BOSTON BEER CO INC
Form 10-K
February 20, 2013
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 29, 2012

OR

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

For the transition period from to .

Commission file number: 1-14092

THE BOSTON BEER COMPANY, INC.

(Exact name of registrant as specified in its charter)

Massachusetts	**04-3284048**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

One Design Center Place, Suite 850, Boston, Massachusetts

(Address of principal executive offices)

02210

(Zip Code)

(617) 368-5000

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Class A Common Stock	NYSE

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No þ

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 þ 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 þ No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulations S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act)

Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨

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

The aggregate market value of the Class A Common Stock ($.01 par value) held by non-affiliates of the registrant totaled $1,010.6 million (based on the average price of the Company s Class A Common Stock on the New York Stock Exchange on June 30, 2012). All of the registrant s Class B Common Stock ($.01 par value) is held by an affiliate.

As of February 15, 2013, there were 8,758,696 shares outstanding of the Company s Class A Common Stock ($.01 par value) and 4,107,355 shares outstanding of the Company s Class B Common Stock ($.01 par value).

DOCUMENTS INCORPORATED BY REFERENCE

Certain parts of the registrant s definitive Proxy Statement for its 2013 Annual Meeting to be held on May 29, 2013 are incorporated by reference into Part III of this report.

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THE BOSTON BEER COMPANY, INC. AND SUBSIDIARIES

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PART I

Item 1. ***Business***
General

The Boston Beer Company, Inc. (Boston Beer or the Company) is the largest craft brewer in the United States. In fiscal 2012, Boston Beer sold approximately 2.7 million barrels of its proprietary products (core brands) and brewed or packaged approximately 19,000 barrels under contract (non-core brands) for third parties.

During 2012, the Company sold over fifty beers under the Samuel Adams® or the Sam Adams® brand names, ten flavored malt beverages under the Twisted Tea® brand name, five hard cider beverages under the Angry Orchard ® brand name, and five beers under two brand names under its Alchemy & Science subsidiary. Boston Beer produces malt beverages and hard cider at Company-owned breweries and under contract arrangements at other brewery locations. The Company-owned breweries are located in Boston, Massachusetts (the Boston Brewery), Cincinnati, Ohio (the Cincinnati Brewery), Breinigsville, Pennsylvania (the Pennsylvania Brewery) and Los Angeles, California, (the Angel City Brewery).

The Company s principal executive offices are located at One Design Center Place, Suite 850, Boston, Massachusetts 02210, and its telephone number is (617) 368-5000.

Beer Industry Background

Before Prohibition, the United States beer industry consisted of hundreds of small breweries that brewed full-flavored beers. After the end of Prohibition, most domestic brewers shifted production to less flavorful, lighter beers, which use lower-cost ingredients, and can be mass-produced to take advantage of economies of scale in production. This shift towards mass-produced beers coincided with consolidation in the beer industry. Today, two major brewers, Anheuser-Busch InBev (AB InBev) and MillerCoors LLC (MillerCoors), comprise over 90% of all United States domestic beer production, excluding imports.

The Company s beers are primarily positioned in the Better Beer category of the beer industry, which includes craft (small, independent and traditional) brewers, domestic specialty beers and most imports. Better Beers are determined by higher price, quality, image and taste, as compared with regular domestic beers. Samuel Adams® is one of the largest brands in the Better Beer category of the United States brewing industry. In addition, AB InBev and MillerCoors have entered the Better Beer category, either by developing their own domestic specialty beers, acquiring, in whole or part, existing craft brewers, or by importing and distributing foreign brewers brands. The Company estimates that in 2012 the craft beer category grew approximately 11% to 13%, and the Better Beer category was up approximately 6% to 7%, while the total beer category was up approximately 1%. The Company believes that the Better Beer category is approximately 22% of United States beer consumption by volume.

The domestic beer industry, excluding Better Beers, has experienced a decline in shipments over the last ten years. The Company believes that this decline is due to declining alcohol consumption per person in the population, drinkers trading up to drink high quality, more flavorful beers and increased competition from wine and spirits companies. During the past thirty years, domestic light beers, which are beers with fewer calories than the brewers traditional beers, have experienced significant growth within the industry and now have a higher market share than traditional beers.

The Company s *Twisted Tea* product line competes primarily within the flavored malt beverage (FMB) category of the beer industry. FMB s, such as *Twisted Tea*, Smirnoff Ice®, Mike s Hard Lemonade®, and Bud Light Lime®Lime-a-Rita are flavored malt beverages that are typically priced competitively with Better Beers. The Company believes that the FMB category comprises approximately 2% of United States beer consumption. The Company believes that the volume comprising the FMB category increased 9% in 2012 and that the increased volume in 2012 was due to the launch of Bud Light Lime® Lime-a-Rita which made up most of the category s growth.

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The Company s *Angry Orchard* product line competes within the hard cider category. Hard ciders are typically priced competitively with Better Beers and may compete with beer, wine, spirits, or FMBs for drinkers. Some of these competitors include C&C Group PLC under the brand names Woodchuck , Magners and Hornsby s ; Heineken under the brand name Strongbow ; MillerCoors under the brand name Crispin Cider ABI InBev under Michelob Ultra Cider. The Company believes that the hard cider category comprises less than 0.5% of United States beer consumption and that the volume comprising the hard cider category increased 60% to 70% in 2012.

Narrative Description of Business

The Company s business goal is to become the leading brewer in the Better Beer category by creating and offering high quality full-flavored beers. With the support of a large, well-trained sales organization and world-class brewers, the Company strives to achieve this goal by brewing great products, and increasing brand availability and awareness through advertising, point-of-sale, promotional programs and drinker education.

Products Marketed

The Company s product strategy is to create and offer a world-class variety of traditional and innovative beers and other alcoholic beverages with a focus on promoting the Samuel Adams® product line. In most markets, the Company focuses its advertising and promotional dollars on Samuel Adams Boston Lager® and Samuel Adams® Seasonal Beers.

The Samuel Adams® Brewmaster s Collection is an important part of the Company s portfolio and heritage, but receives limited promotional support. The Small Batch Collection, Barrel Room Collection and Limited Edition Beers are produced in limited quantities and are sold at higher prices than the Company s other products. The *Twisted Tea* brand family has grown each year since the product was first introduced and has established a drinker following in several markets. The *Angry Orchard* brand family was launched in the second half of 2011 in several markets. In 2012, the Company completed its national distribution for both *Twisted Tea* and *Angry Orchard* brand families.

The following is a list of significant continuing styles as of December 29, 2012:

	Year First Introduced
Core Focus Beers	
Samuel Adams Boston Lager® (Flagship brand)	1984
Sam Adams Light®	2001
Seasonal Beers	
Samuel Adams Octoberfest	1989
Samuel Adams Winter Lager	1989
Samuel Adams Summer Ale	1996
Samuel Adams Alpine Spring	2011
Seasonal Limited Releases	
Samuel Adams Porch Rocker	2012
Samuel Adams Harvest Pumpkin Ale	2010
Samuel Adams White Christmas	2012

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	Year First Introduced
Brewmaster s Collection	
Samuel Adams Boston Ale	1987
Samuel Adams Cream Stout	1993
Samuel Adams Cherry Wheat®	1995
Samuel Adams Black Lager	2005
Samuel Adams Irish Red	2008
Samuel Adams Blackberry Witbier	2009
Samuel Adams Coastal Wheat	2009
Samuel Adams Noble Pils	2009
Samuel Adams Latitude 48 IPA	2010
Samuel Adams Whitewater IPA	2011
Small Batch Collection	
Samuel Adams Double Bock	1988
Samuel Adams Imperial White	2009
Samuel Adams Imperial Stout	2009
Samuel Adams Wee Heavy	2011
Samuel Adams Tasman Red	2011
Samuel Adams Third Voyage	2011
Samuel Adams The Vixen	2011
Samuel Adams Griffin s Bow	2011
Samuel Adams Dark Depths	2012
Samuel Adams Norse Legend	2012
Samuel Adams Verloren	2012
Samuel Adams Cinder Bock	2012
Samuel Adams Fat Jack	2012
Samuel Adams Merry Mischief	2012
Barrel Room Collection	
Samuel Adams American Kriek	2009
Samuel Adams Stony Brook Red	2009
Samuel Adams New World Tripel	2009
Samuel Adams Thirteenth Hour	2011
Limited Edition Beers	
Samuel Adams Utopias®	2001
Infinium™	2010
Flavored Malt Beverages	
Twisted Tea Hard Iced Tea	2001
Twisted Tea Raspberry Hard Iced Tea	2001
Twisted Tea Half Hard Iced Tea & Half Hard Lemonade	2003
Twisted Tea Peach Hard Iced Tea	2005
Twisted Tea Light Hard Iced Tea	2007
Twisted Tea Sun-Tea Style Hard Iced Tea	2009
Twisted Tea Blueberry Hard Iced Tea	2011
Twisted Tea Cranberry Hard Iced Tea	2012
Twisted Tea Mango Hard Iced Tea	2012
Twisted Tea Black Cherry Hard Iced Tea	2012
Hard Cider	
Angry Orchard Crisp Apple Hard Cider	2011
Angry Orchard Apple Ginger Hard Cider	2011
Angry Orchard Traditional Dry Hard Cider	2011
Angry Orchard Iceman Hard Cider	2012
Angry Orchard Strawman Hard Cider	2012

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Certain products may be produced at select times during the year solely for inclusion in the Company s variety packs. During 2012, *Samuel Adams* Mighty Oak Ale, was brewed and included in the *Samuel Adams* Brewers Choice Variety Mix Pack, *Samuel Adams* Belgian Session and *Samuel Adams* East West Kolsh were brewed and included in the Summer Styles variety pack, *Samuel Adams* Dunkelweizen and *Samuel Adams* Hazel Brown Ale were brewed and included in the Harvest Collection variety pack and *Samuel Adams* Chocolate Bock, *Samuel Adams* Old Fezziwig® Ale and *Samuel Adams* Holiday Porter were brewed and included in the *Samuel Adams* Winter Classics variety pack.

During 2012, the Company released *Samuel Adams* IPA Hopology Variety Mix Pack, a specialty variety pack which included *Samuel Adams* Latitude 48 IPA, *Samuel Adams* Whitewater IPA and *Samuel Adams* Grumpy Monk Belgian IPA along with three Small Batch IPA beers, *Samuel Adams* Dark Depths, *Samuel Adams* Tasman Red and *Samuel Adams* Third Voyage. Also, the Company released *Samuel Adams* Hop Tour Variety Six Pack, a specialty variety six pack which included *Samuel Adams* Latitude 48 IPA and *Samuel Adams* Whitewater IPA and *Samuel Adams* Noble Pils.

Also during 2012, the Company released a variety of specialty draft beers brewed in limited quantities for its Single Batch Series, festivals and Beer Week celebrations.

In 2012, the Company completed its national rollout for both the *Twisted Tea* and *Angry Orchard* brand families. The company believes the gross profits from these brands have helped the Company increase its investment in Samuel Adams and have built a stronger Boston Beer brand portfolio with wholesalers and retailers. The Company will continue to look for complementary opportunities to leverage its capabilities, provided that they do not distract from its primary focus on its Samuel Adams brand.

The Company continually evaluates the performance of its various beers, flavored malt beverages and hard cider styles and the rationalization of its product line, as a whole. Periodically, the Company discontinues certain styles, *Samuel Adams* Pale Ale and *HardCore* cider were discontinued during 2012. Certain styles discontinued in previous years may be produced for the Company s variety packs or reintroduced.

Product Innovations

The Company is committed to maintaining its position as a leading innovator in the Better Beer category by developing new products that allow the *Samuel Adams* beer drinker to try new styles of malt beverages. To that end, the Company continually test brews different beers and occasionally sells them under various brand labels for evaluation of drinker interest. The Company also promotes the annual *LongShot* American Homebrew Contest® in which *Samuel Adams* beer drinkers and employees of the Company submit homebrews for inclusion in the *LongShot*® six-pack in the following year. During the year, the Company sold over fifty *Samuel Adams* beers commercially and brewed many more test brews. The Company s Boston Brewery spends most of its time ideating, testing and developing beers and ciders for the Company s potential future commercial development.

In late 2011, the Company formed a subsidiary, A&S Brewing Collaborative LLC, d/b/a Alchemy & Science, headed by Alan Newman, founder of Magic Hat Brewing, as a craft brew incubator headquartered in Burlington, Vermont. The mission of Alchemy & Science is to find new opportunities in craft brewing which may be geographical or stylistic and some may be with existing breweries or brewpubs. Alchemy & Science will be looking for unique brewing techniques and ingredients, as well as hunting for ancient or new recipes and beer styles to develop and introduce to beer lovers, and will have the brewing talents and broad resources of the Company as it looks for opportunities around the country. During the first quarter of 2012, Alchemy and Science purchased the assets of Southern California Brewing Company, Inc., a Los Angeles based craft brewer doing business as Angel City Brewing Company. During 2012, Angel City Brewery launched two new beers, Angeleno IPA and Eureka Wit on draft in the Los Angeles market, and the Angel City Brewery and Beer Hall in downtown Los Angeles opened to the public in the first quarter of 2013. Also during 2012, Alchemy & Science formed

House of Shandy (later renamed Traveler Beer Co.) which rolled out in test markets with its Curious Traveler and Tenacious Traveler shandy style beers. The Traveler Beer Co. is likely to roll-out more markets in 2013. These projects have had minimal sales to date.

Sales, Distribution and Marketing

The Company sells its products to a network of approximately 340 wholesale distributors. These distributors, in turn, sell the products to retailers, such as pubs, restaurants, grocery, convenience stores, package stores, stadiums and other retail outlets, where the products are sold to drinkers. With few exceptions, the Company s products are not the primary brands in distributors portfolios. Thus, the Company, in addition to competing with other malt beverages for a share of the drinker s business, competes with other brewers for a share of the distributor s attention, time and selling efforts.

The Company sells its products predominantly in the United States, but also has markets in Canada, Europe, Israel, the Caribbean, the Pacific Rim and Mexico. During 2012, the Company s largest customer accounted for approximately 6% of the Company s net sales. The top three customers accounted for approximately 12%, collectively. In some states, the terms of the Company s contracts with its distributors may be affected by laws that restrict the enforcement of some contract terms, especially those related to the Company s right to terminate the services of its distributors.

Most core brands are shipped within days of completion and there has not been any significant product order backlog. The Company has historically received most of its orders in the first week of a month for products to be shipped the following month and would carry three to five weeks of packaged inventory (usually at ambient temperatures) and three to four weeks of draft inventory.

In an effort to reduce both the time and temperature the Company s beers experience at wholesaler warehouses before reaching the market, the Company introduced its Freshest Beer Program with domestic wholesalers in several markets in late 2010. The goal of the Freshest Beer Program is to provide better on-time service, forecasting, production planning and cooperation with the wholesalers, while substantially reducing inventory levels at the wholesaler. At December 29, 2012, the Company had 89 wholesalers participating in the program at various stages of inventory reduction, which constitutes over 59% of its volume. The Company believes that by the end of 2013 between 65% and 75% of its volume will be in the Freshest Beer Program. The Company successfully reduced the inventories of participating wholesalers by approximately two weeks, resulting in fresher beer being delivered to retail. The Freshest Beer Program has resulted in lower shipments of approximately 50,000, 133,000 and 241,000 case equivalents in 2010, 2011 and 2012, respectively, when measured at the end of the year, which historically has been the low point of the year for wholesaler inventories. The wholesaler ordering process has changed significantly for wholesalers that participate in the Freshest Beer Program and has resulted in a shorter period between order placement and shipment. There are various risks associated with the Freshest Beer Program that are discussed in *Risk Factors* below.

During 2012, Boston Beer had a sales force of approximately 330 people, which the Company believes is one of the largest in the domestic beer industry. The Company s sales organization is designed to develop and strengthen relations at each level of the three-tier distribution system by providing educational and promotional programs encompassing distributors, retailers and drinkers. The Company s sales force has a high level of product knowledge and is trained in the details of the brewing and selling processes. Sales representatives typically carry hops, barley and other samples to educate wholesale and retail buyers about the quality and taste of the Company s beers. The Company has developed strong relationships with its distributors and retailers, many of which have benefited from the Company s premium pricing strategy and growth.

The Company also engages in media campaigns primarily television, radio, billboards and print. These media efforts are complemented by participation in sponsorships of cultural and community events, local beer festivals, industry-related trade shows and promotional events at local establishments, to the extent permitted under local laws and regulations. The Company uses a wide array of point-of-sale items (banners, neons, umbrellas, glassware, display pieces, signs and menu stands) designed to stimulate impulse sales and continued awareness.

The Company launched a philanthropic program in 2008 called Samuel Adams Brewing the American Dream®. Partnering with ACCION USA, the nation s largest non-profit micro-lender, the program is designed to provide low to moderate income small business owners in the food, beverage and hospitality industries with small loans and support through training and speed coaching programs. Since its inception, the *Samuel Adams Brewing the American Dream* fund at ACCION has made loans of over $1.9 million to over 200 small business owners and craft brewers.

Ingredients and Packaging

The Company has been successful to date in obtaining sufficient quantities of the ingredients used in the production of its beers. These ingredients include:

Malt. The two-row varieties of barley used in the Company s malt are mainly grown in the United States and Canada. The 2012 barley crop in the United States and Canada was consistent with ten-year averages overall in terms of quality and quantity. The 2011, barley crop in the United States and Canada was slightly below ten-year averages overall in terms of quality and quantity. The 2012 and 2011 barley crop prices were significantly above the comparable averages. The Company purchased most of the malt used in the production of its beer from two major suppliers during 2012. The Company currently has a multi-year contract with one supplier, but also believes that there are other malt vendors available that are capable of supplying its needs.

Hops. The Company uses Noble hops varieties for most of its Samuel Adams® beers. Noble hops are produced in several specific growing areas recognized for growing hops with superior taste and aroma properties and include Hallertau-Hallertauer, Tettnang-Tettnanger, Hersbruck-Hersbrucker and Spalt-Spalter from Germany and Saaz-Saazer from the Czech Republic. Noble hops are rare and more expensive than most other varieties of hops. Traditional English hops, namely, East Kent Goldings and English Fuggles, are used in many of the Company s ales and United States hops, namely Ahtanum, Cascade and Simcoe are used in certain of the Companys ales and lagers. The Company enters into purchase commitments with six hops dealers, based on the Company s projected future volumes and brewing needs. The dealers then contract with farmers to meet the Company s needs. The contracts with the hop dealers are denominated in Euros for the German and Czech hops, in Pounds Sterling for the English hops and in US Dollars for United States hops. The Company does not currently hedge its forward currency commitments. The crops harvested in 2012 were consistent with historical averages in terms of both quality and quantity for most hop varieties and the Company expects to realize near full delivery on hops that were contracted for. While under-delivery occurred with some niche varieties, this under-delivery was not significant and is not expected to impact the production of the Company s beers. The Company attempts to maintain approximately two year s supply of essential hop varieties on-hand in order to limit the risk of an unexpected reduction in supply. The Company stores its hops in multiple cold storage warehouses to minimize the impact of a catastrophe at a single site.

Yeast. The Company maintains a supply of proprietary strains of yeast used in its breweries. Since these yeasts would be impossible to duplicate if destroyed, the Company maintains secure supplies in several locations and the strains are stored and protected at an outside laboratory.

Apples. The Company uses special varieties of apples in its ciders that it believes are important for the ciders flavor profile. These apples are purchased from European suppliers and include bittersweet apples from France and culinary apples from Italy. There is limited availability of these apples and many outside factors, including weather conditions, farmers rotating from apples to other crops, government regulations and legislation affecting agriculture, could affect both price and supply. During 2012, the Company experienced shortages of apples that impacted the timing of shipments of ciders to wholesalers. In late 2012, the Company entered into purchase commitments with apple suppliers, designed to cover its 2013 needs. The Company is evaluating entering into multiple year contracts for apples with various suppliers.

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Other Ingredients. The Company maintains competitive sources for most of the other ingredients used in its specialty malt-based and cider products.

Packaging Materials. The Company maintains competitive sources for the supply of certain packaging materials, such as shipping cases, six-pack carriers and crowns. The Company enters into limited-term supply agreements with certain vendors in order to receive preferential pricing. Currently, glass and labels are each supplied by a single source, although the Company believes that alternative suppliers are available.

The Company initiates bottle deposits in some states and reuses glass bottles that are returned pursuant to certain state bottle recycling laws. The Company derives some economic benefit from its reuse of returned glass bottles. The cost associated with reusing the glass varies, based on the costs of collection, sorting and handling, including arrangements with retailers, wholesalers and dealers in recycled products. There is no guarantee that the current economics relating to the use of returned glass will continue or that the Company will continue to reuse returnable bottles.

Quality Assurance

As of December 29, 2012, the Company employed over fifteen brewmasters to monitor the Company s brewing operations and control the production of its beers and ciders. Extensive tests, tastings and evaluations are typically required to ensure that each batch of *Samuel Adams* beer, *Twisted Tea* flavored malt beverage and *Angry Orchard* hard cider conforms to the Company s standards. The Company has on-site quality control labs at each brewery.

With the exception of certain specialty products, the Company includes a clearly legible freshness code on every bottle and keg of its Samuel Adams® products in order to ensure that its customers enjoy only the freshest beer. Boston Beer was the first American brewer to use this practice.

Brewing Strategy

During 2012, the Company brewed and packaged approximately 90% of its core brand volume at Company-owned breweries. The Company had capital investments in 2012 of approximately $67 million to invest in efficiency projects, support the increasing complexity of its portfolio and the Freshest Beer Program, and to expand the quality, capacity and capabilities of its breweries to meet anticipated future growth. The Company expects to invest between $70 million and $85 million in 2013, after which capital investment should return to a level of between $30 million and $50 million, including capacity expansion initiatives to accommodate expected growth; however, the actual amount spent may well be different from these estimates. Under this capital plan, along with expanding the Company s use of production arrangements with third parties, the Company believes it should be able to support the projected growth in 2013. The Company continues to evaluate capacity optimization at its breweries and the potential significant capital required for expansion of absolute capacity at its existing breweries.

The Company-owned breweries are located in Breinigsville, Pennsylvania (Pennsylvania Brewery), Cincinnati, Ohio Cincinnati Brewery), Boston, Massachusetts (Boston Brewery) and Los Angeles, California, (the Angel City Brewery). The Pennsylvania and Cincinnati Breweries produce the full range of the Company s core brands and produce most of the Company s shipment volume. The Pennsylvania Brewery is the Company s largest brewery and the Cincinnati Brewery is the primary brewery for the production of most of the Company s specialty and lower volume products. The Boston Brewery s production is mainly for developing new types of innovative and traditional beers and brewing and packaging beers in the *Samuel Adams* Barrel Room Collection and certain keg beers for the local market. The Angel City Brewery production currently supports draft accounts in the Los Angeles market and on-premise consumption at its beer hall. Product development entails researching market needs and competitive products, sample brewing and market taste testing. Most of the Company s *Samuel Adams* beers are produced at the Boston Brewery in the course of each year.

The Company currently has a brewing and packaging services agreement with City Brewing Company, LLC, to produce its products at facilities in Latrobe, Pennsylvania and La Crosse, Wisconsin and an agreement with Pleasant Valley Wine Company to brew and/or package at facilities in Hammondsport, New York. The Company carefully selects breweries and packaging facilities owned by others with (i) the capability of utilizing traditional brewing methods and (ii) first-rate quality control capabilities throughout brewing, fermentation, finishing and packaging. Under its brewing and packaging arrangements with third parties, the Company is charged a service fee based on units produced at each of the facilities and bears the costs of raw materials, excise taxes and deposits for pallets and kegs and specialized equipment required to brew and package the Company s beers.

The Company believes that it has secured sufficient alternatives in the event that production at any of its brewing locations is interrupted, although as volumes at the Pennsylvania Brewery increase, interruptions there could become more problematic. In addition, the Company may not be able to maintain its current economics if interruptions were to occur and could face significant delays in starting up such replacement brewing locations. Potential interruptions at breweries include labor issues, governmental actions, quality issues, contractual disputes, machinery failures or operational shut downs. Also, as the brewing industry has consolidated, the financial stability of the breweries owned by others where the Company could brew some of its beers, if necessary, and their ability or willingness to meet the Company s needs, has become a more significant concern. The Company continues to work with all of its breweries to attempt to minimize any potential disruptions.

Competition

The Better Beer category within the United States beer market is highly competitive due to the large number of craft brewers and imported beers with similar pricing and target drinkers. The Company anticipates competition and innovation among domestic craft brewers to remain strong, as craft brewers experienced their eighth successive year of growth in 2012 and there were many new startups. The Company estimates there are approximately 3,600 breweries in operation or in the planning stages up from approximately 420 operating craft breweries in 2006. Also, existing craft breweries are building more capacity, expanding geographically, adding more SKUs and styles, as distributors and retailers are promoting and making more shelf space available for more craft beer brands.

Imported beers, such as Corona® and Heineken®, continue to compete aggressively in the United States and have gained market share over the last ten years. These import competitors may have substantially greater financial resources, marketing strength and distribution networks than the Company. The two largest brewers in the United States, MillerCoors and AB InBev, have entered the Better Beer category with domestic specialty beers, either by developing their own beers, acquiring, in whole or part, existing craft brewers, importing and distributing foreign brewers brands or increasing their development and marketing efforts on their own domestic specialty beers that might compete in the Better Beer category.

In June 2012, AB InBev agreed to purchase an additional 50% interest in the Mexican brewer Grupo Modelo, owner of Corona and other imported brands for $20.1 billion, which if completed would result in AB InBev s 100% ownership of Grupo Modelo. This acquisition is currently the subject of a complaint filed by the U.S. Department of Justice Anti-Trust Division.

The Company s products also compete with other alcoholic beverages for drinker attention and consumption. In recent years, wine and spirits have been competing more directly with beers. The Company monitors such activity and attempts to develop strategies which benefit from the drinker s interest in trading up in order to position its beers competitively with wine and spirits.

The Company competes with other beer and alcoholic beverage companies within a three-tier distribution system. The Company competes for a share of the distributor s attention, time and selling efforts. In retail establishments, the Company competes for shelf, cold box and tap space. From a drinker perspective, competition exists for brand acceptance and loyalty. The principal factors of competition in the Better Beer segment of the beer industry include product quality and taste, brand advertising and imagery, trade and drinker promotions, pricing, packaging and the development of new products.

The Company distributes its products through independent distributors who may also distribute competitors products. Certain brewers have contracts with their distributors that impose requirements on distributors that are intended to maximize the wholesalers attention, time and selling efforts on that brewer s products. These contracts generally result in increased competition among brewers as the contracts may affect the manner in which a distributor allocates selling effort and investment to the brands included in its portfolio. The Company closely monitors these and other trends in its distributor network and works to develop programs and tactics intended to best position its products in the market.

The Company has certain competitive advantages over the regional craft brewers, including a long history of awards for product quality, greater available resources and the ability to distribute and promote its products on a more cost-effective basis. Additionally, the Company believes it has competitive advantages over imported beers, including lower transportation costs, higher product quality, a lack of import charges and superior product freshness.

The Company s *Twisted Tea* products compete within the FMB category of the beer industry. This category is highly competitive due to, among other factors, the presence of large spirits companies, the advertising of malt-based spirits brands in channels not available to the parent brands and a fast pace of product innovation.

The Company s *Angry Orchard* ciders compete within the hard cider category. This category is small but growing and highly competitive and includes large international competitors and many small regional and local hard cider companies.

Regulation and Taxation

The alcoholic beverage industry is regulated by federal, state and local governments. These regulations govern the production and distribution of alcoholic beverages, including permitting, licensing, marketing and advertising, distributor relationships, sales, environmental, and occupational health and safety issues. To operate its breweries, the Company must obtain and maintain numerous permits, licenses and approvals from various governmental agencies, including the Alcohol and Tobacco Tax and Trade Bureau, the Food and Drug Administration, state alcohol regulatory agencies and state and federal environmental agencies.

Governmental entities may levy various taxes, license fees and other similar charges and may require bonds to ensure compliance with applicable laws and regulations. The federal excise tax on malt beverages is $18 per barrel, on hard cider (with alcohol by volume of 7% or less) is $0.226 per gallon and on artificially carbonated wine (hard cider with alcohol by volume greater than 7%) is $3.30 per gallon. States levy excise tax at varying rates based on the type of beverage and alcohol content. Failure by the Company to comply with applicable federal, state or local laws and regulations could result in higher taxes, penalties, fees and suspension or revocation of permits, licenses or approvals. While there can be no assurance that any such regulatory action would not have a material adverse effect upon the Company or its operating results, the Company is not aware of any infraction affecting any of its licenses or permits that would materially impact its ability to continue its current operations.

Trademarks

The Company has obtained United States Trademark Registrations for over 90 trademarks, including Samuel Adams®, the design logo of Samuel Adams®, Samuel Adams Boston Lager®, Samuel Adams Utopias®, Twisted Tea®, Angry Orchard ® and Samuel Adams Brewing the American Dream ®. It also has a number of common law marks, including Infinium . The *Samuel Adams* trademark, the *Samuel Adams Boston Lager* trademark, the design logo of Samuel Adams, the *Twisted Tea* trademark and other Company trademarks are also registered or registration is pending in various foreign countries. The Company regards its *Samuel Adams* family of trademarks and other trademarks as having substantial value and as being an important factor in the marketing of

its products. The Company is not aware of any trademark infringements that could materially affect its current business or any prior claim to the trademarks that would prevent the Company from using such trademarks in its business. The Company s policy is to pursue registration of its marks whenever appropriate and to vigorously oppose any infringements of its marks.

Environmental, Health and Safety Regulations and Operating Considerations

The Company s operations are subject to a variety of extensive and changing federal, state and local environmental and occupational health and safety laws, regulations and ordinances that govern activities or operations that may have adverse effects on human health or the environment. Environmental laws, regulations or ordinances may impose liability for the cost of remediation, and for certain damages resulting from, sites of past releases of hazardous materials. The Company believes that it currently conducts, and in the past has conducted, its activities and operations in substantial compliance with applicable environmental laws, and believes that any costs arising from existing environmental laws will not have a material adverse effect on the Company s financial condition or results of operations.

The Company has adopted various policies and procedures intended to ensure that its facilities meet occupational health and safety requirements. The Company believes that it currently is in compliance with applicable requirements and will continue to endeavor to remain in compliance. There can be no assurances, however, that new and more restrictive requirements might not be adopted, compliance with which might have a material, adverse financial effect on the Company and its operating results, or that such policies and procedures will be consistently followed and be sufficient to prevent serious accidents.

As part of its efforts to be environmentally friendly, the Company has reused its glass bottles returned from certain states that have bottle deposit bills. The Company believes that it benefits economically from washing and reusing these bottles, which result in a lower cost than purchasing new glass, and that it benefits the environment by the reduction in landfill usage, the reduction of usage of raw materials and the lower utility costs for reusing bottles versus producing new bottles. The economics of using recycled glass varies based on the cost of collection, sorting and handling, and may be affected by local regulation, and retailer, distributor and glass dealer behavior. There is no guarantee that the current economics of using returned glass will continue, or that the Company will continue its current used glass practices.

Employees

As of December 29, 2012, the Company employed approximately 950 people, of which approximately 79 were covered by collective bargaining agreements at the Cincinnati Brewery. The representation involves three labor unions with one contract expiring in 2015 and two expiring in 2017. The Company believes it maintains a good working relationship with all three labor unions and has no reason to believe that the good working relationship will not continue. The Company has experienced no work stoppages, or threatened work stoppages, and believes that its employee relations are good.

Other

The Company submitted the Section 12(a) CEO Certification to the New York Stock Exchange in accordance with the requirements of Section 303A of the NYSE Listed Company Manual. This Annual Report on Form 10-K contains at Exhibits 31.1 and 31.2 the certifications of the Chief Executive Officer and Chief Financial Officer, respectively, in accordance with the requirements of Section 302 of the Sarbanes-Oxley Act of 2002. The Company makes available free of charge copies of its Annual Report on Form 10-K, as well as other reports required to be filed by Section 13(a) or 15(d) of the Securities Exchange Act of 1934, on the Company s website at *www.bostonbeer.com*, or upon written request to Investor Relations, The Boston Beer Company, Inc., One Design Center Place, Suite 850, Boston, Massachusetts 02210.

Item 1A. ***Risk Factors***

In addition to the other information in this Annual Report on Form 10-K, the risks described below should be carefully considered before deciding to invest in shares of the Company s Class A Common Stock. These are risks and uncertainties that management believes are most likely to be material and therefore are most important for an investor to consider. The Company s business operations and results may also be adversely affected by additional risks and uncertainties not presently known to it, or which it currently deems immaterial, or which are similar to those faced by other companies in its industry or business in general. If any of the following risks or uncertainties actually occurs, the Company s business, financial condition, results of operations or cash flows would likely suffer. In that event, the market price of the Company s Class A Common Stock could decline.

The Company Faces Substantial Competition.

The Better Beer category within the United States beer market is highly competitive, due to the large number of craft brewers with similar pricing and target drinkers and gains in market share achieved by domestic specialty beers and imported beers, a number of which are now promoted or imported by the two largest domestic brewing companies, AB InBev and MillerCoors. The Company faces strong competition from these two brewers as they introduce new domestic specialty brands to many markets and expand their efforts behind existing brands. Imported beers, such as Corona® and Heineken®, continue to compete aggressively in the United States beer market. *Samuel Adams* is one of the largest brands in the Better Beer category of the United States brewing industry. The Company anticipates competition among domestic craft brewers to remain strong, as craft brewers experienced their eighth successive year of growth in 2012 and there were many new startups. In 2012, the Company estimates there are approximately 3,600 breweries in operation or in the planning stages up from approximately 420 operating craft breweries in 2006. Also, existing craft breweries are building more capacity, expanding geographically, adding more SKUs and styles as distributors and retailers are promoting and making more shelf space available for more craft beer brands. The continued growth in the sales of craft-brewed domestic beers and in imported beers is expected to increase the competition in the Better Beer category within the United States beer market and, as a result, prices and market share of the Company s products may fluctuate and possibly decline. No assurance can be given that any decline in price would be offset by an increase in market share.

The Company s products, including its *Twisted Tea* and *Angry Orchard* products, also compete generally with other alcoholic beverages. The Company competes with other beer and beverage companies not only for drinker acceptance and loyalty, but also for shelf, cold box and tap space in retail establishments and for marketing focus by the Company s distributors and their customers, all of which also distribute and sell other beers and alcoholic beverage products. Many of the Company s competitors, including Corona®, Heineken®, AB InBev and MillerCoors, have substantially greater financial resources, marketing strength and distribution networks than the Company. Moreover, the introduction of new products by competitors that compete directly with the Company s products or that diminish the importance of the Company s products to retailers or distributors may have a material adverse effect on the Company s results of operations, cash flows and financial position.

Further, in recent years, the beer industry has seen continued consolidation among brewers in order to take advantage of cost savings opportunities for supplies, distribution and operations. Illustrative of this consolidation are the domestic joint venture between SABMiller and Molson Coors and the acquisition of Anheuser Busch by InBev, both of which occurred in 2008, the acquisition of FEMSA Cerveza by Heineken in 2010, and the planned acquisition of Grupo Modelo by AB InBev. Due to the increased leverage that these combined operations will have, the costs to the Company of competing could increase and the availability of brewing capacity could be reduced. The potential also exists for MillerCoors, AB InBev and Heineken to increase their influence with their distributors, making it difficult for smaller brewers to maintain their market presence or enter new markets. These potential increases in the number and availability of competing brands, the costs to compete, reductions in contract brewing capacity and decreases in distribution support and opportunities may have a material adverse effect on the Company s results of operations, cash flows and financial position.

There Is No Assurance of Continued Growth.

The Company s future growth may be limited by both its ability to continue to increase its market share in domestic and international markets, including those markets that may be dominated by one or more regional or local craft breweries, and by the growth in the craft-brewed beer market and the Better Beer market. The development of new products by the Company may lead to reduced sales in the Company s other products, including its flagship *Samuel Adams Boston Lager*. The Company s future growth may also be limited by its ability to meet production goals at the Company s owned breweries, its ability to enter into new brewing contracts with third party-owned breweries on commercially acceptable terms or the availability of suitable production capacity at third party-owned breweries, should production at the Company s owned breweries miss targets, and its ability to obtain sufficient quantities of certain ingredients and packaging materials, such as hops and bottles, from suppliers.

The Unpredictability and Fluctuation of the Company s Quarterly Results May Adversely Affect the Trading Price of Its Common Stock. The Company s Advertising and Promotional Investments May Not be Effective.

The Company s revenues and results of operations have in the past and may in the future vary from quarter to quarter due to a number of factors, many of which are outside of the Company s control and any of which may cause its stock price to fluctuate. As a growth-oriented company, the Company has made, and expects to continue to make, significant advertising and promotional expenditures to enhance its brands. These expenditures may not result in higher sales volume. Variations in the levels of advertising and promotional expenditures have in the past caused, and are expected in the future to continue to cause, variability in the Company s quarterly results of operations. The Company has in the past made, and expects from time to time in the future to make, significant advertising and promotional expenditures to enhance its brands even though those expenditures may adversely affect the Company s results of operations in a particular quarter or even for the full year, and may not result in increased sales. While the Company attempts to invest only in effective advertising and promotional expenditures, it is difficult to correlate such investments with sales results, and there is no guarantee that the Company s expenditures will be effective in building brand equity or growing long term sales. In addition, the Company fills orders from its wholesalers who may choose independently to build their inventories or run their inventories down.

Such a change in wholesaler inventories is somewhat unpredictable, and can lead to fluctuations in the Company s quarterly or annual results.

Unexpected Events at Company-Owned Breweries, Reduced Availability of Breweries Owned by Others, Increased Complexity of the Company s Business, or the Expansion Costs of the Company-Owned Breweries Could Have A Material Adverse Effect on the Company s Operations or Financial Results.

Prior to 2008, the Company pursued a production strategy that combined the capacity at the Cincinnati Brewery that was acquired in 1997, with significant production arrangements at breweries owned by third parties. The brewing services arrangements with breweries owned by others allowed the Company to utilize excess capacity, providing the Company flexibility, as well as cost advantages over its competitors, while maintaining full control over the brewing process for the Company s beers. The Company purchased the Pennsylvania Brewery in June 2008. As a result, the volume of core brands brewed at Company-owned breweries increased from approximately 35% in 2007 to virtually all of its volume in 2012.

In 2012, the Company brewed its flagship beer, *Samuel Adams Boston Lager*, at each of its breweries, but at any particular time it may rely on only one brewery for its products other than *Samuel Adams Boston Lager*. The Company expects to brew almost all of its core brands volume in 2013 at its Company-owned breweries and to have less reliance on brewing services arrangements with third parties. This increased reliance on its own breweries exposes the Company to capacity constraints, as these breweries are operating close to current capacity in peak months. Nevertheless, management believes that it has secured sufficient alternatives for most of its

brands and packages in the event that production at any of its brewing locations is interrupted or discontinued, although it may not be able to maintain its current economics if such a disruption were to occur and it might experience interruptions to supply. Potential disruptions at breweries include labor issues, governmental action, quality issues, contractual disputes, machinery failures or operational shut downs.

The combination of the Company s recent growth, increased product complexity, and its reliance on its own breweries, continues to increase the operating complexity of the Company s business. There can be no assurance that the Company will effectively manage such increasing complexity, without experiencing planning failures, operating inefficiencies, control deficiencies or other issues that could have a material adverse effect on the Company s business. The growth of the Company, changes in operating procedures and increased complexity, are also requiring significant capital investment.

While the Company has shifted its production to its own breweries, it continues to avail itself of capacity at third-party breweries. During 2012, the Company brewed and/or packaged certain products under service contracts at facilities located in Latrobe, Pennsylvania and Hammondsport, New York. In selecting third party breweries for brewing services arrangements, the Company carefully weighs brewery s (i) capability of utilizing traditional brewing methods and (ii) first rate quality control capabilities throughout brewing, fermentation, finishing and packaging. To the extent that the Company needs to avail itself of third party brewing services arrangement, it exposes itself to higher than planned costs of operating under such contract arrangements than would apply at the Company-owned breweries or an unexpected decline in the brewing capacity available to it, either of which could have a material adverse effect on the Company s results of operations, cash flows and financial position.

As the brewing industry continues to consolidate, the financial stability of the breweries owned by others where the Company could brew some of its beers, if necessary, and their ability or willingness to meet the Company s needs, has become a more significant concern and there are no guarantees that the Company s brewing needs will be met. The Company continues to work with all of the breweries at which it might brew its products in an attempt to minimize any potential interruptions. Nevertheless, should an interruption occur, the Company could experience temporary shortfalls in production and/or increased production or distribution costs, and be required to make significant capital investments to secure alternative capacity for certain brands and packages, the combination of which could have a material adverse effect on the Company s results of operations, cash flows and financial position. A simultaneous interruption at several of the Company s production locations or an unexpected interruption at one of the Company-owned breweries would likely cause significant disruption, increased costs and, potentially, lost sales.

The Company Is Dependent on Its Distributors.

In the United States, where approximately 97% of its beer is sold, the Company sells its beer to independent beer distributors for distribution to retailers and, ultimately, to drinkers. Although the Company currently has arrangements with approximately 340 wholesale distributors, sustained growth will require it to maintain such relationships and possibly enter into agreements with additional distributors. Changes in control or ownership of the current distribution network could lead to less support of the Company s products. No assurance can be given that the Company will be able to maintain its current distribution network or secure additional distributors on terms favorable to the Company.

Contributing to distribution risk is the fact that the Company s distribution agreements are generally terminable by the distributor on short notice. While these distribution agreements contain provisions giving the Company enforcement and termination rights, some state laws prohibit the Company from exercising these contractual rights. The Company s ability to maintain its existing distribution agreements may be adversely affected by the fact that many of its distributors are reliant on one of the major beer producers for a large percentage of their revenue and, therefore, they may be influenced by such producers. If the Company s existing distribution agreements are terminated, it may not be able to enter into new distribution agreements on substantially similar terms, which may result in an increase in the costs of distribution.

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The Company Expects That the Freshest Beer Program Will Adversely Affect Short-term Operating Results and Cash Flow During Implementation and Could Disrupt the Company s Business.

In late 2010, the Company started a Freshest Beer Program with domestic wholesalers in different markets to reduce both the time and temperature the Company s beers experience at wholesalert-size:8pt;">Total stockholders' equity – Dolby Laboratories, Inc.

2,049,707

2,136,742

Controlling interest
6,217

7,100

Total stockholders' equity
2,055,924

2,143,842

Total liabilities and stockholders' equity
$
2,514,709

$
2,533,554

See accompanying notes to unaudited interim condensed consolidated financial statements

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

	Fiscal Quarter Ended	
	December 29, 2017	December 30, 2016
Revenue:		
Licensing	$258,016	$ 232,699
Products	24,933	28,211
Services	4,848	5,357
Total revenue	287,797	266,267
Cost of revenue:		
Cost of licensing	9,259	8,121
Cost of products	17,035	17,720
Cost of services	4,582	4,126
Total cost of revenue	30,876	29,967
Gross margin	256,921	236,300
Operating expenses:		
Research and development	56,444	57,518
Sales and marketing	70,149	71,175
General and administrative	48,285	41,540
Restructuring charges/(credits)	(197)	—
Total operating expenses	174,681	170,233
Operating income	82,240	66,067
Other income/expense:		
Interest income	3,781	1,814
Interest expense	(35)	(26)
Other income/(expense), net	(1,152)	(199)
Total other income	2,594	1,589
Income before income taxes	84,834	67,656
Provision for income taxes	(166,312)	(14,082)
Net income/(loss) including controlling interest	(81,478)	53,574
Less: net (income) attributable to controlling interest	(144)	(200)
Net income/(loss) attributable to Dolby Laboratories, Inc.	$(81,622)	$ 53,374
Net income/(loss) per share:		
Basic	$(0.80)	$ 0.53
Diluted	$(0.80)	$ 0.51
Weighted-average shares outstanding:		
Basic	102,552	101,483

Diluted	102,552	103,876
Related party rent expense:		
Included in operating expenses	$784	$ 782
Included in net income attributable to controlling interest	$177	$ 175
Cash dividend declared per common share	$0.16	$ 0.14
Cash dividend paid per common share	$0.16	$ 0.14

See accompanying notes to unaudited interim condensed consolidated financial statements

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

	Fiscal Quarter Ended	
	December 29, 2017	December 30, 2016
Net income/(loss) including controlling interest	$(81,478)	$ 53,574
Other comprehensive income:		
Currency translation adjustments, net of tax	1,218	(7,724)
Unrealized gains/(losses) on investments, net of tax	(1,593)	(2,019)
Comprehensive income/(loss)	(81,853)	43,831
Less: comprehensive (income)/loss attributable to controlling interest	(138)	61
Comprehensive income/(loss) attributable to Dolby Laboratories, Inc.	$(81,991)	$ 43,892

See accompanying notes to unaudited interim condensed consolidated financial statements

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DOLBY LABORATORIES, INC.
INTERIM CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands)
(unaudited)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total Dolby Laboratories, Inc.	Controlling Interest	Total
Balance at September 29, 2017	$101	$61,331	$2,083,063	$(7,753)	$2,136,742	$7,100	$2,143,842
Net income/(loss)			(81,622)		(81,622)	144	(81,478)
Currency translation adjustments, net of tax of $(274)				1,224	1,224	(6)	1,218
Unrealized gains on investments, net of tax of $83				(1,593)	(1,593)		(1,593)
Distributions to controlling interest					—	(1,021)	(1,021)
Stock-based compensation expense		18,684			18,684		18,684
Repurchase of common stock		(29,993)			(29,993)		(29,993)
Cash dividends declared and paid on common stock			(16,377)		(16,377)		(16,377)
Common stock issued under employee stock plans	1	41,462			41,463		41,463
Tax withholdings on vesting of restricted stock		(18,821)			(18,821)		(18,821)
Balance at December 29, 2017	$102	$72,663	$1,985,064	$(8,122)	$2,049,707	$6,217	$2,055,924

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total Dolby Laboratories, Inc.	Controlling Interest	Total
Balance at September 30, 2016	$101	$42,032	$1,938,320	$(10,197)	$1,970,256	$8,479	$1,978,735
Net income			53,374		53,374	200	53,574
Currency translation adjustments, net of tax of $1,265				(7,463)	(7,463)	(261)	(7,724)
Unrealized gains on investments, net of tax of $95				(2,019)	(2,019)		(2,019)
Distributions to controlling interest					—	(2,094)	(2,094)
Stock-based compensation expense		17,215			17,215		17,215
Repurchase of common stock	(1)	(25,000)			(25,001)		(25,001)
Cash dividends declared and paid on common stock			(14,216)		(14,216)		(14,216)
Tax benefit from employee stock plans		2,853			2,853		2,853
Common stock issued under employee stock plans	1	13,990			13,991		13,991
	(1)	(14,655)			(14,656)		(14,656)

Tax withholdings on vesting of restricted stock							
Balance at December 30, 2016	$100	$36,435	$1,977,478	$(19,679)	$1,994,334	$6,324	$2,000,658

See accompanying notes to unaudited interim condensed consolidated financial statements

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

	Fiscal Quarter-To-Date Ended December 29, 2017			December 30, 2017		
Operating activities:						
Net income/(loss) including controlling interest	$	(81,478	)	$	53,574	
Adjustments to reconcile net income/(loss) to net cash provided by operating activities:						
Depreciation and amortization	19,882			21,810		
Stock-based compensation	18,684			17,215		
Amortization of premium on investments	742			662		
Provision for doubtful accounts	1,119			67		
Deferred income taxes	51,074			(3,275		)
Other non-cash items affecting net income	587			(376		)
Changes in operating assets and liabilities:						
Accounts receivable	(50,268		)	(5,782		)
Inventories	(1,491		)	878		
Prepaid expenses and other assets	(6,609		)	(8,705		)
Accounts payable and other liabilities	(35,390		)	(11,528		)
Income taxes, net	99,551			6,245		
Deferred revenue	650			(479		)
Other non-current liabilities	96			417		
Net cash provided by operating activities	17,149			70,723		
Investing activities:						
Purchases of investment securities	(74,479		)	(37,073		)
Proceeds from sales of investment securities	28,383			7,524		
Proceeds from maturities of investment	49,476			26,902		

securities				
Purchases of PP&E	(19,275	)	(22,576	)
Purchase of intangible assets	(11,198	)	—	
Change in restricted cash	(279	)	(1,430	)
Net cash used in investing activities	(27,372	)	(26,653	)
Financing activities:				
Proceeds from issuance of common stock	41,463		13,991	
Repurchase of common stock	(29,993	)	(25,001	)
Payment of cash dividend	(16,377	)	(14,216	)
Distribution to controlling interest	(1,021	)	(2,094	)
Shares repurchased for tax withholdings on vesting of restricted stock	(15,346	)	(14,656	)
Net cash used in financing activities	(21,274	)	(41,976	)
Effect of foreign exchange rate changes on cash and cash equivalents	870		(5,368	)
Net decrease in cash and cash equivalents	(30,627	)	(3,274	)
Cash and cash equivalents at beginning of year	627,017		516,112	
Cash and cash equivalents at end of year	$ 596,390		$ 512,838	
Supplemental disclosure:				
Cash paid for income taxes, net of refunds received	$ 17,355		$ 13,792	
Non-cash investing activities:				
Net change in PP&E purchased and unpaid at period-end	$ 2,333		$ 6,901	

See accompanying notes to unaudited interim condensed consolidated financial statements

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DOLBY LABORATORIES, INC.
NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation
Unaudited Interim Condensed Consolidated Financial Statements
We have prepared the accompanying unaudited interim condensed consolidated financial statements in accordance with U.S. GAAP, and with SEC rules and regulations, which allow for certain information and footnote disclosures that are normally included in annual financial statements prepared in accordance with U.S. GAAP to be condensed or omitted. In our opinion, these unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements for the fiscal year ended September 29, 2017 and include all adjustments necessary for fair presentation. The accompanying unaudited interim condensed consolidated financial statements should be read in conjunction with our consolidated financial statements for the fiscal year ended September 29, 2017, which are included in our Annual Report on Form 10-K filed with the SEC.
The results for the fiscal quarter ended December 29, 2017 are not necessarily indicative of the results to be expected for any subsequent quarterly or annual financial period, including the fiscal year ending September 28, 2018.
Principles of Consolidation
The unaudited interim condensed consolidated financial statements include the accounts of Dolby Laboratories, Inc. and our wholly owned subsidiaries. In addition, we have consolidated the financial results of jointly owned affiliated companies in which our principal stockholder has a controlling interest. We report these controlling interests as a separate line in our consolidated statements of operations as net income attributable to controlling interest and in our consolidated balance sheets as a controlling interest. We eliminate all intercompany accounts and transactions upon consolidation.
Operating Segments
Since we operate as a single reporting segment, all required financial segment information is included in our unaudited interim condensed consolidated financial statements. This determination reflects the fact that our CODM, our Chief Executive Officer, evaluates our financial information and resources, and assesses the performance of these resources on a consolidated basis.
Use of Estimates
The preparation of our financial statements in accordance with U.S. GAAP requires management to make certain estimates and assumptions that affect the amounts reported and disclosed in our unaudited interim condensed consolidated financial statements and accompanying notes. Significant items subject to such estimates and assumptions include estimated selling prices for elements sold in ME revenue arrangements; valuation allowances for accounts receivable; carrying values of inventories and certain property, plant, and equipment, goodwill and intangible assets; fair values of investments; accrued liabilities including liabilities for unrecognized tax benefits, deferred income tax assets and liabilities, and stock-based compensation. Actual results could differ from our estimates.
Fiscal Year
Our fiscal year is a 52 or 53 week period ending on the last Friday in September. The fiscal periods presented herein include the 13 week periods ended December 29, 2017 and December 30, 2016. Our fiscal year ending September 28, 2018 (fiscal 2018) and our fiscal year ended September 29, 2017 (fiscal 2017) both consist of 52 weeks.
Reclassifications
We have reclassified certain prior period amounts within our consolidated financial statements and accompanying notes to conform to our current period presentation. These reclassifications did not affect total revenue, operating income, or net income.

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2. Summary of Significant Accounting Policies

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

Recently Issued Accounting Standards

Adopted Standards

Share-Based Compensation. During the first quarter of fiscal 2018, we adopted ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which simplifies several aspects of the accounting for employee share-based payment transactions including the accounting for income taxes, forfeitures, and statutory withholding requirements, as well as classification in the statement of cash flows. Upon adoption, excess tax benefits or deficiencies from stock-based awards are recorded as a component of the income tax provision, whereas they previously were recorded as additional paid-in capital. In the first quarter of fiscal 2018, we recognized an excess tax benefit of $6.0 million related to stock-based awards in the provision for income taxes. We elected to continue to account for forfeitures based on an estimate of expected forfeitures, rather than to account for forfeitures as they occur. Additionally, we adopted the aspects of the guidance affecting the cash flow presentation retrospectively, which results in a reclassification of excess tax benefits from financing activities to operating activities in the consolidated statements of cash flows.

Standards Not Yet Effective

Revenue Recognition. In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which outlines a comprehensive revenue recognition model and supersedes most current revenue recognition guidance. The new standard defines a five-step approach for recognizing revenue, which may require a company to use more judgment and make more estimates than under the current guidance. Amongst the elements in the new standard are requirements for an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers, to capitalize certain direct costs associated with revenues and contract acquisition costs, and to provide expanded disclosures.

We have evaluated the impact of adoption of Topic 606 on all of our revenue streams and believe that the following are the most significant changes that could occur:

- Estimating and recording royalty-based revenue earned from our licensees' shipments in the same period in which those shipments occurred, rather than recognizing our royalty-based revenue in the quarter in which it is reported to us by our licensees, which is typically in the quarter after those shipments have occurred;
- For certain transactions that have minimum commitment or fixed fee terms, recognizing licensing revenues on contract execution instead of over the contract term;
- Specified performance obligations for which we have not historically had VSOE and which resulted in the deferral of revenue balances may accelerate revenue recognition as VSOE for the undelivered elements is no longer required to separately recognize revenue for the delivered elements;
- Recording a one-time adjustment to retained earnings to reflect the cumulative impact of the changes noted above for the periods prior to adoption.

We have not yet quantified the impact of these anticipated changes.

We plan to adopt the new standard using the full retrospective method, whereby the standard is applied to all periods presented, on the adoption date. Although permitted, we do not intend to early-adopt the new standard, but will adopt it on September 29, 2018, which is the beginning of our first quarter of fiscal 2019.

In addition to our ongoing evaluation of the accounting changes and of our transition options, we are also addressing the impact of the new accounting standard and its expanded disclosure requirements on our policies, processes, controls, and systems.

Leases. In February 2016, the FASB issued ASU 2016-02, Leases, which amends the existing accounting standards for leases. Under the new guidance, a lessee will be required to recognize a lease liability and right-of-use asset for most leases. The new guidance also modifies the classification criteria and accounting for sales-type and

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direct financing leases, and requires additional disclosures to enable users of financial statements to understand the amount, timing, and uncertainty of cash flows arising from leases. The ASU must be applied using a modified retrospective approach. Upon adoption, we will recognize a lease liability and right-of-use asset for each of our long-term lease arrangements, which exceed 70 as of December 29, 2017. We intend to early adopt this new standard concurrently with the adoption of the new revenue recognition standard beginning September 29, 2018.
We continue to refine our quantification and anticipate this standard will have a material impact on our consolidated balance sheets, but will not have a material impact on our consolidated income statements. We currently expect the most significant impact will be the recognition of right-of-use assets and lease liabilities for operating leases. Our accounting for capital leases is expected to remain substantially unchanged.
Going Concern. In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements – Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. ASU 2014-15 requires management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards as specified in the guidance. The ASU is effective for us beginning September 29, 2018. Early adoption is permitted, including adoption in an interim period. We do not anticipate that the new standard will impact our consolidated financial statements.
Cash Flow Classification. In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. The new guidance addresses eight specific cash flow issues, with the objective of reducing an existing diversity in practices regarding the manner in which certain cash receipts and payments are presented and classified in the statement of cash flows. The ASU is effective for us beginning September 29, 2018. Early adoption is permitted, including adoption in an interim period, and we are currently evaluating the timing and impact of the standard on our consolidated financial statements.
Income Taxes: Intra-Entity Asset Transfers. In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory. The new guidance requires the recognition of the income tax consequences of an intercompany asset transfer, other than transfers of inventory, when the transfer occurs. For intercompany transfers of inventory, the income tax effects will continue to be deferred until the inventory has been sold to a third party. The ASU is effective for us beginning September 29, 2018. Early adoption is permitted, including adoption in an interim period. We do not anticipate that the new standard will materially impact our consolidated financial statements.
Restricted Cash. In November 2016, the FASB issued ASU 2016-18, Restricted Cash — a consensus of the FASB Emerging Issues Task Force, which clarifies how entities should present restricted cash and restricted cash equivalents in the statement of cash flows. The new guidance requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. The ASU is effective for us beginning September 29, 2018. Early adoption is permitted, including adoption in an interim period. Aside from conforming to new cash flow presentation and restricted cash disclosure requirements, we do not anticipate that the new standard will materially impact our consolidated financial statements.
Accounting for Hedging Activities. In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, which enables entities to better portray the economics of their risk management activities in the financial statements while enhancing the transparency and understandability of hedge results. The new guidance eliminates the requirement to separately measure and report hedge ineffectiveness. The ASU is effective for us beginning September 29, 2018 and we do not currently plan to early adopt. We do not anticipate that the new standard will materially impact our consolidated financial statements.

3. Composition of Certain Financial Statement Captions
The following tables present detailed information from our consolidated balance sheets as of December 29, 2017 and September 29, 2017 (amounts displayed in thousands, except as otherwise noted).

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Accounts Receivable

	December 29, 2017	September 29, 2017
Trade accounts receivable	$ 107,068	$ 62,305
Accounts receivable from patent administration program customers	19,936	14,412
Accounts receivable, gross	127,004	76,717
Less: allowance for doubtful accounts	(4,087)	(2,967)
Total	$ 122,917	$ 73,750

Inventories

	December 29, 2017	September 29, 2017
Raw materials	$ 4,465	$ 6,812
Work in process	6,321	4,954
Finished goods	14,076	13,285
Total	$ 24,862	$ 25,051

Inventories are stated at the lower of cost and net realizable value. Inventory with a consumption period expected to exceed twelve months is recorded within other non-current assets in our consolidated balance sheets. In addition to the amounts shown in the table above, we have included $3.1 million and $1.8 million of raw materials inventory within other non-current assets in our consolidated balance sheets as of December 29, 2017 and September 29, 2017, respectively. We write-down inventory at the time it is deemed excess or obsolete.

Prepaid Expenses And Other Current Assets

	December 29, 2017	September 29, 2017
Prepaid expenses	$ 17,852	$ 16,681
Other current assets	12,743	11,383
Income tax receivable	510	2,444
Total	$ 31,105	$ 30,508

Accrued Liabilities

	December 29, 2017	September 29, 2017
Accrued royalties	$ 2,298	$ 2,274
Amounts payable to patent administration program partners	59,619	49,141
Accrued compensation and benefits	60,365	92,277
Accrued professional fees	7,500	5,530
Unpaid PP&E additions	10,203	10,096
Other accrued liabilities	38,434	47,716
Total	$ 178,419	$ 207,034

Other Non-Current Liabilities

	December 29, 2017	September 29, 2017
Supplemental retirement plan obligations	$ 3,067	$ 2,928
Non-current tax liabilities	182,882	91,013
Other liabilities	12,862	13,573
Total	$ 198,811	$ 107,514

4. Investments & Fair Value Measurements

We use cash holdings to purchase investment grade securities diversified among security types, industries, and issuers. All of our investment securities are measured at fair value, and are recorded within cash equivalents and both short-term and long-term investments in our consolidated balance sheets. With the exception of our mutual fund investments held in our SERP and classified as trading securities, all of our investments are classified as AFS securities.

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Our investment securities primarily consist of government bonds, certificates of deposit, municipal debt securities, corporate bonds, U.S. agency securities, and commercial paper. In addition, our cash and cash equivalents may also consist of corporate bonds, money market funds, and municipal debt securities that meet the high liquidity requirements set forth in our accounting policy. Consistent with our investment policy, none of our municipal debt investments are supported by letters of credit or standby purchase agreements. Our cash and investment portfolio consisted of the following (in thousands):

	December 29, 2017						
		Unrealized			Estimated Fair Value		
	Cost	Gains	Losses	Total	Level 1	Level 2	Level 3
Cash and cash equivalents:							
Cash	$587,136			$587,136			
Cash equivalents:							
Corporate bonds	5,866		(1)	5,865		5,865	
Money market funds	2,787			2,787	2,787		
Municipal debt securities	602			602		602	
Cash and cash equivalents	596,391	—	(1)	596,390	2,787	6,467	—
Short-term investments:							
Certificate of deposit (1)	22,981	7	(2)	22,986		22,986	
U.S. agency securities	8,443		(33)	8,410		8,410	
Government bonds	535		(2)	533	533		
Commercial paper	13,636	—	(15)	13,621		13,621	
Corporate bonds	170,740	25	(295)	170,470		170,470	
Municipal debt securities	36,679	—	(92)	36,587		36,587	
Short-term investments	253,014	32	(439)	252,607	533	252,074	—
Long-term investments:							
Certificate of deposit (1)	10,345		(1)	10,344		10,344	
U.S. agency securities	20,283		(272)	20,011		20,011	
Government bonds	20,965	4	(222)	20,747	20,747		
Corporate bonds	225,639	147	(1,313)	224,473		224,473	
Municipal debt securities	23,853	1	(168)	23,686		23,686	
Other long-term investments (2)	3,944	296		4,240	296		
Long-term investments	305,029	448	(1,976)	303,501	21,043	278,514	—
Total cash, cash equivalents, and investments	$1,154,434	$480	$(2,416)	$1,152,498	$24,363	$537,055	$ —
Investments held in supplemental retirement plan:							
Assets	3,165			3,165	3,165		
Included in prepaid expenses and other current assets & other non-current assets							
Liabilities	3,165			3,165	3,165		
Included in accrued liabilities & other non-current liabilities							

(1) Certificates of deposit include marketable securities, while those with a maturity in excess of one year as of December 29, 2017 are classified within long-term investments.

(2) Other long-term investments as of December 29, 2017 include a marketable equity security of $0.3 million, and other investments that are not carried at fair value including an equity method investment of $0.4 million and two

cost method equity investments of $3.0 million and $0.5 million.

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	September 29, 2017						
		Unrealized			Estimated Fair Value		
	Cost	Gains	Losses	Total	Level 1	Level 2	Level 3
Cash and cash equivalents:							
Cash	$623,244			$623,244			
Cash equivalents:							
Commercial paper	1,223	—	—	1,223		1,223	
Money market funds	2,550	—	—	2,550	2,550		
Cash and cash equivalents	627,017	—	—	627,017	2,550	1,223	—
Short-term investments:							
Certificate of deposit (1)	17,236	9	(1)	17,244		17,244	
U.S. agency securities	9,518	—	(20)	9,498		9,498	
Government bonds	2,034	—	(6)	2,028	2,028		
Commercial paper	15,160	2	(1)	15,161		15,161	
Corporate bonds	174,750	54	(163)	174,641		174,641	
Municipal debt securities	29,178	16	(9)	29,185		29,185	
Short-term investments	247,876	81	(200)	247,757	2,028	245,729	—
Long-term investments:							
Certificate of deposit (1)	22,940	5	(6)	22,939		22,939	
U.S. agency securities	21,779	—	(178)	21,601		21,601	
Government bonds	17,839	—	(107)	17,732	17,732		
Corporate bonds	218,857	327	(537)	218,647		218,647	
Municipal debt securities	28,913	29	(25)	28,917		28,917	
Other long-term investments (2)	4,171	357	—	4,528	357		—
Long-term investments	314,499	718	(853)	314,364	18,089	292,104	—
Total cash, cash equivalents, and investments	$1,189,392	$799	$(1,053)	$1,189,138	$22,667	$539,056	$ —
Investments held in supplemental retirement plan:							
Assets	3,026			3,026	3,026		
Included in prepaid expenses and other current assets & other non-current assets							
Liabilities	3,026			3,026	3,026		
Included in accrued liabilities & other non-current liabilities							

(1) Certificates of deposit include marketable securities, while those with a maturity in excess of one year as of September 29, 2017 are classified within long-term investments.

(2) Other long-term investments as of September 29, 2017 include a marketable equity security of $0.4 million, and other investments that are not carried at fair value including an equity method investment of $0.6 million and two cost method equity investments of $3.0 million and $0.5 million.

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

Level 1: Quoted prices in active markets at the measurement date for identical assets and liabilities. We base the fair value of our Level 1 financial instruments, which are traded in active markets, using quoted market prices for identical instruments.
Level 2: Prices may be based upon quoted prices in active markets or inputs not quoted on active markets but are corroborated by market data. We obtain the fair value of our Level 2 financial instruments from a professional pricing service, which may use quoted market prices for identical or comparable instruments, or model driven valuations using observable market data or inputs corroborated by observable market data. To validate the fair value determination provided by our primary pricing service, we perform quality controls over values received which include comparing our pricing service provider's assessment of the fair values of our investment securities against the fair values of our investment securities obtained from another independent source, reviewing the pricing movement in the context of overall market trends, and reviewing trading information from our investment managers. In addition, we assess the inputs and methods used in determining the fair value in order to determine the classification of securities in the fair value hierarchy.
Level 3: Unobservable inputs are used when little or no market data is available and reflect management's estimates of assumptions that market participants would use in pricing the asset or liability.

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Securities In Gross Unrealized Loss Position. We periodically evaluate our investments for other-than- temporary declines in fair value. The unrealized losses on our AFS securities were primarily the result of unfavorable changes in interest rates subsequent to the initial purchase of these securities. The following table presents the gross unrealized losses and fair value for those AFS securities that were in an unrealized loss position for less than twelve months and for twelve months or greater as of December 29, 2017 and September 29, 2017 (in thousands):

	December 29, 2017				September 29, 2017			
	Less Than 12 Months		12 Months Or Greater		Less Than 12 Months		12 Months Or Greater	
Investment Type	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Certificate of deposit	$12,323	$ (3)	$—	$ —	$19,750	$ (6)	$—	$ —
U.S. agency securities	6,177	(53)	22,243	(253)	19,713	(91)	11,386	(108)
Government bonds	10,892	(112)	7,412	(111)	15,029	(64)	4,729	(49)
Commercial paper	10,015	(15)	—	—	4,292	(1)	—	—
Corporate bonds	210,057	(800)	119,766	(808)	125,890	(251)	109,806	(449)
Municipal debt securities	56,136	(236)	3,586	(23)	26,749	(24)	3,625	(10)
Total	$305,600	$ (1,219)	$153,007	$ (1,195)	$211,423	$ (437)	$129,546	$ (616)

Although we had certain securities that were in an unrealized loss position as of December 29, 2017, we expect to recover the full carrying value of these securities as we do not intend to, nor do we currently anticipate a need to sell these securities prior to recovering the associated unrealized losses. As a result, we do not consider any portion of the unrealized losses at either December 29, 2017 or September 29, 2017 to represent an other-than-temporary impairment, nor do we consider any of the unrealized losses to be credit losses.

Investment Maturities. The following table summarizes the amortized cost and estimated fair value of the AFS securities within our investment portfolio based on stated maturities as of December 29, 2017 and September 29, 2017, which are recorded within cash equivalents and both short and long-term investments in our consolidated balance sheets (in thousands):

	December 29, 2017		September 29, 2017	
Range of maturity	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within 1 year	$259,529	$259,137	$251,649	$251,530
Due in 1 to 2 years	183,876	182,787	213,555	213,154
Due in 2 to 3 years	119,948	119,200	96,773	96,682
Total	$563,353	$561,124	$561,977	$561,366

5. Property, Plant, & Equipment

Property, plant, and equipment are recorded at cost, with depreciation expense included in cost of licensing, cost of products, cost of services, R&D, S&M, and G&A expenses in our consolidated statements of operations. PP&E consist of the following (in thousands):

	December 29, 2017	September 29, 2017
Land	$ 43,363	$ 43,364
Buildings and building improvements	280,993	281,196
Leasehold improvements	64,858	65,034
Machinery and equipment	101,436	98,437
Computer equipment and software	178,588	173,341
Furniture and fixtures	29,336	28,118

Equipment provided under operating leases	107,808	97,456
Construction-in-progress	6,467	3,673
Property, plant, and equipment, gross	812,849	790,619
Less: accumulated depreciation	(319,676)	(305,344)
Property, plant, & equipment, net	$ 493,173	$ 485,275

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6. Goodwill & Intangible Assets

Goodwill

The following table outlines changes to the carrying amount of goodwill (in thousands):

	Goodwill
Balance at September 29, 2017	$311,087
Translation adjustments	99
Balance at December 29, 2017	$311,186

Intangible Assets

Our intangible assets are stated at their original cost less accumulated amortization, and principally consist of acquired technology, patents, trademarks, customer relationships and contracts. Intangible assets subject to amortization consist of the following (in thousands):

	December 29, 2017			September 29, 2017		
Intangible Assets	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Acquired patents and technology	$311,886	$(134,929)	$176,957	$299,707	$(128,986)	$170,721
Customer relationships	56,849	(39,035)	17,814	56,843	(38,368)	18,475
Other intangibles	22,749	(22,315)	434	22,742	(22,290)	452
Total	$391,484	$(196,279)	$195,205	$379,292	$(189,644)	$189,648

We purchase various patents and developed technologies that enable us to further develop our audio, imaging and potential product offerings.

With regard to our purchase of intangible assets during the periods presented, the following table summarizes the consideration paid, the weighted-average useful lives over which the acquired assets will be amortized using the greater of either the straight-line basis or a ratio-to-revenue method, and the classification of their amortized expense in our consolidated statements of operations:

Fiscal Period	Total Purchase Consideration (1)	Weighted-Average Useful Life
	(in millions)	(in years)
Fiscal 2017		
Q1 - Quarter ended December 30, 2016	None	
Fiscal 2018		
Q1 - Quarter ended December 29, 2017	$12.0	14.1

(1) Amortization expense on the intangible assets from patent portfolio acquisitions is included within cost of revenue, R&D, and G&A in our consolidated statements of operations.

Amortization expense for our intangible assets is included in cost of licensing, cost of products, R&D, S&M, and G&A expenses in our consolidated statements of operations. Amortization expense was $6.5 million and $8.4 million in the first quarter of fiscal 2018 and 2017, respectively. As of December 29, 2017, estimated amortization expense in future fiscal periods was as follows (in thousands):

Fiscal Year	Amortization Expense
Remainder of 2018	$ 19,725
2019	25,719
2020	25,256
2021	25,229
2022	23,309
Thereafter	75,967
Total	$ 195,205

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7. Stockholders' Equity & Stock-Based Compensation
We provide stock-based awards as a form of compensation for employees, officers and directors. We have issued stock-based awards in the form of stock options and RSUs under our equity incentive plans, as well as shares under our ESPP.
Common Stock - Class A and Class B
Our Board of Directors has authorized two classes of common stock, Class A and Class B. At December 29, 2017, we had authorized 500,000,000 Class A shares and 500,000,000 Class B shares. At December 29, 2017, we had 60,541,095 shares of Class A common stock and 42,733,597 shares of Class B common stock issued and outstanding. Holders of our Class A and Class B common stock have identical rights, except that holders of our Class A common stock are entitled to one vote per share and holders of our Class B common stock are entitled to ten votes per share. Shares of Class B common stock can be converted to shares of Class A common stock at any time at the option of the stockholder and automatically convert upon sale or transfer, except for certain transfers specified in our amended and restated certificate of incorporation.
Stock Incentive Plans
2005 Stock Plan. In January 2005, our stockholders approved our 2005 Stock Plan, which our Board of Directors adopted in November 2004. The 2005 Stock Plan became effective on February 16, 2005, the day prior to the completion of our initial public offering. Our 2005 Stock Plan, as amended and restated, provides for the ability to grant incentive stock options, non-qualified stock options, restricted stock, RSUs, stock appreciation rights, deferred stock units, performance units, performance bonus awards, and performance shares. A total of 46.0 million shares of our Class A common stock is authorized for issuance under the 2005 Stock Plan. For awards granted prior to February 2011, any shares subject to an award with a per share price less than the fair market value of our Class A common stock on the date of grant and any shares subject to an outstanding RSU award will be counted against the authorized share reserve as two shares for every one share subject to the award, and if returned to the 2005 Stock Plan, such shares will be counted as two shares for every one share returned. For those awards granted from February 2011 onward, any shares subject to an award with a per share price less than the fair market value of our Class A common stock on the date of grant and any shares subject to an outstanding RSU award will be counted against the authorized share reserve as 1.6 shares for every one share subject to the award, and if returned to the 2005 Stock Plan, such shares will be counted as 1.6 for every one share returned.
Stock Options. Stock options are granted at fair market value on the date of grant. Options granted to employees and officers prior to June 2008 generally vested over four years, with equal annual cliff-vesting and expire on the earlier of ten years after the date of grant or three months after termination of service. Options granted to employees and officers from June 2008 onward generally vest over four years, with 25% of the shares subject to the option becoming exercisable on the one-year anniversary of the date of grant and the balance of the shares vesting in equal monthly installments over the following 36 months. These options expire on the earlier of ten years after the date of grant or three months after termination of service. All options granted vest over the requisite service period and upon the exercise of stock options, we issue new shares of Class A common stock under the 2005 Stock Plan. Our 2005 Stock Plan also allows us to grant stock awards which vest based on the satisfaction of specific performance criteria.
Performance-Based Stock Options (PSOs). In fiscal 2016, we began granting PSOs to our executive officers with shares of our Class A common stock underlying such options. The contractual term for the PSOs is seven years, with vesting contingent upon market-based performance conditions, representing the achievement of specified Dolby annualized TSR targets at the end of a three-year measurement period following the date of grant. If the minimum conditions are met, the PSOs earned will cliff vest on the third anniversary of the grant date, upon certification of achievement of the performance conditions by our Compensation Committee. Anywhere from 0% to 125% of the shares subject to a PSO may vest based on achievement of the performance conditions at the end of the three-year performance period.
In valuing the PSOs which will be recognized as compensation cost, we used a Monte Carlo valuation model. Aside from the use of an expected term for the PSOs commensurate with their shorter contractual term, the nature of the valuation inputs used in the Monte Carlo valuation model were consistent with those used to value our

non-performance based options granted under the 2005 Plan. Compensation cost is being amortized on a straight-line basis over the requisite service period.

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On December 15, 2017, we granted PSOs to our executive officers exercisable for an aggregate of 264,000 shares at the target award amount, which would be exercisable up to an aggregate of to 330,000 shares at 125% of the target award amount. On December 15, 2016, we granted PSOs to our executive officers exercisable for an aggregate of 276,199 shares at the target award amount, which would be exercisable up to an aggregate of 345,248 shares at 125% of the target award amount. On December 15, 2015, we granted PSOs to our executive officers exercisable for an aggregate of 335,699 shares at the target award amount, which would be exercisable up to an aggregate of 419,623 shares at 125% of the target award amount. As of December 29, 2017, PSOs which would be exercisable for an aggregate of 784,898 shares at the target award amount (981,121 at 125% of the target award amount) were outstanding.

The following table summarizes information about all stock options issued under our 2005 Stock Plan:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life	Aggregate Intrinsic Value (1)
	(in thousands)		(in years)	(in thousands)
Options outstanding at September 29, 2017	8,741	$ 38.65		
Grants	1,262	62.31		
Exercises	(911)	38.31		
Forfeitures and cancellations	(306)	40.68		
Options outstanding at December 29, 2017	8,786	42.02	6.9	$ 175,980
Options vested and expected to vest at December 29, 2017	8,212	41.26	6.8	170,650
Options exercisable at December 29, 2017	4,529	$ 36.74	5.7	114,392

(1) Aggregate intrinsic value is based on the closing price of our Class A common stock on December 29, 2017 of 62.00 and excludes the impact of options that were not in-the-money.

Restricted Stock Units. Beginning in fiscal 2008, we began granting RSUs to certain directors, officers, and employees under our 2005 Stock Plan. Awards granted to employees and officers generally vest over four years, with equal annual cliff-vesting. Awards granted to directors prior to November 2010 generally vest over three years, with equal annual cliff-vesting. Awards granted after November 2010 and prior to fiscal 2014 to new directors vest over approximately two years, with 50% vesting per year, while awards granted from November 2010 onward to ongoing directors generally vest over approximately one year. Awards granted to new directors from fiscal 2014 onward vest on the earlier of the first anniversary of the award's date of grant, or the day immediately preceding the date of the next annual meeting of stockholders that occurs after the award's date of grant. Our 2005 Stock Plan also allows us to grant RSUs that vest based on the satisfaction of specific performance criteria, although no such awards had been granted as of December 29, 2017. At each vesting date, the holder of the award is issued shares of our Class A common stock. Compensation expense from these awards is equal to the fair market value of our Class A common stock on the date of grant and is recognized on a straight-line basis over the requisite service period.

The following table summarizes information about RSUs issued under our 2005 Stock Plan:

	Shares	Weighted-Average Grant Date Fair Value
	(in thousands)	
Non-vested at September 29, 2017	2,839	$ 44.38
Granted	1,066	62.28
Vested	(849)	39.76
Forfeitures	(175)	41.41
Non-vested at December 29, 2017	2,881	$ 52.55

Employee Stock Purchase Plan. Our plan allows eligible employees to have up to 10 percent of their eligible compensation withheld and used to purchase Class A common stock, subject to a maximum of $25,000 worth of stock

purchased in a calendar year or no more than 1,000 shares in an offering period, whichever is less. An offering period consists of successive six-month purchase periods, with a look back feature to our stock price at the commencement of a one-year offering period. The plan provides for a discount equal to 15 percent of the lower of the closing price of our Class A common stock on the New York Stock Exchange on the first and last day of the offering periods. The plan also includes an automatic reset feature that provides for an offering period to be reset and recommenced to a new lower-priced offering if the offering price of a new offering period is less than that of the immediately preceding offering period.

Stock Option Valuation Assumptions

We use the Black-Scholes option pricing model to determine the estimated fair value of employee stock options at the date of the grant. The Black-Scholes model includes inputs that require us to make certain estimates and assumptions regarding the expected term of the award, as well as the future risk-free interest rate, and the volatility of our stock price over the expected term of the award.

Expected Term. The expected term of an award represents the estimated period of time that options granted will remain outstanding, and is measured from the grant date to the date at which the option is either exercised or canceled. Our determination of the expected term involves an evaluation of historical terms and other factors such as the exercise and termination patterns of our employees who hold options to acquire our Class A common stock, and is based on certain assumptions made regarding the future exercise and termination behavior.

Risk-Free Interest Rate. The risk-free interest rate is based on the yield curve of United States Treasury instruments in effect on the date of grant. In determining an estimate for the risk-free interest rate, we use average interest rates based on these instruments' constant maturities with a term that approximates and corresponds with the expected term of our awards.

Expected Stock Price Volatility. The expected volatility represents the estimated volatility in the price of our Class A common stock over a time period that approximates the expected term of the awards, and is determined using a blended combination of historical and implied volatility. Historical volatility is representative of the historical trends in our stock price for periods preceding the measurement date for a period that is commensurate with the expected term. Implied volatility is based upon externally traded option contracts of our Class A common stock.

Dividend Yield. The dividend yield is based on our anticipated dividend payout over the expected term of our option awards. Dividend declarations and the establishment of future record and payment dates are subject to the Board of Directors' continuing determination that the dividend policy is in the best interests of our stockholders. The dividend policy may be changed or canceled at the discretion of the Board of Directors at any time.

The weighted-average assumptions used in the determination of the fair value of our stock options were as follows:

	Fiscal Quarter Ended			
	December 29, 2017		December 30, 2016	
Expected life (in years)	5.06		5.13	
Risk-free interest rate	2.2	%	2.1	%
Expected stock price volatility	22.6	%	27.6	%
Dividend yield	1.1	%	1.1	%

Stock-Based Compensation Expense

Stock-based compensation expense for equity awards granted to employees is determined by estimating their fair value on the date of grant, and recognizing that value as an expense on a straight-line basis over the requisite service period in which our employees earn the awards. Compensation expense related to these equity awards is recognized net of estimated forfeitures, which reduce the expense recorded in the consolidated statements of operations. The selection of applicable estimated forfeiture rates is based on an evaluation of trends in our historical forfeiture data with consideration for other potential driving factors. If in subsequent periods actual forfeitures significantly differ from our initial estimates, we will revise such estimates accordingly.

The following two tables separately present stock-based compensation expense both by award type and classification in our consolidated statements of operations (in thousands):

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Expense - By Award Type

	Fiscal Quarter Ended	
	December 29, 2017	December 30, 2016
Compensation Expense - By Type		
Stock options	$6,964	$ 4,803
Restricted stock units	10,780	11,583
Employee stock purchase plan	940	829
Total stock-based compensation	18,684	17,215
Benefit from income taxes	(3,896)	(5,028)
Total stock-based compensation, net of tax	$14,788	$ 12,187

Expense - By Income Statement Line Item Classification

	Fiscal Quarter Ended	
	December 29, 2017	December 30, 2016
Compensation Expense - By Classification		
Cost of products	$262	$ 258
Cost of services	118	134
Research and development	4,877	4,930
Sales and marketing	5,951	6,867
General and administrative	7,476	5,026
Total stock-based compensation expense	18,684	17,215
Benefit from income taxes	(3,896)	(5,028)
Total stock-based compensation, net of tax	$14,788	$ 12,187

The tax benefit that we recognize from shares issued under our ESPP is excluded from the tables above. This benefit was as follows (in thousands):

	Fiscal Quarter Ended	
	December 29, 2017	December 30, 2016
Tax benefit - shares issued under ESPP	$ 305	$ 324

Unrecognized Compensation Expense. At December 29, 2017, total unrecorded compensation expense associated with employee stock options expected to vest was approximately $37.6 million, which is expected to be recognized over a weighted-average period of 2.6 years. At December 29, 2017, total unrecorded compensation expense associated with RSUs expected to vest was approximately $115.7 million, which is expected to be recognized over a weighted-average period of 2.9 years.

Common Stock Repurchase Program

In November 2009, we announced a stock repurchase program ("program"), providing for the repurchase of up to $250.0 million of our Class A common stock. The following table summarizes the initial amount of authorized repurchases as well as additional repurchases approved by our Board of Directors as of December 29, 2017 (in thousands):

Authorization Period	Authorization Amount
Fiscal 2010: November 2009	$ 250,000
Fiscal 2010: July 2010	300,000
Fiscal 2011: July 2011	250,000
Fiscal 2012: February 2012	100,000
Fiscal 2015: October 2014	200,000

Fiscal 2017: January 2017	200,000
Total	$ 1,300,000

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Stock repurchases under the program may be made through open market transactions, negotiated purchases, or otherwise, at times and in amounts that we consider appropriate. The timing of repurchases and the number of shares repurchased depend upon a variety of factors, including price, regulatory requirements, the rate of dilution from our equity compensation plans, and other market conditions. The program does not have a specified expiration date, and can be limited, suspended or terminated at our discretion at any time without prior notice. Shares repurchased under the program will be returned to the status of authorized but unissued shares of Class A common stock. As of December 29, 2017, the remaining authorization to purchase additional shares is approximately $122.0 million.
The following table provides information regarding share repurchase activity under the program during fiscal 2018:

Quarterly Repurchase Activity	Shares Repurchased	Cost in thousands (1)	Average Price Paid Per Share (2)
Q1 - Quarter ended December 29, 2017	493,884	$ 29,999	$ 60.73

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

Dividend

In October 2014, our Board of Directors initiated a recurring quarterly dividend program for our stockholders. The following table summarizes dividends declared under the program in relation to fiscal 2018:

Fiscal Period	Declaration Date	Record Date	Payment Date	Cash Dividend Per Common Share	Dividend Payment	
Fiscal 2018						
Q1 - Quarter ended December 29, 2017	January 24, 2018	February 5, 2018	February 14, 2018	$ 0.16	$16.5 million	(1)

(1) The amount of the dividend payment is estimated based on the number of shares of our Class A and Class B common stock that we estimate will be outstanding as of the Record Date.

8. Accumulated Other Comprehensive Income

Other comprehensive income consists of two components: unrealized gains or losses on our AFS marketable investment securities and the gains and losses from the translation of assets and liabilities denominated in non-U.S. dollar functional currencies. Until realized and reported as a component of net income, these comprehensive income items accumulate and are included within accumulated other comprehensive income, a subsection within stockholders' equity in our consolidated balance sheets. Unrealized gains and losses on our investment securities are reclassified from AOCI into earnings when realized upon sale, and are determined based on specific identification of securities sold.

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

	Fiscal Quarter Ended December 29, 2017		
	Investment Securities	Currency Translation Adjustments	Total
Beginning Balance	$(377)	$ (7,376)	$(7,753)
Other comprehensive income before reclassifications:			—
Unrealized gains/(losses) - investment securities	(1,696)		(1,696)
Foreign currency translation gains/(losses) (1)		1,498	1,498
Income tax effect - benefit/(expense)	87	(274)	(187)
Net of tax	(1,609)	1,224	(385)
Amounts reclassified from AOCI into earnings:			
Realized gains/(losses) - investment securities (1)	20		20
Income tax effect - benefit/(expense) (2)	(4)		(4)
Net of tax	16	—	16
Net current-period other comprehensive income/(loss)	(1,593)	1,224	(369)
Ending Balance	$(1,970)	$ (6,152)	$(8,122)

	Fiscal Quarter Ended December 30, 2016		
	Investment Securities	Currency Translation Adjustments	Total
Beginning Balance	$742	$ (10,939)	$(10,197)
Other comprehensive income before reclassifications:			
Unrealized gains/(losses) - investment securities	(2,160)		(2,160)
Foreign currency translation gains/(losses) (1)		(8,728)	(8,728)
Income tax effect - benefit/(expense)	102	1,265	1,367
Net of tax	(2,058)	(7,463)	(9,521)
Amounts reclassified from AOCI into earnings:			
Realized gains/(losses) - investment securities (1)	46		46
Income tax effect - benefit/(expense) (2)	(7)		(7)
Net of tax	39	—	39
Net current-period other comprehensive income/(loss)	(2,019)	(7,463)	(9,482)
Ending Balance	$(1,277)	$ (18,402)	$(19,679)

(1) Realized gains or losses, if any, from the sale of our AFS investment securities or from foreign currency translation adjustments are included within other income/expense, net in our consolidated statements of operations.

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

9. Earnings Per Share

Basic EPS is computed by dividing net income attributable to Dolby Laboratories, Inc. by the number of weighted-average shares of Class A and Class B common stock outstanding during the period. Through application of the treasury stock method, diluted EPS is computed in the same manner, except that the number of weighted-average shares outstanding is increased by the number of potentially dilutive shares from employee incentive plans during the period.

Basic and diluted EPS are computed independently for each fiscal quarter and year-to-date period presented,

which involves the use of different weighted-average share count figures relating to quarterly and annual periods. As a result, and after factoring the effect of rounding to the nearest cent per share, the sum of all four quarter-to-date EPS figures may not equal year-to-date EPS.

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Potentially dilutive shares represent the hypothetical number of incremental shares issuable under the assumed exercise of outstanding stock options (both vested and non-vested) and vesting of outstanding RSUs. The calculation of dilutive shares outstanding excludes out-of-the-money stock options (e.g., such options' exercise prices were greater than the average market price of our common shares for the period) because their inclusion would have been antidilutive. In periods when we report a net loss, stock awards are excluded from our calculation of earnings per share as their inclusion would have an antidilutive effect. In the first quarter of fiscal 2018, we excluded stock awards of 2,424 stock options and 1,358 RSUs.

The following table sets forth the computation of basic and diluted EPS attributable to Dolby Laboratories, Inc. (in thousands, except per share amounts):

	Fiscal Quarter Ended	
	December 29, 2017	December 30, 2016
Numerator:		
Net income/(loss) attributable to Dolby Laboratories, Inc.	$(81,622)	$ 53,374
Denominator:		
Weighted-average shares outstanding—basic	102,552	101,483
Potential common shares from options to purchase common stock	—	1,385
Potential common shares from restricted stock units	—	1,008
Weighted-average shares outstanding—diluted	102,552	103,876
Net income/(loss) per share attributable to Dolby Laboratories, Inc.:		
Basic	$(0.80)	$ 0.53
Diluted	$(0.80)	$ 0.51
Antidilutive awards excluded from calculation:		
Stock options	2,424	739
Restricted stock units	1,358	42

10. Income Taxes

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

Tax Act Enacted in 2017

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act ("Tax Act"). The Tax Act makes broad and complex changes to the U.S. tax code, including, but not limited to, (1) reducing the U.S. federal corporate income tax rate from 35 percent to 21 percent; (2) requiring companies to pay a one-time transition tax on certain unrepatriated earnings of foreign subsidiaries; (3) generally eliminating U.S. federal corporate income taxes on dividends from foreign subsidiaries; (4) capitalizing specific R&D expenses which are amortized over five to 15 years; and (5) other changes to how foreign and domestic earnings are taxed.

Our accounting for the impact of the Tax Act reflects reasonable estimates of certain effects. We recorded a total provisional amount of $154.6 million in our first quarter of fiscal 2018 income tax provision as follows:

- Remeasurement of net deferred tax assets: The Tax Act reduces the corporate tax rate from 35 percent to 21 percent, which results in an estimated net decrease of $57.9 million in our net deferred tax asset balance. While we are able to make a reasonable estimate of the impact of the reduced corporate tax rate on our net deferred tax asset balances, we are continuing to gather additional information to assess the impact.
- Deemed Repatriation Transition Tax: The Deemed Repatriation Transition Tax ("Transition Tax") is a tax on certain unrepatriated earnings of our foreign subsidiaries. To determine the amount of the Transition Tax, we must determine, in addition to other factors, the amount of post-1986 earnings and profits of the relevant subsidiaries, as well as the amount of foreign income taxes paid on such earnings and profits. The portion of earnings and profits comprised of cash and other specified assets is taxed at a rate of 15.5 percent and any

remaining amount of earnings and profits is taxed at a rate of eight percent. We made a reasonable estimate of the Transition Tax and recorded a liability for a provisional Transition Tax obligation of $96.7 million payable over a period of up to eight years. However, we are continuing to gather additional information to more precisely compute the liability for the Transition Tax.

Other significant provisions that are not yet effective, but will impact income taxes in future years include: an exemption from U.S. tax on dividends of future foreign earnings, an incremental tax on excessive amounts paid to foreign related parties, and a minimum tax on certain foreign earnings in excess of 10 percent of the foreign subsidiaries' tangible assets ("minimum foreign tax"). We are still evaluating whether to make a policy election to treat the minimum foreign tax as a period expense or to provide U.S. deferred taxes on temporary differences related to the minimum foreign tax.

The final transitional impacts of the Tax Act may differ from our initial estimate, due to, among other things, changes in interpretations of the Tax Act, any legislative actions to address questions that arise because of the Tax Act, any changes in accounting standards for income taxes or related interpretations in response to the Tax Act, any updates or changes to estimates we have utilized to calculate the transition impacts, any impact of changes to our current assertion to indefinitely reinvest foreign earnings as a result of the Tax Act, and any impacts from changes to current year earnings estimates. The Securities Exchange Commission has issued rules that would allow for a measurement period of up to one year after the enactment date of the Tax Act to finalize the recording of the related tax impacts. We currently anticipate finalizing and recording any resulting adjustments by the end of our current fiscal year ending September 28, 2018.

Unrecognized Tax Benefit

As of December 29, 2017, the total amount of gross unrecognized tax benefits was $101.0 million, of which $87.9 million, if recognized, would reduce our effective tax rate. As of September 29, 2017, the total amount of gross unrecognized tax benefits was $98.7 million, of which $85.0 million, if recognized, would reduce our effective tax rate. Our net liability for unrecognized tax benefits is classified within other non-current liabilities in our consolidated balance sheets.

Withholding Taxes

We recognize licensing revenue gross of withholding taxes, which our licensees remit directly to their local tax authorities, and for which we receive a partial foreign tax credit in our income tax provision. The foreign current tax provision includes this withholding tax expense while the appropriate foreign tax credit benefit is included in current federal and foreign taxes. Withholding taxes were as follows (in thousands):

	Fiscal Quarter Ended	
	December 29, 2017	December 30, 2016
Withholding taxes	$12,264	$ 8,991

Effective Tax Rate

Each period, the combination of different factors can impact our effective tax rate. These factors include both recurring items such as tax rates and the relative amount of income earned in foreign jurisdictions, as well as discrete items such as changes to our uncertain tax positions, that may occur in, but are not necessarily consistent between periods.

Our effective tax rate in the first quarter of fiscal 2018 was 196.0%, compared to 20.8% in the first quarter of fiscal 2017. The 175 percentage point increase in our effective tax rate reflects a 182 percentage point impact from the Tax Act, partially offset by a seven percentage point decrease from the excess tax benefit related to stock-based awards.

11. Restructuring

Restructuring charges recorded in our statements of operations represent costs associated with separate individual restructuring plans implemented in various fiscal periods. Costs arising from these actions, including fluctuations in related balances between fiscal periods, are based on the nature of activities under the various plans.

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Fiscal 2017 Restructuring Plan ("Restructuring Plan"). In September 2017, we implemented a plan to reduce certain activities in order to reallocate those resources towards higher priority investment areas. As a result, we recorded $12.9 million in restructuring costs during fiscal 2017, representing severance and other related benefits offered to approximately 80 employees that were affected by this action. The table presented below summarizes changes in restructuring accruals under this plan (in thousands):

	Severance and associated costs
Restructuring charges	$ 12,856
Cash payments	(168)
Non-cash and other adjustments	—
Balance at September 29, 2017	$ 12,688
Restructuring charges	67
Cash payments	(9,060)
Non-cash and other adjustments	(264)
Balance at December 29, 2017	$ 3,431

Accruals for restructuring charges are included within accrued liabilities in our consolidated balance sheets while restructuring charges/(credits) are included within restructuring charges/(credits) in our consolidated statements of operations.

12. Legal Matters

We are involved in various legal proceedings that occasionally arise in the normal course of business. These can include claims of alleged infringement of IP rights, commercial, employment, and other matters. In our opinion, resolution of these proceedings is not expected to have a material adverse impact on our operating results or financial condition. Given the unpredictable nature of legal proceedings, it is possible that an unfavorable resolution of one or more such proceedings could materially affect our future operating results or financial condition in a particular period, including as a result of required changes to our licensing terms, monetary penalties, and other potential consequences. However, based on the information known by us as of the date of this filing and the rules and regulations applicable to the preparation of our consolidated financial statements, any such amounts are either immaterial, or it is not possible to provide an estimated amount of any such potential losses.

13. Commitments & Contingencies

In the ordinary course of business, we enter into contractual agreements with third parties that include non-cancelable payment obligations, for which we are liable in future periods. These arrangements can include terms binding us to minimum payments and/or penalties if we terminate the agreement for any reason other than an event of default as described by the agreement. The following table presents a summary of our contractual obligations and commitments as of December 29, 2017(in thousands):

	Payments Due By Fiscal Period						
	Remainder of Fiscal 2018	Fiscal 2019	Fiscal 2020	Fiscal 2021	Fiscal 2022	Thereafter	Total
Naming rights	$3,857	$7,811	$7,909	$8,008	$8,108	$86,865	$122,558
Operating leases	12,428	15,306	13,095	10,429	9,174	25,540	85,972
Purchase obligations	18,062	25,358	22,047	333	333	—	66,133
Donation commitments	200	6,300	322	122	122	958	8,024
Total	$34,547	$54,775	$43,373	$18,892	$17,737	$113,363	$282,687

Naming Rights. We are party to an agreement for naming rights and related benefits with respect to the Dolby Theatre in Hollywood, California, the location of the Academy Awards®. The term of the agreement is 20 years, over which we will make payments on a semi-annual basis until fiscal 2032. Our payment obligations are conditioned in part on the Academy Awards being held and broadcast from the Dolby Theatre.

Operating Leases. Operating lease payments represent our commitments for future minimum rent made under non-cancelable leases for office space, including those payable to our principal stockholder and portions attributable to the controlling interests in our wholly owned subsidiaries.

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Purchase Obligations. Purchase obligations primarily consist of our commitments made under agreements to purchase goods and services related to Dolby Cinema and for purposes that include IT and telecommunications, marketing and professional services, and manufacturing and other R&D activities.
Donation Commitments. Donation commitments primarily relate to a non-cancelable obligation entered into during fiscal 2014 to install and donate imaging and audio products to the Museum of the Academy of Motion Picture Arts and Sciences in Los Angeles, California, and to provide maintenance services for fifteen years from its expected opening date in fiscal 2019, in exchange for various marketing, branding, and publicity benefits.
Indemnification Clauses. On a limited basis, our contractual agreements contain a clause under which we agree to provide indemnification to the counterparty, most commonly to licensees in connection with licensing arrangements that include our IP. We have also entered into indemnification agreements with our officers, directors, and certain employees, and our certificate of incorporation and bylaws contain similar indemnification obligations. Additionally, and although not a contractual requirement, we have at times elected to defend our licensees from third party IP infringement claims. Since the terms and conditions of our contractual indemnification clauses do not explicitly specify our obligations, we are unable to reasonably estimate the maximum potential exposure for which we could be liable. Furthermore, we have not historically made any payments in connection with any such obligation and believe there to be a remote likelihood that any potential exposure in future periods would be of a material amount. As a result, no amounts have been accrued in our consolidated financial statements with respect to the contingent aspect of these indemnities.

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

The following discussion and analysis should be read in conjunction with our unaudited interim condensed consolidated financial statements and the related notes that appear elsewhere in this Quarterly Report on Form 10-Q. This discussion contains forward-looking statements reflecting our current expectations and are subject to risks and uncertainties, including, but not limited to statements regarding: operating results and underlying measures; demand and acceptance for our technologies and products; market growth opportunities and trends; our plans, strategies and expected opportunities; future competition; our stock repurchase plan; and our dividend policy. Use of words such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential," "continue" or similar expr indicates a forward-looking statement. Actual results may differ materially from those discussed in these forward-looking statements due to a number of factors, including the risks set forth in Part II, Item 1A, "Risk Factors." Such forward-looking statements are based on management's reasonable current assumptions and expectations. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We are under no duty to update any of the forward-looking statements after the date of this Quarterly Report on Form 10-Q to conform our prior statements to new developments or actual results.

Investors and others should note that we disseminate information to the public about our company, our products, services and other matters through various channels, including our website (www.dolby.com), our investor relations website (http://investor.dolby.com), SEC filings, press releases, public conference calls, and webcasts, in order to achieve broad, non-exclusionary distribution of information to the public. We encourage investors and others to review the information we make public through these channels, as such information could be deemed to be material information.

OVERVIEW

Dolby Laboratories creates audio and imaging technologies that transform entertainment and communications at the cinema, at home, at work, and on mobile devices. Founded in 1965, our strengths stem from expertise in analog and digital signal processing and digital compression technologies that have transformed the ability of artists to convey entertainment experiences to their audiences through recorded media. Such technologies led to the development of our noise-reduction systems for analog tape recordings, and have since evolved into multiple offerings that enable more immersive sound for cinema, digital television transmissions and devices, OTT video services, DVD and Blu-ray Discs, gaming consoles, and mobile devices. Today, we derive the majority of our revenue from licensing our audio technologies. We also derive revenue from licensing our consumer imaging and communication technologies, as well as audio and imaging technologies for premium cinema offerings in collaboration with exhibitors. Finally, we provide products and services for a variety of applications in the cinema, broadcast, and communications markets.

OUR STRATEGY

Key elements of our strategy include:

Advancing the Science of Sight and Sound. We apply our understanding of the human senses, audio, and imaging engineering to develop technologies aimed at improving how people experience and interact with their entertainment and communications content.

Providing Creative Solutions. We promote the use of our solutions as creative tools, and provide our products, services, and technologies to filmmakers, sound mixers, and other production teams in their creative processes. Our tools help showcase the quality and impact of their efforts and intent, and this may generate market demand.

Delivering Superior Experiences. Our technologies and solutions optimize playback and communications so that users may enjoy sound and sight in Dolby, which provide a more rich, clear, and immersive experience.

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REVENUE GENERATION

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

Revenue	Fiscal Quarter Ended	
	December 29, 2017	December 30, 2016
Licensing	90%	87%
Products	8%	11%
Services	2%	2%
Total	100%	100%

We license our technologies in approximately 50 countries, and our licensees distribute products that incorporate our technologies throughout the world. As shown in the table below, we generate the majority of our revenue from outside the United States. Geographic data for our licensing revenue is based on the location of our licensees' headquarters, products revenue is based on the destination to which we ship our products, and services revenue is based on the location where services are performed.

Revenue By Geographic Location	Fiscal Quarter Ended	
	December 29, 2017	December 30, 2016
United States	26%	32%
International	74%	68%

We have active licensing arrangements with over 550 electronics product OEMs and software developer licensees. As of December 29, 2017, we had approximately 8,500 issued patents relating to technologies from which we derive a significant portion of our licensing revenue. We have approximately 1,000 trademark registrations throughout the world for a variety of wordmarks, logos, and slogans. These trademarks are an integral part of our technology licensing program as licensees typically place them on their products which incorporate our technologies to inform consumers that they have met our quality specifications.

Licensing

We license our technologies to a range of customers who incorporate them into their products for enhanced audio and imaging functionality whether it be at home, at work, on mobile devices, or at the cinema. Our key technologies are as follows:

Technology	Description
AAC & HE-AAC	An advanced digital audio codec solution with higher bandwidth efficiency used for a wide range of media applications such as TVs, STBs, PCs, gaming consoles, mobile devices, and digital radio.
AVC	A digital video codec with high bandwidth efficiency used in a wide range of media devices, such as TVs, STBs, PCs, gaming consoles, and mobile devices.
Dolby® AC-4	A next-generation digital audio coding technology that increases transmission efficiency while delivering new audio experiences to a wide range of playback devices, including TVs, STBs, PCs, gaming consoles, and mobile devices.
Dolby Atmos®	An object-oriented audio technology for home theaters, cinema, device speakers, and headphones that allows sound to be precisely placed and moved anywhere in the listening environment including the overhead dimension. Dolby Atmos is an immersive experience that can be provided via multiple Dolby audio coding technologies.
Dolby Digital®	A digital audio coding technology that provides multichannel sound to applications such as DVD players, TVs, and STBs.
Dolby Digital Plus™	An advanced digital audio coding technology that offers more efficient audio transmission for a wide range of media applications such as TVs, STBs, Blu-ray Discs, PCs, and mobile devices.
Dolby® TrueHD	A digital audio coding technology providing lossless encoding for premium quality media applications such as Blu-ray Discs and home theaters.
Dolby Vision™	

	An imaging technology combining HDR, an expanded color spectrum, and dynamic metadata to deliver higher contrast, brighter highlights, and improved details for TV, cinema, mobile devices, and other consumer devices.
Dolby Voice®	An audio conferencing technology with superior spatial perception, voice clarity, and background noise reduction that emulates the in-person meeting experience.
HEVC	A next-generation digital video codec with high bandwidth efficiency to support ultra-high definition experiences for a wide range of media devices.

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

Market	Fiscal Quarter Ended December 29, 2017	December 30, 2016	Main Offerings Incorporating Our Technologies
Broadcast	40%	46%	STBs & Televisions
Mobile	23%	10%	Smartphones & Tablets
CE	11%	12%	DMAs, Blu-ray Disc devices, AVRs, Soundbars, DVDs, & HTIBs
PC	10%	15%	Windows and macOS operating systems
Other	16%	17%	Gaming consoles, Auto DVD, Dolby Cinema, Dolby Voice
Total	100%	100%	

We have various licensing models: a two-tier model, an integrated licensing model, a patent licensing model, and collaboration arrangements.

Two-Tier Licensing Model. Most of our consumer entertainment licensing business consists of a two-tier licensing model whereby our decoding technologies, included in reference software and firmware code, are first provided under license to semiconductor manufacturers whom we refer to as "implementation licensees." Implementation licensees incorporate our technologies in ICs which they sell to OEMs of consumer entertainment products, whom we refer to as "system licensees." System licensees separately obtain licenses from us that allow them to make and sell end-user products using ICs that incorporate our technologies.

Implementation licensees pay us a one-time, up-front fee per license. In exchange, the licensee receives a licensing package which includes information that is useful in implementing our technologies into their chipsets. Once implemented, the licensee sends us a sample chipset for quality control evaluation, and following our validation of the design, the licensee is permitted to sell the chipset for use solely to our network of system licensees.

System licensees provide us with prototypes of products, or self-test results of products that incorporate our technologies. Upon our confirmation that our technologies are optimally and consistently incorporated, the system licensee may buy ICs under a license for the same Dolby technology from our network of implementation licensees, and may further sell approved products to retailers, distributors, and consumers. For the use of our technologies, our system licensees pay an initial licensing fee as well as royalties, which represent the majority of the revenue recognized from these arrangements. The amount of royalties we collect on a particular product depends on several factors including the nature of the implementations, the mix of Dolby technologies used, and the volume of products using our technologies that are shipped by the system licensee.

Integrated Licensing Model. We also license our technologies to software operating system vendors and to certain other OEMs that act as combined implementation and system licensees. These licensees incorporate our technologies in their software used on PCs, in mobile applications, or in ICs they manufacture and incorporate into their products. As with the two-tier licensing model, the combined implementation and system licensee pays us an initial licensing fee in addition to royalties as determined by the mix of Dolby technologies used, the nature of the implementations, and the volume of products using our technologies that are shipped, and is subject to the same quality control evaluation process.

Patent Licensing Model. We license our patents through patent pools which are arrangements between multiple patent owners to jointly offer and license pooled patents to licensees. We also license our patents directly to manufacturers that use our IP in their products. Finally, we generate service fees for managing patent pools on behalf of third party patent owners through our wholly-owned subsidiary, Via Licensing Corporation. By aggregating and offering pooled IP, patent pools deliver efficiencies that reduce transactional costs for both IP owners and licensees. The Via Licensing patent pools enable product manufacturers to efficiently and transparently secure patent licenses for audio coding, interactive television, digital radio, and wireless technologies. We offer our AAC, AVC, HE-AAC, HEVC, and other IP through patent licensing. Currently, most of our revenue earned from patent licensing relates to the licensing of AAC and HE-AAC technologies.

Collaboration Arrangements.

Dolby Cinema: We partner with exhibitors to deliver a premium cinema offering with Dolby Vision and Dolby Atmos at new and pre-existing venues. We receive a portion of box-office receipts from the installed theaters.

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Dolby Voice: We enter into arrangements with audio and video conferencing providers where, in return for licensing our IP and know-how, we earn revenue based on access to our technology and services as well as on sales of the Dolby Conference Phone (see "Products" below).
Settlements & Back Payments From Licensees: Licensing revenue recognized in any given quarter may include back payments and/or settlements with licensees. Within the Results of Operations section of Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations," settlements and back payments are collectively referred to as "recoveries." Such recoveries have become a recurring element of our business and are particularly subject to fluctuation and unpredictability.
Products
We design and manufacture audio and imaging products for the cinema, television, broadcast, and entertainment industries. Distributed in over 80 countries, these products are used in content creation, distribution, and playback to enhance image and sound quality, and improve transmission and playback. We also market and sell the Dolby Conference Phone which optimizes the conference call experience when using Dolby Voice.
Products revenue is derived primarily from sales of the following:

Product		Description
Cinema	Cinema Imaging Products	Digital Cinema Servers used to load, store, decrypt, decode, watermark, and playback digital film files for presentation on digital cinema projectors and software used to encrypt, encode, and package digital media files for distribution.
	Cinema Audio Products	Cinema Processors, amplifiers, and loudspeakers used to decode, render, and optimally playback digital cinema soundtracks including those using Dolby Atmos.
Other	Dolby Conference Phone	An integral hardware component of the Dolby Voice conferencing solution that enhances productivity through superior sound, full-room voice capture, spatial voice separation, and touch-screen interface.
	Other Products	3-D glasses and kits, broadcast hardware and software used to encode, transmit, and decode multiple channels of high quality audio for DTV and HDTV distribution, monitors, and accessibility solutions for hearing and visually impaired consumers.

Services
We offer various services to support theatrical and television production for cinema exhibition, broadcast, and home entertainment, including equipment training and maintenance, mixing room alignment, equalization, as well as audio, color, and light image calibration. We also provide PCS for products sold and equipment installed at Dolby Cinema theaters operated by exhibitor partners, and support the implementation of our technologies into products manufactured by our licensees.

EXECUTIVE SUMMARY

We are focused on expanding our leadership in audio solutions for entertainment content and delivering dynamic new audio and imaging technologies. This will broaden the number of Dolby experiences that people can enjoy, which in turn will help drive our revenue growth. Following is a discussion of the key markets that we address and the various Dolby technologies and solutions that serve these markets.

EXPANDING OUR LEADERSHIP IN AUDIO SOLUTIONS
AUDIO LICENSING
The majority of our licensing revenue is derived from the licensing of audio technologies. The following are highlights of our first quarter of fiscal 2018 and key challenges related to audio licensing by markets.
Broadcast
Highlights: We have an established presence in developed markets with respect to our DD+ and HE-AAC technologies in HDTV services and devices. We are focused on increased adoption of DD+ in emerging markets such as China and India, where the HDTV transition is still underway, by working with country-specific operators and standards bodies to drive longer term growth.
We continue to see new products introduced that incorporate our leading audio technologies, such as Dolby Atmos and AC-4. At CES in January 2018, LG announced that all 2018 LG OLED and Super UHD TVs will support both Dolby Atmos and Dolby Vision. In addition, TCL announced that they would be offering TVs with Dolby Atmos and Dolby Vision, and Skyworth announced that they would be offering TVs with Dolby Atmos.
Along with these new product introductions, the availability of content in Dolby formats continues to grow in streaming and live broadcast. Dolby Atmos is now available through two new streaming OTT providers, Rakuten in Europe and Okko in Russia, adding to the list of OTT providers which includes Netflix, Tencent, and iQiYi.
In live broadcast, BT and Sky TV continue the production of live sporting events in Dolby Atmos. During the first quarter of fiscal 2018, in China, the New Year's Gala was broadcast in Dolby Atmos by two tier one networks, including HunanTV, one of the most watched channels in China. This event marks the first time that Dolby Atmos was broadcast by paid TV operators in China. Most recently, Comcast announced that they will deliver the 2018 Winter Olympics in Dolby Atmos and Canal Plus announced their first Dolby Atmos set-top box along with availability of Dolby Atmos content.
Key Challenges: To achieve growth and further adoption in emerging markets where conversion to digital television is still underway, our success will be impacted by a number of factors such as regional fragmentation of operators and regulators, and the pace of their decision-making and implementation. Further, in some emerging growth countries, such as China, we face difficulties enforcing our contractual and IP rights, including instances in which our licensees fail to accurately report the shipment of products using our technologies. We must continue to present compelling reasons for consumers to demand our audio and imaging technologies. To the extent that OEMs do not incorporate our technologies in current and future products, our revenue could be impacted.
Consumer Electronics
Highlights: We have an established presence in the home theater market that provides compatibility across devices, such as AVRs and DMAs, through the inclusion of our DD+ and HE-AAC technologies. Additionally, the adoption of Dolby Atmos continues to expand across a wide range of devices including AVRs, speakers, soundbars, and DMAs. At CES in January 2018, new soundbars featuring Dolby Atmos were announced by LG and Sony with price points starting below $600. These hardware offerings can be paired with a growing array of Dolby enabled content via OTT services and Blu-ray discs, and the lower price points make them more accessible to mainstream consumers.
We will continue to work with OEMs to expand the range of Dolby Atmos-enabled hardware, and with content developers and distributors to expand the range of entertainment offerings that utilize our audio technologies.

Key Challenges: We must continue to present compelling reasons for consumers to demand our audio and imaging technologies wherever they enjoy entertainment content. To the extent that OEMs do not incorporate our technologies in current and future products, our revenue could be impacted.

Mobile

Highlights: DD+ is incorporated in Apple's iOS, and we continue to focus on adoption of our technologies across other major mobile ecosystems, such as Android, Windows, and Amazon, to facilitate delivery and enhanced consumption of Dolby-enabled content from a multitude of streaming services. In addition, HE-AAC is a de facto audio standard across mobile devices. Dolby Atmos is currently featured on a number of mobile devices from partners such as Amazon, Lenovo, ZTE, and Razer.

We had higher revenue from recoveries in our mobile market in the first quarter of fiscal 2018 compared to the first quarter of fiscal 2017. We also derive revenue in our mobile market from patent licensing, and we saw revenue growth in this market in the first quarter of fiscal 2018 compared to the first quarter of fiscal 2017.

Key Challenges: Growth in this market is dependent on several factors. Due to short product lifecycles, it is easier for mobile device OEMs to add or remove certain of our technologies from mobile devices. Our success depends on our ability to address the rapid pace of change in mobile devices. We must continuously collaborate with manufacturers of mobile devices to incorporate our technologies. Finally, we must continue to support the development and distribution of Dolby content via various ecosystems.

Personal Computers

Highlights: DD+ and HE-AAC continue to enhance playback in both Mac and Windows operating systems, including native support in their respective Safari and Microsoft Edge browsers. Dolby's presence in these browsers enables us to reach more users through new types of content, including streaming video entertainment.

Dolby Atmos is currently featured on PCs from partners such as Lenovo, Huawei, and Xiaomi.

Key Challenges: In recent years, unit demand for PCs has experienced secular decline as consumer choices have shifted towards other devices such as tablets and mobile phones. This has caused downward pressure on our PC revenues. Furthermore, a decline in the portion of PCs that have optical disc functionality will have a negative impact on our ASPs.

Other

Highlights: DD+ is incorporated in both the Xbox and Playstation gaming consoles and platforms. Dolby Atmos is enabled for Windows and Xbox One, which enables playback on devices such as Dolby Atmos soundbars and AVRs. Additionally, purchasing an app on the Microsoft app store or an OEM gaming headset bundled with Dolby Atmos for Headphones can enable Dolby Atmos on a user's headphones. Six Dolby Atmos games are currently available on the Xbox One.

We also generate revenue from the automotive industry primarily through DVD players as well as other elements of the entertainment system.

Key Challenges: The gaming console market continues to be challenged by competition from mobile devices and gaming PCs, which have faster refresh cycles and appeal to a broader consumer base. This may impact our future revenues.

PRODUCTS AND SERVICES

We also generate revenue by providing products and services for a variety of applications in the cinema, broadcast, and communications markets.

Highlights: We offer servers and audio processors to enable the playback of content in cinemas. We continue to see continued adoption of Dolby Atmos by studios, content creators, post-production facilities, and exhibitors. As of the end of the first quarter of fiscal 2018, there were approximately 3,200 Dolby Atmos-enabled screens installed and approximately 880 Dolby Atmos theatrical titles announced or released.

We expect future growth from our newer cinema products, which include the IMS3000, an integrated imaging and audio server with Dolby Atmos, the Dolby Multichannel Amplifier, and our 3-Axis speaker. These products allow us to offer a more complete Dolby Atmos offering that can also provide exhibitors with a more cost effective solution than what was previously available to them.
Key Challenges: Demand for our cinema products is dependent upon industry and economic cycles and box office performance generally, along with our ability to develop and introduce new technologies, further our relationships with content creators, and promote new cinematic audio and imaging experiences. To the extent that we do not make progress in these areas, or are faced with pricing pressures or competing technologies, our revenue may be adversely affected.

EXPANDING INTO NEW AUDIO AND VISUAL EXPERIENCES
Our new growth initiatives include Imaging Licensing (comprised of Dolby Vision™ and our patent licensing initiatives related to consumer imaging), Dolby Cinema™, and Dolby Voice®. New growth initiative revenue, which is mostly in licensing, but also includes product revenue for Dolby Conference Phones, was approximately $60 million in fiscal 2017 and is expected to approximately double in fiscal 2018. Key highlights of our first quarter of fiscal 2018 and future challenges related to our new growth initiatives are described below.

Imaging Licensing
Highlights: Dolby Vision is our end-to-end solution for delivering HDR content across TVs, Blu-ray players, smartphones, tablets, DMAs, STBs, and now PCs.
At CES in January 2018, additional products with Dolby Vision were announced with both new and existing partners. Over 10 TV partners have announced their 2018 Dolby Vision TVs and many are expanding Dolby Vision into mainstream lines with price points starting at $500, making these devices more accessible to mainstream customers. Sony and Panasonic announced their first UHD Blu-ray players, joining LG, Phillips, and Oppo who launched Dolby Vision Blu-ray players in fiscal 2017. In the PC marketplace, Lenovo recently announced the inclusion of Dolby Vision in two of its ThinkPad X1 Series models, the X1 Carbon and X1 Yoga, which marks the first PCs to support Dolby Vision.
The availability of entertainment content in Dolby Vision continues to grow. Disney, Lionsgate, Paramount, Sony Pictures, Universal, and Warner Bros. have all released content in Dolby Vision and Dolby Atmos for the home, and an increasing number of Blu-ray discs are being released in Dolby Vision and Dolby Atmos. Movie titles and original TV content are also available in Dolby Vision through a number of OTT streaming partners, which include Netflix, iTunes, Amazon, Vudu, Tencent, Rakuten, and iQiYi.
Netflix and iTunes have provided Dolby Vision content to iOS since the release of Dolby Vision in the iPhone X, iPhone 8, iPad Pro lineup, and Apple TV 4K. In the first quarter of fiscal 2018, Tencent also began streaming Dolby Vision content to these devices. iTunes now has over 200 movies available in Dolby Vision, compared to 100 as of the fourth quarter of fiscal 2017, and Netflix now has over 200 hours of original content in Dolby Vision.
Our HEVC and AVC imaging technologies offer efficient delivery of video content across a variety of devices. We are seeing expanded adoption of these consumer imaging technologies, which helped drive increased revenue in the first quarter of fiscal 2018, primarily in the broadcast and mobile markets.
Key Challenges: The success of Dolby Vision and our consumer imaging IP initiatives will depend on a number of factors, such as the expansion of available Dolby Vision content, broader adoption of our technologies into mainstream consumer device models, licensing penetration, and competition from alternative technologies.

Dolby Cinema
Highlights: During the first quarter of fiscal 2018, we opened 20 new Dolby Cinema screens with our exhibitor partners. Our partners include AMC in the U.S., Wanda, Jackie Chan Cinema, CGV, and Huayi Brothers in Asia, Les cinémas Gaumont Pathé, Cineplexx, and Vue in Europe, and Reel Cinemas in the Middle East. In total, 132 Dolby Cinema locations were operational as of the end of the first quarter of fiscal 2018 compared to 66 as of the end of the

first quarter of fiscal 2017, and we are on track to open approximately as many new Dolby Cinema locations in fiscal 2018 as we did in fiscal 2017. In addition, approximately 130 theatrical titles with Dolby

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Vision and Dolby Atmos have been announced or released with participation from every major studio, and during calendar year 2017, all ten of the highest grossing films in the U.S. were optimized for Dolby Cinema.
Key Challenges: Although the premium large format market for the cinema industry is currently growing, Dolby Cinema is in competition with other existing offerings. Our success with this initiative depends on our ability to differentiate our offering, deploy new sites in accordance with plans, and attract and retain a global viewing audience. In addition, the success of our Dolby Cinema offering will be tied to the pipeline and success of motion pictures available at Dolby Cinema locations and box office performance generally.

Dolby Voice
Highlights: Our primary partners in Dolby Voice are: BlueJeans, a leading video meetings platform, West, a leading global audio conferencing services provider, PGi, Highfive, and BT. We continue to focus on expanding Dolby Voice's availability to the global market for audio and video conferencing services.
Key Challenges: Our success in this market will depend on the number of service providers and enterprise customers we are able to attract from competing solutions, the number of Dolby Conference Phones that we are able to sell, and the volume of usage of the service.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

For a description of the critical accounting policies that affect our more significant judgments and estimates used in the preparation of our consolidated financial statements, refer to Item 7 on Management Discussion and Analysis in our Fiscal 2017 Annual Report on Form 10-K filed with the SEC.

RESULTS OF OPERATIONS

For each line item included on our consolidated statements of operations described and analyzed below, the significant factors identified as the leading drivers contributing to the overall fluctuation are presented in descending order of their impact on the overall change (from an absolute value perspective). Note that recovery payments received from licensees either in the form of back payments or settlements are collectively referred to as "recoveries."

Revenue and Gross Margin

Licensing

Licensing revenue consists of fees earned from licensing our technologies to customers who incorporate them into their products and services to enable and enhance audio, imaging, and voice capabilities. The technologies that we license are either internally developed, acquired, or licensed from third parties. Our cost of licensing consists mainly of amortization of purchased intangible assets and intangible assets acquired in business combinations, third party royalty obligations, and direct fees incurred.

	Fiscal Quarter Ended		Change	
Licensing	December 29, 2017	December 30, 2016	$	%
Revenue	$258,016	$232,699	$25,317	11%
Percentage of total revenue	90%	87%		
Cost of licensing	9,259	8,121	1,138	14%
Gross margin	248,757	224,578	24,179	11%
Gross margin percentage	96%	97%		

Quarter-To-Date: Q1 2018 vs. Q1 2017

Factor		Revenue		Gross Margin
Mobile	á	Higher revenues from recoveries and patent licensing, along with higher volumes	â	Higher cost of licensing primarily due to depreciation of Dolby Cinema equipment
PC	â	Lower revenues from recoveries and lower ASP due to decrease in ODD mix		
Broadcast	â	Lower revenues from STBs, partially offset by higher revenues from imaging and patent licensing as well as timing of recognition due to payment terms in new arrangements		
CE	á	Higher revenue from patent licensing and higher volume of DMAs, partially offset by lower average pricing		
Other	á	Higher revenues from patent licensing in automotive and gaming, administrative fees from Via Licensing patent pools, and Dolby Cinema, partially offset by lower automotive recoveries		

Products

Products revenue is generated from the sale of audio, imaging, and voice products for the cinema, television broadcast, and communications industries. Cost of products consists of materials, labor, and manufacturing overhead, amortization of certain intangible assets, as well as third party royalty obligations.

Products	Fiscal Quarter Ended December 29, 2017	December 30, 2016	Change $	%
Revenue	$24,933	$28,211	$(3,278)	(12)%
Percentage of total revenue	8%	11%		
Cost of products	17,035	17,720	(685)	(4)%
Gross margin	7,898	10,491	(2,593)	(25)%
Gross margin percentage	32%	37%		

Quarter-To-Date: Q1 2018 vs. Q1 2017

Factor		Revenue		Gross Margin
Cinema	â	Lower units of digital server products and audio products	â	Lower utilization of manufacturing capacity and higher excess & obsolete charges, partially offset by improved mix of products

Services

Services revenue consists of fees for production and licensing services, maintenance and support, mixing room alignment, equalization, as well as audio, color, and light image calibration. Cost of services consists of personnel and personnel-related costs for providing our professional services, software maintenance and support, external consultants, and other direct expenses incurred on behalf of customers.

Services	Fiscal Quarter Ended December 29, 2017	December 30, 2016	Change $	%
Revenue	$4,848	$5,357	$(509)	(10)%
Percentage of total revenue	2%	2%		
Cost of services	4,582	4,126	456	11%
Gross margin	266	1,231	(965)	(78)%
Gross margin percentage	5%	23%		

Quarter-To-Date: Q1 2018 vs. Q1 2017

Factor	Revenue	Gross Margin
	â	â

Configuration & Post-Production Support & Other	Lower mastering services and decreased support and maintenance services	Lower utilization of available capacity

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Operating Expenses

Research & Development

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

	Fiscal Quarter Ended		Change	
	December 29, 2017	December 30, 2016	$	%
Research and development	$56,444	$57,518	$(1,074)	(2)%
Percentage of total revenue	20%	22%		

Quarter-To-Date: Q1 2018 vs. Q1 2017

Category	Key Drivers
Product Development	âLower costs related to various research projects and new product development

Sales & Marketing

S&M expenses consist primarily of employee compensation and benefits expenses, stock-based compensation, marketing and promotional expenses for events such as trade shows and conferences, marketing campaigns, travel-related expenses, consulting fees, facilities costs, depreciation and amortization, information technology expenses, and legal costs associated with the protection of our IP.

	Fiscal Quarter Ended		Change	
	December 29, 2017	December 30, 2016	$	%
Sales and marketing	$70,149	$71,175	$(1,026)	(1)%
Percentage of total revenue	24%	27%		

Quarter-To-Date: Q1 2018 vs. Q1 2017

Category	Key Drivers
Marketing Programs	áHigher costs associated with selected marketing efforts
Stock-Based Compensation	âDecrease in award grants
Depreciation & Amortization	âLower amortization from assets that have been fully amortized

General & Administrative

G&A expenses consist primarily of employee compensation and benefits expenses, stock-based compensation, depreciation, facilities and information technology costs, as well as professional fees and other costs associated with external consulting and contract labor.

	Fiscal Quarter Ended		Change	
	December 29, 2017	December 30, 2016	$	%
General and administrative	$48,285	$41,540	$6,745	16%
Percentage of total revenue	17%	16%		

Quarter-To-Date: Q1 2018 vs. Q1 2017

Category	Key Drivers
Stock-Based Compensation	áHigher fair value of award grants
Legal, Professional, & Consulting	áHigher costs associated with patent filings and other various legal activities
Compensation & Benefits	áHigher due to employee base mix
Bad Debt	áHigher charges recorded in the current period

Restructuring

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Restructuring charges recorded as operating expenses in our statement of operations represent costs associated with separate individual restructuring plans implemented in various fiscal periods. The extent of our costs arising as a result of these actions, including fluctuations in related balances between fiscal periods, is based on the nature of activities under the various plans.

Net restructuring charges recorded in the fiscal quarter ended December 29, 2017 were incurred in relation to our fiscal 2017 Restructuring Plan implemented during the fourth quarter of fiscal 2017, and represent costs to reduce certain activities in order to reallocate resources towards higher priority investment areas. These charges and credits primarily related to severance and other related benefits provided to employees that were affected as a result of this action.

Other Income/Expense

Other income/(expense) primarily consists of interest income earned on cash and investments and the net gains/(losses) from foreign currency transactions, derivative instruments, and sales of marketable securities from our investment portfolio.

Other Income/Expense	Fiscal Quarter Ended		Change	
	December 29, 2017	December 30, 2016	$	%
Interest income	$3,781	$1,814	$1,967	108%
Interest expense	(35)	(26)	(9)	35%
Other income/(expense), net	(1,152)	(199)	(953)	479%
Total	$2,594	$1,589	$1,005	63%

Quarter-To-Date: Q1 2018 vs. Q1 2017

Category	Key Drivers
Interest Income	á Increase due to higher yields on our investment balances
Other Income/(Expense)	â Decrease in other expense primarily due to higher currency translation losses

Income Taxes

Our effective tax rate is based on a projection of our annual fiscal year results, and is affected each quarter-end by several factors. These include changes in our projected fiscal year results and recurring items such as tax rates and relative income earned in foreign jurisdictions, as well as discrete items such as the impact of the Tax Act and changes to our uncertain tax positions that may occur in, but are not necessarily consistent between periods. For additional information related to effective tax rates, see Note 10 “Income Taxes” to our consolidated financial statements.

	Fiscal Quarter Ended	
	December 29, 2017	December 30, 2016
Provision for income taxes	$(166,312)	$(14,082)
Effective tax rate	196.0%	20.8%

Quarter-To-Date: Q1 2018 vs. Q1 2017

Factor	Impact On Effective Tax Rate
Tax Act	á Higher tax provision for deemed repatriation and write-down of deferred tax assets
Stock-Based Compensation	â Higher benefit related to the settlement of stock-based awards

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LIQUIDITY, CAPITAL RESOURCES, AND FINANCIAL CONDITION

Our principal sources of liquidity are cash, cash equivalents, and investments, as well as cash flows from operations. We believe that these sources will be sufficient to satisfy our currently anticipated cash requirements through at least the next twelve months. As of December 29, 2017, we had cash and cash equivalents of $596.4 million, which mainly consisted of cash, highly-liquid money market funds, corporate bonds, and municipal debt securities. In addition, we had short and long-term investments of $556.1 million, which consisted primarily of municipal debt securities, certificates of deposit, government bonds, commercial paper, corporate bonds, and U.S. agency securities.

As a result of the Tax Act, we recognized a liability for taxes due on deemed repatriation of unremitted earnings of foreign subsidiaries in our first quarter of fiscal 2018. We are currently evaluating our existing policy to indefinitely reinvest a portion of our undistributed earnings in certain foreign subsidiaries to support the operations and growth of these subsidiaries. Of our total cash, cash equivalents, and investments held as of December 29, 2017, approximately $815 million, or 71%, was held by our foreign subsidiaries. This represented a $15 million decrease from the approximately $830 million that was held by our foreign subsidiaries as of September 29, 2017.

The following table presents selected financial information as of December 29, 2017 and September 29, 2017 (amounts displayed are in thousands):

	December 29, 2017	September 29, 2017
Cash and cash equivalents	$ 596,390	$ 627,017
Short-term investments	252,607	247,757
Long-term investments	303,501	314,364
Accounts receivable, net	122,917	73,750
Accounts payable and accrued liabilities	192,827	221,407
Working capital	812,329	765,661

Capital Expenditures and Uses of Capital

Our capital expenditures consist of purchases of land, building, building fixtures, laboratory equipment, office equipment, computer hardware and software, leasehold improvements, and production and test equipment. Included in capital expenditures are amounts associated with Dolby Cinema locations. We continue to invest in S&M and R&D that contribute to the overall growth of our business and technological innovation.

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

Shareholder Return

We have returned cash to stockholders through repurchases of Class A common stock under our repurchase program initiated in fiscal 2010 and our quarterly dividend program initiated in fiscal 2015. Refer to Note 7 "Stockholders' Equity & Stock-Based Compensation" to our interim condensed consolidated financial statements for a summary of dividend payments made under the program during fiscal 2018 and additional information regarding our stock repurchase program.

Stock Repurchase Program. Our stock repurchase program was approved in fiscal 2010, and since then we have completed approximately $1.2 billion of stock repurchases.

Quarterly Dividend Program. During the first quarter of fiscal 2015, we initiated a recurring quarterly cash dividend program for our stockholders. Under the program, current quarterly dividends of $0.16 per share are paid on our Class A and Class B common stock to eligible stockholders of record for each respective dividend record date.

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Cash Flows Analysis

For the following comparative analysis performed for each of the sections of the statement of cash flows, the significant factors identified as the leading drivers contributing to the fluctuation are presented in descending order of their impact relative to the overall change (amounts displayed in thousands, except as otherwise noted).

Operating Activities

	Fiscal Quarter Ended	
	December 29, 2017	December 30, 2016
Net cash provided by operating activities	$17,149	$ 70,723

Net cash provided by operating activities decreased $53.6 million in the fiscal quarter-to-date period ended December 29, 2017 as compared to the fiscal quarter-to-date period ended December 30, 2016, primarily due to the following:

Factor		Impact On Cash Flows
Income Taxes, Net	á	Higher long term tax liabilities due to impact of the Tax Act
Net Income/(Loss)	â	Net loss in Q1 fiscal 2018 due to impact of the Tax Act
Working Capital	â	Lower inflows due to increase in accounts receivable and decrease in accrued liabilities

Investing Activities

	Fiscal Quarter Ended	
	December 29, 2017	December 30, 2016
Net cash used in investing activities	$(27,372)	$ (26,653)
Capital expenditures	(19,275)	(22,576)

Net cash used in investing activities was $0.7 million higher in the fiscal quarter-to-date period ended December 29, 2017 as compared to the fiscal quarter-to-date period ended December 30, 2016, primarily due to the following:

Factor		Impact On Cash Flows
Proceeds From Investments	á	Higher inflows from the sale & maturity of marketable investment securities
Purchase Of Investments	â	Higher outflows for the purchase of marketable investment securities
Acquisition Of Intangible Assets	â	Higher outflows for the purchase of patent portfolios
Capital Expenditures	á	Lower expenditures for PP&E

Financing Activities

	Fiscal Year-To-Date Ended	
	December 29, 2017	December 30, 2016
Net cash used in financing activities	$(21,274)	$ (41,976)
Repurchase of common stock	(29,993)	(25,001)

Net cash used in financing activities was $20.7 million lower in the fiscal quarter-to-date period ended December 29, 2017 as compared to the fiscal quarter-to-date period ended December 30, 2016, primarily due to the following:

Factor		Impact On Cash Flows
Common Stock Issuance	á	Higher cash inflows from increased employee stock option exercises and shares issued under our ESPP
Share Repurchases	â	Higher outflows from increases in common stock repurchases

Off-Balance Sheet Arrangements and Contractual Obligations

Our liquidity is not dependent upon the use of off-balance sheet financing arrangements, and we have not entered into any arrangements that are expected to have a material effect on liquidity or the availability of capital resources. Since the end of our most recent fiscal year ended September 29, 2017, there have been no material

changes in either our off-balance sheet financing arrangements or contractual obligations outside the ordinary course of business. For additional details regarding our contractual obligations, see Note 13 “Commitments & Contingencies” to our unaudited interim condensed consolidated financial statements.

Indemnification Clauses

We are party to certain contractual agreements under which we have agreed to provide indemnification of varying scope and duration to the other party relating to our licensed IP. Historically, we have not made any payments for these indemnification obligations and no amounts have been accrued in our consolidated financial statements with respect to these obligations. Since the terms and conditions of the indemnification clauses do not explicitly specify our obligations, we are unable to reasonably estimate the maximum potential exposure for which we could be liable. For additional details regarding indemnification clauses within our contractual agreements, see Note 13 “Commitments & Contingencies” to our interim condensed consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Sensitivity

As of December 29, 2017, we had cash and cash equivalents of $596.4 million, which consisted of cash and highly liquid money market funds. In addition, we had both short and long-term investments of $556.1 million, which consisted primarily of municipal debt securities, certificates of deposit, government bonds, commercial paper, corporate bonds, and U.S. agency securities. Our investment policy is focused on the preservation of capital and support for our liquidity requirements. Under the policy, we invest in highly rated securities with a minimum credit rating of A- while limiting the amount of credit exposure to any one issuer other than the U.S. government. At December 29, 2017, the weighted-average credit quality of our investment portfolio was AA, with a weighted-average maturity of approximately fourteen months. We do not invest in financial instruments for trading or speculative purposes, nor do we use leveraged financial instruments. We utilize external investment managers who adhere to the guidelines of our investment policy.

The investments within our fixed-income portfolio are subject to fluctuations in interest rates, which could affect our financial position, and to a lesser extent, results of operations. Based on our investment portfolio balance as of December 29, 2017, hypothetical changes in interest rates of 1% and 0.5% would have an impact on the carrying value of our portfolio of approximately $5.4 million and $2.7 million, respectively.

Foreign Currency Exchange Risk

We maintain business operations in foreign countries, most significantly in Australia, China, Germany, the Netherlands, Poland, and the United Kingdom. Additionally, a growing portion of our business is conducted outside of the U.S. through subsidiaries with functional currencies other than the U.S. dollar, most notably:

- Australian Dollar
- British Pound
- Chinese Yuan
- Euro
- Indian Rupee
- Japanese Yen
- Korean Won
- Polish Zloty
- Russian Ruble
- Singapore Dollar
- Swedish Krona

As a result, we face exposure to adverse movements in currency exchange rates as the financial results of our international operations are translated from local currency into U.S. dollars upon consolidation. The majority of our revenue generated from international markets is denominated in U.S. dollars, while the operating expenses of our foreign subsidiaries are predominantly denominated in local currencies. Therefore, our operating expenses will increase when the U.S. dollar weakens against the local currency and decrease when the U.S. dollar strengthens against the local currency. Additionally, foreign exchange rate fluctuations on transactions denominated in currencies other than the functional currency result in gains or losses that are reflected in our consolidated statements of operations. Our foreign operations are subject to the same risks present when conducting business internationally, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures, foreign exchange rate volatility, and other regulations and restrictions.

In an effort to reduce the risk that our earnings will be adversely affected by foreign currency exchange rate fluctuations, we enter into foreign currency forward contracts to hedge against assets and liabilities for which we have foreign currency exchange rate exposure. These derivative instruments are carried at fair value with changes in the fair value recorded to other income, net, in our consolidated statements of operations. While not designated as hedging instruments, these foreign currency forward contracts are used to reduce the exchange rate risk associated primarily

with intercompany receivables and payables. These contracts do not subject us to material balance sheet risk due to exchange rate movements as gains and losses on these derivatives are intended to offset gains and losses on the related receivables and payables for which we have foreign currency exchange rate exposure. As of December 29, 2017 and September 29, 2017, the outstanding derivative instruments had maturities of equal to or less than 31 and 31 days, respectively, and the total notional amounts of outstanding contracts were $28.9 million and

$24.5 million, respectively. The fair values of these contracts were nominal as of December 29, 2017 and September 29, 2017, and were included within prepaid expenses and other current assets and within accrued liabilities in our consolidated balance sheets. For additional information related to our foreign currency forward contracts, see Note 2 "Summary of Significant Accounting Policies" to our consolidated financial statements.

A sensitivity analysis was performed on all of our foreign currency forward contracts as of December 29, 2017. This sensitivity analysis was based on a modeling technique that measures the hypothetical market value resulting from a 10% shift in the value of exchange rates relative to the U.S. dollar. For these forward contracts, duration modeling was used where hypothetical changes are made to the spot rates of the currency. A 10% increase in the value of the U.S. dollar would lead to an increase in the fair value of our financial instruments by $1.8 million. Conversely, a 10% decrease in the value of the U.S. dollar would result in a decrease in the fair value of these financial instruments by $1.8 million.

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ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

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

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the fiscal quarter ended December 29, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are involved in various legal proceedings from time to time arising from the normal course of business activities, including claims of alleged infringement of IP rights, commercial, employment, and other matters. In our opinion, resolution of these pending matters is not expected to have a material adverse impact on our operating results or financial condition. Given the unpredictable nature of legal proceedings, it is possible that an unfavorable resolution of one or more such proceedings could materially affect our future operating results or financial condition in a particular period; however, based on the information known by us as of the date of this filing and the rules and regulations applicable to the preparation of our consolidated financial statements, any such amounts are either immaterial or it is not possible to provide an estimated amount of any such potential losses.

ITEM 1A. RISK FACTORS

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

REVENUE GENERATION

Markets We Target

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

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

- Purchasing trends away from traditional PCs and toward computing devices without optical disc drives, such as mobile devices, which trends we expect to continue;
- Because PC OEMs are required to pay us a higher per-unit royalty for Windows PCs that include optical disc playback functionality than Windows PCs that do not include such functionality, the continued decreasing inclusion of optical disc drives in Windows PCs will result in lower per-unit royalties;
- PC software that includes our technologies on an unauthorized and infringing basis, for which we receive no royalty payments; and
- Continued decreasing inclusion of independent software vendor media applications by PC OEMs.

Declines in Optical Disc Media. For many years, movies have been distributed, purchased, and consumed through optical disc media, such as DVD and Blu-ray Disc. However, the rapid advancement of online and mobile content delivery has resulted in a trend toward movie downloading and streaming services. We expect the shift away from optical disc media to online media content consumption to continue, resulting in decreased revenue from DVD and Blu-ray Disc players.

Mobile Industry Risks. Successful penetration of the mobile device market is important to our future growth. The mobile device market, particularly smartphones and tablets, is characterized by rapidly changing market conditions, frequent product introductions and intense competition based on features and price. Our technologies are not mandated as an industry standard for mobile devices. We must continually convince mobile device OEMs and end users of mobile devices of the value of our technologies. With shorter product lifecycles, it is easier for mobile device OEMs to add or remove our technologies from mobile devices than it is for TV OEMs and other hardware OEMs.

In order to increase the value of our technologies in the mobile market, we have worked with online and mobile media content service providers to encode their content with our technologies, which could affect OEM and software vendor demand for our decoding technologies. However, the online and mobile media content services markets are

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

Cinema Industry Risks. Revenue from Dolby Cinema and cinema product sales is subject to the pace of construction or upgrade of screens, the advent of new or competing technologies, the willingness of movie studios to produce films in our Dolby Atmos and Dolby Vision formats, consumer trends, box-office performance generally, and other events or conditions in the cinema industry. Although we have invested, and expect to continue to invest, a substantial amount of time and resources developing Dolby Cinema and building our partnerships in connection with the launch of Dolby Cinema locations, this is a relatively new market for us and we may not recognize a meaningful amount of revenue from these efforts in the near future, or at all, if new Dolby Cinema locations are not ultimately successful, or if there is a decrease in the performance of our existing locations. Additionally, we have collaborations with multiple exhibitors in foreign markets, including China and the Middle East, and we may face a number of risks in expanding Dolby Cinema in these and other new international markets. The revenue we receive from Dolby Cinema exhibitors are based on a portion of box-office receipts from the installed theaters, and the timing of such theater installations is dependent upon a number of factors beyond our control. In addition, the success of our Dolby Cinema offering will be tied to the pipeline and success of motion pictures available at Dolby Cinema locations generally. The success of Dolby Cinema depends in large part on our ability to differentiate our offering, deploy new sites in accordance with plans, provide a compelling experience, and attract and retain a viewing audience. In addition, a decrease in our ability to develop and introduce new cinema products and services successfully could affect licensing of our consumer technologies, because the strength of our brand and our ability to use professional product developments to introduce new consumer technologies would be negatively impacted.

Our revenue and associated demand from cinema product sales is dependent upon industry and economic cycles, along with our ability to develop and introduce new technologies, further our relationships with content creators, and promote new cinematic audio and imaging experiences. Furthermore, future growth of our cinema products business also depends upon new theater construction and entering into an equipment replacement cycle whereby previously purchased cinema products are upgraded or replaced. To the extent that we do not make progress in these areas, or are faced with pricing pressures, competing technologies, or other global macroeconomic challenges our revenue may be adversely impacted.

Customers and Distributors

Loss of Key Licensee or Customer. A small number of our licensees or customers may represent a significant percentage of our licensing, products, or services revenue. Although we generally have agreements with these licensees or customers, these agreements typically do not require any minimum purchases or minimum royalty fees and do not prohibit licensees from using competing technologies or customers from purchasing products and services from competitors. Customer demand for our technologies and products can shift quickly as many of our markets are rapidly evolving. As a result of our increased presence across consumer electronic device markets where our technologies are not mandated and are subject to significant competition, the risk that a large licensee may reduce or eliminate its use of our technologies has increased.

Reliance on Semiconductor Manufacturers. Our licensing revenue from system licensees depends in large part upon the availability of ICs that implement our technologies. IC manufacturers incorporate our technologies into these ICs, which are then incorporated in consumer entertainment products. We do not manufacture these ICs, but rather depend on IC manufacturers to develop, produce, and then sell them to system licensees in accordance with their agreements. We do not control the IC manufacturers' decisions whether or not to incorporate our technologies into their ICs, and we do not control their product development or commercialization efforts.

Consumer Spending Weakness. Weakness in general economic conditions may suppress consumer demand in our markets. Many of the products in which our technologies are incorporated are discretionary goods, such as PCs, TVs, STBs, Blu-ray Disc players, video game consoles, AVRs, mobile devices, in-car entertainment systems, and

home-theater systems. Weakness in general economic conditions may also lead to licensees and customers becoming delinquent on their obligations to us or being unable to pay, resulting in a higher level of write-offs. Economic conditions may increase underreporting and non-reporting of royalty-bearing revenue by our licensees as well as increase the unauthorized use of our technologies.

Reliance on Distributors. We rely significantly on a global network of independent, regional distributors to market and distribute our cinema and broadcast products. Our distributor arrangements are non-exclusive and our

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distributors are not obligated to buy our products and can represent competing products, and they may be unwilling or unable to dedicate the resources necessary to promote our portfolio of products. Our distributors could retain product channel inventory levels that exceed future anticipated sales, which could affect future sales to those distributors. In addition, failure of our distributors to adhere to our policies designed to promote compliance with global anticorruption laws, export controls, and local laws, could subject us to criminal or civil penalties and stockholder litigation.

Marketing and Branding

Importance of Brand Strength. Maintaining and strengthening the Dolby brand is critical to maintaining and expanding our licensing, products, and services business, as well as our ability to offer technologies for new markets, including Dolby Voice for the communications market, Dolby Cinema, Dolby Vision and other imaging offerings for the consumer market, and others. Our continued success depends on our reputation for providing high quality technologies, products, and services across a wide range of entertainment markets, including the consumer entertainment, PC, broadcast, and gaming markets. If we fail to promote and maintain the Dolby brand successfully in licensing, products or services, our business will suffer. Furthermore, we believe that the strength of our brand may affect the likelihood that our technologies are adopted as industry standards in various markets and for various applications. Our ability to maintain and strengthen our brand will depend heavily on our ability to develop innovative technologies for the entertainment industry, to enter into new markets successfully, and to provide high quality products and services in these new markets.

Industry Standards

The entertainment industry depends upon industry standards to ensure compatibility across delivery platforms and a wide variety of consumer entertainment products. We make significant efforts to design our products and technologies to address capability, quality, and cost considerations so that they either meet, or more importantly, are adopted as industry standards across the broad range of entertainment industry markets in which we participate, as well as the markets in which we hope to compete in the future. To have our products and technologies adopted as industry standards, we must convince a broad spectrum of standards-setting organizations throughout the world, as well as our major customers and licensees who are members of such organizations, to adopt them as such. The market for broadcast technologies has traditionally been heavily based on industry standards, often mandated by governments choosing from among alternative standards, and we expect this to continue to be the case in the future.

Difficulty Becoming Incorporated in an Industry Standard. Standards-setting organizations establish technology standards for use in a wide range of consumer entertainment products. It can be difficult for companies to have their technologies adopted as an industry standard, as multiple companies, including ones that typically compete against one another, are involved in the development of new technology standards for use in entertainment-oriented products. Furthermore, some standards-setting organizations choose to adopt a set of optional standards or a combination of mandatory and optional standards; in such cases, our technologies may be adopted only as an optional standard and not a mandatory standard. Standards may also change in ways that are unfavorable to Dolby.

Participants May Choose Among Alternative Technologies within Standards. Even when a standards-setting organization incorporates our technologies in an industry standard for a particular market, our technologies may not be the sole technologies adopted for that market. Furthermore, different standards may be adopted for different markets. 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, including in emerging markets, and the choice to use our technologies where it is one of several accepted industry standards.

Being Part of a Standard May Limit Our Licensing Practices. When a standards-setting organization mandates our technologies, we generally must agree to license such technologies on a fair, reasonable, and non-discriminatory basis, which could limit our control over the use of these technologies. In these situations, we must often limit the royalty rates we charge for these technologies, and we may be unable to limit to whom we license such technologies or to

restrict many terms of the license. We have in the past, and may in the future, be subject to claims that our licensing of industry standard technologies may not conform to the requirements of the standards-setting organization. Allegations such as these could be asserted in private actions seeking monetary damages and injunctive relief, or in regulatory actions. Claimants in such cases could seek to restrict or change our licensing practices or our ability to license our technologies.

Royalty Reporting

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

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

Inaccurate Licensee Royalty Reporting. We generate licensing revenue primarily from OEMs who license our technologies and incorporate those technologies into their products. Our license agreements generally obligate our licensees to pay us a specified royalty for every product they ship that incorporates our technologies, and we rely on our licensees to report their shipments accurately. However, we have difficulty independently determining whether our licensees are reporting shipments accurately, particularly with respect to software incorporating our technologies because unauthorized copies of such software can be made relatively easily. A third party may disagree with our interpretation of the terms of a license agreement or, as a result of an audit, a third party could challenge the accuracy of our calculation. We are regularly involved in discussions with third party technology licensees regarding license terms. Most of our license agreements permit us to audit our licensees' records, and we routinely exercise these rights, but audits are generally expensive, time-consuming, and potentially detrimental to our ongoing business relationships with our licensees. In the past, licensees have understated or failed to report the number of products incorporating our technologies that they shipped, and we have not been able to collect and recognize revenue to which we were entitled. We expect that we will continue to experience understatement and non-reporting of royalties by our licensees. We have been able to obtain certain recovery payments from licensees (either in the form of back payments or settlements), and such recoveries have become a recurring element of our business; however, we are unable to predict with certainty the revenue that we may recover in the future or if we will be able to continue to obtain such recoveries at all.

Royalties We Owe Others. In some cases, the products we sell and the technologies we license to our customers include IP 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 are regularly involved in discussions with third party technology licensors regarding license terms. A successful challenge by a third party could result in the termination of a license agreement or an increase in the amount of royalties we have to pay to the third party.

Changes in Revenue Recognition Standard. In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers (Topic 606), which outlines a comprehensive revenue recognition model and supersedes most current revenue recognition guidance. The new standard defines a five-step approach for recognizing revenue, which may require a company to use more judgment and make more estimates than under the current guidance. Amongst the elements in the new standard are requirements for an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers and make expanded disclosures.

Under the new standard, our current practice of reporting revenue from per-unit royalty based arrangements one quarter in arrears, when reported by licensees, will no longer be accepted. Instead, the new standard will require us to estimate per-unit royalty-based revenue shipped in the quarter for which we are reporting our results of operations. In addition, the new standard will require us to make a variety of additional estimates and judgments that are subject to risks and complexities, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price, and allocating the transaction price to each separate performance obligation. The new standard may also impact the timing of revenue recognition associated with various revenues including, but not limited to, arrangements with guaranteed minimums and fixed fees as well as recoveries.

Such changes to our reporting practices could significantly affect our results of operations to the extent that actual revenues differ significantly from estimated revenues, or that we are required to accelerate recognition of revenue under certain arrangements, potentially causing the amount of revenue we recognize to vary materially from quarter to quarter. While the adoption of the new standard will not change the cash flows we receive from our contracts with customers, the changes to our reporting practices and the potential fluctuations in our reported revenue could cause a decline and/or fluctuations in the price of our common stock.

Although permitted, we do not intend to early-adopt the new standard, but will adopt it beginning in the first quarter of fiscal 2019.

TECHNOLOGY TRENDS AND DEVELOPMENTS

Technology Innovation. Our revenue growth will depend upon our success in new and existing markets for our technologies, such as digital broadcast, mobile devices, online and mobile media distribution, cinema, consumer imaging and communications. The markets for our technologies and products are defined by:

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

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

Experience with New Markets and Business Models. Our future growth will depend, in part, upon our expansion into areas beyond our audio licensing business. Over the past few years, we have introduced Dolby Voice technology for the communications market, Dolby Vision for the home and cinema markets, and our branded-theater experience, Dolby Cinema. In connection with entering into these new markets, we face new sources of competition, new business models, and new customer relationships. In order to be successful in these markets, we will need to cultivate new industry relationships and strengthen existing relationships to bring our products, services, and technologies to market. Our limited experience to date in one or more of these markets could limit our ability to successfully execute on our growth strategy.

Incorporation of Dolby Formats into New Products & Availability of Content in Dolby Formats. The success of many of our newer initiatives, such as Dolby Atmos, Dolby Vision, and Dolby Cinema, is dependent upon the availability and success of (i) products that incorporate Dolby formats and (ii) content produced in Dolby formats. However, there is no guarantee that device makers will continue to incorporate Dolby formats into their products, that content creators will continue to release content in Dolby formats, or that either those products or that content will be commercially successful.

For instance, to successfully establish Dolby Vision and Dolby Atmos, we will need to continue to expand the array of products and consumer devices that incorporate Dolby Atmos and Dolby Vision, expand the pipeline of Dolby Atmos and Dolby Vision content available from content creators, and encourage consumer adoption in the face of competing products and technologies. Similarly, the success of Dolby Cinema is dependent upon our ability to partner with movie theater exhibitors to launch new Dolby Cinema sites and deploy new sites in accordance with plans, as well as the continued release and box-office success of new films in the Dolby Vision and Dolby Atmos formats released through Dolby Cinemas.

Further, the commercial success of products incorporating Dolby formats, content released in Dolby formats, and Dolby Cinemas generally, depends upon a number of factors outside of our control, including, but not limited to, consumer preferences, critical reception, timing of release, marketing efforts of third-parties, and general market conditions. Moreover, release and distribution of such products and content can be subject to delays in production or changes in release schedule, which can negatively impact the quantity, timing and quality of such products and content released in Dolby formats and available at Dolby Cinema theaters.

INTELLECTUAL PROPERTY

Our business is dependent upon protecting our patents, trademarks, trade secrets, copyrights, and other IP rights, the loss or expiration of which may significantly impact our results of operations and financial condition. Effective IP rights protection, however, may not be available under the laws of every country in which our products and services

and those of our licensees are distributed. The efforts we have taken to protect our proprietary rights may not be sufficient or effective. We also seek to maintain select IP as trade secrets, and third parties or our employees could intentionally or accidentally compromise the IP that we maintain as trade secrets. In addition, protecting our IP rights is costly and time consuming. We have taken steps in the past to enforce our IP rights and

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expect to do so in the future. However, it may not be practicable or cost effective for us to enforce our IP rights fully, particularly in some countries or where the initiation of a claim might harm our business relationships.
We generally seek patent protection for our innovations. However, our patent program faces a number of challenges, including:
- Possibility that innovations may not be protectable;
- Failure to protect innovations that later turn out to be important;
- Insufficient patent protection to prevent third parties from designing around our patent claims;
- Our pending patent applications may not be approved; and
- Possibility that an issued patent may later be found to be invalid or unenforceable.

Patent Royalties and Expiration. Many of the technologies that we license to our system licensees are covered by patents, and the licensing revenue that we receive from those licenses depends in large part upon the life of such patents. In general, our agreements with our licensees require them to pay us a full royalty with respect to a particular technology only until the last patent covering that technology expires in a particular country. As of December 29, 2017, we had approximately 8,500 issued patents in addition to approximately 4,100 pending patent applications in more than 100 jurisdictions throughout the world. Our currently issued patents expire at various times through May 2042.
We seek to mitigate this risk in a variety of ways. We regularly look for opportunities to expand our patent portfolio through organic development and acquisitions. We develop proprietary technologies to replace licensing revenue from technologies covered by expiring patents with licensing revenue supported by patents with a longer remaining life. And we develop and license our technologies in a manner designed to minimize the chance that a system licensee would develop competing technologies that do not include any Dolby IP.
In the case of our patent coverage related to DD, some of our relevant patents have expired, but others continue to apply. DD is our solution that includes technology necessary to implement AC-3 as it has been updated over time. We have continued to innovate and develop intellectual property to support the standard and its implementation. Our customers use our DD implementation for quality, reliability, and performance, even in locations where we have not had applicable patent coverage. While in the past, we derived a significant portion of our licensing revenue from our DD technologies, this is no longer the case as revenues attributed to DD technologies have declined and are expected to continue to decline.
Many of our partners have adopted newer generations of our offerings such as DD+, and the range of products incorporating DD solutions is now limited to DVD players (but not Blu-ray players) and some TVs, STBs and soundbars. To continue to be successful in our audio licensing business, we must keep transitioning our DD licensees to our newer technologies, including our DD+ and Dolby AC-4 technologies.
Unauthorized Use of Our Intellectual Property. We have often experienced, and expect to continue to experience, problems with non-licensee OEMs and software vendors, particularly in China and certain emerging economies, incorporating our technologies and trademarks into their products without our authorization and without paying us any licensing fees. Manufacturers of ICs containing our technologies occasionally sell these ICs to third parties who are not our system licensees. These sales, and the failure of such manufacturers to report the sales, facilitate the unauthorized use of our IP. As emerging economies transition from analog to digital content, such as the transition from analog to digital broadcast, we expect to experience increased problems with this form of piracy.
Intellectual Property Litigation. Companies in the technology and entertainment industries frequently engage in litigation based on allegations of infringement or other violations of IP rights. We have faced such claims in the past, and we expect to face similar claims in the future. Any IP claims, with or without merit, could be time-consuming, expensive to litigate or settle, and could divert management resources and attention. In the past, we have settled claims relating to infringement allegations and agreed to make payments in connection with such settlements. An adverse determination in any IP claim could require that we pay damages or stop using technologies found to be in violation of a third party's rights and could prevent us from offering our products and services to others. In order to avoid these restrictions, we may have to seek a license for the technology, which may not be available on reasonable terms or at

all. Licensors could also require us to pay significant royalties. As a result, we may be required to develop alternative non-infringing technologies, which could require significant effort and expense. If we cannot license or develop technologies for any aspects of our business found to be infringing, we may be forced to limit our product and service offerings and may be unable to compete effectively.

In some instances, we have contractually agreed to provide indemnifications to licensees relating to our

IP. Additionally, at times we have chosen to defend our licensees from third party IP infringement claims even where such defense was not contractually required, and we may choose to take on such defense in the future.

Licensee Disputes. At times, we are engaged in disputes regarding the licensing of our IP rights, including matters related to our royalty rates and other terms of our licensing arrangements. These types of disputes can be asserted by our customers or prospective customers or by other third parties as part of negotiations with us or in private actions seeking monetary damages or injunctive relief, or in regulatory actions. In the past, licensees have threatened to initiate litigation against us based on potential antitrust claims or regarding our licensing royalty rate practices. Damages and requests for injunctive relief asserted in claims like these could be significant, and could be disruptive to our business.

U.S. and Foreign Patent Rights. Our licensing business depends in part on the uniform and consistent treatment of patent rights in the U.S. and abroad. Changes to the patent laws and regulations in the U.S. and abroad may limit our ability to obtain, license, and enforce our rights. Additionally, court and administrative rulings may interpret existing patent laws and regulations in ways that hurt our ability to obtain, license, and enforce our patents. We face challenges protecting our IP in foreign jurisdictions, including:

- Our ability to enforce our contractual and IP rights, especially in countries that do not recognize and enforce IP rights to the same extent as the U.S., Japan, Korea, and European countries do, which increases the risk of unauthorized use of our technologies;
- Limited or no patent protection for our DD technologies in countries such as China, Taiwan, and India, which may require us to obtain patent rights for new and existing technologies in order to grow or maintain our revenue; and
- Because of limitations in the legal systems in many countries, our ability to obtain and enforce patents in many countries is uncertain, and we must strengthen and develop relationships with entertainment industry participants worldwide to increase our ability to enforce our IP and contractual rights without relying solely on the legal systems in the countries in which we operate.

OPERATIONS

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

Product Quality. Our products, and products that incorporate our technologies, are complex and sometimes contain undetected software or hardware errors, particularly when first introduced or when new versions are released. In addition, we have limited control over manufacturing performed by contract manufacturers, which could result in quality problems. Furthermore, our products and technologies are sometimes combined with or incorporated into products from other vendors, sometimes making it difficult to identify the source of a problem or, in certain instances, making the quality of our implementation dependent in part upon the quality of such other vendors' products. Any negative publicity or impact relating to these product problems could affect the perception of our brand and market acceptance of our products or technologies. These errors could result in a loss of or delay in market acceptance of our products or cause delays in delivering them and meeting customer demands, any of which could reduce our revenue and raise significant customer relations issues. In addition, if our products or technologies contain errors, we could be required to replace or reengineer them or rely upon parties who have incorporated our technologies into their products

to implement updates to address such issues, which could cause delays or increase our costs. Moreover, if any such errors cause unintended consequences, we could incur substantial costs in defending and settling product liability claims. Although we generally attempt to contractually limit our liability, if these contract provisions are not enforced, or are unenforceable for any reason, or if liabilities arise that are not effectively limited, we could incur substantial costs in defending and settling product liability claims.

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

Data Security. We rely on information technology systems in the conduct of our business, including systems designed and managed by third parties. Many of these systems contain sensitive and confidential information, including our trade secrets and proprietary business information, personal data, and information of or pertaining to our customers, suppliers and business partners. The secure maintenance of this information is critical to our operations and business strategy. Increasingly, companies are subject to a wide variety of attacks on their networks and systems on an ongoing basis. Our information technology and infrastructure may be vulnerable to penetration or attacks by computer programmers and hackers, software bugs or other technical malfunctions, or other disruptions.

While we have taken a number of steps to protect our information technology systems, the number and sophistication of malicious attacks that companies have experienced from third parties has increased over the past few years. In addition, because techniques used by computer programmers and hackers (many of whom are highly sophisticated and well-funded) to access or sabotage networks and computer systems change frequently and often are not recognized until after they are used, we may be unable to anticipate or immediately detect these techniques. This could delay our response or the effectiveness of our response and impede our operations and ability to limit our exposure to third-party claims and potential liability. Attacks on our systems are sometimes successful, and, in some instances, we might be unaware of an incident or its magnitude and effects. We also may suffer data security breaches and the unauthorized access to, misuse or acquisition of, personal data or other sensitive and confidential information as the result of intentional or inadvertent breaches by our employees or service providers. Any data security breach, whether external or internal in origin, could compromise our networks and systems, creating system disruptions or slowdowns and exploiting security vulnerabilities of our products. Any such breach can result in the information stored on our networks and systems being improperly accessed, publicly disclosed, lost, or stolen, which could subject us to liability to our customers, suppliers, business partners and others. We seek to detect and investigate such attempts and incidents and to prevent their recurrence where practicable through changes to our internal processes and tools, but in some cases preventive and remedial action might not be successful. In addition, despite the implementation of network security measures, our networks also may be vulnerable to computer viruses, break-ins, denial of service attacks, and similar other disruptions.

Disruptions to our information technology systems, due to outages, security breaches or other causes, can have severe consequences to our business, including financial loss and reputational damage.

Business Interruptions by Natural Disasters and Other Events Beyond Our Control. Although we maintain crisis management plans, our business operations are subject to interruption by natural disasters and catastrophic events beyond our control, including, but not limited to, earthquakes, hurricanes, typhoons, tropical storms, floods, tsunamis, fires, droughts, tornadoes, public health issues and pandemics, severe changes in climate, war, terrorism, and geo-political unrest and uncertainties. Additionally, several of our offices, including our corporate headquarters in San Francisco, are located in seismically active regions. Because we do not carry earthquake insurance for earthquake–related losses and significant recovery time could be required to resume operations, our financial condition and operating results could be materially adversely affected in the event of a major earthquake or catastrophic event.

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COMPETITION

The markets for our technologies are highly competitive, and we face competitive threats and pricing pressure in our markets. Consumers may perceive the quality of the visual and audio experiences produced by some of our competitors' technologies to be equivalent or superior to the sight and sound experiences produced by our technologies. Some of our current or future competitors may have significantly greater financial, technical, marketing, and other resources than we do, or may have more experience or advantages in the markets in which they compete. These competitors may also be able to offer integrated systems in markets for entertainment technologies on a royalty-free basis or at a lower price than our technologies, including audio, imaging, and other technologies, which could make competing technologies that we develop less attractive.

Pricing Pressures. The markets for the consumer entertainment products in which our technologies are incorporated are intensely competitive and price sensitive. We expect to face increased royalty pricing pressure for our technologies as we seek to drive the adoption of our technologies into online content and portable devices, such as tablets and smartphones. Retail prices for consumer entertainment products that include our sound technologies, such as DVD and Blu-ray players and home theater systems, have decreased significantly, and we expect prices to decrease for the foreseeable future. In response, OEMs have sought to reduce their product costs, which can result in downward pressure on the licensing fees we charge.

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

Competition from Other Audio Formats, Imaging Solutions, and Integrated System Offerings. We believe that the success we have had licensing our audio technologies to system licensees is due, in part, to the perception that our technologies provide a high quality solution for multichannel audio and the strength of our brand. However, both free and proprietary sound technologies are becoming increasingly prevalent, and we expect competitors to continue to enter this field with other offerings. Furthermore, to the extent that customers perceive our competitors' products as providing the same or similar advantages as our technologies at a lower or comparable price, there is a risk that these customers may treat sound encoding technologies as commodities, resulting in loss of status of our technologies, decline in their use, and significant pricing pressure. For example, we face competition with respect to our HDR imaging technology, Dolby Vision, and there can be no assurance that additional consumers will adopt Dolby Vision in the near future, or at all, or that we will maintain our existing customers.

In addition, some of our current or potential competitors may be able to offer integrated systems in certain markets for entertainment technologies, including audio, imaging, and digital rights management technologies, which could make competing technologies that we develop or acquire obsolete. By offering an integrated system solution, these potential competitors may also be able to offer competing technologies at lower prices than we can, which could adversely affect our operating results.

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

STRATEGIC ACTIVITIES

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

- Content creators, such as film directors, studios, mobile and online content producers, and music producers;
- Content distributors, such as studios, film exhibitors, broadcasters, operators, and OTT video service providers and video game publishers; and

- Device manufacturers.

Relationships have historically played an important role in the entertainment markets that we serve. For example, sales of our products and services are particularly dependent upon our relationships with major film studios and broadcasters, and licensing of our technologies is particularly dependent upon our relationships with system licensees and IC manufacturers. If we fail to maintain and strengthen these relationships, these entertainment industry participants may be less likely to purchase and use our technologies, products, and services, or create content incorporating our technologies. Industry relationships also play an important role in other markets we serve; for instance, our partner relationships in the audio and video conferencing markets are important to our communications business.

Consequences of M&A Activity. We evaluate a wide array of possible strategic transactions, including acquisitions. We consider these types of transactions in connection with, among other things, our efforts to strengthen our audio and cinema businesses and expand beyond sound technologies. Although we cannot predict whether or not we will complete any such acquisitions or other transactions in the future, any of these transactions could be significant in relation to our market capitalization, financial condition, or results of operations. The process of integrating an acquired company, business, or technology may create unforeseen difficulties and expenditures. Foreign acquisitions involve unique risks in addition to those mentioned above, including those related to integration of operations across different geographies, cultures, and languages; currency risks; and risks associated with the economic, political, and regulatory environment in specific countries. Future acquisitions could result in potentially dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities, amortization expenses, and write-offs of goodwill. Future acquisitions may also require us to obtain additional equity or debt financing, which may not be available on favorable terms or at all. Also, the anticipated benefits of our acquisitions may not materialize.

We face various risks in integrating acquired businesses, including:

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

LEGAL AND REGULATORY COMPLIANCE

International Business and Compliance. We are dependent on international sales for a substantial amount of our total revenue. Approximately 74% and 68% of our revenue was derived outside of the U.S. in the fiscal quarter ended December 29, 2017 and December 30, 2016, respectively. We are subject to a number of risks related to conducting business internationally, including:

- U.S. and foreign government trade restrictions, including those which may impose restrictions on importation of programming, technology, or components to or from the U.S.;
- Compliance with applicable international laws and regulations, including antitrust laws, that may change unexpectedly, differ, or conflict with laws in other countries where we conduct business, or are otherwise not harmonized with one another;
- Foreign government taxes, regulations, and permit requirements, including foreign taxes that we may not be able to offset against taxes imposed upon us in the U.S., and other laws limiting our ability to repatriate funds to the U.S.;
- Potential adverse changes in the political and/or economic stability of foreign countries or in their diplomatic relations with the U.S.;

- Changes in diplomatic and trade relationships, including new tariffs, trade protection measures, import or export licensing requirements, trade embargoes and other trade barriers;
- Difficulty in establishing, staffing, and managing foreign operations, including but not limited to restrictions on the ability to obtain or retain licenses required for operation, relationships with local labor unions and

works councils, investment restrictions and/or requirements, and restrictions on foreign ownership of subsidiaries;

- Adverse fluctuations in foreign currency exchange rates and interest rates, including risks related to any interest rate swap or other hedging activities we undertake;
- Poor recognition of IP rights;
- Difficulties in enforcing contractual rights;
- Multi-jurisdictional data protection and privacy laws, including restrictions on transferring personally identifiable information outside of a jurisdiction;
- Political or social instability in the U.K. and Europe (including but not limited to uncertainty resulting from the Brexit referendum in the U.K.) and in Russia, the Middle East, North Africa, Latin America and other emerging markets;
- Uncertainties related to any geopolitical, economic and regulatory effects or changes due to the current political climate in the U.S.;
- Natural disasters, war or events of terrorism; and
- The strength of international economies.

Certain foreign governments, particularly in China, have advanced arguments under their competition laws that exert downward pressure on royalties for IP. The regulatory enforcement activities in such jurisdictions can be unpredictable, in some cases because these jurisdictions have only recently implemented competition laws. For instance, in March 2014, the National Development and Reform Commission of China ("NDRC") initiated a review of our business practices under the Chinese competition laws and requested information relating to our business practices in China. In early May 2015, the NDRC confirmed that the matters under review have been resolved on mutually agreeable terms. The implementation of these terms remains ongoing. Additionally, in December 2013, the Korean Fair Trade Commission ("KFTC") initiated a review of the Company under Korean competition law. The KFTC requested information relating to our business practices in Korea and we cooperated during its review. As a result of this review, in July 2015, the KFTC issued an order and we agreed to modify certain terms in our standard licensing agreements going forward without admitting to any liability or wrongdoing.

In many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by U.S. regulations applicable to us such as the FCPA and U.S. export controls. Although we implement policies and procedures designed to ensure compliance with the FCPA and U.S. export controls, there can be no assurance that all of our employees, distributors, dealers, and agents will not take actions in violation of our policies or these regulations.

Costs of Environmental Laws and Regulation. Our operations use substances regulated under federal, state, local, and international laws governing the environment, including those governing the discharge of pollutants into the air and water, the management, disposal, and labeling of hazardous substances and wastes, and the cleanup of contaminated sites. In addition, future environmental laws and regulations have the potential to affect our operations, increase our costs, decrease our revenue, or change the way we design or manufacture our products. We face increasing complexity in our product design as we adjust to requirements relating to the materials composition of our products. For some products, substituting particular components containing regulated hazardous substances is more difficult or costly, and additional redesign efforts could result in production delays. We could incur costs, fines, and civil or criminal sanctions, third party property damage or personal injury claims, or could be required to incur substantial investigation or remediation costs, if we were to violate or become liable under environmental laws.

Conflict Minerals. The SEC has adopted rules regarding disclosure of the use of conflict minerals (commonly referred to as tantalum, tin, tungsten, and gold), which are sourced from the Democratic Republic of the Congo and surrounding countries. This requirement could affect the sourcing, availability and pricing of materials used in our products as well as the companies we use to manufacture our products. In circumstances where sources of conflict minerals from the Democratic Republic of the Congo or surrounding countries are not validated as conflict free, Dolby may take actions to change materials, designs or manufacturers to reduce the possibility that Dolby's contracts to manufacture products that contain conflict minerals finance or benefit local armed groups in the region. The implementation of these rules could adversely affect the sourcing, supply and pricing of materials used in our products. As there may be only a limited number of suppliers that can certify to us that they are offering "conflict free"

conflict minerals, we cannot be sure that we will be able to obtain necessary conflict minerals from such suppliers in sufficient quantities or at competitive prices. These actions could also add engineering and other costs in connection with the manufacturing of our products.

We may not be able to sufficiently verify the origins for the minerals used in our products. Our reputation may suffer if we determine that our products contain conflict minerals that are not determined to be conflict free or if we are unable to sufficiently verify the origins for all conflict minerals used in our products. In addition, some customers may require that all of our products are certified to be conflict free and if we cannot satisfy these customers, they may choose a competitor's products.

Tax Rates and Liabilities. Changes in the valuation of our deferred tax assets and liabilities, the geographic mix of our revenue, or changes in tax laws or their interpretation could affect our future effective tax rates. We file a consolidated federal U.S. income tax return and separate income tax returns in numerous state and local jurisdictions as well as multiple countries, and we must use judgment in determining our worldwide provision for income taxes. For example, the following could affect our income taxes:

- Earnings being lower than anticipated in countries that have lower tax rates and higher than anticipated in countries that have higher tax rates;
- Changes in the valuation of our deferred tax assets and liabilities;
- Transfer pricing adjustments;
- Tax effects of nondeductible compensation;
- Tax costs related to intercompany realignments;
- Any obligations or decisions to repatriate earnings from abroad earlier than anticipated;
- Changes in accounting principles; or
- Changes in tax laws and regulations in the countries in which we operate, including the Tax Act.

A number of international legislative and regulatory bodies have proposed model legislation and begun investigations on the tax practices of multinational companies. One of these efforts has been led by the OECD, an international association of many countries including the United States, which has finalized recommendations to revise individual country corporate tax laws, transfer pricing requirements, and tax treaty provisions in member countries. As a result, a number of new transfer pricing documentation requirements have been adopted in countries in which we operate. We will be complying with these requirements in fiscal 2018. In addition, the European Union and its European Commission is reviewing and deciding on the appropriateness of agreements between various member countries and companies that might be in violation of European Union competition rules against unjustified state aid. Several affected companies have appealed these decisions to the European Court of Justice for re-consideration. Further, the OECD, European Union and European Commission could conceivably make competing jurisdictional claims over the taxes owed on earnings of multinational companies in their respective countries or regions. While none of these bodies has identified Dolby as a potential target of its actions, it is possible that these efforts may in the future have an adverse impact on our income tax liabilities.

As a result of the Tax Act, there have been many significant changes to the U.S. federal income tax laws, including changes in the U.S. corporate income tax rates, the realizability of the net deferred tax assets relating to our U.S. operations, the taxation of foreign earnings, and the deductibility of expenses. These changes caused us to incur a deemed repatriation tax on certain undistributed earnings of foreign subsidiaries estimated at $96.7 million. The reduction of the U.S. corporate tax rate to 21% from 35% caused us to adjust our U.S. deferred tax assets and liabilities, resulting in an estimated decrease of $57.9 million in our net deferred tax assets. We estimate the overall impact of the Tax Act to reduce earnings for the first quarter of fiscal 2018 by $154.6 million, resulting in a net loss for the first quarter of fiscal 2018. However, we are still evaluating the full impact of the Tax Act to our overall financial position. In addition, changes to the taxation of undistributed foreign earnings could change our future intentions regarding reinvestment of such earnings. The foregoing items could have a material impact on business, cash flow, results of operation or financial condition.

We are subject to the periodic examination of our income tax returns by tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for

income taxes, but an adverse decision by tax authorities could significantly impact our financial results. Additionally, due to the evolving nature of tax rules combined with the large number of jurisdictions in which we operate, it is possible that our estimates of our tax liability and the realizability of our deferred tax assets could change in the future, which may result in additional tax liabilities.

STOCK-RELATED ISSUES

Controlling Stockholder. At December 29, 2017, the Dolby family and their affiliates owned 1,738,706 shares of our Class A common stock and 42,632,210 shares of our Class B common stock. As of December 29, 2017, the Dolby family and their affiliates had voting power of 99.8% of our outstanding Class B common stock, which combined with their shares of our Class A common stock, represented 87.7% 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.

As a result of this dual class structure, the Dolby family and their affiliates will, for the foreseeable future, have significant influence over our management and affairs, and will be able to control virtually all matters requiring stockholder approval, including the election of directors and significant corporate transactions such as mergers or other sales of our company or assets, even if they come to own considerably less than 50% of the total number of outstanding shares of our Class A and Class B common stock. 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.

Moreover, the Dolby family and their affiliates may take actions in their own interests that our other stockholders do not view as beneficial.

Insider Sales of Common Stock. If our large shareholders, officers, directors or employees sell, or indicate an intention to sell, substantial amounts of our Class A common stock in the public market, including shares of Class A common stock issuable upon conversion of shares of Class B common stock, the trading price of our Class A common stock could decline.

Stock Repurchase Program. Our stock repurchase program may reduce the public float of shares available for trading on a daily basis. Such purchases may be limited, suspended, or terminated at any time without prior notice. There can be no assurance that we will buy additional shares of our Class A common stock under our stock repurchase program or that any future repurchases will have a positive impact on our stock price or earnings per share. Important factors that could cause us to discontinue or decrease our share repurchases include, among others, unfavorable market conditions, the market price of our Class A common stock, the nature of other investment or strategic opportunities presented to us, the rate of dilution of our equity compensation programs, our ability to make appropriate, timely, and beneficial decisions as to when, how, and whether to purchase shares under the stock repurchase program, and the availability of funds necessary to continue purchasing stock. If we curtail our repurchase program, our stock price may be negatively affected.

Dividend Program. We cannot provide assurance that we will continue to increase dividend payments and/or pay dividends. We are not obligated to pay dividends on our Class A and Class B common stock. In October 2014, we announced a quarterly cash dividend program for our stockholders that was initiated by our Board of Directors. Since the initial commencement of our dividend program, our Board of Directors has annually approved an increase to our cash dividend. Although we anticipate paying regular quarterly dividends for the foreseeable future, dividend declarations and the establishment of future record and payment dates are subject to the Board of Directors' continuing determination that the dividend policy is in the best interests of our stockholders. The dividend policy may be changed or canceled at the discretion of the Board of Directors at any time. If we do not pay dividends, the market price of our Class A common stock must appreciate for investors to realize a gain on their investment. This appreciation may not occur and our Class A common stock may in fact depreciate in value.

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

Sales of Unregistered Securities

None.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Our Board of Directors announced a $250.0 million stock repurchase program on November 3, 2009. The program, which has no expiration date, approved the repurchase of shares of our Class A common stock, $0.001 par value per share. The authorized maximum was subsequently increased by $300.0 million, $250.0 million, $100.0 million, $200.0 million and $200.0 million as announced on July 27, 2010, August 4, 2011, February 8, 2012, October 23, 2014, and January 25, 2017, respectively. Stock repurchases under this program may be made through open market transactions, negotiated purchases, or otherwise, at times and in such amounts as we consider appropriate.

The following table provides information regarding our share repurchases made under program during the first quarter of fiscal 2018:

Repurchase Activity	Total Shares Repurchased	Average Price Paid Per Share (1)	Total Shares Purchased As Part Of Publicly Announced Programs	Remaining Authorized Share Repurchases (2)
September 30, 2017 - October 27, 2017				$152.0 million
October 28, 2017 - November 24, 2017	402,416	60.35	402,416	$127.7 million
November 25, 2017 - December 29, 2017	91,468	62.38	91,468	$122.0 million
Total	493,884		493,884	

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

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

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ITEM 6. EXHIBITS

Exhibit Number	Description	Incorporated By Reference Herein			Provided Herewith
		Form	File Number	Date	
10.1	2018 Dolby Executive Annual Incentive Plan	Form 8-K	001-32431	November 15, 2017	
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act				X
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act				X
32.1+	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act				X
101.INS	XBRL Instance Document				X
101.SCH	XBRL Taxonomy Extension Schema Document				X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document				X
101.DEF	XBRL Extension Definition				X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document				X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document				X

* Denotes a management contract or compensatory plan or arrangement.
\+ Furnished herewith.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: January 31, 2018

DOLBY LABORATORIES, INC.

By: /S/ LEWIS CHEW

Lewis Chew

Executive Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)

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