Dolby Laboratories, Inc.
Form 10-Q
July 30, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended June 26, 2009

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Transition Period From To

Commission File Number: 001-32431

DOLBY LABORATORIES, INC.

(Exact name of registrant as specified in its charter)

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

(415) 558-0200

(Registrant s telephone number, including area code)

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

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

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

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

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

On July 16, 2009 the registrant had 53,074,942 shares of Class A common stock, par value $0.001 per share, and 60,487,219 shares of Class B common stock, par value $0.001 per share, outstanding.

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DOLBY LABORATORIES, INC.

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PART I FINANCIAL INFORMATION

ITEM 1 CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

DOLBY LABORATORIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(*in thousands*)

	September 26, 2008	June 26, 2009 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 394,761	$ 363,376
Short-term investments	119,667	211,279
Accounts receivable, net	27,650	49,817
Inventories	18,133	9,986
Deferred taxes	91,824	68,192
Prepaid expenses and other current assets	39,834	35,498
Total current assets	691,869	738,148
Property, plant and equipment, net	87,915	90,577
Intangible assets, net	83,060	81,694
Goodwill	250,356	250,582
Long-term investments	180,996	289,745
Deferred taxes	24,900	33,130
Other assets	17,050	24,873
Total assets	**$ 1,336,146**	**$ 1,508,749**
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 10,137	$ 8,184
Accrued liabilities	146,788	102,525
Income taxes payable	4,811	897
Current portion of long-term debt	1,593	1,615
Deferred revenue	37,344	35,110
Total current liabilities	200,673	148,331
Long-term debt	7,782	6,315
Deferred revenue	6,171	10,838
Deferred taxes	16,755	15,223
Other liabilities	33,414	29,205
Total liabilities	264,795	209,912
Controlling interest	22,098	22,170
Stockholders equity:		
Class A common stock	52	53
Class B common stock	60	60
Additional paid-in capital	434,907	466,297

Retained earnings	609,495	808,176
Accumulated other comprehensive income	4,739	2,081
Total stockholders equity	1,049,253	1,276,667
Total liabilities and stockholders equity	**$ 1,336,146**	**$ 1,508,749**

See accompanying notes to unaudited condensed consolidated financial statements

DOLBY LABORATORIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(*in thousands, except per share amounts*)

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 27, 2008	June 26, 2009	June 27, 2008	June 26, 2009
		(unaudited)		
Revenue:				
Licensing	$ 127,558	$ 142,141	$ 399,607	$ 456,076
Product sales	18,060	21,790	53,698	75,744
Services	8,699	7,313	23,796	23,806
Total revenue	154,317	171,244	477,101	555,626
Cost of revenue:				
Cost of licensing	3,361	3,362	12,179	11,223
Cost of product sales (1)	9,461	13,142	29,649	46,776
Cost of services (1)	3,194	3,246	9,400	9,546
Gain from amended patent licensing agreement				(20,041)
Total cost of revenue	16,016	19,750	51,228	47,504
Gross margin	138,301	151,494	425,873	508,122
Operating expenses:				
Selling, general and administrative (1)	54,979	55,575	161,275	162,975
Research and development (1)	15,366	17,222	44,998	48,631
Restructuring charges, net		1,278		4,012
Gain on settlements	(250)	(1,000)	(499)	(5,900)
Total operating expenses	70,095	73,075	205,774	209,718
Operating income	68,206	78,419	220,099	298,404
Interest income	3,481	2,431	13,777	9,183
Interest expense	(329)	(187)	(1,324)	(599)
Other expenses, net	(491)	(1,644)	(2,184)	(2,790)
Income before provision for income taxes and controlling interest	70,867	79,019	230,368	304,198
Provision for income taxes	(24,117)	(27,502)	(78,516)	(104,555)
Income before controlling interest	46,750	51,517	151,852	199,643
Controlling interest in net income	(302)	(371)	(953)	(951)
Net income	**$ 46,448**	**$ 51,146**	**$ 150,899**	**$ 198,692**
Earnings per share (basic)	$ 0.42	$ 0.45	$ 1.36	$ 1.76
Earnings per share (diluted)	$ 0.40	$ 0.44	$ 1.32	$ 1.73
Weighted-average shares outstanding (basic)	111,844	113,261	111,209	112,907
Weighted-average shares outstanding (diluted)	114,875	115,528	114,672	115,153

Expense for rent to related party included in selling, general and administrative expenses	$	340	$	378	$	1,021	$	1,059

(1) Stock-based compensation included above was classified as follows:

Cost of product sales	$	167	$	93	$	670	$	471
Cost of services		48		29		126		85
Selling, general and administrative		4,262		5,165		13,157		12,233
Research and development		1,158		1,268		3,277		3,186

See accompanying notes to unaudited condensed consolidated financial statements

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DOLBY LABORATORIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(*in thousands*)

	Fiscal Year-to-Date Ended	
	June 27, 2008	June 26, 2009
	(unaudited)	
Operating activities:		
Net income	$ 150,899	$ 198,692
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	18,292	21,501
Stock-based compensation expense	16,921	15,551
Accretion of discounts/amortization of premium on investments	982	3,942
Excess tax benefit from exercise of stock options	(18,517)	(3,548)
Provision for doubtful accounts	767	1,148
Deferred taxes	(20,485)	19,832
Gain on Put Rights		(9,452)
Unrealized losses on auction rate certificates		10,854
Gain from amended patent licensing agreement		(20,041)
Other non-cash items affecting net income	2,316	2,746
Changes in operating assets and liabilities:		
Accounts receivable	(16,281)	(24,694)
Inventories	(8,874)	145
Prepaid expenses and other assets	(9,535)	3,163
Accounts payable and accrued liabilities	19,688	(24,244)
Income taxes, net	6,147	248
Deferred revenue	18,283	4,788
Other liabilities	4,410	(2,367)
Payment on litigation settlement	(3,000)	(3,000)
Net cash provided by operating activities	162,013	195,264
Investing activities:		
Purchases of available-for-sale securities	(213,028)	(304,723)
Proceeds from sale of available-for-sale and trading securities	283,132	97,985
Purchases of property, plant and equipment	(7,666)	(9,236)
Purchase of intangible assets		(8,321)
Acquisitions, net of cash acquired	(253,176)	(16,621)
Other	40	
Net cash used in investing activities	(190,698)	(240,916)
Financing activities:		
Payments on debt	(1,146)	(1,121)
Proceeds from the exercise of stock options	10,916	9,410
Issuance of Class A common stock (ESPP)	1,133	3,465
Excess tax benefit from exercise of stock options	18,517	3,548
Net cash provided by financing activities	29,420	15,302

Effect of foreign exchange rate changes on cash and cash equivalents	705	(1,035)
Net increase/(decrease) in cash and cash equivalents	1,440	(31,385)
Cash and cash equivalents at beginning of period	368,467	394,761
Cash and cash equivalents at end of period	**$ 369,907**	**$ 363,376**
Supplemental disclosure:		
Cash paid for income taxes	$ 89,137	$ 84,397
Cash paid for interest	843	782

See accompanying notes to unaudited condensed consolidated financial statements

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DOLBY LABORATORIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Summary of Business and Significant Accounting Policies

Dolby Laboratories develops and delivers innovative products and technologies that improve the entertainment experience. Since Ray Dolby founded Dolby Laboratories in 1965, we have been at the forefront of delivering sound technologies that are employed throughout the entertainment creation, distribution and playback process to enhance the entertainment experience. Today, Dolby technologies are standard in a wide range of entertainment platforms. Our technologies are used in virtually all DVD players and personal computer DVD playback software, increasingly in digital televisions, set top boxes, portable media devices and in a wide array of consumer electronic products such as gaming systems and audio/video receivers. Movie theatres and broadcasters around the world use Dolby s products.

Our objective is to be an essential element in the best entertainment technologies by delivering innovative and enduring technologies that enrich the entertainment experience. We believe that our well recognized brand and established history of successful innovations position us to expand the use of our technologies in existing and new markets and to capitalize on key trends in digital entertainment, such as the transition to digital television, digital cinema, high definition home theater systems, portable media devices and downloadable content services.

We deliver innovative technologies, products and services throughout the entertainment industry, including content creation, content distribution and content playback. We work with consumer electronics manufacturers and media software vendors to help develop and incorporate innovations that are designed to improve the entertainment experience at home and on-the-go. Similarly, we focus on developing and delivering new innovations for the professional community. This community includes filmmakers and exhibitors, television producers, music producers and video game designers, who use Dolby technologies to generate a more realistic and immersive entertainment experience. We believe that our involvement across the entertainment industry has resulted in a globally recognized brand and better positions us to meet our long-term objective of being an essential element in the best entertainment technologies.

Unaudited Interim Financial Statements

The accompanying interim condensed consolidated balance sheets as of September 26, 2008 and June 26, 2009, the condensed consolidated statements of operations for the fiscal quarters and fiscal year-to-date periods ended June 27, 2008 and June 26, 2009, and the condensed consolidated statements of cash flows for the fiscal year-to-date periods ended June 27, 2008 and June 26, 2009 are unaudited. These interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). In our opinion, the interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements for the fiscal year ended September 26, 2008 and include all adjustments necessary for fair presentation. The results for the fiscal quarter and fiscal year-to-date period ended June 26, 2009 are not necessarily indicative of the results to be expected for any subsequent quarterly or annual financial period, including the fiscal year ending September 25, 2009.

The accompanying interim condensed consolidated financial statements are prepared in accordance with Securities and Exchange Commission rules and regulations, which allow certain information and footnote disclosures that are normally included in annual financial statements to be condensed or omitted. As a result, the accompanying interim condensed consolidated financial statements should be read in conjunction with our consolidated financial statements for the fiscal year ended September 26, 2008 that are included in our Annual Report on Form 10-K and filed with the Securities and Exchange Commission. Certain prior period amounts have been reclassified to conform to current year presentation. We have evaluated the impact of subsequent events up to the filing date, July 30, 2009, of these interim condensed consolidated financial statements.

Use of Estimates

The preparation of the condensed consolidated financial statements in accordance with U.S. GAAP requires management to make certain estimates and assumptions that affect the amounts reported and disclosed in our condensed consolidated financial statements and accompanying notes. Significant items subject to such estimates and assumptions include valuation allowances for receivables, carrying values of inventories, goodwill, intangible assets, stock-based compensation, fair values of investments, put rights, accrued expenses including our bonus accrual, liabilities for unrecognized tax benefits and deferred income tax assets. Actual results could differ from our estimates.

Per Share Data

Basic earnings per share is computed by dividing net income by the weighted average number of shares of Class A and Class B common stock outstanding during the period. Diluted earnings per share is computed by dividing net income by the sum of the weighted average number of shares of Class A and Class B common stock outstanding and the potential number of shares of dilutive Class A and Class B common stock outstanding during the period.

The following table sets forth the computation of basic and diluted earnings per share:

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 27, 2008	**June 26, 2009**	**June 27, 2008**	**June 26, 2009**
	(in thousands, except per share amounts)			
Numerator:				
Net income	$ 46,448	$ 51,146	$ 150,899	$ 198,692
Denominator:				
Weighted average shares outstanding (basic)	111,844	113,261	111,209	112,907
Potential common shares from options to purchase Class A and Class B common stock	3,031	2,267	3,463	2,246
Weighted average shares outstanding (diluted)	114,875	115,528	114,672	115,153
Basic earnings per share	**$ 0.42**	**$ 0.45**	**$ 1.36**	**$ 1.76**
Diluted earnings per share	**$ 0.40**	**$ 0.44**	**$ 1.32**	**$ 1.73**

A total of 1,837,222 and 3,121,320 options were excluded from the calculation of potential common shares in the third quarter of fiscal 2008 and 2009, respectively, because their inclusion would have been anti-dilutive. A total of 1,874,151 and 3,545,485 options were excluded from the calculation of potential common shares for the fiscal year-to-date periods ended June 27, 2008 and June 26, 2009, respectively, because their inclusion would have been anti-dilutive.

Cash and Cash Equivalents

We consider all short-term highly liquid investments that have original maturities of 90 days or less from the date of purchase, to be cash equivalents. Cash and cash equivalents consist of funds held in general checking accounts, money market accounts and municipal debt securities.

Investments

We account for our investments under the provisions of Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Investments that have original maturities between 91 days and one year from the date of purchase are classified as short-term investments and investments that have maturities of more than one year from the date of purchase are classified as long-term investments. All of our investments, except for an equity investment and auction rate certificates, are classified as available-for-sale securities. Our investments are recorded at fair value in the condensed consolidated balance sheet. Unrealized gains and losses on our available-for-sale securities, except for credit losses as defined in FASB Staff Position FAS 115-2 and FAS 124-2 *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP FAS 115-2 and FAS 124-2), are reported as a component of accumulated other comprehensive income while realized gains and losses as well as credit losses are reported as a component of net income. Auction rate certificates are classified as trading securities. Unrealized gains or losses on trading securities are reported as a component of net income.

Our investments in auction rate securities have been illiquid since February 2008 due to failed auctions. In November 2008, we elected to accept a rights offering providing us with certain put rights to sell our auction rate certificates at par value. See Note 2, Composition of Certain

Financial Statement Captions for further discussion regarding our auction rate certificates and put rights.

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We evaluate our investment portfolio for other-than-temporary impairments in accordance with FASB Staff Position FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* (FSP FAS 115-1 and FAS 124-1) and FSP FAS 115-2 and FAS 124-2.

Stock-Based Compensation

We account for stock-based compensation under the provisions of Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* (SFAS 123R). SFAS 123R requires measurement of all employee stock-based awards using a fair-value method and recording of related compensation expense, net of estimated forfeitures, in the financial statements over the requisite service period. See Note 4 Stock-Based Compensation for further discussion.

Income Taxes

Our quarterly provision for income taxes includes U.S. federal, state and international income taxes and is based on our estimated annual effective tax rate. We estimate our annual effective tax rate based on projections of our income before taxes for the full fiscal year. However, events that occur in a quarter are reflected as discrete items, which could impact the tax rate. A deferred tax liability is recognized for all future taxable temporary differences, and a deferred tax asset is recognized for all future deductible temporary differences. A valuation allowance is recognized if it is more likely than not that some portion of the deferred tax asset will not be realized.

Goodwill and Intangible Assets

We account for goodwill in accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). We evaluate and test our goodwill for impairment in accordance with the provisions of SFAS 142 at a reporting unit level. A reporting unit is an operating segment or one level below an operating segment. The goodwill impairment test is a two-step process. In the first step, the carrying value of the net assets of a reporting unit, including goodwill, is compared to the fair value of the reporting unit. If the fair value of the reporting unit is determined to be less than the carrying value, a second step is performed to compute the amount of the impairment. We test goodwill for impairment annually during our third fiscal quarter and when an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. During our annual goodwill impairment test performed in the third quarter of fiscal 2009, we had two reporting units Via which had no assigned goodwill and Dolby Entertainment Technology with goodwill of $250.6 million.

We used the income approach to determine the fair value of our reporting units based on the estimated future cash flows for each reporting unit. The cash flow model was based on our best estimate of future revenues and operating costs. Future revenues were estimated over the period we expect to earn such cash flows, at growth rates consistent with our internal forecasts. The revenue and cost estimates were based on several sources including our historical information, third party industry data and reviews of our internal operations. The cash flow forecasts were adjusted by a discount rate of approximately 13% based on our weighted average cost of capital (WACC) derived through a capital asset pricing model. The primary components of this model included our considerations of the relative weighting of our total asset structure between our equity and debt, the risk-free rate of return given by the rate of return on U.S. Treasury bonds, an average market risk premium based on a range of historical returns and forward looking estimates and our beta. Our model utilized an effective tax rate of approximately 35%. Further, we evaluated the reasonableness of the fair value of our reporting units by comparing the aggregate fair value of our reporting units determined under the income approach to our market capitalization.

Our market capitalization at the end of our third quarter of fiscal 2009, the period of our annual impairment test, was approximately equal to the aggregate fair value of our reporting units determined under the income approach. Our market capitalization and the aggregate fair value of our reporting units each approximated $4.2 billion which exceeded the aggregate carrying value of our reporting units by approximately 220%. As of June 26, 2009, the fair values of our two reporting units exceeded their carrying values and therefore no impairment charge was required.

Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144), requires that long-lived assets, including intangible assets, with definite lives be amortized over their estimated useful lives and reviewed for impairment whenever events or changes in circumstances indicate an asset s carrying value may not be recoverable. Recoverability of an asset is measured by comparison of its carrying amount to the expected future undiscounted cash flows that the asset is expected to generate. If it is determined that an asset is not recoverable, an impairment loss is recorded in the amount by which the carrying amount of the asset exceeds its fair value. Our intangible assets principally consist of acquired technology, patents, trademarks, customer relationships and contracts, and are amortized on a straight-line basis over their useful lives ranging from two to fifteen years. We did not record any material impairment charges on our intangible or long-lived assets for the fiscal year-to-date period ended June 26, 2009.

Comprehensive Income

Comprehensive income includes net income, foreign currency translation adjustments and unrealized gains and losses on available-for-sale securities. The components of comprehensive income were as follows:

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 27, 2008	June 26, 2009	June 27, 2008	June 26, 2009
	(in thousands)			
Net income	$ 46,448	$ 51,146	$ 150,899	$ 198,692
Other comprehensive income (loss):				
Foreign currency translation adjustment, net of tax	1,223	14,081	17,360	(8,181)
Unrealized (losses) gains on available-for-sale securities, net of tax (see Note 2)	(768)	(39)	(2,901)	1,796
Reclassification of unrealized losses on auction rate certificates, net of tax (see Note 2)				3,727
Comprehensive income	$ 46,903	$ 65,188	$ 165,358	$ 196,034

Withholding and Sales Tax

Licensing revenue is recognized gross of withholding taxes that are remitted by our licensees directly to their local tax authorities. Withholding taxes were $4.5 million and $4.9 million in the third quarter of fiscal 2008 and 2009, respectively. Withholding taxes were $13.1 million and $17.0 million in the fiscal year-to-date periods ended June 27, 2008 and June 26, 2009, respectively. Sales tax is accounted for on a net basis and is excluded from revenues.

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2. Composition of Certain Financial Statement Captions

Cash, Cash Equivalents and Investments

Cash, cash equivalents and investments as of September 26, 2008 and June 26, 2009 consisted of the following:

	September 26, 2008	June 26, 2009
	(in thousands)	
Cash and cash equivalents:		
Cash	$ 121,676	$ 172,145
Cash equivalents:		
Money market funds	270,034	188,731
Municipal debt securities	3,051	2,500
Total cash and cash equivalents	394,761	363,376
Short-term investments:		
Municipal debt securities	56,663	100,737
U.S. government agency securities	2,514	5,094
U.S. government bonds		24,988
Variable rate demand notes	60,490	80,460
Total short-term investments	119,667	211,279
Long-term investments:		
Auction rate certificates	66,146	58,796
Corporate bonds		22,571
Equity investment	610	44
Municipal debt securities	95,028	157,537
U.S. government agency securities	19,212	27,860
U.S. government bonds		22,937
Total long-term investments	180,996	289,745
Total cash, cash equivalents and investments	$ 695,424	$ 864,400

At June 26, 2009, we held tax-exempt auction rate certificates with a par value of $69.7 million. Auctions for these instruments have failed and there is no assurance that future auctions will succeed. As a result, we may not be able to liquidate our investment and fully recover the par value in the near term. We do not believe that the underlying issuers of our auction rate certificates are currently at risk of default. We continue to receive interest payments on the auction rate certificates in accordance with their terms. We believe we will ultimately be able to liquidate our auction rate certificates without significant loss primarily due to the collateral securing the auction rate certificates and our acceptance of the rights offering detailed below. Due to the changes and uncertainty in the auction rate certificates market, we believe the recovery period for these investments is likely to be longer than 12 months and as a result, we have classified these investments as long-term as of June 26, 2009.

In November 2008, we elected to accept a rights offering from UBS AG, which we refer to, along with its wholly owned subsidiaries UBS Financial Services, Inc. and UBS Securities LLC, as UBS. The rights offering provides us with rights (the Put Rights) to sell to UBS at par value our auction rate certificates purchased through UBS, at any time during a two year sale period beginning June 30, 2010. We elected to measure the Put Rights under the fair value option of SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115* (SFAS 159) and recorded a pre-tax gain of $6.6 million in the first quarter of fiscal 2009. We have classified the Put Rights as a financial asset within our other assets line item in our condensed consolidated balance sheet. Simultaneous with the acceptance of the rights offering, we reclassified our auction rate certificates from available-for-sale securities to trading securities within our long-term investments line item in our condensed consolidated balance sheet. As a result of the reclassification, we recognized a loss of $8.0 million in the first quarter of fiscal 2009. The observable market information to determine the fair value of our auction rate certificates continues to be insufficient and therefore we continue to estimate the fair value by incorporating assumptions that market participants would use in their estimates of fair value. Some of these assumptions included the collateral underlying the security investments, the creditworthiness of the counterparty, the timing of expected future cash flows, the likelihood of a successful auction in a future period and the final stated maturities.

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During the second and third quarter of fiscal 2009, the fair value of our auction rate certificates declined further by $2.6 million and $0.2 million, respectively. These declines were offset by gains of $2.6 million and $0.2 million, respectively, related to the Put Rights. The decline in the fair value of our auction rate certificates was primarily due to a decline in the variable yield of these securities. For the third quarter of fiscal 2009, we did not change our assessment of the credit risk associated with UBS and the related Put Rights. As a result, in the third quarter of fiscal 2009, the decline of $0.2 million in the fair value of auction rate certificates was offset by a commensurate gain in the fair value of the Put Rights.

Our investment portfolio which is recorded as cash equivalents, short-term investments and long-term investments as of September 26, 2008 and June 26, 2009 was as follows:

	September 26, 2008			
	Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
	(in thousands)			
Auction rate certificates	$ 72,200	$	$ (6,054)	$ 66,146
Equity investment	610			610
Money market funds	270,034			270,034
Municipal debt securities	154,870	173	(301)	154,742
U.S. government agency securities	21,775	23	(72)	21,726
Variable rate demand notes	60,490			60,490
Cash equivalents and investments	$ 579,979	$ 196	$ (6,427)	$ 573,748

	June 26, 2009			
	Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
	(in thousands)			
Auction rate certificates	$ 58,796	$	$	$ 58,796
Corporate bonds	22,446	139	(14)	22,571
Equity investment	44			44
Money market funds	188,731			188,731
Municipal debt securities	258,558	2,304	(88)	260,774
U.S. government agency securities	32,583	410	(39)	32,954
U.S. government bonds	47,897	57	(29)	47,925
Variable rate demand notes	80,460			80,460
Cash equivalents and investments	$ 689,515	$ 2,910	$ (170)	$ 692,255

The following table shows the gross unrealized losses and fair values for those available-for-sale investments that were in an unrealized loss position as of June 26, 2009:

	Less than 12 months		12 months or greater		Total	
	Fair Values	Gross Unrealized Losses	Fair Values	Gross Unrealized Losses	Fair Values	Gross Unrealized Losses
	(in thousands)					
Corporate bonds	$ 5,023	$ (14)	$	$	$ 5,023	$ (14)
Municipal debt securities	43,406	(88)			43,406	(88)
U.S. government agency securities	11,108	(39)			11,108	(39)
U.S. government bonds	37,915	(29)			37,915	(29)
Total	$ 97,452	$ (170)	$	$	$ 97,452	$ (170)

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The unrealized losses on our available-for-sale investments were caused primarily by unfavorable changes in interest rates. We have the intent and ability to hold these securities until we recover any unrealized losses. As a result, we do not consider the unrealized losses at June 26, 2009 to be other-than-temporarily impaired.

Accounts Receivable

Accounts receivable consists of the following:

	September 26, 2008	June 26, 2009
	(in thousands)	
Trade accounts receivable	$ 24,604	$ 35,030
Amounts receivable related to patent administration program	3,532	15,794
Other accounts receivable	1,313	1,079
	29,449	51,903
Less: Allowance for doubtful accounts	(1,799)	(2,086)
Accounts receivable, net	$ 27,650	$ 49,817

Inventories

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

	September 26, 2008	June 26, 2009
	(in thousands)	
Raw materials	$ 3,315	$ 3,107
Work in process	1,891	1,228
Finished goods	12,927	5,651
Inventories	$ 18,133	$ 9,986

The reduction in finished goods inventory was primarily due to lower quantities on hand of our first generation digital cinema products as we begin the transition to our next generation digital cinema solution.

Goodwill and Intangible Assets

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

	Total (in thousands)
Balance at September 26, 2008	$ 250,356
Acquired goodwill	10,755
Translation adjustments	(10,529)
Balance at June 26, 2009	$ 250,582

Intangible assets consist of the following:

	September 26, 2008	June 26, 2009
	(in thousands)	
Amortized intangible assets:		
Acquired patents and technology	$ 55,519	$ 56,838
Customer relationships	30,270	29,598
Customer contracts	5,300	5,853
Other intangibles	11,862	20,179
	102,951	112,468
Less: Accumulated amortization	(19,891)	(30,774)
Intangible assets, net	$ 83,060	$ 81,694

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In April 2009, we acquired a company for a total purchase price of $16.6 million. Based on a preliminary allocation of the purchase price, goodwill and intangible assets resulting from this acquisition amounted to approximately $10.8 million and $3.7 million, respectively. The intangible assets are expected to be amortized over a period of approximately five years.

The increase in other intangible assets from September 26, 2008 to June 26, 2009 is primarily due to the recording of an asset attributable to a lump sum payment to an unrelated patent licensor in the first quarter of fiscal 2009. See *Accrued Liabilities* for further discussion.

Amortization expense associated with our intangible assets was $3.0 million and $3.5 million in the third quarter of fiscal 2008 and 2009, respectively, and is included in cost of licensing, cost of product sales and selling, general and administrative expenses in the accompanying condensed consolidated statements of operations. Amortization expense associated with our intangible assets was $9.4 million and $11.5 million for the fiscal year-to-date periods ended June 27, 2008 and June 26, 2009, respectively.

Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets were $39.8 million and $35.5 million at September 26, 2008 and June 26, 2009, respectively. In the second and third quarters of fiscal 2009, we recognized $22.4 million and $7.9 million respectively, in revenue related to digital cinema products which was previously deferred. Therefore, the associated deferred costs of $15.9 million and $5.1 million, respectively, were transferred from prepaid expenses and other current assets to cost of product sales. See *Deferred Revenue* below for further discussion.

Accrued Liabilities

Accrued liabilities consist of the following:

	September 26, 2008	June 26, 2009
	(in thousands)	
Accrued royalties	$ 32,064	$ 2,324
Amounts payable to joint licensing program partners	40,266	38,258
Accrued compensation and benefits	47,617	35,821
Accrued professional fees	3,749	3,517
Current portion of litigation settlement (see Note 6)	2,686	2,715
Other accrued liabilities	20,406	19,890
Accrued liabilities	$ 146,788	$ 102,525

At September 26, 2008, accrued royalties included amounts related to an ongoing dispute regarding the terms of a license agreement with an unrelated patent licensor. We had been accruing royalties related to this matter from the third quarter of fiscal 2006 through the third quarter of fiscal 2007. In the first quarter of fiscal 2009, we entered into an amendment to the license agreement with the unrelated patent licensor. Under the terms of the amendment, we paid a one time lump sum amount of $17.5 million to buy out all payment obligations and each party released any claims it may have against the other with respect to the license agreement. Of the $17.5 million lump sum payment, $8.3 million was recorded as an intangible asset representing the fair value of the future benefit to be obtained from the payment. The intangible asset is being amortized to cost of revenue over a period of three years. The remaining amount of the lump sum payment, or $9.2 million, was recorded as a reduction to accrued royalties which as of September 26, 2008 was approximately $29.2 million. The remaining accrual balance of approximately $20.0 million was eliminated in the first quarter of fiscal 2009 and recorded as a gain from amended patent licensing agreement.

Deferred Revenue

Deferred revenue included in current liabilities was $37.3 million and $35.1 million at September 26, 2008 and June 26, 2009, respectively. The period-end balances were comprised of deferrals of product sales, primarily consisting of digital cinema server sales, and to a lesser extent licensing and services revenue. We had recorded deferred digital cinema revenue related to our obligation to upgrade our equipment to be compliant with the Digital Cinema Initiatives (DCI) specifications. During the second quarter of fiscal 2009, we achieved compliance with these specifications by making certain software upgrades available. As a result, we recognized $22.4 million and $7.9 million in product sales revenue in our second and third quarter of fiscal 2009, respectively.

Digital cinema server sales are multiple-element arrangements that include the sale of products and product support. As vendor specific objective evidence (VSOE) of fair value does not currently exist for the product support included within digital cinema server arrangements, digital cinema sales and costs are deferred, and recognized for the entire arrangement ratably over the support period. The amounts recognized as product revenue for the fiscal year-to-date period ended June 26, 2009 consist of product and product support revenue, pro-rated over the lapsed support period.

Debt

We maintain three term loans through our consolidated affiliates Dolby Properties, LLC, Dolby Properties Burbank, LLC and Dolby Properties United Kingdom, LLC, for financing commercial and real property at various locations in which we are the primary tenant. The loans are collateralized by commercial real property and are guaranteed by Dolby Laboratories, Inc.

Following is a summary of our debt balances:

	September 26, 2008	June 26, 2009
	(in thousands)	
$12.0 million term loan at prime interest rate, repayable in monthly installments with remaining principal due May 2013	$ 5,214	$ 4,495
$2.5 million term loan at 6.2% effective interest rate, repayable in monthly installments with remaining principal due April 2014	1,261	1,121
Term loan denominated in U.K. pounds at 6.9% effective interest rate, repayable in quarterly installments with the remaining principal due April 2015	2,900	2,314
Total debt	9,375	7,930
Less: Current portion of debt	(1,593)	(1,615)
Long-term debt	$ 7,782	$ 6,315

The fair value of our debt approximates the carrying value based on borrowing rates currently available to us for loans with similar terms and remaining maturities.

Accumulated Other Comprehensive Income

Accumulated foreign currency translation gains, net of tax were $9.4 million at September 26, 2008, compared to an accumulated foreign currency translation gain, net of tax of $0.4 million at June 26, 2009. Accumulated unrealized losses on investments, net, were $4.7 million at September 26, 2008, compared to accumulated unrealized gains on investments of $1.7 million, net, at June 26, 2009.

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3. Fair Value Measurements

Effective September 27, 2008, we adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value as 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. The standard describes three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices in active markets that are accessible by us at the measurement date for identical assets and liabilities.

Level 2: Prices not directly accessible by us. Such prices may be based upon quoted prices in active markets or inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available.

The hierarchy noted above requires us to minimize the use of unobservable inputs and to use observable market data, if available, when determining fair value.

Financial assets carried at fair value as of June 26, 2009 are classified below:

	Level 1	Level 2	Level 3	Total
		(in thousands)		
Auction rate certificates	$	$	$ 58,796	$ 58,796
Corporate bonds		22,571		22,571
Investments held in supplemental retirement plan	3,739			3,739
Money market funds	188,731			188,731
Municipal debt securities		260,774		260,774
Put Rights			9,461	9,461
U.S. government agency securities		32,954		32,954
U.S. government bonds		47,925		47,925
Variable rate demand notes		80,460		80,460
Total	$ 192,470	$ 444,684	$ 68,257	$ 705,411

Financial liabilities carried at fair value as of June 26, 2009 are classified below:

	Level 1	Level 2	Level 3	Total
		(in thousands)		
Interest rate derivative	$	$ 280	$	$ 280

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The following table provides a reconciliation between the beginning and ending balances of items measured at fair value on a recurring basis that used significant unobservable inputs (Level 3):

	Auction rate certificates and Put Rights (in thousands)	
Balances at September 26, 2008	$	66,146
Unrealized loss from auction rate certificates included in earnings		(4,963)
Redemptions at par		(2,550)
Realized gain on redemptions of auction rate certificates included in earnings		163
Unrealized gain from Put Rights included in earnings		9,461
Balances at June 26, 2009	$	68,257

The unrealized loss from auction rate certificates, the realized gain on redemptions and the unrealized gain from Put Rights are included in the other expenses, net line item in our condensed consolidated statement of operations for the quarter and the year-to-date period ended June 26, 2009.

The fair values of our Level 1 financial assets are based on quoted market prices of the identical underlying securities and include money market funds and trading securities held in our supplemental retirement plan with quoted prices in active markets. The fair values of our Level 2 financial assets and liabilities are obtained from professional pricing sources for these or comparable instruments, rather than direct observations of quoted prices in active markets and include corporate bonds, municipal debt securities, U.S. government agency securities, U.S. government bonds, variable rate demand notes and interest rate derivative. Fair values of auction rate certificates and Put Rights are classified as Level 3 because quoted prices are unobservable or no market data is available.

4. Stock-Based Compensation

We have adopted stock compensation plans which provide for grants of stock-based awards as a form of compensation to employees, officers, directors and certain non-employee consultants. We have issued stock-based awards in the form of stock options, restricted stock units, stock appreciation rights and shares issued under our employee stock purchase plan. Stock-based compensation expense was $5.6 million and $6.6 million for the third quarter of fiscal 2008 and 2009, respectively. Stock-based compensation expense was $17.2 million and $16.0 million for the year-to-date periods ended June 27, 2008 and June 26, 2009, respectively.

Our stock-based compensation expense for the third quarter of fiscal 2008 was $4.7 million and $0.7 million related to stock options and restricted stock units, respectively, and the remaining $0.2 million was related to stock appreciation rights and employee stock purchase plan issuances. Our stock-based compensation expense for the third quarter of fiscal 2009 was comprised of $4.8 million and $1.7 million for stock options and restricted stock units, respectively and the remaining $0.1 million was related to stock appreciation rights and employee stock purchase plan issuances.

During the year-to-date period ended June 26, 2009, we granted 1,453,650 stock options at a weighted average exercise price of $32.89 per share. We also granted 443,670 restricted stock units at a weighted average grant price of $32.47 per share.

5. Restructuring

Prior to the first quarter of fiscal 2009, our Cinea reporting unit operated as a stand alone business with its own dedicated resources and facilities. In the first quarter of fiscal 2009, we ceased using two of Cinea s leased facilities in Virginia, terminated 20 employees and integrated Cinea into our Dolby Entertainment Technology reporting unit. This activity resulted in severance and other charges attributable to the termination of employees and facilities charges relating to non-cancelable lease costs, net of expected sublease income. In regard to this restructuring activity, we recorded total charges of $0.9 million in the first and second quarters of fiscal 2009.

In the second quarter of fiscal 2009, we consolidated our Wootton Bassett, U.K. manufacturing operations into our Brisbane, California facility. As of June 26, 2009, we had not ceased using our Wootton Bassett facilities, therefore no facility related restructuring costs were recognized in the third quarter of fiscal 2009. We are exploring

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alternatives pertaining to our facilities in Wootton Bassett and depending upon which alternative we choose, we may recognize facility related restructuring costs in the future. Due to this restructuring, we reduced our work force by 46 employees in the third quarter of fiscal 2009 and expect an additional 12 employees will be involuntarily terminated through the remainder of fiscal 2009 and fiscal 2010. In our third quarter and year-to-date period ended June 26, 2009, we recorded $1.3 million and $3.1 million, respectively, of charges related to the consolidation of our manufacturing operations.

Changes in restructuring accruals included in accrued liabilities in our condensed consolidated balance sheet as of June 26, 2009 were as follows:

	Severance	Facilities and contract termination costs	Fixed assets write-off (in thousands)	Other associated costs	Total
Balance at September 26, 2008	$	$	$	$	$
Restructuring charges	3,228	232	137	415	4,012
Cash payments	(2,427)	(137)		(353)	(2,917)
Non-cash charges			(137)		(137)
Balance at June 26, 2009	$ 801	$ 95		$ 62	$ 958

6. Legal Proceedings

In March 1997, an unrelated third party filed a lawsuit against us alleging breach of a written agreement. In April 2002, we settled the dispute and agreed to pay a total of $30.0 million, without interest, in ten equal annual installments of $3.0 million per year beginning in June 2002. We recorded this liability at its present value of $24.2 million in the condensed consolidated balance sheet using a discount rate of 5.125%, which approximated our incremental cost of borrowing rate. Interest related to this liability is recorded quarterly and is included in interest expense on the accompanying condensed consolidated statements of operations. Other than such payments, neither party has any material obligations as a result of the settlement. As of June 26, 2009, we had $6.0 million remaining to be paid under this settlement.

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

7. Geographic Data

Licensing, products and services revenue is based on the location of the corporate headquarters of the licensee, the location where products are shipped or where services are performed. Revenue by geographic regions were as follows:

	Revenue by Geographic Region			
	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 27, 2008	June 26, 2009	June 27, 2008	June 26, 2009
	(in thousands)			
United States	$ 54,072	$ 58,398	$ 159,273	$ 192,122
International	100,245	112,846	317,828	363,504
Total revenue	$ 154,317	$ 171,244	$ 477,101	$ 555,626

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The concentration of our revenue from individual countries or geographic regions was as follows:

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 27, 2008	June 26, 2009	June 27, 2008	June 26, 2009
United States	*35%*	*34%*	*33%*	*35%*
Japan	*20%*	*27%*	*21%*	*22%*
Europe	*16%*	*12%*	*18%*	*16%*
Taiwan	*12%*	*12%*	*11%*	*11%*
South Korea	*5%*	*7%*	*6%*	*8%*
China	*8%*	*5%*	*8%*	*6%*
Other	*4%*	*3%*	*3%*	*2%*

In the third quarter of fiscal 2008, revenue from two customers represented $18.7 million and $15.3 million, or 12% and 10%, respectively, of the total revenue for the quarter. In the third quarter of fiscal 2009, revenue from one customer represented $25.0 million, or 15%, of the total revenue for the quarter. Revenue from one customer represented $59.9 million, or 13% of total revenue for the fiscal year-to-date period ended June 27, 2008. Revenue from two customers represented $58.3 million and $57.8 million, or 10% of total revenue for each customer for the fiscal year-to-date period ended June 26, 2009.

Long-lived tangible assets, net of accumulated depreciation, by geographic region were as follows:

	Long-Lived Tangible Assets by Geographic Region	
	September 26, 2008	June 26, 2009
	(in thousands)	
United States	$ 63,402	$ 69,826
International	24,513	20,751
Total long-lived tangible assets, net of accumulated depreciation	$ 87,915	$ 90,577

Long-lived tangible assets, which consist of property, plant and equipment, net of accumulated depreciation, held in the United Kingdom were $19.2 million and $16.1 million at September 26, 2008 and June 26, 2009, respectively.

8. Recently Issued Accounting Standards

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141R, *Business Combinations* (SFAS 141R). SFAS 141R requires an entity to recognize the assets acquired, liabilities assumed, contractual contingencies and contingent consideration at their fair value on the acquisition date. Subsequent changes to the estimated fair value of contingent consideration will be reflected in earnings until the contingency is settled. SFAS No. 141R also requires acquisition-related costs and restructuring costs to be expensed as incurred rather than treated as part of the purchase price. The adoption of SFAS No. 141R will change our accounting treatment for business combinations on a prospective basis beginning September 26, 2009.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Non-controlling Interests in Consolidated Financial Statements* (SFAS 160). SFAS 160 changes the accounting and reporting for minority interests, which will be characterized as non-controlling interests and classified as a component of equity. SFAS 160 is effective for us on a prospective basis beginning in the first quarter of our fiscal 2010. We do not expect SFAS 160 to have a material impact on our condensed consolidated financial statements.

In December 2007, the FASB issued Emerging Issues Task Force Issue No. 07-1, *Accounting for Collaborative Arrangements* (EITF 07-1). EITF 07-1 applies to participants in collaborative arrangements that are conducted with the creation of a separate legal entity for the arrangement. EITF 07-1 requires disclosure of payments to or from collaborators based on the nature of the arrangement (including its contractual terms), the nature of the business and whether the payments are within the scope of other accounting literature. EITF 07-1 requires an entity to report the effects of adopting EITF 07-1 as a change in accounting principle through retrospective application to all prior periods presented for all arrangements in place at the effective date unless it is impracticable. EITF 07-1 is effective for fiscal years beginning after December 15, 2008. We do not expect EITF 07-1 to have a material impact on our condensed consolidated financial statements.

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In February 2008, the FASB issued FASB Staff Position FAS 157-2, *Effective Date of FASB Statement No. 157* (FSP FAS 157-2). FSP FAS 157-2 defers the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair values in the financial statements on a recurring basis (at least annually), to fiscal years, and interim periods within those fiscal years beginning after November 15, 2008. We do not expect the adoption of FSP FAS 157-2 to have a material impact on our consolidated financial statements.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133* (SFAS 161). SFAS No. 161 provides new disclosure requirements for an entity s derivative and hedging activities. SFAS 161 is effective for fiscal years beginning after November 15, 2008. We do not expect the adoption of SFAS 161 to have a material impact on our condensed consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP FAS 142-3). FSP FAS 142-3 removes the requirement to consider whether an intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions associated with the intangible asset and, instead, requires an entity to consider its own historical experience in renewing similar arrangements. If the entity has no relevant experience, it would consider market participant assumptions regarding renewal. FSP FAS 142-3 also requires expanded disclosures relating to the determination of useful lives of intangible assets. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008, and may impact any intangible asset we acquire in future transactions.

In April 2009, the FASB issued FASB Staff Position FAS 107-1 and Accounting Principles Board (APB) Opinion No. 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP FAS 107-1 and APB 28-1). FSP FAS 107-1 and APB 28-1 expands the fair value disclosures currently required on an annual basis for financial instruments to interim reporting periods. FSP FAS 107-1 and APB 28-1 also requires entities to disclose the methods and significant assumptions used to estimate the fair value of financial instruments on an interim basis and describe changes in methods and significant assumptions, if any, during the period. FSP FAS 107-1 and APB 28-1 is effective for interim reporting periods ending after June 15, 2009. We adopted FAS 107-1 and APB 28-1 in the third quarter of fiscal 2009. See Note 2 Composition of Certain Financial Statement Captions and Note 3 Fair Value Measurements for information on the fair value of financial instruments.

In April 2009, the FASB issued FASB Staff Position FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP FAS 115-2 and FAS 124-2). FSP FAS 115-2 and FAS 124-2 amends the other-than-temporary guidance in U.S. GAAP for debt securities to modify the requirement for recognizing other-than-temporary impairments, changes the existing impairment model, and modifies the presentation and frequency of related disclosures. FSP FAS 115-2 and FAS 124-2 is effective for interim and annual periods ending after June 15, 2009. We adopted FSP FAS 115-2 and FAS 124-2 in the third quarter of fiscal 2009. The adoption of the FSP did not have a material impact on our condensed consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS 157-4). FSP FAS 157-4 provides additional guidance for estimating fair value when the market activity for an asset or liability has declined significantly. FSP FAS 157-4 is effective for interim and annual periods ending after June 15, 2009. We adopted FSP FAS 157-4 in the third quarter of fiscal 2009. The adoption of the FSP did not have an impact on our condensed consolidated financial statements.

In May 2009, the FASB issued Statement of Financial Accounting Standards No. 165, *Subsequent Events*, (SFAS 165). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 is effective for interim and annual periods ending after June 15, 2009. We adopted SFAS 165 in the third quarter of fiscal 2009. See Note 1 Summary of Business and Significant Accounting Policies for more information.

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* (SFAS 168). SFAS 168

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defines the new hierarchy for U.S. GAAP and explains how the FASB will use its Accounting Standards Codification as the sole source for all authoritative guidance. SFAS 168 replaces SFAS 162, *The Hierarchy of Generally Accepted Accounting Principles*, which was issued in May 2008. The Codification will be effective for all reporting periods that end after September 15, 2009. We do not expect the adoption of SFAS 168 to have a material impact on our condensed consolidated financial statements.

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ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Overview

Dolby Laboratories develops and delivers innovative products and technologies that improve the entertainment experience. Since Ray Dolby founded Dolby Laboratories in 1965, we have been at the forefront of delivering sound technologies that are employed throughout the entertainment creation, distribution and playback process to enhance the entertainment experience. Today, Dolby technologies are standard in a wide range of entertainment platforms. Our technologies are used in virtually all DVD players and personal computer DVD playback software, increasingly in digital televisions, set top boxes, portable media devices and in a wide array of consumer electronic products such as gaming systems and audio/video receivers. Movie theatres and broadcasters around the world use Dolby s products.

Our objective is to be an essential element in the best entertainment technologies by delivering innovative and enduring technologies that enrich the entertainment experience. We believe that our well recognized brand and established history of successful innovations position us to expand the use of our technologies in existing and new markets and to capitalize on key trends in digital entertainment, such as the transition to digital television, digital cinema, high definition home theater systems, portable media devices and downloadable content services.

We deliver innovative technologies, products and services throughout the entertainment industry, including content creation, content distribution and content playback. We work with consumer electronics manufacturers and media software vendors to help develop and incorporate innovations that are designed to improve the entertainment experience at home and on-the-go. Similarly, we focus on developing and delivering new innovations for the professional community. This community includes filmmakers and exhibitors, television producers, music producers and video game designers, who use Dolby technologies to generate a more realistic and immersive entertainment experience. We believe that our involvement across the entertainment industry has resulted in a globally recognized brand and helps position us to meet our long-term objective of being an essential element in the best entertainment technologies.

We are a global organization. We generate revenue by licensing our technologies to manufacturers of consumer electronics products and media software vendors, and selling our professional products and related services to entertainment content creators, producers and distributors. We have licensed our technologies to manufacturers in approximately 35 countries and our licensees distribute products incorporating our technologies throughout the world. We sell our products and services in over 50 countries. In fiscal 2007, 2008 and the fiscal year-to-date period ended June 26, 2009, revenue from outside the United States was 70%, 66% and 65%, respectively, of our total revenue, respectively. Licensing, products and services revenue from outside the United States is based on the location of the corporate headquarters of the licensee, the location where products are shipped or where services are performed.

Opportunities, Challenges and Risks

Recent deteriorating macroeconomic conditions have reduced consumer demand in the markets into which we license and sell products and limited the availability of funding for system integrators to finance digital cinema rollouts in which we could participate. Our business is exposed to adverse changes in general economic conditions because products that incorporate our technologies are entertainment-oriented and generally discretionary goods, such as DVD players, personal computers, digital televisions, mobile devices, set top boxes, home-theaters-in-a-box, camcorders, portable media devices, gaming systems, audio/video receivers and in-car DVD players. In the third quarter of fiscal 2009, our revenue was affected by general economic weakness. The slowdown in consumer spending resulted in a lower number of PCs sold with our technologies, a continued decline in sales of standard definition DVD players and a decline in sales of game consoles. However, our licensing revenue in the third quarter of fiscal 2009 grew as compared to the third quarter of fiscal 2008 due to recognition of $21.6 million relating to shipments in prior quarters by three large customers.

Licensing revenue constitutes the majority of our total revenue, representing 80%, 84% and 82% of total revenue in fiscal 2007, 2008 and the fiscal year-to-date period ended June 26, 2009, respectively. We categorize our licensing revenue into the following markets:

- Personal computer (PC) market primarily comprised of software DVD players, Microsoft Windows Vista Home Premium and Ultimate Editions as well as the PC Entertainment Experience.
- Consumer electronics (CE) market primarily comprised of DVD players, DVD recorders, camcorders, audio/video receivers, home-theaters-in-a-box and Blu-ray Disc players.
- Broadcast market primarily comprised of televisions and set top boxes.
- Gaming market primarily comprised of video game consoles.
- Mobile market primarily comprised of mobile devices.
- Automotive market primarily comprised of in-car DVD players.
- Licensing services revenue from the administration of joint licensing programs.

Our personal computer market, which represented just over 30% of our licensing revenue in fiscal 2006, approximately 35% in fiscal 2007 and just over 40% in fiscal 2008, has been primarily driven by the inclusion of our technologies in media applications that are often included in PC shipments. These applications include DVD playback and/or DVD authoring software made by third party software vendors, as well as operating systems which contain similar media applications. Our PC market also includes revenue from our PC Entertainment Experience (PCEE) program which is a suite of technologies for entertainment oriented PCs that enhance the audio quality of media.

Microsoft includes Dolby technologies in two editions of its Vista operating system, Vista Home Premium and Vista Ultimate, which are primarily aimed at the consumer market. In addition, Microsoft recently announced that its newest operating system, Windows 7, will be available in October 2009 and will include Dolby technologies in four of the six available editions. Dolby technologies, including Dolby s next generation audio codec Dolby Digital Plus, will be included in the Windows 7 Home Premium and Ultimate editions as well as the Windows 7 Professional and Enterprise editions. Almost half of the world s personal computer shipments are to the business market, and therefore adoption of Dolby technologies in the Professional and Enterprise editions increases the potential for Dolby to receive royalties on a greater percentage of personal computer shipments. However, there are uncertainties associated with this opportunity. Today, we receive royalties for PCs that ship with third party software containing our technologies. As Windows 7 provides enhanced DVD playback and incorporates some of the functionality found in these third party software applications, we expect some PC manufacturers will exclude these applications from their offerings. In addition, business customers may take several years to upgrade to Windows 7 given the longer adoption cycles associated with enterprise customers and the effects the current economy may have on information technology budgets.

Consumers are increasingly purchasing low cost PCs particularly netbooks which do not have Microsoft Vista Home Premium or Ultimate Edition operating systems and generally do not have DVD playback functionality or Dolby technologies. We expect a large number of netbooks will be sold in the future with Windows 7 Starter or Home Basic editions, which do not contain Dolby technologies.

Our consumer electronics market, which is driven primarily by revenue attributable to sales of DVD players, represented approximately 45% of licensing revenue in fiscal 2006, just under 40% in fiscal 2007 and just over 25% in fiscal 2008. The decrease in the consumer electronics market as a percentage of total licensing revenue has been due primarily to faster revenue growth in our other markets, mainly the PC and broadcast markets, as well as decreased sales of standard definition DVD players. A potential growth opportunity within our consumer electronics market is the Blu-ray format, as Dolby Digital has been selected as a mandatory audio standard, Dolby Digital Plus has been selected as a mandatory audio standard for secondary track playback and Dolby TrueHD has been selected as an optional audio standard in the Blu-ray Disc format. However, depending upon the success of the Blu-ray format, revenue from Blu-ray Disc players may not offset future declines in revenue from standard definition DVD players.

Our broadcast market, which is primarily driven by demand for Dolby Digital in set top boxes and televisions, represented just over 10% of our licensing revenue in fiscal 2006, just over 15% in fiscal 2007 and just under 20% in fiscal 2008. Our broadcast market has benefited from increased global shipments of set top boxes, including the contribution of revenue from digital converter boxes, and digital televisions in Europe and North America that contain Dolby Digital. We also view broadcast services operating under particular bandwidth constraints, such as terrestrial broadcast or IPTV services, as an area of opportunity for us to offer Dolby Digital Plus and HE-AAC, which are able to deliver multi channel surround sound at reduced bit rates. Notwithstanding our success in the broadcast market to date, we may not be able to capitalize on these opportunities and actual results may differ from our expectations.

Revenue generated from the gaming and automotive markets has primarily been driven by sales of video game consoles, portable gaming devices and in-car entertainment systems with Dolby Digital, ATRAC or Dolby TrueHD technologies. Revenue generated by our licensing services market has primarily been driven by demand for MPEG 4 audio and MPEG 2 audio technologies used in portable media devices. Revenue from our mobile market is primarily driven by demand for our HE-AAC technology incorporated into mobile devices. We view the mobile market as an area of opportunity to increase revenue from mobile devices, however actual results may differ from our expectations.

We have also introduced new technologies for the broadcast, consumer electronics, mobile and gaming markets, including Dolby Volume, dynamic range image technologies, Dolby Mobile and Dolby Axon. Dolby Volume is a sound leveling technology that performs measurement and analysis of signals according to a model based on the characteristics of human hearing, in order to provide consistency of volume and quality across various programs. Our dynamic range imaging technologies include Dolby Contrast and Dolby Vision. Dolby Contrast provides enhanced contrast, while Dolby Vision combines enhanced contrast with extended brightness and dynamic range for LCD televisions with LED backlit technology. Dolby Mobile is a suite of post-processing technologies optimized for mobile devices and designed to enhance the audio quality of media delivered on the device. Dolby Axon is a voice technology that enables online gamers to perceive other players locations, making online gaming more real and immersive. We do not anticipate generating significant revenue from these technologies in fiscal 2009.

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

Product sales consist of revenue from sales of equipment to cinema operators and broadcasters representing 14%, 11% and 14% of total revenue in fiscal 2007, 2008 and the fiscal year-to-date period ended June 26, 2009, respectively.

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Our cinema products represented approximately 75% of product sales in fiscal 2006, 71% of product sales in fiscal 2007 and 68% of product sales in fiscal 2008. Our traditional cinema products are primarily used to read and decode a film s soundtrack, calibrate cinema sound systems and to adapt analog cinema audio systems to digital audio formats. Our digital cinema servers load, store, decrypt and decode encrypted digital film files for presentation on a digital projector, and our digital 3D products provide 3D image capabilities. There is a trend in the cinema industry towards the transition to digital cinema. Digital cinema offers the motion picture industry a possible means to achieve cost savings in printing and distributing movies, to combat piracy, and to enable movies to be played repeatedly without degradation in image and audio quality. We offer a Dolby Digital Cinema server, which allows for the storage and playback of digital content, as well as Dolby 3D Digital Cinema technology, which delivers a 3D experience when combined with an exhibitor s existing digital cinema projector and server. We expect most exhibitors constructing new theatres or upgrading existing theatres to generally choose digital cinema over traditional film cinema. Digital cinema is based on open standards, which unlike traditional cinema, does not include our proprietary audio formats. We face more pricing and other competitive pressures in the digital cinema market than we have historically experienced for our traditional cinema products. For example, a competitor has introduced a digital cinema solution which supports the presentation of movies with higher resolution 4K digital cinema projectors. Certain major U.S. exhibitors have announced their intention to outfit their theatres exclusively with 4K digital cinema equipment. Other exhibitors may feel that they need to outfit some of their theatres with 4K digital cinema equipment to compete in the same markets where competitors are promoting 4K solutions. Dolby currently does not offer a digital cinema 4K solution. If we do not offer a solution that supports 4K presentation, our future prospects in digital cinema may be limited and our business could be materially and adversely affected. In addition, as the film industry is transitioning to digital cinema, the demand for our traditional cinema products and services is declining, and we anticipate that the demand for film based products will continue to decline in future periods.

Our broadcast products, which represented approximately 21% of product sales in fiscal 2006, 23% of product sales in fiscal 2007 and 24% of product sales in fiscal 2008, are used to encode, transmit and decode multiple channels of high quality audio for DTV and HDTV program production and broadcast distribution and to measure the subjective loudness of audio content within broadcast programming. In recent years, growth in consumer demand for high quality television content has increased the demand from broadcasters to deliver more content in Dolby Digital 5.1 surround sound which has contributed to sales of our professional broadcast products.

Our services revenue, which represented 6%, 5% and 4% of total revenue in fiscal 2007, 2008 and the fiscal year-to-date period ended June 26, 2009, respectively, is primarily tied to the motion picture production industry and, in particular, to the number of films being made by studios and independent filmmakers. The number of films that are produced can be affected by a number of factors, including strikes and work stoppages within the motion picture industry as well as by the tax incentive arrangements that many foreign governments provide filmmakers to promote local filmmaking.

Critical Accounting Policies

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 of America, or U.S. GAAP. The preparation of these financial statements in accordance with U.S. GAAP requires us to utilize 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 to be critical if it is both important to a company s financial condition and results of operations and it requires significant judgment and estimates on the part of management in its application. We have discussed the selection and development of the critical accounting policies with the audit committee of our board of directors, and the audit committee has reviewed our related disclosures in this Quarterly Report on Form 10-Q. Although we believe that our judgments and estimates are appropriate and correct, actual results may differ from those estimates.

The following are our critical accounting policies because we believe they are both important to the portrayal of our financial condition and results of operations and require critical management judgments and estimates about matters that are uncertain. If actual results or events differ materially from those contemplated by us in making these estimates, our reported financial condition and results of operations for future periods could be materially affected. See Risk Factors for certain matters bearing risks on our future results of operations.

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Revenue Recognition

We evaluate revenue recognition for transactions to license technologies, trademarks and know how, and to sell products and services using the criteria set forth by the SEC in Staff Accounting Bulletin 104, *Revenue Recognition* (SAB 104). For revenue transactions that involve software or software related products, such as fees we earn from integrated software vendors, certain product sales with software elements and certain other transactions, we recognize revenue under the guidance established by Statement of Position No. 97-2, *Software Revenue Recognition* (SOP 97-2). Both SAB 104 and SOP 97-2 state that revenue is recognized when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller s price to the buyer is fixed or determinable and collectibility is probable. Judgment is required to assess whether collectibility is probable. We determine collectibility based on an evaluation of our customer s recent payment history, the existence of a standby letter of credit between the customer s financial institution and our financial institution and other factors.

The application of SOP 97-2 requires judgment, including whether the software element included with a hardware product is more-than-incidental to the hardware, whether a software arrangement includes multiple elements, and if so, whether vendor specific objective evidence, or VSOE of fair value exists for those elements. For some of our arrangements, customers receive certain elements of the arrangement over a period of time or after delivery of the initial product. These elements may include support and maintenance and/or the right to receive product upgrades. The fair value of these elements is recognized over the estimated period for which these elements will be delivered, which is sometimes the estimated life of the product. If we do not have VSOE of fair value for any undelivered element included in a multiple element arrangement containing 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.

Goodwill

We account for goodwill in accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). We evaluate and test our goodwill for impairment in accordance with the provisions of SFAS 142 at a reporting unit level. A reporting unit is an operating segment or one level below an operating segment. The goodwill impairment test is a two-step process. In the first step, the carrying value of the net assets of a reporting unit, including goodwill, is compared to the fair value of the reporting unit. If the fair value of the reporting unit is determined to be less than the carrying value, a second step is performed to compute the amount of the impairment. We test goodwill for impairment annually during our third fiscal quarter and when an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. During our annual goodwill impairment test performed in the third quarter of fiscal 2009, we had two reporting units Via which had no assigned goodwill and Dolby Entertainment Technology with goodwill of $250.6 million.

We used the income approach to determine the fair value of our reporting units based on the estimated future cash flows for each reporting unit. The cash flow model was based on our best estimate of future revenues and operating costs. Future revenues were estimated over the period we expect to earn such cash flows, at growth rates consistent with our internal forecasts. The revenue and cost estimates were based on several sources including our historical information, third party industry data and review of our internal operations. The cash flow forecasts were adjusted by a discount rate of approximately 13% based on our weighted average cost of capital (WACC) derived through a capital asset pricing model. The primary components of this model included our considerations of the relative weighting of our total asset structure between our equity and debt, the risk-free rate of return given by the rate of return on U.S. Treasury bonds, an average market risk premium based on a range of historical returns and forward looking estimates and our beta. Our model utilized an effective tax rate of approximately 35%. Further, we evaluated the reasonableness of the fair value of our reporting units by comparing the aggregate fair value of our reporting units determined under the income approach to our market capitalization.

Our market capitalization at the end of our third quarter of fiscal 2009, the period of our annual impairment test, was approximately equal to the aggregate fair value of our reporting units determined under the income approach. Our market capitalization and the aggregate fair value of our reporting units each approximated $4.2 billion which exceeded the aggregate carrying value of our reporting units by approximately 220%. As of June 26, 2009, the fair values of our two reporting units exceeded their carrying values and therefore no impairment charge was required.

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Accounting for Income Taxes

In preparing our condensed consolidated financial statements, we are required to make estimates and judgments that affect our accounting for income taxes. This process includes estimating actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences, including the timing of recognition of stock-based compensation expense, result in deferred tax assets and liabilities, which are included in our condensed 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 have established a valuation allowance.

Significant judgment is required in determining the provision for income taxes, deferred tax assets and liabilities, the valuation allowance against our deferred tax assets and uncertainty in income tax positions. Our financial position and results of operations may be materially impacted if actual results significantly differ from these estimates or the estimates are adjusted in future periods.

Stock-Based Compensation

We account for stock-based compensation under the provisions of Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* (SFAS 123R). SFAS 123R requires measurement of all employee stock-based compensation awards using a fair-value method and recording of such expense in the condensed consolidated financial statements over the requisite service period. We utilize the Black-Scholes option pricing model to determine the fair value of employee stock options at the date of grant. To determine the fair value of a stock-based award using the Black-Scholes option pricing model requires that we make certain 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. We develop our assumptions for the Black-Scholes pricing model in accordance with guidelines set forth by the SEC in Staff Accounting Bulletin No. 107, *Share-Based Payment* (SAB 107). We estimate the expected term of stock-based awards by evaluating historical exercise patterns of our employees and applying an assumption of future exercise patterns. We utilize a blend of our historical volatility of our common stock and implied volatility based on traded options with similar terms 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. The amount of stock-based compensation expense is reduced for estimated forfeitures based on historical experience. Forfeitures are required to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Investments

We account for our investments under the provisions of Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Investments that have original maturities between 91 days and one year from the date of purchase are classified as short-term investments and investments that have maturities of more than one year from the date of purchase are classified as long-term investments. All of our investments, except for an equity investment and auction rate certificates, are classified as available-for-sale securities. Our investments are recorded at fair value in the condensed consolidated balance sheet. Unrealized gains and losses on our available-for-sale securities, except for credit losses as defined in FSP FAS 115-2 and FAS 124-2 *Recognition and Presentation of Other-Than-Temporary Impairments*, are reported as a component of accumulated other comprehensive income while realized gains and losses as well as credit losses are reported as a component of net income. Auction rate certificates are classified as trading securities. Unrealized gains or losses on trading securities are reported as a component of net income.

Our investments in auction rate securities have been illiquid since February 2008 due to failed auctions. The observable market information to determine the fair value of our auction rate certificates continues to be insufficient and therefore we continue to estimate the fair value by incorporating assumptions that market participants would use in their estimates of fair value. These assumptions included the collateral underlying the securities, the creditworthiness of the counterparty, the timing of expected future cash flows, the likelihood of a successful auction in a future period and the final stated maturities.

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Results of Operations

Revenue

	Fiscal Quarter Ended		Change		Fiscal Year-to-Date Ended		Change	
	June 27, 2008	June 26, 2009	$	%	June 27, 2008	June 26, 2009	$	%
	($ in thousands)							
Revenue:								
Licensing	$ 127,558	$ 142,141	$ 14,583	11%	$ 399,607	$ 456,076	$ 56,469	14%
Percentage of total revenue	*83%*	*83%*			*84%*	*82%*		
Product sales	18,060	21,790	3,730	21%	53,698	75,744	22,046	41%
Percentage of total revenue	*12%*	*13%*			*11%*	*14%*		
Services	8,699	7,313	(1,386)	(16)%	23,796	23,806	10	0%
Percentage of total revenue	*6%*	*4%*			*5%*	*4%*		
Total revenue	**$ 154,317**	**$ 171,244**	**$ 16,927**	**11%**	**$ 477,101**	**$ 555,626**	**$ 78,525**	**16%**

Licensing. The 11% increase in licensing revenue from the third quarter of fiscal 2008 to the third quarter of fiscal 2009 was primarily driven by increased revenue in our consumer electronics and broadcast markets, partially offset by a decrease in revenue from our PC market. The increase in revenue from our consumer electronics market was primarily driven by revenue from reported shipments of camcorders and Blu-ray Disc players with our technologies pertaining to prior periods, partially offset by lower sales of standard definition DVD players. The increase in revenue from our broadcast market was primarily driven by shipments of set top boxes, including National Telecommunications and Information Administration (NTIA) converter boxes and Digital Transport Adapters (DTA devices), and an increase in the number of digital televisions in Western Europe and Asia that incorporate Dolby Digital compared to a year ago, all driven by the continued conversion from analog to digital. In total, we recognized $21.6 million in prior period royalties from three large customers in our consumer electronics and mobile markets during the quarter. Licensing revenue would have declined as compared to the third quarter of fiscal 2008 if we had not recognized these prior period royalties.

The decrease in revenue from our PC market was largely attributable to weakness in shipments of computers compared to a year ago. The decrease reflects the impact of recent deterioration in macroeconomic conditions and a slowdown in consumer spending.

We expect that our licensing revenue will decline further for the remainder of fiscal 2009 due to current macroeconomic conditions, reduced consumer spending, an expected lower percentage of PCs sold with our technologies due to increased growth in netbooks that do not have Microsoft Vista operating systems or software DVD players, and an expected continued decline in sales of DVD players.

The 14% increase in licensing revenue from the fiscal year-to-date period ended June 27, 2008 to the fiscal year-to-date period ended June 26, 2009 was primarily driven by increases in our broadcast market. The increase in revenue from our broadcast market was driven by shipments of set top boxes, including NTIA converter boxes and DTA devices, and an increase in the number of digital televisions in Western Europe and Asia that incorporated Dolby Digital compared to a year ago, all driven by the continued conversion from analog to digital broadcast.

Product Sales. The 21% increase in product sales from the third quarter of fiscal 2008 to the third quarter of fiscal 2009 was primarily driven by the recognition of approximately $7.9 million of previously deferred revenue related to our digital cinema products partially offset by a decrease in sales of our traditional cinema products.

The 41% increase in product sales from the fiscal year-to-date period ended June 27, 2008 to the fiscal year-to-date period ended June 26, 2009, was primarily driven by the recognition of approximately $30.3 million of previously deferred revenue related to sales of digital cinema related products as a result of achieving compliance with the Digital Cinema Initiative specifications in our second quarter of fiscal 2009 partially offset by a decrease in sales of our traditional cinema products.

Our digital cinema server sales are multiple-element arrangements that include the sale of products and product support. Vendor specific objective evidence (VSOE) of fair value has not been established for the product support included within digital cinema server arrangements, and therefore digital cinema sales and costs are deferred, and recognized for the entire arrangement ratably over the support period. If we are able to establish VSOE for product

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support, we expect to immediately recognize revenue and associated costs related to our digital cinema servers that are currently deferred. The remaining amounts attributable to product support included within our digital cinema arrangements will be recognized ratably over the remaining support period.

Services. The 16% decrease in services revenue from the third quarter of fiscal 2008 to the third quarter of fiscal 2009 was primarily attributable to general economic weakness and delay in film releases.

Services revenue from the fiscal year-to-date period ended June 27, 2008 to the fiscal year-to-date period ended June 26, 2009 was flat.

Gross Margin

	Fiscal Quarter Ended		**Fiscal Year-to-Date Ended**	
	June 27, 2008	**June 26, 2009**	**June 27, 2008**	**June 26, 2009**
Gross margin:				
Licensing gross margin percentage	*97%*	*98%*	*97%*	*102%*
Licensing gross margin percentage excluding gain from amended patent licensing	*97%*	*98%*	*97%*	*98%*
Product sales gross margin percentage	*48%*	*40%*	*45%*	*38%*
Services gross margin percentage	*63%*	*56%*	*60%*	*60%*
Total gross margin percentage	**90%**	**88%**	**89%**	**91%**

Licensing Gross Margin. We license to our customers intellectual property that may be internally developed, acquired by us or licensed from other parties. Our cost of licensing consists principally of royalty obligations to third parties for the licensing of intellectual property rights that we sublicense as part of our licensing arrangements with our customers. Our cost of licensing also includes amortization expenses associated with purchased intangible assets. Licensing gross margin from the third quarter of fiscal 2008 to the third quarter of fiscal 2009 was essentially flat. Licensing gross margin from the fiscal year-to-date period ended June 27, 2008 to the fiscal year-to-date period ended June 26, 2009 increased 5 points due to a gain from an amended patent licensing agreement. The gain from the amended patent licensing agreement was recorded within cost of revenue in our condensed consolidated statement of operations in the first quarter of fiscal 2009.

Product Sales Gross Margin. Cost of product sales primarily consists of material costs related to the products sold, applied labor and manufacturing overhead and, to a lesser extent, amortization of certain intangible assets. Product sales gross margin decreased by 8 points from the third quarter of fiscal 2008 to the third quarter of fiscal 2009 primarily due to the recognition of revenue and associated costs related to a number of digital cinema related equipment with significantly lower margins than our traditional cinema and broadcast products.

Prior to the second quarter of fiscal 2009, we had not recognized revenue related to sales of our digital cinema related products as we had not yet achieved compliance with the DCI specifications. In the second quarter of fiscal 2009, we achieved compliance with the DCI specifications and therefore began recognizing this revenue and related costs. The total amount of previously deferred products revenue which we recognized in the second quarter of fiscal 2009 was $22.4 million. The product margins related to the digital cinema related equipment revenue recognized in the second quarter of fiscal 2009 were particularly low due to a combination of factors that are common with new product launches, which includes higher initial per unit costs resulting from low manufacturing volumes. Additionally, field upgrade costs were incurred after the initial shipment of the products to the end users to ensure our products complied with our contractual obligations. As a result of these factors, product sales gross margin in the second quarter of fiscal 2009 was significantly lower than our product sales gross margin in prior periods.

Product sales gross margin in the third quarter of fiscal 2009 of 40% was approximately 7 points higher than our product sales gross margin of 33% in the second quarter of fiscal 2009, primarily due to a lower amount of digital cinema products revenue and costs recognized in the third quarter compared to the second quarter of fiscal 2009.

In the second quarter of fiscal 2009, we decided to consolidate our Wootton Bassett, U.K. manufacturing operations into our Brisbane, California facility. As a result of the consolidation, we are focusing our internal manufacturing capacity on lower volume products and engineering prototypes and we are working with contract manufacturers to support higher volume products as necessary. This hybrid model, which is based on using internal

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and contract manufacturing resources, is designed to provide us the capacity to scale production when needed. We anticipate that this will favorably impact our product sales gross margin in future periods due to lower manufacturing costs and increased flexibility as market demands change. However, actual results may differ from our expectations.

Services Gross Margin. Cost of services primarily consists of the payroll and benefits costs of employees performing our professional services, the cost of outside consultants and reimbursable expenses incurred on behalf of customers. Services gross margin decreased by 7 points from the third quarter of fiscal 2008 to the third quarter of fiscal 2009 primarily due to lower revenue relative to our largely flat fixed cost structure.

Operating Expenses

	Fiscal Quarter Ended		Change		Fiscal Year-to-Date Ended		Change	
	June 27, 2008	June 26, 2009	$	%	June 27, 2008	June 26, 2009	$	%
				($ in thousands)				
Operating expenses:								
Selling, general and administrative	$ 54,979	$ 55,575	$ 596	1%	$ 161,275	$ 162,975	$ 1,700	1%
Percentage of total revenue	*36%*	*32%*			*34%*	*29%*		
Research and development	15,366	17,222	1,856	12%	44,998	48,631	3,633	8%
Percentage of total revenue	*10%*	*10%*			*9%*	*9%*		
Restructuring charges, net		1,278	1,278	*n/a*		4,012	4,012	*n/a*
Percentage of total revenue	*n/a*	*n/a*			*n/a*	*n/a*		
Gain on settlements	(250)	(1,000)	(750)	*n/a*	(499)	(5,900)	(5,401)	n/a
Percentage of total revenue	*n/a*	*n/a*			*n/a*	*n/a*		
Total operating expenses	**$ 70,095**	**$ 73,075**	**$ 2,980**	**4%**	**$ 205,774**	**$ 209,718**	**$ 3,944**	**2%**

Selling, General and Administrative. Selling, general and administrative expense consists primarily of personnel and personnel-related expenses, professional service fees and facility costs for our sales, marketing and administrative functions. The 1% increase in selling, general and administrative expense from the third quarter of fiscal 2008 to the third quarter of fiscal 2009 was primarily due to an increase in personnel expenses relating to an increase in headcount and stock-based compensation expense, partially offset by decreases in bonus expense, advertising and promotional costs as well as travel and entertainment expenses.

The 1% increase in selling, general and administrative expenses from the fiscal year-to-date period ended June 27, 2008 to the fiscal year-to-date period ended June 26, 2009 was due to the same factors discussed above with respect to the third quarter of fiscal 2009.

Research and Development. Research and development expense consists primarily of compensation and benefits related costs for personnel responsible for the research and development of new technologies and products. The 12% increase in research and development expense from the third quarter of fiscal 2008 to the third quarter of fiscal 2009 was primarily driven by an increase in personnel expenses due to an increase in headcount and professional consulting expenses resulting from an increase in research and development projects, partially offset by a decrease in bonus expense.

The 8% increase in research and development expenses from the fiscal year-to-date period ended June 27, 2008 to the fiscal year-to-date period ended June 26, 2009 was due to the same factors discussed above with respect to the third quarter of fiscal 2009.

Restructuring Charges, net. Restructuring charges for the fiscal quarter ended June 26, 2009 consisted of severance and other charges attributable to the consolidation of our Wootton Bassett, U.K. manufacturing operations into our Brisbane, California facility. In the third quarter of fiscal 2009, we recorded charges of $1.3 million related to the consolidation of our manufacturing operations. We anticipate approximately $5.0 million in restructuring charges in fiscal 2009.

For the fiscal year-to-date period ended June 26, 2009, restructuring charges of $4.0 million included $3.1 million related to the consolidation of our manufacturing operations and the remaining $0.9 million related to severance and non-cancelable lease costs, net of expected sublease income, for two leased facilities in Virginia.

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Gain on Settlements. Gain on settlements includes payments received related to the resolution of disputes with implementation licensees from which we typically do not earn royalties.

Other Income, Net

	Fiscal Quarter Ended		Change		Fiscal Year-to-Date Ended		Change	
	June 27, 2008	June 26, 2009	$	%	June 27, 2008	June 26, 2009	$	%
	($ in thousands)							
Interest income	$ 3,481	$ 2,431	$ (1,050)	(30)%	$ 13,777	$ 9,183	$ (4,594)	(33)%
Interest expense	(329)	(187)	142	43%	(1,324)	(599)	725	55%
Other expenses, net	(491)	(1,644)	(1,153)	235%	(2,184)	(2,790)	(606)	28%
Total other income, net	**$ 2,661**	**$ 600**	**$ (2,061)**	**(77)%**	**$ 10,269**	**$ 5,794**	**$ (4,475)**	**(44)%**

Other income, net, primarily consists of interest income earned on cash, cash equivalent and investments, offset by interest expense principally attributable to the outstanding balances on our facility debt obligations. Interest income declined 30% in the third quarter of fiscal 2009 from the third quarter of fiscal 2008, primarily driven by lower yields generated on our investment portfolio driven by lower interest rates partially offset by an increase in cash, cash equivalents and investments balances. Our other expenses, net increased from the third quarter of fiscal 2008 to the third quarter of fiscal 2009, primarily due to losses from foreign currency transactions. Losses from currency transactions were primarily due to the change in the value of the Euro and the British Pound Sterling relative to the U.S. Dollar.

Income Taxes

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 27, 2008	June 26, 2009	June 27, 2008	June 26, 2009
	($ in thousands)			
Income taxes:				
Provision for income taxes	$ 24,117	$ 27,502	$ 78,516	$ 104,555
Effective tax rate	34.0%	34.8%	34.1%	34.4%

Our effective tax rate is based upon a projection of our annual fiscal year results. Our effective tax rate for the third quarter of fiscal 2008 was 34.0% compared to 34.8% for the third quarter of fiscal 2009. Our effective tax rate was 34.1% and 34.4% for the fiscal year-to-date periods ended June 27, 2008 and June 26, 2009, respectively.

The change in our effective tax rate from the third quarter of fiscal 2008 to the third quarter of fiscal 2009 was primarily due to a decrease in the projected tax-exempt interest income.

Liquidity, Capital Resources and Financial Condition

	September 26, 2008	June 26, 2009
	(in thousands)	
Cash and cash equivalents	$ 394,761	$ 363,376
Short-term investments	119,667	211,279
Long-term investments	180,996	289,745
Accounts receivable, net	27,650	49,817
Accounts payable and accrued liabilities	156,925	110,709
Working capital[(a)]	491,196	589,817

	June 27, 2008	June 26, 2009
Net cash provided by operating activities	162,013	195,264
Capital expenditures [b]	(7,666)	(9,236)
Net cash used in investing activities	(190,698)	(240,916)
Net cash provided by financing activities	29,420	15,302

[a] Working capital consists of total current assets less total current liabilities.

[b] Capital expenditures consist of purchases of office equipment, building fixtures, computer hardware and software, leasehold improvements, production and test equipment.

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As of June 26, 2009, we had cash and cash equivalents of $363.4 million, compared to $394.8 million at September 26, 2008. In addition, at June 26, 2009, we had short-term and long-term investments of $501.0 million, compared to $300.7 million at September 26, 2008. Our principal sources of liquidity are our cash, cash equivalents and short-term investments, as well as cash flows from our operations. We believe that our cash, cash equivalents and potential cash flows from operations will be sufficient to satisfy our currently anticipated cash requirements through at least the next 12 months.

Cash provided by operating activities was $195.3 million for the fiscal year-to-date period ended June 26, 2009, compared to $162.0 million for the fiscal year-to-date period ended June 27, 2008. Cash flows from operating activities consisted of net income adjusted for certain non-cash items, including stock-based compensation, depreciation and amortization, and the effect of changes in working capital and other operating activities. Cash flows from operating activities for the fiscal year-to-date period ended June 26, 2009 were primarily driven by net income of $198.7 million. Adjustments for non-cash items included depreciation and amortization expense of $21.5 million, deferred taxes of $19.8 million and stock-based compensation expense of $15.6 million, offset by the gain from amended patent licensing agreement of $20.0 million. Changes in working capital were primarily driven by increases in current assets of $21.4 million and decreases in accounts payable and accrued liabilities of $24.2 million offset by an increase in deferred revenues of $4.8 million.

Cash used in investing activities for the fiscal year-to-date period ended June 26, 2009 was primarily driven by purchases of available-for-sale securities of $206.7 million, net of sales, cash paid for the purchase of intangible assets of $8.3 million and an acquisition of approximately $16.6 million. Capital expenditures were $9.2 million for the fiscal year-to-date period ended June 26, 2009.

Cash provided by financing activities was $15.3 million for the fiscal year-to-date period ended June 26, 2009, compared to $29.4 million for the fiscal year-to-date period ended June 27, 2008. Cash flows from financing activities were primarily driven by proceeds from the exercise of stock options and issuance of stock under our employee stock purchase plan.

As of June 26, 2009, we held auction rate certificates with a par value totaling $69.7 million. In the event we need access to the funds invested in these securities, we will not be able to liquidate these securities until a future auction of these securities is successful, they are refinanced and redeemed by the issuers, or a buyer is found outside of the auction process. In November 2008, we accepted a rights offering from UBS AG, which we refer to, along with its wholly owned subsidiaries UBS Financial Services, Inc. and UBS Securities LLC, as UBS, to liquidate our auction rate certificates held in UBS accounts on February 13, 2008. The rights offering provides us with rights (the Put Rights) to sell our auction rate certificates for a price equal to the liquidation preference of the auction rate certificates plus accrued but unpaid dividends or interest, if any, at any time during a two year period from June 30, 2010 through July 2, 2012. There is a risk that UBS may not perform its obligations in accordance with their offer and consequently we may have to write down the value of the Put Rights. Furthermore, there is no assurance that we will be able to recoup our investments in the auction rate certificates.

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Contractual Obligations and Commitments

The following table presents a summary of our contractual obligations and commitments as of June 26, 2009.

	Payments Due By Period				
	Remainder of Fiscal 2009	Fiscal 2010 to 2011	Fiscal 2012 to 2013 (in thousands)	After Fiscal 2013	Total
Long-term debt (1)	$ 401	$ 3,372	$ 3,327	$ 830	$ 7,930
Operating leases (2)	1,604	12,498	9,750	5,634	29,486
Payments on litigation settlement (3)		6,000			6,000
Total	$ 2,005	$ 21,870	$ 13,077	$ 6,464	$ 43,416

(1) We maintain three term loans through our consolidated affiliates Dolby Properties, LLC, Dolby Properties Burbank, LLC and Dolby Properties United Kingdom, LLC, for financing commercial and real property at various locations in which we are the primary tenant.

(2) Operating lease payments include future minimum rental commitments, including those payable to our principal stockholder, for non-cancelable operating leases of office space as of June 26, 2009.

(3) In April 2002, we settled a dispute with an unrelated third party and agreed to pay a total of $30.0 million in ten equal annual installments of $3.0 million per year beginning in June 2002. Refer to Note 6 Legal Proceedings for further discussion.

Other Cash Obligations. Under the terms of the agreement to acquire all outstanding shares of our subsidiary, Cinea, in September 2003, we have future payment obligations that equal approximately 5% to 8% of the revenue generated from products incorporating certain technologies we acquired in the transaction through 2022. As of June 26, 2009, no additional purchase consideration had been paid and no liability is reflected on our balance sheet. We have not met the revenue threshold that would trigger a payment obligation.

Recently Issued Accounting Standards

See Note 8 of the Condensed Consolidated Financial Statements Recently Issued Accounting Standards.

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ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Sensitivity

Cash, Cash Equivalents and Investments.

As of June 26, 2009, we had cash and cash equivalents of $363.4 million, which consisted of cash and highly-liquid money market funds. In addition, we had short-term and long-term investments of $501.0 million, which consisted primarily of auction rate certificates, corporate bonds, municipal debt securities, United States government agency securities, United States government bonds and variable rate demand notes with original maturities greater than 90 days. Many of these investments are subject to fluctuations in interest rates, which could impact our results. Based on our investment portfolio balance as of June 26, 2009, a hypothetical change in interest rates of 1% would have approximately a $5.2 million impact, and a change of 0.5% would have approximately a $2.6 million impact on the carrying value of our portfolio. Furthermore, a hypothetical change in interest rates of 1% would have approximately a $4.0 million impact, and a change of 0.5% would have approximately a $2.0 million impact on interest income over a one-year period.

As of June 26, 2009, we held auction rate certificates with a par value totaling $69.7 million. Auctions for these instruments have failed and there is no assurance that future auctions will succeed. In the event we need access to the funds invested in these securities, we will not be able to liquidate these securities until a future auction of these securities is successful, they are refinanced and redeemed by the issuers, or a buyer is found outside of the auction process. On November 11, 2008, we accepted an offer from UBS AG, which we refer to, along with its wholly owned subsidiaries UBS Financial Services, Inc. and UBS Securities LLC, as UBS, to liquidate our auction rate certificates held in UBS accounts on February 13, 2008. The UBS offer entitles us to sell our auction rate certificates for a price equal to the liquidation preference of the auction rate certificates plus accrued but unpaid dividends or interest, if any, at any time during a two year period from June 30, 2010 through July 2, 2012. There is a risk that UBS will not perform its obligations in accordance with their offer. Furthermore, there is no assurance that we will be able to recoup our investments in the auction rate certificates.

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

Foreign Currency Exchange Risk

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

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ITEM 4 CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

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

Changes in Internal Control Over Financial Reporting

In the third quarter of fiscal 2009, we completed an upgrade to our existing enterprise resource planning system. We evaluated the potential impact to the effectiveness of our internal control over financial reporting prior to and subsequent to the implementation. This change, while significant, did not materially affect, nor is it reasonably likely to affect our internal control over financial reporting. There were no other changes during the third quarter of fiscal 2009 that have materially affected, or are reasonably likely to affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

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

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

Our business is particularly exposed to adverse changes in general economic conditions, because products that incorporate our technologies are entertainment-oriented and generally discretionary goods, such as DVD players, personal computers, digital televisions, mobile devices, set top boxes, home theaters in a box, camcorders, portable media devices, gaming systems, audio/video receivers and in-car DVD players. The current slowdown or decline in U.S. and foreign economic growth has adversely affected consumer confidence, disposable income and spending. These conditions may persist or worsen. Sales by our licensees of consumer electronics and other products incorporating our technologies may not grow as rapidly as in prior periods or may decrease, which would adversely affect our licensing revenue. Generally weak macroeconomic conditions adversely affected our revenue in the third quarter of fiscal 2009 and revenue would have declined as compared to the third quarter of fiscal 2008 if we had not recognized $21.6 million in licensing revenue relating to shipments in prior quarters from three large customers. We do not expect to sustain historical levels of licensing growth, and we expect licensing revenue will decrease, in the future due to a slowdown in consumer spending. A continued decline in sales of standard definition DVD players, decreased digital converter box sales and further declines in the shipment of game consoles along with a potential decline in sales of number of PCs with our technologies, will contribute to an expected decline in revenue growth or even a decline in revenue. In addition, any slowdown in consumer spending will likely negatively impact the motion picture industry and cinema owners, which could result in decreased growth, or a decrease in product sales and services, which will adversely affect our revenue. Furthermore, deteriorating economic conditions result in a greater likelihood that more of our licensees and customers will become delinquent on their obligations to us or be unable to pay, which in turn, could result in a higher level of write-offs, all of which would adversely affect our earnings. Moreover, deteriorating economic conditions and other factors may result in increased underreporting and non-reporting of royalty bearing revenues by our licensees as well as increased unauthorized use of our technologies, which would adversely affect our earnings.

To the extent that sales of personal computers with Dolby technologies level off or decline, our licensing revenue will be adversely affected.

Historically, PC manufacturers have frequently included DVD playback functionality as part of the software applications included in their products. Two of six editions of Microsoft s Windows Vista operating system, the Vista Home Premium Edition and the Vista Ultimate Edition, include Dolby technologies which help enable DVD playback functionality and DVD authoring capabilities. In addition, many major PC manufacturers continue to include additional DVD software applications which offer added DVD functionality not included in the Microsoft operating systems. Microsoft recently announced that its newest operating system, Windows 7, will be available in October 2009. Windows 7 will include Dolby technologies, including Dolby s next generation audio codec, Dolby Digital Plus, in the four Windows 7 editions that include DVD software applications. There are risks and uncertainties associated with this opportunity. Although consumers may pre-order Windows 7 or upgrade from Vista to Windows 7, consumers may delay purchasing personal computers until Windows 7 is available. Due in part to Windows 7 DVD playback enhancements and pricing pressure, we expect some PC manufacturers will exclude additional DVD software applications on personal computers that include Windows 7 Home Premium, Professional, Enterprise and Ultimate editions. Additionally, it is uncertain at what pace consumer and business customers will migrate from their current operating systems to the Windows 7 operating system and what the adoption rate of the editions with Dolby technologies will be. In addition, a growing number of lower priced PCs, particularly netbooks, are being sold or are anticipated to be sold which do not have Dolby technologies. Consumers may elect to purchase these lower priced PCs instead of computers with DVD playback functionality and Dolby technologies. Revenue from our PC market decreased from the third quarter of fiscal 2008 to the third quarter of fiscal 2009 and may decline in the future. Future shipments of PCs with Dolby technologies could also decline. If any of the foregoing occur, our licensing revenue will be adversely affected.

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

Maintaining and strengthening the Dolby brand is critical to maintaining and expanding our licensing, products and services, as well as to our ability to enter new markets for our sound and other technologies. Our continued success depends, in part, on our reputation for providing high quality products, services and technologies across a wide range of entertainment industries, including the consumer electronics products industry. If we fail to promote and maintain the Dolby brand successfully in licensing, products or services, our business and prospects will suffer. Moreover, we believe that the likelihood that our technologies will be adopted as industry standards in various markets and for various applications depends, in part, upon the strength of our brand, because professional organizations and industry participants are more likely to accept, as an industry standard, technologies developed by a well-respected and well-known brand. Our ability to maintain and strengthen our brand will depend heavily on our ability to continue to develop innovative technologies for the entertainment industry, successfully enter into new markets and to continue to provide high quality products and services, which we may not do successfully. Establishing brand recognition is particularly challenging in newer markets in which we have limited experience.

Sales of component DVD players have declined significantly and we expect them to decline further. To the extent that sales of component DVD players continue to decline or alternative technologies in which we do not participate replace DVDs or Blu-ray Disc as a dominant medium for consumer video entertainment, our licensing revenue will be adversely affected.

Growth in our revenue over the past several years had been the result, in large part, of the rapid growth in sales of component DVD players incorporating our technologies. However, as the markets for DVD players have matured, sales of component DVD players have declined significantly and we expect future sales of component consumer DVD players to continue to decline. As sales of component DVD players decline our licensing revenue will be adversely affected. Additionally, future revenue from Blu-ray Disc player may not offset future declines in revenue from standard definition DVD players, which would adversely affect our licensing revenue. In addition, if new technologies are developed for use with DVDs or new technologies are developed that substantially compete with or replace DVDs and Blu-ray Disc players as a dominant medium for consumer video entertainment, and if we are unable to develop and successfully market technologies that are incorporated into or compatible with those new technologies, our business, operating results and prospects will be adversely affected.

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

We derive most of our revenue from the licensing of our technologies to consumer electronics product manufacturers. Licensing revenue represented 80%, 84% and 82% of our total revenue in fiscal 2007, 2008 and the fiscal year-to-date period ended June 26, 2009, respectively. We do not manufacture consumer electronics products ourselves and our licensing revenue is dependent on sales by our licensees of products that incorporate our technologies. We cannot control these manufacturers product development or commercialization efforts or predict their success. In addition, our license agreements, which typically require manufacturers of consumer electronics products and media software vendors to pay us a specified royalty for every electronics product shipped that incorporates our technologies, do not require these manufacturers to include our technologies in any specific number or percentage of units, and only a few of these agreements guarantee us a minimum aggregate licensing fee. Accordingly, if our licensees sell fewer products incorporating our technologies, or otherwise face significant economic difficulties, our revenue will decline. Moreover, we have a widespread presence in markets for electronics

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products, such as the consumer electronics product market, which includes DVD players, audio/video receivers and other home theater consumer electronics products, and, as a result, there is little room for us to further penetrate such markets. Lower sales of products incorporating our technologies could occur for a number of reasons. Changes in consumer tastes or trends, changes in industry standards or adverse changes in business and economic conditions, may adversely affect our licensing revenue. Increasing market saturation, durability of products in the marketplace, competing products and alternate consumer entertainment options could adversely affect demand for new products incorporating our technologies.

Inaccurate licensee royalty reporting and unauthorized use of our intellectual property could materially adversely affect our operating results.

Our licensing revenue is generated primarily from consumer electronics product manufacturers and media software vendors who license our technologies and incorporate them in their products. Under our existing arrangements, these licensees typically pay us a specified royalty for every product they ship that incorporates our technologies. We rely on our licensees to accurately report the number of units shipped that incorporate our technologies. We calculate our license fees, prepare our financial reports, projections and budgets, and direct our sales and product development efforts based on these reports we receive from our licensees. However, it is often difficult for us to independently determine whether or not our licensees are reporting shipments accurately. This is especially true with respect to software incorporating our technologies because software can be copied relatively easily and we often do not have easy ways to determine how many copies have been made. Most of our license agreements permit us to audit our licensees records, but audits are generally expensive and time consuming and initiating audits could harm our customer relationships. In the past, licensees, particularly in emerging economies, such as China, have understated or failed to report the number of products incorporating our technologies that they shipped, and we have not been able to collect and recognize revenue to which we were entitled. We expect that we will continue to experience understatement and non-reporting of royalty bearing revenues by licensees, which could adversely affect our operating results. Conversely, to the extent that our licensees overstate the number of products incorporating our technologies, or report the products under the wrong categories, negative corrections could result in reductions of royalty revenue in subsequent periods. In addition, some of our licensees may begin to more closely scrutinize their past or future licensing statements which may result in an increased receipt of negative corrective statements.

We also have often experienced, and expect to continue to experience, problems with non-licensee consumer electronics product manufacturers and media software vendors, particularly in emerging economies, such as China, incorporating our technologies or incorporating our technologies and trademarks into their products without our authorization and without paying us any licensing fees. This unauthorized use of our intellectual property could adversely affect our operating results.

Our future success depends, in part, upon the growth of new and existing markets for our technologies and our ability to develop and adapt our technologies for those markets. If those markets do not grow or we are not able to develop successful products for them, our business prospects could be limited.

We expect that the future growth of our licensing revenue will depend, in part, upon the growth of, and our successful participation in, new opportunities for our technologies, including:

- Digital television and radio broadcasting;
- HDTV;
- Personal computer technology;
- Blu-ray Disc;
- Mobile devices;

Video game consoles and video games;

Imaging;

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Personal audio and video players, including internet music applications;

Broadband internet; and

Home DVD recording.

Our ability to penetrate these markets depends on increased consumer demand for products that contain our technologies, which may not occur. If these markets do not develop or consumer demand does not grow, it would have a material adverse effect on our business and prospects. For example, the extent to which our revenue from digital broadcast networks and broadband internet services increases depends upon the expansion of digital broadcast technologies and broadband internet as a medium of entertainment. In addition, even when our technologies are adopted as industry standards for a particular market, such market may not fully develop. In such case, our success depends not only on whether our technologies are adopted as industry standards for such market, but also on the development of that market, which may not occur. Demand for our technologies in any of these developing markets may not continue to grow, and a sufficiently broad base of consumers and professionals may not adopt or continue to use these technologies. In addition, our ability to generate revenue from these markets may be limited to the extent that service providers in these markets choose to provide select technologies and entertainment for little or no cost, such as many of the services provided in connection with broadband internet services. Moreover, some of these markets are ones in which we have not previously participated and, because of our limited experience, we may not be able to adequately adapt our business and our technologies to the needs of customers in these fields.

If we fail to develop and deliver innovative technologies in response to industry changes, our business could decline.

The markets for our products and the markets for consumer electronics products using our licensed technologies are characterized by rapid change and technological evolution. We will need to expend considerable resources on research and development, or acquisitions, in the future in order to continue to design and deliver enduring, innovative entertainment products and technologies. Despite our efforts, we may not be able to develop, or acquire, and effectively market new products, technologies and services that adequately or competitively address the needs of the changing marketplace. For example, we cannot ensure that Dolby Volume, Dolby s volume leveling solution designed to address the annoyances of inconsistent loudness, Dolby 3D Digital Cinema, Dolby s 3D digital cinema solution, Dolby Contrast or Dolby Vision, Dolby s dynamic range image technologies for LED backlit LCD televisions, will address the needs of the marketplace, be effectively marketed or be successful technologies. In addition, we may not correctly identify new or changing market trends at an early enough stage to capitalize on market opportunities. At times such changes can be dramatic, such as the shift from VHS tapes to DVDs for consumer playback of movies in homes and elsewhere. Our future success depends to a great extent on our ability to develop, or acquire, and deliver innovative technologies that are widely adopted in response to changes in the entertainment industry and that are compatible with the technologies or products introduced by other entertainment industry participants.

If we are unable to expand our business into non-sound technologies, our future growth could be limited.

Our future growth will depend, in part, upon our expansion into areas beyond sound technologies. For example, in addition to our digital cinema initiative, we are exploring other areas that facilitate delivery of digital entertainment, such as technologies for processing digital moving images. We will need to spend considerable resources on research and development or acquisitions in the future in order to deliver innovative non-sound technologies. However, we have limited experience in non-sound technology markets and, despite our efforts, we cannot predict whether we will be successful in developing, or acquiring and marketing non-sound products, technologies and services. We will face significant risks in integrating non-sound businesses that we acquire into our business.

In addition, many of the non-sound technology markets are relatively new and may not develop as we currently anticipate. Moreover, although we believe that many of the technological advances we may develop or acquire for digital cinema may have applicability in other areas, such as broadcasting or consumer electronics products, we may not ever be able to achieve these anticipated benefits in these other markets. A number of competitors and potential competitors may develop non-sound technologies similar to those that we develop or acquire, some of which may provide advantages over our products, technologies and services. Some of these competitors have much greater experience and expertise than we do in the non-sound fields we may enter. The non-sound products, technologies

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and services we expect to market may not achieve or sustain market acceptance, may not meet industry needs, and may not be accepted as industry standards. If we are unsuccessful in selling non-sound products, technologies and services, the future growth of our business may be limited. In addition, our efforts to enter or strengthen our positions in non-sound markets may be tied to the success of specific programs.

We face significant competition in various markets, and if we are unable to compete successfully, our business will suffer.

The markets for entertainment industry technologies are highly competitive, and we face competitive threats and pricing pressure in our markets. Competitors for our licensed technologies include: DivX, DTS, Fraunhofer Institute for Integrated Circuits, Microsoft, Philips, RealNetworks, Sony, SRS Labs and Thomson. Competitors for our products include: Avica, Audyssey Laboratories, Doremi, DTS, EVS, GDC, Kodak, Linear Acoustic, NEC, Panastereo, Qube, QuVis, REAL D, RED Digital Cinema Camera Company, Sony, Texas Instruments and USL. Competitors for our services include DTS and Sony. In addition, other companies may become competitors in the future. Some people may perceive the quality of sound produced by some of our competitors technologies to be equivalent or superior to that produced by ours. In addition, some of our current and/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. For example, Microsoft and RealNetworks may have an advantage over us in the market for internet technologies because of their greater experience and presence in that market. In addition, some of our current or potential competitors, such as Microsoft and RealNetworks, may be able to offer integrated system solutions in markets for sound or non-sound entertainment technologies, including audio, video and rights management technologies related to personal computers or the internet, which could make competing technologies that we develop unnecessary. By offering an integrated system solution, these potential competitors also may be able to offer competing technologies at lower prices than our technologies, which could adversely affect our operating results. Further, many of the consumer electronics products that include our sound technologies also include sound technologies developed by our competitors. As a result, we must continue to invest significant resources in research and development in order to enhance our technologies and our existing products and services and introduce new high quality technologies, products and services to meet the wide variety of such competitive pressures. Our business will suffer if we fail to do so successfully.

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

Our quarterly operating results may fluctuate depending upon the timing of when we receive royalty reports from our licensees and of the satisfaction of our revenue recognition criteria. We recognize license revenue only after we receive royalty reports from our licensees regarding the shipment of their products that incorporate our technologies. As a result, the timing of our revenue depends upon the timing of our receipt of those reports. In addition, it is not uncommon for royalty reports to include positive or negative corrective or retroactive royalties that cover extended periods of time. Furthermore, there have been times in the past when we have recognized an unusually large amount of licensing revenue from a licensee in a given quarter because not all of our revenue recognition criteria were met in prior periods. This can result in a large amount of licensing revenue from a licensee being recorded in a given quarter that is not necessarily indicative of the amounts of licensing revenue to be received from that licensee in future quarters, thus causing fluctuations in our operating results. For example, in the third quarter of fiscal 2009 we recognized a total of approximately $21.6 million in licensing revenue from three licensees related to royalties on shipments in prior periods. Moreover, there have been times in the past when we have not recognized large amounts of products and services revenue in a given quarter, or over several quarters, because not all of our revenue recognition criteria were met in prior periods. For example, in the second and third quarters of fiscal 2009 we recognized approximately $22.4 million and $7.9 million, respectively, in products revenue relating to digital cinema related equipment sold in prior periods.

If our products and technologies fail to be adopted as industry standards, our business prospects could be limited and our operating results could be adversely affected.

The entertainment industry depends upon industry standards to ensure the compatibility of its content across a wide variety of entertainment systems and products. Accordingly, we make significant efforts to design our products and technologies to address capability, quality and cost considerations so that they either meet, or, more importantly, are adopted as, industry standards across the broad range of entertainment industry markets in which we participate, as well as the markets in which we hope to compete in the future, including digital cinema. To have our products and technologies adopted as industry standards, we must convince a broad spectrum of professional organizations throughout the world, as well as our major customers and licensees who are members of such organizations, to adopt them as such and to ensure that other industry standards are consistent with our products and technologies. If our technologies are not adopted or do not remain as industry standards, our business, operating results and prospects could be materially and adversely affected. We expect that meeting, maintaining and establishing industry standard technologies will continue to be critical to our business in the future. In addition, the market for broadcast technologies has traditionally been heavily based upon industry standards, often set by governments or other regulatory bodies, and we expect this to continue to be the case in the future. If our technologies are not chosen as industry standards for broadcasting in particular geographic areas, this could adversely affect our ability to compete in these markets.

It may be more difficult for us, in the future, to have our technologies adopted as individual industry standards to the extent that entertainment industry participants collaborate on the development of industry standard technologies.

Increasingly, standards-setting organizations are adopting or establishing technology standards for use in a wide range of consumer electronics products. As a result, it is more difficult for individual companies to have their technologies adopted wholesale as an informal industry standard. We call this type of standard a de facto industry standard, meaning that the standard is not explicitly mandated by any industry standards-setting body but is nonetheless widely adopted. In addition, increasingly there are a large number of companies, including ones that typically compete against one another, involved in the development of new technologies for use in consumer entertainment products. As a result, these companies often license their collective intellectual property rights as a group, making it more difficult for any single company to have its technologies adopted widely as a de facto industry standard or to have its technologies adopted as an exclusive, explicit industry standard for consumer electronics products.

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

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

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

When a standards-setting body mandates our technologies as explicit industry standards, we generally must agree to license such technologies on a fair, reasonable and non-discriminatory basis, which could limit our control over the use of these technologies. In these situations, we must often limit the royalty rates we charge for these technologies, which could adversely affect our gross margins. Furthermore, we may be unable to limit to whom we license such technologies, and may be unable to restrict many terms of the license. From time to time we may be subject to claims that our licenses of our industry standard technologies may not conform to the requirements of the standards-setting body. Private parties have raised this type of issue with us in the past. Allegations such as these could be asserted in private actions seeking monetary damages and injunctive relief, or in regulatory actions. Claimants in such cases could seek to restrict or change our licensing practices or our ability to license our technologies in ways that could injure our reputation and otherwise materially and adversely affect our business, operating results and prospects.

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

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

A successful challenge by a third party could increase the amount of royalties we have to pay to the third party, decrease our gross margin and adversely affect our operating results. Such a challenge could result in the termination of the license agreement which would impair our ability to continue to use and re-license intellectual property from that third party which, in turn, could adversely affect our business and prospects.

We face risks in conducting business in emerging economies, such as China, particularly due to the limited recognition and enforcement of intellectual property and contractual rights in these countries.

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

Our licensing revenue depends in large part upon semiconductor manufacturers incorporating our technologies into integrated circuits, or ICs, for sale to our electronics product licensees and if, for any reason, our technologies are not incorporated in these ICs or fewer ICs are sold that incorporate our technologies, our operating results would be adversely affected.

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

Pricing pressures on the electronics product manufacturers who incorporate our technologies into their products could limit the licensing fees we charge for our technologies, which could adversely affect our revenues.

The markets for the consumer electronics products in which our technologies are incorporated are intensely competitive and price sensitive. Retail prices for consumer electronics products that include our sound technology, such as DVD players and home theater systems, have decreased significantly, and we expect prices to continue to decrease for the foreseeable future. In response, manufacturers have sought to reduce their product costs, which can result in downward pressure on the licensing fees we charge our customers who incorporate our technologies into the consumer electronics products that they sell. Further, while we have contractual rights with many of our licensees for cost of living adjustments to our royalty rights, we may not be able to negotiate those terms in future contracts with existing and new licensees. A decline in, or the loss of the contractual right to increase, the licensing fees we charge could materially and adversely affect our operating results.

Our inability to deploy our digital cinema servers in significant numbers in the transition to digital cinema, coupled with the price of our products, could limit our future prospects in the digital cinema market and could materially and adversely affect our business.

A small percentage of theatres have adopted digital cinema for the distribution and exhibition of movies. A number of companies offer competing products for digital cinema, some of which are priced lower than our products or offer features, such as support for 4K presentation, that exhibitors may perceive to be potentially advantageous to our products. At least one competitor has a significantly greater installed base of its competing digital cinema playback servers than we do and another competitor has a significantly greater installed base of its competing 3D products than we do, either of which could limit our eventual share of the digital cinema market and materially and adversely affect our operating results. As the market for digital cinema has grown, we have faced more pricing and other competitive pressures than we have traditionally experienced for our traditional cinema products. As a result, we have implemented and may have to continue to implement pricing strategies which will have an adverse impact on our product sales gross margins in the future.

If the market for digital cinema develops more slowly than expected, our future prospects could be limited and our business could be materially and adversely affected.

If the major motion picture studios and the cinema exhibition industry cannot agree on one or more business models for digital cinema equipment financing or if funding is not available on favorable terms or at all, the broad adoption of digital cinema will be delayed further. The conversion of movie theatres from film to digital cinema will require significant capital investment and recent events in the lending market have resulted in system integrator difficulty in obtaining funding delaying broader adoption of digital cinema. We cannot predict how quickly digital cinema will become widely adopted. At present only a small percentage of movie theatres have been converted to digital cinema, and we expect the broad conversion of theatres to digital cinema technologies, if it occurs, to be a multi year process due to both technological and financial obstacles. If the demand for digital cinema equipment develops more slowly than expected, or if there is significant and sustained resistance by the motion picture studios or cinema exhibitors to this technology or the cost of implementation, or if funding is not available on favorable terms or at all, the broad adoption of digital cinema will continue to be delayed which could adversely affect our revenue.

If we do not identify opportunities, respond to challenges and successfully execute our initiatives to participate in the emerging digital cinema market, our future prospects could be limited and our business could be adversely affected.

A small percentage of theatres have adopted digital cinema for the distribution and exhibition of movies. Industry participants continue to discuss business models to facilitate adoption of digital cinema by allocating the costs among industry participants, and the business models that ultimately emerge may vary from country to country. Participating in some of the models under discussion has required and may require us to depart from our traditional model of selling our cinema products pursuant to one time contracts, and could expose us to various risks we have not faced in the past. For example, we have participated in one model by deploying, at our expense, fully integrated digital cinema systems and seeking payment from motion picture distributors for films presented on the systems. Further, as digital cinema has grown the digital cinema initiative specifications as well as exhibitor and studio expectations have evolved. For example, a competitor has introduced a digital cinema solution which supports the presentation of movies with higher resolution 4K digital cinema projectors. Certain major U.S. exhibitors have announced their intention to outfit their theatres exclusively with 4K digital cinema equipment. Other exhibitors may feel that they need to outfit some of their theatres with 4K digital cinema equipment to compete in the same markets where competitors are promoting 4K solutions. Dolby currently does not offer a digital cinema 4K solution. In fiscal 2007, we introduced Dolby 3D Digital Cinema technology, providing us with an additional opportunity to participate in digital cinema. However, there are risks that recent renewed interest in 3D cinema could be a fad and may not be long lasting and that our business model, which relies on reusable glasses for 3D viewing, will not succeed. If we do not identify and successfully execute on opportunities and respond to challenges to generate revenues from our digital cinema products and services, our future prospects in this market will be limited and our business could be materially and adversely affected.

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If our digital cinema initiatives do not perform to expectations, our reputation may suffer and demand for our digital cinema products and services may not develop.

As we participate in the digital cinema transition, if we or our equipment do not perform to expectations, our relationships with cinema exhibitors or other digital cinema industry participants may be adversely affected and our reputation may suffer, affecting the demand for our digital cinema products and services. Any negative publicity or significant problems with our digital cinema products and services could materially and adversely affect our relationships with the motion picture studios and cinema exhibition industry or the perception of our brand.

Acquisition activities could result in operating difficulties, dilution to our stockholders and other harmful consequences.

We have evaluated, and expect to continue to evaluate, a wide array of possible strategic transactions, including acquisitions. We consider these types of transactions in connection with our efforts to expand our business beyond sound technologies to other technologies related to the delivery of digital entertainment. Although we cannot predict whether or not we will complete any such acquisition or other transactions in the future, any of these transactions could be material in relation to our market capitalization, financial condition or results of operations. The process of integrating an acquired company, business or technology may create unforeseen difficulties and expenditures. The areas where we may face risks in integrating acquired businesses include:

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

Foreign acquisitions involve unique risks in addition to those mentioned above, including those related to integration of operations across different geographies, cultures and languages, currency risks and risks associated with the particular economic, political and regulatory environment in specific countries. Also, the anticipated benefit of our acquisitions may not materialize. Future acquisitions could result in potentially dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities or amortization expenses, or write-offs of goodwill, any of which could harm our operating results or financial condition. Future acquisitions may also require us to obtain additional equity or debt financing, which may not be available on favorable terms or at all. Moreover, acquisitions may have an adverse impact on our financial condition and results of operations, including a potential adverse impact on our gross margins.

If sales of consumer electronics products incorporating our technologies do not grow in emerging markets, our ability to increase our licensing revenue may be limited.

We also expect that growth in our licensing revenue will depend, in part, upon the growth of sales of consumer electronics products incorporating our technologies in emerging economies, as consumers in these markets have more disposable income and are increasingly purchasing entertainment products with surround sound capabilities. However, if our licensing revenue from the use of our technologies in these new markets or geographic areas does not expand, our prospects could be adversely affected.

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Our relationships with entertainment industry participants are particularly important to our products, services and technology licensing, and if we fail to maintain such relationships our business could be materially harmed.

If we fail to maintain and expand our relationships with a broad range of participants throughout the entertainment chain, including motion picture studios, broadcasters, video game designers, music producers, mobile content producers and manufacturers of consumer electronics products, our business and prospects could be materially harmed. Relationships have historically played an important role in the entertainment industries that we serve. For example, sales of our products and services are particularly dependent upon our relationships with the major motion picture studios and broadcasters, and licensing of our technology is particularly dependent upon our relationships with consumer electronics product manufacturers, media software vendors and integrated circuit, or IC, manufacturers. If we fail to maintain and strengthen these relationships, these entertainment industry participants may be more likely not to purchase and use our products, services and technologies, or create content incorporating our technologies, which could materially harm our business and prospects. In addition to directly providing substantially all of our revenue, these relationships are also critical to our ability to have our technologies adopted as industry standards. In addition, if major industry participants form strategic relationships that exclude us, whether in products, services or licensing, our business and prospects could be materially adversely affected.

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

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

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

We are dependent on international sales for a substantial amount of our total revenue. For fiscal 2007, 2008 and the year-to-date period ended June 26, 2009, revenue from outside the United States was 70%, 66% and 65% of our total revenue, respectively. We expect that international and export sales will continue to represent a substantial portion of our revenue for the foreseeable future. This future revenue will depend to a large extent on the continued use and expansion of our technologies in entertainment industries worldwide. Increased worldwide use of our technologies is also an important factor in our future growth.

Due to our reliance on sales to customers outside the United States, we are subject to the risks of conducting business internationally, including:

- Our ability to enforce our contractual and intellectual property rights, especially in those foreign countries that do not respect and protect intellectual property rights to the same extent as do the United States, Japan and European countries, which increases the risk of unauthorized, and uncompensated, use of our technology;

- United States and foreign government trade restrictions, including those which may impose restrictions on importation of programming, technology or components to or from the United States;

- 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 United States, and foreign tax and other laws limiting our ability to repatriate funds to the United States;

- Foreign labor laws, regulations and restrictions;

- Changes in diplomatic and trade relationships;

Difficulty in staffing and managing foreign operations;

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Adverse fluctuations in foreign currency exchange rates and interest rates, including risks related to any interest rate swap or other hedging activities we undertake;

Political instability, natural disasters, war or events of terrorism; and

The strength of international economies.

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

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

Any intellectual property claims, with or without merit, could be time consuming, expensive to litigate or settle and could divert management resources and attention. In the past we have settled claims relating to infringement allegations and agreed to make payments in connection with such settlements. We expect that similar claims will be asserted against us in the future in the ordinary course of our business. An adverse determination in any intellectual property claim could require that we pay damages or stop using technologies found to be in violation of a third party s rights and could prevent us from offering our products and services to others. In order to avoid these restrictions, we may have to seek a license for the technology. This license may not be available on reasonable terms, could require us to pay significant royalties and may significantly increase our operating expenses. The technologies also may not be available for license to us at all. 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 infringing aspects of our business, we may be forced to limit our product and service offerings and may be unable to compete effectively. In addition, at times in the past, we have chosen to defend our licensees from third party intellectual property infringement claims even where such defense was not contractually required, and we may choose to take on such defense in the future. Any of these results could harm our brand, our operating results and our financial condition. In addition, from time to time we are engaged in disputes regarding the licensing of our intellectual property rights, including matters related to our royalty rates and other terms of our licensing arrangements. These types of disputes can be asserted by our customers or prospective customers or by other third parties as part of negotiations with us or in private actions seeking monetary damages or injunctive relief, or in regulatory actions. In the past, licensees have threatened to initiate litigation against us regarding our licensing royalty rate practices, including potential antitrust claims. Damages and requests for injunctive relief asserted in claims like these could be material, and could have a significant impact on our business. Any disputes with our customers or potential customers or other third parties could adversely affect our business, results of operations and prospects.

The licensing of patents constitutes a significant source of our revenue. If we are unable to replace expiring patents with new patents or proprietary technologies, our revenue could decline.

We hold patents covering much of the technology that we license to consumer electronics product manufacturers, and our licensing revenue is tied in large part to the life of those patents. Our right to receive royalties related to our patents terminates with the expiration of the last patent covering the relevant technologies. However, many of our licensees choose to continue to pay royalties for continued use of our trademarks and know how even after the licensed patents have expired, although at a reduced royalty rate. Accordingly, to the extent that we do not continue to replace licensing revenue from technologies covered by expiring patents with licensing revenue based on new patents and proprietary technologies, our revenue could decline.

As of June 26, 2009, we had approximately 1,570 individual issued patents and more than 2,050 pending patent applications in nearly 45 jurisdictions throughout the world. Our issued patents are scheduled to expire at various times through January 2028. Of these, one patent is scheduled to expire in the remainder of calendar year 2009, 110 patents are scheduled to expire in calendar year 2010 and 34 patents are scheduled to expire in calendar year 2011. We derive our licensing revenue principally from our Dolby Digital technologies. Patents relating to our Dolby Digital technologies generally expire between 2010 and 2017, and patents relating to our Dolby Digital Plus technologies, an extension of Dolby Digital, expire between 2019 and 2026. In addition, the remaining patents relating to Dolby Digital Live technologies, an extension of Dolby Digital, are scheduled to expire in 2021.

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Revisions to patent laws and regulations in the U.S. and abroad may adversely impact our ability to obtain, license and enforce our patent rights.

Our licensing business depends in part on the uniform and consistent treatment of patent rights in the U.S. and abroad. Changes to the patent laws and regulations in the U.S. and abroad may limit our ability to obtain, license and enforce our rights. For example, in recent years the U.S. Congress has considered a number of changes to the patent laws including changes to the calculation of damages for patent infringement. In addition, court and administrative rulings may interpret existing patent laws and regulations in ways that adversely affect our ability to obtain, license and enforce our patents. For example, in recent years the U.S. Supreme Court has issued rulings on the standard for determining whether an invention is obvious, which is a key issue when assessing patentability, the ability of a patent holder to obtain injunctive relief against infringers, and the ability of patent licensees to challenge the patents under which they are licensed. The ruling concerning injunctions may make it more difficult, under some circumstances, for us to obtain injunctive relief against a party that has been found to infringe one or more of our patents, and the ruling regarding patent challenges by licensees could potentially make it easier for our licensees to challenge our patents even though they have already agreed to take a license.

Our ability to develop proprietary technology in markets in which open standards are adopted may be limited, which could adversely affect our ability to generate revenue.

Standards-setting bodies, such as those for digital cinema technologies, may require the use of so-called open standards, meaning that the technologies necessary to meet those standards are publicly available. The use of open standards may reduce our opportunity to generate revenue, as open standards technologies are based upon non-proprietary technology platforms in which no one company maintains ownership over the dominant technologies.

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

Sales of our cinema products and services tend to fluctuate based on the underlying trends in the motion picture industry. For example, when box office receipts for the motion picture industry increase, we have typically seen sales of our cinema products increase as well, as cinema owners are more likely to build new theatres and upgrade existing theatres with our more advanced products when they are doing well financially. Conversely, when box office receipts are down cinema owners tend to scale back on plans to expand or upgrade their systems. Our cinema product sales are also subject to fluctuations based on events and conditions in the cinema exhibition industry generally that may or may not be tied to box office receipts in particular time periods. For example, the growth in piracy of motion pictures adversely affects the construction of new screens, the renovation of existing theatres and the continued production of new motion pictures. Technological advances and the conversion of motion pictures into digital formats have made it easier to create, transmit and share high quality unauthorized copies of motion pictures, including on pirated DVDs and on the internet. The launch of new high definition digital services by broadcasters may also influence the sale of our cinema products if consumers decide to watch content at home rather than going to the cinema to watch motion pictures. On the other hand, our services revenue, both in the United States and internationally, is tied to the number of films being made by major studios and independent filmmakers. A number of factors can affect the number of films that are produced, including strikes and work stoppages within the motion picture industry, as well as by the tax incentive arrangements that many foreign governments provide filmmakers to promote local filmmaking.

We may be unable to significantly expand our current product sales in the cinema industry because our products are already used by the vast majority of major cinema operators and major motion picture studios in the United States and much of the rest of the world. If the cinema industry does not expand, or if it contracts, the demand for our cinema products will be adversely affected.

Our ability to further penetrate the market for motion picture sound playback is limited because of the widespread use of our current cinema products by major motion picture content creators, distributors and cinema exhibitors. As a result, our future revenue from our products for the cinema industry will depend, in part, upon events and conditions in that industry, specifically, the continued production and distribution of motion pictures, and the construction of new theatres and the renovation of existing theatres, using our products and services. For example, in the late 1990s cinema operators in the United States built a large number of new cinema megaplexes. This initially resulted in increased sales of our cinema processors, but also resulted in an oversupply of screens in some markets. This oversupply led to significant declines in new theatre construction in the United States in the early 2000s, resulting in a corresponding decline in sales of our cinema processors. As a result, future growth in sales of our existing cinema products may be limited, and may decrease in the future, as the number of new cinemas being built and the number of existing cinemas without our products continues to decline.

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

Although only a small percentage of theatres have adopted digital cinema technologies for the distribution and exhibition of motion pictures, the number of cinema exhibitors adopting digital cinema for new theatre construction or existing theatre upgrades continues to grow. As exhibitors have constructed new theatres or upgraded existing theatres they have generally chosen digital cinema over traditional film cinema and we expect this trend to continue. While our film sound formats are the de facto standard and our film soundtrack cinema processors are widely used around the world, digital cinema, which is based on open standards, does not include our proprietary audio formats. As the film industry continues to adopt digital cinema, the demand for our traditional cinema products and services has declined significantly and we anticipate that the demand for film based products will continue to decline in future periods. Furthermore, exhibitors adopting digital cinema can choose from multiple digital cinema playback servers other than ours, none of which contain our technologies. A continued decrease in the demand for our traditional film cinema products and services that is not accompanied by a meaningful increase in revenue from digital cinema products and services would adversely affect our revenue stream from the cinema industry.

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

Fluctuations in our quarterly and annual operating results may significantly affect the value of our stock.

A number of factors, many of which are outside our control, may cause or contribute to significant fluctuations in our quarterly and annual revenue and operating results. These fluctuations may make financial planning and forecasting more difficult. In addition, these fluctuations may result in unanticipated decreases in our available cash, which could negatively impact our business and prospects. As discussed more fully below, these fluctuations also could increase the volatility of our stock price. Factors that may cause or contribute to fluctuations in our operating results and revenue include:

- Fluctuations in demand for our products and for the consumer electronics products of our licensees;

- Fluctuations in the timing of royalty reports we receive from our licensees, including late, sporadic or inaccurate reports;

- Sporadic payments we may be able to recover from companies utilizing our technologies without licenses;

- Corrections to licensees reports received in periods subsequent to those in which the original revenue was reported;

- Introduction or enhancement of products, services and technologies by us, our licensees and our competitors, and market acceptance of these new or enhanced products, services and technologies;

- Rapid, wholesale changes in technology in the entertainment industries in which we compete;

- Events and conditions in the motion picture industry, including box office receipts that affect the number of theatres constructed, the number of movies produced and exhibited, the general popularity of motion pictures and strikes by motion picture industry participants;

- The financial resources of cinema operators available to buy our products or to equip their theatres to accommodate upgraded or new technologies;

Adverse developments in general macroeconomic conditions;

- Consolidation by participants in the markets in which we compete, which could result among other things in pricing pressure;
- The amount and timing of our operating costs, capital expenditures and related charges, including those related to the expansion or consolidation of our business, operations and infrastructure;
- Variations in the time-to-market of our technologies in the entertainment industries in which we operate;
- Seasonal electronics product shipment patterns by our consumer electronics product licensees, particularly in the first quarter, which generally result in revenue in the second quarter;
- The impact of, and our ability to react to, interruptions in the entertainment distribution chain, including as a result of work stoppages at our facilities, our customers facilities and other points throughout the entertainment distribution chain;
- Changes in business cycles that affect the markets in which we sell our products and services or the markets for consumer electronics products incorporating our technologies;
- Adverse outcomes of litigation or governmental proceedings, including any foreign, federal, state or local tax assessments or audits;
- Costs of litigation and intellectual property protection; and
- Seasonal demand for services in the motion picture industry, which could result in reduced revenue.

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

If securities or industry analysts publish inaccurate or unfavorable research about our business, our stock price could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. If one or more of the analysts who cover us or our industry downgrade our stock or the stock of other companies in our industry, or publish inaccurate or unfavorable research about our business or industry, our stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, demand for our stock could decrease, which might cause our stock price and trading volume to decline.

Some of our customers are also our current or potential competitors, and if those customers were to choose to use their competing technologies rather than ours, our business and operating results would be adversely affected.

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

Surround sound technologies could be treated as a commodity in the future, which could adversely affect our business, operating results and prospects.

We believe that the success we have had licensing our surround sound technologies to consumer electronics product manufacturers is due, in part, to the strength of our brand and the perception that our technologies provide a high quality solution for surround sound. However, as applications that incorporate surround sound technologies become increasingly prevalent, we expect more competitors to enter this field with other solutions. Furthermore, to the extent that competitors solutions are perceived, accurately or not, to provide the same advantages as our technologies, at a lower or comparable price, there is a risk that sound encoding technologies such as ours will be treated as commodities, resulting in loss of status of our technologies, decline in their use, and significant pricing pressure. To the extent that our audio technologies become a commodity, rather than a premium solution, our business, operating results and prospects could be adversely affected.

We may face many challenges in conducting our joint licensing programs or patent pools .

We license some of our patents through our wholly owned subsidiary Via Licensing Corporation in joint licensing programs, or patent pools, with other companies in an effort to ensure that our technologies are compatible with other technologies in the entertainment industry and to promote our technologies as industry standards. These patent pools allow product manufacturers streamlined access to selected foundational technologies and are comprised of a group of patents held by a number of companies, including us in some cases, and administered by Via Licensing. If we do not identify new or changing market trends and technologies at an early enough stage to capitalize on market opportunities for joint licensing programs, we may not continue to be successful with this business model. Also, to the extent that Dolby technologies are included in patent pools, we have less control over the licensing of those technologies through the patent pools compared to licensing through our traditional business model in which we license our patents as bundles of technologies and interact directly with our customers. In addition, we may have less control over the application and quality control of our technologies included in these pools.

The loss of or interruption in operations of one or more of our key suppliers could materially delay or stop the production of our products and impair our ability to generate revenue.

Our reliance on outside suppliers for some of the key materials and components we use in manufacturing our products involves risks, including limited control over the price, timely delivery and quality of such components. We have no agreements with our suppliers to ensure continued supply of materials and components. Although we have identified alternate suppliers for most of our key materials and components, any required changes in our suppliers could cause material delays in our production operations and increase our production costs. In addition, our suppliers may not be able to meet our future production demands as to volume, quality or timeliness. Moreover, we rely on sole source suppliers for some of the components that we use to manufacture our products, including specific charged coupled devices, light emitting diodes and digital signal processors. These sole source suppliers may become unable or unwilling to deliver these components to us at an acceptable cost or at all, which could force us to redesign those specific products. Our inability to obtain timely delivery of key components of acceptable quality, any significant increases in the prices of components, or the redesign of our products could result in material production delays, increased costs and reductions in shipments of our products, any of which could increase our operating costs, harm our customer relationships or materially and adversely affect our business and operating results.

Revenue from our products may suffer if our production processes encounter problems or if we are not able to match our production capacity to fluctuating levels of demand.

Our products are highly complex, and production difficulties or inefficiencies can interrupt production, resulting in our inability to deliver products on time in a cost effective manner, which could harm our competitive position. We recently consolidated our manufacturing operations into a single location and engaged contract manufacturers to begin producing some of our higher volume product lines as needed. Our reliance on contract manufacturers for the manufacture of our higher volume products involves risks, including limited control over timely delivery and quality of such products. If production of our products is interrupted as a result of the consolidation, our use of contract manufacturers or otherwise, we may not be able to manufacture products on a timely basis, and customers may purchase products from our competitors. A shortage of manufacturing capacity for our products could adversely affect our operating results and damage our customer relationships. We generally cannot quickly adapt our manufacturing capacity to rapidly changing market conditions and a contract manufacturer may encounter difficulties as well. Likewise, we may be unable to respond to fluctuations in customer demand. At times we underutilize our manufacturing facilities as a result of reduced demand for some of our products. Any inability to respond to fluctuations in customer demand for our products may adversely affect our gross margins.

Our products, from time to time, experience quality problems that can result in decreased sales and higher operating expenses.

Our products are complex and sometimes contain undetected software or hardware errors, particularly when first introduced or when new versions are released. In addition, to the extent that we engage contract manufacturers we will not have as much control over manufacturing which could result in quality problems. Furthermore, our products are sometimes combined with or incorporated into products from other vendors, sometimes making it difficult to identify the source of a problem. These errors could result in a loss of or delay in market acceptance of our products or cause delays in delivering them and meeting customer demands, any of which could reduce our revenue and raise significant customer relations issues. In addition, if our products contain errors we could be required to replace or reengineer them, which would increase our costs. Moreover, if any such errors cause unintended consequences, we could face claims for product liability. Although we generally attempt to contractually limit liability for defective products to the cost of repairing or replacing these products, if these contract provisions are not enforced, or are unenforceable for any reason, or if liabilities arise that are not effectively limited, we could incur substantial costs in defending and settling product liability claims.

Awareness of our brand depends to a significant extent upon decisions by our customers to display our trademarks on their products, and if our customers do not display our trademarks on their products, our ability to increase our brand awareness may be harmed.

Because we engage in relatively little direct brand advertising, the promotion of our brand depends upon entertainment industry participants displaying our trademarks on their products that incorporate our technologies, such as film prints and consumer electronics products. Although we do not require our customers to place our brand on their products, we actively encourage them to do so. For example, we rely on consumer electronics product manufacturers that license our technologies to display our trademarks on their products in order to promote our brand. If our customers choose for any reason not to display our trademarks on their products, our ability to maintain or increase our brand awareness may be harmed, which would have an adverse effect on our business and prospects. In addition, if we fail to maintain high quality standards for our products, or the products that incorporate our technologies through the quality control evaluation process that we require of our licensees, the strength of our brand could be adversely affected.

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

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

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

From time to time, one or a small number of our customers or licensees may represent a significant percentage of our products, services or licensing revenue. For example, revenue from two customers represented 10% of total revenue for each customer for the fiscal year-to-date period ended June 26, 2009. Although we have agreements with many of these customers, these agreements typically do not require any minimum purchases or minimum royalty fees and do not prohibit customers from purchasing products and services from competitors. A decision by any of our major customers or licensees not to use our technologies, or their failure or inability to pay amounts owed to us in a timely manner, or at all, whether due to strategic redirections or adverse changes in their businesses or for other reasons, could have a significant adverse effect on our operating results.

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

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

We also face increasing complexity in our product design as we adjust to new and future requirements relating to the materials composition of our products. For example, we redesigned our products so we could continue to offer them for sale within the European Union, when restrictions on lead and other hazardous substances that apply to specified electronic products put on the market in the European Union became effective as of July 1, 2006. Similar requirements related to marking of electronic products became effective in China as of March 1, 2007. For some products, substituting particular components containing regulated hazardous substances is more difficult or costly, and additional redesign efforts could result in production delays. Selected electronic products that we maintain in inventory may be rendered obsolete if not in compliance with the new environmental laws, which could negatively impact our ability to generate revenue from those products.

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

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

Our business is dependent upon our patents, trademarks, trade secrets, copyrights and other intellectual property rights. Licensing revenue represented 80%, 84% and 82% of our total revenue in the fiscal years 2007, 2008 and the fiscal year-to-date period ended June 26, 2009, respectively. Effective intellectual property rights protection, however, may not be available under the laws of every country in which our products and services and those of our licensees are distributed. Also, the efforts we have taken to protect our proprietary rights may not be sufficient or effective. Any significant impairment of our intellectual property rights could harm our business or our ability to compete. In addition, protecting our intellectual property rights is costly and time consuming. We have taken steps in the past to enforce our intellectual property rights and expect to continue 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. For example, we have many times experienced, and expect to continue to experience, problems with consumer electronics product manufacturers incorporating our technologies into their products without our authorization. If we are unable to successfully identify and stop unauthorized use of our intellectual property, we could experience increased operational and enforcement costs, which could adversely affect our financial condition and results of operations. We generally seek patent protection for our innovations. However, it is possible that some of these innovations may not be protectable. In addition, given the costs of obtaining patent protection, we may choose not to protect particular innovations that later turn out to be important. Moreover, we have limited or no patent protection in particular foreign jurisdictions. For example, in China we have only limited patent protection, especially with respect to our Dolby Digital technologies, and in India we have no issued patents. Furthermore, there is always the possibility, despite our efforts, that the scope of the protection gained will be insufficient or that an issued patent may later be found to be invalid or unenforceable. Moreover, we seek to maintain select intellectual property as trade secrets. These trade secrets could be compromised by third parties, or intentionally or accidentally by our employees, which would cause us to lose the competitive advantage resulting from them.

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

We maintain an investment portfolio of various holdings, types and maturities, including money market funds, U.S. government agency securities, variable rate demand notes, auction rate certificates and municipal debt securities. These investments are subject to general credit, liquidity, market and interest rate risks.

Our long-term investments include auction rate certificates at fair value. Auctions for these instruments began failing during the second quarter of fiscal 2008 and continued to fail through the end of our third quarter of fiscal 2009, resulting in our inability to liquidate these securities. Moreover, a liquid secondary market has not developed for these instruments. In November 2008, we accepted a rights offering from UBS AG, which we refer to, along with its wholly owned subsidiaries UBS Financial Services, Inc. and UBS Securities LLC, as UBS, to liquidate our auction rate certificates held in UBS accounts on February 13, 2008. The rights offering provides us with rights (the Put Rights) to sell our auction rate certificates for a price equal to the liquidation preference of the auction rate certificates plus accrued but unpaid dividends or interest, if any, at any time during a two year period from June 30, 2010 through July 2, 2012. There is a risk that UBS will not perform its obligations in accordance with their offer and consequently we may have to write down the value of the Put Rights. Furthermore, there is no assurance that we will be able to recoup our investments in the auction rate certificates.

If the global credit market continues to deteriorate, other components of our investment portfolio may be adversely impacted. While as of the date of this filing, we are not aware of any other downgrades, losses, failed auctions or other significant deterioration in the fair value of our cash, cash equivalents or investments, no assurance can be given that any further deterioration of the global credit and financial markets will not negatively impact our investments or our ability to meet our investment objectives. Such negative impact, should it arise, could require an impairment charge, which would adversely impact our financial results.

We face risks associated with international trade and currency exchange.

We maintain sales, marketing and business operations in foreign countries, most significantly in the United Kingdom. Consequently, we are exposed to fluctuations in exchange rates associated with the local currencies of our foreign business operations. While nearly all of our revenue is derived from transactions denominated in U.S. dollars, nearly all of our costs from our foreign operations are denominated in the currency of that foreign location. Consequently, exchange rate fluctuations between the U.S. dollar and other currencies could have a material impact on our profitability.

Failure to comply with applicable current and future government regulations could have a negative effect on our business.

Our operations and business practices are subject to federal, state and local government laws and regulations, as well as international laws and regulations, including those relating to consumer and other safety related compliance for electronic equipment, as well as compulsory license requirements as a prerequisite to being included as part of industry standards, such as the United States HDTV standard. Any failure by us to comply with the laws and regulations applicable to us or our products could result in our inability to sell those products, additional costs to redesign products to meet such laws and regulations, fines or other administrative actions by the agencies charged with enforcing compliance and, possibly, damages awarded to persons claiming injury as the result of our non-compliance. Changes in or enactment of new statutes, rules or regulations applicable to us could have a material adverse

effect on our business.

The loss of members of our management team could substantially disrupt our business operations.

Our success depends to a significant degree upon the continued individual and collective contributions of our management team. A limited number of individuals have primary responsibility for managing our business, including our relationships with key customers and licensees. These individuals, as well as the rest of our management team and key employees, are at-will employees, and we do not maintain any key person life insurance policies. Losing the services of any key member of our team, whether from retirement, competing offers or other causes, could prevent us from executing our business strategy, cause us to lose key customer or licensee relationships, or otherwise materially affect our operations.

We rely on highly skilled personnel, and if we are unable to retain or motivate key personnel or hire qualified personnel, we may not be able to maintain our operations or grow effectively.

Our performance is largely dependent on the talents and efforts of highly skilled individuals. Our future success depends on our continuing ability to identify, hire, develop, motivate and retain highly skilled personnel for all areas of our organization. We have maintained a rigorous, highly selective and time consuming hiring process, which we believe has significantly contributed to our success to date, but has made it more difficult for us to hire a sufficient number of qualified employees. As we grow, our hiring process may prevent us from hiring the personnel we need

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in a timely manner. In addition, we are aware that some of our competitors have directly targeted our employees. If we are unable to hire and train a sufficient number of qualified employees or retain and motivate existing employees, our existing operations may suffer and we may be unable to grow effectively.

If we fail to maintain proper and effective internal controls, our ability to produce accurate financial statements could be impaired, which could adversely affect our operating results, our ability to operate our business and our investors views of us.

We have a complex business organization that is international in scope. Ensuring that we have adequate internal financial and accounting controls and procedures in place to help ensure that we can produce accurate financial statements on a timely basis is a costly and time consuming effort that needs to be re-evaluated frequently. On an ongoing basis, we document, review and, if appropriate, improve our internal controls and procedures in connection with Section 404 of the Sarbanes-Oxley Act, which requires annual management assessments of the effectiveness of our internal controls over financial reporting and a report by our independent auditors addressing these assessments. Both we and our independent auditors periodically test our internal controls in connection with the Section 404 requirements and could, as part of that documentation and testing, identify areas for further attention or improvement. Implementing any appropriate changes to our internal controls may require specific compliance training of our directors, officers and employees, entail substantial costs in order to modify our existing accounting systems, and take a significant period of time to complete. Such changes may not, however, be effective in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and could materially impair our ability to operate our business. In addition, investors perceptions that our internal controls are inadequate or that we are unable to produce accurate financial statements may seriously affect our stock price.

Changes in, or interpretations of, accounting principles could result in unfavorable accounting charges.

We prepare our condensed consolidated financial statements in accordance U.S. GAAP. These principles are subject to interpretation by the SEC and various bodies formed to interpret and create appropriate accounting principles. A change in these principles can have a significant effect on our reported results and may even retroactively affect previously reported transactions. Our accounting principles that recently have been or may be affected by changes in the accounting principles are as follows:

- software revenue recognition;
- accounting for stock-based compensation;
- accounting for income taxes; and
- accounting for business combinations and related goodwill.

For example, in December 2007, the FASB issued SFAS 141R which changes the accounting for business combinations including the measurement of acquirer shares issued in consideration for a business combination, the recognition of contingent consideration, the accounting for pre-acquisition gain and loss contingencies, the recognition of capitalized in-process research and development, the accounting for acquisition related restructuring liabilities, the treatment of acquisition related transaction costs and the recognition of changes in the acquirer s income tax valuation allowance.

For the foreseeable future, Ray Dolby or his affiliates will be able to control the selection of all members of our board of directors, as well as virtually every other matter that requires stockholder approval, which will severely limit the ability of other stockholders to influence corporate matters.

At June 26, 2009, Ray Dolby and his affiliates owned 100 shares of our Class A common stock and 60,000,000 shares of our Class B common stock. As of June 26, 2009, Ray Dolby and his affiliates, including his family members, had voting power of approximately 99% of our outstanding Class B common stock, which in the aggregate represented approximately 91% of the combined voting power of our outstanding Class A and Class B common stock. Under our certificate of incorporation, holders of Class B common stock are entitled to ten votes per share while holders of Class A common stock are entitled to one vote per share. Generally, shares of Class B common stock automatically convert into shares of Class A common stock upon transfer of such Class B common

stock, other than transfers to certain specified persons and entities, including the spouse and descendants of Ray Dolby and the spouses and domestic partners of such descendants. Because of this dual class structure, Ray Dolby, his affiliates, and his family members and descendants will, for the foreseeable future, have significant influence over our management and affairs, and will be able to control virtually all matters requiring stockholder approval, including the election of directors and significant corporate transactions such as mergers or other sales of our company or assets, even if they come to own considerably less than 50% of the total number of outstanding shares of our Class A and Class B common stock. Ray Dolby, his affiliates, his family members and descendants will maintain this control even if in the future they come to own considerably less than 50% of the total number of outstanding shares of our Class A and Class B common stock. Moreover, these persons may take actions in their own interests that you or our other stockholders do not view as beneficial. Absent a transfer of Class B common stock that would trigger an automatic conversion as described above, there is no threshold or time deadline at which the shares of Class B common stock will automatically convert into shares of Class A common stock. Assuming conversion of all shares of Class B common stock held by persons not affiliated with Ray Dolby into shares of Class A common stock, so long as Ray Dolby and his affiliates, his family members and descendants continue to hold shares of Class B common stock representing approximately 10% or more of the total number of outstanding shares of our Class A and Class B common stock, they will hold a majority of the combined voting power of the Class A and Class B common stock.

Future sales of shares by insiders could cause our stock price to decline.

If our founder, officers, directors or employees sell, or indicate an intention to sell, substantial amounts of our Class A common stock in the public market, including shares of Class A common stock issuable upon conversion of shares of Class B common stock, the trading price of our Class A common stock could decline. As of June 26, 2009, we had a total of 113,480,939 shares of Class A and Class B common stock outstanding. Of these shares, 31,625,000 shares of Class A common stock were sold in our initial public offering by us and the selling stockholders, and an additional 8,000,000 shares of Class A common stock were sold in a secondary offering in May 2007 by our principal stockholder.

As of June 26, 2009, our directors and executive officers beneficially held 60,180,000 shares of Class B common stock, 11,828 shares of Class A common stock, vested options to purchase 474,784 shares of Class B common stock and vested options to purchase 350,583 shares of Class A common stock. We expect that any sale of our Class A common stock by our directors and executive officers would be subject to compliance with Rule 144 under the Securities Act.

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

Sales of Unregistered Securities

In the fiscal quarter ended June 26, 2009, we issued an aggregate of 167,925 shares of our Class B common stock to certain employees, officers and directors upon the exercise of options awarded under our 2000 Stock Incentive Plan and since June 27, 2009 through July 16, 2009, we issued an aggregate of 40,830 shares of our Class B common stock to certain employees and officers upon the exercise of options awarded under our 2000 Stock Incentive Plan. We received aggregate proceeds of approximately $0.5 million in the fiscal quarter ended June 26, 2009, and approximately $0.1 million in the period since June 27, 2009 through July 16, 2009 as a result of the exercise of these options. We believe these transactions were exempt from the registration requirements of the Securities Act in reliance on Rule 701 thereunder as transactions pursuant to compensatory benefit plans and contracts relating to compensation as provided under Rule 701. As of July 16, 2009, options to purchase an aggregate of 1,909,024 shares of our Class B common stock remain outstanding. All issuances of shares of our Class B common stock pursuant to the exercise of these options will be made in reliance on Rule 701. All option grants made under the 2000 Stock Incentive Plan were made prior to the effectiveness of our initial public offering. No further option grants will be made under our 2000 Stock Incentive Plan.

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

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

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ITEM 6. EXHIBITS

Exhibit Number	Description
10.1*	Offer Letter dated April 21, 2009, by and between Murray J. Demo and Dolby Laboratories, Inc., a California corporation
31.1	Certification by the Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by the Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification by the Chief Executive Officer and the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Denotes a management contract or compensatory arrangement
Furnished herewith

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SIGNATURES

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

Date: July 30, 2009

DOLBY LABORATORIES, INC.

By: /s/ Murray J. Demo
Murray J. Demo
Chief Financial Officer
(Principal Financial and Accounting Officer and Duly Authorized Officer)

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