Dolby Laboratories, Inc.
Form 10-Q
August 04, 2011
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# UNITED STATES

## SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

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

**For the Quarterly Period Ended July 1, 2011**

**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 x 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 x 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 x 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 x

On July 21, 2011 the registrant had 52,655,614 shares of Class A common stock, par value $0.001 per share, and 57,773,454 shares of Class B common stock, par value $0.001 per share, outstanding.

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**DOLBY LABORATORIES, INC.**

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**PART I FINANCIAL INFORMATION**

**ITEM 1 CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**DOLBY LABORATORIES, INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

(*in thousands*)

| | September 24, 2010 | July 1, 2011 (unaudited) |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 545,861 | $ 594,604 |
| Short-term investments | 302,269 | 309,067 |
| Accounts receivable, net | 54,257 | 39,370 |
| Inventories | 28,338 | 23,416 |
| Deferred taxes | 102,758 | 91,401 |
| Prepaid expenses and other current assets | 26,930 | 36,058 |
| Total current assets | 1,060,413 | 1,093,916 |
| Long-term investments | 190,837 | 280,380 |
| Property, plant and equipment, net | 94,097 | 108,334 |
| Intangible assets, net | 67,019 | 55,463 |
| Goodwill | 264,580 | 268,009 |
| Deferred taxes | 19,948 | 18,811 |
| Other non-current assets | 14,878 | 6,314 |
| **Total assets** | **$ 1,711,772** | **$ 1,831,227** |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 3,606 | $ 5,621 |
| Accrued liabilities | 144,608 | 114,344 |
| Income taxes payable | 7,895 | 3,675 |
| Deferred revenue | 9,647 | 12,976 |
| Total current liabilities | 165,756 | 136,616 |
| Long-term deferred revenue | 12,775 | 14,850 |
| Deferred taxes | 11,547 | 621 |
| Other non-current liabilities | 27,015 | 23,274 |
| Total liabilities | 217,093 | 175,361 |
| Stockholders equity: | | |
| Class A common stock | 53 | 53 |
| Class B common stock | 59 | 58 |
| Additional paid-in capital | 329,902 | 255,575 |
| Retained earnings | 1,135,922 | 1,366,118 |
| Accumulated other comprehensive income | 7,801 | 11,895 |
| Total stockholders equity Dolby Laboratories, Inc. | 1,473,737 | 1,633,699 |
| Controlling interest | 20,942 | 22,167 |
| Total stockholders equity | 1,494,679 | 1,655,866 |

| | | |
|---|---|---|
| **Total liabilities and stockholders equity** | **$ 1,711,772** | **$ 1,831,227** |

*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*)

| | Fiscal Quarter Ended | | Fiscal Year-to-Date Ended | |
|---|---|---|---|---|
| | **June 25, 2010** | **July 1, 2011** | **June 25, 2010** | **July 1, 2011** |
| | | (unaudited) | | |
| **Revenue:** | | | | |
| Licensing | $ 170,326 | $ 181,790 | $ 532,045 | $ 584,593 |
| Products | 52,651 | 28,395 | 140,147 | 100,769 |
| Services | 7,292 | 8,814 | 22,714 | 26,375 |
| Total revenue | 230,269 | 218,999 | 694,906 | 711,737 |
| **Cost of revenue:** | | | | |
| Cost of licensing | 3,719 | 4,095 | 13,282 | 13,827 |
| Cost of products (1) | 23,336 | 20,320 | 72,042 | 62,549 |
| Cost of services (1) | 3,407 | 3,518 | 10,554 | 9,153 |
| Impairment of products provided under operating leases | 9,594 | - | 9,594 | - |
| Total cost of revenue | 40,056 | 27,933 | 105,472 | 85,529 |
| Gross margin | 190,213 | 191,066 | 589,434 | 626,208 |
| **Operating expenses:** | | | | |
| Research and development (1) | 27,513 | 34,086 | 75,561 | 90,812 |
| Sales and marketing (1) | 36,527 | 36,726 | 93,635 | 112,488 |
| General and administrative (1) | 29,165 | 32,397 | 86,677 | 104,594 |
| Restructuring charges, net | 1,068 | (48) | 1,371 | 737 |
| Total operating expenses | 94,273 | 103,161 | 257,244 | 308,631 |
| **Operating income** | 95,940 | 87,905 | 332,190 | 317,577 |
| Interest income | 1,879 | 1,670 | 5,665 | 5,237 |
| Interest expense | (392) | 690 | (589) | 322 |
| Other income, net | 655 | 186 | 1,124 | 875 |
| Income before provision for income taxes | 98,082 | 90,451 | 338,390 | 324,011 |
| Provision for income taxes | (34,394) | (28,404) | (118,890) | (92,717) |
| Net income including controlling interest | 63,688 | 62,047 | 219,500 | 231,294 |
| Less: net income attributable to controlling interest | (236) | (299) | (1,064) | (1,098) |
| **Net income attributable to Dolby Laboratories, Inc.** | **$ 63,452** | **$ 61,748** | **$ 218,436** | **$ 230,196** |
| Earnings per share attributable to Dolby Laboratories, Inc.: | | | | |
| Basic | $ 0.56 | $ 0.55 | $ 1.92 | $ 2.06 |
| Diluted | $ 0.55 | $ 0.55 | $ 1.89 | $ 2.03 |
| Weighted-average shares outstanding: | | | | |
| Basic | 113,254 | 111,494 | 113,775 | 111,893 |
| Diluted | 115,282 | 112,349 | 115,780 | 113,165 |

| | | | | |
|---|---|---|---|---|
| Related party rent expense included in general and administrative expenses | $ 343 | $ 343 | $ 1,029 | $ 1,029 |
| | | | | |
| (1) Stock-based compensation was classified as follows: | | | | |
| Cost of products | $ 126 | $ 169 | $ 305 | $ 483 |
| Cost of services | 36 | 47 | 99 | 129 |
| Research and development | 1,869 | 2,632 | 4,613 | 7,566 |
| Sales and marketing | 2,573 | 3,429 | 6,522 | 9,792 |
| General and administrative | 3,540 | 4,639 | 9,476 | 14,946 |

*See accompanying notes to unaudited condensed consolidated financial statements*

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**DOLBY LABORATORIES, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

*(in thousands)*

| | Fiscal Year-to-Date Ended | |
|---|---|---|
| | **June 25, 2010** | **July 1, 2011** |
| **Operating activities:** | **(unaudited)** | |
| Net income including controlling interest | $ 219,500 | $ 231,294 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 25,545 | 33,975 |
| Stock-based compensation | 21,015 | 32,916 |
| Amortization of premium on investments | 6,384 | 12,375 |
| Excess tax benefit from exercise of stock options | (16,890) | (12,643) |
| Provision for doubtful accounts | (181) | 828 |
| Losses on Put Rights | 6,506 | - |
| Gains on auction rate certificates | (7,601) | - |
| Deferred income taxes | (21,782) | 1,573 |
| Impairment of products provided under operating leases | 9,594 | - |
| Payment on litigation settlement | (3,000) | (3,000) |
| Other non-cash items affecting net income | 2,007 | 175 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (24,595) | 14,065 |
| Inventories | (4,087) | 4,927 |
| Prepaid expenses and other assets | 15,730 | (6,718) |
| Accounts payable and accrued liabilities | 23,759 | (27,789) |
| Income taxes, net | 31,903 | 6,386 |
| Deferred revenues | (24,282) | 5,400 |
| Other non-current liabilities | (74) | 395 |
| Net cash provided by operating activities | 259,451 | 294,159 |
| **Investing activities:** | | |
| Purchases of available-for-sale securities | (556,172) | (454,795) |
| Proceeds from sales and maturities of available-for-sale securities | 519,857 | 345,619 |
| Purchases of property, plant and equipment | (24,882) | (30,334) |
| Acquisitions, net of cash acquired | - | (3,350) |
| Other investments | (825) | - |
| Proceeds from sales of property, plant and equipment and assets held for sale | - | 3,077 |
| Net cash used in investing activities | (62,022) | (139,783) |
| **Financing activities:** | | |
| Repayment of long-term debt | (1,192) | - |
| Proceeds from issuance of Class A common stock (Employee Stock Purchase Plan) | 4,060 | 5,429 |
| Net proceeds from exercise of stock options | 32,948 | 17,491 |
| Repurchase of common stock | (177,648) | (142,500) |
| Excess tax benefit from exercise of stock options | 16,890 | 12,643 |
| Net cash used in financing activities | (124,942) | (106,937) |
| Effect of foreign exchange rate changes on cash | (5,067) | 1,304 |
| Net decrease in cash and cash equivalents | 67,420 | 48,743 |
| Cash and cash equivalents at beginning of period | 451,678 | 545,861 |
| **Cash and cash equivalents at end of period** | **$ 519,098** | **$ 594,604** |

| | | |
|---|---|---|
| **Supplemental disclosure:** | | |
| Cash paid for income taxes | $ 108,598 | $ 84,689 |
| Cash paid for interest | 546 | 242 |

*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. (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 U.S. 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 24, 2010 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 24, 2010, which are included in our Annual Report on Form 10-K filed with the SEC.

The results for the fiscal quarter and fiscal year-to-date period ended July 1, 2011 are not necessarily indicative of the results to be expected for any subsequent quarterly or annual financial period, including the fiscal year ending September 30, 2011.

***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 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 have eliminated all intercompany accounts and transactions upon consolidation.

***Use of Estimates***

The preparation of the consolidated financial statements in accordance with U.S. 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, products provided under operating leases, 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 June 25, 2010 and July 1, 2011, and the 39 week period ended June 25, 2010 and the 40 week period ended July 1, 2011. Our fiscal year ended September 24, 2010 (fiscal 2010) consisted of 52 weeks, while our fiscal year ending September 30, 2011 (fiscal 2011) consists of 53 weeks.

***Reclassifications***

Certain prior period amounts have been reclassified to conform to current year presentation.

## 2. Summary of Significant Accounting Policies

There have been no material changes to our significant accounting policies as compared to those described in our Annual Report on Form 10-K for the fiscal year ended September 24, 2010.

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### 3. Composition of Certain Financial Statement Captions

***Cash, Cash Equivalents, and Investments***

Cash, cash equivalents, and investments as of September 24, 2010 and July 1, 2011 consist of the following:

| | September 24, 2010 | July 1, 2011 |
|---|---|---|
| | (in thousands) | |
| Cash and cash equivalents: | | |
| Cash | $ 156,440 | $ 361,005 |
| Cash equivalents: | | |
| Money market funds | 354,428 | 218,600 |
| U.S. agency securities | 10,000 | - |
| Commercial paper | 19,993 | 14,999 |
| Municipal debt securities | 5,000 | - |
| Total cash and cash equivalents | 545,861 | 594,604 |
| Short-term investments: | | |
| Corporate bonds | 3,788 | 38,230 |
| Commercial paper | 9,990 | - |
| Municipal debt securities | 188,123 | 253,585 |
| U.S. agency securities | 70,376 | 17,252 |
| U.S. and foreign government bonds | 29,992 | - |
| Total short-term investments | 302,269 | 309,067 |
| Long-term investments: | | |
| Corporate bonds | 25,870 | 76,267 |
| Municipal debt securities | 127,458 | 194,111 |
| U.S. agency securities | 27,522 | 10,002 |
| U.S. government bonds | 9,987 | - |
| Total long-term investments | 190,837 | 280,380 |
| **Total cash, cash equivalents and investments** | **$ 1,038,967** | **$ 1,184,051** |

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Our investment portfolio, which is recorded as cash equivalents, short-term investments, and long-term investments, was as follows:

| | September 24, 2010 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| | (in thousands) | | | |
| Commercial paper | $ 29,983 | $ - | $ - | $ 29,983 |
| Corporate bonds | 29,238 | 420 | - | 29,658 |
| Money market funds | 354,428 | - | - | 354,428 |
| Municipal debt securities | 318,825 | 1,781 | (25) | 320,581 |
| U.S. agency securities | 107,512 | 390 | (4) | 107,898 |
| U.S. government bonds | 39,949 | 30 | - | 39,979 |
| **Cash equivalents and investments** | **$ 879,935** | **$ 2,621** | **$ (29)** | **$ 882,527** |

| | July 1, 2011 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| | (in thousands) | | | |
| Commercial paper | $ 14,999 | $ - | $ - | $ 14,999 |
| Corporate bonds | 113,979 | 546 | (28) | 114,497 |
| Money market funds | 218,600 | - | - | 218,600 |
| Municipal debt securities | 446,314 | 1,456 | (74) | 447,696 |
| U.S. agency securities | 27,073 | 181 | - | 27,254 |
| **Cash equivalents and investments** | **$ 820,965** | **$ 2,183** | **$ (102)** | **$ 823,046** |

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

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

| | September 24, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | 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) | | | | |
|---|---|---|---|---|---|---|
| Municipal debt securities | $ 62,494 | $ (25) | $ - | $ - | $ 62,494 | $ (25) |
| U.S. agency securities | 30,112 | (4) | - | - | 30,112 | (4) |
| **Total** | **$ 92,606** | **$ (29)** | **$ -** | **$ -** | **$ 92,606** | **$ (29)** |

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| | July 1, 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) | | | | | |
| Corporate bonds | $ 10,957 | $ (28) | $ - | $ - | $ 10,957 | $ (28) |
| Municipal debt securities | 82,873 | (74) | - | - | 82,873 | (74) |
| **Total** | **$ 93,830** | **$ (102)** | **$ -** | **$ -** | **$ 93,830** | **$ (102)** |

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 July 1, 2011, we owned 31 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 unrealized losses. We expect to recover the full carrying value of these securities. As a result, we do not consider any portion of the unrealized losses at September 24, 2010 or July 1, 2011 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 as of July 1, 2011:

| | Amortized Cost | July 1, 2011 Fair Value |
|---|---|---|
| | | (in thousands) |
| Due within 1 year | $ 308,099 | $ 309,067 |
| Due in 1 to 2 years | 247,738 | 248,715 |
| Due in 2 to 3 years | 31,529 | 31,665 |
| **Total** | **$ 587,366** | **$ 589,447** |

***Accounts Receivable***

Accounts receivable consists of the following:

| | September 24, 2010 | July 1, 2011 |
|---|---|---|
| | (in thousands) | |
| Trade accounts receivable | $ 45,651 | $ 36,379 |
| Accounts receivable related to patent administration program | 10,646 | 5,603 |
| Accounts receivable, gross | 56,297 | 41,982 |
| Less: allowance for doubtful accounts | (2,040) | (2,612) |
| **Accounts receivable, net** | **$ 54,257** | **$ 39,370** |

***Inventories***

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

| | September 24, 2010 | July 1, 2011 |
|---|---|---|
| | (in thousands) | |
| Raw materials | $ 10,314 | $ 10,042 |
| Work in process | 3,109 | 3,606 |
| Finished goods | 14,915 | 9,768 |
| **Inventories** | **$ 28,338** | **$ 23,416** |

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***Prepaid Expenses and Other Current Assets***

Prepaid expenses and other current assets consist of the following:

| | September 24, 2010 | July 1, 2011 |
|---|---|---|
| | (in thousands) | |
| Prepaid assets | $ 16,191 | $ 17,980 |
| Other current assets | 1,650 | 6,233 |
| Income tax receivable | 3,497 | 9,854 |
| Assets held for sale | 5,592 | 1,991 |
| **Prepaid expenses and other current assets** | **$ 26,930** | **$ 36,058** |

Assets held for sale represent digital cinema equipment that we leased to exhibitors beginning in fiscal 2005 in an effort to encourage the cinema industry to transition to digital cinema. In fiscal 2010, management committed to a plan to sell some of this leased equipment, which required us to classify these assets as held for sale as of September 24, 2010. We have reviewed the carrying value of remaining assets classified as held for sale against recent sales prices and expect to recover the current carrying value of the assets.

We also hold digital cinema equipment that we leased to exhibitors with a carrying value of approximately $1.0 million that is not yet classified as held for sale since it does not meet all the held for sale criteria. These assets are classified as products provided under operating leases and held for use, and remain within property, plant and equipment.

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***Property, Plant and Equipment***

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

| | September 24, 2010 | July 1, 2011 |
|---|---|---|
| | (in thousands) | |
| Land | $ 12,835 | 12,890 |
| Buildings | 27,029 | 27,163 |
| Leasehold improvements | 33,264 | 39,704 |
| Machinery and equipment | 16,080 | 20,749 |
| Computer systems and software | 43,611 | 64,465 |
| Furniture and fixtures | 9,440 | 9,661 |
| Products provided under operating leases | 1,209 | 1,045 |
| | 143,468 | 175,677 |
| Less: accumulated depreciation | (49,371) | (67,343) |
| **Property, plant and equipment, net** | **$ 94,097** | **$ 108,334** |

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 the accompanying condensed consolidated statements of operations.

***Goodwill and Intangible Assets***

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

| | Total |
|---|---|
| | (in thousands) |
| Balance at September 24, 2010 | $ 264,580 |
| Acquired goodwill | 182 |
| Translation adjustments | 3,247 |
| **Balance at July 1, 2011** | **$ 268,009** |

Intangible assets consist of the following:

| | September 24, 2010 | | | July 1, 2011 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated Amortization | Net | Cost | Accumulated Amortization | Net |
| | | | (in thousands) | | | |
| Intangible assets subject to amortization: | | | | | | |
| Acquired patents and technology | $ 61,767 | $ (24,986) | $ 36,781 | $ 61,748 | $ (30,156) | $ 31,592 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Customer relationships | | 30,790 | | (10,095) | | 20,695 | | 30,749 | | (12,027) | | 18,722 |
| Customer contracts | | 5,973 | | (4,483) | | 1,490 | | 6,063 | | (6,063) | | - |
| Other intangibles | | 20,307 | | (12,254) | | 8,053 | | 20,308 | | (15,159) | | 5,149 |
| **Total** | **$** | **118,837** | **$** | **(51,818)** | **$** | **67,019** | **$** | **118,868** | **$** | **(63,405)** | **$** | **55,463** |

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

As of July 1, 2011, we expect amortization expense in future periods to be as follows:

| **Fiscal Year** | | **Amortization Expense (in thousands)** |
|---|---|---|
| Remainder of 2011 | $ | 3,825 |
| 2012 | | 12,711 |
| 2013 | | 11,937 |
| 2014 | | 10,293 |
| 2015 | | 7,833 |
| Thereafter | | 8,864 |
| **Total** | **$** | **55,463** |

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***Accrued Liabilities***

Accrued liabilities consist of the following:

| | September 24, 2010 | July 1, 2011 |
|---|---|---|
| | (in thousands) | |
| Accrued royalties | $ 4,140 | $ 3,225 |
| Amounts payable to joint licensing program partners | 42,837 | 50,643 |
| Accrued compensation and benefits | 62,044 | 28,952 |
| Accrued professional fees | 8,078 | 5,732 |
| Current portion of litigation settlement | 2,890 | - |
| Accrued customer refunds | 4,120 | 6,143 |
| Other accrued liabilities | 20,499 | 19,649 |
| **Accrued liabilities** | **$ 144,608** | **$ 114,344** |

***Other Non-Current Liabilities***

Other non-current liabilities consist of the following:

| | September 24, 2010 | July 1, 2011 |
|---|---|---|
| | (in thousands) | |
| Supplemental retirement plan obligations | $ 2,118 | $ 2,158 |
| Non-current tax liabilities | 20,036 | 15,259 |
| Other liabilities | 4,861 | 5,857 |
| **Other non-current liabilities** | **$ 27,015** | **$ 23,274** |

***Accumulated Other Comprehensive Income***

Accumulated other comprehensive income consists of the following:

| | September 24, 2010 | July 1, 2011 |
|---|---|---|
| | (in thousands) | |
| Accumulated foreign currency translation gains, net of tax of ($2,655) and ($2,804) | $ 6,195 | $ 10,603 |
| Accumulated unrealized gains on available-for-sale securities, net of tax of ($986) and ($789) | 1,606 | 1,292 |

| | | |
|---|---|---|
| **Total accumulated other comprehensive income** | **$ 7,801** | **$ 11,895** |

***Per Share Data***

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.:

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| | Fiscal Quarter Ended | | Fiscal Year-to-Date Ended | |
|---|---|---|---|---|
| | June 25, 2010 | July 1, 2011 | June 25, 2010 | July 1, 2011 |
| | (in thousands, except per share amounts) | | | |
| **Numerator:** | | | | |
| Net income attributable to Dolby Laboratories, Inc. | $ 63,452 | $ 61,748 | $ 218,436 | $ 230,196 |
| **Denominator:** | | | | |
| Weighted-average shares outstanding - basic | 113,254 | 111,494 | 113,775 | 111,893 |
| Potential common shares from options to purchase Class A and Class B common stock | 1,817 | 757 | 1,835 | 1,076 |
| Potential common shares from restricted stock units | 211 | 98 | 170 | 196 |
| Weighted-average shares outstanding - diluted | 115,282 | 112,349 | 115,780 | 113,165 |
| **Net income per share attributable to Dolby Laboratories, Inc. - basic** | **$ 0.56** | **$ 0.55** | **$ 1.92** | **$ 2.06** |
| **Net income per share attributable to Dolby Laboratories, Inc. - diluted** | **$ 0.55** | **$ 0.55** | **$ 1.89** | **$ 2.03** |
| Anti-dilutive options excluded from calculation | 1,414 | 3,563 | 1,950 | 3,043 |
| Anti-dilutive restricted stock units excluded from calculation | 29 | 384 | 403 | 471 |

***Withholding and Sales Tax***

We recognize licensing revenue gross of withholding taxes, which our licensees remit directly to their local tax authorities, and for which we receive a related foreign tax credit in our income tax provision. Withholding tax remittances were $8.0 million and $7.6 million in the fiscal quarters ended June 25, 2010 and July 1, 2011, respectively. Withholding tax remittances were $24.1 million and $23.4 million in the fiscal year-to-date periods ended June 25, 2010 and July 1, 2011, respectively. We account for sales tax on a net basis by excluding sales tax from our revenue.

***Revenue from Material Customer***

In the fiscal quarters ended June 25, 2010 and July 1, 2011, revenue from one customer was $28.9 million and $28.7 million, respectively, or 13% of revenue for each quarter, respectively. In the fiscal year-to-date periods ended June 25, 2010 and July 1, 2011, the same customer accounted for $84.2 million and $95.0 million, respectively, or 12% and 13% of total revenue, respectively.

***Income Taxes***

Our effective tax rate is based on a projection of our annual fiscal year results. Our effective tax rate was 35% and 31% for the fiscal quarters ended June 25, 2010 and July 1, 2011, respectively, and 35% and 29% for the fiscal year-to-date periods ended June 25, 2010 and July 1, 2011, respectively.

In the fiscal quarter ended December 31, 2010, we made an election to indefinitely reinvest a portion of our undistributed earnings in a foreign subsidiary, which resulted in a reduction to the fiscal year 2011 tax rate. Additionally, in the same quarter, a change in the tax law retroactively reinstated the federal research and development tax credits for a portion of fiscal 2010. As a result, we recognized an increase in federal research and development tax credits for fiscal 2011 compared to fiscal 2010, thereby further lowering our effective tax rate.

In the fiscal quarter ended December 31, 2010, we also 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.

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***Release of Value-Added Tax (VAT) Reserves***

During the fiscal quarter ended July 1, 2011, we completed our analysis of recent VAT law changes enacted in the European Union. Based on this analysis, we released $2.1 million of VAT reserves and related estimated penalties which were recorded as a reduction of general and administrative expense. Additionally, we released $0.8 million of VAT-related interest reserves, which was recorded as a reduction of interest expense. These liabilities were previously recorded in other accrued liabilities.

**4. Fair Value Measurements**

Fair value is the exchange price that would be received for an asset or that would be 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 on quoted prices in active markets or inputs not quoted on active markets but are corroborated by market data.

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 as of September 24, 2010 are classified below:

| | Level 1 | Level 2 (in thousands) | Level 3 | Total |
|---|---|---|---|---|
| **Assets:** | | | | |
| Investments held in supplemental retirement plan (1) | $ 2,200 | $ - | $ - | $ 2,200 |
| Money market funds (2) | 354,428 | - | - | 354,428 |
| Commercial paper (2) | - | 29,983 | - | 29,983 |
| Corporate bonds (2) | - | 29,658 | - | 29,658 |
| Municipal debt securities (2) | - | 320,581 | - | 320,581 |
| U.S. agency securities (2) | - | 107,898 | - | 107,898 |
| U.S. government bonds (2) | - | 39,979 | - | 39,979 |
| **Total** | **$ 356,628** | **$ 528,099** | **$ -** | **$ 884,727** |

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

| | Level 1 | Level 2 (in thousands) | Level 3 | Total |
|---|---|---|---|---|
| **Liabilities:** | | | | |
| Investments held in supplemental retirement plan (1) | $ 2,200 | $ - | $ - | $ 2,200 |
| **Total** | **$ 2,200** | **$ -** | **$ -** | **$ 2,200** |

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

Financial assets and liabilities carried at fair value as of July 1, 2011 are classified below:

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| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| | | (in thousands) | | |
| **Assets:** | | | | |
| Investments held in supplemental retirement plan (1) | $ 2,349 | $ - | $ - | $ 2,349 |
| Money market funds (2) | 218,600 | - | - | 218,600 |
| Commercial paper (2) | - | 14,999 | - | 14,999 |
| Corporate bonds (3) | - | 114,497 | - | 114,497 |
| Municipal debt securities (3) | - | 447,696 | - | 447,696 |
| U.S. agency securities (3) | - | 27,254 | - | 27,254 |
| **Total** | **$ 220,949** | **$ 604,446** | **$ -** | **$ 825,395** |

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

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| | | (in thousands) | | |
| **Liabilities:** | | | | |
| Investments held in supplemental retirement plan (1) | $ 2,349 | $ - | $ - | $ 2,349 |
| **Total** | **$ 2,349** | **$ -** | **$ -** | **$ 2,349** |

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

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

We obtain the fair value of our Level 2 financial instruments, which are not in active markets, from a third-party professional pricing service using quoted market prices for identical or comparable instruments, rather than direct observations of quoted prices in active markets. Our professional pricing service gathers observable inputs for all of our fixed income securities from a variety of industry data providers (e.g. large custodial institutions) and other third-party sources. Once the observable inputs are gathered, all data points are considered and an average price is determined.

We validate the quoted market prices provided by our primary pricing service by comparing their assessment of the fair values of our Level 2 investment portfolio balance against the fair values of our Level 2 investment portfolio balance provided by our investment managers. Our investment managers use similar techniques to our professional pricing service to derive pricing as described above.

We did not own any Level 3 financial assets or liabilities as of September 24, 2010 or July 1, 2011.

**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. Stock-based compensation expense for the fiscal quarters and fiscal year-to-date periods ended June 25, 2010 and July 1, 2011 was as follows:

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| | Fiscal Quarter Ended | | Fiscal Year-to-Date Ended | |
|---|---|---|---|---|
| | June 25, 2010 | July 1, 2011 | June 25, 2010 | July 1, 2011 |
| | (in thousands) | | | |
| Stock-based compensation | | | | |
| Stock options | $ 5,133 | $ 5,930 | $ 13,348 | $ 18,957 |
| Restricted stock units | 2,735 | 4,805 | 6,676 | 13,526 |
| Employee stock purchase plan | 165 | 227 | 477 | 593 |
| Stock appreciation rights | 111 | (46) | 514 | (160) |
| **Total stock-based compensation** | **$ 8,144** | **$ 10,916** | **$ 21,015** | **$ 32,916** |

During the fiscal quarters and fiscal year-to-date periods ended June 25, 2010 and July 1, 2011, grants of stock-based awards were as follows:

| | Fiscal Quarter Ended | | Fiscal Year-to-Date Ended | |
|---|---|---|---|---|
| | June 25, 2010 | July 1, 2011 | June 25, 2010 | July 1, 2011 |
| Stock options granted | 106,710 | 98,155 | 1,446,881 | 1,529,468 |
| Weighted average exercise price of options granted | $ 64.13 | $ 46.35 | $ 51.91 | $ 64.09 |
| Restricted stock units granted | 22,580 | 26,540 | 406,030 | 456,165 |
| Weighted average grant price of restricted stock units granted | $ 64.21 | $ 46.35 | $ 51.82 | $ 63.24 |

## 6. Restructuring

During the fiscal quarter ended June 25, 2010, we informed approximately 60 general and administrative employees of our plans to reorganize certain aspects of our global business infrastructure. As a result of this action, we offered severance benefits to the affected employees. The majority of these employees were required to render service through November 15, 2010 to receive these severance benefits. We recognized the total severance and other associated costs of approximately $3.9 million for these employees on a ratable basis through termination dates for each employee. These expenses are recognized in restructuring charges, net, in the condensed consolidated statements of operations.

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

| | Severance | Other associated costs | Total |
|---|---|---|---|
| | (in thousands) | | |
| Balance at September 24, 2010 | $ 2,804 | $ 230 | $ 3,034 |
| | 836 | (99) | 737 |

| | | | |
|---|---|---|---|
| Restructuring charges | | | |
| Cash payments | (3,640) | (131) | (3,771) |
| **Balance at July 1, 2011** | **$ -** | **$ -** | **$ -** |

**7. 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. Other than as described in Note 11 *Subsequent Events* , there has been no material change in the status of legal proceedings since our fiscal year ended September 24, 2010.

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### 8. Guarantees and Contingencies

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 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.

### 9. Common Stock Repurchase Program

In November 2009, we announced a stock repurchase program, whereby we may repurchase up to $250.0 million of our Class A common stock. In July 2010, our Board of Directors approved an additional $300.0 million for our stock repurchase program, for a total authorization of up to $550.0 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, 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.

Stock repurchase activity under the stock repurchase program during the fiscal year-to-date period ended July 1, 2011 is summarized as follows:

| | Shares Repurchased | Cost (in thousands) (1) | Average Price Paid per Share (2) |
|---|---|---|---|
| Repurchase activity for the fiscal quarter ended December 31, 2010 | 732,665 | $ 45,966 | $ 62.72 |
| Repurchase activity for the fiscal quarter ended April 1, 2011 | 546,940 | 29,158 | $ 53.30 |
| Repurchase activity for the fiscal quarter ended July 1, 2011 | 1,465,264 | 67,376 | $ 45.97 |
| **Total** | 2,744,869 | $ 142,500 | |

(1) Cost of stock repurchases includes the price paid per share and applicable commissions.

(2) Excludes commission costs.

### 10. Comprehensive Income and Supplemental Equity Information

***Comprehensive Income***

The components of comprehensive income were as follows:

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| | Fiscal Quarter Ended | | Fiscal Year-to-Date Ended | |
|---|---|---|---|---|
| | June 25, 2010 | July 1, 2011 | June 25, 2010 | July 1, 2011 |
| | (in thousands) | | | |
| Net income including controlling interest | $ 63,688 | $ 62,047 | $ 219,500 | $ 231,294 |
| Other comprehensive income: | | | | |
| Foreign currency translation adjustment, net of tax | (975) | 1,191 | (5,101) | 4,535 |
| Unrealized gains / (losses) on available-for-sale securities, net of tax | 91 | 342 | (532) | (314) |
| Comprehensive income | 62,804 | 63,580 | 213,867 | 235,515 |
| Less: comprehensive income attributable to controlling interest | (361) | (292) | (414) | (1,225) |
| **Comprehensive income attributable to Dolby Laboratories, Inc.** | **$ 62,443** | **$ 63,288** | **$ 213,453** | **$ 234,290** |

***Supplemental Equity Information***

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

**Dolby Laboratories, Inc. (in thousands)**

| | Shares of common stock | Common stock | Additional paid-in capital | Retained earnings | Accumulated other comprehensive income | Total Dolby Laboratories, Inc. | Controlling Interest | Total |
|---|---|---|---|---|---|---|---|---|
| **Balance at September 25, 2009** | **113,849** | **$ 113** | **$ 478,979** | **$ 852,475** | **$ 9,541** | **$ 1,341,108** | **$ 21,997** | **$ 1,363,105** |
| Net income | - | - | - | 218,436 | - | 218,436 | 1,064 | 219,500 |
| Translation adjustments, net of taxes of $2,882 | - | - | - | - | (4,451) | (4,451) | (650) | (5,101) |
| Unrealized losses on available-for-sale securities, net of taxes of $324 | - | - | - | - | (532) | (532) | - | (532) |
| Distributions to controlling interest | - | - | - | - | - | - | (127) | (127) |
| Stock-based compensation expense | - | - | 20,501 | - | - | 20,501 | - | 20,501 |
| Repurchase of common stock | (3,099) | - | (177,648) | - | - | (177,648) | - | (177,648) |
| Tax benefit from the exercise of Class A and Class B stock options and vesting of restricted stock units | - | - | 16,401 | - | - | 16,401 | - | 16,401 |
| Class A common stock issued under employee stock plans, net of stock withheld for taxes | 1,289 | - | 34,814 | - | - | 34,814 | - | 34,814 |
| Exercise of Class B stock options | 887 | - | 2,194 | - | - | 2,194 | - | 2,194 |
| **Balance at June 25, 2010** | **112,926** | **$ 113** | **$ 375,241** | **$ 1,070,911** | **$ 4,558** | **$ 1,450,823** | **$ 22,284** | **$ 1,473,107** |

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**Dolby Laboratories, Inc. (in thousands)**

| | Shares of common stock | Common stock | Additional paid-in capital | Retained earnings | Accumulated other comprehensive income | Total Dolby Laboratories, Inc. | Controlling Interest | Total |
|---|---|---|---|---|---|---|---|---|
| **Balance at September 24, 2010** | **112,084** | **112** | **329,902** | **1,135,922** | **7,801** | **$ 1,473,737** | **20,942** | **1,494,679** |
| Net income | - | - | - | 230,196 | - | 230,196 | 1,098 | 231,294 |
| Translation adjustments, net of taxes of ($149) | - | - | - | - | 4,408 | 4,408 | 127 | 4,535 |
| Unrealized losses on available-for-sale securities, net of taxes of $197 | - | - | - | - | (314) | (314) | - | (314) |
| Distributions to controlling interest | - | - | - | - | - | - | - | - |
| Stock-based compensation expense | - | - | 32,575 | - | - | 32,575 | - | 32,575 |
| Capitalized stock-based compensation expense | - | - | 445 | - | - | 445 | - | 445 |
| Repurchase of common stock | (2,745) | (3) | (142,497) | - | - | (142,500) | - | (142,500) |
| Tax benefit from the exercise of Class A and Class B stock options and vesting of restricted stock units | - | - | 12,232 | - | - | 12,232 | - | 12,232 |
| Class A common stock issued under employee stock plans, net of stock withheld for taxes | 963 | 1 | 21,845 | - | - | 21,846 | - | 21,846 |
| Exercise of Class B stock options | 450 | 1 | 1,073 | - | - | 1,074 | - | 1,074 |
| **Balance at July 1, 2011** | **110,752** | **$ 111** | **$ 255,575** | **$ 1,366,118** | **$ 11,895** | **$ 1,633,699** | **$ 22,167** | **$1,655,866** |

**11. Subsequent Events**

During the fiscal quarter ended July 1, 2011, we filed patent infringement lawsuits in the United States and in Germany against Research in Motion Ltd. (RIM), a previously unlicensed user of certain of our patented technologies. After July 1, 2011, RIM signed a license agreement with Via, our wholly-owned subsidiary and the licensing administrator for the patent pool which includes Dolby s essential AAC patents, which entitles us to back royalties for Dolby technologies used in RIM s products. Based on this license agreement, we expect to recognize back royalties related to the Dolby patents and Via administration fees of approximately $15.2 million as revenue during the fourth quarter of fiscal 2011. We also expect to receive interest related to these back royalties of approximately $2.2 million, which is expected to be recognized as interest income.

On August 4, 2011, we announced an additional $250.0 million authorization for repurchases of our Class A Common Stock under our existing stock repurchase program to offset dilution from the Company s equity compensation programs. 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. The timing of repurchases and the number of shares repurchased will depend on a variety of factors including price, regulatory requirements, the rate of dilution from the Company s equity compensation programs, and other market conditions. We may limit, suspend or terminate the stock repurchase program at any time without prior notice. Any shares repurchased under the program will be returned to the status of authorized but unissued shares of Class A Common Stock.

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## 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 Form 10-Q. These discussions contain forward-looking statements reflecting our current expectations that 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 other comp 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 measures of results of operations; our expectations regarding demand and acceptance for our technologies; growth opportunities and trends in the market in which we operate; our plans, strategies and expected opportunities in general, and with respect to our PC market in particular; the deployment of and demand for our products and 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 the section entitled Risk Factors in Part II, Item 1A 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 actual results.*

### Overview

Dolby Laboratories develops and delivers innovative products and technologies that are used throughout the entertainment industry to produce immersive and enjoyable experiences. Over the years, Dolby has introduced innovations that have significantly improved audio entertainment, such as noise reduction for the recording and cinema industries and surround sound for cinema and home entertainment. As a result of these innovations, we believe the Dolby brand has come to symbolize a superior entertainment experience.

Our audio technologies are used throughout the global entertainment industry to deliver a premium audio experience to consumers. Use of our technologies in each step of the entertainment creation, distribution, and playback process enables the creator, the producer, and the distributor to develop and present their content to consumers in the manner they intended.

There are a number of current industry trends that provide us with opportunities for future growth, such as the transition to digital television from analog television, and the delivery of media content online and via mobile devices. These trends present us with an opportunity to extend the adoption of our technologies to new devices, as the methods by which content can be delivered and the number of devices capable of playing back content increase.

We are developing and marketing video technologies that we believe can improve the quality of video presentation. Our offerings include video products aimed at the cinema market, such as our digital cinema server and our Dolby 3D Digital Cinema products. We also offer our Dolby PRM-4200 Professional Reference Monitor, which we market to video professionals. In addition, we are developing and marketing multiparty voice technologies for use in online gaming and other markets.

We view the voice market and certain areas of the video market, such as our Professional Reference Monitor, as early-stage opportunities for us. We believe that our well-recognized brand, our existing customer relationships, and our history of introducing successful, innovative technologies are important strengths that will help us pursue these opportunities.

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**Business Model**

Dolby Laboratories is a global organization that generates revenue by licensing technologies to original equipment manufacturers (OEM) of consumer entertainment (CE) products and to software vendors, and by selling products and related services to entertainment content creators and to distributors.

We work with the global entertainment industry in three principal ways:

First, we offer products and services to content creators and distributors, such as studios, television broadcasters, cable television operators, satellite television operators and increasingly, content streaming and download service providers. These content creators and distributors use our products and services to encode content using our technologies, allowing them to deliver a rich and immersive audio experience for consumers.

Second, we license our technologies, such as Dolby Digital, Dolby Digital Plus and Dolby Pulse, to OEMs and to software vendors to decode and play back audio content so that consumers can enjoy the content that has been encoded with our proprietary technologies. In so doing, we develop and deliver innovations directly to OEMs and to software vendors.

Third, we work directly with standards-setting organizations in an effort to have our technologies adopted in their specifications to ensure a common standard across devices that improves the overall consumer experience. Today, our technologies are standard in a wide range of CE products, including virtually all DVD players, audio/video receivers, and personal computer (PC) software DVD players.

We have licensed our technologies to OEMs and to software vendors in 40 countries and our licensees distribute their products incorporating our technologies throughout the world. We sell our products and provide services in over 85 countries. In fiscal 2009, 2010, and the fiscal year-to-date period ended July 1, 2011, revenue from outside of the U.S. was 65%, 66%, 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 end location where we ship our products, while services revenue is based on the location where services are performed.

**Opportunities, Challenges, and Risks**

Our revenue increased 2% in the fiscal year-to-date period ended July 1, 2011 when compared to the same period in the prior fiscal year, driven by increased licensing revenue which more than offset decreased products revenue. 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. Additionally, as described below, our licensing revenue is subject to uncertainties and market and technology trends relating to market growth as well as the mix of CE products containing our technologies. Our licensing business could be affected by adverse changes in general economic conditions because our technologies are incorporated in CE products, many of which are discretionary goods. Furthermore, as described below, our products business and revenue are subject to intense competition and uncertainties relating to the transition to 3D cinema, and events and uncertainties relating to purchasing decisions by our customers.

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Licensing revenue constitutes the majority of our total revenue, representing 83%, 77%, and 82% of total revenue in fiscal 2009, fiscal 2010, and the fiscal year-to-date period ended July 1, 2011, respectively. We categorize our licensing revenue into the following markets (items listed in each market incorporate our technologies):

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

The growth of the internet, accompanied by a shift to online content consumption, has resulted in a consumer trend toward an array of online streaming and download services around the world. With this shift, online content is now being delivered to a universe of playback devices beyond the PC, such as connected TVs, set-top boxes, and gaming consoles as well as tablets and mobile devices. We view this shift as an opportunity to provide additional value to the entertainment ecosystem by improving the audio experience for content delivered online and by increasing compatibility across these devices. In particular, we view this as an opportunity to deliver high quality audio experiences across a wider range of playback devices and online services while reducing the likelihood of inconsistent playback experiences.

In the area of content creation and delivery, in addition to our formats being standard in DVD, Blu-ray and broadcast, we are working to extend our formats to online delivery services. To achieve this we are working to get more online content encoded with our technologies. For example, we work with aggregators of online content, such as Netflix, Amazon, VUDU, Apple, and the Roxio Now platform, to encode content and with leading music services, such as Rhapsody and Omnifone, to adopt our encoding tools for a rich music experience.

Our PC market represented approximately 35%, 36%, and 31% of our licensing revenue in fiscal 2009, fiscal 2010, and the fiscal year-to-date period ended July 1, 2011, respectively. Our technologies are a common ingredient in most PCs today, primarily due to the popularity of DVD and Blu-ray playback being incorporated into PCs as well as the inclusion of Dolby technologies in the DVD and Blu-ray standards. We expect the growth of the internet and online content consumption to provide an opportunity to deliver additional value on the PC and to increase our addressable market by improving the audio experience for content delivered online and by increasing the compatibility across these devices.

Over time, we have licensed our technologies to a range of PC licensees including independent software vendors (ISVs), PC manufacturers (OEMs), and operating system providers. The release of major operating systems has historically resulted in changes in the mix of our PC licensees. In 2007, Microsoft introduced its Windows Vista operating system, which included our technologies within two of its operating system editions to enable DVD audio playback. In fiscal 2009, Microsoft released its current operating system, Windows 7, which includes our technologies within four editions to enable DVD audio playback. Over this period of time, the mix of our PC licensing revenue from operating systems has increased relative to that from OEMs and ISVs. Currently, we 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. We also license our technologies through ISVs such as Cyberlink and Corel.

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Our technologies are not included in the current software build of the Windows 8 operating system under development. If our technologies are not included in the commercial version of the Windows 8 operating system, we expect to support DVD playback functionality by increasingly licensing our technologies directly to OEMs and ISVs and we will seek to extend our technologies to support online content playback. Given the anticipated release date of Windows 8, we would not expect these changes to have a financial impact until fiscal 2013, 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. Beyond this, the financial impact is uncertain and would depend on several factors, including:

- The extent and rate at which Windows 8 is adopted in the marketplace;
- The extent to which earlier versions of Microsoft operating systems, including Windows 7, continues to be licensed after the release of Windows 8;
- Our ability to establish and extend direct licensing relationships with OEMs and ISVs, as we have done in the past;
- The rate at which disc-based media shifts to online media content resulting in fewer PCs with optical disc drives and declines in PC DVD and Blu-ray Disc players;
- If we license our technologies on a per device basis, rather than on a per application basis, we will no longer collect multiple royalties per PC which may impact our results of operations; and
- Our ability to extend the adoption of our technologies in online and mobile platforms.

In the short term, revenue from our PC market continues to be 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:

- Unauthorized and infringing PC software with our technologies for which we do not receive royalty payments;
- Purchasing trends for netbooks, low-cost PCs, and tablets, which may not include operating systems or ISV media applications with our technologies;
- We may not realize positive effects to the extent we anticipate, or the positive effects may be delayed, from the inclusion of our technologies in business-oriented editions of Windows 7;
- The inclusion of our technologies in business-oriented editions of Windows 7 could result in our technologies residing in a greater percentage of PCs, resulting in substantial discounts and reducing the average per unit royalty we receive from Microsoft over time; and
- Certain PC OEMs have excluded, and we expect others will exclude in the future, ISV media applications from their product offerings, because Windows 7 incorporates DVD playback software.

Our broadcast market, driven by demand for our technologies in televisions and set-top boxes, represented approximately 25%, 27%, and 30% of our licensing revenue in fiscal 2009, fiscal 2010, and the fiscal year-to-date period ended July 1, 2011, respectively. We view the broadcast market as an area for potential continued growth, primarily driven by geographic markets outside of the U.S. We also view broadcast services,

such as terrestrial broadcast or IPTV services, which operate under particular bandwidth constraints, as another area of opportunity for us to offer Dolby Digital Plus, HE AAC, and Dolby Pulse, which enable the delivery of high-quality audio content at reduced bit rates, thereby conserving bandwidth. Notwithstanding our success in the broadcast market to date, we may not be able to capitalize on these opportunities and actual results may differ from our expectations.

Our CE market, driven primarily by revenue attributable to sales of DVD players and recorders and Blu-ray Disc players, represented approximately 25%, 22%, and 22% of licensing revenue in fiscal 2009, fiscal 2010, and the fiscal year-to-date period ended July 1, 2011, respectively. Blu-ray Disc continues to represent an important source of revenue within our CE market, as Blu-ray Disc players are required to support Dolby Digital for primary audio content and Dolby Digital Plus for secondary audio content, and Dolby TrueHD is an optional audio standard. However, there is a risk that revenue from Blu-ray Disc players may not offset future declines in revenue from DVD players and that Blu-ray Disc revenue could decline.

Revenue generated from our other markets was driven by gaming, mobile, licensing services, and automotive. Gaming and automotive revenue was primarily driven by sales of video game consoles and in-car entertainment systems with Dolby Digital, Dolby TrueHD, Dolby Digital Plus and ATRAC technologies. Mobile revenue was primarily driven by demand for the AAC, HE AAC, and Dolby Pulse audio compression technologies incorporated into mobile devices and Dolby Mobile, our suite of post processing technologies optimized for mobile devices. We

view the mobile market as an area of opportunity to increase revenue, however actual results may differ from our expectations. Revenue from licensing services was primarily driven by demand for standards-based audio compression technologies used in broadcast, PC, CE, and mobile products.

During the fiscal quarter ended July 1, 2011, we filed patent infringement lawsuits in the United States and in Germany against Research in Motion Ltd. (RIM), a previously unlicensed user of certain of our patented technologies. After July 1, 2011, RIM signed a license agreement with Via, our wholly-owned subsidiary and the licensing administrator for the patent pool which includes Dolby s essential AAC patents, which entitles us to back-royalties for Dolby technologies used in RIM s products. See Note 11, *Subsequent Events* for additional information.

Consumer entertainment products throughout the world incorporate our technologies. We expect that sales of products incorporating our technologies in emerging economies, such as Brazil, China, India, and Russia, will increase as consumers in these markets have more disposable income to purchase entertainment products, although there can be no assurance that this will occur. We also expect that OEMs in lower cost manufacturing countries, including China, will increase production of consumer entertainment products in the future to satisfy this increased demand. Additionally, we have seen OEMs shift product manufacturing to these lower cost manufacturing countries. There are risks associated with the opportunities of doing business in emerging economies that have affected, and will continue to affect, our operating results, such as OEMs failing to report or underreporting product shipments containing our technologies.

We continue to monitor the situation in Japan in light of the March 2011 earthquake and tsunami to determine any potential risks of disruption which would adversely affect our operating results. While we are unable to predict the effect of the recent earthquake and tsunami on our licensee s global supply chains and on demand in Japan, if the situation in Japan does not improve or worsens, it could adversely affect our future operating results. While we have not identified any significant disruptions to our business or supply chains to date, the situation remains uncertain.

Products revenue, driven primarily by sales of equipment to cinema operators and broadcasters, represented 13%, 20%, and 14% of our total revenue in fiscal 2009, fiscal 2010, and the fiscal year-to-date period ended July 1, 2011, respectively.

Our cinema products represented approximately 82%, 90%, and 88% of total products revenue in fiscal 2009, fiscal 2010, and the fiscal year-to-date period ended July 1, 2011, respectively. Sales of our cinema products tend to fluctuate based on the underlying trends in the cinema industry including the popularity of individual films, as cinema owners often purchase equipment to meet expected box office demand.

There is a trend in the cinema industry to transition to digital cinema. Digital cinema offers motion picture studios a means to achieve cost savings in printing and distributing movies, to combat piracy, and to enable repeated movie playback without degradation in image and audio quality. We offer our Dolby Digital Cinema screen server and central library server, which allow for the storage and playback of digital content, as well as our digital audio processor. We expect most cinema owners who are either constructing new theaters or upgrading existing theaters to choose digital cinema products over traditional film cinema products. 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 in the digital cinema products market than we have experienced with our traditional film cinema products.

Digital cinema standards are defined by the Digital Cinema Initiative ( DCI ) specifications. Our currently available digital cinema server software does not comply with the current DCI specifications. We are developing software upgrades and expect to be able to comply with the current DCI specifications in early fiscal 2012. In the meantime, cinema owners may delay or choose not to purchase our digital cinema products. If cinema owners do purchase our digital cinema products, they may require contractual provisions that obligate us to comply with the current DCI specifications within a certain period of time. Should Dolby systems not be in compliance within the timeframe, we may be contractually obligated for selected customers to replace the non-compliant systems with compliant systems.

The transition to digital cinema has been driven, in part, by the recent transition to 3D enabled screens, which require digital servers for 3D playback. Our digital 3D products provide 3D image capabilities when combined with a digital cinema projector and server. While we believe the success of certain 3D cinema releases has led to the creation and distribution of more 3D cinema content, we are uncertain at what point demand for 3D enabled screens will be substantially satisfied. Additionally, the 3D market has become increasingly competitive, leading to our loss

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of market share. We also face risks that our customers maintain excess product inventory levels which could reduce future anticipated sales.

Several competitors have introduced digital cinema products that support the presentation of movies with higher resolution 4K digital cinema projectors. Certain major exhibitors have begun installing 4K digital cinema equipment into their theaters. In the future, other exhibitors may feel that they need to outfit some or all of their theaters with 4K digital cinema equipment to compete in the same markets where competitors are promoting 4K products. Dolby currently does not offer a 4K digital cinema solution. We are developing a 4K digital cinema solution and if we encounter delays or cancel the development of the solution, our future prospects in digital cinema may be limited and our business could be adversely affected.

Our traditional film cinema products are primarily used to read and decode a film s soundtrack, to calibrate cinema sound systems, and to adapt analog cinema audio systems to digital audio formats. As the cinema industry has invested more in digital cinema, revenue from our traditional film cinema products has declined. We expect this decline to continue.

Our broadcast products represented approximately 13%, 9%, and 10% of products revenue in fiscal 2009, fiscal 2010, and the fiscal year-to-date period ended July 1, 2011. 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 the fiscal quarter ended December 31, 2010, we began selling our Professional Reference Monitor product, which is a flat-panel video reference display for video professionals. 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 enable enhanced contrast, extended brightness and dynamic range, along with reduced power consumption in LED backlit LCD televisions. We do not anticipate generating significant revenue from this product in fiscal 2011.

Our services revenue, which represented approximately 4%, 3%, and 4% of total revenue in fiscal 2009, fiscal 2010, and the fiscal year-to-date period ended July 1, 2011, respectively, is primarily tied to the cinema industry and, in particular, to the number of movies being made 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 that many governments provide filmmakers to promote local filmmaking.

**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., or U.S. GAAP, and with Securities and Exchange Commission (SEC) rules and regulations. U.S. 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 and estimate to be critical if it is both important to a company s financial condition and/or results of operations and if it 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. There have been no material changes to our critical accounting policies and estimates as compared to those described in our Annual Report on Form 10-K for the fiscal year ended September 24, 2010. 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 they 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 our *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 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 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 separately and we allocate the arrangement fees based on the relative selling price of each element. For some arrangements, customers receive certain elements over a period 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 over either 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 involving tangible products, we allocate consideration 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 have established VSOE for a majority of the undelivered elements in our ME arrangements. For these arrangements, the VSOE and the ESP values are essentially the same. For arrangements where VSOE does not exist, we use ESP.

We account for the majority of our digital cinema server sales as ME arrangements that have two 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

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hardware element and is typically delivered over a service period subsequent to the initial sale. The application of 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, which we recognize as revenue at the time of sale. A small portion of the arrangement fees are allocated to the undelivered support and maintenance element, based on its VSOE or ESP, and is recognized as revenue ratably over the estimated service period, which is typically three years.

***Goodwill, Intangible Assets, and Long-Lived Assets***

We evaluate and test our goodwill for impairment at a reporting unit level. A reporting unit is an operating segment or one level below. Our operating segments are aligned with the management principles of our business. The goodwill impairment test is a two-step process. In the first step, we compare the carrying value of the net assets of a reporting unit, including goodwill, to its fair value. If we determine that the fair value of the reporting unit is less than its carrying value, we move to the second step to determine the implied fair value of the reporting unit s goodwill. If the carrying value of a reporting unit s goodwill exceeds its implied fair value, we would record an impairment loss equal to the difference. We test goodwill for impairment annually during our third fiscal quarter and if an event occurs or circumstances change such that there is an indication of a reduction in the fair value of a reporting unit below its carrying value.

We use the income approach to determine the fair value of our reporting units, which is based on the present value of estimated future cash flows for each reporting unit. Fair value reflects the price a market participant would be willing to pay in a potential sale of the reporting unit. During our annual goodwill impairment test performed during the third quarter of fiscal 2011, we had two reporting units Via, which has no assigned goodwill, and Dolby Entertainment Technology (DET), with goodwill of $268.0 million. The cash flow model was based on our best estimate of future revenue and operating costs. We estimated our future revenue by applying growth rates consistent with those used in our internal forecasts to our current revenue forecasts. The revenue and cost estimates were based on several sources including our historical information, third-party industry data, and review of our internal operations. The cash flow forecasts were adjusted by a discount rate of approximately 13.5% based on our weighted average cost of capital derived by using the capital asset pricing model. The primary components of this model include weighting our total asset structure between our equity and debt, the risk-free rate of return on U.S. Treasury bonds, market risk premium based on a range of historical returns and forward-looking estimates, and the beta of our common stock. Our model used an effective tax rate of approximately 30%.

Based on the methodology described above, the fair value of our DET reporting unit exceeds its carrying value; therefore, we did not recognize an impairment charge related to goodwill in the third quarter of fiscal 2011. Our market capitalization at the end of our third quarter of fiscal 2011 was approximately $4.8 billion, which exceeded the aggregate carrying value of our reporting units by approximately 190%.

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 comparison of its carrying amount to the total future undiscounted cash flows that the asset is expected to generate. If it is determined that an asset is not recoverable, an impairment loss is recorded in the amount by which the carrying amount of the asset exceeds its estimated fair value.

***Accounting for Income Taxes***

We make estimates and judgments that affect our accounting for income taxes. This includes estimating actual tax exposure together with assessing 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

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sheets. We also assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent that we believe that 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 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 uncertainties in income 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 that would be 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. Authoritative guidance 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 that are not in active markets from a primary professional pricing service using quoted market prices for identical or comparable instruments, rather than direct observations of quoted prices in active markets.

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 unobservable 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 employee stock-based awards by estimating their fair value and by recognizing that value as an expense, on a ratable basis, in the condensed consolidated financial statements over the requisite service period in which our employees earn the awards. 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 awards, the expected future volatility of our stock price over the expected term of the awards, and the risk-free interest rate over the expected term of the awards. 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.

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**Results of Operations**

***Revenue***

| | Fiscal Quarter Ended | | Change | | Fiscal Year-to-Date Ended | | Change | |
|---|---|---|---|---|---|---|---|---|
| | June 25, 2010 | July 1, 2011 | $ | % | June 25, 2010 | July 1, 2011 | $ | % |
| | ($ in thousands) | | | | | | | |
| Licensing | $ 170,326 | $ 181,790 | $ 11,464 | 7% | $ 532,045 | $ 584,593 | $ 52,548 | 10% |
| *Percentage of total revenue* | *74%* | *83%* | | | *77%* | *82%* | | |
| Products | 52,651 | 28,395 | (24,256) | -46% | 140,147 | 100,769 | (39,378) | -28% |
| *Percentage of total revenue* | *23%* | *13%* | | | *20%* | *14%* | | |
| Services | 7,292 | 8,814 | 1,522 | 21% | 22,714 | 26,375 | 3,661 | 16% |
| *Percentage of total revenue* | *3%* | *4%* | | | *3%* | *4%* | | |
| **Total revenue** | **$ 230,269** | **$ 218,999** | **$ (11,270)** | **-5%** | **$ 694,906** | **$ 711,737** | **$ 16,831** | **2%** |

*Licensing*. The 7% increase in licensing revenue from the third quarter of fiscal 2010 to the third quarter of fiscal 2011 was primarily driven by an increase in revenue from our broadcast market and to a lesser extent, by increases in revenue from our other markets, which was partially offset by a decrease in revenue from our PC market. The increase in revenue from our broadcast market was primarily driven by shipments of set-top boxes and digital televisions that incorporate our technologies in the third quarter of fiscal 2011 when compared to the third quarter of fiscal 2010. The increase in revenue from our other markets was primarily due to an increase in our mobile market. The decreases in our PC market were primarily due to decreased ISV media applications in PC shipments. We expect that the decreases in ISV-related revenue will continue in the future, although the effect on our future PC licensing revenue is uncertain.

The 10% increase in licensing revenue from the fiscal year-to-date period ended June 25, 2010 to the fiscal year-to-date period ended July 1, 2011 was primarily driven by increases in our broadcast and CE markets, in addition to increases in revenue from our other markets, partially offset by declines in PC. The increase in revenue from our broadcast market was primarily driven by shipments of digital televisions and set-top boxes that incorporate our technologies in the fiscal year-to-date period ended July 1, 2011 when compared to the fiscal year-to-date period ended June 25, 2010.

The increase in revenue from our CE market is primarily driven by an increase in revenue from shipments of Blu-ray Disc players and home-theater-in-a-box systems incorporating our technologies. The increase in revenue from our other markets was primarily driven by an increase in our mobile market, due to sales of products containing Dolby Mobile technology. The decrease in revenue from PC is due to the same reasons discussed above.

*Products*. The 46% decrease in products revenue from the third quarter of fiscal 2010 to the third quarter of fiscal 2011 was primarily driven by a decrease in revenue from our 3D products and to a lesser extent by a decrease in revenue from our digital cinema video and traditional cinema products. Additionally, in the third quarter of fiscal 2010, revenue included recognition of $5.1 million of deferred revenue related to sales prior to the beginning of fiscal 2010, which were accounted for under previous revenue accounting standards. In the third quarter of fiscal 2011, substantially all products revenue resulted from current period sales accounted for under the new accounting standards.

Decreased 3D product sales in the third quarter of fiscal 2011 resulted from increased competition and reduced demand from a significant 3D customer. Our product sales are likely to be materially affected if demand for our 3D products does not improve. Decreases in our digital cinema video products revenue resulted from increased competition and reduced pricing, while decreases in traditional cinema products revenue were primarily due to lower units shipments as more exhibitors convert to digital cinema.

Products revenue decreased 28% from the fiscal year-to-date period ended June 25, 2010 to the fiscal year-to-date period ended July 1, 2011. The year-to date period ended June 25, 2010 included recognition of $27.1 million

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of deferred revenue related to sales prior to the beginning of fiscal 2010, which were accounted for under previous revenue accounting standards. Additionally, we saw decreased sales of 3D products from the fiscal year-to-date period ended June 25, 2010 to the fiscal year-to-date period ended July 1, 2011, for the same reasons discussed above.

*Services*. The 21% increase in services revenue from the third quarter of fiscal 2010 to the third quarter of fiscal 2011 was primarily attributable to increases in revenue from mastering services on digital and traditional films and other engineering services.

The 16% increase in services revenue from the fiscal year-to-date period ended June 25, 2010 to the fiscal year-to-date period ended July 1, 2011 was due to engineering services, support and maintenance, and content protection services.

***Gross Margin***

| | **Fiscal Quarter Ended** | | **Fiscal Year-to-Date Ended** | |
|---|---|---|---|---|
| | **June 25, 2010** | **July 1, 2011** | **June 25, 2010** | **July 1, 2011** |
| | **($ in thousands)** | | | |
| Cost of licensing | $ 3,719 | $ 4,095 | $ 13,282 | $ 13,827 |
| *Licensing gross margin percentage* | *98%* | *98%* | *98%* | *98%* |
| Cost of products | 23,336 | 20,320 | 72,042 | 62,549 |
| *Products gross margin percentage* | *56%* | *28%* | *49%* | *38%* |
| Cost of services | 3,407 | 3,518 | 10,554 | 9,153 |
| *Services gross margin percentage* | *53%* | *60%* | *54%* | *65%* |
| Impairment of products provided under operating leases | 9,594 | - | 9,594 | - |
| **Total gross margin percentage** | **83%** | **87%** | **85%** | **88%** |

*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 was unchanged from the third quarter of fiscal 2010 to the third quarter of fiscal 2011, and from the fiscal year-to-date period ended June 25, 2010 when compared to the fiscal year-to-date period ended July 1, 2011.

*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 decreased 28 points from the third quarter of fiscal 2010 to the third quarter of fiscal 2011, primarily due to increased promotional pricing on 3D and reduced pricing on digital cinema products during the third quarter of fiscal 2011. Additionally, as exhibitors continue to transition to digital cinema, we are realizing reduced margins on traditional cinema products.

Products gross margin decreased 11 points from the fiscal year-to-date period ended June 25, 2010 to the fiscal year-to-date period ended July 1, 2011. This decrease is primarily due to $4.2 million of discrete charges in the second quarter of fiscal 2011, as well as an additional $0.5 million of net discrete charges in the third quarter related to inventory adjustments partially offset by retroactive third-party royalty reductions. The decrease in margin is also partially attributable to increased promotional pricing on 3D products during the second and third quarters of fiscal 2011, as well as recognition in the fiscal year-to-date period ended June 25, 2010 of $27.1 million of deferred revenue and associated costs related to digital cinema and 3D product sales prior to the beginning of fiscal 2010,

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which had higher margins than our current digital cinema and 3D product sales.

*Services Gross Margin*. Cost of services primarily consists of personnel and personnel-related costs for employees performing our professional services, the cost of outside consultants, and reimbursable expenses incurred on behalf of customers. Services gross margin increased 7 points from the third quarter of fiscal 2010 to the third quarter of fiscal 2011 due to a higher percentage of security certificate and support and maintenance revenue, which have higher gross margins due to lower associated costs, in the third quarter of fiscal 2011. These increases were partially offset by a lower percentage of virtual print fee revenue. While we continue to recognize revenue related to our digital cinema equipment that we leased to exhibitors, the majority of these assets were classified as held for sale. Accordingly, depreciation was not recorded for these assets in fiscal 2011.

Services gross margin increased 11 points from the fiscal year-to-date period ended June 25, 2010 to the fiscal year-to-date period ended July 1, 2011, due to the same reasons discussed above.

***Operating Expenses***

| | Fiscal Quarter Ended | | Change | | Fiscal Year-to-Date Ended | | Change | |
|---|---|---|---|---|---|---|---|---|
| | June 25, 2010 | July 1, 2011 | $ | % | June 25, 2010 | July 1, 2011 | $ | % |
| | ($ in thousands) | | | | | | | |
| Research and development | $ 27,513 | $ 34,086 | $ 6,573 | 24% | $ 75,561 | $ 90,812 | $ 15,251 | 20% |
| *Percentage of total revenue* | *12%* | *16%* | | | *11%* | *13%* | | |
| Sales and marketing | 36,527 | 36,726 | 199 | 1% | 93,635 | 112,488 | 18,853 | 20% |
| *Percentage of total revenue* | *16%* | *17%* | | | *13%* | *16%* | | |
| General and administrative | 29,165 | 32,397 | 3,232 | 11% | 86,677 | 104,594 | 17,917 | 21% |
| *Percentage of total revenue* | *13%* | *15%* | | | *12%* | *15%* | | |
| Restructuring charges, net | 1,068 | (48) | (1,116) | -104% | 1,371 | 737 | (634) | -46% |
| *Percentage of total revenue* | *n/a* | *n/a* | | | *n/a* | *n/a* | | |
| | **$ 94,273** | **$ 103,161** | **$ 8,888** | **9%** | **$ 257,244** | **$ 308,631** | **$ 51,387** | **20%** |

The fiscal year-to-date periods presented herein include the 39 week period ended June 25, 2010, and the 40 week period ended July 1, 2011. This additional week in the first quarter of fiscal 2011 resulted in additional expenses, primarily related to personnel and personnel-related costs.

*Research and Development*. Research and development expenses consist primarily of personnel and personnel-related costs, facility costs, stock-based compensation expense, consulting and temporary help, and depreciation of property, plant and equipment. The 24% increase in research and development expenses from the third quarter of fiscal 2010 to the third quarter of fiscal 2011 was primarily driven by increases in personnel costs due to increased headcount, accelerated amortization due to a change in estimated useful life of certain acquired intangible assets, and stock-based compensation expense, partially offset by decreases in performance-based compensation expenses.

The 20% increase in research and development expenses for the fiscal year-to-date period ended June 25, 2010 to the fiscal year-to-date period ended July 1, 2011 is primarily due to the same reasons discussed above.

*Sales and Marketing*. Sales and marketing expenses consist primarily of personnel and personnel-related expenses, advertising and promotion expenses, stock-based compensation expense, travel-related expenses for our sales and marketing functions, and facility costs. Sales and marketing expenses increased 1% from the third quarter of fiscal 2010 to the third quarter of fiscal 2011. This slight increase is due to increases in personnel and personnel-related costs, as well as stock-based compensation expense, offset by decreases in performance-based compensation expenses and outside marketing expenses.

The 20% increase in sales and marketing expenses from the fiscal year-to-date period ended June 25, 2010 to the fiscal year-to-date period ended July 1, 2011 was primarily driven by increases in personnel costs due to increased headcount, and decreases in gains on settlements, which are reductions to operating expenses, due to payments received from implementation licensees in the amount of $7.6 million in the year-to-date period ended June 25, 2010

as compared to less than $0.7 million in the year-to-date period ended July 1, 2011. There were further increases in stock-based compensation expense and depreciation expense related to new offices resulting from worldwide expansion. These increases were partially offset by decreases in performance-based compensation expenses.

*General and Administrative*. General and administrative expenses consist primarily of personnel and personnel-related expenses, professional fees, stock-based compensation expense, consulting and temporary help, and depreciation of property, plant and equipment. The 11% increase in general and administrative expenses from the third quarter of fiscal 2010 to the third quarter of fiscal 2011 was primarily due to increases in consulting and temporary help expense, professional fees related to litigation and patent filings, stock-based compensation expense, lower capitalized labor related to prior year infrastructure projects, and higher facilities costs related to new offices resulting from worldwide expansion. These increases were partially offset by decreases in performance-based compensation expenses and the release of $2.1 million of value-added tax reserves and related estimated penalties resulting from completion of our analysis of recent tax changes in the European Union.

The 21% increase in general and administrative expenses from the fiscal year-to-date period ended June 25, 2010 to the fiscal year-to-date period ended July 1, 2011 is primarily due to the same reasons discussed above.

*Restructuring Charges, net*. Restructuring charges for the fiscal quarter and fiscal year-to-date period ended July 1, 2011 include severance charges attributable to the reorganization of our global business infrastructure. See Note 6 *Restructuring* for additional details.

***Other Income, Net***

| | Fiscal Quarter Ended | | Change | | Fiscal Year-to-Date Ended | | Change | |
|---|---|---|---|---|---|---|---|---|
| | June 25, 2010 | July 1, 2011 | $ | % | June 25, 2010 | July 1, 2011 | $ | % |
| | (in thousands) | | | | | | | |
| Interest income | $ 1,879 | $ 1,670 | $ (209) | (11%) | $ 5,665 | $ 5,237 | $ (428) | (8%) |
| Interest expense | (392) | 690 | 1,082 | 276% | (589) | 322 | 911 | 155% |
| Other income, net | 655 | 186 | (469) | (72%) | 1,124 | 875 | (249) | (22%) |
| **Total other income, net** | **$ 2,142** | **$ 2,546** | **$ 404** | **19%** | **$ 6,200** | **$ 6,434** | **$ 234** | **4%** |

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. Interest expense recorded in the third quarter of fiscal 2011 was driven primarily by the release of $0.8 million of value-added tax interest reserves resulting from completion of our analysis of recent tax changes in the European Union.

***Income Taxes***

| | Fiscal Quarter Ended | | Fiscal Year-to-Date Ended | |
|---|---|---|---|---|
| | June 25, 2010 | July 1, 2011 | June 25, 2010 | July 1, 2011 |
| | ($ in thousands) | | | |
| Provision for income taxes | $34,394 | $28,404 | $118,890 | $92,717 |
| *Effective tax rate* | 35% | 31% | 35% | 29% |

Our effective tax rate is based on a projection of our annual fiscal year results. Our effective tax rate was 35% and 31% for the fiscal quarters ended June 25, 2010 and July 1, 2011, respectively. In the fiscal quarter ended December 31, 2010, we made an election to indefinitely reinvest a portion of our undistributed earnings in a foreign subsidiary, which resulted in a reduction to the fiscal year 2011 tax rate. This election may result in additional decreases to the effective tax rate in future years, but the decreases, if any, cannot yet be determined. Additionally,

in the fiscal quarter ended December 31, 2010, a change in the tax law retroactively reinstated the federal research and development tax credits. As a result, we recognized an increase in federal research and development tax credits for fiscal 2011 compared to fiscal 2010, thereby further lowering our effective tax rate.

As of July 1, 2011, the Company had gross unrecognized tax benefits of $9.7 million, of which $3.6 million would impact the effective tax rate from continuing operations if recognized. During the year-to-date period ended July 1, 2011, there was a $5.3 million decrease in unrecognized tax benefits resulting from the Company s settlement of an audit during the period, of which $0.3 million favorably impacted the effective tax rate.

Our effective tax rate was 35% for the year-to-date period ended June 25, 2010 and 29% for the fiscal year-to-date period ended July 1, 2011. The decrease in the effective tax rate is primarily due to the release in the first quarter of fiscal 2011 of a deferred tax liability of $11.0 million related to the amortization of an intangible asset from a prior year acquisition, which was the result of the restructuring of our international operations. Additionally, the same reasons discussed above with respect to the changes from the third quarter of fiscal 2010 to the third quarter of fiscal 2011 also decreased the effective tax rate for the year-to-date period ended July 1, 2011 when compared to the year-to-date period ended June 25, 2010.

**Liquidity, Capital Resources, and Financial Condition**

| | September 24, 2010 | July 1, 2011 |
|---|---|---|
| | (in thousands) | |
| Cash and cash equivalents | $ 545,861 | $ 594,604 |
| Short-term investments | 302,269 | 309,067 |
| Long-term investments | 190,837 | 280,380 |
| Accounts receivable, net | 54,257 | 39,370 |
| Accounts payable and accrued liabilities | 148,214 | 119,965 |
| Working capital[a] | 894,657 | 957,300 |

| | June 25, 2010 | July 1, 2011 |
|---|---|---|
| Net cash provided by operating activities | $ 259,451 | $ 294,159 |
| Capital expenditures [b] | (24,882) | (30,334) |
| Net cash used in investing activities | (62,022) | (139,783) |
| Net cash used in financing activities | (124,942) | (106,937) |

[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 our operations. We believe that our cash, cash equivalents, short-term investments, and potential cash flows from operations will be sufficient to satisfy our currently anticipated cash requirements through at least the next 12 months.

Net cash provided by operating activities during the fiscal year-to-date period ended July 1, 2011 increased $34.7 million when compared to the fiscal year-to-date period ended June 25, 2010, primarily due to the following:

- An increase in net income, as described above in *Results of Operations*, and
- Increases in non-cash expenses including depreciation and amortization, as well as stock-based compensation expense.

Net cash used in investing activities during the fiscal year-to-date period ended July 1, 2011 increased $77.8 million when compared to the fiscal year-to-date period ended June 25, 2010, primarily due to the following:

An increase in net purchases of available-for-sale investments, and

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An increase in capital expenditures in the fiscal year-to-date period ended July 1, 2011.

Net cash used in financing activities during the fiscal year-to-date period ended July 1, 2011 decreased $18.0 million when compared to the fiscal year-to-date period ended June 25, 2010, primarily due to the following:

Fewer share repurchases and a lower average price paid per share in the fiscal year-to-date period ended July 1, 2011; offset by

Reduced net proceeds from the exercise of employee stock awards.

***Off-Balance-Sheet and Contractual Obligations***

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

As of September 24, 2010, the Company had total outstanding commitments on noncancelable operating leases of approximately $24.9 million. As a result of worldwide expansion and additional leased facilities, total outstanding commitments on noncancelable operating leases rose to approximately $47.2 million as of July 1, 2011.

Other than described above, there has been no material change in our contractual obligations other than in the ordinary course of business since our fiscal year ended September 24, 2010. See our Annual Report on Form 10-K for the fiscal year ended September 24, 2010 for additional information regarding our contractual obligations.

## ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

***Interest Rate Sensitivity***

*Cash, Cash Equivalents and Investments.*

As of July 1, 2011, we had cash and cash equivalents of $594.6 million, which consisted of cash and highly-liquid money market funds. In addition, we had short-term and long-term investments of $589.4 million, which consisted primarily of municipal debt securities, corporate bonds, and U.S. agency securities. These investments are subject to fluctuations in interest rates, which could impact our results. At July 1, 2011 the weighted-average effective maturity of our investment portfolio was less than one year. Based on our investment portfolio balance as of July 1, 2011, a hypothetical change in interest rates of 1% would have approximately a $5.4 million impact, and a change of 0.5% would have approximately a $2.7 million impact on the carrying value of our portfolio.

We do not use financial instruments for trading or other speculative purposes, nor do we use leveraged financial instruments.

***Foreign Currency Exchange Risk***

We maintain sales, marketing, and business operations in foreign countries, most significantly in the United Kingdom, Australia, China and Europe. 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 Pounds, 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 would have increased operating expenses, which would only be partially offset by net revenue. Conversely, if the U.S. dollar strengthens against the local currency, operating expenses will decrease, which would 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 statement 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.

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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 is also based in part on 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 operated 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 July 1, 2011 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 occur, 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 83%, 77%, and 82% in fiscal 2009, 2010, and the fiscal year-to-date period ended July 1, 2011, respectively. We do not manufacture consumer entertainment products ourselves and we depend on licensees and customers, including software vendors and original equipment manufacturers (OEMs), 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.

We continue to monitor the situation in Japan in light of the March 2011 earthquake and tsunami to determine any potential risks of disruption which would adversely affect our operating results. While we are unable to predict the effect of the recent earthquake and tsunami on our licensee s global supply chains and on demand in Japan, if the situation in Japan does not improve or worsens, it could adversely affect our future operating results. While we have not identified any significant disruptions to our business or supply chains to date, the situation remains uncertain.

**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 in operating systems and independent software vendors (ISV) media applications, 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:

- Unauthorized and infringing PC software with our technologies for which we do not receive royalty payments;

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- Purchasing trends for netbooks, low-cost PCs, and tablets, which may not include operating systems or ISV media applications with our technologies;
- We may not realize positive effects to the extent we anticipate, or the positive effects may be delayed, from the inclusion of our technologies in business-oriented editions of Windows 7;
- The inclusion of our technologies in business-oriented editions of Windows 7 could result in our technologies residing in a greater percentage of PCs, resulting in substantial discounts and reducing the average per unit royalty we receive from Microsoft over time; and
- Certain PC OEMs have excluded, and we expect others will exclude in the future, ISV media applications from their product offerings, because Windows 7 incorporates DVD playback software.

In the long term, we face additional risks, including, but not limited to the following:

- Whether our technologies will be included in future PC operating systems, such as Windows 8;
- The extent and rate at which Windows 8 is adopted in the marketplace;
- The extent to which earlier versions of Microsoft operating systems, including Windows 7, continues to be licensed after the release of Windows 8;
- Our ability to establish and extend direct licensing relationships with OEMs and ISVs, as we have done in the past;
- The rate at which disc-based media shifts to online media content resulting in fewer PCs with optical disc drives and declines in PC DVD and Blu-ray Disc players;
- If we license our technologies on a per device basis, rather than on a per application basis, we will no longer collect multiple royalties per PC which may impact our results of operations; and
- Our ability to extend the adoption of our technologies in online and mobile platforms.

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 our technologies are incorporated in consumer entertainment products, which are generally 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. 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 PC revenue is dependent upon the growth of the PC market and the continued adoption of our technologies into PC operating systems as well as the adoption of our technologies into emerging types of devices such as tablets. 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 content delivery market.

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, 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 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 emerging 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 are uncertain at what point demand for new 3D enabled screens will be substantially satisfied;
- 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;
- 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 made by major film 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 by the tax incentive arrangements that many foreign governments provide filmmakers to promote local filmmaking.

**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. If the demand for our traditional film cinema products and services continues to decrease without a meaningful increase in revenue from digital cinema products and services, our revenue stream from the cinema industry would be adversely affected.

**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 content delivery market and declines in disc-based media.**

For nearly 20 years movies have been distributed, purchased, and consumed through disc-based 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, and other devices accompanied by a shift to home network and online content has resulted in the recent trend to movie download and streaming services in various parts of the world. A further shift away from disc-based media to online media content consumption could result in declines in revenue from DVD and Blu-ray Disc players. Such declines would adversely affect our licensing revenue.

In addition, online 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. 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 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 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 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 initiative, we are exploring other areas that facilitate delivery of digital entertainment, such as technologies for processing digital moving images. 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

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technologies adopted 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 July 1, 2011, we had over 2,200 individual issued patents and nearly 2,300 pending patent applications in over 60 jurisdictions throughout the world. Our issued patents are scheduled to expire at various times through February 2030. Of these, seven patents are scheduled to expire in the remainder of calendar year 2011, 52 patents are scheduled to expire in calendar year 2012, and 31 patents are scheduled to expire in calendar year 2013. 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, Philips, RealNetworks, Sonic Solutions, Sony, SRS Labs, and Thomson. Competitors for our products include: Barco, Doremi, GDC, IMAX, MasterImage 3D, NEC, Panavision, QSC Audio Products, Qube Cinema, REALD, Sony, Technicolor, Texas Instruments, USL, and XpanD. Competitors for our services include DTS and Sony. Other companies may become competitors in one or more of these areas in the future. 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.

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 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 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.**

The markets for the consumer entertainment products in which our technologies are incorporated are intensely competitive and price sensitive. 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 may 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 4K presentation;
- 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; and
- Delay or failure to update our server software to comply with the current DCI specifications could result in lost or delayed product sales and the deferral of future products sales due to revenue recognition restrictions.

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.

**Changes to our enterprise resource planning and other key software applications could cause unexpected problems to occur and disrupt the management of our business.**

We recently replaced our enterprise resource planning (ERP) system as well as other key software applications used in our global operations. Our ERP system and related applications are integral to our ability to accurately and efficiently maintain our books and records, manage royalty and product revenue streams, record our transactions, provide critical information to our management, and prepare our financial statements. Any unexpected difficulties resulting from these replacement efforts, could adversely affect our operating results and the accuracy and timely reporting of those results.

**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 2009, 2010, and the fiscal year-to-date period ended July 1, 2011, revenue from outside the U.S. was 65%, 66%, 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. States;
- 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. States, and other laws limiting our ability to repatriate funds to the U.S. States;
- Burdens of complying with a variety of foreign laws;
- Changes in diplomatic and trade relationships;
- Difficulty in 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 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

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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, 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:

- 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.

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**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 83%, 77%, and 82% of our total revenue in the fiscal years 2009, 2010, and the fiscal year-to-date period ended July 1, 2011, 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 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 trades 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.

**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.

We continue to monitor the situation in Japan in light of the March 2011 earthquake and tsunami to determine any potential risks of disruption to the supply chain for our products. At this point, the situation does not appear to have a material negative effect on the manufacture of our products in the short term although the long term effect on our supply chain remains uncertain.

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 we use contract manufacturers to produce some of our higher volume product lines as needed. Our reliance on contract manufacturers for the manufacture of our higher volume 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. 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 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.

**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 12% of total revenue for fiscal 2010. Although we have agreements with many of these

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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, market, and interest rate risks. Any downgrades, losses, failed auctions 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 will 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 implement 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 July 1, 2011, Ray Dolby and his affiliates owned 100 shares of our Class A common stock and 57,890,000 shares of our Class B common stock. As of July 1, 2011, 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 91.4% 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, Ray Dolby as Trustee of the Ray Dolby Trust under the Dolby Family Trust Instrument dated May 7, 1999 adopted a Rule 10b5-1 trading plan in the second quarter of fiscal 2011 to sell a total of up to 3 million shares of the Company s Class A common stock (or approximately 5.1% of Ray Dolby s direct and indirect holdings at the time) in compliance with Rule 144 under the Securities Act. Sales under the trading plan commenced in May 2011, are based on pre-established stock price thresholds, and are subject to daily volume limits. The trading plan will expire once all of the shares have been sold or on May 31, 2012, 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 July 1, 2011, we had a total of 110,751,795 shares of Class A and Class B common stock outstanding. Of these shares, we along with our selling stockholders sold 31,625,000 shares of Class A common stock, and our principal stock holder sold an additional 8,000,000 shares of Class A common stock in a secondary offering in May 2007.

As of July 1, 2011, our directors and executive officers beneficially held 57,900,000 shares of Class B common stock, 80,147 shares of Class A common stock, vested options to purchase 30,000 shares of Class B common stock and vested options to purchase 483,788 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 July 1, 2011, we issued an aggregate of 39,863 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 and since July 2, 2011 through July 21, 2011, we issued an aggregate of 11,743 shares of our Class B common stock to certain employees and officers upon the exercise of options awarded under our 2000 Stock Incentive Plan. We received aggregate proceeds of approximately $0.1 million in the fiscal quarter ended July 1, 2011, and less than $0.1 million in the period since July 2, 2011, through July 21, 2011 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 July 21, 2011 options to purchase an aggregate of 283,656 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.

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**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 fiscal quarter ended July 1, 2011:

| | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) | Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (2) |
|---|---|---|---|---|
| April 2, 2011 - April 29, 2011 | 235,119 | $ 48.47 | 235,119 | $222.2 million |
| April 30, 2011 - May 27, 2011 | 474,794 | 48.37 | 474,794 | $199.2 million |
| May 28, 2011 - July 1, 2011 | 755,351 | 43.68 | 755,351 | $166.2 million |
| **Total** | **1,465,264** | | **1,465,264** | |

(1) 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 the Company considers appropriate.

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

## ITEM 6. EXHIBITS

| Exhibit Number | Description | Incorporated by Reference Herein | |
|---|---|---|---|
| | | Form | Date |
| 10.1* | Form of Restricted Stock Unit Agreement Non-U.S. under the 2005 Stock Plan | | |
| 10.2* | Form of Stock Option Agreement International under the 2005 Stock Plan | | |
| 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 4, 2011

DOLBY LABORATORIES, INC.

By: /s/ Murray J. Demo

**Murray J. Demo**
**Executive Vice President and Chief Financial Officer**
**(Principal Financial and Accounting**
**Officer and Duly Authorized Officer)**