

Dolby Laboratories, Inc.  
Form 10-Q  
January 29, 2014  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

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

For the Quarterly Period Ended December 27, 2013

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 94103-4813 (415) 558-0200  
San Francisco, CA

(Address of principal executive offices) (Zip Code) (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  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  No

Indicate by a check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  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

On January 17, 2014 the registrant had 48,495,921 shares of Class A common stock, par value \$0.001 per share, and 53,641,706 shares of Class B common stock, par value \$0.001 per share, outstanding.

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## PART I - FINANCIAL INFORMATION

## ITEM 1. UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

## DOLBY LABORATORIES, INC.

## INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

	December 27, 2013	September 27, 2013
	(unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$484,640	\$454,397
Restricted cash	3,349	3,175
Short-term investments	179,406	140,267
Accounts receivable, net of allowance of \$901 at December 27, 2013 and \$514 at September 27, 2013	75,949	97,460
Inventories	8,253	10,093
Deferred taxes	81,630	84,238
Prepaid expenses and other current assets	25,584	28,949
Total current assets	858,811	818,579
Long-term investments	293,719	306,338
Property, plant and equipment, net	243,712	242,917
Intangible assets, net	37,996	41,315
Goodwill	279,059	279,724
Deferred taxes	41,265	37,434
Other non-current assets	11,063	11,638
Total assets	\$1,765,625	\$1,737,945
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$7,490	\$10,695
Accrued liabilities	124,964	137,795
Income taxes payable	2,412	3,394
Deferred revenue	15,165	20,931
Total current liabilities	150,031	172,815
Long-term deferred revenue	19,532	19,663
Other non-current liabilities	46,292	45,441
Total liabilities	215,855	237,919
Stockholders' equity:		
Class A common stock, \$0.001 par value, one vote per share, 500,000,000 shares authorized: 48,060,689 shares issued and outstanding at December 27, 2013 and 46,862,893 at September 27, 2013	49	47
Class B common stock, \$0.001 par value, ten votes per share, 500,000,000 shares authorized: 53,969,786 shares issued and outstanding at December 27, 2013 and 54,876,494 at September 27, 2013	54	55

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Additional paid-in capital	23,594	18,812
Retained earnings	1,498,897	1,454,382
Accumulated other comprehensive income	7,385	7,814
Total stockholders' equity – Dolby Laboratories, Inc.	1,529,979	1,481,110
Controlling interest	19,791	18,916
Total stockholders' equity	1,549,770	1,500,026
Total liabilities and stockholders' equity	\$1,765,625	\$1,737,945

See accompanying notes to unaudited interim condensed consolidated financial statements

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

	Fiscal Quarter Ended	
	December 27, 2013	December 28, 2012
Revenue:		
Licensing	\$205,660	\$204,876
Products	18,104	25,498
Services	7,513	6,228
Total revenue	231,277	236,602
Cost of revenue:		
Cost of licensing	4,001	3,080
Cost of products	13,788	18,489
Cost of services	3,593	4,036
Total cost of revenue	21,382	25,605
Gross margin	209,895	210,997
Operating expenses:		
Research and development	44,463	42,436
Sales and marketing	60,379	58,421
General and administrative	41,908	43,108
Restructuring charges	3,215	—
Total operating expenses	149,965	143,965
Operating income	59,930	67,032
Interest income	654	1,339
Interest expense	(112)	(25)
Other income, net	229	713
Income before income taxes	60,701	69,059
Provision for income taxes	(15,455)	(17,582)
Net income including controlling interest	45,246	51,477
Less: net (income) attributable to controlling interest	(731)	(128)
Net income attributable to Dolby Laboratories, Inc.	\$44,515	\$51,349
Net income per share:		
Basic	\$0.44	\$0.50
Diluted	\$0.43	\$0.50
Weighted-average shares outstanding:		
Basic	101,750	102,361
Diluted	103,192	103,523

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Related party rent expense:

Included in operating expenses	\$346	\$343
Included in net income attributable to controlling interest	\$1,255	\$732

See accompanying notes to unaudited interim condensed consolidated financial statements

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DOLBY LABORATORIES, INC.  
 INTERIM CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (in thousands)  
 (unaudited)

	Fiscal Quarter Ended		
	December 27, 2013	December 28, 2012	
Net income including controlling interest	\$45,246	\$51,477	
Other comprehensive income/(loss):			
Foreign currency translation adjustments, net of tax	(390	) 1,234	
Unrealized gains/(losses) on available-for-sale securities, net of tax	105	(737	)
Comprehensive income	44,961	51,974	
Less: comprehensive (income) attributable to controlling interest	(875	) (98	)
Comprehensive income attributable to Dolby Laboratories, Inc.	\$44,086	\$51,876	
See accompanying notes to unaudited interim condensed consolidated financial statements			

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## DOLBY LABORATORIES, INC.

## INTERIM CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

(unaudited)

	Dolby Laboratories, Inc.							
	Common Stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Total Dolby Laboratories, Inc.	Controlling Interest	Total	
Balance at September 27, 2013	\$ 102	\$ 18,812	\$ 1,454,382	\$ 7,814	\$ 1,481,110	\$ 18,916	\$ 1,500,026	
Net income	—	—	44,515	—	44,515	731	45,246	
Translation adjustments, net of tax of \$(61)	—	—	—	(534	) (534	) 144	(390	)
Unrealized losses on available-for-sale securities, net of tax of \$(58)	—	—	—	105	105	—	105	
Stock-based compensation expense	—	15,054	—	—	15,054	—	15,054	
Repurchase of common stock	—	(11,660	)—	—	(11,660	)—	(11,660	)
Tax benefit/(deficiency) from stock incentive plans	—	(11	)—	—	(11	)—	(11	)
Class A common stock issued under employee stock plans	1	8,088	—	—	8,089	—	8,089	
Shares repurchased for tax withholdings on vesting of restricted stock	—	(6,727	)—	—	(6,727	)—	(6,727	)
Exercise of Class B stock options	—	38	—	—	38	—	38	
Balance at December 27, 2013	\$ 103	\$ 23,594	\$ 1,498,897	\$ 7,385	\$ 1,529,979	\$ 19,791	\$ 1,549,770	

	Dolby Laboratories, Inc.							
	Common Stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Total Dolby Laboratories, Inc.	Controlling Interest	Total	
Balance at September 28, 2012	\$ 103	\$ —	\$ 1,709,479	\$ 10,687	\$ 1,720,269	\$ 22,964	\$ 1,743,233	
Net income	—	—	51,349	—	51,349	128	51,477	
Translation adjustments, net of tax of \$328	—	—	—	1,264	1,264	(30	) 1,234	
Unrealized losses on available-for-sale securities, net of tax of \$414	—	—	—	(737	) (737	)—	(737	)
Distributions to controlling interest	—	—	—	—	—	(5,039	) (5,039	)
Stock-based compensation expense	—	17,704	—	—	17,704	—	17,704	
Repurchase of common stock	(1	) (17,794	) (36,161	)—	(53,956	)—	(53,956	)
Cash dividends declared and paid on common stock	—	—	(408,206	)—	(408,206	)—	(408,206	)



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Tax benefit/(deficiency) from stock incentive plans	—	(776 )	—	—	(776 )	—	(776 )
Class A common stock issued under employee stock plans	—	4,360	—	—	4,360	—	4,360
Shares repurchased for tax withholdings on vesting of restricted stock	—	(3,636 )	—	—	(3,636 )	—	(3,636 )
Exercise of Class B stock options	—	142	—	—	142	—	142
Balance at December 28, 2012	\$ 102	\$ —	\$ 1,316,461	\$ 11,214	\$ 1,327,777	\$ 18,023	\$ 1,345,800

See accompanying notes to unaudited interim condensed consolidated financial statements

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

	Fiscal Quarter Ended	
	December 27, 2013	December 28, 2012
Operating activities:		
Net income including controlling interest	\$45,246	\$51,477
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	12,409	13,129
Stock-based compensation	15,054	17,704
Amortization of premium on investments	2,266	3,794
Excess tax benefit from exercise of stock options	(1,010)	(469)
Provision for doubtful accounts	374	(179)
Deferred income taxes	(1,322)	(2,627)
Other non-cash items affecting net income	105	(691)
Changes in operating assets and liabilities:		
Accounts receivable	21,148	(8,064)
Inventories	2,225	(6,173)
Prepaid expenses and other assets	(1,631)	8,916
Accounts payable and other liabilities	(16,696)	(19,898)
Income taxes, net	4,795	9,512
Deferred revenue	(5,897)	(143)
Other non-current liabilities	216	1,012
Net cash provided by operating activities	77,282	67,300
Investing activities:		
Purchases of available-for-sale securities	(102,717)	(204,135)
Proceeds from sales of available-for-sale securities	27,426	389,068
Proceeds from maturities of available-for-sale securities	46,739	51,325
Purchases of property, plant and equipment	(8,967)	(6,717)
Other investments	—	(3,000)
Purchases of intangible assets	—	(4,048)
Proceeds from sale of property, plant and equipment and assets held for sale	42	19
Change in restricted cash	(174)	(291)
Net cash provided by/(used in) investing activities	(37,651)	222,221
Financing activities:		
Proceeds from issuance of common stock	8,127	4,502
Repurchase of common stock	(11,660)	(53,956)
Payment of cash dividend	—	(408,206)
Distribution to controlling interest	—	(5,039)
Excess tax benefit from the exercise of stock options	1,010	469
Shares repurchased for tax withholdings on vesting of restricted stock	(6,727)	(3,636)
Net cash used in financing activities	(9,250)	(465,866)
Effect of foreign exchange rate changes on cash and cash equivalents	(138)	(62)
Net increase/(decrease) in cash and cash equivalents	30,243	(176,407)
Cash and cash equivalents at beginning of period	454,397	492,600

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Cash and cash equivalents at end of period	\$484,640	\$316,193
Supplemental disclosure:		
Cash paid for income taxes, net of refunds received	\$11,593	\$11,734
Cash paid for interest	\$1	\$1
See accompanying notes to unaudited interim condensed consolidated financial statements		

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DOLBY LABORATORIES, INC.

NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

Unaudited Interim Condensed Consolidated Financial Statements

We have prepared the accompanying unaudited interim condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States ("GAAP"), and with Securities and Exchange Commission ("SEC") rules and regulations, which allow for certain information and footnote disclosures that are normally included in annual financial statements prepared in accordance with GAAP to be condensed or omitted. In our opinion, these unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements for the fiscal year ended September 27, 2013 and include all adjustments necessary for fair presentation. The accompanying unaudited interim condensed consolidated financial statements should be read in conjunction with our consolidated financial statements for the fiscal year ended September 27, 2013, which are included in our Annual Report on Form 10-K filed with the SEC.

The results for the fiscal quarter ended December 27, 2013 are not necessarily indicative of the results to be expected for any subsequent quarterly or annual financial period, including the fiscal year ending September 26, 2014.

Principles of Consolidation

The unaudited interim 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 consolidated statements of operations as net income attributable to controlling interest and in our consolidated balance sheets as a controlling interest. We eliminate all intercompany accounts and transactions upon consolidation.

Operating Segments

We operate as a single reporting segment, and thus all required financial segment information is included in our unaudited interim condensed consolidated financial statements. This determination reflects the fact that our chief operating decision-maker ("CODM"), our Chief Executive Officer, evaluates our financial information and resources, and assesses the performance of these resources on a consolidated basis.

Use of Estimates

The preparation of our financial statements in accordance with GAAP requires management to make certain estimates and assumptions that affect the amounts reported and disclosed in our unaudited interim condensed consolidated financial statements and accompanying notes. Significant items subject to such estimates and assumptions include estimated selling prices for elements sold in multiple-element revenue arrangements; valuation allowances for accounts receivable; carrying values of inventories and certain property, plant, and equipment, goodwill and intangible assets; fair values of investments, accrued liabilities including liabilities for unrecognized tax benefits, deferred income tax assets and stock-based compensation. 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 December 27, 2013 and December 28, 2012. Our fiscal year ending September 26, 2014 (fiscal 2014) and our fiscal year ended September 27, 2013 (fiscal 2013) both consist of 52 weeks.

Reclassifications

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



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## 2. Summary of Significant Accounting Policies

We continually assess any new accounting pronouncements issued by the Financial Accounting Standards Board ("FASB") to determine their applicability and impact on us. Where it is determined that a new accounting pronouncement will result in a change to our financial reporting, we take the appropriate steps to ensure that such changes are properly reflected on our consolidated financial statements or notes thereto.

## Recently Issued Accounting Standards

## Adopted Standards

Accumulated Other Comprehensive Income. In February 2013, the FASB issued Accounting Standards Update No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income. This new standard, which we adopted in the first quarter of fiscal 2014, adds enhanced disclosure requirements for items reclassified out of Accumulated Other Comprehensive Income ("AOCI") with the intent of helping entities improve the transparency of changes in Other Comprehensive Income ("OCI") and items reclassified out of AOCI in their financial statements. The standard is to be applied on a prospective basis, and requires registrants to disclose either in a single note, or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of AOCI based on its source and the income statement line items affected by the reclassification. Since this new standard only results in changes to our financial statement presentation and does not amend any existing requirements for reporting net income or OCI in the financial statements, adoption of this standard does not impact our financial position or results of operations.

The adoption of new accounting pronouncements has not had a significant impact on our unaudited interim condensed consolidated financial statements or notes thereto, and has not resulted in a change to our significant accounting policies. Furthermore, there have not been any changes to our significant accounting policies from those that were described in our Form 10-K for the prior fiscal year ended September 27, 2013.

## 3. Composition of Certain Financial Statement Captions

The following tables present detailed information from our consolidated balance sheets as of December 27, 2013 and September 27, 2013 (in thousands, except as otherwise noted):

## Cash, Cash Equivalents, and Investments

	December 27, 2013	September 27, 2013
Cash and cash equivalents:		
Cash	\$475,927	\$420,069
Cash equivalents:		
Money market funds	2,813	16,193
U.S. agency securities	5,200	13,135
Commercial paper	700	5,000
Total cash and cash equivalents	484,640	454,397
Short-term investments:		
U.S. agency securities	31,414	6,007
Commercial paper	14,947	5,991
Corporate bonds	32,686	43,847
Municipal debt securities	100,359	84,422
Total short-term investments	179,406	140,267
Long-term investments (1):		
U.S. agency securities	21,433	40,924
Commercial paper	4,971	—
Corporate bonds	91,267	90,391
Municipal debt securities	173,048	172,023
Other long-term investments (2)	3,000	3,000

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Total long-term investments	293,719	306,338
Total cash, cash equivalents and investments (3)	\$957,765	\$901,002

(1) Our long-term investments have maturities that range from one to three years.

(2) Other long-term investments include a cost method investment for which no other-than-temporary impairment exists as of December 27, 2013.

(3) Total cash, cash equivalents, and investments exclude \$3.3 million and \$3.2 million of restricted cash as of December 27, 2013 and September 27, 2013.

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

	December 27, 2013			
	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Money market funds	\$2,813	\$—	\$—	\$2,813
U.S. agency securities	58,085	14	(52)	58,047
Commercial paper	20,618	—	—	20,618
Corporate bonds	123,821	290	(158)	123,953
Municipal debt securities	273,030	488	(111)	273,407
Cash equivalents and investments (1)	\$478,367	\$792	\$(321)	\$478,838
	September 27, 2013			
	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Money market funds	\$16,193	\$—	\$—	\$16,193
U.S. agency securities	60,126	16	(76)	60,066
Commercial paper	10,991	—	—	10,991
Corporate bonds	134,097	315	(174)	134,238
Municipal debt securities	256,218	384	(157)	256,445
Cash equivalents and investments (1)	\$477,625	\$715	\$(407)	\$477,933

(1) Other long-term investments include a cost method investment of \$3.0 million for no other-than-temporary impairment exists as of December 27, 2013.

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

	December 27, 2013					
	Less than 12 months		12 months or greater		Total	
	Gross		Gross		Gross	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. agency securities	\$26,930	\$(52)	\$—	\$—	\$26,930	\$(52)
Corporate bonds	50,145	(158)	—	—	50,145	(158)
Municipal debt securities	66,214	(111)	—	—	66,214	(111)
Total	\$143,289	\$(321)	\$—	\$—	\$143,289	\$(321)
	September 27, 2013					
	Less than 12 months		12 months or greater		Total	
	Gross		Gross		Gross	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. agency securities	\$21,407	\$(76)	\$—	\$—	\$21,407	\$(76)
Corporate bonds	53,350	(174)	—	—	53,350	(174)
Municipal debt securities	72,485	(157)	—	—	72,485	(157)
Total	\$147,242	\$(407)	\$—	\$—	\$147,242	\$(407)

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 December 27, 2013, we had certain securities that were in an unrealized loss position, however we do not intend to, nor do we currently anticipate a need to sell these securities prior to recovering 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 December 27, 2013 or September 27, 2013 to be an other-than-temporary impairment, nor do we consider any of the unrealized losses to be credit losses.





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The following table summarizes the amortized cost and estimated fair value of the available-for-sale securities within our investment portfolio based on stated maturities as of December 27, 2013 and September 27, 2013, which are recorded within cash equivalents and both short-term and long-term investments in our consolidated balance sheets:

	December 27, 2013		September 27, 2013	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within 1 year	\$185,232	\$185,306	\$158,275	\$158,402
Due in 1 to 2 years	175,577	175,986	172,993	173,373
Due in 2 to 3 years	114,745	114,734	130,164	129,965
Total	\$475,554	\$476,026	\$461,432	\$461,740

## Accounts Receivable

	December 27, 2013	September 27, 2013
Trade accounts receivable	\$72,660	\$86,823
Accounts receivable related to patent administration program	4,190	11,151
Accounts receivable, gross	76,850	97,974
Less: allowance for doubtful accounts	(901)	(514)
Accounts receivable, net	\$75,949	\$97,460

## Inventories

	December 27, 2013	September 27, 2013
Raw materials	\$2,081	\$2,050
Finished goods	6,172	8,043
Inventories	\$8,253	\$10,093

Inventories are stated at the lower of cost (first-in, first-out) or market. Inventory with a consumption period expected to exceed twelve months is recorded within other non-current assets in our consolidated balance sheets. We have included \$3.6 million and \$4.0 million of raw materials inventory within other non-current assets in our consolidated balance sheets as of December 27, 2013 and September 27, 2013, respectively. The majority of the inventory included in non-current assets was purchased in bulk in fiscal 2012 to obtain a significant volume discount, and is expected to be consumed over a period that exceeds twelve months. Based on anticipated inventory consumption rates, and aside from existing write-downs due to excess inventory, we do not believe that material risk of obsolescence exists prior to ultimate sale.

## Prepaid Expenses and Other Current Assets

	December 27, 2013	September 27, 2013
Prepaid expenses	\$12,064	\$10,195
Other current assets	10,835	10,863
Income tax receivable	2,685	7,891
Prepaid expenses and other current assets	\$25,584	\$28,949

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As of December 27, 2013, other current assets include the carrying value of \$3.7 million of land and building that is currently held for sale as Management has committed to a plan to sell the property.

## Property, Plant and Equipment

	December 27, 2013	September 27, 2013
Land	\$46,155	\$46,049
Buildings	32,394	32,305
Leasehold improvements	66,949	64,991
Machinery and equipment	40,944	38,408
Computer systems and software	95,497	91,939
Furniture and fixtures	13,397	13,490
Construction in progress	90,554	88,872
	385,890	376,054
Less: accumulated depreciation	(142,178)	(133,137)
Property, plant and equipment, net	\$243,712	\$242,917

Property, plant and equipment are recorded at cost, with depreciation expense included in cost of licensing, cost of products, cost of services, research and development expenses, sales and marketing expenses and general and administrative expenses in our consolidated statements of operations.

In fiscal 2012, we purchased an approximately 354,000 square foot property in San Francisco, California for approximately \$109.8 million. We allocated \$35.5 million of the purchase price of the property to land and \$74.3 million to building, based on a fair value analysis. This fair value analysis utilized a combination of an income approach and a cost approach in conjunction with a consideration of comparable transactions in the San Francisco marketplace. After making certain improvements to the property to prepare the building for our use, we intend to begin using the space as our worldwide headquarters in fiscal 2014. As of December 27, 2013, construction in progress includes the book value of the building and related costs of construction.

## Goodwill and Intangible Assets

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

Balance at September 27, 2013	Goodwill \$279,724
Translation adjustments	(665)
Balance at December 27, 2013	\$279,059

Intangible assets consist of the following:

	December 27, 2013			September 27, 2013		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Intangible assets subject to amortization:						
Acquired patents and technology	\$80,106	\$(53,693)	\$26,413	\$79,925	\$(51,267)	\$28,658
Customer relationships	30,724	(20,394)	10,330	30,723	(19,592)	11,131
Other intangibles	21,018	(19,765)	1,253	20,992	(19,466)	1,526
Intangible assets, net	\$131,848	\$(93,852)	\$37,996	\$131,640	\$(90,325)	\$41,315

Amortization expense for our intangible assets is included in cost of licensing, cost of products, research and development and sales and marketing expenses in our consolidated statements of operations. As of December 27, 2013, expected amortization expense of our intangible assets in future periods is as follows:

Fiscal Year	Amortization Expense
Remainder of Fiscal 2014	\$10,315

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2015	11,312
2016	9,130
2017	6,010
2018	758
Thereafter	471
Total	\$37,996

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## Accrued Liabilities

	December 27, 2013	September 27, 2013
Accrued royalties	\$7,897	\$6,075
Amounts payable to joint licensing program partners	42,241	40,091
Accrued compensation and benefits	37,887	54,423
Accrued professional fees	5,219	4,402
Other accrued liabilities	31,720	32,804
Accrued liabilities	\$124,964	\$137,795
Other Non-Current Liabilities		

	December 27, 2013	September 27, 2013
Supplemental retirement plan obligations	\$2,218	\$2,144
Non-current tax liabilities	31,580	30,986
Other liabilities	12,494	12,311
Other non-current liabilities	\$46,292	\$45,441

Refer to Note 8 "Income Taxes" for additional information related to tax liabilities.

## 4. Earnings Per Share

We compute basic earnings per share ("EPS") 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 EPS, 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 EPS attributable to Dolby Laboratories, Inc. (in thousands, except per share amounts):

	Fiscal Quarter Ended	
	December 27, 2013	December 28, 2012
Numerator:		
Net income attributable to Dolby Laboratories, Inc.	\$44,515	\$51,349
Denominator:		
Weighted-average shares outstanding—basic	101,750	102,361
Potential common shares from options to purchase Class A and Class B common stock	328	326
Potential common shares from restricted stock units	1,114	836
Weighted-average shares outstanding—diluted	103,192	103,523
Net income per share attributable to Dolby Laboratories, Inc.:		
Basic	\$0.44	\$0.50
Diluted	\$0.43	\$0.50
Antidilutive awards excluded from calculation:		
Stock options	6,791	5,178
Restricted stock units	1,038	1,327

## 5. Fair Value Measurements

Under our investment management strategy, we use cash holdings to purchase investment grade securities that are diversified among security types, industries and issuers. Each of the investments within our investment portfolio is

measured at fair value, and is recorded within cash equivalents, short-term investments, and long-term investments in our consolidated balance sheets. With the exception of our mutual fund investments held in our supplemental retirement plan, all of our investments are classified as available-for-sale securities. Investments held in our supplemental retirement plan are classified as trading securities. Our investments primarily consist of municipal debt securities, commercial paper, corporate bonds and United States agency securities. In addition to the security types noted above, our cash and cash equivalents also consist of highly-liquid money market funds. Consistent with our investment policy, none of the municipal debt investments that we hold are supported by letters of credit or standby purchase agreements.

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

Level 1: Quoted prices in active markets at the measurement date for identical assets and liabilities.

Level 2: Prices may be based upon quoted prices in active markets or inputs not quoted on active markets but are corroborated by market data.

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

Financial assets and liabilities carried at fair value are classified below (in thousands):

	December 27, 2013			
	Level 1	Level 2	Level 3	Total
Assets:				
Investments held in supplemental retirement plan (1)	\$2,316	\$—	\$—	\$2,316
Money market funds (2)	2,813	—	—	2,813
U.S. agency securities (2), (3), (4)	58,047	—	—	58,047
Commercial paper (2), (3), (4)	—	20,618	—	20,618
Corporate bonds (3), (4)	—	123,953	—	123,953
Municipal debt securities (3), (4)	—	273,407	—	273,407
Total	\$63,176	\$417,978	\$—	\$481,154
Liabilities:				
Investments held in supplemental retirement plan (5)	\$2,316	\$—	\$—	\$2,316
Total	\$2,316	\$—	\$—	\$2,316
	September 27, 2013			
	Level 1	Level 2	Level 3	Total
Assets:				
Investments held in supplemental retirement plan (1)	\$2,242	\$—	\$—	\$2,242
Money market funds (2)	16,193	—	—	16,193
U.S. agency securities (2), (3), (4)	60,066	—	—	60,066
Commercial paper (2), (3)	—	10,991	—	10,991
Corporate bonds (3), (4)	—	134,238	—	134,238
Municipal debt securities (3), (4)	—	256,445	—	256,445
Total	\$78,501	\$401,674	\$—	\$480,175
Liabilities:				
Investments held in supplemental retirement plan (5)	\$2,242	\$—	\$—	\$2,242
Total	\$2,242	\$—	\$—	\$2,242

(1) These assets are included within prepaid expenses and other current assets and within other non-current assets.

(2) These assets are included within cash and cash equivalents.

(3) These assets are included within short-term investments.

(4) These assets are included within long-term investments.

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

We base the fair value of our Level 1 financial instruments, which are traded in active markets, using quoted market prices for identical instruments.

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

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

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We did not own any Level 3 financial assets or liabilities as of December 27, 2013 or September 27, 2013.

6. Stockholders' Equity and Stock-Based Compensation

We provide stock-based awards as a form of compensation for employees, officers and directors. We have issued stock-based awards in the form of stock options, restricted stock units ("RSUs") and stock appreciation rights under our equity incentive plans, as well as shares under our Employee Stock Purchase Plan ("ESPP").

Common Stock - Class A and Class B

Our Board of Directors has authorized two classes of common stock, Class A and Class B. At December 27, 2013, we had authorized 500,000,000 Class A shares and 500,000,000 Class B shares. At December 27, 2013, we had 48,060,689 shares of Class A common stock and 53,969,786 shares of Class B common stock issued and outstanding. Holders of our Class A and Class B common stock have identical rights, except that holders of our Class A common stock are entitled to one vote per share and holders of our Class B common stock are entitled to ten votes per share. Shares of Class B common stock can be converted to shares of Class A common stock at any time at the option of the stockholder and automatically convert upon sale or transfer, except for certain transfers specified in our amended and restated certificate of incorporation.

Stock Incentive Plans

2000 Stock Incentive Plan. Effective October 2000, we adopted the 2000 Stock Incentive Plan. The 2000 Stock Incentive Plan, as amended, provides for the issuance of incentive and non-qualified stock options to employees, directors, and consultants of Dolby Laboratories to purchase up to 15.1 million shares of Class B common stock. Under the terms of this plan, options became exercisable as established by the Board of Directors (ratably over four years), and expire ten years after the date of the grant. Options granted under the plan were granted at not less than fair market value at the date of grant.

As of December 27, 2013, there were options outstanding to purchase 0.1 million shares of Class B common stock, of which all were vested and exercisable. The options outstanding have a remaining weighted-average contractual life of 0.5 years. Subsequent to fiscal 2005, no further options were granted under this plan. The 2000 Stock Incentive Plan terminated on October 1, 2010 and no shares of our common stock remained available for future issuance under that plan other than pursuant to outstanding options.

2005 Stock Plan. In January 2005, our stockholders approved our 2005 Stock Plan, which our Board of Directors adopted in November 2004. The 2005 Stock Plan became effective on February 16, 2005, the day prior to the completion of our initial public offering. Our 2005 Stock Plan, as amended and restated, provides for the ability to grant incentive stock options, nonstatutory stock options, restricted stock, restricted stock units, stock appreciation rights, deferred stock units, performance units, performance bonus awards and performance shares. A total of 29.0 million shares of our Class A common stock is authorized for issuance under the 2005 Stock Plan. For any awards granted prior to February 2011, any shares subject to an award with a per share price less than the fair market value of our Class A common stock on the date of grant and any shares subject to an outstanding restricted stock unit award will be counted against the authorized share reserve as two shares for every one share subject to the award, and if returned to the 2005 Stock Plan, such shares will be counted as two shares for every one share returned. For those awards granted from February 2011 onward, any shares subject to an award with a per share price less than the fair market value of our Class A common stock on the date of grant and any shares subject to an outstanding restricted stock unit award will be counted against the authorized share reserve as 1.6 shares for every one share subject to the award, and if returned to the 2005 Stock Plan, such shares will be counted as 1.6 shares for every one share returned. As of December 27, 2013, there were options outstanding to purchase 8.1 million shares of Class A common stock, of which 3.1 million were vested and exercisable. The options outstanding have a remaining weighted-average contractual life of 8.0 years.

Stock Options. Stock options are generally granted at fair market value on the date of grant. Options granted to employees and officers prior to June 2008 generally vest over four years, with equal annual cliff-vesting and expire on the earlier of 10 years after the date of grant or 3 months after termination of service. Options granted to employees and officers from June 2008 onward generally vest over four years, with 25% of the shares subject to the option

becoming exercisable on the one-year anniversary of the date of grant and the balance of the shares vesting in equal monthly installments over the following 36 months. These options expire on the earlier of 10 years after the date of grant or 3 months after termination of service. All options granted vest over the requisite service period and upon the exercise of stock options, we issue new shares of Class A common stock under the 2005 Stock

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Plan and new shares of Class B common stock under the 2000 Stock Incentive Plan. Our 2005 Stock Plan also allows us to grant stock awards which vest based on the satisfaction of specific performance criteria.

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

	Shares (in thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (1) (in thousands)
Options outstanding at September 27, 2013	6,385	\$29.82		
Grants	2,075	37.33		
Exercises	(178)	26.56		
Forfeitures and cancellations	(37)	32.58		
Options outstanding at December 27, 2013	8,245	31.77	7.9	\$56,745
Options vested and expected to vest at December 27, 2013	8,031	31.80	7.9	54,999
Options exercisable at December 27, 2013	3,177	29.20	5.9	31,049

(1) Aggregate intrinsic value is based on the closing price of our common stock on December 27, 2013 of \$38.38 and excludes the impact of options that were not in-the-money.

**Restricted Stock Units.** We grant RSUs to certain employees, officers and directors under our 2005 Stock Plan. Awards granted to employees and officers generally vest over four years, with equal annual cliff-vesting. Awards granted to directors prior to November 2010 generally vest over three years, with equal annual cliff-vesting. Awards granted after November 2010 to new directors vest over approximately two years, with 50% vesting per year, while awards granted from November 2010 onwards to ongoing directors vest over approximately one year. Our 2005 Stock Plan also allows us to grant RSUs which vest based on the satisfaction of specific performance criteria, although no such awards have been granted as of December 27, 2013. At each vesting date, the holder of the award is issued shares of our Class A common stock. Compensation expense from these awards is equal to the fair market value of our common stock on the date of grant and is recognized on a straight-line basis over the requisite service period. No RSUs were granted prior to fiscal 2008.

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

	Shares (in thousands)	Weighted-Average Grant Date Fair Value
Non-vested at September 27, 2013	2,853	\$34.66
Granted	953	37.24
Vested	(495)	35.26
Forfeitures	(45)	34.99
Non-vested at December 27, 2013	3,266	35.32

**Stock Appreciation Rights.** We have granted stock appreciation rights to certain of our foreign employees. These awards are settled in cash rather than stock, and are classified as liability awards.

**Employee Stock Purchase Plan.** Our plan allows eligible employees to have up to 10 percent of their eligible compensation withheld and used to purchase Class A common stock, subject to a maximum of \$25,000 worth of stock purchased in a calendar year or no more than 1,000 shares in an offering period, whichever is less. An offering period consists of successive six-month purchase periods, with a look back feature to our stock price at the commencement of a one-year offering period. The plan provides for a discount equal to 15 percent of the closing price of our common stock on the New York Stock Exchange on the last day of the purchase period and for overlapping one-year offering periods. The plan also includes an automatic reset feature that provides for an offering period to be reset and

recommended to a new lower-priced offering if the offering price of a new offering period is less than that of the immediately preceding offering period.

Compensation Expense

Stock-based compensation expense for equity awards granted to employees is determined by estimating their fair value on the date of grant, and recognizing that value as an expense on a straight-line basis over the requisite service period in which our employees earn the awards.

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Stock Option Valuation Assumptions. We use the Black-Scholes option pricing model to determine the estimated fair value of employee stock options at the date of the grant. The weighted-average assumptions used in the determination of the fair value of our stock options were as follows:

	Fiscal Quarter Ended	
	December 27, 2013	December 28, 2012
Expected term (in years)	4.57	4.37
Risk-free interest rate	1.4%	0.5%
Expected stock price volatility	31.9%	40.6%
Dividend yield	—	—

Compensation expense related to these equity awards is recognized net of estimated forfeitures. We determine our estimated forfeiture rate based on an evaluation of historical forfeitures and revise our estimate, if necessary, in subsequent periods if actual forfeitures differ from our estimate. The two tables shown below separately present stock-based compensation expense both by award type and classification in our consolidated statements of operations (in thousands). No compensation cost was capitalized in either the fiscal quarter ended December 27, 2013 or December 28, 2012.

## Compensation Expense - By Award Type

	Fiscal Quarter Ended	
	December 27, 2013	December 28, 2012
Stock-based compensation:		
Stock options	\$3,870	\$8,309
Restricted stock units	10,257	8,340
Employee stock purchase plan	927	1,055
Total stock-based compensation	15,054	17,704
Benefit from income taxes	(4,396)	(5,413)
Total stock-based compensation, net of tax	\$10,658	\$12,291

## Compensation Expense - By Income Statement Line Item Classification

	Fiscal Quarter Ended	
	December 27, 2013	December 28, 2012
Stock-based compensation expense was classified as follows:		
Cost of products	\$190	\$248
Cost of services	87	151
Research and development	4,307	4,887
Sales and marketing	5,025	5,991
General and administrative	5,445	6,427
Total stock-based compensation expense	\$15,054	\$17,704

The tax benefit that we recognize from certain exercises of incentive stock options ("ISOs") and shares issued under our ESPP are excluded from the tables above. This benefit was as follows (in thousands):

	Fiscal Quarter Ended	
	December 27, 2013	December 28, 2012
Tax Benefit - stock option exercises & shares issued under ESPP	\$175	\$96

At December 27, 2013, total unrecorded stock-based compensation expense associated with employee stock options expected to vest was approximately \$54.9 million, which is expected to be recognized over a weighted-average period of 3.0 years. At December 27, 2013, total unrecorded stock-based compensation expense associated with RSUs

expected to vest was approximately \$94.9 million, which is expected to be recognized over a weighted-average period of 2.9 years.

**Special Dividend and Equity Award Modification**

On December 11, 2012, our Board of Directors declared a special dividend in the amount of \$4.00 per share on our Class A and Class B Common Stock. Payment of the special dividend was made on December 27, 2012 to all stockholders of record as of the close of business on December 21, 2012 ("Record Date"). Based on the

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102,051,386 shares of Class A and Class B Common Stock outstanding as of the record date, the total special dividend payment was \$408.2 million.

In connection with the declaration of this special dividend in the first quarter of fiscal 2013, we adjusted the number and exercise price of certain eligible outstanding stock options and stock appreciation rights granted under our 2005 Stock Plan and 2000 Stock Incentive Plan in a manner intended to preserve the pre-cash dividend economic value of these awards. Eligible awards include stock options and stock appreciation rights that were granted prior to December 2012 and were outstanding as of the day following the record date, with the exception of stock options held by employees in Australia which were not adjusted due to tax considerations. The modification of these existing awards at the dividend declaration date resulted in a total net incremental compensation cost of approximately \$7.9 million. Of this amount, approximately \$0.4 million and \$3.1 million was recognized in the first quarter of fiscal 2014 and first quarter of fiscal 2013, respectively. This incremental charge is being recognized over the vesting periods of the original awards, determined on a grant-by-grant basis, based on the extent to which the awards were vested as of the date of modification. The incremental charge related to all fully-vested awards as of the modification date was recognized in the first quarter of fiscal 2013. The vesting period for those awards not fully-vested at the time of modification range from one to four years.

Additionally, all outstanding RSUs under the 2005 Stock Plan that were unvested on the day following the record date, including RSUs that were granted on the record date, were modified to allow for the granting of a dividend equivalent (as such term is defined in the 2005 Stock Plan) with respect to each share of our Class A Common Stock underlying the unvested RSU. The dividend equivalent is payable in cash in a per share amount equal to the per share cash dividend on the same date that the related underlying RSU shares vest. The granting of the dividend equivalent for all outstanding RSUs resulted in a total net incremental compensation cost of approximately \$11.9 million. Of this amount, approximately \$0.8 million and less than \$0.1 million was recognized in the first quarter of fiscal 2014 and first quarter of fiscal 2013, respectively. This incremental charge is being recognized over the remaining vesting periods of the RSUs at the date of modification, determined on a grant-by-grant basis. These vesting periods range from one to four years beginning on the first anniversary of the grant.

#### Common Stock Repurchase Program

In November 2009, we announced a stock repurchase program, providing for the repurchase of up to \$250.0 million of our Class A common stock. Our Board of Directors approved an additional \$300.0 million for our stock repurchase program in July 2010, \$250.0 million in July 2011, and an additional \$100.0 million in February 2012, for a total authorization of up to \$900.0 million in stock repurchases. Stock repurchases under this program may be made through open market transactions, negotiated purchases, or otherwise, at times and in amounts that we consider appropriate. The timing of repurchases and the number of shares repurchased depend upon a variety of factors, including price, regulatory requirements, the rate of dilution from our equity compensation programs and other market conditions. We may limit, suspend or terminate the stock repurchase program at any time without prior notice. This program does not have a specified expiration date. Shares repurchased under the program will be returned to the status of authorized but unissued shares of Class A common stock. As of December 27, 2013, the remaining authorization to purchase additional shares is \$104.4 million.

Stock repurchase activity under the stock repurchase program during the first quarter of fiscal 2014 is summarized as follows:

Quarterly Repurchase Activity	Shares Repurchased	Cost (1) (in thousands)	Average Price Paid per Share (2)
Q1 - Quarter ended December 27, 2013	330,000	\$11,660	\$35.32
Total	330,000	\$11,660	

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

(2) Average price paid per share excludes commission costs.





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## 7. Restructuring

## Fiscal 2014 Restructuring Plan

In October 2013, we implemented a plan to reorganize and consolidate certain activities and positions within our global business infrastructure. As a result, we recorded \$3.2 million in restructuring costs during the first quarter of fiscal 2014, representing severance and other related benefits offered to approximately 50 employees that were affected as a result of this action. Changes in restructuring accruals under this restructuring plan were as follows (in thousands):

	Severance and associated costs
Restructuring charges	\$3,215
Cash payments	(892)
Non-cash restructuring charges	(10)
Balance at December 27, 2013	\$2,313

Accruals for restructuring charges are included within accrued liabilities in the accompanying consolidated balance sheets while restructuring charges are included within restructuring charges in the accompanying consolidated statements of operations.

## 8. Income Taxes

Our income tax expense, deferred tax assets and liabilities, and reserves for unrecognized tax benefits reflect management's best assessment of estimated current and future taxes to be paid. We are subject to income taxes in the United States and numerous foreign jurisdictions. Significant judgments and estimates are required in determining the consolidated income tax expense.

## Unrecognized Tax Benefit

Our gross unrecognized tax benefit is reduced by a liability recorded to reduce our unrecognized tax benefit to the amount that we ultimately expect to be realized. As of December 27, 2013, the total amount of gross unrecognized tax benefits was \$32.8 million, of which \$22.1 million, if recognized, would reduce our effective tax rate. Our net liability for unrecognized tax benefits is classified within other non-current liabilities in our consolidated balance sheets.

## Withholding Taxes

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. The foreign current tax includes this withholding tax expense while the appropriate foreign tax credit benefit is included in current federal and foreign taxes. Withholding taxes were as follows (in thousands):

	Fiscal Quarter Ended	
	December 27, 2013	December 28, 2012
Withholding Taxes	\$10,425	\$9,413
Effective Tax Rate		

Each period, the combination of multiple different factors can impact our effective tax rate. These factors include both recurring items such as tax rates and the relative amount of income earned in foreign jurisdictions, as well as discrete items that may occur in, but are not necessarily consistent between periods. Our effective tax rate was 25% and 25% in the first quarter of fiscal 2014 and 2013, respectively. Our estimated fiscal year 2014 tax provision reflects additional benefits from our election to indefinitely reinvest a portion of our undistributed earnings in a foreign subsidiary.

## 9. Accumulated Other Comprehensive Income

Other comprehensive income ("OCI") consists of two components: unrealized gains or losses on our available-for-sale marketable investment securities and the gain or loss from foreign currency translation adjustments. Until realized and reported as a component of net income, these comprehensive income items accumulate and are included within accumulated other comprehensive income ("AOCI"), a subsection within



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stockholders' equity on our consolidated balance sheet. Unrealized gains and losses on our available-for-sale securities are reclassified from AOCI into earnings when realized upon sale, and are determined based on specific identification of securities sold. Gains and losses from the translation of assets and liabilities denominated in non-U.S. dollar functional currencies are included in AOCI.

The following table summarizes the changes in the accumulated balances during the period, and includes information regarding the manner in which the reclassifications out of AOCI into earnings affect our consolidated statements of operations (in thousands):

	Unrealized Gains/Losses On Available-For-Sale Securities	Foreign Currency Translation Adjustments	Total
Balance at September 27, 2013	\$203	\$7,611	\$7,814
Other Comprehensive Income/(Loss) - Before Reclassifications:			
Unrealized Gain/(Loss) On Available-For-Sale Securities	235		235
Foreign Currency Translation Gains/(Losses) (1)		(473)	(473)
Income Tax Effect - Benefit/(Expense) (2)	(84)	(61)	(145)
Net Of Tax	151	(534)	(383)
Amounts Reclassified From AOCI Into Earnings:			
Realized Gain/(Loss) On Sale Of Available-For-Sale Securities (1)	(72)		(72)
Income Tax Effect - Benefit/(Expense) (2)	26		26
Net Of Tax	105	(534)	(429)
Balance at December 27, 2013	\$308	\$7,077	\$7,385

(1) Realized gains/(losses) on our available-for-sale securities and the gains/(losses) on foreign currency translation adjustments are included within other income/(expense), net in our consolidated statements of operations.

(2) The income tax benefit/(expense) is included within provision for income taxes in our consolidated statements of operations.

#### 10. Commitments and Contingencies

The following table presents a summary of our contractual obligations and commitments as of December 27, 2013 (in thousands):

	Payments Due By Fiscal Period						Total
	Remainder of Fiscal 2014	Fiscal 2015	Fiscal 2016	Fiscal 2017	Fiscal 2018	Thereafter	
Naming rights	\$3,670	\$7,432	\$7,525	\$7,619	\$7,715	\$118,699	\$152,660
Operating leases	13,065	9,755	6,375	4,517	2,919	3,096	39,727
Purchase obligations	6,058	2,266	1,014	56	—	—	9,394
Total	\$22,793	\$19,453	\$14,914	\$12,192	\$10,634	\$121,795	\$201,781

**Naming rights.** In fiscal 2012, we entered into an agreement for naming rights and related benefits with respect to the Dolby Theatre in Hollywood, California, the location of the Academy Awards®. The term of the agreement is 20 years, over which we will make payments on a semi-annual basis. Our payment obligations are conditioned in part on the Academy Awards® being held and broadcast from the Dolby Theatre.

**Operating leases.** Operating lease payments include future minimum rental commitments, including those payable to our principal stockholder and portions attributable to the controlling interests in our wholly owned subsidiaries, for non-cancelable operating leases of office space as of December 27, 2013.

Purchase obligations. Our purchase obligations consist of agreements to purchase goods and services, entered into in the ordinary course of business. These represent non-cancelable commitments for which a penalty would be imposed if the agreement was canceled for any reason other than an event of default as described by the agreement. We are party to certain contractual agreements under which we have agreed to provide indemnifications of varying scope and duration to the other party relating to our licensed intellectual property. Historically, we have not made any payments for these indemnification obligations and no amounts have been accrued in our unaudited interim condensed consolidated financial statements with respect to these obligations. Due to their varying terms and conditions, we are unable to make a reasonable estimate of the maximum potential amount we could be required to pay.

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11. 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 impact on our operating results or financial condition. Given the unpredictable nature of legal proceedings, 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; however, based on the information known by us as of the date of this filing and the rules and regulations applicable to the preparation of our unaudited interim condensed financial statements, any such amount is either immaterial or it is not possible to provide an estimated amount of any such potential loss.

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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 unaudited interim condensed consolidated financial statements and the related notes that appear elsewhere in this Quarterly Report on Form 10-Q. These discussions contain forward-looking statements reflecting our current expectations and are subject to risks and uncertainties, including, but not limited to statements regarding: operating results and underlying measures; demand and acceptance for our technologies and products; market growth opportunities and trends; our plans, strategies and expected opportunities; and future competition. Use of words such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential," "continue" or similar expressions indicates a forward-looking statement. Such forward-looking statements are based on management's reasonable current assumptions and expectations. 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. We are under no duty to update any of the forward-looking statements after the date of this Quarterly Report on Form 10-Q to conform our prior statements to new developments or actual results.

## OVERVIEW

Dolby Laboratories creates audio, video, and voice technologies that transform entertainment and communications at the cinema, at home, at work and on mobile devices. Founded in 1965, our core strengths stem from our expertise in digital signal processing and compression technologies that have transformed the ability of artists to convey entertainment experiences to their audiences through recorded media. Such technologies led to the development of our noise-reduction systems for analog tape recordings, and have since evolved into multichannel sound for cinema, digital television transmissions and devices, DVDs and Blu-ray discs and devices, and more recently, into the next generation of audio technologies for the cinema, home entertainment, mobile and gaming experiences. We continue to develop new commercial applications for our technologies such as those aimed at enhancing voice conferencing communications. Today, we derive the majority of our revenue from licensing our audio technologies.

We also provide products and services that enable entertainment content creators and distributors to produce, encode, transmit and playback content for superior consumer experiences. We have extended our know-how into imaging technologies through digital cinema products, our professional monitor, Dolby 3D glasses-free technology for home and mobile displays, as well as Dolby Vision, a new technology that enhances televisions by enabling more realistic images and an expanded color palette for several formats including HD, 4K UHD, and 8K.

## Revenue Generation

The following table presents a summary of the composition of our revenues for all periods presented:

Revenue	Fiscal Quarter Ended	
	December 27, 2013	December 28, 2012
Licensing	89%	86%
Products	8%	11%
Services	3%	3%
Total	100%	100%

We license our technologies in 50 countries, and our licensees distribute products with our technologies throughout the world. We sell our products and services in over 80 countries. As shown in the table below, we generate a significant portion of our revenue from outside the United States. Geographic data for our licensing revenue is based on the location of our licensees' headquarters. Products revenue is based on the destination to which we ship our products, while services revenue is based on the location where services are performed.

Revenue By Geographic Location	Fiscal Quarter Ended	
	December 27, 2013	December 28, 2012
United States	25%	32%
International	75%	68%



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Revenue From Significant Customers

Revenue from Samsung represented approximately 13% and 11% of our total revenue in the first quarter of fiscal 2014 and 2013, respectively, and consisted primarily of licensing revenue from our mobile and broadcast markets. Although revenue from Microsoft did not exceed 10% of our total revenue in the first quarter of fiscal 2014, revenue from Microsoft did represent approximately 12% of our total revenue in the first quarter of fiscal 2013, and included licensing revenue from our PC ("personal computer"), CE ("consumer electronics"), and other markets. Under the Windows 8 licensing agreement, we now receive certain royalties directly from PC original equipment manufacturers ("OEMs"), which differs from the prior Windows 7 arrangement where these royalties came from Microsoft.

Licensing

We license our technologies to various third parties who incorporate them into their products to enable and enhance audio and video capabilities. These products cover a wide range of end-user experiences whether it be at Home, at Work, in the Cinema or on-the-go with a Mobile Device:

At Home: Software vendors and OEMs of devices such as digital televisions, set-top boxes ("STBs"), home-theater-in-a-box systems ("HTIBs"), audio/video receivers ("AVRs"), DVD and Blu-ray devices as well as gaming consoles;

At Work: OEMs of PCs as well as an audio and video conference service provider that incorporates specified digital audio technologies into their solutions for superior spatial perception and voice clarity;

At the Cinema: Movie theatres that use our digital audio technology to provide enhanced sound; and

On Mobile Devices: Software vendors and OEMs of devices such as smartphones, tablets, auto entertainment systems as well as portable PCs.

We have three primary licensing models: a two-tier model, an integrated licensing model, and a patent licensing model.

**Two-Tier Licensing Model.** Most of our consumer entertainment licensing business consists of a two-tier licensing model whereby our decoding technologies, included in reference software and firmware code, are first provided under license to a semiconductor manufacturer. The manufacturer then incorporates our technologies in integrated circuits ("ICs"). Licensed semiconductor manufacturers, whom we refer to as "implementation licensees," sell their ICs to OEMs of consumer entertainment products, which we refer to as "system licensees." System licensees separately obtain licenses from us that allow them to make and sell finished end-user products that incorporate our technologies in ICs purchased from our implementation licensees.

Implementation licensees pay us a one-time, up-front fee per license. In exchange, the licensee receives a licensing package, which includes information useful in implementing our technologies into their chipsets. Once implemented, the licensee sends us a sample chipset for quality control evaluation and if we validate the design, the licensee may sell the chipset for use solely by our system licensees.

System licensees are required to provide us with prototypes of products that incorporate our technologies for which they are licensed for quality control evaluation, or under certain circumstances, with self-test results for our review. If the prototype or test results are approved, the licensee is permitted to buy ICs from any Dolby implementation licensee with a license for the same Dolby technology, and to sell approved products to retailers, distributors, and consumers. For the use of our technologies, our system licensees pay an initial licensing fee as well as royalties, which represent the majority of the revenue recognized from these arrangements. The amount of royalties we collect from a system licensee on a particular product depends on a number of factors including the mix of Dolby technologies used, the nature of the implementations, and the volume of products incorporating our technologies that are shipped by the system licensee.

**Integrated Licensing Model.** We also license our technologies to software operating system vendors and independent software vendors ("ISVs"), and to certain other OEMs that act as combined implementation and system licensees. These licensees incorporate our technologies in their software used on PCs, in mobile applications, or in ICs they manufacture and incorporate into their products. As with the two-tier licensing model, the combined implementation and system licensee pays us an initial licensing fee in addition to royalties as determined





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by the mix of Dolby technologies used, the nature of the implementations and the volume of products incorporating our technologies that are shipped, and is subject to the same quality control evaluation process.

**Patent Licensing.** We license our patents directly to manufacturers that use our intellectual property in their products. We also license our patents indirectly through patent pools, arrangements between multiple patent owners to jointly offer and license pooled patents to licensees. Finally, we generate service fees for managing patent pools on behalf of third party patent owners through our wholly owned subsidiary, Via Licensing Corporation. The Via Licensing patent pools enable product manufacturers to efficiently secure patent licenses for audio coding, interactive television, digital radio and wireless technologies.

We have active licensing arrangements with over 560 electronics product OEMs and software developer licensees, with corporate headquarters located in 50 countries.

**Products**

We design and manufacture video and audio products for the film production, cinema, and television broadcast industries. Distributed in over 60 countries, these products are used in content creation, distribution, and playback to enhance image and sound quality, and improve transmission and playback.

Digital cinema is based on open standards that, unlike standards for film-based cinema, do not include our proprietary audio technologies.

**Services**

We offer a variety of services to support film production, television broadcast, and music production. Our engineers assist in the use of our products and technologies to create and reproduce content. Such assistance can involve equipment calibration, mixing room alignment, and equalization. To ensure movie playback with optimal quality, our engineers also provide equipment training, system and venue design consultation, as well as on-site technical expertise to cinema operators throughout the world.

**OPPORTUNITIES, CHALLENGES, AND RISKS**

Today, content is captured, delivered, and played back in more ways than ever before. Consumers access content at will and on the go through multiple channels, including cinema, optical disc, digital broadcast, wired internet, and cellular networks. As consumers are presented with more options for receiving content, competition across delivery channels has intensified. As such, our licensing and product markets are characterized by rapid technological changes, new product introductions, changing customer and licensee demands and evolving industry standards that present a high risk of obsolescence.

**Licensing**

The following table presents the composition of our licensing business and revenues for all periods presented:

Market	Fiscal Quarter Ended		Main Products Incorporating Our Technologies
	December 27, 2013	December 28, 2012	
Broadcast	36%	33%	Televisions and set-top boxes
PC	21%	29%	Microsoft Windows operating systems and DVD software players
Consumer Electronics	19%	17%	DVD and Blu-ray Disc players and recorders, audio/video receivers, and home-theater-in-a-box systems
Mobile	15%	11%	Smartphones, tablets and other mobile devices
Other	9%	10%	Video game consoles, Automotive (in-car DVD players)
Total	100%	100%	

Content creators and distributors are increasingly focused on delivering content for online consumption across a multitude of media and devices with varying bandwidth and performance capabilities, including PCs, connected TVs, STBs, gaming consoles, connected Blu-ray Disc players, and various mobile devices. Many mobile devices now designed for enhanced capture and playback present a challenge for content creators and device manufacturers seeking consistent audio quality. We believe this challenge provides opportunities whereby we can provide solutions designed to optimize the audio experience across the online and portable device markets.

With the continued evolution of consumer entertainment choices and our efforts to provide competitive audio and video technologies for a wide variety of devices, the composition of our optical and non-optical based licensing

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revenue has changed. Our optical disc-based revenue is generated from the licensing of technologies that enable DVD or Blu-ray Disc playback, including those incorporated in the Microsoft Windows 7 and 8 operating systems, independent PC DVD software players, and consumer DVD and Blu-ray Disc players. Non-optical disc based licensing revenue includes revenue derived from products such as TVs, set-top boxes, and mobile phones, as well as our post-processing technologies on a range of devices. The portion of our total licensing revenue comprised of our non-optical disc based licensing has been increasing over time, as shown in the following table:

Licensing Revenue	Fiscal Quarter Ended	
	December 27, 2013	December 28, 2012
Non-Optical	68%	59%
Optical	32%	41%

**Broadcast Market**

In our broadcast market we derive the majority of our revenue from licensing our technologies to OEMs of televisions and set-top boxes. The efficiency and quality of our multichannel technologies are well suited to digital broadcast bandwidth requirements and to delivering a premium HD content experience. A high percentage of global sales of TV and STBs are shipped with our technologies, especially in North America and Europe.

As countries within emerging markets convert to digital television, we are well positioned to benefit from this transition, and our growth in this market is dependent in part upon continued adoption of our technologies. Broadcast services that operate under bandwidth constraints, such as terrestrial broadcast or Internet protocol television (“IPTV”) services, benefit from Dolby technologies, which enable the delivery of high quality audio content at reduced bit rates, thereby conserving bandwidth.

**PC Market**

Our technologies are in the majority of PCs sold today due to their incorporation in Microsoft Windows 8 for disc and online content playback and, for versions prior to Windows 8, primarily because of their inclusion in DVD and Blu-ray Disc playback functionality. Historically, we have licensed our technologies to a range of PC licensees, including ISVs, PC OEMs, and operating system providers. The release of new versions of major PC operating systems has sometimes resulted in changes in the mix of our PC licensees. Revenue from our PC licensees has declined faster than the decline in the overall PC market over the past two quarters due in part to our transition to the Windows 8 business model, a trend which we expect to continue in the second quarter of fiscal 2014. Under the Windows 8 arrangement, we are now paid a royalty by PC OEMs, which differs from the prior Windows 7 arrangement under which we were paid a royalty by Microsoft and PC licensees for the use of our decoder.

**Consumer Electronics (“CE”) Market**

Our CE market is primarily driven by revenue attributable to HTIBs, AVRs, DVD and Blu-ray Disc players and recorders. Sales of DVD players are declining as a result of the maturity of the DVD platform and a shift to Blu-ray players and other connected devices capable of delivering content. The decline in DVD revenue is only partially offset by revenue from Blu-ray players which have not reached the annual volumes generated by DVD players in prior periods. This is partially due to the large number of competing products and services that currently deliver content over the Internet.

**Mobile Market**

Our mobile market is largely driven by sales of smartphones, tablets and other mobile devices that incorporate our technologies. Our growth in this market is dependent not only on the performance of the mobile device market as a whole, but also on our success of collaborating with manufacturers of mobile devices to incorporate our technologies. Currently, these devices include various Android and Windows 8 smartphones and tablets and certain Amazon Kindle models. Historically, our growth in smartphones has stemmed primarily from high-end models, but growth in this sector is slowing. As a result, we are focused on further penetrating the high-end sector and expanding our target market to include mid-tier smartphones and additional tablets. At the same time, the rate of new product development in this sector continues to be rapid and can result in dramatic swings in consumer adoption trends. Therefore, and in order to remain competitive, we must continue to align our technologies with a shifting array of mobile devices.



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## Other Markets

Revenue generated from our other markets typically stems from gaming devices and peripherals, automotive and licensing services. Revenue attributable to gaming and automotive is primarily driven by sales of video game consoles and in-car entertainment systems that incorporate our Dolby Digital, Dolby Digital Plus, advanced audio coding (“AAC”), and Dolby TrueHD technologies. Licensing services revenue, from the administration of our patent pools through our wholly-owned subsidiary Via Licensing Corporation, is primarily driven by demand for standards-based audio compression technologies for broadcast, CE, and mobile products, as well as voice technologies.

## Products

The following table presents the composition of our products revenue for all periods presented:

Market	Fiscal Quarter Ended	
	December 27, 2013	December 28, 2012
Cinema	86%	87%
Broadcast	10%	9%
Other	4%	4%
Total	100%	100%

Revenue from our cinema products tends to fluctuate based on the underlying trends in the cinema industry, including technology adoption and replacement cycles. One such significant trend is the industry's transition from film-based to digital cinema, the latter of which eliminates film printing and distribution costs, combats piracy and enables repeated movie playback without image or audio degradation.

## Digital cinema products

Our cinema products include our digital audio processor that provides multichannel surround playback for our digital cinema servers, and central library server for the storage and playback of digital content, as well as our Dolby Digital Cinema Integrated Media Block (“IMB”) which performs audio and video decoding and playback. As the market for digital cinema servers and related equipment has become increasingly competitive and the industry's transition from film to digital nears completion, revenue from our cinema products will likely further decline until the industry's replacement cycle reverses this trend. We are actively managing our product portfolio through this cycle while also striving to provide further technological solutions for the cinema.

Our Dolby Atmos object-oriented sound platform enhances the cinema experience and provides more flexibility and control for sound designers and mixers to deliver more natural and realistic sound. To date, no standards exist for object audio playback in cinema. However, both the North American Theatre Owners (“NATO”) and Digital Cinema Initiative (“DCI”), a group representing the top Hollywood studios, have encouraged the development of an industry standard for object-oriented audio. We will continue to collaborate with these industry participants since the outcome may impact future adoption of our products.

## Digital 3D products

Our digital cinema 3D products provide 3D image capabilities when combined with a digital cinema projector and server. Our revenue in this area has been negatively impacted by declines in unit shipments and lower selling prices for 3D products, as the market for 3D cinema equipment has become increasingly competitive and the adoption rate of new 3D screens has slowed considerably.

## Broadcast products

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. Since our broadcast products support the use of our encoding technologies, revenue from these products will be affected by the level of adoption of our encoding technologies especially in new and emerging markets.

## Film-based products

Our film cinema products are used primarily to read, decode, and play back film soundtracks, to calibrate cinema sound systems, and to enable soundtracks encoded in digital audio to be played back on analog cinema audio systems.

As the cinema industry has increasingly adopted digital-based formats, revenue from our film

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cinema products has declined, and we anticipate this decline to continue.

Services

Services revenue is primarily tied to activity in the cinema industry, and has been adversely impacted by the industry's transition from film to digital-based production. Services are also dependent upon the volume of film production 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 and budgetary constraints and changes in cinema industry business models. Our services revenue continues to face significant competition from full-service post-production companies.

**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 United States ("GAAP"), and pursuant to Securities and Exchange Commission ("SEC") rules and regulations. The preparation of these financial statements requires us to establish 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 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. The Audit Committee has reviewed our related disclosures in our Annual Report on Form 10-K for the fiscal year ended September 27, 2013. Although we believe that our judgments and estimates are appropriate and correct, actual results may differ from these estimates.

We consider the following accounting policies and estimates listed below to be the most critical due to both their importance on our financial condition and results of operations and the level of management judgment required. If actual results or events differ materially, our reported financial condition and results of operation for future periods could be materially affected. Historically, our estimates and assumptions have not significantly differed from actual results. The estimates and/or assumptions relevant to these critical policies have not significantly changed in recent years, nor do we anticipate them to significantly change in the future. For additional information describing all of our significant accounting policies and methods used in the preparation of our financial statements, refer to our Annual Report on Form 10-K for the fiscal year ended September 27, 2013 in addition to Note 2, "Summary of Significant Accounting Policies" of the Notes to the Unaudited Interim Condensed Consolidated Financial Statements in Part I, Item 1. Further information regarding the potential risks to our future results of operations are included within "Risk Factors" in Part II, Item 1A of this Form 10-Q.



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Goodwill, Intangible Assets, and Long-Lived Assets

We test goodwill for impairment annually during our third fiscal quarter and whenever events or changes in circumstances indicate that the carrying amount may be impaired. 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 three to seventeen years.

Description

We review long-lived assets, including intangible assets, for impairment whenever events or a change in circumstances indicate that an asset's carrying value may not be recoverable. Recoverability of an asset is measured by comparing its carrying value to the total future undiscounted cash flows that the asset is expected to generate. If it is determined that an asset is not recoverable, an impairment loss is recorded in the amount by which the carrying value of the asset exceeds its estimated fair value.

Beginning in the third quarter of fiscal 2012, we adopted the provisions of the FASB's recently issued accounting standard (ASU 2011-08) which permits the execution of a qualitative assessment as a determinant for whether the two-step annual goodwill impairment test should be performed. In performing our annual goodwill impairment test, we first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform a two-step goodwill test. In performing the qualitative assessment, we consider events and circumstances, including but not limited to, macroeconomic conditions, industry and market considerations, cost factors, overall financial

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performance, changes in management or key personnel, changes in strategy, changes in customers, changes in the composition or carrying amount of a reporting unit's net assets and changes in the price of our common stock. If, after assessing the totality of events or circumstances, we determine that it is more likely than not that the fair value of a reporting unit is greater than its carrying amount, then the two-step goodwill impairment test is not performed.

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If the two-step goodwill test is performed, we evaluate and test our goodwill for impairment at a reporting-unit level using expected future cash flows to be generated by the reporting unit. If the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the calculated fair value of the goodwill. A reporting unit is an operating segment or one level below.

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## 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 completed, the seller's price to the buyer is fixed or determinable and collectibility is probable.

**Multiple-Element Arrangements.** Some of our revenue arrangements include multiple elements ("MEs"), such as hardware, software, maintenance and other services. We evaluate each element in a multiple element arrangement to determine whether it represents a separate unit of accounting. An element constitutes a separate unit of accounting when it has standalone value and delivery of an undelivered element is both probable and within our control. When these criteria are not met, the delivered and undelivered elements are combined and the arrangement fees are allocated to this combined single unit. If the unit separation criteria are met, we account for each element within a ME arrangement (such as hardware, software, maintenance and other services) separately, whereby the total arrangement fees are allocated 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 vendor specific objective evidence ("VSOE"), if available, third party evidence ("TPE"), if VSOE is not available, or estimated selling price ("ESP"), if neither VSOE nor TPE is available.

## Description

For some arrangements, customers receive certain elements over a period of time, after delivery of the initial product. These elements may include support and maintenance and/or the right to receive upgrades. Revenue allocated to the undelivered element is recognized either over its estimated service period or when the upgrade is delivered. We do not recognize revenue that is contingent upon the future delivery of products or services or upon future performance obligations. We recognize revenue for delivered elements only when we have completed all contractual obligations.

We determine our ESP 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. We account for the majority of our digital cinema server and processor sales as ME arrangements that may include up to four separate units, or elements, of accounting.

1. 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.
2. The second element is the right to receive support and maintenance, which is included with the purchase of the hardware element and is typically delivered over a service period subsequent to the initial sale.
3. The third element is the right to receive specified upgrades, which is included with the purchase of the hardware element and is typically delivered when a specified upgrade is available, subsequent to the initial sale. Under revenue recognition accounting standards, sales of our digital cinema servers typically result 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 once delivery has occurred. A small portion of the arrangement fees are allocated to the undelivered support and maintenance element, and in some cases to the undelivered specified upgrade element, based on the VSOE or ESP of each element. The portion of the arrangement fees allocated to the support and maintenance element are recognized as revenue ratably over the estimated service period, and the portion of the arrangement fees allocated to specified upgrades are recognized as revenue upon delivery of the upgrade.

4. The fourth element is the right to receive commissioning services performed solely in connection with our digital servers necessary for the installation of Dolby Atmos-enabled theatres. These services consist of the review of venue designs specifying proposed speaker placement, as well as calibration services performed for installed speakers to ensure optimal playback. A small portion of the arrangement fee is allocated to these services based on their ESP which we recognize as revenue once the services have been completed.

Software Arrangements. Revenue recognition for transactions that involve software, such as fees we earn from certain system licensees, may include multiple elements. For some of our ME arrangements, customers receive certain elements 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.

In certain cases, our arrangements require the licensee to pay a fixed fee for units they may distribute in the future. These fees are generally recognized upon contract execution, unless the arrangement includes contingency terms or is considered a ME arrangement.

Revenue recognition for transactions that may include multiple elements, such as fees we earn from certain system licensees, requires judgment in several possible areas including the following:

- Identifying the significant deliverables within the arrangements and determining whether the significant deliverables constitute separate units of accounting;
- Timing of delivery or performance of service for the significant deliverables;
- The assumptions and inputs used to determine selling price (whether vendor-specific objective evidence, third-party evidence, or estimated selling price) for the significant deliverables;
- To the extent that customers receive certain elements of the arrangement over a period of time following initial delivery, as necessary, we estimate the period of time over which revenue is recognized; and
- 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.

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## Income Taxes

We use the asset and liability method, under which deferred income tax assets and liabilities are determined based upon the difference between the financial statement carrying amounts and the tax bases of assets and liabilities and net operating loss carryforwards and tax credits are measured using the enacted tax rate expected to apply to taxable income in the years in which the differences are expected to be reversed.

Description 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. In assessing the realizability of deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The realization of deferred tax assets is additionally dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. We consider the scheduled reversal of deferred tax liabilities and projected future taxable income in making this assessment. We record a valuation allowance to reduce our deferred tax assets when uncertainty regarding their realizability exists.

We include interest and penalties related to gross unrecognized tax benefits within our provision for income taxes. To the extent accrued interest and penalties do not ultimately become payable, amounts accrued are reduced in the period that such determination is made and are reflected as a reduction of the overall income tax provision.

Judgments And Uncertainties 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 consolidated balance 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.

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.

## Investments

Description Valuation. Our investments are recorded at fair value in our consolidated balance sheets. Fair value is the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants at the measurement date. We evaluate our investment portfolio for credit losses and other-than-temporary impairments by comparing the fair value with the cost basis for each of our investment securities. An investment is impaired if the fair value is less than its cost basis. If any portion of the impairment is deemed to be the result of a credit loss, the credit loss portion of the impairment is included as a component of net income. If we deem it probable that we will not recover the full cost basis of the security, the security is other-than-temporarily impaired and the impairment loss is recognized as a component of net income. 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 and input from independent third parties, the frequency of trading in the investments, and the investment's complexity. If different judgments regarding inputs were made, we could potentially reach different conclusions regarding the fair value of

our investments.

**Classification.** All of our investments are classified as available-for-sale securities, with the exception of our investments held in our supplemental retirement plan, which are classified as trading securities. Investments that have an original maturity of 91 days or more at the date of purchase and a current maturity of less than one year are classified as short-term investments, while investments with a current maturity of more than one year are classified as long-term investments.

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.

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

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

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## Stock-Based Compensation

**Description** We determine the expense for all employee stock-based compensation awards by estimating their fair value and recognizing that value as an expense, on a ratable basis, in our 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.

**Judgments And Uncertainties** To determine the fair value of a stock-based award using the Black-Scholes option pricing model, we make assumptions regarding the expected term of the award, the expected future volatility of our stock price over the expected term of the award, and the risk-free interest rate over the expected term of the award. We estimate the expected term of our stock-based awards by evaluating historical exercise patterns of our employees. We use a blend of the historical volatility of our common stock and the implied volatility of our traded options as an estimate of the expected volatility of our stock price over the expected term of the awards. We use an average interest rate based on U.S. Treasury instruments with terms consistent with the expected term of our awards to estimate the risk-free interest rate. We reduce the stock-based compensation expense for estimated forfeitures based on our historical experience. We are required to estimate forfeitures at the time of the grant and revise our estimate, if necessary, in subsequent periods if actual forfeitures differ from our estimate.

## Recently Issued Accounting Standards

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

## RESULTS OF OPERATIONS

Key drivers identified throughout this section reflect their order of magnitude in descending order for the respective periods noted.

## Revenue and Gross Margin

## Licensing

The intellectual property that we license to our customers is either internally developed, acquired, or licensed from third parties. Our cost of licensing consists mainly of amortization of purchased intangible assets and intangible assets acquired in business combinations as well as third party royalty obligations paid to license intellectual property that we then sublicense to our customers.

	Fiscal Quarter Ended		Q1 '14 vs. Q1 '13	
	December 27, 2013	December 28, 2012	\$	%
Licensing				
Revenue	\$205,660	\$204,876	\$784	—%
Percentage Of Total Revenue	89%	86%		
Cost Of Licensing	4,001	3,080	921	30%
Gross Margin	201,659	201,796	(137)	—%
Gross Margin Percentage	98%	98%		

## Q1 '14 vs. Q1 '13

Key Drivers	Revenue	Gross Margin
Mobile	á Driven by higher unit shipments of smartphones and tablets that incorporate our technologies	Although licensing gross margin percentage remained consistent at 98% from the first quarter of fiscal 2013 to the first quarter of fiscal 2014,
Broadcast	á Driven by an increase in net back royalties and settlements and higher shipments of set-top boxes using our technologies which was partially offset by	cost of licensing increased over the comparative period, primarily due to an increase in fees

	lower shipments of TV units	payable to a third party
CE	á	Attributable to increases in net back royalties and settlement revenue from DVD and Blu-ray Disc devices
PC	â	Driven primarily by market declines of shipments as well as our transition to the Windows 8 business model

Products

Cost of products primarily consists of the cost of materials related to products sold, applied labor and 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 include in our products.

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Products	Fiscal Quarter Ended		Q1 '14 vs. Q1 '13	
	December 27, 2013	December 28, 2012	\$	%
Revenue	\$18,104	\$25,498	\$(7,394)	(29)%
Percentage Of Total Revenue	8%	11%		
Cost Of Products	13,788	18,489	(4,701)	(25)%
Gross Margin	4,316	7,009	(2,693)	(38)%
Gross Margin Percentage	24%	27%		

## Q1 '14 vs. Q1 '13

Key Drivers	Revenue	Gross Margin
Digital Cinema (Video)	â Driven by lower average selling prices and lower unit shipments	â Driven by lower average selling prices, partially offset by lower unit standard costs
3D Cinema	â Driven by lower shipments of glasses and kits	â Driven by lower average selling prices and higher unit costs
Film-Based Cinema	â Driven by lower shipments resulting from the industry transition to digital cinema	â Driven by lower unit standard costs in addition to higher average selling prices
Broadcast	â Driven by lower shipments as our customers transition to software licensing solutions	â Driven by higher average selling prices, partially offset by net higher unit standard costs
Atmos	á Driven by worldwide installations of the Dolby Atmos processors for which we had not started shipping in the first quarter of fiscal 2013	á Driven by higher margins realized on installations of Dolby Atmos processors

## Services

Cost of services primarily consists of personnel and personnel-related costs for employees performing our professional services, the cost of outside consultants, and other direct expenses incurred on behalf of customers.

Services	Fiscal Quarter Ended		Q1 '14 vs. Q1 '13	
	December 27, 2013	December 28, 2012	\$	%
Revenue	\$7,513	\$6,228	\$1,285	21%
Percentage Of Total Revenue	3%	3%		
Cost Of Services	3,593	4,036	(443)	(11)%
Gross Margin	3,920	2,192	1,728	79%
Gross Margin Percentage	52%	35%		

## Q1 '14 vs. Q1 '13

Key Drivers	Revenue	Gross Margin
Film-based production services	á Driven by the release of deferred revenue, partially offset by declines in film-based production services consistent with the industry transition to digital cinema	á Driven by lower labor and other related costs
Other	á Driven by an increase in Atmos commissioning services that did not occur in the prior year fiscal quarter as well as an increase in revenue from maintenance and support services.	á The first quarter of fiscal 2013 reflected relatively higher costs associated with early Atmos installations



Operating Expenses

Research and Development

Research and development expenses consist primarily of employee compensation and benefits expenses, stock-based compensation, consulting and contract labor costs, depreciation and amortization, facilities costs, costs for outside materials and services, and information technology expenses.

	Fiscal Quarter Ended		Q1 '14 vs. Q1 '13	
	December 27, 2013	December 28, 2012	\$	%
Research and Development	\$44,463	\$42,436	\$2,027	5%
Percentage of total revenue	19%	18%		

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## Q1 '14 vs. Q1 '13

Expense Category	Key Drivers
Compensation and benefits	á Driven by increased headcount aimed at developing new product offerings and technology solutions
Stock-based compensation	â Decreased primarily due to nonrecurring incremental expense related to equity award modifications that occurred in connection with the special dividend made in the first quarter of fiscal 2013 (refer to footnote 6 for additional information), partially offset by expense related to increased headcount

## Sales and Marketing

Sales and marketing expenses consist primarily of employee compensation and benefits expenses, stock-based compensation, marketing and promotional expenses particularly for events such as trade shows and conferences, travel-related expenses for our sales and marketing personnel, consulting fees, facilities costs, depreciation and amortization, and information technology expenses.

	Fiscal Quarter Ended		Q1 '14 vs. Q1 '13	
	December 27, 2013	December 28, 2012	\$	%
Sales and Marketing	\$60,379	\$58,421	\$1,958	3%
Percentage of total revenue	26%	25%		

## Q1 '14 vs. Q1 '13

Expense Category	Key Drivers
Consulting and external labor costs	á Driven by higher consulting expenses associated with expanded sales and marketing efforts across our target markets and related geographic locations
Stock-based compensation	â Decreased primarily due to nonrecurring incremental expense related to equity award modifications that occurred in connection with the special dividend made in the first quarter of fiscal 2013 (refer to footnote 6 for additional information), partially offset by expense related to increased headcount

## General and Administrative

General and administrative expenses consist primarily of employee compensation and benefits expenses, stock-based compensation, depreciation, information technology expenses, professional fees, consulting and contract labor and facilities costs.

	Fiscal Quarter Ended		Q1 '14 vs. Q1 '13	
	December 27, 2013	December 28, 2012	\$	%
General and Administrative	\$41,908	\$43,108	\$(1,200)	(3)%
Percentage of total revenue	18%	18%		

## Q1 '14 vs. Q1 '13

Expense Category	Key Drivers
Legal and professional fees	â Decreased as the first quarter of fiscal 2013 included higher external legal expenses, partially offset by higher costs in the current quarter attributed to patent filings and other legal activities
Stock-based compensation	â Decreased primarily due to nonrecurring incremental expense related to equity award modifications that occurred in connection with the special dividend made in the first quarter of fiscal 2013 (refer to footnote 6 for additional information), partially offset by expense related to increased headcount

Compensation and benefits      á Driven by increased headcount  
 Driven by an increase in our allowance for doubtful accounts as larger outstanding  
 Bad debt expense                á balances due from certain licensing customers remained uncollected as of the  
 current quarter-end

Restructuring

	Fiscal Quarter Ended		Q1 '14 vs. Q1 '13	
	December 27, 2013	December 28, 2012	\$	%
Restructuring	\$3,215	\$—	\$3,215	100%
Percentage of total revenue	1%	—%		

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Restructuring charges for the first quarter of fiscal 2014 represent costs incurred in relation to a plan implemented during the current quarter to reorganize and consolidate certain activities and positions within our global business infrastructure. These charges were primarily related to severance and other related benefits provided to employees that were affected as a result of this action. For additional information on this restructuring plan, see Note 7 “Restructuring” to our unaudited interim condensed consolidated financial statements.

## Other Income/(Expense)

Other income/(expense) primarily consists of interest income earned on cash, cash equivalents, and investments and other income/(expense) related to net gains/(losses) from foreign currency transactions, derivative instruments, and sales of available-for-sale or trading securities.

	Fiscal Quarter Ended		Q1 '14 vs. Q1 '13	
	December 27, 2013	December 28, 2012	\$	%
Other Income/(Expense)				
Interest income	\$654	\$1,339	\$(685)	(51)%
Interest expense	(112)	(25)	(87)	348%
Other income, net	229	713	(484)	(68)%
Total other income, net	\$771	\$2,027	\$(1,256)	(62)%

## Q1 '14 vs. Q1 '13

Expense Category	Key Drivers
Interest income	â Attributed to lower average portfolio balances during the current fiscal quarter as compared to the first quarter of fiscal 2013 when interest was earned for nearly the entire quarter on a higher average portfolio balance before payment of a special dividend
Other income/(expense)	â Primarily attributed to lower realized gains on the sale of marketable securities as compared to higher gains realized in the first quarter of fiscal 2013 when we sold significant holdings to fund the special dividend

## Income Taxes

Our effective tax rate is based on a projection of our annual fiscal year results, and is affected each quarter-end by several factors. These include changes in our projected fiscal year results, recurring items such as tax rates and relative income earned in foreign jurisdictions as well as discrete items that may occur in, but are not necessarily consistent between periods. For additional information related to effective tax rates, see Note 8 “Income Taxes” to our unaudited interim condensed consolidated financial statements.

	Fiscal Quarter Ended	
	December 27, 2013	December 28, 2012
Provision for income taxes	\$(15,455)	\$(17,582)
Effective tax rate	25%	25%

## Q1 '14 vs. Q1 '13

Factor	Impact On Effective Tax Rate
Foreign Operations	â In the current fiscal quarter, our estimated fiscal year 2014 tax provision reflects additional benefits from our election to indefinitely reinvest a portion of our undistributed earnings in a foreign subsidiary
Uncertain Tax Positions	á In the current fiscal quarter, our effective tax rate does not include the recognition of tax benefits from expired statute of limitations on some uncertain tax positions as it did in the first quarter of fiscal 2013



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## LIQUIDITY, CAPITAL RESOURCES, AND FINANCIAL CONDITION

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

As of December 27, 2013, we had cash and cash equivalents of \$484.6 million, which consisted of cash and highly-liquid money market funds. In addition, we had short-term and long-term investments of \$473.1 million, which consisted primarily of municipal debt securities, commercial paper, corporate bonds, and U.S. agency securities. Of our total cash, cash equivalents, and investments held as of December 27, 2013, \$294.4 million, or 31%, was held by our foreign subsidiaries. This represented a \$28.4 million increase from the \$266.0 million that was held by our foreign subsidiaries as of September 27, 2013. A majority of the amounts held outside of the U.S. are utilized to support non-U.S. liquidity needs in order to fund operations and other growth of our non-U.S. subsidiaries and acquisitions. Our policy is to indefinitely reinvest a portion of our undistributed earnings in certain foreign subsidiaries. If these undistributed earnings held by foreign subsidiaries are repatriated to the U.S., they may be subject to U.S. federal income taxes and foreign withholding taxes, less applicable foreign tax credits.

	December 27, 2013	September 27, 2013
	(in thousands)	
Cash and cash equivalents	\$484,640	\$454,397
Short-term investments	179,406	140,267
Long-term investments	293,719	306,338
Accounts receivable, net	75,949	97,460
Accounts payable and accrued liabilities	132,454	148,490
Working capital (1)	708,780	645,764

	Fiscal Quarter Ended	
	December 27, 2013	December 28, 2012
	(in thousands)	
Net cash provided by operating activities	\$77,282	\$67,300
Capital expenditures	(8,967)	(6,717)
Repurchase of common stock	(11,660)	(53,956)
Net cash provided by/(used in) investing activities	(37,651)	222,221
Net cash used in financing activities	(9,250)	(465,866)

(1) Working capital consists of total current assets less total current liabilities.

## Capital Expenditures and Uses of Capital

Our capital expenditures consist of purchases of land, building, building fixtures, office equipment, computer hardware and software, leasehold improvements, and production and test equipment. We continue to invest in sales and marketing and research and development that contribute to the overall growth of our business and technological innovation. In fiscal 2012, we purchased an approximately 354,000 square foot property in San Francisco, California for \$109.8 million, using existing cash. We are in the process of making substantial improvements to the property in order to prepare the building for its intended use as our new worldwide headquarters.

On December 11, 2012, our Board of Directors declared a special dividend in the amount of \$4.00 per share on our Class A and Class B Common Stock. Payment of the special dividend was made on December 27, 2012 to eligible stockholders of record as of the close of business on December 21, 2012 ("Record Date"). Based on the 102,051,386 shares of Class A and Class B Common Stock outstanding as of the record date, the total special dividend payment was \$408.2 million. To fund the dividend payment, we used existing cash along with proceeds from the sale of

securities from our investment portfolio.

We retain sufficient cash holdings to support our operations and we also purchase investment grade securities diversified among security types, industries, and issuers. We have used cash generated from our operations to fund a variety of activities related to our business in addition to our ongoing operations, including business expansion and growth, acquisitions, and repurchases of our common stock. We have historically generated significant cash from operations, however these cash flows and the value of our investment portfolio could be affected by various risks and uncertainties, as described in Part II, Item 1A “Risk Factors.”

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## Indemnification

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 not made any payments for these indemnification obligations and no amounts have been accrued in our unaudited interim condensed consolidated financial statements with respect to these obligations. Due to their varying terms and conditions, we are unable to make a reasonable estimate of the maximum potential amount we could be required to pay.

## Cash Flows

Factors identified below reflect their order of magnitude in descending order.

## Operating Activities

Net cash provided by operating activities increased \$10.0 million from the first quarter of fiscal 2013 as compared to the first quarter of fiscal 2014, primarily due to the following:

Factor	Impact On Cash Flows
Changes in operating assets and liabilities	á Due largely to higher cash collections of accounts receivable, current assets decreased by a greater margin than the decrease in accrued liabilities due to cash payments
Net Income	â Due largely to an increase in operating expenses

## Investing Activities

Net cash provided by/(used in) investing activities decreased \$259.9 million from the first quarter of fiscal 2013 as compared to the first quarter of fiscal 2014, primarily due to the following:

Factor	Impact On Cash Flows
Proceeds from sale of marketable securities	â A decrease in proceeds received from the sale of available-for-sale securities as we sold significant holdings from our investment portfolio to fund the special dividend payment made in the first quarter of fiscal 2013
Purchases of marketable securities	á Increased as we purchased less available-for-sale securities in the first quarter of fiscal 2014

## Financing Activities

Net cash used in financing activities was \$456.6 million higher in the first quarter of fiscal 2013 as compared to the first quarter of fiscal 2014, primarily due to the following:

Factor	Impact On Cash Flows
Dividend	â Due to the payment of a special dividend to holders of our Class A and Class B common stock in the first quarter of fiscal 2013 and absence of such a transaction in the current fiscal quarter
Share repurchases	â Fewer share repurchases of our Class A common stock in the first quarter of fiscal 2014 compared to the first quarter of fiscal 2013
Distributions	â Due to a distribution made to our controlling interest in the first quarter of fiscal 2013 and absence of such a transaction in the current fiscal quarter

## Off-Balance-Sheet and Contractual Obligations

Our liquidity is not dependent upon the use of off-balance sheet financing arrangements, and we have not entered into any arrangements that are expected to have a material effect on liquidity or the availability of capital resources.

Unrecognized Tax Benefits. As of December 27, 2013, we had an accrued liability for unrecognized tax benefits and related interest and penalties, net of related deferred tax assets, totaling \$32.8 million. We are unable to estimate when any cash settlement with a taxing authority might occur.

There has been no material change in our contractual obligations outside the ordinary course of business since the end of our last fiscal year ended September 27, 2013. For additional details regarding our contractual obligations, see Note 10 "Commitments and Contingencies" to our unaudited interim condensed consolidated financial statements.



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## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

## Interest Rate Sensitivity

As of December 27, 2013, we had cash and cash equivalents of \$484.6 million, which consisted of cash and highly-liquid money market funds. In addition, we had short-term and long-term investments of \$473.1 million, which consisted primarily of municipal debt securities, corporate bonds, commercial paper and U.S. agency securities. Our investment policy and strategy are focused on the preservation of capital and on supporting our liquidity requirements. We do not invest in financial instruments for trading or speculative purposes, nor do we use leveraged financial instruments. Our holdings of cash and cash equivalents and marketable securities, the majority of which are managed by external managers, meet the guidelines of our investment policy. We invest in highly rated securities with a minimum credit rating of A- and our policy limits the amount of credit exposure to any one issuer other than the U.S. government. At December 27, 2013, our weighted-average portfolio credit quality was AA and the weighted-average maturity of our investment portfolio was approximately fourteen months.

The investments within our fixed-income portfolio are subject to fluctuations in interest rates, which could affect our financial position, and to a lesser extent, results of operations. Based on our investment portfolio balance as of December 27, 2013, hypothetical changes in interest rates of 1% and 0.5% would have an impact on the carrying value of our portfolio of approximately \$5.2 million and \$2.6 million, respectively.

## Foreign Currency Exchange Risk

We maintain business operations in foreign countries, most significantly in the United Kingdom, Australia, China, Germany and the Netherlands. We also conduct a growing portion of our business outside of the U.S. through subsidiaries with functional currencies other than the U.S. dollar (primarily British Pound, Australian Dollar, Chinese Yuan Renminbi, Indian Rupee, Japanese Yen, Korean Won 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. The majority of our revenue generated from international markets is denominated in U.S. dollars, while the operating expenses of our foreign subsidiaries are predominantly denominated in local currencies. Therefore, our operating expenses will increase when the U.S. dollar weakens against the local currency and decrease when the U.S. dollar strengthens against the local currency. 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 consolidated statements of operations. Our foreign operations are subject to the same risks present when conducting business internationally, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures, foreign exchange rate volatility and other regulations and restrictions. In an effort to reduce the risk that our earnings will be adversely affected by foreign currency exchange rate fluctuations, we enter into foreign currency forward contracts to hedge against assets and liabilities for which we have foreign currency exchange rate exposure. These derivative instruments are carried at fair value with changes in the fair value recorded to other income, net, in our consolidated statements of operations. While not designated as hedging instruments, these foreign currency forward contracts are used to reduce the exchange rate risk associated primarily with intercompany receivables and payables. These contracts do not subject us to material balance sheet risk due to exchange rate movements as gains and losses on these derivatives are intended to offset gains and losses on the related receivables and payables for which we have foreign currency exchange rate exposure. As of December 27, 2013 and September 27, 2013, the outstanding derivative instruments had maturities of 31 days or less and the total notional amounts of outstanding contracts were \$14.5 million and \$11.6 million, respectively. The fair values of these contracts were nominal as of December 27, 2013 and September 27, 2013, and were included within prepaid expenses and other current assets and within accrued liabilities in our consolidated balance sheets. For additional information related to our foreign currency forward contracts, see Note 5 "Fair Value Measurements" to our unaudited interim condensed consolidated financial statements.

A sensitivity analysis was performed on all of our foreign currency forward contracts as of December 27, 2013. This sensitivity analysis was based on a modeling technique that measures the hypothetical market value resulting from a

10% shift in the value of exchange rates relative to the U.S. dollar. For these forward contracts, duration modeling was used where hypothetical changes are made to the spot rates of the currency. A 10% increase in the value of the U.S. dollar would lead to a decrease in the fair value of our financial instruments by \$0.3 million. Conversely, a 10% decrease in the value of the U.S. dollar would result in an increase in the fair value of these financial instruments by \$0.3 million.

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ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain “disclosure controls and procedures,” as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (“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 (“CEO”) and Chief Financial Officer (“CFO”), as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognizes that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Subject to the limitations noted above, our management, with the participation of our CEO and CFO, 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 CEO and CFO have concluded that, as of such date, our disclosure controls and procedures were effective to meet the objective for which they were designed and operate at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the fiscal quarter ended December 27, 2013 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 pending matters is not expected to have a material adverse impact on our operating results or financial condition. Given the unpredictable nature of legal proceedings, 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; however, based on the information known by us as of the date of this filing and the rules and regulations applicable to the preparation of our condensed consolidated financial statements, any such amount is either immaterial or it is not possible to provide an estimated amount of any such potential loss.

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 currently known to us or that we currently deem less significant may also affect our business operations or financial results. If any of the following risks actually occur, our business, operating results and financial condition could be materially adversely affected.

REVENUE GENERATION

Markets We Target

**Dependence on Sales by Licensees.** We depend on original equipment manufacturers (“OEMs”) and other licensees to incorporate our technologies into their products. Our license agreements generally do not have minimum purchase commitments, are typically non-exclusive, and frequently do not require incorporation or use of our technologies. Our revenue will decline if our licensees choose not to incorporate our technologies in their products or they sell fewer products incorporating our technologies.

**Impact of PC Sales.** Revenue from our personal computer (“PC”) market depends on several factors, including underlying PC unit shipment growth, the extent to which our technologies are included on computers, through operating systems or otherwise, and the terms of any royalties or other payments we receive. We face challenges in the PC market, including:

- Purchasing trends away from traditional PCs and toward computing devices without optical disc drives, such as ultrabooks and tablets;

- PC software that includes our technologies on an unauthorized and infringing basis, for which we receive no royalty payments; and

- Continued decreasing inclusion of independent software vendor media applications by PC OEMs.

**Declines in Optical Disc Media.** For many years, movies have been distributed, purchased, and consumed through optical disc media, such as DVD and more recently, Blu-ray Disc. However, the rapid advancement of online and mobile content delivery has resulted in a trend toward movie downloading and streaming services in various parts of the world. We have seen and we expect to continue to see a shift away from optical disc media to online and mobile media content consumption, which will result in declines in revenue from DVD and Blu-ray Disc players.

**Mobile Industry Risks.** Successful penetration of the mobile device market is critical to our future growth. The mobile device market, particularly smartphones and tablets, is characterized by rapidly changing market conditions, frequent product introductions and intense competition based on features and price. Our Dolby Digital and Dolby Digital Plus technologies are not mandated as an industry standard for mobile devices. We must continually convince mobile device OEMs and end users of mobile devices of the value of our technologies. To date, we have been more successful in the high-end of the smartphone market, and this segment of the market has recently experienced slower growth compared to the low and mid-tier market segments. With shorter product lifecycles, it is easier for mobile device OEMs to remove our technologies from mobile devices than it was for PC OEMs. In order to increase the value of our technologies in the mobile market, we have worked with online and mobile media content service

providers to encode their content with our technologies, which could affect OEM and software vendor demand for our decoding technologies. However, the online and mobile media content services markets are also characterized by intense competition, evolving industry standards and business and distribution

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models, disruptive software and hardware technology developments, frequent product and service introductions and short life cycles, and price sensitivity on the part of consumers, all of which may result in downward pressure on pricing or the removal of our technologies by these providers.

**Cinema Industry Risks.** Our cinema product sales are subject to fluctuations based on events and conditions in the cinema industry, such as the construction of new screens or upgrade of existing screens. A decrease in our ability to develop and introduce new cinema products and services successfully could affect licensing of our consumer technologies, because the strength of our brand and our ability to use professional product developments to introduce new consumer technologies would be impaired. A number of factors can affect the number of movies that are produced, including strikes and work stoppages within the cinema industry and budgetary constraints and changes in cinema industry business models.

**Maturity of Digital Cinema Market.** The industry transition to digital cinema is nearing completion, and the demand for new digital cinema screens has dropped significantly, leading to lower sales volumes of our cinema products. Future cinema product growth depends on a number of factors, including new theater construction, the introduction of new technologies, such as Dolby Atmos, and entering into a replacement cycle where previously purchased cinema products are upgraded or replaced. We face a number of challenges relating to the maturity of the digital cinema market, including:

- Exhibitors may choose competing products with different features or lower prices;
- Some of our competitors have a significantly greater installed base of digital cinema servers than we do, which may limit our share of the market, particularly in the U.S.; and

Pricing and other competitive pressures have caused us to implement pricing strategies which have adversely affected gross margins of our cinema products.

**3D Cinema Market Risks.** We face risks related to the 3D cinema market, including:

- Exclusive licensing arrangements between our competitors and exhibitors;
- Future demand for new 3D enabled screens; and
- Decreases in the number of 3D cinema releases and the commercial success of those releases.

## Customers and Distributors

**Loss of Key Licensee or Customer.** A small number of our licensees or customers may represent a significant percentage of our licensing, products, or services revenue. Although we generally have agreements with these licensees or customers, these agreements typically do not require any minimum purchases or minimum royalty fees and do not prohibit licensees from using competing technologies or customers from purchasing products and services from competitors. Because many of our markets are rapidly evolving, customer demand for our technologies and products can shift quickly. Because of our increased presence in the mobile market where our Dolby Digital and Dolby Digital Plus technologies are not mandated as industry standards, the risk that a large licensee may reduce or eliminate its use of our technologies has increased.

**Reliance on Semiconductor Manufacturers.** Our licensing revenue from system licensees depends in large part upon the availability of integrated circuits ("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 in accordance with their agreements. 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.

**Consumer Spending Weakness.** Weakness in general economic conditions may suppress consumer demand in our markets. Many of the products in which our technologies are incorporated are discretionary goods, such as PCs, televisions, set-top boxes, Blu-ray Disc players, video game consoles, audio/video receivers ("AVRs"), mobile devices, in-car entertainment systems, and home-theater systems. Weakness in general economic conditions may also lead to licensees and customers becoming delinquent on their obligations to us or being unable to pay, resulting in a higher level of write-offs. Economic conditions may increase underreporting and non-reporting of royalty-bearing

revenue by our licensees as well as increase the unauthorized use of our technologies.

**Reliance on Distributors.** 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, and they may be unwilling

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or unable to dedicate the resources necessary to promote our portfolio of products. Our distributors could retain product channel inventory levels that exceed future anticipated sales, which could affect future sales to those distributors. In addition, failure of our distributors to adhere to our policies designed to promote compliance with global anticorruption laws, export controls, and local laws, could subject us to criminal or civil penalties and stockholder litigation.

Marketing and Branding

**Importance of Brand Strength.** Maintaining and strengthening the Dolby brand is critical to maintaining and expanding our licensing, products, and services business, as well as our ability to enter new markets we are pursuing for our technologies, including Dolby Voice for the communications market, Dolby Vision and other video solutions for the consumer market, and others. Our continued success depends on our reputation for providing high quality technologies, products, and services across a wide range of entertainment markets, including the consumer entertainment, PC, broadcast, and gaming markets. If we fail to promote and maintain the Dolby brand successfully in licensing, products or services, our business 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 enter into new markets successfully, and to provide high quality products and services in these new markets.

Industry Standards

The entertainment industry depends upon industry standards to ensure compatibility across delivery platforms and a wide variety of consumer entertainment products. 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. The market for broadcast technologies has traditionally been heavily based on industry standards, often mandated by governments choosing from among alternative standards, and we expect this to be the case in the future.

**Difficulty Becoming Incorporated in an Industry Standard.** Standards-setting organizations establish technology standards for use in a wide range of consumer entertainment products. It can be difficult for companies to have their technologies adopted as an industry standard, as multiple companies, including ones that typically compete against one another, are involved in the development of new technology standards for use in entertainment-oriented products. **Participants May Choose Among Alternative Technologies within Standards.** Even when a standards-setting organization incorporates our technologies in an industry standard for a particular market, our technologies may not be the sole technologies adopted for that market. 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.

**Being Part of a Standard May Limit Our Licensing Practices.** When a standards-setting organization mandates our technologies, 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 and we may be unable to limit to whom we license such technologies or to restrict many terms of the license. We have in the past, and may in the future, be subject to claims that our licensing of industry standard technologies may not conform to the requirements of the standards-setting organization. Allegations such as these could be asserted in private actions seeking monetary damages and injunctive relief, or in regulatory actions. Claimants in such cases could seek to restrict or change our licensing practices or our ability to license our technologies.





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### Royalty Reporting

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

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

**Inaccurate Licensee Royalty Reporting.** We generate licensing revenue primarily from OEMs 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 report their shipments accurately. However, we have difficulty independently determining whether 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. 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 licensees regarding license terms. Most of our license agreements permit us to audit our licensees' records and we routinely exercise these rights, but audits are generally expensive, time-consuming, and potentially detrimental to our ongoing business relationships with our licensees. In the past, licensees 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.

**Royalties We Owe Others.** 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 an increase in the amount of royalties we have to pay to the third party.

### TECHNOLOGY TRENDS AND DEVELOPMENTS

**Technology Innovation.** The future growth of our licensing revenue will depend upon our success in new and existing markets for our technologies, such as digital broadcast, mobile devices, online and mobile media distribution, consumer video and voice. The markets for our technologies and products are defined by:

- Rapid technological change;
- New and improved technology and frequent 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 technologies and products and to develop 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, 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.

**Experience with New Markets and Business Models.** Our future growth will depend, in part, upon our expansion into areas beyond our core audio and cinema markets. In addition to our digital cinema initiatives, we are exploring other areas that facilitate delivery of digital entertainment, such as Dolby Vision and other video solutions for the

consumer market and Dolby Voice technology for the communications market. As we enter into these new markets, we will face new sources of competition, new business models, and new customer relationships. In order to be successful in these markets, we will need to cultivate new industry relationships to bring our products, services, and technologies to market. Our inexperience in one or more of these markets could limit our ability to successfully execute on our growth strategy.

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**INTELLECTUAL PROPERTY**

Our business is dependent upon protecting our patents, trademarks, trade secrets, copyrights, and other intellectual property rights. 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. The efforts we have taken to protect our proprietary rights may not be sufficient or effective. We also seek to maintain select intellectual property as trade secrets, and third parties or our employees could intentionally or accidentally compromise the intellectual property that we maintain as trade secrets. In addition, protecting our intellectual property rights is costly and time consuming. We have taken steps in the past to enforce our intellectual property rights and expect to do so in the future. However, it may not be practicable or cost effective for us to enforce our intellectual property rights fully, particularly in some countries or where the initiation of a claim might harm our business relationships.

We generally seek patent protection for our innovations. However, our patent program faces a number of challenges, including:

- Possibility that some of these innovations may not be protectable;
- Failure to protect innovations that later turn out to be important;
- Insufficient patent protection to prevent third parties from designing around our patent claims; and
- Possibility that an issued patent may later be found to be invalid or unenforceable.

**Patent Royalties and Expiration.** Many of the technologies that we license to our system licensees are covered by patents, and the licensing revenue that we receive from those licenses depends in large part upon the life of such patents. In general, our agreements with our licensees require them to pay us a full royalty with respect to a particular technology only until the last patent covering that technology expires in a particular country. As of December 27, 2013, we had over 3,600 issued patents and over 2,800 pending patent applications in more than 50 jurisdictions throughout the world. Our currently issued patents expire at various times through April 2038.

We seek to mitigate this risk in a variety of ways. We regularly look for opportunities to expand our patent portfolio through organic development and acquisitions. We develop proprietary technologies to replace licensing revenue from technologies covered by expiring patents with licensing revenue supported by patents with a longer remaining life. And we develop and license our technologies in a manner designed to minimize the chance that a system licensee would develop competing technologies.

In particular, some of our patents relating to Dolby Digital technologies, from which we derive a significant part of our licensing revenue, have expired and others will expire over the next several years. We have transitioned a number of our Dolby Digital licensees, and continue to make progress in transitioning other Dolby Digital licensees, to Dolby Digital Plus technologies, an extension of our Dolby Digital technologies, whose patents generally expire later than the Dolby Digital patents. We now derive a significant part of our licensing revenue from Dolby Digital Plus. To be successful, we must continue to transition licensees to Dolby Digital Plus, and discourage licensees of Dolby Digital Plus to transition back to Dolby Digital as our original patents covering this technology expire.

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

**Intellectual Property Litigation.** Companies in the technology and entertainment industries frequently engage in 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. 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. Licensors could also

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require us to pay significant royalties. 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 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.

**Licensee Disputes.** 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 based on potential antitrust claims or regarding our licensing royalty rate practices. Damages and requests for injunctive relief asserted in claims like these could be significant, and could be disruptive to our business.

**U.S. and Foreign 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 hurt our ability to obtain, license, and enforce our patents. We face challenges protecting our intellectual property in foreign jurisdictions, including:

Our ability to enforce our contractual and intellectual property rights, especially in countries that do not recognize and enforce intellectual property rights to the same extent as the U.S., Japan, Korea, and European countries do, which increases the risk of unauthorized use of our technologies;

Limited or no patent protection for our Dolby Digital technologies in countries such as China, Taiwan, and India, which may require us to obtain patent rights for new and existing technologies in order to grow or maintain our revenue; and

Because of limitations in the legal systems in many countries, our ability to obtain and enforce patents in many countries is uncertain, and we must strengthen and develop 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.

**OPERATIONS**

**Reliance on Key Suppliers.** Our reliance on 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 generally 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 delays in our operations and increase our production costs. In addition, our suppliers may not be able to meet our production demands as to volume, quality, or timeliness. Moreover, we rely on sole source suppliers for some of the components that we use to manufacture our products, including specific charged coupled devices, light emitting diodes, and digital signal processors. These sole source suppliers may become unable or unwilling to deliver these components to us at an acceptable cost or at all, which could force us to redesign those specific products. Our inability to obtain timely delivery of key components of acceptable quality, any significant increases in the prices of components, or the redesign of our products could result in production delays, increased costs, and reductions in shipments of our products.

**Product Quality.** Our products, and products that incorporate our technologies, are complex and sometimes contain undetected software or hardware errors, particularly when first introduced or when new versions are released. In addition, we do not have as much control over manufacturing performed by contract manufacturers, which could result in quality problems. Furthermore, our products and technologies are sometimes combined with or incorporated

into products from other vendors, sometimes making it difficult to identify the source of a problem. Any negative publicity or impact relating to these product problems could affect the perception of our brand and market acceptance of our products or technologies. 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 or technologies

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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 our liability, 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.

**Production Processes and Production.** Production difficulties or inefficiencies can interrupt production, resulting in our inability to deliver products on time in a cost effective manner, which could harm our competitive position. We have a single production facility and increasingly use contract manufacturers for a significant portion of our production capacity. Our reliance on contract manufacturers for the manufacture of our products involves risks, including limited control over timely delivery and quality of such products. If production of our products is interrupted, we may not be able to manufacture products on a timely basis. A shortage of manufacturing capacity for our products could materially adversely affect our operating results and damage our customer relationships. We may be unable to quickly adapt our manufacturing capacity to rapidly changing market conditions and a contract manufacturer may encounter similar difficulties. Likewise, we may be unable to quickly respond to fluctuations in customer demand or contract manufacturer interruptions. At times we underutilize our manufacturing facilities as a result of reduced demand for some of our products.

**Cybersecurity.** We rely on information technology systems in the conduct of our business, including systems designed and managed by third parties. Many of these systems contain confidential information, including personal information, trade secrets and other intellectual property. While we have taken a number of steps to protect these systems, the number and sophistication of malicious attacks that companies have experienced from third parties has increased over the past few years. Disruptions to these systems, due to outages, breaches or other causes, can have severe consequences to our business, including financial loss and reputational damage.

## COMPETITION

The markets for entertainment industry technologies are highly competitive, and we face competitive threats and pricing pressure in our markets. 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. 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. These competitors may also be able to offer integrated system solutions in markets for entertainment technologies on a royalty-free basis or at a lower price than our technologies, including audio, video, and other technologies, which could make competing technologies that we develop less attractive.

**Pricing Pressures.** The markets for the consumer entertainment products in which our technologies are incorporated are intensely competitive and price sensitive. We expect to face increased royalty pricing pressure for our technologies as we seek to drive the adoption of our technologies into online content and portable devices, such as tablets and smartphones. 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.

**Customers as Competitors.** We face competitive risks in situations where our customers are also current or potential competitors. For example, Sony and Technicolor are significant licensee customers, but are also competitors with respect to some of our consumer, broadcast, and cinema technologies. Our customers may choose to use competing technologies they have developed or in which they have an interest rather than use our technologies. The existence of important customer relationships may influence which strategic opportunities we pursue, as we may forgo some opportunities in the interests of preserving a critical customer relationship.

**Competition from Other Audio Formats.** We believe that the success we have had licensing our 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 multichannel audio. 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 as commodities, resulting in loss of status of our technologies, decline in their use, and significant pricing pressure.

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**Competition for Employees.** In order to be successful, we must attract, develop, and retain employees, including employees to work on our growth initiatives where our current employees may lack experience with the business models and markets we are pursuing. Competition for experienced employees in our markets can be intense. In order to attract and retain employees, we must provide a competitive compensation package, including cash and equity compensation. Our equity awards include stock options and restricted stock units, and the future value of these awards is uncertain, and depends on our stock price performance over time. In order for our compensation packages to be viewed as competitive, prospective employees must perceive our equity awards to be a valuable benefit.

## STRATEGIC ACTIVITIES

**Importance of Relationships with Entertainment Industry.** To be successful, we must maintain and grow our relationships with a broad range of entertainment industry participants, including:

- Content creators, such as film directors, studios, music producers and mobile and online content producers;
- Content distributors, such as film exhibitors, broadcasters, operators, and over-the-top ("OTT") video service providers and video game publishers; and
- Device manufacturers.

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 major film studios and broadcasters, and licensing of our technologies is particularly dependent upon our relationships with system licensees 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.

**Consequences of M&A Activity.** We evaluate a wide array of possible strategic transactions, including acquisitions. We consider these types of transactions in connection with, among other things, our efforts to strengthen our core audio and cinema businesses and expand 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 significant 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 economic, political, and regulatory environment in specific countries. 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. Future acquisitions may also require us to obtain additional equity or debt financing, which may not be available on favorable terms or at all. Also, the anticipated benefits 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, suppliers and customers 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.

## LEGAL AND REGULATORY COMPLIANCE

Costs of Environmental Laws and Regulation. Our operations use substances regulated under 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

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cleanup of contaminated sites. In addition, future environmental laws and regulations have the potential to affect our operations, increase our costs, decrease our revenue, or change the way we design or manufacture our products. We face increasing complexity in our product design as we adjust to requirements relating to the materials composition of our products. For some products, substituting particular components containing regulated hazardous substances is more difficult or costly, and additional redesign efforts could result in production delays. 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.

**International Business and Compliance.** We are dependent on international sales for a substantial amount of our total revenue. We are subject to a number of risks related to conducting business internationally, including:

- 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.;
- Compliance with applicable international laws and regulations that may differ or conflict with laws in other countries where we conduct business, or are otherwise not harmonized with one another;
- Foreign government taxes, regulations, and permit requirements, including foreign taxes that we may not be able to offset against taxes imposed upon us in the U.S., and other laws limiting our ability to repatriate funds to the U.S.;
- Changes in diplomatic and trade relationships;
- Difficulty in establishing, staffing, and managing foreign operations;
- Adverse fluctuations in foreign currency exchange rates and interest rates, including risks related to any interest rate swap or other hedging activities we undertake;
- Political or social instability, natural disasters, war or events of terrorism; and
- The strength of international economies.

In many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by U.S. regulations applicable to us such as the Foreign Corrupt Practices Act ("FCPA") and U.S. export controls. Although we implement policies and procedures designed to ensure compliance with the FCPA 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.

**Conflict Minerals.** The Securities and Exchange Commission ("SEC") has adopted rules regarding disclosure of the use of conflict minerals (commonly referred to as tantalum, tin, tungsten, and gold), which are mined from the Democratic Republic of the Congo and surrounding countries. This requirement could affect the sourcing of materials used in our products as well as the companies we use to manufacture our products. In circumstances where conflict minerals in our products are found to be sourced from the Democratic Republic of the Congo or surrounding countries, Dolby may take actions to change materials or designs to reduce the possibility that Dolby's purchase of conflict minerals may fund armed groups in the region. These actions could add engineering and other costs to the manufacture of our products.

We expect to incur costs to design and implement a process to discover the origin of the tantalum, tin, tungsten, and gold used in our products, including components we purchase from third parties, and to audit our conflict minerals disclosures. Our reputation may also suffer if we have included conflict minerals originating in the Democratic Republic of the Congo or surrounding countries in our products, and those conflict minerals funded armed groups in the region.

**Tax Rates and Liabilities.** Changes in the valuation of our deferred tax assets and liabilities, the geographic mix of our revenue, or changes in tax laws or their interpretation could 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 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 research and development ("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;
- Any obligations or decisions to repatriate earnings from abroad earlier than anticipated;

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Changes in accounting principles; or

Changes in tax laws and regulations in the countries in which we operate 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, but an adverse decision by tax authorities could significantly impact our financial results. 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.

STOCK-RELATED ISSUES

**Controlling Stockholder.** On September 12, 2013, our founder, Ray Dolby, passed away. At December 27, 2013, Ray Dolby's family members and their affiliates owned 21,557 shares of our Class A common stock and 53,821,378 shares of our Class B common stock. As of December 27, 2013, Ray Dolby's family members and their affiliates had voting power of approximately 99.7% of our outstanding Class B common stock, which in the aggregate represented approximately 91.6% 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's family members and their affiliates 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.

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.

**Insider Sales of Common Stock.** If our founder's family, 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.

**Stock Repurchase Program.** Our stock repurchase program may reduce the public float of shares available for trading on a daily basis. Such purchases may be limited, suspended, or terminated at any time without prior notice. There can be no assurance that we will buy additional shares of our Class A common stock under our stock repurchase program or that any future repurchases will have a positive impact on our stock price or earnings per share. Important factors that could cause us to discontinue or decrease our share repurchases include, among others, unfavorable market conditions, the market price of our Class A common stock, the nature of other investment or strategic opportunities presented to us, 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.



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

## Sales of Unregistered Securities

During the fiscal quarter ended December 27, 2013, we issued an aggregate of 14,733 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, for which we received aggregate proceeds of approximately \$0.1 million. We believe these transactions were exempt from the registration requirements of the Securities Act of 1933, as amended (“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 December 27, 2013, options to purchase an aggregate of 101,812 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, and no further option grants will be made under our 2000 Stock Incentive Plan. None of the foregoing transactions involved any underwriters, underwriting discounts or commissions, or any public offering.

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

## Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Our Board of Directors announced a \$250.0 million stock repurchase program on November 3, 2009. The program, which has no expiration date, approved the repurchase of shares of our Class A common stock, \$0.001 par value per share. The authorized maximum was subsequently increased by \$300.0 million, \$250.0 million, and \$100.0 million as announced on July 27, 2010, August 4, 2011, and February 8, 2012, respectively. 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 following table provides information regarding our share repurchases made during the first quarter of fiscal 2014:

	Total Number of Shares Purchased as Part of Publicly Announced Repurchase Program	Average Price Paid per Share (1)	Total Shares Repurchased	Approximate Dollar Value of Remaining Authorized Share Repurchases (2)
September 28, 2013 - October 25, 2013	—	\$—	—	\$116.1 million
October 26, 2013 - November 22, 2013	290,025	35.29	290,025	\$105.8 million
November 23, 2013 - December 27, 2013	39,975	35.52	39,975	\$104.4 million
Total	330,000		330,000	

(1) Average price paid per share excludes commission costs.

(2) Amounts represent the approximate dollar value of the maximum remaining number of shares that may yet be purchased under the stock repurchase program.



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## ITEM 6. EXHIBITS

Exhibit Number	Description	Incorporated by Reference Herein Form	Date
10.1*	Waiver and Extension Relating to Potrero Avenue Leases dated as of September 29, 2013, by and among Dolby Laboratories, Inc. and the Dolby Family Trust and affiliated Trusts	Annual Report on Form 10-K	November 15, 2013
10.2*	2014 Dolby Executive Annual Incentive Plan	Current Report on Form 8-K	November 14, 2013
10.3*	Offer Letter dated December 9, 2013, by and between Bob Borchers and Dolby Laboratories, Inc.		
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act		
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act		
32.1‡	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act		
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 plan or arrangement.

‡Furnished herewith.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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: January 29, 2014

DOLBY LABORATORIES, INC.

By: /S/ LEWIS CHEW  
Lewis Chew  
Executive Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)