

Dolby Laboratories, Inc.  
Form 10-Q  
August 01, 2018  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

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

For the Quarterly Period Ended June 29, 2018

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

For the Transition Period From \_\_\_\_\_ To \_\_\_\_\_  
Commission File Number: 001-32431

DOLBY LABORATORIES, INC.

(Exact name of registrant as specified in its charter)

Delaware

90-0199783

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

1275 Market Street  
San Francisco, CA

94103-1410(415) 558-0200

(Address of principal executive offices)

(Zip Code) (Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

On July 27, 2018, the registrant had 64,363,621 shares of Class A common stock, par value \$0.001 per share, and 39,283,678 shares of Class B common stock, par value \$0.001 per share, outstanding.

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FORM 10-Q  
For the Fiscal Quarter Ended June 29, 2018  
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Signatures

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## GLOSSARY OF TERMS

The following table summarizes certain terms and abbreviations that may be used within the text of this report:

| Abbreviation | Term   |
|--------------|--|
| AAC          | Advanced Audio Coding  |
| AFS          | Available-For-Sale (Securities)                                    |
| AOCI         | Accumulated Other Comprehensive Income                             |
| APIC         | Additional-Paid In-Capital   |
| ASC          | Accounting Standards Codification                                  |
| ASP          | Average Selling Price  |
| ASU          | Accounting Standards Update  |
| ATSC         | Advanced Television Systems Committee                              |
| AVR          | Audio/Video Receiver   |
| CE           | Consumer Electronics   |
| CES          | Consumer Electronics Show  |
| CODM         | Chief Operating Decision Maker                                     |
| COGS         | Cost Of Goods Sold   |
| COSO         | Committee Of Sponsoring Organizations (Of The Treadway Commission) |
| DD           | Dolby Digital®   |
| DD+          | Dolby Digital Plus™  |
| DMA          | Digital Media Adapter  |
| DTV          | Digital Television   |
| DVB          | Digital Video Broadcasting   |
| DVD          | Digital Versatile Disc   |
| EPS          | Earnings Per Share   |
| ESP          | Estimated Selling Price  |
| ESPP         | Employee Stock Purchase Plan                                       |
| FASB         | Financial Accounting Standards Board                               |
| FCPA         | Foreign Corrupt Practices Act                                      |
| FIFO         | First-in, First-out  |
| G&A          | General & Administrative   |
| HD           | High Definition  |
| HDR          | High-Dynamic Range   |
| HDTV         | High Definition Television   |
| HE-AAC       | High Efficiency Advanced Audio Coding                              |
| HEVC         | High Efficiency Video Coding                                       |
| HFR          | High Frame Rate  |
| HTIB         | Home Theater In-A-Box  |
| IC           | Integrated Circuit   |
| IMB          | Integrated Media Block   |
| IP           | Intellectual Property  |
| IPO          | Initial Public Offering  |
| IPTV         | Internet Protocol Television                                       |
| IT           | Information Technology   |
| LIFO         | Last-in, First-out   |
| LP           | Limited Partner/Partnership  |
| ME           | Multiple Element   |
| NOL          | Net Operating Loss   |
| OCI          | Other Comprehensive Income   |

|           |   |
|-----------|---|
| ODD       | Optical Disc Drive  |
| OECD      | Organization For Economic Co-Operation & Development          |
| OEM       | Original Equipment Manufacturer                               |
| OLED      | Organic Light-Emitting Diode                                  |
| OTT       | Over-The-Top  |
| PC        | Personal Computer   |
| PCS       | Post-Contract Support   |
| PP&E      | Property, Plant, & Equipment                                  |
| PSO       | Performance-Based Stock Option                                |
| R&D       | Research & Development  |
| RSU       | Restricted Stock Unit   |
| S&M       | Sales & Marketing   |
| SERP      | Supplemental Executive Retirement Plan                        |
| SoC       | System(s)-On-A-Chip   |
| STB       | Set-Top Box   |
| TPE       | Third Party Evidence  |
| TSR       | Total Stockholder Return                                      |
| UHD       | Ultra High Definition   |
| U.S. GAAP | Generally Accepted Accounting Principles In The United States |
| VSOE      | Vendor Specific Objective Evidence                            |

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## PART I - FINANCIAL INFORMATION

## ITEM 1. UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## DOLBY LABORATORIES, INC.

## INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

(unaudited)

|  | June 29,<br>2018 | September 29,<br>2017 |
|--|------------------|-----------------------|
| <b>ASSETS</b>  |                  |                       |
| Current assets:  |                  |                       |
| Cash and cash equivalents  | \$829,621        | \$ 627,017            |
| Restricted cash  | 7,842            | 7,351                 |
| Short-term investments   | 195,284          | 247,757               |
| Accounts receivable, net of allowance for doubtful accounts of \$5,622 and \$2,967   | 149,582          | 73,750                |
| Inventories  | 23,932           | 25,051                |
| Prepaid expenses and other current assets  | 32,672           | 30,508                |
| Total current assets   | 1,238,933        | 1,011,434             |
| Long-term investments  | 243,179          | 314,364               |
| Property, plant, and equipment, net  | 502,041          | 485,275               |
| Intangible assets, net   | 185,140          | 189,648               |
| Goodwill   | 314,317          | 311,087               |
| Deferred taxes   | 143,949          | 190,915               |
| Other non-current assets   | 42,260           | 30,831                |
| Total assets   | \$2,669,819      | \$ 2,533,554          |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                  |                       |
| Current liabilities:   |                  |                       |
| Accounts payable   | \$16,970         | \$ 14,373             |
| Accrued liabilities  | 197,076          | 207,034               |
| Income taxes payable   | 4,830            | 1,216                 |
| Deferred revenue   | 21,436           | 23,150                |
| Total current liabilities  | 240,312          | 245,773               |
| Long-term deferred revenue   | 37,775           | 36,425                |
| Other non-current liabilities  | 203,813          | 107,514               |
| Total liabilities  | 481,900          | 389,712               |
| Stockholders' equity:  |                  |                       |
| Class A, \$0.001 par value, one vote per share, 500,000,000 shares authorized: 64,077,013 shares issued and outstanding at June 29, 2018 and 59,281,837 at September 29, 2017  | 60               | 58                    |
| Class B, \$0.001 par value, ten votes per share, 500,000,000 shares authorized: 39,511,036 shares issued and outstanding at June 29, 2018 and 42,873,597 at September 29, 2017 | 43               | 43                    |
| Additional paid-in capital   | 89,077           | 61,331                |
| Retained earnings  | 2,105,621        | 2,083,063             |
| Accumulated other comprehensive (loss)   | (13,301)         | (7,753)               |
| Total stockholders' equity – Dolby Laboratories, Inc.  | 2,181,500        | 2,136,742             |
| Controlling interest   | 6,419            | 7,100                 |

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|   |             |              |
|---|-------------|--------------|
| Total stockholders' equity  | 2,187,919   | 2,143,842    |
| Total liabilities and stockholders' equity  | \$2,669,819 | \$ 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 |                  | Fiscal Year-To-Date Ended |                  |
|---|----------------------|------------------|---------------------------|------------------|
|   | June 29,<br>2018     | June 30,<br>2017 | June 29,<br>2018          | June 30,<br>2017 |
| Revenue:  |                      |                  |                           |                  |
| Licensing   | \$286,325            | \$278,106        | \$817,484                 | \$752,422        |
| Products  | 26,265               | 22,569           | 73,863                    | 71,493           |
| Services  | 4,857                | 4,990            | 15,252                    | 15,491           |
| Total revenue   | 317,447              | 305,665          | 906,599                   | 839,406          |
| Cost of revenue:  |                      |                  |                           |                  |
| Cost of licensing                                       | 12,111               | 12,711           | 31,980                    | 29,628           |
| Cost of products  | 17,213               | 14,910           | 49,851                    | 46,618           |
| Cost of services  | 5,141                | 4,504            | 14,469                    | 12,823           |
| Total cost of revenue                                   | 34,465               | 32,125           | 96,300                    | 89,069           |
| Gross margin  | 282,982              | 273,540          | 810,299                   | 750,337          |
| Operating expenses:                                     |                      |                  |                           |                  |
| Research and development                                | 60,357               | 59,631           | 176,294                   | 175,490          |
| Sales and marketing                                     | 79,834               | 73,480           | 224,002                   | 220,275          |
| General and administrative                              | 48,081               | 44,497           | 147,113                   | 129,290          |
| Restructuring credits                                   | (82)                 | )—               | (446)                     | )—               |
| Total operating expenses                                | 188,190              | 177,608          | 546,963                   | 525,055          |
| Operating income  | 94,792               | 95,932           | 263,336                   | 225,282          |
| Other income/expense:                                   |                      |                  |                           |                  |
| Interest income   | 5,488                | 2,511            | 13,161                    | 6,511            |
| Interest expense  | (87)                 | )(31)            | )(151)                    | )(94)            |
| Other income/(expense), net                             | (3,603)              | )(2,109)         | )(5,439)                  | )(1,546)         |
| Total other income                                      | 1,798                | 371              | 7,571                     | 4,871            |
| Income before income taxes                              | 96,590               | 96,303           | 270,907                   | 230,153          |
| Provision for income taxes                              | (13,302)             | )(20,117)        | )(198,332)                | )(49,666)        |
| Net income including controlling interest               | 83,288               | 76,186           | 72,575                    | 180,487          |
| Less: net (income) attributable to controlling interest | (143)                | )(143)           | )(421)                    | )(480)           |
| Net income attributable to Dolby Laboratories, Inc.     | \$83,145             | \$76,043         | \$72,154                  | \$180,007        |
| Net income per share:                                   |                      |                  |                           |                  |
| Basic   | \$0.80               | \$0.75           | \$0.70                    | \$1.77           |
| Diluted   | \$0.78               | \$0.73           | \$0.67                    | \$1.73           |
| Weighted-average shares outstanding:                    |                      |                  |                           |                  |

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|         |         |         |         |         |
|---------|---------|---------|---------|---------|
| Basic   | 103,836 | 101,905 | 103,386 | 101,725 |
| Diluted | 106,950 | 104,222 | 106,943 | 103,986 |

Related party rent expense:

|   |         |       |         |         |
|---|---------|-------|---------|---------|
| Included in operating expenses                              | \$1,017 | \$784 | \$2,585 | \$2,359 |
| Included in net income attributable to controlling interest | \$179   | \$176 | \$535   | \$526   |

|   |        |        |        |        |
|---|--------|--------|--------|--------|
| Cash dividend declared per common share | \$0.16 | \$0.14 | \$0.48 | \$0.42 |
|---|--------|--------|--------|--------|

|                                     |        |        |        |        |
|-------------------------------------|--------|--------|--------|--------|
| Cash dividend paid per common share | \$0.16 | \$0.14 | \$0.48 | \$0.42 |
|-------------------------------------|--------|--------|--------|--------|

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 |          | Fiscal       |           |
|---|----------------|----------|--------------|-----------|
|   | Ended          |          | Year-To-Date |           |
|   | June 29,       | June 30, | June 29,     | June 30,  |
|   | 2018           | 2017     | 2018         | 2017      |
| Net income including controlling interest   | \$83,288       | \$76,186 | \$72,575     | \$180,487 |
| Other comprehensive income:   |                |          |              |           |
| Currency translation adjustments, net of tax  | (8,297 )       | 3,267    | (2,815 )     | (12 )     |
| Unrealized gains/(losses) on investments, net of tax                                    | 339            | 75       | (2,813 )     | (1,363 )  |
| Comprehensive income  | 75,330         | 79,528   | 66,947       | 179,112   |
| Less: comprehensive (income)/loss attributable to controlling interest                  | 130            | (295 )   | (341 )       | (426 )    |
| Comprehensive income attributable to Dolby Laboratories, Inc.                           | \$75,460       | \$79,233 | \$66,606     | \$178,686 |
| See accompanying notes to unaudited interim condensed consolidated financial statements |                |          |              |           |

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## DOLBY LABORATORIES, INC.

## INTERIM CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)

(unaudited)

|  | Dolby Laboratories, Inc. |                                  |                      |  |                                      |                         |              |
|--|--------------------------|----------------------------------|----------------------|--|--------------------------------------|-------------------------|--------------|
|  | Common<br>Stock          | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income/(Loss) | Total Dolby<br>Laboratories,<br>Inc. | Controlling<br>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   |                          |                                  | 72,154               |  | 72,154                               | 421                     | 72,575       |
| Currency translation adjustments, net<br>of tax of \$110 |                          |                                  |                      | (2,735 )   | (2,735 )                             | (80 )                   | (2,815 )     |
| Unrealized losses on investments,<br>net of tax of \$155 |                          |                                  |                      | (2,813 )   | (2,813 )                             |                         | (2,813 )     |
| Distributions to controlling interest                    |                          |                                  |                      |  | —                                    | (1,022 )                | (1,022 )     |
| Stock-based compensation expense                         |                          | 53,476                           |                      |  | 53,476                               |                         | 53,476       |
| Repurchase of common stock                               | (1 )                     | (90,479 )                        |                      |  | (90,480 )                            |                         | (90,480 )    |
| Cash dividends declared and paid on<br>common stock      |                          |                                  | (49,596 )            |  | (49,596 )                            |                         | (49,596 )    |
| Common stock issued under<br>employee stock plans        | 3                        | 85,938                           |                      |  | 85,941                               |                         | 85,941       |
| Tax withholdings on vesting of<br>restricted stock       | —                        | (21,189 )                        |                      |  | (21,189 )                            |                         | (21,189 )    |
| Balance at June 29, 2018                                 | \$ 103                   | \$ 89,077                        | \$ 2,105,621         | \$ (13,301 )   | \$ 2,181,500                         | \$ 6,419                | \$ 2,187,919 |
|  | Dolby Laboratories, Inc. |                                  |                      |  |                                      |                         |              |
|  | Common<br>Stock          | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income/(Loss) | Total Dolby<br>Laboratories,<br>Inc. | Controlling<br>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   |                          |                                  | 180,007              |  | 180,007                              | 480                     | 180,487      |
| Currency translation adjustments, net<br>of tax of \$205 |                          |                                  |                      | 42   | 42                                   | (54 )                   | (12 )        |
| Unrealized losses on investments,<br>net of tax of \$22  |                          |                                  |                      | (1,363 )   | (1,363 )                             |                         | (1,363 )     |
| Distributions to controlling interest                    |                          |                                  |                      |  | —                                    | (2,094 )                | (2,094 )     |
| Stock-based compensation expense                         |                          | 48,940                           |                      |  | 48,940                               |                         | 48,940       |
| Repurchase of common stock                               | (2 )                     | (74,992 )                        |                      |  | (74,994 )                            |                         | (74,994 )    |
| Cash dividends declared and paid on<br>common stock      |                          |                                  | (42,768 )            |  | (42,768 )                            |                         | (42,768 )    |
| Tax benefit from employee stock<br>plans                 |                          | 4,558                            |                      |  | 4,558                                |                         | 4,558        |
| Common stock issued under<br>employee stock plans        | 2                        | 47,763                           |                      |  | 47,765                               |                         | 47,765       |
|  |                          | (16,875 )                        |                      |  | (16,875 )                            |                         | (16,875 )    |

Tax withholdings on vesting of  
restricted stock

|                          |       |          |             |              |             |          |             |
|--------------------------|-------|----------|-------------|--------------|-------------|----------|-------------|
| Balance at June 30, 2017 | \$101 | \$51,426 | \$2,075,559 | \$ (11,518 ) | \$2,115,568 | \$ 6,811 | \$2,122,379 |
|--------------------------|-------|----------|-------------|--------------|-------------|----------|-------------|

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 Year-To-Date Ended |                  |
|---|---------------------------|------------------|
|   | June 29,<br>2018          | June 30,<br>2017 |
| Operating activities:   |                           |                  |
| Net income including controlling interest   | \$ 72,575                 | \$ 180,487       |
| Adjustments to reconcile net income to net cash provided by operating activities: |                           |                  |
| Depreciation and amortization   | 61,398                    | 64,543           |
| Stock-based compensation  | 53,476                    | 48,940           |
| Amortization of premium on investments  | 2,046                     | 2,077            |
| Provision for doubtful accounts   | 2,653                     | 1,167            |
| Deferred income taxes   | 47,145                    | (11,446)         |
| Other non-cash items affecting net income   | 5,147                     | 2,547            |
| Changes in operating assets and liabilities:                                      |                           |                  |
| Accounts receivable   | (78,480)                  | (7,576)          |
| Inventories   | (508)                     | (6,840)          |
| Prepaid expenses and other assets   | (13,719)                  | (10,657)         |
| Accounts payable and other liabilities  | (12,781)                  | 14,877           |
| Income taxes, net   | 102,422                   | 19,033           |
| Deferred revenue  | (366)                     | (560)            |
| Other non-current liabilities   | (537)                     | 773              |
| Net cash provided by operating activities   | 240,471                   | 297,365          |
| Investing activities:   |                           |                  |
| Purchases of investment securities  | (151,585)                 | (204,447)        |
| Proceeds from sales of investment securities                                      | 72,090                    | 36,579           |
| Proceeds from maturities of investment  | 194,038                   | 126,199          |

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|  |            |   |            |   |
|--|------------|---|------------|---|
| securities   |            |   |            |   |
| Purchases of PP&E  | (54,869    | ) | (81,668    | ) |
| Payments for business acquisitions, net of cash acquired               | (6,563     | ) | —          |   |
| Purchase of intangible assets  | (12,543    | ) | (5,250     | ) |
| Change in restricted cash  | (491       | ) | (2,542     | ) |
| Net cash provided by (used in) investing activities                    | 40,077     |   | (131,129   | ) |
| Financing activities:  |            |   |            |   |
| Proceeds from issuance of common stock                                 | 85,941     |   | 47,765     |   |
| Repurchase of common stock   | (90,480    | ) | (74,994    | ) |
| Payment of cash dividend   | (49,596    | ) | (42,768    | ) |
| Distribution to controlling interest                                   | (1,022     | ) | (2,094     | ) |
| Shares repurchased for tax withholdings on vesting of restricted stock | (21,189    | ) | (16,875    | ) |
| Net cash used in financing activities                                  | (76,346    | ) | (88,966    | ) |
| Effect of foreign exchange rate changes on cash and cash equivalents   | (1,598     | ) | (766       | ) |
| Net increase in cash and cash equivalents                              | 202,604    |   | 76,504     |   |
| Cash and cash equivalents at beginning of period                       | 627,017    |   | 516,112    |   |
| Cash and cash equivalents at end of period                             | \$ 829,621 |   | \$ 592,616 |   |
| Supplemental disclosure:   |            |   |            |   |
| Cash paid for income taxes, net of refunds received                    | \$ 48,931  |   | \$ 44,694  |   |
| Non-cash investing activities:   | \$ 4,820   |   | \$ (11,614 | ) |

Net change in PP&E  
purchased and unpaid at  
period-end

|   |    |     |    |   |
|---|----|-----|----|---|
| Purchase consideration<br>payable for acquisition | \$ | 750 | \$ | — |
| Purchase consideration<br>payable for intangibles | \$ | 200 | \$ | — |

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 June 29, 2018 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 June 29, 2018 and June 30, 2017. 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 fiscal quarter and year-to-date periods ended June 29, 2018, we recognized an excess tax benefit of \$0.5 million and \$9.9 million, respectively, 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 are expected to 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;

• 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;

• For certain transactions that have minimum commitment or fixed fee terms, recognizing licensing revenues on contract execution instead of as payments become due.

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 (Topic 842), 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-

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type and 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. Topic 842 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 June 29, 2018. 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.

**Financial Instruments.** In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The new guidance requires certain equity investments that are not consolidated or accounted for under the equity method of accounting to be measured at fair value with changes in fair value recognized in net income. Additionally, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. 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.

**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, and we do not currently plan to early adopt. We do not anticipate that the new standard will materially impact 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, and we do not currently plan to early adopt. 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, and we do not currently plan to early adopt. 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.

**Income Taxes: Comprehensive Income.** On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act ("Tax Act"). In February 2018, the FASB issued ASU 2018-02, Income Statement — Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income, which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Act and requires entities to provide certain disclosures regarding stranded tax effects. The ASU is effective for us beginning September 28, 2019,

and we do not currently plan to early adopt. We are currently evaluating the timing and impact of the standard on our consolidated financial statements.

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## 3. Composition of Certain Financial Statement Captions

The following tables present detailed information from our consolidated balance sheets as of June 29, 2018 and September 29, 2017 (amounts displayed in thousands, except as otherwise noted).

## Accounts Receivable

|  | June 29,<br>2018 | September 29,<br>2017 |
|--|------------------|-----------------------|
| Trade accounts receivable  | \$ 131,916       | \$ 62,305             |
| Accounts receivable from patent administration program customers | 23,288           | 14,412                |
| Accounts receivable, gross                                       | 155,204          | 76,717                |
| Less: allowance for doubtful accounts                            | (5,622 )         | (2,967 )              |
| Total  | \$ 149,582       | \$ 73,750             |

Trade accounts receivable includes unbilled accounts receivable balances related to amounts that are contractually owed.

## Inventories

|                 | June 29,<br>2018 | September 29,<br>2017 |
|-----------------|------------------|-----------------------|
| Raw materials   | \$ 4,202         | \$ 6,812              |
| Work in process | 4,566            | 4,954                 |
| Finished goods  | 15,164           | 13,285                |
| Total           | \$ 23,932        | \$ 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 \$3.5 million and \$1.8 million of inventory within other non-current assets in our consolidated balance sheets as of June 29, 2018 and September 29, 2017, respectively. We write-down inventory at the time it is deemed excess or obsolete.

## Prepaid Expenses And Other Current Assets

|                       | June 29,<br>2018 | September 29,<br>2017 |
|-----------------------|------------------|-----------------------|
| Prepaid expenses      | \$ 17,941        | \$ 16,681             |
| Other current assets  | 14,079           | 11,383                |
| Income tax receivable | 652              | 2,444                 |
| Total                 | \$ 32,672        | \$ 30,508             |

## Accrued Liabilities

|   | June 29,<br>2018 | September 29,<br>2017 |
|---|------------------|-----------------------|
| Accrued royalties   | \$ 2,764         | \$ 2,274              |
| Amounts payable to patent administration program partners | 49,926           | 49,141                |
| Accrued compensation and benefits                         | 74,157           | 92,277                |
| Accrued professional fees                                 | 7,632            | 5,530                 |
| Unpaid PP&E additions                                     | 13,130           | 10,096                |
| Other accrued liabilities                                 | 49,467           | 47,716                |
| Total   | \$ 197,076       | \$ 207,034            |

## Other Non-Current Liabilities

|  | June 29,<br>2018 | September 29,<br>2017 |
|--|------------------|-----------------------|
|--|------------------|-----------------------|

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|  |           |            |
|--|-----------|------------|
| Supplemental retirement plan obligations | \$3,220   | \$ 2,928   |
| Non-current tax liabilities              | 188,027   | 91,013     |
| Other liabilities                        | 12,566    | 13,573     |
| Total                                    | \$203,813 | \$ 107,514 |

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## 4. Investments &amp; 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.

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):

|   | June 29, 2018 |                     |           | Estimated Fair Value |          |           |            |
|---|---------------|---------------------|-----------|----------------------|----------|-----------|------------|
|   | Cost          | Unrealized<br>Gains | Losses    | Total                | Level 1  | Level 2   | Level<br>3 |
| Cash and cash equivalents:                        |               |                     |           |                      |          |           |            |
| Cash  | \$702,582     |                     |           | \$702,582            |          |           |            |
| Cash equivalents:                                 |               |                     |           |                      |          |           |            |
| Commercial paper                                  | 61,194        | 5                   | —         | 61,199               |          | 61,199    |            |
| Corporate bonds                                   | 4,404         | —                   | —         | 4,404                |          | 4,404     |            |
| Money market funds                                | 61,136        |                     |           | 61,136               | 61,136   |           |            |
| Municipal debt securities                         | 300           |                     |           | 300                  |          | 300       |            |
| Cash and cash equivalents                         | 829,616       | 5                   | —         | 829,621              | 61,136   | 65,903    | —          |
| Short-term investments:                           |               |                     |           |                      |          |           |            |
| Certificate of deposit (1)                        | 26,065        | 23                  |           | 26,088               |          | 26,088    |            |
| U.S. agency securities                            | 2,802         |                     | (6)       | 2,796                |          | 2,796     |            |
| Government bonds                                  | 535           |                     |           | 535                  | 535      |           |            |
| Commercial paper                                  | 5,517         | —                   | (4)       | 5,513                |          | 5,513     |            |
| Corporate bonds                                   | 129,156       | 58                  | (474)     | 128,740              |          | 128,740   |            |
| Municipal debt securities                         | 31,672        | —                   | (60)      | 31,612               |          | 31,612    |            |
| Short-term investments                            | 195,747       | 81                  | (544)     | 195,284              | 535      | 194,749   | —          |
| Long-term investments:                            |               |                     |           |                      |          |           |            |
| U.S. agency securities                            | 20,286        |                     | (327)     | 19,959               |          | 19,959    |            |
| Government bonds                                  | 14,962        |                     | (289)     | 14,673               | 14,673   |           |            |
| Corporate bonds                                   | 187,728       | 53                  | (2,310)   | 185,471              |          | 185,471   |            |
| Municipal debt securities                         | 21,970        | 9                   | (75)      | 21,904               |          | 21,903    |            |
| Other long-term investments (2)                   | 924           | 248                 |           | 1,172                | 248      |           |            |
| Long-term investments                             | 245,870       | 310                 | (3,001)   | 243,179              | 14,921   | 227,333   | —          |
| Total cash, cash equivalents, and investments     | \$1,271,233   | \$396               | \$(3,545) | \$1,268,084          | \$76,592 | \$487,985 | \$ —       |
| Investments held in supplemental retirement plan: |               |                     |           |                      |          |           |            |
| Assets  | 3,318         |                     |           | 3,318                | 3,318    |           |            |

Included in prepaid expenses and other current assets & other non-current assets

|             |       |       |       |
|-------------|-------|-------|-------|
| Liabilities | 3,318 | 3,318 | 3,318 |
|-------------|-------|-------|-------|

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 June 29, 2018 are classified within long-term investments.

Other long-term investments as of June 29, 2018 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 one cost method equity investment of \$0.5 million. During the third quarter of fiscal 2018, we recorded a write-off charge to reduce the carrying value of a cost method equity investment to zero in recognition of an other-than-temporary impairment.

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|  | September 29, 2017 |                     |           | Estimated Fair Value |           |            |            |
|--|--------------------|---------------------|-----------|----------------------|-----------|------------|------------|
|  | Cost               | Unrealized<br>Gains | Losses    | Total                | Level 1   | Level 2    | Level<br>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.

Other long-term investments as of September 29, 2017 include a marketable equity security of \$0.4 million, and (2) 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 June 29, 2018 and September 29, 2017 (in thousands):

| Investment Type           | June 29, 2018       |                         |                      |                         | September 29, 2017  |                         |                      |                         |
|---------------------------|---------------------|-------------------------|----------------------|-------------------------|---------------------|-------------------------|----------------------|-------------------------|
|                           | Less Than 12 Months |                         | 12 Months Or Greater |                         | Less Than 12 Months |                         | 12 Months Or Greater |                         |
|                           | Fair Value          | Gross Unrealized Losses | Fair Value           | Gross Unrealized Losses | Fair Value          | Gross Unrealized Losses | Fair Value           | Gross Unrealized Losses |
| Certificate of deposit    |                     |                         |                      |                         | \$19,750            | \$ (6)                  | \$—                  | \$ —                    |
| U.S. agency securities    | 22,755              | (333)                   | —                    | —                       | 19,713              | (91)                    | 11,386               | (108)                   |
| Government bonds          | 14,673              | (289)                   | —                    | —                       | 15,029              | (64)                    | 4,729                | (49)                    |
| Commercial paper          | 4,418               | (4)                     | —                    | —                       | 4,292               | (1)                     | —                    | —                       |
| Corporate bonds           | 221,466             | (2,438)                 | 26,804               | (347)                   | 125,890             | (251)                   | 109,806              | (449)                   |
| Municipal debt securities | 48,699              | (135)                   | —                    | —                       | 26,749              | (24)                    | 3,625                | (10)                    |
| Total                     | \$312,011           | \$ (3,199)              | \$26,804             | \$ (347)                | \$211,423           | \$ (437)                | \$129,546            | \$ (616)                |

Although we had certain securities that were in an unrealized loss position as of June 29, 2018, we expect to recover the full carrying value of these securities. As a result, we do not consider any portion of the unrealized losses at either June 29, 2018 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 June 29, 2018 and September 29, 2017, which are recorded within cash equivalents and both short and long-term investments in our consolidated balance sheets (in thousands):

| Range of maturity   | June 29, 2018  |            | September 29, 2017 |            |
|---------------------|----------------|------------|--------------------|------------|
|                     | Amortized Cost | Fair Value | Amortized Cost     | Fair Value |
| Due within 1 year   | \$322,782      | \$322,323  | \$251,649          | \$251,530  |
| Due in 1 to 2 years | 148,567        | 147,032    | 213,555            | 213,154    |
| Due in 2 to 3 years | 96,380         | 94,975     | 96,773             | 96,682     |
| Total               | \$567,729      | \$564,330  | \$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):

|   | June 29, 2018 | September 29, 2017 |
|---|---------------|--------------------|
| Land                                      | \$43,339      | \$ 43,364          |
| Buildings and building improvements       | 283,459       | 281,196            |
| Leasehold improvements                    | 62,560        | 65,034             |
| Machinery and equipment                   | 104,643       | 98,437             |
| Computer equipment and software           | 187,701       | 173,341            |
| Furniture and fixtures                    | 29,737        | 28,118             |
| Equipment provided under operating leases | 129,301       | 97,456             |

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|                                       |            |            |
|---------------------------------------|------------|------------|
| Construction-in-progress              | 11,115     | 3,673      |
| Property, plant, and equipment, gross | 851,855    | 790,619    |
| Less: accumulated depreciation        | (349,814 ) | (305,344 ) |
| Property, plant, & equipment, net     | \$502,041  | \$ 485,275 |

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## 6. Goodwill &amp; Intangible Assets

## Goodwill

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

|                               | Goodwill  |
|-------------------------------|-----------|
| Balance at September 29, 2017 | \$311,087 |
| Acquired goodwill             | 4,807     |
| Translation adjustments       | (1,577 )  |
| Balance at June 29, 2018      | \$314,317 |

## 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):

| Intangible Assets               | June 29, 2018 |                          |           | September 29, 2017 |                          |           |
|---------------------------------|---------------|--------------------------|-----------|--------------------|--------------------------|-----------|
|                                 | Cost          | Accumulated Amortization | Net       | Cost               | Accumulated Amortization | Net       |
| Acquired patents and technology | \$314,799     | \$ (146,549 )            | \$168,250 | \$299,707          | \$ (128,986 )            | \$170,721 |
| Customer relationships          | 56,836        | (40,345 )                | 16,491    | 56,843             | (38,368 )                | 18,475    |
| Other intangibles               | 22,734        | (22,335 )                | 399       | 22,742             | (22,290 )                | 452       |
| Total                           | \$394,369     | \$ (209,229 )            | \$185,140 | \$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)<br>(in millions) | Weighted-Average Useful Life<br>(in years) |
|--------------------------------------|---|--|
| Fiscal 2017                          |   |  |
| Q1 - Quarter ended December 30, 2016 | None  |  |
| Q2 - Quarter ended March 31, 2017    | 5.3   | 18.0                                       |
|                                      | \$5.3   | 18.0                                       |
| Fiscal 2018                          |   |  |
| Q1 - Quarter ended December 29, 2017 | \$12.0  | 14.1                                       |
| Q2 - Quarter ended March 30, 2018    | \$2.8   | 5.3  |
| Q3 - Quarter ended June 29, 2018     | \$0.7   | 5.0  |
|                                      | \$15.5  | 12.1                                       |

(1) Amortization expense on the intangible assets from patent portfolio and business 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 \$6.7 million and \$7.3 million in the third quarter of fiscal 2018 and 2017, respectively, and \$19.8 million and \$24.0 million in the fiscal year-to-date period ended June 29, 2018 and June 30, 2017, respectively. As of June 29, 2018, estimated amortization expense in

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future fiscal periods was as follows (in thousands):

| Fiscal Year       | Amortization<br>Expense |
|-------------------|-------------------------|
| Remainder of 2018 | \$ 6,778                |
| 2019              | 26,525                  |
| 2020              | 26,061                  |
| 2021              | 26,034                  |
| 2022              | 23,370                  |
| Thereafter        | 76,372                  |
| Total             | \$ 185,140              |

### 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 June 29, 2018, we had authorized 500,000,000 Class A shares and 500,000,000 Class B shares. At June 29, 2018, we had 64,077,013 shares of Class A common stock and 39,511,036 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 shares 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

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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.

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 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 June 29, 2018, 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 (in years) | Aggregate Intrinsic Value (1) (in thousands) |
|--|---------|---------------------------------|--|--|
| Options outstanding at September 29, 2017            | 8,741   | \$ 38.65                        |  |  |
| Grants   | 1,295   | 62.33                           |  |  |
| Exercises  | (1,938) | ) 37.20                         |  |  |
| Forfeitures and cancellations                        | (382)   | ) 40.43                         |  |  |
| Options outstanding at June 29, 2018                 | 7,716   | 42.90                           | 6.75   | \$ 145,793                                   |
| Options vested and expected to vest at June 29, 2018 | 7,241   | 42.27                           | 6.67   | 141,285                                      |
| Options exercisable at June 29, 2018                 | 4,123   | \$ 37.61                        | 5.81   | 99,275                                       |

(1) Aggregate intrinsic value is based on the closing price of our Class A common stock on June 29, 2018 of \$61.69 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 vested over three years, with equal annual cliff-vesting. Awards granted after November 2010 and prior to fiscal 2014 to new directors vested 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 June 29, 2018. 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) |  |

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|                                  |         |          |
|----------------------------------|---------|----------|
| Non-vested at September 29, 2017 | 2,839   | \$ 44.38 |
| Granted                          | 1,224   | 62.59    |
| Vested                           | (1,002) | ) 40.53  |
| Forfeitures                      | (302)   | ) 44.15  |
| Non-vested at June 29, 2018      | 2,759   | \$ 53.89 |

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**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 |               | Fiscal Year-To-Date Ended |               |
|---------------------------------|----------------------|---------------|---------------------------|---------------|
|                                 | June 29, 2018        | June 30, 2017 | June 29, 2018             | June 30, 2017 |
| Expected life (in years)        | 5.06                 | 5.13          | 5.06                      | 5.13          |
| Risk-free interest rate         | 2.9 %                | 1.8 %         | 2.2 %                     | 2.1 %         |
| Expected stock price volatility | 22.5 %               | 25.1 %        | 22.6 %                    | 27.4 %        |
| Dividend yield                  | 1.0 %                | 1.1 %         | 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.

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

## Expense - By Award Type

|  | Fiscal Quarter   |                  | Fiscal           |                  |
|--|------------------|------------------|------------------|------------------|
|  | Ended            |                  | Year-To-Date     |                  |
|  | June 29,<br>2018 | June 30,<br>2017 | June 29,<br>2018 | June 30,<br>2017 |
| Compensation expense - by type             |                  |                  |                  |                  |
| Stock options                              | \$4,500          | \$4,489          | \$16,554         | \$13,867         |
| Restricted stock units                     | 11,581           | 10,349           | 33,993           | 32,446           |
| Employee stock purchase plan               | 1,020            | 904              | 2,929            | 2,627            |
| Total stock-based compensation             | 17,101           | 15,742           | 53,476           | 48,940           |
| Benefit from income taxes                  | (3,488)          | (4,568)          | (11,041)         | (14,231)         |
| Total stock-based compensation, net of tax | \$13,613         | \$11,174         | \$42,435         | \$34,709         |

## Expense - By Income Statement Line Item Classification

|  | Fiscal Quarter   |                  | Fiscal           |                  |
|--|------------------|------------------|------------------|------------------|
|  | Ended            |                  | Year-To-Date     |                  |
|  | June 29,<br>2018 | June 30,<br>2017 | June 29,<br>2018 | June 30,<br>2017 |
| Compensation expense - by classification   |                  |                  |                  |                  |
| Cost of products                           | \$249            | \$229            | \$756            | \$710            |
| Cost of services                           | 151              | 126              | 411              | 383              |
| Research and development                   | 4,859            | 4,551            | 14,486           | 13,987           |
| Sales and marketing                        | 6,469            | 6,187            | 18,266           | 19,563           |
| General and administrative                 | 5,373            | 4,649            | 19,557           | 14,297           |
| Total stock-based compensation expense     | 17,101           | 15,742           | 53,476           | 48,940           |
| Benefit from income taxes                  | (3,488)          | (4,568)          | (11,041)         | (14,231)         |
| Total stock-based compensation, net of tax | \$13,613         | \$11,174         | \$42,435         | \$34,709         |

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           |                  | Fiscal           |                  |
|--|------------------|------------------|------------------|------------------|
|  | Quarter          |                  | Year-To-Date     |                  |
|  | June 29,<br>2018 | June 30,<br>2017 | June 29,<br>2018 | June 30,<br>2017 |
| Tax benefit - shares issued under ESPP | \$113            | \$367            | \$470            | \$786            |

Unrecognized Compensation Expense. At June 29, 2018, total unrecorded compensation expense associated with employee stock options expected to vest was approximately \$30.6 million, which is expected to be recognized over a weighted-average period of 2.3 years. At June 29, 2018, total unrecorded compensation expense associated with RSUs expected to vest was approximately \$101.7 million, which is expected to be recognized over a weighted-average period of 2.5 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 June 29, 2018 (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 June 29, 2018, the remaining authorization to purchase additional shares is approximately \$61.5 million.

The following table provides information regarding share repurchase activity under the program during fiscal 2018:

| Quarterly Repurchase Activity        | Shares Repurchased | Cost in thousands<br>(1) | Average Price Paid Per Share<br>(2) |
|--------------------------------------|--------------------|--------------------------|-------------------------------------|
| Q1 - Quarter ended December 29, 2017 | 493,884            | \$ 29,999                | \$ 60.73                            |
| Q2 - Quarter ended March 30, 2018    | 77,705             | 5,001                    | 64.33                               |
| Q3 - Quarter ended June 29, 2018     | 896,689            | 55,480                   | 61.86                               |
| Total                                | 1,468,278          | \$ 90,480                |                                     |

(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                        | Announcement 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                        | \$16.6 million     |
| Q2 - Quarter ended March 30, 2018    | April 24, 2018    | May 7, 2018      | May 16, 2018      | \$ 0.16                        | \$16.7 million     |
| Q3 - Quarter ended June 29, 2018     | July 24, 2018     | August 6, 2018   | August 14, 2018   | \$ 0.16                        | \$16.6 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<br>June 29, 2018 |  |             | Fiscal Year-To-Date Ended<br>June 29, 2018 |  |             |
|--|---------------------------------------|--|-------------|--|--|-------------|
|  | Investment<br>Securities              | Currency<br>Translation<br>Adjustments | Total       | Investment<br>Securities                   | Currency<br>Translation<br>Adjustments | Total       |
| Beginning Balance  | \$ (3,529)                            | \$ (2,087 )                            | \$ (5,616 ) | \$ (377 )                                  | \$ (7,376 )                            | \$ (7,753 ) |
| Other comprehensive income before reclassifications:           | —                                     |  |             |  |  |             |
| Unrealized gains/(losses) - investment securities              | 490                                   |  | 490         | (2,599 )                                   | —                                      | (2,599 )    |
| Foreign currency translation gains/(losses) <sup>(1)</sup>     |                                       | (9,275 )                               | (9,275 )    | —  | (2,845 )                               | (2,845 )    |
| Income tax effect - benefit/(expense)                          | (21 )                                 | 1,251                                  | 1,230       | 82   | 110                                    | 192         |
| Net of tax   | 469                                   | (8,024 )                               | (7,555 )    | (2,517 )                                   | (2,735 )                               | (5,252 )    |
| Amounts reclassified from AOCI into earnings:                  |                                       |  |             |  |  |             |
| Realized gains/(losses) - investment securities <sup>(1)</sup> | (162 )                                |  | (162 )      | (369 )                                     |  | (369 )      |
| Income tax effect - benefit/(expense) <sup>(2)</sup>           | 32                                    |  | 32          | 73   |  | 73          |
| Net of tax   | (130 )                                | —                                      | (130 )      | (296 )                                     | —                                      | (296 )      |
| Net current-period other comprehensive income/(loss)           | 339                                   | (8,024 )                               | (7,685 )    | (2,813 )                                   | (2,735 )                               | (5,548 )    |
| Ending Balance   | \$ (3,190)                            | \$ (10,111 )                           | \$ (13,301) | \$ (3,190)                                 | \$ (10,111 )                           | \$ (13,301) |
|  | Fiscal Quarter Ended<br>June 30, 2017 |  |             | Fiscal Year-To-Date<br>June 30, 2017       |  |             |
|  | Investment<br>Securities              | Currency<br>Translation<br>Adjustments | Total       | Investment<br>Securities                   | Currency<br>Translation<br>Adjustments | Total       |
| Beginning Balance  | \$ (696)                              | \$ (14,012 )                           | \$ (14,708) | \$ 742                                     | \$ (10,939 )                           | \$ (10,197) |
| Other comprehensive income before reclassifications:           |                                       |  |             |  |  |             |
| Unrealized gains/(losses) - investment securities              | 67                                    |  | 67          | (1,407)                                    |  | (1,407 )    |
| Foreign currency translation gains/(losses) <sup>(1)</sup>     |                                       | 3,576                                  | 3,576       | (163 )                                     |  | (163 )      |
| Income tax effect - benefit/(expense)                          | 17                                    | (461 )                                 | (444 )      | 20   | 205                                    | 225         |
| Net of tax   | 84                                    | 3,115                                  | 3,199       | (1,387)                                    | 42                                     | (1,345 )    |
| Amounts reclassified from AOCI into earnings:                  |                                       |  |             |  |  |             |
| Realized gains/(losses) - investment securities <sup>(1)</sup> | (12 )                                 |  | (12 )       | 22   |  | 22          |
| Income tax effect - benefit/(expense) <sup>(2)</sup>           | 3                                     |  | 3           | 2  |  | 2           |
| Net of tax   | (9 )                                  | —                                      | (9 )        | 24   | —                                      | 24          |
| Net current-period other comprehensive income/(loss)           | 75                                    | 3,115                                  | 3,190       | (1,363)                                    | 42                                     | (1,321 )    |
| Ending Balance   | \$ (621)                              | \$ (10,897 )                           | \$ (11,518) | \$ (621)                                   | \$ (10,897 )                           | \$ (11,518) |

(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.

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.

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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 |               | Fiscal Year-To-Date Ended |               |
|--|----------------------|---------------|---------------------------|---------------|
|  | June 29, 2018        | June 30, 2017 | June 29, 2018             | June 30, 2017 |
| Numerator:   |                      |               |                           |               |
| Net income attributable to Dolby Laboratories, Inc.            | \$83,145             | \$76,043      | \$72,154                  | \$180,007     |
| Denominator:   |                      |               |                           |               |
| Weighted-average shares outstanding—basic                      | 103,836              | 101,905       | 103,386                   | 101,725       |
| Potential common shares from options to purchase common stock  | 2,198                | 1,571         | 2,364                     | 1,494         |
| Potential common shares from restricted stock units            | 916                  | 746           | 1,193                     | 767           |
| Weighted-average shares outstanding—diluted                    | 106,950              | 104,222       | 106,943                   | 103,986       |
| Net income per share attributable to Dolby Laboratories, Inc.: |                      |               |                           |               |
| Basic  | \$0.80               | \$0.75        | \$0.70                    | \$1.77        |
| Diluted  | \$0.78               | \$0.73        | \$0.67                    | \$1.73        |
| Antidilutive awards excluded from calculation:                 |                      |               |                           |               |
| Stock options  | 1,292                | 1,757         | 950                       | 1,429         |
| Restricted stock units   | 44                   | —             | 16                        | 10            |

## 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 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 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

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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 and 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 quarter ending December 28, 2018.

**Unrecognized Tax Benefit**

As of June 29, 2018, the total amount of gross unrecognized tax benefits was \$105.1 million, of which \$92.2 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 |               | Fiscal Year-To-Date Ended |               |
|----------------------|---------------|---------------------------|---------------|
| June 29, 2018        | June 30, 2017 | June 29, 2018             | June 30, 2017 |
| \$10,366             | \$12,381      | \$38,940                  | \$34,780      |

Withholding taxes \$10,366 \$12,381 \$38,940 \$34,780

**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 third quarter of fiscal 2018 was 13.8%, compared with our Federal statutory rate of 24.6% and with our effective tax rate in the third quarter of fiscal 2017 of 20.9%. The decrease from the Federal statutory rate was primarily due to foreign earned income being taxed at a rate lower than our Federal statutory rate. The decrease from our effective tax rate in the third quarter of fiscal 2017 was primarily due to the reduction in the Federal statutory rate from the Tax Act.

Our effective tax rate was 73.2% in the fiscal year-to-date period ended June 29, 2018, compared with our Federal statutory rate of 24.6% and with our effective tax rate in the fiscal year-to-date period ended June 30, 2017 of 21.6%. The increase in our effective tax rate reflects the impact from the Tax Act, most notably the remeasurement of net deferred tax assets and the deemed repatriation of certain earnings of our foreign subsidiaries, partially offset by a

decrease from the excess benefit related to stock-based awards.

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## 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.

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<br>and<br>associated<br>costs |
|--------------------------------|---|
| Restructuring charges          | \$ 12,856                               |
| Cash payments                  | (168 )                                  |
| Non-cash and other adjustments | —                                       |
| Balance at September 29, 2017  | \$ 12,688                               |
| Restructuring charges          | 23                                      |
| Cash payments                  | (11,946 )                               |
| Non-cash and other adjustments | (583 )                                  |
| Balance at June 29, 2018       | \$ 182                                  |

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 &amp; 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 June 29, 2018 (in thousands):

|                      | Payments Due By Fiscal Period |                |                |                |  | Thereafter | Total |
|----------------------|-------------------------------|----------------|----------------|----------------|--|------------|-------|
| of<br>Fiscal<br>2018 | Fiscal<br>2019                | Fiscal<br>2020 | Fiscal<br>2021 | Fiscal<br>2022 |  |            |       |
| Remainder            |                               |                |                |                |  |            |       |

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|                      |          |          |          |          |          |           |           |
|----------------------|----------|----------|----------|----------|----------|-----------|-----------|
| Naming rights        | \$—      | \$7,811  | \$7,909  | \$8,008  | \$8,108  | \$86,865  | \$118,701 |
| Operating leases     | 4,484    | 17,105   | 14,381   | 11,105   | 9,524    | 25,698    | 82,297    |
| Purchase obligations | 32,872   | 25,536   | 22,225   | 433      | 333      | —         | 81,399    |
| Donation commitments | —        | 6,300    | 322      | 122      | 122      | 958       | 7,824     |
| Total                | \$37,356 | \$56,752 | \$44,837 | \$19,668 | \$18,087 | \$113,521 | \$290,221 |

**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.

14. Subsequent Events

**Share Repurchase Program.** On July 25, 2018, we announced that our Board of Directors approved an increase to the size of our stock repurchase program by \$350 million, bringing the amount available for future repurchases of the Company's Class A Common Stock to \$412 million. 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. Any shares repurchased under the program will be returned to the status of authorized, but unissued shares of Class A Common Stock.

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

The following discussion and analysis should be read in conjunction with our 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 expressions 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](http://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 |               | Fiscal Year-To-Date Ended |               |
|-----------|----------------------|---------------|---------------------------|---------------|
|           | June 29, 2018        | June 30, 2017 | June 29, 2018             | June 30, 2017 |
| Licensing | 90%                  | 91%           | 90%                       | 90%           |
| Products  | 8%                   | 7%            | 8%                        | 8%            |
| Services  | 2%                   | 2%            | 2%                        | 2%            |
| Total     | 100%                 | 100%          | 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 Year-To-Date Ended |               |
|--------------------------------|---------------------------|---------------|
|                                | June 29, 2018             | June 30, 2017 |
| United States                  | 27%                       | 32%           |
| International                  | 73%                       | 68%           |

We have active licensing arrangements with over 500 electronics product OEMs and software developer licensees. As of June 29, 2018, we had approximately 9,100 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, mobile devices, 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.  |



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|                     |   |
|---------------------|---|
| 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 high dynamic range and dynamic metadata to deliver higher color contrast, brighter highlights, and improved details for cinema and 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 |               | Fiscal Year-To-Date Ended |               | Main Offerings Incorporating Our Technologies              |
|-----------|----------------------|---------------|---------------------------|---------------|--|
|           | June 29, 2018        | June 30, 2017 | June 29, 2018             | June 30, 2017 |  |
| Broadcast | 33%                  | 37%           | 37%                       | 42%           | STBs & Televisions   |
| Mobile    | 23%                  | 20%           | 22%                       | 14%           | Smartphones & Tablets                                      |
| CE        | 14%                  | 14%           | 13%                       | 13%           | DMAs, Blu-ray Disc devices, AVRs, Soundbars, DVDs, & HTIBs |
| PC        | 17%                  | 17%           | 13%                       | 16%           | Windows and macOS operating systems                        |
| Other     | 13%                  | 12%           | 15%                       | 15%           | Gaming consoles, Auto DVD, Dolby Cinema, Dolby Voice       |
| Total     | 100%                 | 100%          | 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. In addition, we sell hardware that facilitates the Dolby conferencing experience, including the Dolby Conference Phone for audio use only, and the recently released Dolby Voice Room, our solution that provides a premium video conferencing experience.

**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 90 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 products, as discussed above, which help improve the conference call experience when using Dolby Voice.

Products revenue is derived primarily from sales of the following:

| Product                           | Description  |
|-----------------------------------|--|
| Cinema<br>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<br>Cinema Audio Products   | Cinema Processors, amplifiers, and loudspeakers used to decode, render, and optimally playback digital cinema soundtracks including those using Dolby Atmos.   |
| Dolby<br>Conference<br>Phone      | An integral hardware component of the Dolby Voice conferencing solution that enhances full-room voice capture, spatial voice separation, and playback.   |
| Other<br>Dolby Voice<br>Room      | Video conferencing solution for huddle rooms and small conference rooms that combines a camera product with the Dolby Conference Phone.  |
| 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.

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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 third quarter of fiscal 2018 and key challenges related to audio licensing, by market.

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 broader adoption.

We continue to see new products introduced in the broadcast market that incorporate our leading audio technologies. Hisense, Konka, and Changhong announced TVs with Dolby Atmos earlier this year, adding to the growing list of Dolby Atmos TV partners including LG, TCL, and Skyworth.

Along with these new product introductions, the availability of content in Dolby formats continues to expand globally through streaming and live broadcast. In the third quarter of fiscal 2018, Apple announced Atmos in iTunes. Apple now joins other OTT providers offering Dolby Atmos content such as Netflix, Amazon, Tencent, iQiYi, Rakuten, and Okko. We continue to see further use of our technology in live broadcast. In July 2018, the World Cup was carried in Dolby Atmos by various broadcasters in Brazil, Russia, the Middle East, and China, among others.

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. In the third quarter of fiscal 2018, we also saw a decline in STB volume, particularly in China and North America, which had a negative impact on our operating results for the quarter. Additionally, in the broadcast market, as well as other markets, we also face challenges related to changes in diplomatic and trade relationships, trade protection measures, and import or export licensing requirements.

Consumer Electronics

Highlights: We have an established presence in the home theater market that provides compatibility across devices, such as AVRs, soundbars, and DMAs, through the inclusion of our DD+ technologies. Additionally, the adoption of Dolby Atmos continues to expand to devices at lower price points. Amazon will stream Dolby Atmos content to Fire TV and Fire TV Cube in addition to a variety of compatible devices including TVs, soundbars, and home theatre systems.

Other announcements this quarter included Apple's support of Dolby Atmos on Apple TV 4K and in iTunes. We now have 11 Atmos soundbar partners including recent launches from 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 the technology available to a broader range of consumers.

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**Key Challenges:** We must continue to present compelling reasons for consumers to demand our 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:** We continue to focus on adoption of our technologies across major mobile ecosystems such as Apple's iOS, Android, Windows, and Amazon. In addition, HE-AAC is a de facto audio standard across mobile devices. At Mobile World Congress in February 2018, Samsung announced that it had adopted Dolby Atmos into its latest flagship model, and shortly thereafter, Huawei announced its first mobile phone models with Dolby Atmos. In these new Samsung and Huawei mobile devices, Dolby Atmos will be delivered with AC-4, Dolby's next-generation codec. During our third quarter of 2018, we partnered with Samsung and Huawei to trial live-streaming of matches from the French Open to their phones in Dolby Atmos and AC-4. Dolby Atmos is also featured on a number of other mobile devices from partners such as Amazon and Lenovo.

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

### Personal Computers

**Highlights:** DD+ continues 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.

During our third fiscal quarter of 2018, Lenovo launched two new PCs with Dolby Atmos, thus adding to the existing array of PCs available with Dolby Atmos from partners such as Huawei and Xiaomi. We partnered with Lenovo to design the audio subsystem of their PC to create a more immersive audio experience.

**Key Challenges:** For the first three quarters of fiscal 2018, PC revenues have been impacted by a decline in the portion of PCs that have optical disc functionality which has resulted in a decline in our ASPs. We must continuously collaborate with PC manufacturers to incorporate our technologies, and we must continue to support the development and distribution of Dolby content via various ecosystems. If these conditions and trends persist, and OEMs do not incorporate our technologies in current and future products, our PC revenues could face continuing downward pressure.

### Other

**Highlights:** DD+ is incorporated in both the Xbox and Playstation gaming consoles and platforms. In addition, Dolby Atmos is enabled for Windows and Xbox One, which enables playback on devices such as Dolby Atmos soundbars and AVRs. Also, customers can purchase an app on the Microsoft app store or an OEM gaming headset bundled with Dolby Atmos for Headphones to enable Dolby Atmos on their headphones. Six Dolby Atmos titles from major game publishers are currently available on the Xbox One.

We also generate revenue from the automotive industry primarily through disc playback devices 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.

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**Highlights:** We offer servers and audio processors to enable the playback of content in cinemas. We continue to see adoption of Dolby Atmos by studios, content creators, post-production facilities, and exhibitors. As of the end of the third quarter of fiscal 2018, there were approximately 3,800 Dolby Atmos-enabled screens installed, and approximately 1,000 Dolby Atmos theatrical titles announced or released.

We also offer a variety of 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 exhibitors a more complete Dolby Atmos solution that is potentially more cost effective 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 has continued to grow in fiscal 2018. Key highlights of our third 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 high-dynamic range solution for TVs, STBs, Blu-ray players, smartphones, tablets, DMAs, PCs, and gaming consoles. Our HEVC and AVC imaging technologies offer efficient delivery of video content across a variety of devices, and we continue to see expanded adoption of our HEVC technologies, primarily in the broadcast and mobile markets.

During our third fiscal quarter of 2018, Vizio announced the inclusion of Dolby Vision in their E-Series with price points starting at \$350, broadening the adoption of Dolby Vision beyond its mid- and high-end models. We continue to see a growing number of TV manufacturers offer an increasingly greater range of TV models that include Dolby Vision aimed at mainstream customers.

In July 2018, Microsoft announced that it will support Dolby Vision on the Xbox One. Dolby Vision is included in the iPhone X, iPhone 8, and iPad Pro, as well as TVs from our OEM partners including LG, TCL, and Hisense, among others. Six of our OEM partners feature the combined experience of Dolby Vision and Dolby Atmos on their TVs. In addition, the first PCs with Dolby Vision are now shipping from Lenovo, and more Blu-ray players are expected to come to market from partners such as Sony, Panasonic, and LG.

Movie titles and original TV content are increasingly available in the combined experience of Dolby Vision and Dolby Atmos via OTT partners such as iTunes, Netflix, Vudu, iQiyi, Tencent, and Rakuten. Content encoded only in Dolby Vision is also available via these partners. Currently, iTunes has over 300 movies available in Dolby Vision, and Netflix has over 400 hours of original content in Dolby Vision. In China, during the third quarter of fiscal 2018, Alibaba's Youku started streaming in Dolby Vision, joining Tencent and iQiyi. As a result, the top three OTT services in China now stream in Dolby Vision. Content is also available through an increasing number of Blu-ray discs from major studios such as Disney, Lionsgate, Paramount, Sony Pictures, Universal, and Warner Bros.

During our third quarter of fiscal 2018, the first mobile phone with the combined Dolby Atmos and Dolby Vision experience was launched by Sharp in Japan, and NTT-Plala began streaming in the full Dolby experience to these phones.

**Key Challenges:** The success of Dolby Vision and our consumer imaging patent licensing initiatives will depend on a number of factors, such as the breadth of available Dolby Vision content, the rate of adoption of our technologies into mainstream consumer device models, the degree of licensing penetration, and the level of competition from alternative technologies.





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Dolby Cinema

**Highlights:** In the third fiscal quarter of 2018, we announced several new exhibitor partners. In the U.K., Odeon Cinema Group plans to launch seven Dolby Cinema locations, and the first Dolby Cinemas will open in Germany and Kuwait, in partnership with Kinopolis, and Kuwait National Cinema Company, respectively. These partners join a growing list of exhibitors featuring Dolby Cinema that 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.

As of the end of the third quarter of fiscal 2018, we had approximately 160 Dolby Cinema locations in operation compared to approximately 100 as of the end of the third quarter of fiscal 2017, with AMC reaching a milestone with the opening of their 100th Dolby Cinema. We have over 390 Dolby Cinema locations open or committed around the world. The content pipeline for Dolby Cinema continues to grow with over 180 theatrical titles with Dolby Vision and Dolby Atmos having been announced or released from every major studio with recent releases including "Ant-Man and the Wasp" and "The Incredibles 2".

**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:** During the third fiscal quarter of 2018, we introduced our newest offering, Dolby Voice Room, our video conferencing solution for huddle rooms and small conference rooms that combines a camera product with the Dolby Conference Phone. Dolby Voice Room creates an experience that more closely resembles an in-person meeting by coupling the benefits of the Dolby Voice audio quality with new innovations in the video experience. In addition, Dolby Voice Room is designed to be easy to set up and use. Our first go-to-market partners for Dolby Voice Room, which began shipping at the end of the quarter, are BlueJeans and Highfive, two of our current Dolby Voice partners. We continue to focus on expanding Dolby Voice's availability to the global market for audio and video conferencing services with Dolby Voice Room which will address a broader set of customers in the growing huddle room space.

**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 conferencing service providers, the volume of products 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.

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## 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, depreciation, third party royalty obligations, and associated fees.

|                             | Fiscal Quarter Ended |               | Change  |      | Fiscal Year-To-Date Ended |               | Change   |    |
|-----------------------------|----------------------|---------------|---------|------|---------------------------|---------------|----------|----|
|                             | June 29, 2018        | June 30, 2017 | \$      | %    | June 29, 2018             | June 30, 2017 | \$       | %  |
| Licensing                   |                      |               |         |      |                           |               |          |    |
| Revenue                     | \$286,325            | \$278,106     | \$8,219 | 3%   | \$817,484                 | \$752,422     | \$65,062 | 9% |
| Percentage of total revenue | 90%                  | 91%           |         |      | 90%                       | 90%           |          |    |
| Cost of licensing           | 12,111               | 12,711        | (600)   | (5)% | 31,980                    | 29,628        | 2,352    | 8% |
| Gross margin                | 274,214              | 265,395       | 8,819   | 3%   | 785,504                   | 722,794       | 62,710   | 9% |
| Gross margin percentage     | 96%                  | 95%           |         |      | 96%                       | 96%           |          |    |

## Current Quarter: Q3 2018 vs. Q3 2017

| Factor    | Revenue   | Gross Margin                |
|-----------|---|-----------------------------|
| Mobile    | Higher adoption of our technologies into more devices   |                             |
| Broadcast | Lower volume of STBs, partially offset by higher recoveries.  |                             |
| CE        | Higher patent licensing and higher volume of DMAs, partially offset by lower recoveries   | No significant fluctuations |
| Other     | Higher revenues from Dolby Voice and gaming, and an increase in Dolby Cinema locations partially offset by lower recoveries in automotive |                             |
| PC        | Higher patent licensing and higher volume, partially offset by lower ASP from decreasing number of PCs with optical disc functionality    |                             |

## Year-To-Date: Q3 2018 vs. Q3 2017

| Factor    | Revenue  | Gross Margin                |
|-----------|--|-----------------------------|
| Mobile    | Higher adoption of our technologies into more devices, recoveries, and higher patent licensing   |                             |
| PC        | Lower recoveries and lower ASP from decreasing number of PCs with optical disc functionality, partially offset by higher patent licensing  |                             |
| Broadcast | Lower volume of STBs, partially offset by higher revenues from TVs, patent licensing, and recoveries                                       | No significant fluctuations |
| Other     | Higher patent licensing, revenue from Dolby Cinema, Via administrative fees, and Dolby Voice, partially offset by lower automotive revenue |                             |
| CE        | Higher patent licensing and higher volume of DMAs, partially offset by lower recoveries and lower volume of DVDs                           |                             |

## 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.

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|                             | Fiscal Quarter Ended |               |           |          | Fiscal Year-To-Date Ended |               |           |          |
|-----------------------------|----------------------|---------------|-----------|----------|---------------------------|---------------|-----------|----------|
|                             | June 29, 2018        | June 30, 2017 | Change \$ | Change % | June 29, 2018             | June 30, 2017 | Change \$ | Change % |
| Products                    |                      |               |           |          |                           |               |           |          |
| Revenue                     | \$26,265             | \$22,569      | \$3,696   | 16%      | \$73,863                  | \$71,493      | \$2,370   | 3%       |
| Percentage of total revenue | 8%                   | 7%            |           |          | 8%                        | 8%            |           |          |
| Cost of products            | 17,213               | 14,910        | 2,303     | 15%      | 49,851                    | 46,618        | 3,233     | 7%       |
| Gross margin                | 9,052                | 7,659         | 1,393     | 18%      | 24,012                    | 24,875        | (863)     | (3)%     |
| Gross margin percentage     | 34%                  | 34%           |           |          | 33%                       | 35%           |           |          |

## Current Quarter: Q3 2018 vs. Q3 2017

| Factor   | Revenue                         | Gross Margin  |
|----------|---------------------------------|---|
| Products | Improved mix of Cinema products | Lower utilization of manufacturing capacity, partially offset by improved mix of products |

## Year-To-Date: Q3 2018 vs. Q3 2017

| Factor   | Revenue   | Gross Margin   |
|----------|---|--|
| Products | Higher units of Cinema and Dolby Voice products | 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.

|                             | Fiscal Quarter Ended |               |           |          | Fiscal Year-To-Date Ended |               |           |          |
|-----------------------------|----------------------|---------------|-----------|----------|---------------------------|---------------|-----------|----------|
|                             | June 29, 2018        | June 30, 2017 | Change \$ | Change % | June 29, 2018             | June 30, 2017 | Change \$ | Change % |
| Services                    |                      |               |           |          |                           |               |           |          |
| Revenue                     | \$4,857              | \$4,990       | \$(133)   | (3)%     | \$15,252                  | \$15,491      | \$(239)   | (2)%     |
| Percentage of total revenue | 2%                   | 2%            |           |          | 2%                        | 2%            |           |          |
| Cost of services            | 5,141                | 4,504         | 637       | 14%      | 14,469                    | 12,823        | 1,646     | 13%      |
| Gross margin                | (284)                | 486           | (770)     | (158)%   | 783                       | 2,668         | (1,885)   | (71)%    |
| Gross margin percentage     | (6)%                 | 10%           |           |          | 5%                        | 17%           |           |          |

## Current Quarter: Q3 2018 vs. Q3 2017

| Factor   | Revenue                     | Gross Margin                            |
|----------|-----------------------------|---|
| Services | No significant fluctuations | Lower utilization of available capacity |

## Year-To-Date: Q3 2018 vs. Q3 2017

| Factor   | Revenue                     | Gross Margin                            |
|----------|-----------------------------|---|
| Services | No significant fluctuations | Lower utilization of available capacity |

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## Operating Expenses

## Research &amp; 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<br>\$ % | Fiscal Year-To-Date Ended |               | Change<br>\$ % |
|-----------------------------|----------------------|---------------|----------------|---------------------------|---------------|----------------|
|                             | June 29, 2018        | June 30, 2017 |                | June 29, 2018             | June 30, 2017 |                |
| Research and development    | \$60,357             | \$59,631      | \$726 1%       | \$176,294                 | \$175,490     | \$804 —%       |
| Percentage of total revenue | 19%                  | 20%           |                | 19%                       | 21%           |                |

## Current Quarter: Q3 2018 vs. Q3 2017

## Category

## Key Drivers

Research & Development ßàNo significant fluctuations

## Year-To-Date: Q3 2018 vs. Q3 2017

## Category

## Key Drivers

Research & Development ßàNo significant fluctuations

## Sales &amp; 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<br>\$ % | Fiscal Year-To-Date Ended |               | Change<br>\$ % |
|-----------------------------|----------------------|---------------|----------------|---------------------------|---------------|----------------|
|                             | June 29, 2018        | June 30, 2017 |                | June 29, 2018             | June 30, 2017 |                |
| Sales and marketing         | \$79,834             | \$73,480      | \$6,354 9%     | \$224,002                 | \$220,275     | \$3,727 2%     |
| Percentage of total revenue | 25%                  | 24%           |                | 25%                       | 26%           |                |

## Current Quarter: Q3 2018 vs. Q3 2017

## Category

## Key Drivers

Legal, Professional, & Consulting áIncreased IP related activities aimed at revenue generation

Marketing Programs áHigher costs related to marketing efforts

Facilities áHigher costs associated with our worldwide headquarters

## Year-To-Date: Q3 2018 vs. Q3 2017

## Category

## Key Drivers

Legal, Professional, & Consulting áIncreased IP related activities aimed at revenue generation

Stock-Based Compensation âDecrease in award grants

## General &amp; 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  |    | Fiscal Year-To-Date Ended |               | Change   |     |
|-----------------------------|----------------------|---------------|---------|----|---------------------------|---------------|----------|-----|
|                             | June 29, 2018        | June 30, 2017 | \$      | %  | June 29, 2018             | June 30, 2017 | \$       | %   |
| General and administrative  | \$48,081             | \$44,497      | \$3,584 | 8% | \$147,113                 | \$129,290     | \$17,823 | 14% |
| Percentage of total revenue | 15%                  | 15%           |         |    | 16%                       | 15%           |          |     |

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## Current Quarter: Q3 2018 vs. Q3 2017

|                                   |  |
|-----------------------------------|--|
| Category                          | Key Drivers  |
| Legal, Professional, & Consulting | • Higher costs associated with various legal activities, patent filings, and implementing regulatory changes |
| Stock-Based Compensation          | • Higher fair value of award grants  |
| Facilities                        | • Higher costs associated with our worldwide headquarters  |

## Year-To-Date: Q3 2018 vs. Q3 2017

|                                   |  |
|-----------------------------------|--|
| Category                          | Key Drivers  |
| Compensation & Benefits           | • Higher costs due to employee base mix and merit increases  |
| Stock-Based Compensation          | • Higher fair value of award grants  |
| Legal, Professional, & Consulting | • Higher costs associated with various legal activities, patent filings, and implementing regulatory changes |

## Restructuring

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 and year-to-date period ended June 29, 2018 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.

|                             | Fiscal Quarter Ended |               | Change  |      | Fiscal Year-To-Date Ended |               | Change  |      |
|-----------------------------|----------------------|---------------|---------|------|---------------------------|---------------|---------|------|
|                             | June 29, 2018        | June 30, 2017 | \$      | %    | June 29, 2018             | June 30, 2017 | \$      | %    |
| Other Income/Expense        |                      |               |         |      |                           |               |         |      |
| Interest income             | \$5,488              | \$2,511       | \$2,977 | 119% | \$13,161                  | \$6,511       | \$6,650 | 102% |
| Interest expense            | (87)                 | (31)          | (56)    | 181% | (151)                     | (94)          | (57)    | 61%  |
| Other income/(expense), net | (3,603)              | (2,109)       | (1,494) | 71%  | (5,439)                   | (1,546)       | (3,893) | 252% |
| Total                       | \$1,798              | \$371         | \$1,427 | 385% | \$7,571                   | \$4,871       | \$2,700 | 55%  |

## Current Quarter: Q3 2018 vs. Q3 2017

|                        |   |
|------------------------|---|
| Category               | Key Drivers   |
| Interest Income        | • Higher yields on our investment balances  |
| Other Income/(Expense) | • Increase in other expense primarily due to a non-cash impairment of a cost method equity investment |

## Year-To-Date: Q3 2018 vs. Q3 2017

|          |             |
|----------|-------------|
| Category | Key Drivers |
|----------|-------------|

|                  |  |
|------------------|--|
| Interest Income  | á Higher yields on our investment balances   |
| Other            | â Increase in other expense primarily due to a non-cash impairment of a cost method equity |
| Income/(Expense) | â investment, and higher foreign currency translation losses                               |

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## 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 unaudited interim condensed consolidated financial statements.

|                            | Fiscal Quarter Ended |               | Fiscal Year-To-Date Ended |               |
|----------------------------|----------------------|---------------|---------------------------|---------------|
|                            | June 29, 2018        | June 30, 2017 | June 29, 2018             | June 30, 2017 |
| Provision for income taxes | \$(13,302)           | \$(20,117)    | \$(198,332)               | \$(49,666)    |
| Effective tax rate         | 13.8%                | 20.9%         | 73.2%                     | 21.6%         |

## Current Quarter: Q3 2018 vs. Q3 2017

## Factor Impact On Effective Tax Rate

Tax Act â Higher benefit due to the reduction of the federal statutory rate

## Year-To-Date: Q3 2018 vs. Q3 2017

## Factor Impact On Effective Tax Rate

Tax Act <sup>a</sup> Higher tax provision for deemed repatriation and write-down of deferred tax assets recognized in Q1 fiscal 2018

Stock-Based Compensation â Higher benefit related to the settlement of stock-based awards

## 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 June 29, 2018, we had cash and cash equivalents of \$829.6 million, which mainly consisted of cash, highly-liquid money market funds, corporate bonds, and commercial paper. In addition, we had short and long-term investments of \$438.5 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 June 29, 2018, approximately \$905.4 million, or 71%, was held by our foreign subsidiaries. This represented a \$75.5 million increase from the approximately \$829.9 million that was held by our foreign subsidiaries as of September 29, 2017.

The following table presents selected financial information as of June 29, 2018 and September 29, 2017 (amounts displayed are in thousands):

|  | June 29, 2018 | September 29, 2017 |
|--|---------------|--------------------|
| Cash and cash equivalents                | \$829,621     | \$ 627,017         |
| Short-term investments                   | 195,284       | 247,757            |
| Long-term investments                    | 243,179       | 314,364            |
| Accounts receivable, net                 | 149,582       | 73,750             |
| Accounts payable and accrued liabilities | 214,046       | 221,407            |
| Working capital                          | 998,621       | 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.

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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.

**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       |          |
|--|--------------|----------|
|  | Year-To-Date |          |
|  | Ended        |          |
|  | June 29,     | June 30, |
|  | 2018         | 2017     |

|   |           |           |
|---|-----------|-----------|
| Net cash provided by operating activities | \$240,471 | \$297,365 |
|---|-----------|-----------|

Net cash provided by operating activities increased \$56.9 million in the fiscal year-to-date period ended June 29, 2018 as compared to the fiscal year-to-date period ended June 30, 2017, 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 | 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 Year-To-Date |          |
|--|---------------------|----------|
|  | Ended               |          |
|  | June 29,            | June 30, |
|  | 2018                | 2017     |

|   |          |             |
|---|----------|-------------|
| Net cash provided by (used in) investing activities | \$40,077 | \$(131,129) |
|---|----------|-------------|

|                      |           |           |
|----------------------|-----------|-----------|
| Capital expenditures | (54,869 ) | (81,668 ) |
|----------------------|-----------|-----------|

Net cash provided by investing activities was \$171.2 million higher in the fiscal year-to-date period ended June 29, 2018 as compared to the fiscal year-to-date period ended June 30, 2017, 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 | á | Lower outflows for the purchase of marketable investment securities |
|-------------------------|---|---|

|                      |   |                             |
|----------------------|---|-----------------------------|
| Capital Expenditures | á | Lower expenditures for PP&E |
|----------------------|---|-----------------------------|



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## Financing Activities

|                                       | Fiscal Year-To-Date<br>Ended |                  |
|---------------------------------------|------------------------------|------------------|
|                                       | June 29,<br>2018             | June 30,<br>2017 |
| Net cash used in financing activities | \$(76,346)                   | \$(88,966)       |
| Repurchase of common stock            | (90,480 )                    | (74,994 )        |

Net cash used in financing activities was \$12.6 million lower in the fiscal year-to-date period ended June 29, 2018 as compared to the fiscal year-to-date period ended June 30, 2017, primarily due to the following:

| Factor                | Impact On Cash Flows  |
|-----------------------|---|
| Common Stock Issuance | Higher cash inflows from increased employee stock option exercises and shares issued under our ESPP |
| Share Repurchases     | 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 unaudited interim condensed consolidated financial statements.

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

## Interest Rate Sensitivity

As of June 29, 2018, we had cash and cash equivalents of \$829.6 million, which consisted of cash, commercial paper, and highly liquid money market funds. In addition, we had both short and long-term investments of \$438.5 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 June 29, 2018, the weighted-average credit quality of our investment portfolio was AA, with a weighted-average maturity of approximately eleven 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 June 29, 2018, hypothetical changes in interest rates of 1% and 0.5% would have an impact on the carrying value of our portfolio of approximately \$4.4 million and \$2.2 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
- Taiwan Dollar
- United Arab Emirates Dirham

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

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June 29, 2018 and September 29, 2017, the outstanding derivative instruments had maturities of equal to or less than 31 days, and the total notional amounts of outstanding contracts were \$29.0 million and \$24.5 million, respectively. The fair values of these contracts were nominal as of June 29, 2018 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 June 29, 2018. 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 \$1.4 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 \$1.4 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 June 29, 2018 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 are 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 our 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.

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### 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

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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

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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 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 June 29, 2018, we had approximately 9,100 issued patents in addition to approximately 4,200 pending patent applications in more than 100 jurisdictions throughout the world. Our currently issued patents expire at various times through February 2043. 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

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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

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liability claims. Although we generally attempt to contractually limit our liability, if these contract provisions are not enforced, or are unenforceable for any reason, or if liabilities arise that are not effectively limited, we could incur substantial costs in defending and settling product liability claims.

**Production Processes and Production.** Production difficulties or inefficiencies can interrupt production, resulting in our inability to deliver products on time in a cost effective manner, which could harm our competitive position. 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 hackers, software bugs or other technical malfunctions, or other disruptions. If we use a vendor that stores information as part of their service or product offerings, we assess the security of such services prior to using the service. Nevertheless, our sensitive, confidential or proprietary information may be misappropriated by that vendor or others who may inappropriately access the vendor's system.

While we have taken a number of steps to protect our information technology systems, including the use of encryption and authentication technologies, the number and sophistication of malicious attacks that companies have experienced has increased over the past few years. In addition, because techniques used by 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 other 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 or other compromises by our employees or service providers. Any data security breach or other incident, 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 or other incident, can result in the information stored on our networks and systems being improperly accessed or acquired, 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, malware, ransomware, social engineering, denial of service, 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.

**Fluctuations in Foreign Currency Exchange Rates.** We earn revenues, pay expenses, own assets and incur liabilities in foreign countries using several currencies other than the U.S. dollar. 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. Additional risks related to

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fluctuations in foreign currency exchange rates are described in the Foreign Currency Exchange Risk section of Part I, Item 3 "Quantitative and Qualitative Disclosures About Market Risk."

**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.

**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

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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 Industry Relationships.** To be successful, we must maintain and grow our relationships with a broad range of 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;
- Leading companies in the audio and video conferencing markets; and
- Device manufacturers.

Industry relationships have historically played an important role in the markets that we serve, particularly in the entertainment market. 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 73% and 68% of our revenue was derived outside of the U.S. in the fiscal quarter ended June 29, 2018 and June 30, 2017, respectively. We are subject to a number of risks related to conducting business internationally, including:

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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.;

U.S. government trade restrictions, including those which may impose restrictions, including prohibitions, on the exportation, reexportation, sale, shipment or other transfer of programming, technology, components, and/or services to foreign persons;

Changes in diplomatic and trade relationships, including new tariffs, trade protection measures, import or export licensing requirements, trade embargoes and other trade barriers;

- Tariffs imposed by the U.S. on goods from other countries and tariffs imposed by other countries on U.S. goods, including the tariffs imposed in July 2018 by the U.S. government on various imports from China and by the Chinese government on certain U.S. goods, the scope and duration of which remain uncertain;

Compliance with applicable international laws and regulations, including antitrust and other competition 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.;

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 the European Union's General Data Protection Regulation and 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. From time to time, we are the subject of requests for information, market conduct examinations, inquiries or investigations by industry groups and/or regulatory agencies in these jurisdictions. In the event that we are involved in significant disputes or are the subject of a formal action by a regulatory agency, our results could be negatively impacted and we could be exposed to costly and time-consuming legal proceedings.

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

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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.** SEC rules require the disclosure of the use of tantalum, tin, tungsten, and gold (commonly referred to as "conflict minerals") that 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 SEC disclosure requirements 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.** We are a U.S. multi-national company that is subject to tax in multiple U.S. and foreign jurisdictions. We must use judgment to determine our worldwide tax provision. We receive significant tax benefits from a portion of our foreign sales, and realizability of these benefits are contingent upon existing current tax laws and regulations in the U.S. and countries where we operate. The following could materially affect our effective tax rate:

- Changes in geographic mix of earnings, where earnings are lower than anticipated in countries with lower tax rates and higher than anticipated in countries with higher tax rates;
- Changes in the valuation of our deferred tax assets and liabilities;
- Changes in transfer pricing arrangements;
- Outcomes of tax audits;
- Changes in accounting principles; or
- Changes in tax laws and regulations in the countries in which we operate, including an increase in tax rates, or an adverse change in the treatment of an item of income or expense.

As a result of the Tax Act enacted into law on December 22, 2017, there have been significant changes to the U.S. Internal Revenue Code, which could have a material impact on our business, including changes in the U.S. corporate income tax rates, the realizability of net deferred tax assets relating to our U.S. operations, and a shift to a territorial tax system for which we incur a transition tax on previously untaxed earnings. Accounting for these provisions in fiscal 2018 requires the use of provisional estimates in our financial statements and exercise of significant judgment in interpreting the Tax Act's provisions. As we evaluate the full impact of its regulations and guidance that are being introduced, our results may materially differ from previous estimates, and those differences may materially affect our financial position. In addition, the Tax Act includes certain international provisions that will be effective for us beginning in fiscal 2019. These provisions and any changes that we make to our corporate tax structure could adversely affect our tax rate and cash flow in future years.

The Organization of Economic Cooperation and Development ("OECD"), an international association of many countries including the United States, has finalized its Base Erosion and Profit Shifting recommendations, and many countries have started to adopt its recommendations, or independently are changing long standing transfer pricing and cross-border taxation rules. In addition, the European Union and its European Commission are proposing model legislation and investigating companies that might be in violation of European Union competition rules against unjustified state aid. 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. To the extent these actions take place in the countries that we operate, it is possible that in the future, these efforts may increase uncertainty and have an adverse impact on our effective tax rates or operations.

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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 in excess of our reserves, could significantly impact our financial results.

**STOCK-RELATED ISSUES**

**Controlling Stockholder.** At June 29, 2018, the Dolby family and their affiliates owned 1,980,314 shares of our Class A common stock and 39,426,233 shares of our Class B common stock. As of June 29, 2018, 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 86.3% 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. For additional details on the increase announced on July 25, 2018, refer to Note 14 "Subsequent Events." to our interim condensed consolidated financial statements.

The following table provides information regarding our share repurchases made under the program during the third 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) |
|---------------------------------|--------------------------|----------------------------------|---|--|
| March 31, 2018 - April 27, 2018 | 38,097                   | \$60.35                          | 38,097  | \$114.7 million                            |
| April 28, 2018 - May 25, 2018   | 701,114                  | 61.83                            | 701,114   | \$71.3 million                             |
| May 26, 2018 - June 29, 2018    | 157,478                  | 62.40                            | 157,478   | \$61.5 million                             |
| Total                           | 896,689                  |                                  | 896,689   |  |

(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<br>Number | Description   | Incorporated By<br>Reference Herein |                |      | Provided<br>Herewith |
|-------------------|---|-------------------------------------|----------------|------|----------------------|
|                   |   | Form                                | File<br>Number | Date |                      |
| 10.1*             | <u>Offer Letter dated June 26, 2018 by and between Todd Pendleton and Dolby Laboratories, Inc.</u>  |                                     |                |      | X                    |
| 31.1              | <u>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</u>            |                                     |                |      | X                    |
| 31.2              | <u>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</u>            |                                     |                |      | X                    |
| 32.1+             | <u>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</u> |                                     |                |      | 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: August 1, 2018

DOLBY LABORATORIES, INC.

By: /S/ LEWIS CHEW

Lewis Chew

Executive Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)