis, in our condensed consolidated financial statements over the requisite service period in which the awards are earned. We use the Black-Scholes option pricing model to determine the fair value of employee stock options at the date of the grant. To determine the fair value of a stock-based award using the Black-Scholes option pricing model, we make assumptions regarding the expected term of the award, the expected future volatility of our stock price over the expected term of the award, and the risk-free interest rate over the expected term of the award. We estimate the expected term of our stock-based awards by evaluating historical exercise patterns of our employees. We use a blend of the historical volatility of our common stock and the implied volatility of our traded options as an estimate of the expected volatility of our stock price over the expected term of the awards. We use an average interest rate based on U.S. Treasury instruments with terms consistent with the expected term of our awards to estimate the risk-free interest rate. We reduce the stock-based compensation expense for estimated forfeitures based on our historical experience. We are required to estimate forfeitures at the time of the grant and revise our estimate, if necessary, in subsequent periods if actual forfeitures differ from our estimate.

Recently Issued Accounting Standards

There have been no new accounting pronouncements not yet effective that have significance, or potential significance, to our condensed consolidated financial statements.

Results of Operations

Revenue

	Fiscal Quarter Ended		Change		Fiscal Year-to-Date Ended		Change	
	July 1, 2011	June 29, 2012	$	%	July 1, 2011	June 29, 2012	$	%
	($ in thousands)							
Licensing	$181,790	$178,436	$(3,354)	(2)%	$584,593	$603,409	$18,816	3%
Percentage of total revenue	83%	86%			82%	86%		
Products	28,395	22,132	(6,263)	(22)%	100,769	75,760	(25,009)	(25)%
Percentage of total revenue	13%	11%			14%	11%		
Services	8,814	7,304	(1,510)	(17)%	26,375	22,340	(4,035)	(15)%
Percentage of total revenue	4%	3%			4%	3%		
Total revenue	$218,999	$207,872	$(11,127)	(5)%	$711,737	$701,509	$(10,228)	(1)%

Licensing. The 2% decrease in licensing revenue from the third quarter of fiscal 2011 to the third quarter of fiscal 2012 was driven primarily by decreases in revenue from our CE and PC markets, partially offset by increases in our broadcast and other markets. The decrease in revenue from our CE market was primarily driven by lower shipments reported in the third quarter of fiscal 2012 of DVD and Blu-ray Disc players that incorporate our technologies, as more content is delivered on devices which do not contain optical drives. The decrease in our PC market was primarily due to fewer shipments of PCs including ISV decoders and PC post processing products (PCEE), partially offset by higher reported units of Windows 7-based PCs. The increase in revenue from our broadcast market was driven by increased sales of televisions and set-top boxes incorporating our technologies. The increase in revenue from our other markets was driven primarily by increased sales of mobile devices incorporating our Dolby Digital Plus and Dolby Digital technologies, as well as increases in in-car entertainment systems.

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The 3% increase in licensing revenue from the fiscal year-to-date period ended July 1, 2011 to the fiscal year-to-date period ended June 29, 2012 was driven primarily by increases in revenue from our broadcast and other markets, partially offset by decreases in our CE and PC markets. The increases and decreases were due primarily to the same reasons described above.

Products. The 22% decrease in products revenue from the third quarter of fiscal 2011 to the third quarter of fiscal 2012 was driven primarily by decreases in revenue from our 3D products, digital cinema video products, and to a lesser extent, traditional cinema products. Decreases in our 3D products revenue were driven primarily by lower units shipments, while decreases in our digital cinema video products revenue in the third quarter of fiscal 2012 resulted primarily from lower selling prices and decreases in traditional cinema revenues were driven by lower unit shipments due to the ongoing transition to digital cinema products.

The 25% decrease in products revenue from the fiscal year-to-date period ended July 1, 2011 to the fiscal year-to-date period ended June 29, 2012 was driven primarily by a decrease in revenue from our 3D products, and to a lesser extent, by a decrease in revenue from our traditional cinema products, both as described above.

Services. The 17% decrease in services revenue from the third quarter of fiscal 2011 to the third quarter of fiscal 2012 was attributable primarily to a decrease in film-based production services revenue as the cinema industry transitions to digital cinema. This decrease was partially offset by an increase in maintenance and support services.

The 15% decrease in services revenue from the fiscal year-to-date period ended July 1, 2011 to the fiscal year-to-date period ended June 29, 2012 was due to the same reasons discussed above as well as decreases in virtual print fees, which were generated from certain leased digital cinema assets, as we discontinued this program in fiscal 2011.

Gross Margin

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	July 1, 2011	June 29, 2012	July 1, 2011	June 29, 2012
	($ in thousands)			
Cost of licensing	$4,095	$2,892	$13,827	$9,523
Licensing gross margin percentage	98%	98%	98%	98%
Cost of products	20,320	14,529	62,549	46,052
Products gross margin percentage	28%	34%	38%	39%
Cost of services	3,518	3,610	9,153	9,458
Services gross margin percentage	60%	51%	65%	58%
Total gross margin percentage	87%	90%	88%	91%

Licensing Gross Margin. We license intellectual property to our customers that may be internally developed, acquired by us, or licensed from third parties. Our cost of licensing consists principally of amortization expenses associated with purchased intangible assets and intangible assets acquired in business combinations. Our cost of licensing also includes third-party royalty obligations paid to license intellectual property that we then sublicense to our customers. Licensing gross margin remained unchanged from the third quarter of fiscal 2011 to the third quarter of fiscal 2012, and from the fiscal year-to-date period ended July 1, 2011 to the fiscal year-to-date period ended June 29, 2012.

Products Gross Margin. Cost of products primarily consists of the cost of materials related to the products sold, applied labor, manufacturing overhead and, to a lesser extent, amortization of certain intangible assets. Our cost of products also includes third-party royalty obligations paid to license intellectual property that we then include in our products. Products gross margin increased from 28% to 34% from the third quarter of fiscal 2011 to the third quarter of fiscal 2012. This increase is primarily due to significant pricing promotions on 3D products in the third quarter of fiscal 2011 which did not recur in the third quarter of fiscal 2012. This was offset by the recognition of excess manufacturing capacity charges in the third quarter of fiscal 2012.

Products gross margin increased from 38% to 39% from the fiscal year-to-date period ended July 1, 2011 to the fiscal year-to-date period ended June 29, 2012. This increase was primarily due to a change in the mix of our product sales, as we recognized a greater proportion of revenue from digital cinema products and a lesser proportion of revenue from

3D products in the fiscal year-to-date period ended June 29, 2012.

Services Gross Margin. Cost of services primarily consists of compensation and benefits expenses for employees performing our professional services and the cost of outside consultants. Services gross margin decreased from 60% to 51% from the third quarter of fiscal 2011 to the third quarter of fiscal 2012 due to decreased revenues which were not fully offset by decreased costs.

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Services gross margin decreased from 65% to 58% from the fiscal year-to-date period ended July 1, 2011 to the fiscal year-to-date period ended June 29, 2012 due to the same reasons discussed above, as well as a decrease in virtual print fees, which had relatively higher gross margins.

Operating Expenses

	Fiscal Quarter Ended		Change		Fiscal Year-to-Date ended		Change	
	July 1, 2011	June 29, 2012	$	%	July 1, 2011	June 29, 2012	$	%
	($ in thousands)							
Research and development	$34,086	$35,123	$1,037	3 %	$90,812	$102,185	$11,373	13 %
Percentage of total revenue	16 %	17 %			13 %	15 %		
Sales and marketing	36,726	46,819	10,093	27 %	112,488	133,029	20,541	18 %
Percentage of total revenue	17 %	23 %			16 %	19 %		
General and administrative	32,397	36,859	4,462	14 %	104,594	109,605	5,011	5 %
Percentage of total revenue	15 %	18 %			15 %	16 %		
Restructuring charges, net	(48)	(85)	(37)	77 %	737	1,193	456	62 %
Percentage of total revenue	n/a	n/a			n/a	n/a		
	$103,161	$118,716	$15,555	15 %	$308,631	$346,012	$37,381	12 %

The fiscal periods presented herein include the 13 week periods ended July 1, 2011 and June 29, 2012, and the 40 week period ended July 1, 2011 and the 39 week period ended June 29, 2012.

Research and Development. Research and development expenses consist primarily of employee compensation and benefits expenses, including stock-based compensation, consulting and contract labor costs, depreciation and amortization expenses, facilities costs, and information technology expenses. The 3% increase in research and development expenses from the third quarter of fiscal 2011 to the third quarter of fiscal 2012 was primarily driven by increases in compensation and benefits expenses related to increased headcount, as well as higher facilities and related costs resulting from worldwide expansion. These increases were offset by prior year accelerated amortization due to a change in the estimated life of certain acquired intangible assets.

The 13% increase in research and development expenses from the fiscal year-to-date period ended July 1, 2011 to the fiscal year-to-date period ended June 29, 2012 was due to the same reasons discussed above.

Sales and Marketing. Sales and marketing expenses consist primarily of employee compensation and benefits expenses, including stock-based compensation, marketing and promotional expenses, travel-related expenses for our sales and marketing personnel, facilities costs, depreciation and amortization expenses, and information technology expenses. Sales and marketing expenses increased 27% from the third quarter of fiscal 2011 to the third quarter of fiscal 2012, driven primarily by higher consulting and marketing costs due to promotional events at the Dolby Theatre and to the launch of Atmos technology, our newest adaptive audio technology, increases in compensation and benefits expenses related to increased headcount, as well as facilities costs resulting from worldwide expansion. These increases were partially offset by increased settlements from implementation licensees in the third quarter of fiscal 2012. These settlements are recorded as an offset to sales and marketing expenses.

The 18% increase in sales and marketing expenses from the fiscal year-to-date period ended July 1, 2011 to the fiscal year-to-date period ended June 29, 2012 was driven primarily by increases in compensation and benefits expenses related to increased headcount, higher consulting and marketing costs, increased facilities costs resulting from worldwide expansion, and to a lesser extent, increases in stock-based compensation. Additionally, increased settlements from implementation licensees in fiscal 2012 partially offset the increases noted above. These settlements are recorded as an offset to sales and marketing expenses.

General and Administrative. General and administrative expenses consist primarily of employee compensation and benefits expenses, including stock-based compensation, depreciation, information technology expenses, and facilities costs. The 14% increase in general and administrative expenses from the third quarter of fiscal 2011 to the third quarter of fiscal 2012 was due primarily to the prior year release of $2.1 million of value-added tax reserves and related estimated penalties upon completion of our analysis of tax changes in the European Union. To a lesser extent, we also had increases in compensation and benefits expenses related to increased headcount and depreciation of property, plant and equipment due to IT projects, partially offset by decreases in stock-based compensation.

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The 5% increase in general and administrative expenses from the fiscal year-to-date period ended July 1, 2011 to the fiscal year-to-date period ended June 29, 2012 was due to the prior year release of value-added tax reserves and increases in compensation and benefits expenses related to increased headcount. Increases in professional services expenses were due to our options exchange program and acquisition and depreciation expenses related to implementation of recent IT projects. These were partially offset by decreases in consulting and external labor costs. In addition, increases in compensation and benefits expenses related to increased headcount were offset by a decrease in stock-based compensation expenses, due to recognition in the first quarter of fiscal 2011 of expense upon the accelerated vesting of equity awards granted to a former employee under a separation agreement.

Restructuring Charges, net. Restructuring charges for the third quarter of fiscal 2012 and the fiscal year-to-date period ended June 29, 2012 include severance and other associated costs attributable to the strategic restructuring program we initiated in the fourth quarter of fiscal 2011. For additional details, see Note 6 “Restructuring” to our condensed consolidated financial statements.

Other Income, Net

	Fiscal Quarter Ended		Change		Fiscal Year-to-Date ended		Change	
	July 1, 2011	June 29, 2012	$	%	July 1, 2011	June 29, 2012	$	%
	($ in thousands)							
Interest income	$1,670	$1,513	$(157)	(9)%	$5,237	$4,664	$(573)	(11)%
Interest expense	690	(26)	(716)	104%	322	(57)	(379)	118%
Other income, net	186	709	523	281%	875	969	94	11%
Total other income, net	$2,546	$2,196	$(350)	(14)%	$6,434	$5,576	$(858)	(13)%

Other income, net, primarily consists of interest income earned on cash, cash equivalents, and investments, as well as net gains/losses from foreign currency transactions.

Income Taxes

	Fiscal Quarter Ended		Fiscal Year-to-Date ended	
	July 1, 2011	June 29, 2012	July 1, 2011	June 29, 2012
	($ in thousands)			
Provision for income taxes	$28,404	$18,915	$92,717	$82,951
Effective tax rate	31%	27%	29%	28%

Our effective tax rate is based on a projection of our annual fiscal year results. Our effective tax rate was 31% and 27% for the third quarters of fiscal 2011 and fiscal 2012, respectively, and 29% and 28% for the fiscal year-to-date periods ended July 1, 2011 and June 29, 2012, respectively.

Our estimated fiscal year 2012 tax provision reflects additional benefits from our election to indefinitely reinvest a portion of our undistributed earnings in a foreign subsidiary. We also benefited from a reduction in the state apportionment percentage. These benefits were partially offset by the expiration of the federal research and development tax credits, effective from the first quarter of fiscal 2012, which resulted in an increase to our effective tax rate.

In the fiscal year-to-date period ended April 1, 2011, we completed the restructuring of our international operations, which resulted in the release of a deferred tax liability of $11.0 million related to the amortization of an intangible asset from a prior year acquisition, thereby lowering our effective tax rate for that period.

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Liquidity, Capital Resources, and Financial Condition

	September 30, 2011	June 29, 2012
	(in thousands)	
Cash and cash equivalents	$551,512	$670,408
Short-term investments	391,281	322,399
Long-term investments	272,797	295,950
Accounts receivable, net	61,815	46,034
Accounts payable and accrued liabilities	127,922	124,192
Working capital[a]	999,213	1,016,593

	July 1, 2011	June 29, 2012
	(in thousands)	
Net cash provided by operating activities	$294,159	$312,998
Capital expenditures [b]	(30,334)	(50,225)
Repurchase of common stock	(142,500)	(189,959)
Net cash used in investing activities	(139,783)	(17,621)
Net cash used in financing activities	(106,937)	(176,202)

[a] Working capital consists of total current assets less total current liabilities.
[b] Capital expenditures consist of purchases of office equipment, building fixtures, computer hardware and software, leasehold improvements, production and test equipment.

Our principal sources of liquidity are our cash, cash equivalents, and investments, as well as cash flows from operations. We believe that our cash, cash equivalents, and potential cash flows from operations will be sufficient to satisfy our currently anticipated cash requirements through at least the next 12 months.

In June 2012, we announced plans to purchase an approximately 354,000 square-foot building in San Francisco for approximately $109.8 million. The purchase was completed in July 2012 and settled in cash, and as such, no debt resulted from this transaction.

We have historically generated significant cash from our operations; however, there can be no assurance that our operations will continue to generate significant cash flows in the future. We retain sufficient cash holdings to support our operations and we also purchase investment grade securities diversified among security types, industries, and issuers. We have used cash generated from our operations to fund a variety of activities related to our business in addition to our ongoing operations, including business expansion and growth, acquisitions, and repurchases of our common stock. Cash provided by operations and the value of our investment portfolio could also be affected by various risks and uncertainties, as described in Part II, Item 1A “Risk Factors.”

Net cash provided by operating activities decreased $18.8 million from the fiscal year-to-date period ended July 1, 2011 to the fiscal year-to-date period ended June 29, 2012, primarily due to the following:

- The payment of significant fiscal 2010 performance bonuses in fiscal 2011, as bonuses related to fiscal 2010 were higher than subsequent periods;
- A decrease in the excess tax benefit in fiscal 2012 due to significant decreases in stock option exercises; partially offset by
- A decrease in net income.

Net cash provided by investing activities increased $122.2 million from the fiscal year-to-date period ended July 1, 2011 to the fiscal year-to-date period ended June 29, 2012, primarily due to the following:

- A decrease in purchases of available-for-sale securities;
- An increase in proceeds from the sales and maturities of available-for-sale securities; offset by
- An increase in capital expenditures due to significant worldwide expansion in fiscal 2012.

Net cash used in financing activities increased $69.3 million from the fiscal year-to-date period ended July 1, 2011 to the fiscal year-to-date period ended June 29, 2012, primarily due to the following:

- An increase in share repurchases of our Class A common stock; partially offset by
- A decrease in net proceeds from the exercise of stock options and the related tax benefit.

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Off-Balance-Sheet and Contractual Obligations

Our liquidity is not dependent on the use of off-balance sheet financing arrangements.

Other than the naming and other rights discussed in Note 9, "Commitments and Contingencies", and Note 12, "Subsequent Events", there has been no material change in our contractual obligations outside the ordinary course of business since the end of our last fiscal year on September 30, 2011. For additional details regarding our contractual obligations, see Note 9 “Commitments and Contingencies” to our condensed consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Sensitivity

We had cash, cash equivalents, and marketable securities totaling approximately $1.3 billion at June 29, 2012. This amount was invested primarily in money market funds, corporate notes and bonds, municipal debt securities, and U.S. agency securities. Our investment policy and strategy are focused on the preservation of capital and on supporting our liquidity requirements. We do not enter into investments for trading or speculative purposes, nor do we use leveraged financial instruments. Our holdings of cash and cash equivalents and marketable securities, the majority of which are managed by external managers, meet the guidelines of our investment policy. We invest in highly rated securities with a minimum credit rating of A- and our policy limits the amount of credit exposure to any one issuer other than the U.S. government. At June 29, 2012, our weighted-average portfolio credit quality was AA- and the weighted-average duration of our investment portfolio was less than one year.

Our fixed-income portfolio is subject to fluctuations in interest rates, which could affect our financial position, and to a lesser extent, results of operations. Based on our investment portfolio balance as of June 29, 2012, a hypothetical change in interest rates of 1% would have approximately a $5.7 million impact, and a change of 0.5% would have approximately a $2.8 million impact on the carrying value of our portfolio.

Foreign Currency Exchange Risk

We maintain sales, marketing, and business operations in foreign countries, most significantly in the United Kingdom, Australia, China, the Netherlands, and Germany. We also conduct a growing portion of our business outside of the U.S. through subsidiaries with functional currencies other than the U.S. dollar (primarily British Pound, Australian Dollar, Chinese Yuan Renminbi, and Euro). As a result, we face exposure to adverse movements in currency exchange rates as the financial results of our international operations are translated from local currency into U.S. dollars upon consolidation. Most of our revenue from international markets is denominated in U.S. dollars, while the operating expenses of our international subsidiaries are predominantly denominated in local currency. Therefore, if the U.S. dollar weakens against the local currency, we will have increased operating expenses, which will only be partially offset by net revenue. Conversely, if the U.S. dollar strengthens against the local currency, operating expenses will decrease, which will only be partially offset by net revenue. Additionally, foreign exchange rate fluctuations on transactions denominated in currencies other than the functional currency result in gains or losses that are reflected in our condensed consolidated statements of operations. Our international operations are subject to risks typical of international business, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions, and foreign exchange rate volatility.

We enter into foreign currency forward contracts to hedge against assets and liabilities for which we have foreign currency exchange rate exposure, in an effort to reduce the risk that our earnings will be adversely affected by foreign currency exchange rate fluctuations. These derivative instruments are carried at fair value with changes in the fair value recorded to other income, net, in our condensed consolidated statements of operations. Our foreign currency forward contracts which are not designated as hedging instruments are used to reduce the exchange rate risk associated primarily with intercompany receivables and payables. These contracts do not subject us to material balance sheet risk due to exchange rate movements because gains and losses on these derivatives are intended to offset gains and losses on the related receivables and payables for which we have foreign currency exchange rate exposure. As of September 30, 2011 and June 29, 2012, the outstanding derivative instruments had maturities of 30 days or less and the total notional amounts of outstanding contracts were $4.7 million and $4.9 million, respectively. The fair values of these contracts were nominal as of September 30, 2011 and June 29, 2012, and were included in prepaids

and other current assets and accrued liabilities in our condensed consolidated balance sheets.
A sensitivity analysis was performed on all of our foreign currency forward contracts as of June 29, 2012. This sensitivity analysis was based on a modeling technique that measures the hypothetical market value resulting from a 10% shift in the value of exchange rates relative to the U.S. dollar. For these forward contracts, duration modeling was used where hypothetical changes are made to the spot rates of the currency. A 10% increase in the value of the U.S. dollar would lead to an increase in

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the fair value of our financial instruments by $0.1 million. Conversely, a 10% decrease in the value of the U.S. dollar would result in a decrease in the fair value of these financial instruments by $0.1 million.

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ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain “disclosure controls and procedures,” as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Subject to the limitations noted above, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the fiscal period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, our disclosure controls and procedures were effective to meet the objective for which they were designed and operate at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the fiscal quarter ended June 29, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II – OTHER INFORMATION
ITEM 1. LEGAL PROCEEDINGS

We are involved in various legal proceedings from time to time arising from the normal course of business activities, including claims of alleged infringement of intellectual property rights, commercial, employment, and other matters. In our opinion, resolution of these proceedings is not expected to have a material adverse effect on our operating results or financial condition. However, it is possible that an unfavorable resolution of one or more such proceedings could materially affect our future operating results or financial condition in a particular period.

ITEM 1A. RISK FACTORS

The following risk factors and other information included in this Quarterly Report on Form 10-Q should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we presently deem less significant may also impair our business operations. If any of the following risks actually occurs, our business, operating results, and financial condition could be materially adversely affected.

We depend on the sale by our licensees of products that incorporate our technologies and any reduction in those sales would adversely affect our licensing revenue.

Licensing revenue constitutes the majority of our total revenue, representing 77%, 83%, and 86% in fiscal 2010, 2011, and the fiscal year-to-date period ended June 29, 2012, respectively. We do not manufacture consumer entertainment products ourselves and we depend on licensees and customers, including software vendors and original equipment manufacturers (“OEM”), to incorporate our technologies into their products.

Although we have license agreements with many of these companies, these agreements do not have minimum purchase commitments, are non-exclusive, and do not generally require incorporation or use of our technologies. Accordingly, our revenue will decline if our licensees choose not to incorporate our technologies in their products, or if they sell fewer products incorporating our technologies, or if they otherwise face significant economic difficulties. Changes in consumer tastes or trends, rapidly evolving technology, competing products, changes in industry standards or adverse changes in business and economic conditions, among other things, may result in lower sales of products incorporating our technologies which would adversely affect our licensing revenue.

We also face the risk that our licensees retain product channel inventory levels that exceed future anticipated sales. If such product sales do not occur in the time frame anticipated by our licensees for any reason, these licensees may substantially decrease the number of technologies they license from us in subsequent periods.

To the extent that sales of PCs with Dolby technologies decline, our licensing revenue will be adversely affected.

Revenue from our PC market depends on several factors, including underlying PC unit shipment growth, the extent to which our technologies are included on computers, through operating systems, independent software vendors (“ISV”) media applications, or otherwise, and the terms of any royalties or other payments we receive from licensors of such software. In the short term, we face many risks in the PC market that may affect our ability to successfully participate in that market, including, but not limited to the following:

- Purchasing trends away from traditional PCs and toward computing devices without optical disc drives, such as ultrabooks and tablets, which may not include our technologies;
- The availability and market attractiveness of PC software that includes our technologies on an unauthorized and infringing basis, for which we receive no royalty payments; and
- Continued decreasing inclusion of ISV media applications by PC OEMs in their Windows 7- based PCs, as Windows 7 already incorporates DVD playback software.

In May 2012, we entered into an agreement with Microsoft relating to the inclusion of Dolby Digital Plus decoding and Dolby Digital Consumer Encoder in the Windows 8 operating system. There are no assurances that we will derive as much licensing revenue under this model as we did under our prior licensing arrangements with Microsoft. The ultimate financial impact of these licensing arrangements for Windows 8 on our licensing revenue is subject to various risks, including:

- The extent and rate at which Windows 8 is adopted in the marketplace;
- The extent to which OEMs include optical disc playback in Windows 8 devices;
- The extent to which earlier versions of Microsoft operating systems, including Windows 7, continue to be

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licensed after the release of Windows 8;

- Our ability to establish and extend licensing relationships directly with PC OEMs and ISVs;
- The rate at which entertainment content shifts from optical disc media to online media, thus reducing the need for PCs to have optical disc drives and DVD and Blu-ray Disc software players; and
- Our ability to extend the adoption of our technologies to online and mobile platforms and devices.

Any of these risks could adversely affect our licensing revenue.

General economic conditions may reduce our revenue and harm our business.

We continue to be cautious regarding future general economic conditions and their potential for suppressed consumer demand in the markets in which we license our technologies and sell our products. Our business could be affected by adverse changes in general economic conditions, because many of the products in which our technologies are incorporated are discretionary goods, such as PCs, digital televisions, set-top boxes, DVD players and recorders, Blu-ray Disc players, video game consoles, audio/video receivers, mobile devices, in-car entertainment systems, home-theater-in-a-box systems, camcorders, and portable media devices. The global economic environment has adversely affected consumer confidence, disposable income, and spending. While we cannot predict future general economic conditions, these conditions may persist or worsen.

Furthermore, continued weakness in general economic conditions may result in a greater likelihood that more of our licensees and customers will become delinquent on their obligations to us or be unable to pay, which in turn could result in a higher level of write-offs. Additionally, such economic conditions may result in increased underreporting and non-reporting of royalty-bearing revenue by our licensees as well as increased unauthorized use of our technologies, all of which would adversely affect our revenues.

Our future success depends upon the growth of new and existing markets for our technologies and our ability to develop and adapt our technologies for those markets.

The future growth of our licensing revenue will depend, in part, upon the growth of, and our successful participation in, new and existing markets for our technologies, such as digital broadcast, online and mobile media distribution, consumer video and voice. For example, growth of our broadcast revenue is dependent upon continued global growth of digital television broadcasting and the adoption of our technologies into emerging digital broadcast standards. In addition, our revenue is dependent upon the growth of the PC market and the continued adoption of our technologies into PCs as well as the adoption of our technologies into connected portable devices such as tablets and smartphones. Furthermore, our ability to drive OEM demand for our technologies depends in part on whether or not we are able to successfully participate in the online and mobile content delivery markets.

Our ability to penetrate new and existing markets for our technologies depends on increased consumer demand for products that contain our technologies, which may not occur. Some of these markets are ones in which we have not previously participated or have limited experience, such as voice and consumer video, and we may not adequately adapt our business and our technologies to consumer demand.

If new and existing markets for our technologies do not develop or consumer demand for products that contain our technologies does not grow, our business and prospects would be materially adversely affected.

If we do not continue to develop and deliver innovative technologies in response to industry and technology changes, our business could decline.

The markets for our technologies and products are defined by:

- Rapid technological change;
- New and improved technology and product introductions;
- Changing consumer and licensee demands;
- Evolving industry standards; and
- Technology and product obsolescence.

Our future success depends on our ability to enhance our existing technologies and products and to develop acceptable new technologies and products that address the needs of the market in a timely manner. The development of enhanced and new technologies and products is a complex and uncertain process requiring high levels of innovation, highly-skilled engineering and development personnel, and the accurate anticipation of technological and market trends. We may not be able to identify, develop, acquire, market, or support new or enhanced technologies or products on a timely basis, if at all. For example, while

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we view the continued advancements in online and mobile media content delivery as an area of opportunity, if we are not able to competitively address the needs of the changing online and mobile markets, our ability to generate revenue from those markets would be limited. At times such changes can be dramatic, such as the shift from VHS tapes to DVDs for consumer playback of movies in homes and elsewhere.

We face many risks related to the 3D cinema market.

We face many risks in the 3D cinema market which may affect our ability to successfully participate in that market, including, but not limited to the following:

- We face risks that our customers maintain excess product inventory levels which could reduce future anticipated sales;
- At least one of our competitors has exclusive licensing arrangements for 3D products with theater exhibitors, which has in the past and we expect will in the future restrict our ability to compete in the 3D market;
- The 3D market has become increasingly competitive and we may lose further market share;
- With the industry transition to 3D enabled screens substantially complete, demand for new 3D enabled screens has dropped significantly and the industry has entered into a replacement cycle;
- Industry participants may perceive our up-front 3D equipment costs and reusable glasses business model or our 3D products as less attractive;
- Our participation in the 3D cinema market will be limited to the extent theaters do not convert from analog to digital cinema;
- Demand for our 3D cinema products is driven by the number of 3D cinema releases and the commercial success of those releases;
- Our 3D glasses could become subject to regulation in the U.S. and other countries in the future, which could restrict how our 3D glasses are manufactured, used, or marketed; and
- There has been increased public scrutiny of potential health risks relating to viewing 3D movies. If these potential health risks are substantiated, the popularity of 3D movies could decline. In addition, if health risks associated with our 3D products materialize, we may become subject to government regulation or product liability claims, including personal injury claims.

If we are unable to manage these risks effectively, our ability to compete profitably in the 3D cinema market may be adversely affected.

Events and conditions in the cinema and broadcast industries may affect sales of our cinema products and other services.

Sales of our cinema products and services tend to fluctuate based on the underlying trends in the cinema industry. For example, when box office receipts for the cinema industry increase, we have typically seen a corresponding increase in sales of our cinema products, as cinema owners will be more likely to build new theaters and upgrade existing theaters with our more advanced products. Conversely, when box office receipts are down, cinema owners tend to scale back on plans to expand or upgrade their systems.

Our cinema product sales are also subject to fluctuations based on events and conditions in the cinema industry generally that may or may not be tied to box office receipts in particular time periods. For example, the growth in piracy of motion pictures adversely affects the construction of new screens, the renovation of existing theaters, and the continued production of new motion pictures.

Our services revenue, both in the U.S. and internationally, is tied to the number of movies being produced and distributed by studios and independent filmmakers. A number of factors can affect the number of movies that are produced, including strikes and work stoppages within the cinema industry, as well as tax incentive arrangements provided by many governments to promote local filmmaking. Services revenue is also impacted by the transition to digital cinema in some regions. For example, the 17% decrease in services revenue from the third quarter of fiscal 2011 to the third quarter of fiscal 2012 was attributable primarily to a decrease in film-based production services revenue in the U.S. as the cinema industry transitions to digital cinema.

The demand for our cinema products and services could decline as the cinema industry adopts digital cinema.

As cinema exhibitors have constructed new theaters or upgraded existing theaters, they have generally chosen digital cinema over traditional film cinema and we expect this trend to continue. Digital cinema, which is based on open standards, does not include our proprietary audio technologies. As the cinema industry continues to adopt digital cinema, the demand for our traditional film cinema products and services has declined significantly and we anticipate that the demand for film based products will decline in future periods. Furthermore, exhibitors adopting digital cinema can choose from multiple digital cinema playback servers and audio processors, many of which may not contain our technologies, and our competitive position

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in the digital cinema market is not as strong as our position in the traditional film cinema market. Decreases in demand for our traditional film cinema products and services accompanied by decreases in revenue from digital cinema products and services would adversely affect our revenue stream from the cinema industry.

A decrease in demand for our cinema products and services could adversely affect our consumer products licensing business.

A decrease in the demand for our cinema products and services could adversely affect licensing of our consumer technologies, because the strength of our brand and our ability to use professional product developments to introduce new technologies, which can later be licensed to OEMs and service providers, would be impaired. If, in such circumstances, we are unable to adapt our products and services or introduce new products for the digital cinema market successfully, our business could be materially adversely affected.

We face risks relating to the online and mobile content delivery markets and declines in optical disc media.

For nearly 20 years, movies have been distributed, purchased, and consumed through optical disc media, such as DVD and more recently Blu-ray Disc. However, the growth of the Internet and home computer usage, connected televisions, set-top boxes, tablets, smartphones, and other devices accompanied by the rapid advancement of online and mobile content delivery has resulted in the recent trend to movie download and streaming services in various parts of the world. We expect a further shift away from optical disc media to online and mobile media content consumption, which will result in declines in revenue from DVD and Blu-ray Disc players. Such declines would adversely affect our licensing revenue.

In addition, online and mobile media content services that compete with or replace DVD and Blu-ray Disc players as dominant media for consumer video entertainment may choose not to encode their content with our proprietary technologies, which could affect OEM and software vendor demand for our decoding technologies. Furthermore, our participation in online media content playback may be less profitable for us than DVD and Blu-ray Disc players. The online and mobile markets are characterized by intense competition, evolving industry standards and business and distribution models, disruptive software and hardware technology developments, frequent new product and service introductions, short product and service life cycles, and price sensitivity on the part of consumers, all of which may result in downward pressure on pricing. Any of the foregoing could adversely affect our business and operating results.

Our operating results may fluctuate depending upon the timing of when we receive royalty reports from our licensees, royalty report adjustments, and the satisfaction of our revenue recognition criteria.

Our quarterly operating results fluctuate based on the risks set forth in this section, as well as on:

- The timing of when we receive royalty reports from our licensees and when we have met all revenue recognition criteria;
- Royalty reports including positive or negative corrective adjustments;
- Retroactive royalties that cover extended periods of time;
- The recognition of unusually large amounts of licensing revenue from licensees in any given quarter because not all of our revenue recognition criteria were met in prior periods; and
- The recognition of large amounts of products and services revenue in any given quarter because not all of our revenue recognition criteria were met in prior periods.

This can result in the recognition of a large amount of revenue in a given quarter that is not necessarily indicative of the amounts of revenue to be received in future quarters, thus causing fluctuations in our operating results.

Inaccurate licensee royalty reporting could materially adversely affect our operating results.

We generate licensing revenue primarily from OEMs and software vendors who license our technologies and incorporate those technologies in their products. Our license agreements generally obligate our licensees to pay us a specified royalty for every product they ship that incorporates our technologies, and we rely on our licensees to accurately report their shipments. However, we have difficulty independently determining whether or not our licensees are reporting shipments accurately, particularly with respect to software incorporating our technologies because unauthorized copies of such software can be made relatively easily. Most of our license agreements permit us to audit our licensees' records, but audits are generally expensive, time consuming, and potentially detrimental to our

ongoing business relationships with our licensees.
In the past, licensees, particularly in emerging economies, such as China, have understated or failed to report the number of products incorporating our technologies that they shipped, and we have not been able to collect and recognize revenue to which we were entitled. We expect that we will continue to experience understatement and non-reporting of royalties by our

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licensees, which could adversely affect our operating results. Conversely, to the extent that our licensees overstate the number of products incorporating our technologies, or report the products under the wrong categories, corrections of prior reports could result in reductions of royalty revenue in subsequent periods, which could also adversely affect our operating results.

Third parties from whom we license technologies may challenge our calculation of the royalties we owe them for inclusion of their technologies in our products and licensed technologies, which could adversely affect our operating results, business, and prospects.

In some cases, the products we sell and the technologies we license to our customers include intellectual property that we have licensed from third parties. Our agreements with these third parties generally require us to pay them royalties for that use, and give the third parties the right to audit our calculation of those royalties. A third party may disagree with our interpretation of the terms of a license agreement or, as a result of an audit, a third party could challenge the accuracy of our calculation. We have in the past been, and may in the future be, involved in disputes with third-party technology licensors regarding license terms.

A successful challenge by a third party could result in the termination of a license agreement or increase the amount of royalties we have to pay to the third party, which would decrease our gross margin and adversely affect our operating results.

Unauthorized use of our intellectual property could materially adversely affect our operating results.

We have often experienced, and expect to continue to experience, problems with non-licensee OEMs and software vendors, particularly in emerging economies, such as China, incorporating our technologies and trademarks into their products without our authorization and without paying us any licensing fees. Manufacturers of integrated circuits, or ICs, containing our technologies occasionally sell these ICs to third parties who are not our system licensees. These sales, and the failure of such manufacturers to report the sales, facilitate the unauthorized use of our intellectual property. As emerging economies transition from analog to digital content, such as the transition from analog to digital broadcast, we expect to experience increased problems with this form of piracy, which would adversely affect our operating results.

We have limited experience in non-sound technology markets which could limit our future growth.

Our future growth will depend, in part, upon our expansion into areas beyond sound technologies. For example, in addition to our digital cinema and 3D digital cinema initiatives, we are exploring other areas that facilitate delivery of digital entertainment, such as video solutions for the consumer market. We will need to spend considerable resources in the future on research and development or acquisitions in order to deliver innovative non-sound products and technologies. However, we have limited experience in non-sound technology markets and, despite our efforts, non-sound products, technologies, and services we expect to develop or acquire and market may not achieve or sustain market acceptance, may not meet industry needs, and may not be accepted as industry standards. If we are unsuccessful in selling non-sound products, technologies, and services, the future growth of our business may be limited.

If our products and technologies are not adopted as industry standards, our business prospects could be limited and our operating results could be adversely affected.

The entertainment industry depends upon industry standards to ensure compatibility across delivery platforms and a wide variety of consumer entertainment products. Accordingly, we make significant efforts to design our products and technologies to address capability, quality, and cost considerations so that they either meet, or, more importantly, are adopted as, industry standards across the broad range of entertainment industry markets in which we participate, as well as the markets in which we hope to compete in the future. To have our products and technologies adopted as industry standards, we must convince a broad spectrum of standards-setting organizations throughout the world, as well as our major customers and licensees who are members of such organizations, to adopt them as such and to ensure that other industry standards are consistent with our products and technologies. If our technologies are not adopted or do not remain as industry standards, our business, operating results, and prospects could be materially and adversely affected.

Additionally, the market for broadcast technologies has traditionally been heavily based on industry standards, often set by governments or other standards-setting organizations, and we expect this to be the case in the future. If our technologies are not chosen as industry standards for broadcasting in particular geographic areas, this could adversely affect our ability to compete in these markets.

It may be more difficult for us, in the future, to have our technologies adopted as individual industry standards to the extent that entertainment industry participants collaborate on the development of industry standard technologies. Standards-setting organizations are increasingly adopting or establishing technology standards for use in a wide range of consumer entertainment products. As a result, it is more difficult for individual companies to have their technologies adopted

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wholesale as an informal industry standard. We call this type of standard a "de facto" industry standard, meaning that the industry has widely adopted the technology, although no industry standards-setting organization has explicitly mandated such standard. Increasingly there are multiple companies, including ones that typically compete against one another, involved in the development of new technologies for use in entertainment-oriented products. As a result, these companies often license their collective intellectual property rights as a group, making it more difficult for any single company to have its technologies adopted widely as a de facto industry standard or to have its technologies adopted as an exclusive, explicit industry standard for consumer entertainment products.

Even if our technologies are adopted as an explicit industry standard for a particular market, market participants may not widely adopt our technologies.

Even when a standards-setting organization mandates our technologies for a particular market, which we call an "explicit" industry standard, our technologies may not be the sole technologies adopted for that market as an explicit industry standard. Accordingly, our operating results depend upon participants in that market choosing to adopt our technologies instead of competitive technologies that also may be acceptable under such standard. For example, the continued growth of our revenue from the broadcast market will depend upon both the continued global adoption of digital television generally and the choice to use our technologies where it is one of several accepted industry standards.

If we do not obtain new patents or proprietary technologies as our existing patents expire, our licensing revenue could decline.

We hold patents covering much of the technologies that we license to system licensees, and our licensing revenue is tied in large part to the life of those patents. Our right to receive royalties related to our patents terminates with the expiration of the last patent covering the relevant technologies in a particular country. Accordingly, to the extent that we do not replace licensing revenue from technologies covered by expiring patents with licensing revenue based on new patents and proprietary technologies, our revenue could decline.

As of June 29, 2012, we had nearly 2,700 individual issued patents and over 2,500 pending patent applications in over 90 jurisdictions throughout the world. Our issued patents are scheduled to expire at various times through November 2032. Of these, 3 patents are scheduled to expire in the remainder of calendar year 2012, 30 patents are scheduled to expire in calendar year 2013 and 91 patents are scheduled to expire in calendar year 2014. Patents relating to our Dolby Digital technologies, from which we principally derive our licensing revenue, have begun to expire and the remaining patents relating to this technology generally expire between now and 2017. Additional patents relating to our Dolby Digital Plus technologies, an extension of Dolby Digital, expire between 2018 and 2026. In addition, the remaining patents relating to Dolby Digital Live technologies, an extension of Dolby Digital, are scheduled to expire between now and 2021.

The markets for our technologies are highly competitive, and if we are unable to compete successfully, our business will suffer.

The markets for entertainment industry technologies are highly competitive, and we face competitive threats and pricing pressure in our markets. Competitors for our licensed technologies include: Audyssey Laboratories, DTS, Fraunhofer Institute for Integrated Circuits, Microsoft, Monster Cable Products, Philips, RealNetworks, Sony, SRS Labs, Technicolor, and Waves Audio. Competitors for our products include: Barco, Doremi, GDC, IMAX, MasterImage 3D, NEC, Panavision, QSC Audio Products, Qube Cinema, REALD, Rovi, Sony, Technicolor, USL, and XpanD. Competitors for our services include DTS and Sony. Consumers may perceive the quality of the audio experience produced by some of our competitors' technologies to be equivalent or superior to the audio experience produced by our technologies. Other companies may become competitors in one or more of these areas in the future. Additionally, some of our current or future competitors may have significantly greater financial, technical, marketing, and other resources than we do, or may have more experience or advantages in the markets in which they compete, particularly in the market for online media content. These competitors may also be able to offer integrated system solutions in markets for sound or non-sound entertainment technologies on a royalty-free basis or at a lower price than our technologies, including audio, video, and rights management technologies related to PCs or the Internet, which could make competing technologies that we develop unnecessary.

Our business and prospects depend on the strength of our brand, and if we do not maintain and strengthen our brand, our business will be materially harmed.

Maintaining and strengthening the Dolby brand is critical to maintaining and expanding our licensing, products, and services business, as well as to our ability to enter new markets for our sound and other technologies. Our continued success depends, in part, on our reputation for providing high quality technologies, products, and services across a wide range of

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entertainment markets, including the CE, PC, broadcast, and gaming markets. If we fail to promote and maintain the Dolby brand successfully in licensing, products or services, our business and prospects will suffer. Furthermore, we believe that the strength of our brand may affect the likelihood that our technologies are adopted as industry standards in various markets and for various applications. Our ability to maintain and strengthen our brand will depend heavily on our ability to develop innovative technologies for the entertainment industry, to successfully enter into new markets, and to provide high quality products and services in these new markets, which we may not do successfully.

Our licensing of industry standard technologies can be subject to restrictions that could adversely affect our business and prospects.

When a standards-setting organization mandates our technologies as explicit industry standards, we generally must agree to license such technologies on a fair, reasonable, and non-discriminatory basis, which could limit our control over the use of these technologies. In these situations, we must often limit the royalty rates we charge for these technologies, which could adversely affect our revenue. Furthermore, we may be unable to limit to whom we license such technologies, and may be unable to restrict many terms of the license.

We have in the past, and may in the future, be subject to claims that our licensing of industry standard technologies may not conform to the requirements of the standards-setting organization. Allegations such as these could be asserted in private actions seeking monetary damages and injunctive relief, or in regulatory actions. Claimants in such cases could seek to restrict or change our licensing practices or our ability to license our technologies in ways that could injure our reputation and otherwise materially and adversely affect our business, operating results, and prospects.

We face risks in conducting business in China and other emerging economies.

We believe that various trends will increase our exposure to the risks of conducting business in emerging economies. For example, we expect the number of OEMs in emerging economies, such as China, to increase due to the availability of lower manufacturing costs as compared to those of other industrial countries and the continued industry shift by retailers towards lower end DVD and more recently Blu-ray Disc player and television offerings. We have seen OEMs shift product manufacturing to these lower cost manufacturing countries and expect more OEMs to do so in the future. We also believe that our sales of products and services in emerging economies will expand in the future to the extent that the use of digital surround sound technologies increases in these countries, including in movies and broadcast television, and as consumers there become more affluent. We face many risks associated with operating in these emerging economies, in large part due to limited recognition and enforcement of contractual and intellectual property rights. As a result, we may experience difficulties in enforcing our intellectual property rights in these emerging economies, where intellectual property rights are not as respected as they are in the U.S., Japan, and Europe. We believe that it is critical that we strengthen existing relationships and develop new relationships with entertainment industry participants worldwide to increase our ability to enforce our intellectual property and contractual rights without relying solely on the legal systems in the countries in which we operate. If we are unable to develop, maintain, and strengthen these relationships, our revenue from these countries could be adversely affected.

We have limited or no patent protection for some of our technologies in particular countries, including China, Taiwan, and India, which could limit our ability to grow our business in these markets.

In China and Taiwan we have only limited patent protection, especially with respect to our Dolby Digital technologies. In India, we have no issued patents for Dolby Digital technologies. Consequently, maintaining or growing our licensing revenue will depend on our ability to obtain patent rights in these countries for existing and new technologies, which is uncertain. Furthermore, because of the limitations of the legal systems in many countries, the effectiveness of patents obtained or that may in the future be obtained, if any, is likewise uncertain.

Our licensing revenue depends in large part upon semiconductor manufacturers incorporating our technologies into integrated circuits.

Our licensing revenue from system licensees depends in large part upon the availability of ICs that implement our technologies. IC manufacturers incorporate our technologies into these ICs, which are then incorporated in consumer entertainment products. We do not manufacture these ICs, but rather depend on IC manufacturers to develop, produce, and then sell them to system licensees. We do not control the IC manufacturers’ decisions whether or not to incorporate our technologies into their ICs, and we do not control their product development or commercialization efforts nor predict their success. As a result, if these IC manufacturers are unable or unwilling, for any reason, to implement our technologies into their ICs, or if, for any reason, they sell fewer ICs incorporating our technologies, our operating results will be adversely affected.

Pricing pressures on the system licensees who incorporate our technologies into their products could limit the licensing fees we charge for our technologies, which could adversely affect our revenue.

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The markets for the consumer entertainment products in which our technologies are incorporated are intensely competitive and price sensitive. We expect to face increased royalty pricing pressure for our technologies as we seek to drive the adoption of our technologies into online content and portable devices, such as tablets and smart phones. Retail prices for consumer entertainment products that include our sound technologies, such as DVD players and home theater systems, have decreased significantly, and we expect prices to decrease for the foreseeable future. In response, OEMs have sought to reduce their product costs, which can result in downward pressure on the licensing fees we charge our customers who incorporate our technologies into the consumer entertainment products that they sell. Furthermore, while we have contractual rights with many of our licensees for cost of living adjustments to our royalty rights, we may not be able to negotiate those terms in our contracts with existing and new licensees. Additionally, downward cost of living adjustments would result in declines in the licensing fees that we charge. A decline in, or the modification or loss of the contractual right to increase, the licensing fees we charge could materially and adversely affect our operating results.

We have in the past, and may in the future be, subject to legal claims related to our intellectual property rights, which are costly to defend, could require us to pay damages, and could limit our ability to use particular technologies in the future.

Companies in the technology and entertainment industries own large numbers of patents, copyrights, trademarks, and trade secrets and frequently enter into litigation based on allegations of infringement or other violations of intellectual property rights. We have faced such claims in the past and we expect to face similar claims in the future.

Any intellectual property claims, with or without merit, could be time consuming, expensive to litigate or settle, and could divert management resources and attention. In the past we have settled claims relating to infringement allegations and agreed to make payments in connection with such settlements. We expect that similar claims will be asserted against us in the future in the ordinary course of our business. An adverse determination in any intellectual property claim could require that we pay damages or stop using technologies found to be in violation of a third party's rights and could prevent us from offering our products and services to others. In order to avoid these restrictions, we may have to seek a license for the technology, which may not be available on reasonable terms or at all. Any license could also require us to pay significant royalties, and may significantly increase our operating expenses. As a result, we may be required to develop alternative non-infringing technologies, which could require significant effort and expense. If we cannot license or develop technologies for any aspects of our business found to be infringing, we may be forced to limit our product and service offerings and may be unable to compete effectively.

In some instances, we have contractually agreed to provide indemnifications to licensees relating to our intellectual property. Additionally, at times in the past, we have chosen to defend our licensees from third-party intellectual property infringement claims even where such defense was not contractually required, and we may choose to take on such defense in the future. Any of these results could harm our brand, our operating results, and our financial condition.

We have in the past and may in the future have disputes with our licensees regarding our licensing arrangements.

At times, we are engaged in disputes regarding the licensing of our intellectual property rights, including matters related to our royalty rates and other terms of our licensing arrangements. These types of disputes can be asserted by our customers or prospective customers or by other third parties as part of negotiations with us or in private actions seeking monetary damages or injunctive relief, or in regulatory actions. In the past, licensees have threatened to initiate litigation against us regarding our licensing royalty rate practices including our adherence to licensing on fair, reasonable, and non-discriminatory terms and potential antitrust claims. Damages and requests for injunctive relief asserted in claims like these could be material, and could be disruptive to our business. Any disputes with our customers or potential customers or other third parties could adversely affect our business, results of operations, and prospects.

We face risks relating to the transition to digital cinema.

We face a number of risks relating to the transition to digital cinema, including:

- Exhibitors may perceive competing products to be potentially advantageous to our products or they may choose lower priced competing products or competing products with different features, such as support for high frame rate content or 4K presentation;

- If we encounter delays in the development of our 4K digital cinema or high frame rate content solutions or if we are unable to provide a solution with a market competitive feature set, price, or compliance with DCI specifications, our results of operations could be adversely affected;
- At least one of our competitors has a significantly greater installed base of its digital cinema servers than we do which has and likely will continue to limit our share of the digital cinema market, particularly in the U.S. market;
- Pricing and other competitive pressures have caused us to implement pricing strategies which have had an adverse

effect on our products gross margins;

- As the industry transition to digital cinema becomes substantially complete, the demand for new digital cinema screens will drop significantly and the industry will enter into a replacement cycle.

These and other risks related to digital cinema could limit our future prospects in digital cinema and could materially and adversely affect our operating results.

Acquisition activities could result in operating difficulties and other harmful consequences.

We have evaluated, and expect to continue to evaluate, a wide array of possible strategic transactions, including acquisitions. We consider these types of transactions in connection with our efforts to expand our business beyond sound technologies. Although we cannot predict whether or not we will complete any such acquisition or other transactions in the future, any of these transactions could be material in relation to our market capitalization, financial condition, or results of operations. The process of integrating an acquired company, business, or technology may create unforeseen difficulties and expenditures. Foreign acquisitions involve unique risks in addition to those mentioned above, including those related to integration of operations across different geographies, cultures, and languages, currency risks, and risks associated with the particular economic, political, and regulatory environment in specific countries. Also, the anticipated benefit of our acquisitions may not materialize.

We face various risks in integrating acquired businesses, including:

- Diversion of management time and focus from operating our business to acquisition integration challenges;
- Cultural and logistical challenges associated with integrating employees from acquired businesses into our organization;
- Retaining employees from businesses we acquire;
- The need to implement or improve internal controls, procedures, and policies appropriate for a public company at businesses that prior to the acquisition may have lacked effective controls, procedures, and policies;
- Possible write-offs or impairment charges resulting from acquisitions;
- Unanticipated or unknown liabilities relating to acquired businesses; and
- The need to integrate acquired businesses' accounting, management information, manufacturing, human resources, and other administrative systems to permit effective management.

Furthermore, acquisitions may have an adverse impact on our financial condition and results of operations, including a potential adverse impact on our gross margins.

Future acquisitions could result in the need to obtain financing on unfavorable terms, including dilutive equity issuances.

Future acquisitions could result in potentially dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities, amortization expenses, and write-offs of goodwill, any of which could harm our operating results or financial condition. Future acquisitions may also require us to obtain additional equity or debt financing, which may not be available on favorable terms or at all.

We are dependent upon our relationships within the entertainment industry, and the failure to maintain such relationships could materially harm our business.

If we fail to maintain and expand our relationships with a broad range of entertainment industry participants, including film studios, broadcasters, video game designers, music producers, mobile media content producers, and OEMs, our business and prospects could be materially harmed. Relationships have historically played an important role in the entertainment markets that we serve. For example, sales of our products and services are particularly dependent upon our relationships with the major film studios and broadcasters, and licensing of our technologies is particularly dependent upon our relationships with system licensees, software vendors, and IC manufacturers. If we fail to maintain and strengthen these relationships, these entertainment industry participants may be less likely to purchase and use our technologies, products, and services, or create content incorporating our technologies, which could materially harm our business and prospects. Additionally, if major entertainment industry participants form strategic relationships that exclude us, whether in licensing, products, or services, our business and prospects could be materially adversely affected.

We face diverse risks in our international business, which could adversely affect our operating results.

We are dependent on international sales for a substantial amount of our total revenue. For fiscal 2010, 2011, and the fiscal year-to-date period ended June 29, 2012, revenue from outside the U.S. was 66%, 68%, and 67% of our total revenue,

respectively. We expect that international and export sales will continue to represent a substantial portion of our revenue for the foreseeable future. This future revenue will depend to a large extent on the continued use and expansion of our technologies in entertainment industries worldwide.
Due to our reliance on sales to customers outside the U.S., we are subject to the risks of conducting business internationally, including:

- Our ability to enforce our contractual and intellectual property rights, especially in those foreign countries that do not recognize and enforce intellectual property rights to the same extent as do the U.S., Japan, and European countries, which increases the risk of unauthorized, and uncompensated, use of our technologies;
- U.S. and foreign government trade restrictions, including those which may impose restrictions on importation of programming, technology, or components to or from the U.S.;
- Our ability to comply with applicable international laws and regulations governing our business and operations, including local consumer and safety laws, as well as license requirements;
- Foreign government taxes, regulations, and permit requirements, including foreign taxes that we may not be able to offset against taxes imposed upon us in the U.S., and other laws limiting our ability to repatriate funds to the U.S.;
- Burdens of complying with a variety of foreign laws;
- Changes in diplomatic and trade relationships;
- Difficulty in establishing, staffing, and managing foreign operations;
- Adverse fluctuations in foreign currency exchange rates and interest rates, including risks related to any interest rate swap or other hedging activities we undertake;
- Political or social instability, natural disasters, war or events of terrorism; and
- The strength of international economies.

In many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by U.S. regulations applicable to us such as the Foreign Corrupt Practices Act and U.S. export controls. Although we implement policies and procedures designed to ensure compliance with the Foreign Corrupt Practices Act and U.S. export controls, there can be no assurance that all of our employees, distributors, dealers, and agents will not take actions in violation of our policies or these regulations. Any such violation, even if prohibited by our policies, could have an adverse effect on our business.
We face risks associated with complying with international employment laws.
A significant number of our employees are located outside the U.S. This means we have exposure to changes in foreign laws governing our relationships with our employees, which could have a direct impact on our operating costs. Expansion into international markets has required, and will require, significant management attention and resources. We incur additional legal compliance costs associated with our international operations and could become subject to legal penalties in foreign countries if we do not comply with local employment laws and regulations, which may be substantially different from those in the U.S.
Revisions to patent laws and regulations in the U.S. and abroad may adversely impact our ability to obtain, license, and enforce our patent rights.
Our licensing business depends in part on the uniform and consistent treatment of patent rights in the U.S. and abroad. Changes to the patent laws and regulations in the U.S. and abroad may limit our ability to obtain, license, and enforce our rights. Additionally, court and administrative rulings may interpret existing patent laws and regulations in ways that adversely affect our ability to obtain, license, and enforce our patents. For example, recent rulings by the U.S. Supreme Court concerning injunctions may make it more difficult, under some circumstances, for us to obtain injunctive relief against a party that has been found to infringe one or more of our patents, and rulings regarding patent challenges by licensees could potentially make it easier for our licensees to challenge our patents even though they have already agreed to take a license.
Our stock repurchase program may be suspended or terminated at any time, which may result in a decrease in our stock price.
Our stock repurchase program, whereby we may continue to repurchase shares of our Class A common stock, may reduce the public float of shares available for trading on a daily basis. Such purchases may be limited, suspended, or

terminated at any time without prior notice. There can be no assurance that we will buy additional shares of our Class A common stock under our stock repurchase program or that any future repurchases will have a positive impact on our stock price or earnings per share. Important factors that could cause us to discontinue or decrease our share repurchases include, among others, unfavorable market conditions, the market price of our Class A common stock, the nature of other investment or strategic opportunities presented to us from time to time, the rate of dilution of our equity compensation programs, our ability to make appropriate,

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timely, and beneficial decisions as to when, how, and whether to purchase shares under the stock repurchase program, and the availability of funds necessary to continue purchasing stock. If we curtail our repurchase program, our stock price may be negatively affected.

Fluctuations in our operating results and other factors may contribute to the volatility of the market price of our stock.

A number of factors, many of which are outside our control, may cause or contribute to significant fluctuations in our quarterly and annual revenue and operating results. These fluctuations may make financial planning and forecasting more difficult. In addition, these fluctuations may result in unanticipated decreases in our available cash, which could negatively impact our business and prospects, and could increase the volatility of our stock price. Factors that may cause or contribute to fluctuations in our operating results and revenue or the volatility of the market price of our stock include those risks set forth in this section as well as the following:

- Fluctuations in demand for our products and for the digital entertainment products of our licensees;
- Adverse developments in general economic conditions;
- The amount and timing of our operating costs, capital expenditures, and related charges, including those related to the expansion or consolidation of our business, operations, and infrastructure;
- Changes in business cycles that affect the markets in which we sell our products and services or the markets for consumer entertainment products incorporating our technologies;
- Fluctuations in the timing of royalty reports we receive from our licensees, including late or sporadic reports;
- Variations in the time-to-market of our technologies in the entertainment industry markets in which we operate;
- Corrections to licensees’ reports received in periods subsequent to those in which the original revenue was reported;
- The announcement, introduction, or enhancement of technologies, products, and services, by us, our licensees, and our competitors, and market acceptance of these new or enhanced technologies, products, and services;
- Rapid, wholesale changes in technology in the entertainment industries in which we compete;
- Events and conditions in the cinema industry, including box office receipts that affect the number of theaters constructed, the number of movies produced and exhibited, the general popularity of motion pictures, and strikes by cinema industry participants;
- The financial resources of cinema exhibitors available to buy our products or to equip their theaters to accommodate upgraded or new technologies;
- Consolidation by participants in the markets in which we compete, which could result among other things in pricing pressure;
- Seasonal electronics product shipment patterns by our system licensees, particularly in the first quarter, which generally result in revenue in the second quarter;
- The impact of, and our ability to react to, interruptions in the entertainment distribution process, including as a result of work stoppages at our facilities, our customers’ facilities, and other points throughout the entertainment distribution process;
- Adverse outcomes of litigation or governmental proceedings, including any foreign, federal, state, or local tax assessments or audits;
- Repurchases we make of our common stock;
- Costs of litigation and intellectual property protection;
- Exchange rate fluctuations between the U.S. dollar and other currencies;
- Variations between our operating results and published analysts’ expectations; and
- Announcements by our competitors or significant customers.

One or more of the foregoing or other factors may cause our operating expenses to be disproportionately higher or lower or may cause our revenue and operating results to fluctuate significantly in any particular quarterly or annual period. Consequently, results from prior periods are not necessarily indicative of the results of future periods.

Changes in tax rates and exposure for additional income tax liabilities or adverse outcomes resulting from examinations of our tax returns could adversely affect our operating results and financial condition.

Changes in the valuation of our deferred tax assets and liabilities, the geographic mix of our revenue, or by changes in tax laws or their interpretation could all favorably or unfavorably affect our future effective tax rates. We file income tax returns in the U.S. and in several U.S. state and foreign jurisdictions, and must use judgment in determining our worldwide provision for income taxes. For example, the following could adversely affect our income taxes:

- Earnings being lower than anticipated in countries that have lower tax rates and higher than anticipated in countries that have higher tax rates;

- Changes in the valuation of our deferred tax assets and liabilities;
- Expiration of or lapses in the R&D tax credit laws;
- Fluctuations in tax exempt interest income;
- Transfer pricing adjustments;
- Tax effects of nondeductible compensation;
- Tax costs related to intercompany realignments;
- Changes in accounting principles; or
- Changes in tax laws and regulations, including possible U.S. changes to the taxation of earnings of our foreign subsidiaries, the deductibility of expenses attributable to foreign income, or the foreign tax credit rules.

We are subject to the periodic examination of our income tax returns by tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance, however, that the outcomes from these continuous examinations will not have an adverse effect on our operating results and financial condition. Additionally, due to the evolving nature of tax rules combined with the large number of jurisdictions in which we operate, it is possible that our estimates of our tax liability and the realizability of our deferred tax assets could change in the future, which may result in additional tax liabilities and adversely affect our results of operations, financial condition, and cash flows.

If securities or industry analysts publish inaccurate or unfavorable research about our business or if our operating results do not meet or exceed their projections, our stock price could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. If one or more of the analysts who cover us or our industry downgrade our stock or the stock of other companies in our industry, or publish inaccurate or unfavorable research about our business or industry, or if our operating results do not meet or exceed their projections, our stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, demand for our stock could decrease, which might cause our stock price and trading volume to decline.

Any inability to protect our intellectual property rights could reduce the value of our products, services, and brand.

Our business is dependent upon protecting our patents, trademarks, trade secrets, copyrights, and other intellectual property rights. Licensing revenue represented 77%, 83%, and 86% of our total revenue in the fiscal years 2010, 2011, and the fiscal year-to-date period ended June 29, 2012, respectively. Effective intellectual property rights protection, however, may not be available under the laws of every country in which our products and services and those of our licensees are distributed. Also, the efforts we have taken to protect our proprietary rights may not be sufficient or effective. Any significant impairment of our intellectual property rights could harm our business or our ability to compete.

In addition, protecting our intellectual property rights is costly and time consuming. We have taken steps in the past to enforce our intellectual property rights and expect to do so in the future. However, it may not be practicable or cost effective for us to enforce our intellectual property rights fully, particularly in some countries or where the initiation of a claim might harm our business relationships. If we are unable to successfully identify and stop unauthorized use of our intellectual property, we could experience increased operational and enforcement costs, which could adversely affect our financial condition and results of operations.

We generally seek patent protection for our innovations. However, it is possible that some of these innovations may not be protectable, or we may choose not to protect particular innovations that later turn out to be important, due to the high costs of obtaining patent protection. Even where we do have patent protection, the scope of such protection may be insufficient to prevent third parties from designing around our particular patent claims. Furthermore, there is always the possibility that an issued patent may later be found to be invalid or unenforceable. We also seek to maintain select intellectual property as trade secrets. Third parties or our employees could intentionally or accidentally compromise the intellectual property that we maintain as trade secrets, which would cause us to lose the competitive advantage resulting from them.

Our customers who are also our current or potential competitors may choose to use their own or competing technologies rather than ours.

We face competitive risks in situations where our customers are also current or potential competitors. For example, Sony and Microsoft are significant licensee customers and Sony is a significant purchaser of our broadcast products and services, but Sony and Microsoft are also competitors with respect to some of our consumer, broadcast, and cinema technologies. To the extent that our customers choose to use competing technologies they have developed or in which they have an interest, rather than use our technologies, our business and operating results could be adversely affected.

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We face competition from other audio formats.
We believe that the success we have had licensing our surround sound technologies to system licensees is due, in part, to the strength of our brand and the perception that our technologies provide a high quality solution for surround sound. However, both free and proprietary sound technologies are becoming increasingly prevalent, and we expect competitors to continue to enter this field with other solutions. Furthermore, to the extent that customers perceive our competitors' solutions to provide the same advantages as our technologies at a lower or comparable price, there is a risk that these customers may treat sound encoding technologies such as ours as commodities, resulting in loss of status of our technologies, decline in their use, and significant pricing pressure. The commoditization of our audio technologies, as opposed to treatment as a premium solution, could adversely affect our business, operating results, and prospects.
The loss of or delay in operations of one or more of our key suppliers could materially delay or stop the production of our products and impair our ability to generate revenue.
Our reliance on outside suppliers for some of the key materials and components we use in manufacturing our products involves risks, including limited control over the price, timely delivery, and quality of such components. We have no formal agreements in place with our suppliers for the continued supply of materials and components. Although we have identified alternate suppliers for most of our key materials and components, any required changes in our suppliers could cause material delays in our production operations and increase our production costs. In addition, at times our suppliers have not been, and in the future may not be, able to meet our production demands as to volume, quality, or timeliness.
Moreover, we rely on sole source suppliers for some of the components that we use to manufacture our products, including specific charged coupled devices, light emitting diodes, and digital signal processors. These sole source suppliers may become unable or unwilling to deliver these components to us at an acceptable cost or at all, which could force us to redesign those specific products.
Our inability to obtain timely delivery of key components of acceptable quality, any significant increases in the prices of components, or the redesign of our products could result in material production delays, increased costs, and reductions in shipments of our products, any of which could increase our operating costs, harm our customer relationships, or materially and adversely affect our business and operating results.
Revenue from our products may suffer if our production processes encounter problems or if we are not able to match our production capacity to fluctuating levels of demand.
Our products are highly complex and production difficulties or inefficiencies can interrupt production, resulting in our inability to deliver products on time in a cost effective manner, which could harm our competitive position. We have a single production facility and increasingly use contract manufacturers for a significant portion of our production capacity. Our reliance on contract manufacturers for the manufacture of our products involves risks, including limited control over timely delivery and quality of such products. If production of our products is interrupted, we may not be able to manufacture products on a timely basis. A shortage of manufacturing capacity for our products could adversely affect our operating results and damage our customer relationships. We are unable to quickly adapt our manufacturing capacity to rapidly changing market conditions and a contract manufacturer may encounter similar difficulties. Likewise, we may be unable to quickly respond to fluctuations in customer demand or contract manufacturer interruptions. At times we underutilize our manufacturing facilities as a result of reduced demand for some of our products. Any inability to effectively respond to fluctuations in customer demand for our products or contract manufacturer interruptions may adversely affect our gross margins.
Our products, from time to time, experience quality problems that can result in decreased sales and higher operating expenses.
Our products are complex and sometimes contain undetected software or hardware errors, particularly when first introduced or when new versions are released. In addition, to the extent that we engage contract manufacturers, we do not have as much control over manufacturing which could result in quality problems. Furthermore, our products are sometimes combined with or incorporated into products from other vendors, sometimes making it difficult to identify the source of a problem. These errors could result in a loss of or delay in market acceptance of our products or cause delays in delivering them and meeting customer demands, any of which could reduce our revenue and raise significant

customer relations issues. In addition, if our products contain errors we could be required to replace or reengineer them, which would increase our costs. Moreover, if any such errors cause unintended consequences, we could incur substantial costs in defending and settling product liability claims. Although we generally attempt to contractually limit liability for defective products to the cost of repairing or replacing these products, if these contract provisions are not enforced, or are unenforceable for any reason, or if liabilities arise that are not effectively limited, we could incur substantial costs in defending and settling product liability claims.

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Licensee products that incorporate our technologies, from time to time, experience quality problems that could damage our brand, decrease revenue, and increase operating expenses.

Newly introduced and new versions of licensee products that incorporate our technologies are complex and may contain undetected software or hardware errors. In addition, the combination or incorporation of these newly introduced products with products from other companies can make it difficult to identify the source of a problem. Any negative publicity or negative impact relating to these product problems could adversely affect the perception of our brand. In addition, these errors could result in loss of, or delay in, market acceptance of those products or Dolby technologies, or cause delays in delivering them and meeting customer demands, any of which could reduce our revenue and raise significant customer relations issues. Although we generally attempt to contractually limit our liability for our licensees' defective products, we may elect to help reengineer those products, which could adversely affect our operating results.

A loss of one or more of our key customers or licensees in any of our markets could adversely affect our operating results.

From time to time, one or a small number of our customers or licensees may represent a significant percentage of our products, services, or licensing revenue. For example, revenue from our largest customer represented approximately 13% of total revenue for fiscal 2011. Although we have agreements with many of these customers, these agreements typically do not require any minimum purchases or minimum royalty fees and do not prohibit customers from purchasing products and services from competitors. A decision by any of our major customers or licensees not to use our technologies, or their failure or inability to pay amounts owed to us in a timely manner, or at all, whether due to strategic redirections or adverse changes in their businesses or for other reasons, could have a significant adverse effect on our operating results.

We are subject to various environmental laws and regulations that could impose substantial costs upon us and may adversely affect our business, operating results, and financial condition.

Some of our operations use substances regulated under various federal, state, local, and international laws governing the environment, including those governing the discharge of pollutants into the air and water, the management, disposal, and labeling of hazardous substances and wastes, and the cleanup of contaminated sites. We could incur costs, fines, and civil or criminal sanctions, third party property damage or personal injury claims, or could be required to incur substantial investigation or remediation costs, if we were to violate or become liable under environmental laws. Liability under environmental laws can be joint and several and without regard to comparative fault. The ultimate costs under environmental laws and the timing of these costs are difficult to predict.

New environmental laws and regulations could impact our operating results.

We expect that new environmental laws and regulations, introduced on an ongoing basis, will have the potential to affect our manufacturing and licensing operations. Although we cannot predict the ultimate impact of any such new laws and regulations, they will likely result in additional costs or decreased revenue, and could require that we redesign or change how we manufacture our products, any of which could have a material adverse effect on our business.

We could incur substantial costs due to regulations regarding the composition of our products, which may adversely affect our business, operating results, and financial condition.

We face increasing complexity in our product design as we adjust to new and future requirements relating to the materials composition of our products. For example, we redesigned our products so we could continue to offer them for sale within the European Union, when restrictions on lead and other hazardous substances that apply to specified electronic products put on the market in the European Union became effective in 2006. Similar requirements related to marking of electronic products became effective in China in 2007. For some products, substituting particular components containing regulated hazardous substances is more difficult or costly, and additional redesign efforts could result in production delays. Selected electronic products that we maintain in inventory may be rendered obsolete if not in compliance with the new environmental laws, which could negatively impact our ability to generate revenue from those products.

Continued global credit market weakness could negatively impact the value and liquidity of our investment portfolio.

We maintain an investment portfolio of various holdings, types, and maturities, including money market funds, U.S. treasury and agency securities, municipal debt securities, corporate bonds, and commercial paper. Although we follow an established investment policy and seek to minimize the credit risk associated with investments, these investments are subject to general credit, liquidity, and interest rate risks. Any downgrades, losses, or other significant deterioration in the fair value of our cash, cash equivalents, or investments could negatively impact our investments or our ability to meet our investment objectives. Such negative impact, should it arise, could require an impairment charge, which would adversely impact our financial results.

We face risks associated with international trade and currency exchange.
We maintain sales, marketing, and business operations in foreign countries. Consequently, we are exposed to fluctuations in exchange rates associated with the local currencies of our foreign business operations. While we derive nearly all of our revenue from transactions denominated in U.S. dollars, nearly all of our costs from our foreign operations are denominated in the currency of that foreign location. Consequently, exchange rate fluctuations between the U.S. dollar and other currencies could have a material impact on our profitability.
We rely on distributors that we do not control.
We rely significantly on a global network of independent, regional distributors to market and distribute our cinema and broadcast products. Our distributor arrangements are non-exclusive and our distributors are not obligated to buy our products and can represent competing products. The loss of a major distributor or the inability or unwillingness of our distributors to dedicate the resources necessary to promote our portfolio of products could adversely affect our revenue. Furthermore, our distributors could retain product channel inventory levels that exceed future anticipated sales, which could adversely affect future sales to those distributors. In addition, failures of our distributors to adhere to our policies or other ethical practices could adversely affect us. For example, while we have implemented policies designed to promote compliance with the Foreign Corrupt Practices Act, export controls, and local laws, we do not have direct control over the business and risk management policies adopted by our distributors, and they could act contrary to our policies.
For the foreseeable future, Ray Dolby or his affiliates will be able to control the selection of all members of our board of directors, as well as virtually every other matter that requires stockholder approval, which will severely limit the ability of other stockholders to influence corporate matters.
At June 29, 2012, Ray Dolby and his affiliates owned 100 shares of our Class A common stock and 56,950,000 shares of our Class B common stock. As of June 29, 2012, Ray Dolby and his affiliates, including his family members, had voting power of approximately 99.7% of our outstanding Class B common stock, which in the aggregate represented approximately 92.0% of the combined voting power of our outstanding Class A and Class B common stock. Under our certificate of incorporation, holders of Class B common stock are entitled to ten votes per share while holders of Class A common stock are entitled to one vote per share. Generally, shares of Class B common stock automatically convert into shares of Class A common stock upon transfer of such Class B common stock, other than transfers to certain specified persons and entities, including the spouse and descendants of Ray Dolby and the spouses and domestic partners of such descendants.
Because of this dual class structure, Ray Dolby, his affiliates, and his family members and descendants will, for the foreseeable future, have significant influence over our management and affairs, and will be able to control virtually all matters requiring stockholder approval, including the election of directors and significant corporate transactions such as mergers or other sales of our company or assets, even if they come to own considerably less than 50% of the total number of outstanding shares of our Class A and Class B common stock. Ray Dolby, his affiliates, his family members, and descendants will maintain this control even if in the future they come to own considerably less than 50% of the total number of outstanding shares of our Class A and Class B common stock.
Moreover, these persons may take actions in their own interests that our stockholders do not view as beneficial. Absent a transfer of Class B common stock that would trigger an automatic conversion as described above, there is no threshold or time deadline at which the shares of Class B common stock will automatically convert into shares of Class A common stock.
Assuming conversion of all shares of Class B common stock held by persons not affiliated with Ray Dolby into shares of Class A common stock, so long as Ray Dolby and his affiliates, his family members, and descendants continue to hold shares of Class B common stock representing approximately 10% or more of the total number of outstanding shares of our Class A and Class B common stock, they will hold a majority of the combined voting power of the Class A and Class B common stock.
Future sales of shares by insiders could cause our stock price to decline.
If our founder, officers, directors or employees sell, or indicate an intention to sell, substantial amounts of our Class A common stock in the public market, including shares of Class A common stock issuable upon conversion of shares of Class B common stock, the trading price of our Class A common stock could decline. As previously announced, (i)

Ray and Dagmar Dolby as Trustees of the Ray Dolby Trust under the Dolby Family Trust Instrument dated May 7, 1999, (ii) Ray and Dagmar Dolby, as Trustees of the Ray Dolby 2002 Trust A dated April 19, 2002, (iii) Ray and Dagmar Dolby, as Trustees of the Ray Dolby 2002 Trust B dated April 19, 2002, (iv) Ray and Dagmar Dolby, as Trustees of the Ray Dolby 2011 Trust A dated December 14, 2011, and (v) Ray and Dagmar Dolby, as Trustees of the Ray Dolby 2011 Trust B dated December 14, 2011 adopted Rule 10b5-1 trading plans in the third quarter of fiscal 2012 to sell up to 5.9 million shares of the Company's Class A common stock (or approximately 10.3% of Ray Dolby's direct and indirect holdings at the time). The trading plans were

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adopted during an “open window” in accordance with guidelines specified by Rule 10b5-1 under the Securities Exchange Act of 1934, as amended, and as permitted by the Company's insider trading policy. Sales under the trading plans may commence in August 2012, are based upon pre-established stock price thresholds, are subject to daily volume limits and will expire once all of the shares have been sold or in August 2013, whichever is earlier.

We cannot predict the effect the trading plan sales may have on the future trading prices of our Class A common stock. As of June 29, 2012, we had a total of 105,241,536 shares of Class A and Class B common stock outstanding. Of these shares, 31,625,000 shares of Class A common stock were sold in our initial public offering by us and the selling stockholders, and an additional 8,000,000 shares of Class A common stock were sold in a secondary offering in May 2007 by our principal stockholder.

As of June 29, 2012, our directors and executive officers beneficially held 56,960,000 shares of Class B common stock, 157,210 shares of Class A common stock, vested options to purchase 20,000 shares of Class B common stock and vested options to purchase 673,008 shares of Class A common stock. We expect that any sale of our Class A common stock by our directors and executive officers would be subject to compliance with Rule 144 under the Securities Act.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Sales of Unregistered Securities

In the fiscal quarter ended June 29, 2012, we issued an aggregate of 36,010 shares of our Class B common stock to certain employees, officers, and directors upon the exercise of options awarded under our 2000 Stock Incentive Plan. We received aggregate proceeds of less than $0.1 million in the fiscal quarter ended June 29, 2012, as a result of the exercise of these options. We believe these transactions were exempt from the registration requirements of the Securities Act in reliance on Rule 701 thereunder as transactions pursuant to compensatory benefit plans and contracts relating to compensation as provided under Rule 701. As of June 29, 2012, options to purchase an aggregate of 195,274 shares of our Class B common stock remain outstanding. All issuances of shares of our Class B common stock pursuant to the exercise of these options will be made in reliance on Rule 701. All option grants made under the 2000 Stock Incentive Plan were made prior to the effectiveness of our initial public offering. No further option grants will be made under our 2000 Stock Incentive Plan.

None of the foregoing transactions involved any underwriters, underwriting discounts or commissions, or any public offering.

Each share of our Class B common stock is convertible into one share of our Class A common stock at any time at the option of the holder or upon the affirmative vote of the holders of a majority of the shares of Class B common stock. In addition, each share of Class B common stock shall convert automatically into one share of Class A common stock upon any transfer, except for certain transfers described in our amended and restated certificate of incorporation.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table provides information regarding the Company’s purchases of its Class A Common stock, $0.001 par value per share, during the third quarter of fiscal 2012:

	Total Number of Shares Purchased	Average Price Paid per Share (1)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (3)
March 31, 2012 - April 27, 2012	871,364	$37.63	871,364	$ 347.5 million
April 28, 2012 - May 25, 2012	751,583	42.97	751,583	315.2 million
May 26, 2012 - June 29, 2012	922,752	41.93	922,752	276.5 million
Total	2,545,699		2,545,699	

(1) Excludes commission costs.

(2) Shares of Class A common stock were purchased under a $250.0 million stock repurchase program announced on November 3, 2009, which was subsequently increased by $300.0 million, $250.0 million, and $100.0 million announced on July 27, 2010, August 4, 2011, and February 8, 2012, respectively. The stock repurchase program does not have an expiration date. Stock repurchases under this program may be made through open market transactions, negotiated purchases, or otherwise, at times and in such amounts as we consider appropriate.

(3) Amounts shown in this column reflect amounts remaining under the stock repurchase program.

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ITEM 6. EXHIBITS

Exhibit Number	Description	Incorporated by Reference Herein	
		Form	Date
10.1*	Form of Subscription Agreement under the ESPP - Non-U.S. Employees		
10.2	Agreement of Sale and Purchase by and between DWF III 1275 Market , LLC and Dolby Laboratories, Inc.		
31.1	Certification by the Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.		
31.2	Certification by the Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.		
32.1‡	Certification by the Chief Executive Officer and the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.		
101.INS‡	XBRL Instance Document		
101.SCH‡	XBRL Taxonomy Extension Schema Document		
101.CAL‡	XBRL Taxonomy Extension Calculation Linkbase Document		
101.DEF‡	XBRL Extension Definition		
101.LAB‡	XBRL Taxonomy Extension Label Linkbase Document		
101.PRE‡	XBRL Taxonomy Extension Presentation Linkbase Document		

* Denotes a management contract or compensatory arrangement
‡ Furnished herewith

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: August 8, 2012

DOLBY LABORATORIES, INC.

By: /s/ Lewis Chew
Lewis Chew
Executive Vice President and Chief Financial Officer
(Principal Financial and
Accounting
Officer and Duly Authorized
Officer)