Dolby Laboratories, Inc.
Form 10-Q
July 31, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended June 27, 2008

OR

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

Commission File Number: 001-32431

DOLBY LABORATORIES, INC.

(Exact name of registrant as specified in its charter)

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

(Address of principal executive offices) *(Zip Code)*

(415) 558-0200

(Registrant s telephone number, including area code)

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

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

Large Accelerated Filer x Accelerated Filer ¨ Non Accelerated Filer ¨ (Do not check if a smaller reporting company) Smaller Reporting Company ¨

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

On July 17, 2008 the registrant had 51,686,262 shares of Class A common stock, par value $0.001 per share, and 60,565,041 shares of Class B common stock, par value $0.001 per share, outstanding.

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PART I FINANCIAL INFORMATION

ITEM 1 CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

DOLBY LABORATORIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(*in thousands*)

	September 28, 2007	June 27, 2008 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 368,467	$ 369,907
Short-term investments	231,217	49,552
Accounts receivable, net of allowance	28,165	45,933
Inventories	14,883	22,000
Deferred income taxes	73,686	85,576
Prepaid expenses and other current assets	17,000	47,018
Total current assets	733,418	619,986
Property, plant and equipment, net	85,552	85,775
Intangible assets, net	35,389	90,751
Goodwill	39,364	273,552
Long-term investments	73,224	179,538
Non-current deferred income taxes	12,393	12,817
Other non-current assets	12,357	13,188
Total assets	**$ 991,697**	**$ 1,275,607**
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 119,068	$ 143,312
Income taxes payable	9,051	2,833
Current portion of long-term debt	1,563	1,607
Deferred revenue	13,522	30,894
Total current liabilities	143,204	178,646
Long-term debt	9,691	8,408
Long-term deferred revenue	5,073	6,069
Deferred income tax liability		18,985
Other non-current liabilities	14,294	29,323
Total liabilities	172,262	241,431
Controlling interest	22,279	22,699
Stockholders equity:		
Class A common stock	49	52
Class B common stock	61	61
Additional paid-in capital	375,830	424,502
Retained earnings	409,749	560,936
Accumulated other comprehensive income	11,467	25,926
Total stockholders equity	797,156	1,011,477

Total liabilities and stockholders equity	**$ 991,697**	**$ 1,275,607**

See accompanying notes to unaudited condensed consolidated financial statements

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DOLBY LABORATORIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(*in thousands, except per share amounts*)

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 29, 2007	June 27, 2008	June 29, 2007	June 27, 2008
	(unaudited)			
Revenue:				
Licensing	$ 94,795	$ 127,558	$ 283,812	$ 399,607
Product sales	17,191	18,060	47,870	53,698
Services	7,627	8,699	21,383	23,796
Total revenue	119,613	154,317	353,065	477,101
Cost of revenue:				
Cost of licensing	8,478	3,361	26,287	12,179
Cost of product sales (1)	8,119	9,461	24,519	29,649
Cost of services (1)	2,963	3,194	8,470	9,400
Total cost of revenue	19,560	16,016	59,276	51,228
Gross margin	100,053	138,301	293,789	425,873
Operating expenses:				
Selling, general and administrative (1)	48,430	54,979	128,266	161,275
Research and development (1)	11,854	15,366	31,650	44,998
Gain on settlements	(350)	(250)	(1,850)	(499)
Total operating expenses	59,934	70,095	158,066	205,774
Operating income	40,119	68,206	135,723	220,099
Interest income	6,592	3,481	19,216	13,777
Interest expense	(825)	(329)	(1,751)	(1,324)
Other non-operating expenses	(8)	(491)	(347)	(2,184)
Income before provision for income taxes and controlling interest	45,878	70,867	152,841	230,368
Provision for income taxes	(15,839)	(24,117)	(53,067)	(78,516)
Income before controlling interest	30,039	46,750	99,774	151,852
Controlling interest in net income, net of tax	(354)	(302)	(1,101)	(953)
Net income	**$ 29,685**	**$ 46,448**	**$ 98,673**	**$ 150,899**
Earnings per share (basic)	$ 0.27	$ 0.42	$ 0.91	$ 1.36
Earnings per share (diluted)	$ 0.26	$ 0.40	$ 0.87	$ 1.32
Weighted-average shares outstanding (basic)	109,692	111,844	108,898	111,209
Weighted-average shares outstanding (diluted)	113,696	114,875	113,389	114,672
Expense for rent to related party included in selling, general and administrative expenses	$ 340	$ 340	$ 1,021	$ 1,021
(1) Stock-based compensation included above was classified as follows:				
Cost of product sales	$ 269	$ 167	$ 679	$ 670

Cost of services	39	48	107	126
Selling, general and administrative	3,838	4,262	11,459	13,157
Research and development	993	1,158	2,512	3,277

See accompanying notes to unaudited condensed consolidated financial statements

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DOLBY LABORATORIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(*in thousands*)

	Fiscal Year-to-Date Ended	
	June 29, 2007	June 27, 2008
	(unaudited)	
Operating activities:		
Net income	$ 98,673	$ 150,899
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,533	19,407
Stock-based compensation expense	14,757	17,230
Accretion of discounts on debt securities	(1,816)	(133)
Tax benefit from exercise of stock options	18,827	19,705
Excess tax benefit from exercise of stock options	(18,524)	(18,517)
Provision for doubtful accounts	1,021	767
Deferred income taxes	(11,088)	(20,485)
Other non-cash items affecting net income	1,558	2,316
Changes in operating assets and liabilities:		
Accounts receivable	(2,039)	(16,281)
Inventories	(6,664)	(8,874)
Prepaid expenses and other assets	(8,017)	(9,535)
Accounts payable and accrued liabilities	23,485	19,577
Income taxes, net	(17,996)	(13,558)
Deferred revenue	5,880	18,283
Other non-current liabilities	(113)	4,212
Payment on litigation settlement	(3,000)	(3,000)
Net cash provided by operating activities	105,477	162,013
Investing activities:		
Purchases of available-for-sale securities	(307,383)	(213,028)
Proceeds from sale of available-for-sale securities	173,172	283,132
Purchases of property, plant and equipment	(6,945)	(7,666)
Purchase of intangible assets	(750)	
Acquisitions, net of cash acquired	(30,230)	(253,176)
Other investing activities	88	40
Net cash used in investing activities	(172,048)	(190,698)
Financing activities:		
Payments on debt	(1,087)	(1,146)
Proceeds from the exercise of stock options	7,253	10,916
Issuance of Class A common stock (ESPP)	967	1,133
Excess tax benefit from exercise of stock options	18,524	18,517
Net cash provided by financing activities	25,657	29,420
Effect of foreign exchange rate changes on cash and cash equivalents	3,286	705
Net increase/(decrease) in cash and cash equivalents	(37,628)	1,440

Cash and cash equivalents at beginning of period	363,537	368,467
Cash and cash equivalents at end of period	**$ 325,909**	**$ 369,907**
Supplemental disclosure:		
Cash paid for income taxes	$ 63,317	$ 89,137
Cash paid for interest	1,335	843

See accompanying notes to unaudited condensed consolidated financial statements

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DOLBY LABORATORIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Summary of Business and Significant Accounting Policies

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

Our objective is to be an essential element in the best entertainment technologies by delivering innovative and enduring technologies that enrich the entertainment experience. We believe that our well recognized brand and established history of successful innovation put us in a position to expand the use of our technologies in existing and new markets and to capitalize on key trends in digital entertainment, such as the transition to high definition television, digital cinema, space efficient home theatre systems, portable media and an increasing number of media delivery channels.

We deliver technologies, products, and services at each critical stage of the entertainment chain content creation, content distribution and content playback. We work closely with content creators, including filmmakers, television producers, music producers, and video game designers to incorporate Dolby technologies in entertainment content. As a result, we believe we are well positioned to work with entertainment distributors to deliver that content with our technologies, whether through 35 millimeter film or digital content for theatres, DVDs, broadcasts or the internet. By working successfully to encode and distribute content with Dolby technologies, we are able to license our decoding technologies to consumer electronics manufacturers and independent software vendors for consumer playback and sell our cinema equipment for large scale public playback in movie theatres. Our involvement across the entertainment chain has resulted in a globally recognized brand and we believe this helps us introduce technologies and services into new areas.

Unaudited Interim Financial Statements

The accompanying interim condensed consolidated balance sheet as of June 27, 2008, the condensed consolidated statements of operations and cash flows for the fiscal quarters and fiscal year-to-date periods ended June 29, 2007 and June 27, 2008 are unaudited. These interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). In our opinion, the interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements for the year ended September 28, 2007 and include all adjustments necessary for fair presentation. The results for the fiscal quarter and fiscal year-to-date periods ended June 27, 2008 are not necessarily indicative of the results to be expected for any subsequent quarterly or annual financial period, including the fiscal year ending September 26, 2008.

The accompanying interim condensed consolidated financial statements are prepared in accordance with Securities and Exchange Commission rules and regulations, which allow certain information and footnote disclosures that are normally included in annual financial statements to be condensed or omitted. As a result, the accompanying interim condensed consolidated financial statements should be read in conjunction with our consolidated financial statements for the year ended September 28, 2007 that are included in our Annual Report on Form 10-K and filed with the Securities and Exchange Commission. Certain prior period amounts have been reclassified to conform to current year presentation.

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Use of Estimates

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

Per Share Data

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

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

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 29, 2007	June 27, 2008	June 29, 2007	June 27, 2008
	(in thousands, except per share amounts)			
Numerator:				
Net income	$ 29,685	$ 46,448	$ 98,673	$ 150,899
Denominator:				
Weighted-average shares outstanding (basic)	109,692	111,844	108,898	111,209
Potential common shares from options to purchase Class A and Class B common stock and restricted stock units	4,004	3,031	4,491	3,463
Weighted-average shares outstanding (diluted)	113,696	114,875	113,389	114,672
Basic earnings per share	**$ 0.27**	**$ 0.42**	**$ 0.91**	**$ 1.36**
Diluted earnings per share	**$ 0.26**	**$ 0.40**	**$ 0.87**	**$ 1.32**

A total of 1,790,872 and 1,837,222 options were excluded from the calculation of potential common shares for the third quarter of fiscal 2007 and 2008, respectively, because their inclusion would have been anti-dilutive. A total of 1,434,147 and 1,874,151 options were excluded from the calculation of potential common shares for the fiscal year-to-date periods ended June 29, 2007 and June 27, 2008, respectively, because their inclusion would have been anti-dilutive.

Cash and Cash Equivalents

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

Investments

As of June 27, 2008, we had investments in United States government agency securities, auction rate certificates and municipal debt securities. We account for these instruments under the provisions of Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Investments that have original maturities between 91 days and one year from the date of purchase are classified as short-term investments and investments that have maturities of more than one year from the date of purchase are classified as long-term investments. We reclassified our auction rate certificates from short-term investments to long-term investments in the second quarter of fiscal 2008 due to the lack of short-term liquidity available for these securities. See Note 2, Composition of Certain Financial Statement Captions for further discussion regarding our auction rate certificates. All of our investments, except for an equity investment and investments held in our supplemental retirement plan for key executives, are classified as available-for-sale and are recorded at fair market value on the

condensed consolidated balance sheet. Unrealized gains or losses on our available-for-sale securities are reported as a component of other comprehensive income and realized gains or losses are reported as a component of net income. Investments held in our supplemental retirement plan for key executives are classified as trading securities and are included in prepaid expenses and other current assets, as well as in other non-current assets on the condensed consolidated balance sheet. Unrealized gains or losses on trading securities are reported as a component of net income.

In accordance with FASB Staff Position FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,* we review our investment portfolio in order to assess whether our investments with unrealized loss positions are other-than-temporarily impaired. See our discussion in Note 2, Composition of Certain Financial Statement Captions regarding our investment securities in unrealized loss positions.

Stock-Based Compensation

We account for stock-based compensation under the provisions of Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* (SFAS 123R). SFAS 123R requires measurement of all employee stock-based awards using a fair-value method and recording of related compensation expense, net of estimated forfeitures, in the consolidated financial statements over the requisite service period. Stock-based compensation expense was $5.1 million and $5.6 million in the third quarter of fiscal 2007 and 2008, respectively. For the fiscal year-to-date periods ended June 29, 2007 and June 27, 2008, we recorded stock-based compensation expense of $14.8 million and $17.2 million, respectively. See Note 4 Stock-Based Compensation for further discussion.

Income Taxes

We recognize our quarterly provision for income taxes based on our estimated full year projected effective tax rate. We estimate our effective tax rate based on projections of our income before taxes for the full fiscal year. However, events that occur in a quarter are reflected as discrete items, which could impact the tax rate. In the period that we file our annual tax returns, we true up our provision for income taxes to reflect any difference between our estimated provision and our filed tax return.

In the first quarter of fiscal 2008, we adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 addresses the accounting for and disclosure of uncertainty in income tax positions by prescribing a minimum recognition threshold that a tax position is required to satisfy before being recognized in the financial statements.

Goodwill and Intangible Assets

We account for goodwill in accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). As required by SFAS 142, we perform an impairment test on recorded goodwill by comparing the estimated fair value of each of our reporting units to the carrying value of the assets and liabilities of each unit, including goodwill. The fair value of each of our reporting units is determined by using a discounted cash-flow model which considers a number of factors, including estimated future cash-flows, risks facing us and our current market capitalization. If the carrying value of the assets and liabilities of the reporting units, including goodwill, were to exceed our estimate of the fair value of the reporting units, we would record an impairment charge in an amount equal to the excess of the carrying value of goodwill over the implied fair value of the goodwill. Our fiscal 2008 impairment test of goodwill, which was performed in the third quarter of fiscal 2008, resulted in no impairment charge.

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

	Total (in thousands)
Balance at September 28, 2007	$ 39,364
Goodwill acquired Coding Technologies AB (see Note 5)	212,928
Translation adjustments	21,260
Balance at June 27, 2008	$ 273,552

Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144), requires that long-lived assets, including intangible assets, with definite lives be amortized over their estimated useful lives and reviewed for impairment whenever events or changes in circumstances indicate an asset s carrying value may not be recoverable. Recoverability of an asset is measured by comparison of its carrying amount to the expected future undiscounted cash flows that the asset is expected to generate. If it is determined that an asset is not recoverable, an impairment loss is recorded in the amount by which the carrying amount of the asset exceeds its fair value. Our intangible assets principally consist of acquired technology, patents, trademarks, customer relationships and contracts, and are amortized on a straight-line basis over their useful lives ranging from four to 15 years. No intangible or long-lived assets were impaired as of June 27, 2008.

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Comprehensive Income

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

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 29, 2007	June 27, 2008	June 29, 2007	June 27, 2008
	(in thousands)			
Net income	$ 29,685	$ 46,448	$ 98,673	$ 150,899
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of tax	3,355	1,223	8,109	17,360
Net unrealized losses on available-for-sale securities, net of tax (see Note 2)	(135)	(768)	(262)	(2,901)
Comprehensive income	$ 32,905	$ 46,903	$ 106,520	$ 165,358

Withholding Taxes

Licensing revenue is recognized gross of withholding taxes that are remitted by our licensees directly to their local tax authorities. Withholding taxes were $2.7 million and $4.5 million in the third quarter of fiscal 2007 and 2008, respectively. Withholding taxes were $9.4 million and $13.1 million in the fiscal year-to-date periods ended June 29, 2007 and June 27, 2008, respectively. Sales tax is accounted for on a net basis and is excluded from revenues.

2. Composition of Certain Financial Statement Captions

Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and investments as of September 28, 2007 and June 27, 2008 consisted of the following:

	September 28, 2007	June 27, 2008
	(in thousands)	
Cash and cash equivalents:		
Cash	$ 128,061	$ 107,294
Cash equivalents:		
Money market funds (tax exempt)	239,198	231,218
Municipal debt securities (tax exempt)		31,395
U.S. government agency securities	1,208	
Total cash and cash equivalents	368,467	369,907
Investments:		
U.S. government agency securities	113,967	8,635
Auction rate certificates (tax exempt)	103,950	71,460
Variable rate demand notes (tax exempt)	54,900	
Municipal debt securities (tax exempt)	30,830	148,386
Equity investment	794	609

Total investments	304,441	229,090
Total cash, cash equivalents and investments	$ 672,908	$ 598,997

At June 27, 2008, we held tax-exempt auction rate certificates (ARCs) with a par value of $75.2 million. These certificates are secured by pools of student loans and guaranteed either by state-designated guaranty agencies or the U.S. government. Auctions for these instruments began failing during the second quarter of fiscal 2008 and continued to fail in the third quarter of fiscal 2008. Additionally, a liquid secondary market has not developed for these instruments. We believe that the market may take more than twelve months to recover. ARCs are classified as available-for-sale securities and reflected at fair value on the condensed consolidated balance sheet. We determined

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that the decline in the market value of these securities is not other-than-temporary and recorded an unrealized loss of $3.7 million to accumulated other comprehensive income in the third quarter of fiscal 2008. If we determine that any future decline in the valuation of the ARCs is other-than temporary, it will be recorded as a component of net income. We continue to classify our investments in ARCs as long-term investments on the condensed consolidated balance sheet at June 27, 2008, based on our ability and intent to hold for more than one year.

Our investment portfolio which is recorded as cash equivalents, short-term investments, and long-term investments as of September 28, 2007 was as follows:

	Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
		(in thousands)		
Money market funds	$ 239,198	$	$	$ 239,198
U.S. government agency securities	115,026	149		115,175
Auction rate certificates	103,950			103,950
Variable rate demand notes	54,900			54,900
Municipal debt securities	30,799	34	(3)	30,830
Equity investment	794			794
Cash equivalents and investments	$ 544,667	$ 183	$ (3)	$ 544,847

Our investment portfolio which is recorded as cash equivalents, short-term investments, and long-term investments as of June 27, 2008 was as follows:

	Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
		(in thousands)		
Money market funds	$ 231,218	$	$	$ 231,218
U.S. government agency securities	8,648	40	(53)	8,635
Auction rate certificates	75,200		(3,740)	71,460
Municipal debt securities	179,935	260	(414)	179,781
Equity investment	609			609
Cash equivalents and investments	$ 495,610	$ 300	$ (4,207)	$ 491,703

All of our investments in the tables above, except for the equity investment, are classified as available-for-sale and are recorded at fair market value on the condensed consolidated balance sheet. The equity investment represents equity securities that we have accounted for under the cost method and classified as long-term investments based on our ability and intent to hold for more than one year.

The following table shows the gross unrealized losses and fair values of investments that were in an unrealized loss position as of June 27, 2008:

	Less than 12 months		12 months or greater		Total	
	Fair Values	Gross Unrealized Losses	Fair Values	Gross Unrealized Losses	Fair Values	Gross Unrealized Losses
			(in thousands)			
Auction rate certificates	$ 68,460	$ (3,740)	$	$	$ 68,460	$ (3,740)
U.S. government agency securities	4,947	(53)			4,947	(53)
Municipal debt securities	108,929	(414)			108,929	(414)

Total	$ 182,336	$ (4,207)	$	$	$ 182,336	$ (4,207)

The unrealized losses on our investments in municipal debt securities and U.S. government agency securities were caused primarily by changes in interest rates. We attribute the unrealized losses on our investments in auction rate certificates to liquidity problems in the auction market, which we believe to be temporary. We have the ability to hold these securities until we recover any unrealized losses. As a result, we do not consider any investment in an unrealized loss position at June 27, 2008 to be other-than-temporarily impaired.

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Accounts Receivable

Accounts receivable consists of the following:

	September 28, 2007	June 27, 2008
	(in thousands)	
Trade accounts receivable	$ 25,245	$ 22,060
Amounts receivable related to patent administration program	2,634	20,972
Other accounts receivable	1,189	4,718
	29,068	47,750
Less: Allowance for doubtful accounts	(903)	(1,817)
Accounts receivable, net of allowance	$ 28,165	$ 45,933

Inventories

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

	September 28, 2007	June 27, 2008
	(in thousands)	
Raw materials	$ 4,799	$ 7,277
Work in process	2,723	3,781
Finished goods	7,361	10,942
Inventories	$ 14,883	$ 22,000

Goodwill and Intangible Assets

Following is a summary of goodwill and intangible assets:

	September 28, 2007	June 27, 2008
	(in thousands)	
Amortized intangible assets:		
Acquired patents and technology	$ 30,986	$ 60,361
Customer relationships	70	30,270
Customer contracts		5,300
Other intangibles	12,278	12,378
	43,334	108,309
Less: Accumulated amortization	(7,945)	(17,558)
Intangible assets, net	$ 35,389	$ 90,751
Non-amortized intangible assets:		
Goodwill	$ 39,364	$ 273,552

Amortization expense associated with our intangible assets was $1.0 million and $3.0 million in the third quarters of fiscal 2007 and 2008, respectively, and is included in cost of licensing, cost of product sales, and selling, general and administrative expenses in the accompanying condensed consolidated statements of operations. Amortization expense associated with our intangible assets was $2.1 million and $9.4 million for the fiscal year-to-date periods ended June 29, 2007 and June 27, 2008, respectively. The increase in intangible assets and goodwill from September 28, 2007 to June 27, 2008 was primarily due to the acquisition of Coding Technologies AB (Coding Technologies) in November 2007. See Note 5, Business Combinations for further discussion regarding the acquisition of Coding Technologies.

Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consist of the following:

	September 28, 2007	June 27, 2008
	(in thousands)	
Accounts payable	$ 9,281	$ 8,431
Accrued royalties	31,051	31,994
Amounts payable to joint licensing program partners	25,781	42,770
Accrued compensation and benefits	30,347	39,751
Accrued professional fees	3,593	3,068
Current portion of litigation settlement (see Note 6)	2,592	2,582
Other accrued liabilities	16,423	14,716
Accounts payable and accrued liabilities	$ 119,068	$ 143,312

Accrued royalties include amounts related to an ongoing dispute regarding the terms of a license agreement with an unrelated patent licensor. From the third quarter of fiscal 2006 through the third quarter of fiscal 2007, we had been accruing royalties related to this matter. We have informed the patent licensor that we may have overpaid them under the terms of the licensing agreement. The patent licensor has claimed that we have underpaid them under the terms of the licensing agreement. In the fourth quarter of fiscal 2007, we determined that it was appropriate to cease accruing additional royalties related to this dispute. We continue to try to resolve this matter with the patent licensor. We believe the amounts accrued as of June 27, 2008 are sufficient to cover any potential exposure we may have related to this dispute.

Accumulated Other Comprehensive Income

Accumulated foreign currency translation gains, net of tax were $11.3 million and $28.6 million at September 28, 2007 and June 27, 2008, respectively. At September 28, 2007, we had accumulated net unrealized gains, net of tax, on available-for-sale securities of $0.2 million. At June 27, 2008, we had accumulated net unrealized losses, net of tax, on available-for-sale securities of $2.7 million. Accumulated unrealized losses at June 27, 2008, primarily reflects the temporary impairment of our auction rate certificates discussed earlier in Note 2, Composition of Certain Financial Statement Captions.

3. Income Tax Uncertainties

In the first quarter of fiscal 2008, we adopted the provisions of FIN 48. FIN 48 addresses the accounting for and disclosure of uncertainties in income tax positions by prescribing a minimum recognition threshold that a tax position is required to satisfy before being recognized in the financial statements.

The cumulative effect of adopting FIN 48 was a decrease in tax reserves of $0.3 million, resulting in an increase of $0.3 million in our beginning retained earnings balance. Upon adoption of FIN 48, we recorded $11.2 million to non-current liabilities, which represented a gross liability for unrecognized tax benefits of $7.9 million, interest of $1.2 million and penalties of $2.1 million. Additionally, we recorded $5.3 million to non-current deferred income tax assets for the effects of potential foreign tax credits, federal deduction of state income taxes and deductibility of interest expense. The net liability of $5.9 million, if recognized, would unfavorably affect our effective tax rate. We do not anticipate a significant change in our unrecognized tax benefits in the next twelve months.

Our policy to include interest and penalties related to gross unrecognized tax benefits within our provision for income taxes did not change upon the adoption of FIN 48. To the extent accrued interest and penalties do not ultimately become payable, amounts accrued will be reduced in the period that such determination is made and reflected as a reduction in the overall income tax provision, to the extent that the interest expense had been provided through the tax provision, or as a reduction in goodwill to the extent it had been recognized through purchase accounting.

For the fiscal year-to-date period ended June 27, 2008, we recorded additional non-current liabilities related to FIN 48 tax uncertainties of $4.9 million, which consists of a gross liability of $3.6 million, interest of $0.8 million and penalties of $0.5 million. Of the $4.9 million, $0.8 million associated with the acquisition of Coding

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Technologies was recorded to goodwill. The remaining amounts are reflected in the provision for income taxes. It is reasonably possible that our liability for unrecognized tax benefits related to Coding Technologies could change based on our finalization of the purchase price allocation, which we expect to complete by the end of fiscal 2008.

We file income tax returns in the United States (U.S.) on a federal basis and in several U.S. state and foreign jurisdictions. Our two most significant tax jurisdictions are the U.S. and the United Kingdom. Our tax filings remain subject to examination by applicable tax authorities for a certain length of time following the tax year to which those filings relate. Our tax filings are no longer subject to examinations by the Internal Revenue Service or the appropriate governmental agencies for the United Kingdom through the tax year 2004. Our California filings for tax years 2000 through 2003 are subject to review by the appropriate California tax agency. Other significant jurisdictions include Sweden, Australia, and Canada. We do not believe that the outcome of any examinations will have a material impact on our financial statements.

4. Stock-Based Compensation

We utilize stock-based awards as a form of compensation for employees, officers, directors and non-employee consultants. Net income included $5.1 million and $14.8 million in stock-based compensation expense for the third quarter of fiscal 2007 and the fiscal year-to-date period ended June 29, 2007, respectively. Net income included $5.6 million and $17.2 million in stock-based compensation expense for the third quarter of fiscal 2008 and the fiscal year-to-date period ended June 27, 2008, respectively.

Stock Options. We have granted stock options to our employees, officers and directors under our 2005 Stock Plan and our 2000 Stock Incentive Plan. We utilize the Black-Scholes option pricing model to determine the fair value of employee stock options at the date of grant. The fair value of our stock-based awards was estimated using the following weighted-average assumptions:

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 29, 2007	June 27, 2008	June 29, 2007	June 27, 2008
Expected term (in years)	5.09	5.03	5.71	5.08
Expected stock price volatility	40.1%	43.6%	43.5%	43.1%
Risk-free interest rate	4.6%	3.0%	4.6%	2.9%
Dividend yield				

Stock-based compensation expense is recorded net of estimated forfeitures. In the third quarter of fiscal 2007 we utilized an estimated annualized forfeiture rate of 5.6%, compared to approximately 4.8% in the third quarter of fiscal 2008.

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

	Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Options outstanding at September 28, 2007	7,609	$ 12.73		
Grants	1,361	46.36		
Exercises	(1,913)	5.71		
Forfeitures and expirations	(137)	29.20		
Options outstanding at June 27, 2008	6,920	20.92	7.2	$ 136,899
Options exercisable at June 27, 2008	3,203	7.27	5.6	$ 102,718

Aggregate intrinsic value is based on the closing price of our common stock on June 27, 2008 of $39.35 and excludes the impact of options that were not in-the-money. The weighted-average fair value of stock options on the date of grant was $14.86 and $16.85 for the third quarter of

fiscal 2007 and 2008, respectively. The weighted-average fair value of stock options on the date of grant was $13.95 and $19.43 for the fiscal year-to-date periods ended June 29, 2007 and June 27, 2008, respectively.

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Restricted Stock Units. We grant restricted stock units to certain employees, officers and directors under our 2005 Stock Plan. These awards generally vest over four years, with equal annual cliff-vesting. At each vesting date, the holder of the award is issued shares of our Class A common stock. Compensation expense from these awards is equal to the fair market value of our common stock on the date of grant and is recognized over the requisite service period. In the third quarter of fiscal 2008, we granted approximately 25,000 restricted stock units at a weighted-average fair value of $43.48 per unit.

Employee Stock Purchase Plan. In January 2005, our board of directors adopted and our stockholders approved our Employee Stock Purchase Plan (ESPP), which 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 one thousand shares in an offering period, whichever is less. The ESPP became effective on February 16, 2005, and the first purchase took place on November 15, 2005. Prior to February 5, 2008, the plan allowed for a purchase price equal to 95 percent of the closing price on the New York Stock Exchange on the last day of the purchase period. On February 5, 2008, the plan was amended to allow for a purchase price equal to 85 percent of the closing price on the New York Stock Exchange on the last day of the purchase period commencing with the offering period on May 15, 2008. Under the ESPP, substantially all employees may purchase Class A common stock through payroll withholdings. Our ESPP is now considered compensatory under SFAS 123R. In the third quarter of fiscal 2008, we recorded compensation expense of $0.1 million for our ESPP. Our ESPP does not have a look-back option and is classified as a liability award. At June 27, 2008, our accrued liabilities included $0.5 million towards employee withholdings and related compensation cost. The ESPP liability will be settled on the purchase date, November 17, 2008, through the issuance of Class A common stock based on the market price on the purchase date.

5. Business Combinations

In the first quarter of fiscal 2008, we acquired all of the outstanding equity interests of Coding Technologies, a privately held provider of audio compression technologies for the mobile, digital broadcast and internet markets. The aggregate cost of the acquisition was approximately $253 million, net of acquired cash, including approximately $6 million in transaction costs. We believe the acquisition of Coding Technologies will increase our presence in the mobile, broadcast, digital radio and digital music download markets. The results of Coding Technologies operations from November 9, 2007, are included in our results of operations.

The allocation of the purchase price is preliminary and is therefore subject to change. We expect to complete the allocation by the end of fiscal 2008. The aggregate cost of the acquisition, net of acquired cash, was allocated as follows:

	Total Purchase Price Allocation (in thousands)	Estimated Useful Lives (in years)
Goodwill	$ 212,928	*n/a*
Developed technology	23,700	8
Customer contracts	5,300	4
Backlog	100	4
Customer relationships	30,200	9
Deferred tax liability	(17,300)	*n/a*
Acquired liabilities, net	(1,752)	*n/a*
Total purchase price	$ 253,176	

6. Legal Proceedings

In March 1997, an unrelated third party filed a lawsuit against us alleging breach of a written agreement. In April 2002, we settled the dispute and agreed to pay a total of $30.0 million, without interest, in ten equal annual installments of $3.0 million per year beginning in June 2002. We recorded this liability at its present value of $24.2 million on the condensed consolidated balance sheet using a discount rate of 5.125%, which approximated our incremental cost of borrowing rate. Interest related to this liability is recorded quarterly and is included in interest expense on the accompanying condensed consolidated statements of operations. Other than such payments, neither party has any material obligations as a result of the settlement. As of September 28, 2007 and June 27, 2008, we had $12.0 and $9.0 million, respectively, remaining to be paid under this settlement.

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

7. Geographic Data

Revenue by geographic region, which was determined based on the location of our licensees for licensing revenue, the location of our direct customers or distributors for product sales, and the location where services were performed for service revenue, was as follows:

	Revenue by Geographic Region			
	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 29, 2007	June 27, 2008	June 29, 2007	June 27, 2008
	(in thousands)			
United States	$ 43,553	$ 54,072	$ 100,081	$ 159,273
International	76,060	100,245	252,984	317,828
Total revenue	$ 119,613	$ 154,317	$ 353,065	$ 477,101

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

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 29, 2007	June 27, 2008	June 29, 2007	June 27, 2008
United States	*36%*	35%	*28%*	33%
Japan	*18%*	20%	*21%*	21%
Europe	*17%*	16%	*20%*	18%
Taiwan	*11%*	12%	*11%*	11%
China	*8%*	8%	*11%*	8%
Other	*10%*	9%	*9%*	9%

In the third quarter of fiscal 2007, revenue from two licensing customers represented $13.0 million and $12.8 million, or 11%, of total revenue for each customer. In the third quarter of fiscal 2008, revenue from one customer represented $18 million, or 12%, of total revenue. Revenue from one customer accounted for $35.3 million, or 10%, of total revenue for the fiscal year-to-date period ended June 29, 2007. Revenue from one customer accounted for $59.1 million, or 12%, of total revenue for the fiscal year-to-date period ended June 27, 2008.

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

	Long-Lived Tangible Assets by Geographic Region	
	September 28, 2007	June 27, 2008
	(in thousands)	
United States	$ 60,237	$ 60,023
International	25,315	25,752
Total long-lived tangible assets, net of accumulated depreciation	$ 85,552	$ 85,775

Long-lived tangible assets, which consist of property, plant and equipment, net of accumulated depreciation, held in the United Kingdom were $22.1 million and $21.0 million at September 28, 2007 and June 27, 2008, respectively.

8. Recently Issued Accounting Standards

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes.* FIN 48 clarifies the accounting for uncertainties in income taxes recognized in an enterprise s financial statements in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*. The Interpretation defines the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. We adopted FIN 48 in the first quarter of fiscal 2008. The adoption of FIN 48 did not have a material impact on our consolidated financial statements. Upon adoption, we recognized a $0.3 million decrease in a liability for unrecognized tax benefits which, as required, was accounted for as an increase to our beginning retained earnings balance.

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, *Fair Value Measures* (SFAS 157). SFAS 157 defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. This standard was issued to be effective for fiscal years beginning after November 15, 2007. The FASB approved a one-year deferral of adoption of the standard as it relates to non-financial assets and liabilities with the issuance in February 2008 of FASB Staff Position FAS 157-2, *Effective Date of FASB Statement No. 157*. In addition, the FASB has excluded leases from the scope of SFAS 157 with the issuance of FASB Staff Position FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements that Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13.* We do not expect the adoption of SFAS 157 will have a material impact on our consolidated financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The provisions of SFAS 159 become effective as of the beginning of our 2009 fiscal year. We are currently evaluating the impact that SFAS 159 will have on our consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141R, *Business Combinations* (SFAS 141R). SFAS 141R requires most identifiable assets, liabilities, non-controlling interests, and goodwill acquired in a business combination to be recorded at full fair value. SFAS 141R applies to all business combinations, including combinations among mutual entities and combinations by contract alone. Under Statement 141R, all business combinations will be accounted for by applying the acquisition method. SFAS 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We are currently evaluating the impact that SFAS 141R will have on our consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Non-controlling Interests in Consolidated Financial Statements* (SFAS 160). SFAS 160 requires the ownership interests in subsidiaries held by parties other than the parent to be treated as a separate component of equity and be clearly identified, labeled, and presented in the consolidated financial statements. SFAS 160 is effective for periods beginning on or after December 15, 2008. Earlier adoption is prohibited. We are currently evaluating the impact that SFAS 160 will have on our consolidated financial statements.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133* (SFAS 161). SFAS 161 requires entities to provide greater transparency about how and why the entity uses derivative instruments, how the instruments and related hedged items are accounted for under SFAS 133, and how the instruments and related hedged items affect the company s financial position, results of operations, and cash flows of the entity. SFAS 161 is effective for fiscal years beginning after November 15, 2008. We do not expect the adoption of SFAS 161 will have a material impact on our consolidated financial statements.

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets* (FSP FAS 142-3). FSP FAS 142-3 removes the requirement of SFAS 142, *Goodwill and Other Intangible Assets* for an entity to consider, when determining the useful life of an acquired intangible asset, whether the intangible asset can

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be renewed without substantial cost or material modifications to the existing terms and conditions associated with the intangible asset. FSP FAS 142-3 replaces the previous useful-life assessment criteria with a requirement that an entity considers its own experience in renewing similar arrangements. If the entity has no relevant experience, it would consider market participant assumptions regarding renewal. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the potential impact of adopting FSP FAS 142-3.

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS 162). SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. This Statement is effective 60 days following the SEC s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. We do not expect SFAS 162 to have a material impact on our consolidated financial statements.

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ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our interim condensed consolidated financial statements and the related notes that appear elsewhere in this Form 10-Q. These discussions contain forward-looking statements reflecting our current expectations that involve risks and uncertainties. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expects, plans, anticipates, believes, estimates, predicts, potential, continue or the negative of these terms or other comp terminology. Forward-looking statements include, but are not limited to: demand for and future revenues from the sale of consumer electronics products incorporating our technologies, including traditional and Blu-ray DVD players; growth opportunities in the consumer electronics market; opportunities to incorporate our technologies in markets outside the traditional consumer electronics market or to deliver technology solutions in areas beyond sound; the impact of inclusion of certain of our technologies in audio standards; the rate of adoption of and sales of Blu-ray DVD players; diversification of sources of licensing revenue; demand for and future revenues from incorporation of our technologies in personal computers; increase in sales of our products and demand for consumer electronics products containing our technologies in emerging economies; concentration of manufacturing of consumer electronic products containing our technologies in emerging economies and the associated challenges in royalty collection and intellectual property enforcement; pricing strategies for our digital cinema product and competitive pricing pressures for our cinema products; the pace of the movie industry s transition to digital cinema and our expected revenue associated with the transition; the expected timing of revenue and cost recognition for a number of digital cinema systems; our expected licensing, product sales and product services gross margins; our expected selling, general and administrative expenses and research and development expenses for the remainder of fiscal 2008; our expected effective tax rate for the remainder of fiscal 2008; our critical accounting policies, including those regarding revenue recognition, allowance for doubtful accounts, accounting for goodwill, accounting for income taxes, stock-based compensation; calculations of royalties due to our licensors; statements regarding the sufficiency of our cash reserves; our ability to liquidate and fully recover the carrying value of our auction rate certificates in the near term; and our expected rate of return on investments. Actual results may differ materially from those discussed in these forward-looking statements due to a number of factors, including: the rate of growth of the markets for consumer electronics that include our technologies; whether our technologies will continue to be included on certain personal computer operating systems; whether PC manufacturers will continue to include DVD software applications on personal computers that include Windows Vista Home Premium Edition or Ultimate Edition; whether sales of personal computers with the Home Premium Edition or the Ultimate Edition will be strong; whether our technologies are selected for and remain part of audio standards; the rate of deployment and adoption of Blu-ray DVD players; the extent to which our expectations regarding new licensing markets are realized; the extent to which consumer electronics manufacturers concentrate their production in emerging economies that present royalty collection and intellectual property enforcement challenges; the extent to which consumers in emerging economies elect to purchase products containing our technologies; the extent to which professionals using our equipment continue to demand innovative technology solutions developed by us; our ability to tailor our traditional model of selling to respond to market trends; whether our competitors are able to develop and sell alternative digital cinema technologies to our customers; the accuracy of our identification of critical accounting policies and the accuracy of the assumptions we make in implementing such policies; the accuracy of our estimates regarding our taxable income and cash needs for the next twelve months; the accuracy of our calculations of royalties due to our licensors; fluctuations in interest rates; the extent to which auctions for auction rate certificates continue to fail; and risks set forth in the section entitled Risk Factors in Part II, Item 1A of this Quarterly Report on Form 10-Q and elsewhere in this filing. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of these forward-looking statements. We are under no duty to update any of the forward-looking statements after the date of this Quarterly Report on Form 10-Q to conform our prior statements to actual results. The periods presented herein consist of our third quarters and fiscal year-to-date periods ended June 29, 2007 and June 27, 2008. Our fiscal quarter periods ended June 29, 2007 and June 27, 2008, both consist of 13 weeks and our fiscal year-to-date periods ended June 29, 2007 and June 27, 2008 both consist of 39 weeks. Our 2008 fiscal year consists of 52 weeks and ends on September 26, 2008. The results for the fiscal quarter and fiscal year-to-date period ended June 27, 2008 are not necessarily indicative of the results to be expected for any subsequent quarterly or annual financial period, including the fiscal year ending September 26, 2008.

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Overview

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

Our objective is to be an essential element in the best entertainment technologies by delivering innovative and enduring technologies that enrich the entertainment experience. We believe that our well recognized brand and established history of successful innovation put us in a position to expand the use of our technologies in existing and new markets and to capitalize on key trends in digital entertainment, such as the transition to high definition television, digital cinema, space efficient home theatre systems, portable media and an increasing number of media delivery channels.

We deliver technologies, products, and services at each critical stage of the entertainment chain - content creation, content distribution and content playback. We work closely with content creators, including filmmakers, television producers, music producers, and video game designers to incorporate Dolby technologies in entertainment content. As a result, we believe we are well positioned to work with entertainment distributors to deliver that content with our technologies, whether through 35 millimeter film or digital content for theatres, DVDs, broadcasts or the internet. By working successfully to encode and distribute content with Dolby technologies, we are able to license our decoding technologies to consumer electronics manufacturers and independent software vendors for consumer playback and sell our cinema equipment for large scale public playback in movie theatres. Our involvement across the entertainment chain has resulted in a globally recognized brand and we believe this helps us introduce technologies and services into new areas.

We are a global organization. We operate as a single reportable segment on an enterprise-wide basis. We generate revenue by licensing our technologies to manufacturers of consumer electronics products and independent software vendors, and selling our professional products and related services to entertainment content creators, producers, and distributors. We have licensed our technologies to manufacturers in approximately 35 countries and our licensees distribute products incorporating our technologies throughout the world. We sell our products and services in over 50 countries. In fiscal 2006, fiscal 2007 and the fiscal year-to-date period ended June 27, 2008 revenue from outside the United States was 74%, 70% and 67% of our total revenue, respectively.

Opportunities, Challenges and Risks

Licensing revenue constitutes the majority of our total revenue, representing 77%, 80% and 84% of total revenue in fiscal 2006, fiscal 2007 and the fiscal year-to-date period ended June 27, 2008, respectively. We categorize our licensing revenue into the following markets:

- Consumer electronics (CE) market primarily comprised of DVD players, DVD recorders, audio/video receivers and home-theatres-in-a-box.

- Personal computer (PC) market primarily comprised of software DVD players and Microsoft Windows Vista Home Premium and Ultimate Editions.

- Broadcast market primarily comprised of televisions and television set-top boxes.

- Gaming market primarily comprised of video-game consoles.

- Mobile primarily comprised of mobile phones.

Automotive market   primarily comprised of in-car DVD players.

Licensing services   revenue from the administration of joint licensing programs.

Historically, the consumer electronics market, which is driven primarily by revenue attributable to sales of DVD players, has been our largest market, generating just over 50% of our licensing revenue in fiscal 2005, approximately 45% in fiscal 2006, and just under 40% in fiscal 2007. The decrease in the consumer electronics market as a percentage of total licensing revenue has been due primarily to faster revenue growth in our other markets, primarily the PC and broadcast markets. We expect Blu-ray DVD players for high-definition content to be a growth opportunity in the consumer electronics market. Dolby Digital has been selected as a mandatory audio standard and Dolby Digital Plus and Dolby TrueHD have been selected as optional audio standards in the Blu-ray Disc format. The release and consumer adoption of Blu-ray DVD players has been slower than expected due, in part, to the competition between HD-DVD and Blu-ray Disc formats. Even though uncertainty over the disc format was resolved in February 2008 when Toshiba Corporation announced that it would cease manufacturing HD-DVD players, the rate of consumer adoption of Blu-ray DVD players is uncertain and may be slower than past growth rates of standard definition DVD players.

We are continuing to attempt to diversify our sources of licensing revenue by actively promoting the incorporation of our technologies for use in growing markets outside of our consumer electronics market, such as PC, broadcast, gaming, mobile and automotive. As a result, while revenue from our consumer electronics market increased in fiscal 2007, it decreased as a percentage of our licensing revenue compared to fiscal 2006 and this trend has continued in fiscal 2008. Any future growth in the PC, broadcast, gaming, mobile and automotive markets may not fully offset a potential decline in the growth of revenue generated from our consumer electronics market.

Our personal computing market, which represented over 25% of our licensing revenue in fiscal 2005, just over 30% in fiscal 2006, and approximately 35% in fiscal 2007, has been primarily driven by sales of software DVD players and to a lesser extent, DVD authoring applications. Historically, PC manufacturers have frequently included DVD playback functionality as part of the software applications included in their products. In fiscal 2007, Microsoft introduced its Windows Vista operating system. Two of the six editions of this operating system, the Windows Vista Home Premium Edition and the Windows Vista Ultimate Edition, include Dolby technologies which help enable DVD playback functionality and DVD authoring capabilities. Since shipments of Windows Vista began in February 2007, sales of personal computers for the consumer market offered with the Home Premium Edition have been strong. In addition, many major PC manufacturers continue to include additional branded software applications with DVD playback capabilities and other features which were not provided in the Microsoft operating systems. This contributed to an increase in licensing revenue from our PC market in the second half of fiscal 2007 and the fiscal year-to-date period ended June 27, 2008. Additionally, through our PC Entertainment Experience, we are licensing a greater number of our technologies into entertainment-oriented PCs.

In the future, PC manufacturers may elect to exclude additional DVD software applications on personal computers that include the Windows Vista Home Premium Edition or Windows Vista Ultimate Edition. Additionally, it is unclear at what pace business customers will migrate from their current operating systems to the Windows Vista operating systems and how such adoption will impact sales of software DVD players for business PCs.

Our broadcast market, which is primarily driven by demand for Dolby Digital in televisions and set-top boxes, represented approximately 10% of our licensing revenue in fiscal 2005, just over 10% in fiscal 2006 and just over 15% in fiscal 2007. Our broadcast market has benefited from the transition from analog televisions to digital televisions, including high-definition televisions (HDTV). We expect this trend to continue, and as a result, we expect revenue from our broadcast market to continue to increase in the remainder of fiscal 2008.

Revenue generated from our gaming and automotive market has primarily been driven by sales of video-game consoles and in-car entertainment systems with Dolby Digital and ATRAC technology. Revenue generated by our licensing services market has primarily been driven by demand for MPEG 4 audio and MPEG 2 audio technologies used in portable music devices. Revenue from our mobile market is primarily driven by demand for our high-efficiency AAC (HE-AAC) technology incorporated into mobile devices, such as cell phones.

We also have introduced new technologies, including Dolby Volume, and high-dynamic range image technologies, Dolby Contrast and Dolby Vision. Our Dolby Volume technology controls the loudness of audio playback to provide a constant volume level, while maintaining the integrity of the signal. Dolby Contrast provides enhanced contrast, while Dolby Vision combines enhanced contrast with extended brightness and dynamic range for LCD televisions with LED backlighting technology. We have not generated any significant revenue from these technologies and we expect this trend to continue for the next several quarters.

In the first quarter of fiscal 2008, we acquired all of the outstanding equity interests of Coding Technologies, a privately held provider of audio compression technologies for the mobile, digital broadcast and internet markets. We believe the acquisition of Coding Technologies will increase our presence in the mobile, broadcast, digital radio, and digital music download markets. Our ability to capitalize on the acquisition is subject to risks and uncertainties including the possibility that anticipated benefits may not be realized, integration risks, shifts in customer demand, and technology risks.

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

Product sales consists of revenue from the sale of equipment to cinema operators and broadcasters, representing 17%, 14% and 11% of total revenue in fiscal 2006, fiscal 2007 and the fiscal year-to-date period ended June 27, 2008, respectively.

Our cinema products, which represented approximately 79% of product sales in fiscal 2005, 75% of product sales in fiscal 2006, and 71% of product sales in fiscal 2007, are primarily used to read and decode film soundtracks, calibrate cinema sound systems and to adapt analog cinema audio systems into digital audio formats. Our digital cinema products load, store, decrypt and decode digital film files for presentation on a digital projector, as well as provide 3D capabilities. Sales of our cinema products and services tend to fluctuate based on the underlying trends in the motion picture industry. A significant trend in the cinema industry is the adoption of digital cinema. Digital cinema offers the motion picture industry possible means to achieve substantial cost savings in printing and distributing movies, to combat piracy, and to enable movies to be played repeatedly without degradation in image and audio quality. In fiscal 2005, we introduced our Dolby Digital Cinema system, which allows for the storage and playback of digital content. The cinema industry is in the early stages of adoption of digital cinema systems and we expect that exhibitors constructing new theatres or upgrading existing theatres will generally choose digital cinema over traditional film cinema. Digital cinema is based on open standards, which unlike traditional cinema, does not include our proprietary audio formats. As the market for digital cinema grows, we continue to face more competitive pricing pressure than we have historically experienced for traditional cinema products, which adversely impacts our product sales gross margins and digital cinema system market share. If our digital cinema systems are not widely deployed, our future prospects in digital cinema will be limited and our business could be materially and adversely affected. As the film industry continues to adopt digital cinema, if we do not adapt our traditional cinema products and services to meet the demands of the digital cinema market, the demand for our traditional cinema products will decline.

In fiscal 2007, we introduced Dolby 3D Digital Cinema technology, which delivers a 3D experience when combined with a digital cinema system. We face challenges surrounding the adoption of our 3D technology due to competition and because our technology requires that exhibitors use re-usable 3D glasses, which may not be a model that exhibitors want to adopt.

Our broadcast products, which represented approximately 17% of product sales in fiscal 2005, 21% of product sales in fiscal 2006, and 23% of product sales in fiscal 2007, are used to encode, transmit, and decode multiple channels of high-quality audio for DTV and HDTV program production and broadcast distribution and to measure the subjective loudness of audio content within broadcast programming. In recent years, growth in consumer demand for high-quality television content has increased the demand from broadcasters to deliver more content in Dolby Digital 5.1 surround sound, which has contributed to sales of our professional broadcast products.

Our services revenue, which represented 6%, 6% and 5% of total revenue in fiscal 2006, fiscal 2007 and the fiscal year-to-date period ended June 27, 2008, respectively, is primarily tied to the motion picture production industry and, in particular, to the number of films being made by studios and independent filmmakers. The number of films that are produced can be affected by a number of factors, including strikes and work stoppages within the motion picture industry as well as by the tax incentive arrangements that many foreign governments provide filmmakers to promote local filmmaking.

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Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based on our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America, or U.S. GAAP. The preparation of these financial statements in accordance with U.S. GAAP requires us to utilize accounting policies and make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies as of the date of the financial statements and the reported amounts of revenue and expenses during a fiscal period. The SEC considers an accounting policy to be critical if it is both important to a company s financial condition and results of operations and it requires significant judgment and estimates on the part of management in its application. We have discussed the selection and development of the critical accounting policies with the audit committee of our board of directors, and the audit committee has reviewed our related disclosures in this Quarterly Report on Form 10-Q. Although we believe that our judgments and estimates are appropriate and correct, actual results may differ from those estimates.

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

Revenue Recognition

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

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

Goodwill

We account for goodwill in accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). As required by SFAS 142, we perform an impairment test on recorded goodwill by comparing the estimated fair value of each of our reporting units to the carrying value of the assets and liabilities of each unit, including goodwill. The fair value of each of our reporting units is determined by using a discounted cash-flow model which considers a number of factors, including estimated future cash-flows, risks facing us and our current market capitalization. If the carrying value of the assets and liabilities of the reporting units, including goodwill, were to exceed our estimation of the fair value of the reporting units, we would record an impairment charge in an amount equal to the excess of the carrying value of goodwill over the implied fair value of the goodwill. We use judgment in determining the estimated fair value of our reporting units, which include making

assumptions of our future cash flows for each reporting unit. Our fiscal 2008 impairment test of goodwill, which was performed in the third quarter of fiscal 2008, resulted in no impairment charge. Fluctuations in our fair value, which may result from changes in economic conditions, our results of operations and other factors, relative to the carrying value, could result in impairment charges in future periods.

Accounting for Income Taxes

In preparing our consolidated financial statements, we are required to make estimates and judgments that affect our accounting for income taxes. This process includes estimating actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences, including differences in the timing of recognition of stock-based compensation expense, result in deferred tax assets and liabilities, which are included in our consolidated balance sheets. We also assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent that we believe that recovery is not likely, we have established a valuation allowance.

In the first quarter of fiscal 2008 we adopted the provisions of FIN 48. FIN 48 addresses the accounting for and disclosure of uncertainties in income tax positions by prescribing a minimum recognition threshold that a tax position is required to satisfy before being recognized in the financial statements. Our policy to include interest and penalties related to gross unrecognized tax benefits within our provision for income taxes did not change upon the adoption of FIN 48.

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

Stock-Based Compensation

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

Investments

We account for investment securities under the provisions of Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115) and related interpretations and staff positions. SFAS 115 requires us to record available-for-sale securities at fair value, with unrealized gains and losses being reported as a component of other comprehensive income. When readily determinable fair values are not available, we use judgment to estimate the fair value of our investments based on observable market inputs or, if no observable market inputs are available, unobservable market inputs, or a combination thereof. Our fair value estimates consider, among other things, credit quality, the underlying collateral, and the timing and amount of expected future cash flows. Additionally, we use judgment in evaluating whether declines in fair value are temporary or other-than-temporary considering the existence the following indicators: changes in credit ratings or asset quality, changes in the economic environment, changes in market conditions, and changes in expected cash flows. Temporary declines in fair value are recorded as charges to accumulated other comprehensive income, while other-than-temporary declines in fair value are recorded to earnings.

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Results of Operations

Revenue

	Fiscal Quarter Ended		Change		Fiscal Year-to-Date Ended		Change	
	June 29, 2007	June 27, 2008	$	%	June 29, 2007	June 27, 2008	$	%
	($ in thousands)							
Revenue:								
Licensing	$ 94,795	$ 127,558	$ 32,763	35%	$ 283,812	$ 399,607	$ 115,795	41%
Percentage of total revenue	*79%*	*83%*			*80%*	*84%*		
Product sales	17,191	18,060	869	5%	47,870	53,698	5,828	12%
Percentage of total revenue	*14%*	*12%*			*14%*	*11%*		
Services	7,627	8,699	1,072	14%	21,383	23,796	2,413	11%
Percentage of total revenue	*7%*	*6%*			*6%*	*5%*		
Total revenue	**$ 119,613**	**$ 154,317**	**$ 34,704**	**29%**	**$ 353,065**	**$ 477,101**	**$ 124,036**	**35%**

Licensing. The 35% increase in licensing revenue from the third quarter of fiscal 2007 to the third quarter of fiscal 2008 was primarily due to increases in our personal computer and broadcast markets. The increase in revenue from our PC market was primarily driven by continued strength in shipments of notebook computers, many of which include third party DVD software and/or Microsoft Vista Home Premium or Ultimate Editions, all of which contain Dolby technologies. In addition, licensing revenue in the third quarter of fiscal 2008 benefited from a growing number of consumer notebook computer shipments with Dolby PC Entertainment Experience, compared to the third quarter of fiscal 2007. The increase in revenue from our broadcast market has been driven by an increase in the number of digital televisions in North America and Europe that incorporate Dolby Digital compared to the same period a year ago, as well as shipments of set-top boxes that incorporate our technologies. Our mobile market also contributed to the increase in licensing revenue due to the inclusion of HE-AAC technology, obtained in the acquisition of Coding Technologies, incorporated into mobile devices such as cell phones.

The 41% increase in licensing revenue from the fiscal year-to-date period ended June 29, 2007 to the fiscal year-to-date period ended June 27, 2008 was driven by increases in all our markets, most notably our PC and broadcast markets for the same reasons discussed above with respect to the third quarter of fiscal 2008. In addition, revenues from our PC market increased considerably because in fiscal 2007, Microsoft Vista did not contribute to our licensing revenue until the third fiscal quarter.

Product Sales. The 5% increase in product sales from the third quarter of fiscal 2007 to the third quarter of fiscal 2008 was due to sales of our 3D products, which were not available in the third quarter of fiscal 2007, as well as an increase in sales of our digital cinema audio and broadcast products. These increases were partially offset by a decrease in sales of our traditional cinema audio products. As the cinema industry transitions to the use of digital cinema audio equipment, we expect sales of our traditional cinema audio products to continue to decline in future periods. We have developed a solution for digital cinema, but have not recognized all of the revenue related to sales of our digital cinema products due to certain obligations which we have yet to satisfy. We currently have approximately $23 million of deferred revenue related to digital cinema sales.

The 12% increase in product sales from the fiscal year-to-date period ended June 29, 2007 to the fiscal year-to-date period ended June 27, 2008 was driven mainly by an increase in sales of our 3D products, as well as increases in our broadcast products, partially offset by a decrease in sales of our traditional cinema products.

Services. The 14% increase in services revenue from the third quarter of fiscal 2007 to the third quarter of fiscal 2008 and the 11% increase in services revenue from the from the fiscal year-to-date period ended June 29, 2007 to the fiscal year-to-date period ended June 27, 2008 was primarily attributable to an increase in film services on original films as well as an increase in the price charged for those services.

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Gross Margin

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 29, 2007	June 27, 2008	June 29, 2007	June 27, 2008
Gross margin:				
Licensing gross margin percentage	*91%*	97%	*91%*	97%
Product sales gross margin percentage	*53%*	48%	*49%*	45%
Services gross margin percentage	*61%*	63%	*60%*	60%
Total gross margin percentage	**84%**	**90%**	**83%**	**89%**

Licensing Gross Margin. We license intellectual property to our customers that may be internally developed, acquired by us or licensed from other parties. Our cost of licensing consists principally of royalty obligations to third parties for the licensing of intellectual property rights that we sublicense as part of our licensing arrangements with our customers. Our cost of licensing also includes amortization expenses associated with purchased intangible assets.

In the fourth quarter of fiscal 2007, we determined that it was appropriate to cease accruing royalty expense related to an ongoing dispute with an unrelated patent licensor. As a result, our licensing gross margin was higher in the third quarter of fiscal 2008 than the third quarter of fiscal 2007. For further detail, see Note 2, Composition of Certain Financial Statement Captions for the discussion regarding accrued liabilities in the notes to our condensed consolidated financial statements. The increase in licensing gross margin was partially offset by the amortization of intangible assets that were acquired as part of the acquisition of Coding Technologies in the first quarter of fiscal 2008.

The increase in licensing gross margin from the fiscal year-to-date period ended June 29, 2007 to the fiscal year-to-date period ended June 27, 2008 was due to the same factors discussed above with respect to the third quarter of fiscal 2008.

Product Sales Gross Margin. Cost of product sales primarily consists of material costs related to the products sold, applied labor and manufacturing overhead and, to a lesser extent, amortization of certain intangible assets. Product sales gross margin decreased by 5% from the third quarter of fiscal 2007 to the third quarter of fiscal 2008, due to the decline in sales of our traditional cinema products and the increase in sales of our 3D products, which have lower margins than our traditional cinema products.

The decrease in product sales gross margin from the fiscal year-to-date period ended June 29, 2007 to the fiscal year-to-date period ended June 27, 2008 was due to the same factors discussed above with respect to the third quarter of fiscal 2008.

Upon satisfying certain obligations, we expect to recognize revenue and associated costs related to a number of digital cinema systems that are currently deferred. We currently expect to recognize these transactions in the first half of fiscal 2009. We expect that upon the eventual recognition, our product sales gross margins will be adversely impacted because these products were sold at a significantly lower margin than our other products. We currently have approximately $23 million of deferred revenue related to digital cinema sales.

Services Gross Margin. Cost of services primarily consists of the payroll and benefits costs of employees performing our professional services, the cost of outside consultants and reimbursable expenses incurred on behalf of customers. Services gross margin was relatively consistent from the third quarter of fiscal 2007 to the third quarter of fiscal 2008 and for the fiscal year-to-date period ended June 29, 2007 to the year to-date-period ended June 27, 2008.

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Operating Expenses

	Fiscal Quarter Ended		Change		Fiscal Year-to-Date Ended		Change	
	June 29, 2007	June 27, 2008	$	%	June 29, 2007	June 27, 2008	$	%
			($ in thousands)					
Operating expenses:								
Selling, general and administrative	$ 48,430	$ 54,979	$ 6,549	14%	$ 128,266	$ 161,275	$ 33,009	26%
Percentage of total revenue	*40 %*	*36 %*			*36 %*	*34 %*		
Research and development	11,854	15,366	3,512	30%	31,650	44,998	13,348	42%
Percentage of total revenue	*10 %*	*10 %*			*9 %*	*9 %*		
Gain on settlements	(350)	(250)	100	n/a	(1,850)	(499)	1,351	n/a
Percentage of total revenue	*n/a*	*n/a*			*n/a*	*n/a*		
Total operating expenses	**$ 59,934**	**$ 70,095**	**$ 10,161**	**17%**	**$ 158,066**	**$ 205,774**	**$ 47,708**	**30%**

Selling, General and Administrative. Selling, general and administrative expense consists primarily of personnel and personnel-related expenses, professional service fees and facility costs for our sales, marketing and administrative functions. The 14% increase in selling, general and administrative expenses from the third quarter of fiscal 2007 to the third quarter of fiscal 2008 was primarily due to an increase in personnel expenses and related occupancy and travel expenses. These increases were primarily driven by increases in headcount, bonus expense, annual pay increases for existing employees and stock-based compensation expense. Additionally, increases in amortization contributed to the increase in selling, general and administrative expenses for the quarter. Amortization expense increased due to an increase in intangible assets from the acquisitions of Coding Technologies in November 2007 and Brightside Technologies, Inc. (Brightside) in April 2007.

The increase in selling, general and administrative expenses from the fiscal year-to-date period ended June 29, 2007 to the fiscal year-to-date period ended June 27, 2008 was due to the same factors discussed above with respect to the third quarter of fiscal 2008.

Research and Development. Research and development expense consists primarily of compensation and benefits related costs for personnel responsible for the research and development of new technologies and products. The 30% increase in research and development expense from the third quarter of fiscal 2007 to the third quarter of fiscal 2008 was primarily driven by an increase in personnel expenses due to an increase in headcount, largely attributable to the acquisitions of Coding Technologies and Brightside, as well as increases in bonus expense, annual pay increases for existing employees and stock-based compensation expense.

The increase in research and development expenses from the fiscal year-to-date period ended June 29, 2007 to the fiscal year-to-date period ended June 27, 2008 was due to the same factors discussed above with respect to the third quarter of fiscal 2008.

Non-operating Income and Expenses

	Fiscal Quarter Ended		Change		Fiscal Year-to-Date Ended		Change	
	June 29, 2007	June 27, 2008	$	%	June 29, 2007	June 27, 2008	$	%
			($ in thousands)					
Interest income	$ 6,592	$ 3,481	$ (3,111)	47%	$ 19,216	$ 13,777	$ (5,439)	28%
Interest expense	(825)	(329)	496	60%	(1,751)	(1,324)	427	24%
Other non-operating expense	(8)	(491)	(483)	n/a	(347)	(2,184)	(1,837)	n/a
Non-operating income and expenses	**$ 5,759**	**$ 2,661**	**$ (3,098)**	**54%**	**$ 17,118**	**$ 10,269**	**$ (6,849)**	**40%**

Non-operating income and expenses primarily consist of interest income earned on cash, cash equivalent and investments. The decrease in interest income of 47%, from the third quarter of fiscal 2007 to the third quarter of fiscal 2008 was primarily due to lower investment balances as a result of the acquisition of Coding Technologies in November 2007 as well as lower interest rates. The interest expense is primarily derived from the outstanding balances on our facility debt obligations as well as interest expense incurred on an outstanding legal liability. For further

detail, see Note 6, Legal Proceedings for the discussion regarding the outstanding legal liability in the notes to our condensed consolidated financial statements. The increase in other non-operating expenses from the third quarter of fiscal 2007 to the third quarter of fiscal 2008 was primarily due to losses from foreign currency transactions. Losses from foreign currency transactions were primarily due to the change in the value of the Euro relative to the U.S. dollar.

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The decrease in interest income of 28%, from the fiscal year-to-date period ended June 29, 2007 to the fiscal year-to-date period ended June 27, 2008 was due to the same factors discussed above with respect to the third quarter of fiscal 2008. The increase in other non-operating expenses from the year-to-date period ended June 29, 2007 to the fiscal year-to-date period ended June 27, 2008, was primarily due to losses on our supplemental retirement plan.

Income Taxes

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 29, 2007	June 27, 2008	June 29, 2007	June 27, 2008
	($ in thousands)			
Income taxes:				
Provision for income taxes	$ 15,839	$ 24,117	$ 53,067	$ 78,516
Effective tax rate	35%	34%	35%	34%

Our effective tax rate is based upon our projection of annual fiscal year results. Our effective tax rate in the third quarter of fiscal 2007 was 35%, compared to 34% in the third quarter of fiscal 2008. The change in our effective tax rate from the third quarter of fiscal 2007 to the third quarter of fiscal 2008 was due to additional tax benefits identified in the fiscal 2007 tax return, which were recorded in the third quarter of fiscal 2008 as a result of a change in our estimate and an increase in Section 199 domestic production deduction benefits. The decrease in our effective tax rate was partially offset by a decreased impact of tax exempt interest income. Our effective tax rate was 35% for the fiscal year-to-date period ended June 29, 2007, compared to 34% for the fiscal year-to-date period ended June 27, 2008. The change in our effective tax rate for the fiscal year-to-date period ended June 29, 2007 to the fiscal year-to-date period ended June 27, 2008, was primarily due to additional tax benefits identified in the fiscal 2007 tax return, which were recorded in the fiscal 2008 as a result of a change in our estimate and an increase in Section 199 domestic production deduction benefits for fiscal 2008.

For United States federal income tax purposes, a corporation is generally considered to be a personal holding company under the United States Internal Revenue Code if (i) at any time during the last half of its taxable year more than 50% of its stock by value is owned, directly or indirectly, by virtue of the application of certain stock ownership attribution rules set forth in the Internal Revenue Code for purposes of applying the personal holding company rules, by five or fewer individuals and (ii) at least 60% of its adjusted ordinary gross income, as defined for United States federal income tax purposes, is personal holding company income. A personal holding company is subject to an additional tax on its undistributed after-tax income, calculated at the statutory tax rate, which is currently 15%. Since the personal holding company tax is imposed only on undistributed income, a personal holding company can avoid or mitigate liability for the tax, but not interest or penalties, by paying a dividend to its stockholders. We meet the ownership test as a personal holding company. Personal holding company income is generally passive income, including royalty income, but does not include certain qualifying software royalties. In July 2008, we received a private ruling from the Internal Revenue Service that, subject to certain factual representations, the licensing fees received by us will be considered qualifying software royalties. Therefore, given our current sources of revenue, we believe that neither we nor any of our subsidiaries is currently liable for personal holding company tax.

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Liquidity and Capital Resources

The following table presents selected financial information for the fiscal quarters ended on the dates indicated:

	September 28, 2007	June 27, 2008
	(in thousands)	
Cash and cash equivalents	$ 368,467	$ 369,907
Short-term investments	231,217	49,552
Long-term investments	73,224	179,538
Accounts receivable, net of allowance	28,165	45,933
Accounts payable and accrued liabilities	119,068	143,312
Working capital (a)	590,214	441,340

	June 29, 2007	June 27, 2008
	(in thousands)	
Net cash provided by operating activities (fiscal year-to-date)	$ 105,477	$ 162,013
Capital expenditures (fiscal year-to-date) (b)	(6,945)	(7,666)
Acquisitions, net of acquired cash	(30,230)	(253,176)
Net cash used in investing activities (fiscal year-to-date)	(172,048)	(190,698)
Net cash provided by financing activities (fiscal year-to-date)	25,657	29,420

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

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

As of June 27, 2008, we had cash and cash equivalents of $369.9 million, compared to $368.5 million at September 28, 2007. In addition, at June 27, 2008, we had short-term and long-term investments of $229.1 million, compared to $304.4 million at September 28, 2007. We believe that our cash, cash equivalents and potential cash flows from operations will be sufficient to satisfy our currently anticipated cash requirements through at least the next 12 months.

Net cash provided by operating activities were $162.0 million for the fiscal year-to-date period ended June 27, 2008, compared to $105.5 million for the fiscal year-to-date period ended June 29, 2007. Cash flows from operating activities consisted of net income adjusted for certain non-cash items, including stock-based compensation, depreciation and amortization, and the effect of changes in working capital and other operating activities. Cash flows from operating activities for the fiscal year-to-date period ended June 27, 2008 were primarily driven by net income of $150.9 million. Adjustments for non-cash items included stock-based compensation expense of $17.2 million and depreciation and amortization expense of $19.4 million, partially offset by an increase in deferred taxes of $20.5 million. Changes in working capital were primarily driven by increases in assets of $34.7 million, partially offset by increases in accounts payable and accrued liabilities of $19.6 million and deferred revenue of $18.3 million.

Net cash used in investing activities for the fiscal year-to-date period ended June 27, 2008 were primarily driven by the acquisition of Coding Technologies in November 2007 for approximately $253.2 million, net of acquired cash, partially offset by sales of available-for-sale securities of $70.1 million, net of purchases. Capital expenditures were $7.7 million for the fiscal year-to-date period ended June 27, 2008.

Net cash provided by financing activities were $29.4 million for the fiscal year-to-date period ended June 27, 2008. Cash flows from financing activities were primarily driven by proceeds and excess tax benefits from the exercise of stock options.

At June 27, 2008, we held tax-exempt auction rate certificates (ARCs) with a par value of $75.2 million. These certificates are secured by pools of student loans and guaranteed either by state-designated guaranty agencies or the U.S. government. Auctions for these instruments began failing during the second quarter of fiscal 2008 and continued to fail in the third quarter of fiscal 2008. Additionally, a liquid secondary market has not developed for these instruments. We believe that the market may take more than twelve months to recover. ARCs are classified as

available-for-sale securities and reflected at fair value on the condensed consolidated balance sheet. We determined that the decline in the market value of these securities is not other-than-temporary and recorded an unrealized loss of $3.7 million to accumulated other comprehensive income in the third quarter of fiscal 2008. If we determine that any future decline in the valuation of the ARCs is other-than temporary, it will be recorded as a component of net income. We continue to classify our investments in ARCs as long-term investments on the condensed consolidated balance sheet at June 27, 2008, based on our ability and intent to hold for more than one year.

Contractual Obligations and Commitments

The following table presents a summary of our contractual obligations and commitments as of June 27, 2008:

	Payments Due by Period				
	Remainder of Fiscal 2008	**Fiscal 2009 to 2010**	**Fiscal 2011 to 2012**	**After Fiscal 2012**	**Total**
			(in thousands)		
Long-term debt (1)	$ 400	$ 3,346	$ 3,730	$ 2,539	$ 10,015
Operating leases (2)	1,770	12,258	10,271	10,400	34,699
Payments on litigation settlement (3)		6,000	3,000		9,000
Total	$ 2,170	$ 21,604	$ 17,001	$ 12,939	$ 53,714

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

(2) Operating lease payments include future minimum rental commitments, including those payable to our principal stockholder, for non-cancelable operating leases of office space as of June 27, 2008.

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

Other Cash Obligations. Under the terms of the agreement to acquire all outstanding shares of our subsidiary, Cinea in September 2003, we have future payment obligations that equal approximately 5% to 8% of the revenue generated from products incorporating certain technologies we acquired in the transaction through 2022. As of June 27, 2008, no additional purchase consideration had been paid and no liability is reflected on our balance sheet.

As of June 27, 2008, we were unable to make a reasonably reliable estimate of when cash settlement with a taxing authority may occur in relation to the unrecognized tax benefits.

Recently Issued Accounting Standards

Refer to Note 8 of the Condensed Consolidated Financial Statements for our disclosure on Recently Issued Accounting Standards.

ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Sensitivity

Cash, Cash Equivalents and Investments. As of June 27, 2008, we had cash and cash equivalents of $369.9 million, which consisted of cash and highly-liquid money market funds. In addition, we had short-term and long-term investments of $229.1 million, which consisted primarily of municipal debt securities, auction rate certificates and United States government agency securities with original maturities greater than 90 days. Many of these investments are subject to fluctuations in interest rates, which could impact our results. At June 27, 2008 the average investment maturity of our investment portfolio was less than six months. Based on our investment portfolio balance as of June 27, 2008, a hypothetical change in interest rates of 1% would have approximately a $2.0 million impact, and a change of 0.5% would have approximately a $1.0 million impact on the carrying value of our portfolio. Furthermore, a hypothetical change in interest rates of 1% would have approximately a $2.5 million impact, and a change of 0.5% would have approximately a $1.3 million impact on interest income over a one-year period.

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

Foreign Currency Exchange Risk

We maintain sales, marketing and business operations in foreign countries, most significantly in the United Kingdom, as well as Germany and Sweden as a result of our acquisition of Coding Technologies. Consequently, we have exposure to adverse changes in exchange rates associated with our foreign business operations. While the majority of our revenue is derived from transactions denominated in United States dollars, nearly all of our costs from our foreign operations are derived from transactions denominated in the functional currency of that foreign location. 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. If the U.S. dollar weakens against the local currency, the translation of these foreign-currency-denominated expenses will result in higher expenses, without a corresponding increase in revenue.

Additionally, assets held by our foreign entities that are in currencies other than the foreign entities functional currency are exposed to changes in exchange rates. For example, our foreign entities have receivable balances denominated in U.S. dollars, which may not be the functional currency for those entities. Changes in exchange rates between the entities functional currency and the U.S. dollar are recorded to the statement of operations.

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ITEM 4 CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

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

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the fiscal quarter ended June 27, 2008, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

A restated description of the risk factors associated with our business is set forth below. This description includes any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in Part I, Item 1A of our Annual Report on Form 10 K for our fiscal year ended September 28, 2007. The following risk factors and other information included in this Quarterly Report on Form 10-Q should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we presently deem less significant may also impair our business operations. If any of the following risks actually occur, our business, operating results and financial condition could be materially adversely affected.

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

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

We do not expect sales of traditional consumer DVD players to sustain their past growth rates. To the extent that sales of DVD players and home theatre systems level off or decline, or alternative technologies in which we do not participate replace DVDs as a dominant medium for consumer video entertainment, our licensing revenue will be adversely affected.

Growth in our revenue over the past several years has been the result, in large part, of the rapid growth in sales of DVD players and home theatre systems incorporating our technologies. However, as the markets for DVD players continue to mature, we do not expect sales of traditional consumer DVD players to sustain their past growth rates. As sales of DVD players and home theatre systems level off or decline, our licensing revenue will be adversely affected. Additionally, the release and consumer adoption of Blu-ray DVD players has been delayed, largely due to two competing incompatible disc formats, resulting in delayed consumer adoption of Blu-ray DVD players. Even though the uncertainty regarding the competing disc format conflict was resolved in February 2008 when Toshiba Corporation announced that it would cease manufacturing HD-DVD players, the rate of consumer adoption of Blu-ray DVD players is uncertain and may be slower than past growth rates of traditional DVD players. Slow consumer adoption of Blu-ray DVD players as well as the leveling off or decline of traditional DVD player license sales, could adversely affect our licensing revenue. In addition, if new technologies are developed for use with DVDs or new technologies are developed that substantially compete with or replace DVDs as a dominant medium for consumer video entertainment, and if we are unable to develop and successfully market technologies that are incorporated into or compatible with those new technologies, our business, operating results and prospects will be adversely affected.

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

We derive most of our revenue from the licensing of our technologies to consumer electronics product manufacturers. Licensing revenue represented 75%, 77% and 80% of our total revenue in fiscal 2005, 2006 and 2007, respectively. We do not manufacture consumer electronics products ourselves and our licensing revenue is dependent on sales by our licensees of products that incorporate our technologies. We cannot control these manufacturers product development or commercialization efforts or predict their success. In addition, our license agreements, which typically require manufacturers of consumer electronics products and independent software vendors to pay us a specified royalty for every electronics product shipped that incorporates our technologies, do not require these manufacturers to include our technologies in any specific number or percentage of units, and only a few of these agreements guarantee us a minimum aggregate licensing fee. Accordingly, if our licensees sell fewer products incorporating our technologies, or otherwise face significant economic difficulties, our revenue will decline. Moreover, we have a widespread presence in markets for electronics products, such as the consumer electronics product market, which includes DVD players, audio/video receivers and other home theatre consumer electronics products, and, as a result, there is little room for us to further penetrate such markets. Lower sales of products incorporating our technologies could occur for a number of reasons. Changes in consumer tastes or trends, or changes in industry standards, may adversely affect our licensing revenue. Increasing market saturation, durability of products in the marketplace, competing products and alternate consumer entertainment options could adversely affect demand for new products incorporating our technologies.

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

Our business is particularly exposed to adverse changes in general economic conditions, because products that incorporate our technologies are entertainment oriented and generally discretionary goods. A slowdown or decline in U.S. or foreign economic growth may adversely affect consumer confidence, disposable income or spending. As a result, sales by our licensees of consumer electronics and other products incorporating our technologies may not grow as rapidly as in prior periods or may even decrease, which could adversely affect our licensing revenue. In addition, any slowdown in consumer spending may negatively impact the motion picture industry and cinema owners, which could result in decreased growth, or potentially a decrease, in product sales and services, which could adversely affect our revenue.

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

Historically, PC manufacturers have frequently included DVD playback functionality as part of the software applications included in their products. Microsoft introduced its Windows Vista operating system in 2007. Two of the six editions of this operating system, the Windows Vista Home Premium Edition and the Windows Vista Ultimate Edition, include Dolby technologies which help enable DVD playback functionality and DVD authoring capabilities. In addition, many major PC manufacturers continue to include additional DVD software applications which offer added DVD functionality not included in the Microsoft operating systems. In the future, PC manufacturers may elect to exclude additional DVD software application on personal computers that include the Windows Vista Home Premium Edition. Additionally, it is unclear at what pace business customers will migrate from their current operating systems to the Windows Vista operating systems, what the adoption rate of the Ultimate Edition will be, and how such adoption will impact sales of software DVD players for business PCs. Future shipments of notebooks with Dolby technologies could decline. Further, equipment manufacturers experiencing pricing pressure may elect to exclude optional DVD playback functionality from their products, thereby requiring an additional cost to add this capability, which may affect demand for our technologies. If any of the foregoing occur, our licensing revenue will be adversely affected.

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

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

- Digital television and radio broadcasting;
- HDTV;
- Personal computer technology;
- Blu-ray DVD;
- Video-game consoles and video-games;
- Imaging;
- Home DVD recording;
- Personal audio and video players, including internet music applications;
- Broadband internet;
- Mobile devices; and
- In-car entertainment systems.

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

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

The markets for our products and the markets for consumer electronics products using our licensed technologies are characterized by rapid change and technological evolution. We will need to expend considerable resources on research and development, or acquisitions, in the future

in order to continue to design and deliver enduring, innovative entertainment products and technologies. Despite our efforts, we may not be able to develop, or acquire, and effectively market new products, technologies and services that adequately or competitively address the needs of the changing marketplace. For example, we cannot provide assurance that Dolby Volume, Dolby s volume leveling solution designed to address the annoyances of inconsistent loudness, or Dolby 3D Digital Cinema, Dolby s 3D digital cinema solution, will address the needs of the marketplace, be effectively marketed or be successful technologies. In addition, we may not correctly identify new or changing market trends at an early enough stage to capitalize on market opportunities. At times such changes can be dramatic, such as the shift from VHS tapes to DVDs for consumer playback of movies in homes and elsewhere. Our future success depends to a great extent on our ability to develop, or acquire, and deliver innovative technologies that are widely adopted in response to changes in the entertainment industry and that are compatible with the technologies or products introduced by other entertainment industry participants.

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

Our future growth will depend, in part, upon our expansion into areas beyond sound technologies. For example, in addition to our digital cinema initiative, we are exploring other areas that facilitate delivery of digital entertainment, such as technologies for processing digital moving images and content protection. We will need to spend considerable resources on research and development or acquisitions in the future in order to deliver innovative non-sound technologies. Our April 2007 acquisition of Brightside Technologies Inc., a development-stage technology company focused on enabling the capture, distribution, and display of more vibrant video on LED backlit LCD televisions, is an example of our efforts to expand into areas beyond sound technologies. However, we have limited experience in non-sound technology markets and, despite our efforts, we cannot predict whether we will be successful in developing, or acquiring and marketing non-sound products, technologies and services. We will face significant risks in integrating non-sound businesses that we acquire, such as Brightside, into our business.

In addition, many of the non-sound technology markets are relatively new and may not develop as we currently anticipate. Moreover, although we believe that many of the technological advances we may develop or acquire for digital cinema may have applicability in other areas, such as broadcasting or consumer electronics products, we may not ever be able to achieve these anticipated benefits in these other markets. A number of competitors and potential competitors may develop non-sound technologies similar to those that we develop or acquire, some of which may provide advantages over our products, technologies and services. Some of these competitors have much greater experience and expertise than we do in the non-sound fields we may enter. The non-sound products, technologies and services we expect to market may not achieve or sustain market acceptance, may not meet industry needs, and may not be accepted as industry standards. If we are unsuccessful in selling non-sound products, technologies and services, the future growth of our business may be limited. In addition, our efforts to enter or strengthen our positions in non-sound markets may be tied to the success of specific programs.

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

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

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

Our quarterly operating results may fluctuate depending upon the timing of when we receive royalty reports from our licensees and of the satisfaction of our revenue recognition criteria. We recognize license revenue only after we receive royalty reports from our licensees regarding the shipment of their products that incorporate our technologies. As a result, the timing of our revenue depends upon the timing of our receipt of those reports. In addition, it is not uncommon for royalty reports to include positive or negative corrective or retroactive royalties that cover extended

periods of time. Furthermore, there have been times in the past when we have recognized an unusually large amount of licensing revenue from a licensee in a given quarter because not all of our revenue recognition criteria were met in prior periods. This can result in a large amount of licensing revenue from a licensee being recorded in a given quarter that is not necessarily indicative of the amounts of licensing revenue to be received from that licensee in future quarters, thus causing fluctuations in our operating results. For example, in the fourth quarter of fiscal 2006 and second quarter of fiscal 2007 we recognized approximately $6.7 million and $7.7 million, respectively, in licensing revenue from two separate licensees related to royalties on shipments in prior periods.

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

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

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

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

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

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

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

When a standards-setting body mandates our technologies as explicit industry standards, we generally must agree to license such technologies on a fair, reasonable and non-discriminatory basis, which could limit our control over the use of these technologies. In these situations, we must often limit the royalty rates we charge for these technologies, which could adversely affect our gross margins. Furthermore, we may be unable to limit to whom we

license such technologies, and may be unable to restrict many terms of the license. From time to time we may be subject to claims that our licenses of our industry standard technologies may not conform to the requirements of the standards-setting body. Private parties have raised this type of issue with us in the past. Allegations such as these could be asserted in private actions seeking monetary damages and injunctive relief, or in regulatory actions. Claimants in such cases could seek to restrict or change our licensing practices or our ability to license our technologies in ways that could injure our reputation and otherwise materially and adversely affect our business, operating results and prospects.

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

In some cases, primarily in connection with the licensing of our Dolby Digital technologies, the products we sell and the technologies we license to our customers include intellectual property that we have licensed from third parties. Our agreements with these third parties generally require us to pay them royalties for that use, and give the third parties the right to audit our calculation of those royalties. A third party may disagree with our interpretation of the terms of a license agreement or, as a result of an audit, a third party could challenge the accuracy of our calculation. We are currently involved in a license agreement dispute with a third party patent licensor.

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

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

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

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

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

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

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

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

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

The cinema industry is still in the early stages of the adoption of digital cinema for the distribution and exhibition of movies. A number of companies offer competing products for digital cinema, some of which are priced lower than our products or offer features that exhibitors may perceive to be potentially advantageous to our products. At least one competitor has a significantly greater installed base of its competing digital cinema playback servers than we do and another competitor has a significantly greater installed base of its competing 3D products than we do, either of which could limit our eventual share of the digital cinema product market and materially and adversely affect our operating results. As the market for digital cinema has matured we have faced more competitive pricing pressures than we have traditionally experienced for our traditional cinema products. As a result, we may have to implement pricing strategies which will have an adverse impact on our product sales gross margins in the future.

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

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

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

The cinema industry is in the early stages of the adoption of digital cinema for the distribution and exhibition of movies. Industry participants continue to discuss business models to facilitate adoption of digital cinema by allocating the costs among industry participants, and the business models that ultimately emerge may vary from country to country. Participating in some of the models under discussion may require us to depart from our traditional model of selling our cinema products pursuant to one-time contracts, and could expose us to various risks we have not faced in the past. For example, we have participated in one model by deploying, at our expense, fully integrated digital cinema systems and seeking payment from motion picture distributors for films presented on the systems. In fiscal 2007, we introduced Dolby 3D Digital Cinema technology, providing us with an additional opportunity to participate in digital cinema. However, there is a risk that recent renewed interest in 3D cinema could be a fad and may not be long-lasting. If we do not identify and successfully execute on opportunities to generate revenues from our digital cinema products and services, our future prospects in this market will be limited and our business could be materially and adversely affected.

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

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

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

We have evaluated, and expect to continue to evaluate, a wide array of possible strategic transactions, including acquisitions. For example, in November 2007 we acquired Coding Technologies, a privately held provider of audio compression technologies for the mobile, digital broadcast and internet markets and in April 2007 we acquired Brightside, a development-stage company focused on enabling the capture, distribution, and display of more vibrant video on LED backlit LCD televisions. Although we cannot predict whether or not we will complete any such acquisition or other transactions in the future, any of these transactions could be material in relation to our market capitalization, financial condition or results of operations. The process of integrating an acquired company, business or technology may create unforeseen difficulties and expenditures. The areas where we may face risks in integrating acquired businesses, including in connection with our acquisitions of Coding Technologies and Brightside, include:

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

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- The need to integrate acquired businesses accounting, management information, manufacturing, human resources and other administrative systems to permit effective management.

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

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

The markets for the consumer electronics products in which our technologies are incorporated are intensely competitive and price sensitive. Retail prices for consumer electronics products that include our sound technology, such as DVD players and home theatre systems, have decreased significantly, and we expect prices to continue to decrease for the foreseeable future. In response, manufacturers have sought to reduce their product costs, which can result in downward pressure on the licensing fees we charge our customers who incorporate our technologies into the consumer electronics products that they sell. A decline in the licensing fees we charge could materially and adversely affect our operating results.

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

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

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

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

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

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

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

We are dependent on international sales for a substantial amount of our total revenue. For fiscal 2006, 2007 and the fiscal year-to-date period ended June 27, 2008, revenue from outside the United States was 74%, 70% and 67% of our total revenue, respectively. We expect that international and export sales will continue to represent a substantial portion of our revenue for the foreseeable future. This future revenue will depend to a large extent on the continued use and expansion of our technologies in entertainment industries worldwide. Increased worldwide use of our technologies is also an important factor in our future growth.

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

- Our ability to enforce our contractual and intellectual property rights, especially in those foreign countries that do not respect and protect intellectual property rights to the same extent as do the United States, Japan and European countries, which increases the risk of unauthorized, and uncompensated, use of our technology;
- United States and foreign government trade restrictions, including those which may impose restrictions on importation of programming, technology or components to or from the United States;
- Foreign government taxes, regulations and permit requirements, including foreign taxes that we may not be able to offset against taxes imposed upon us in the United States, and foreign tax and other laws limiting our ability to repatriate funds to the United States;
- Foreign labor laws, regulations and restrictions;
- Changes in diplomatic and trade relationships;
- Difficulty in staffing and managing foreign operations;
- Fluctuations in foreign currency exchange rates and interest rates, including risks related to any interest rate swap or other hedging activities we undertake;
- Political instability, natural disasters, war or events of terrorism; and
- The strength of international economies.

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

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

As of June 27, 2008, we had approximately 1,450 individual issued patents and nearly 1,870 pending patent applications in nearly 35 jurisdictions throughout the world. Our issued patents are scheduled to expire at various times through July 2027. Of these, three patents are scheduled to expire in the remainder of calendar year 2008, five patents are scheduled to expire in calendar year 2009 and 109 patents are scheduled to expire in calendar year 2010. We derive our licensing revenue principally from our Dolby Digital technologies. Patents relating to our Dolby

Digital technologies generally expire between 2009 and 2017, and patents relating to our Dolby Digital Plus technologies, an extension of Dolby Digital, expire between 2019 and 2025. In addition, the remaining patents relating to Dolby Digital Live technologies, an extension of Dolby Digital, are scheduled to expire in 2021.

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

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

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

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

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

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

Sales of our cinema products and services tend to fluctuate based on the underlying trends in the motion picture industry. For example, when box office receipts for the motion picture industry increase, we have typically seen sales of our cinema products increase as well, as cinema owners are more likely to build new theatres and upgrade existing theatres with our more advanced products when they are doing well financially. Conversely, when box office receipts are down cinema owners tend to scale back on plans to expand or upgrade their systems. Our cinema product sales are also subject to fluctuations based on events and conditions in the cinema exhibition industry generally that may or may not be tied to box office receipts in particular time periods. For example, the growth in piracy of motion pictures adversely affects the construction of new screens, the renovation of existing theatres and the continued production of new motion pictures. Technological advances and the conversion of motion pictures into digital formats have made it easier to create, transmit and share high-quality unauthorized copies of motion pictures, including on pirated DVDs and on the internet. The launch of new high definition digital services by broadcasters may also influence the sale of our cinema products if consumers decide to watch content at home rather

than going to the cinema to watch motion pictures. On the other hand, our services revenue, both in the United States and internationally, is tied to the number of films being made by major studios and independent filmmakers. A number of factors can affect the number of films that are produced, including strikes and work stoppages within the motion picture industry, as well as by the tax incentive arrangements that many foreign governments provide filmmakers to promote local filmmaking.

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

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

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

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

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

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

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

- Fluctuations in demand for our products and for the consumer electronics products of our licensees;
- Fluctuations in the timing of royalty reports we receive from our licensees, including late, sporadic or inaccurate reports;

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

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

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

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

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

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

Consolidation by participants in the markets in which we compete, which could result among other things in pricing pressure;

The amount and timing of our operating costs and capital expenditures, including those related to the expansion of our business, operations and infrastructure;

Variations in the time-to-market of our technologies in the entertainment industries in which we operate;

Seasonal electronics product shipment patterns by our consumer electronics product licensees, particularly in the first quarter, which generally result in revenue in the second quarter;

The impact of, and our ability to react to, interruptions in the entertainment distribution chain, including as a result of work stoppages at our facilities, our customers facilities and other points throughout the entertainment distribution chain;

Changes in business cycles that affect the markets in which we sell our products and services or the markets for consumer electronics products incorporating our technologies;

Adverse outcomes of litigation or governmental proceedings, including any foreign, federal, state or local tax assessments or audits;

Costs of litigation and intellectual property protection; and

Seasonal demand for services in the motion picture industry, which could result in reduced revenue.

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

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

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

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

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

Licensing some of our technologies in joint licensing programs, or patent pools, is a different business model for us, and we may face many challenges in conducting this business.

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

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

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

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

Our products are highly complex, and production difficulties or inefficiencies can interrupt production, resulting in our inability to deliver products on time in a cost effective manner, which could harm our competitive position. If production is interrupted at one of our two manufacturing facilities, we may not be able to shift production to the other facility on a timely basis, and customers may purchase products from our competitors. A shortage of manufacturing capacity for our products could adversely affect our operating results and damage our customer relationships. We generally cannot quickly adapt our manufacturing capacity to rapidly changing market conditions.

Likewise, we may be unable to respond to fluctuations in customer demand. At times we underutilize our manufacturing facilities as a result of reduced demand for some of our products. Any inability to respond to fluctuations in customer demand for our products may adversely affect our gross margins.

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

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

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

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

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

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

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

From time to time, one or a small number of our customers or licensees may represent a significant percentage of our products, services or licensing revenue. For example, revenue from our largest customer represented 12% of total revenue for the fiscal year-to-date period ended June 27, 2008. Although we have agreements with many of these customers, these agreements typically do not require any minimum purchases or minimum royalty fees and do not prohibit customers from purchasing products and services from competitors. A decision by any of our major customers or licensees not to use our technologies, or their failure or inability to pay amounts owed to us in a timely manner, or at all, whether due to strategic redirections or adverse changes in their businesses or for other reasons, could have a significant effect on our operating results.

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

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

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

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

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

Our business is dependent upon our patents, trademarks, trade secrets, copyrights and other intellectual property rights. Licensing revenue represented 77%, 80% and 84% of our total revenue in the fiscal years 2006, 2007 and the fiscal year-to-date period ended June 27, 2008, respectively. Effective intellectual property rights protection, however, may not be available under the laws of every country in which our products and services and those of our licensees are distributed. Also, the efforts we have taken to protect our proprietary rights may not be sufficient or effective. Any significant impairment of our intellectual property rights could harm our business or our ability to compete. In addition, protecting our intellectual property rights is costly and time consuming. We have taken steps in the past to enforce our intellectual property rights and expect to continue to do so in the future. However, it may not be practicable or cost effective for us to enforce our intellectual property rights fully, particularly in particular countries or where the initiation of a claim might harm our business relationships. For example, we have many times experienced, and expect to continue to experience, problems with consumer electronics product manufacturers incorporating our technologies into their products without our authorization. If we are unable to successfully identify and stop unauthorized use of our intellectual property, we could experience increased operational and enforcement costs, which could adversely affect our financial condition and results of operations. We generally seek patent protection for our innovations. It is possible, however, that some of these innovations may not be protectable. In addition, given the costs of obtaining patent protection, we may choose not to protect particular innovations that later turn out to be important. Moreover, we have limited or no patent protection in particular foreign jurisdictions. For example, in China we have only limited patent protection, especially with respect to our Dolby Digital technologies, and in India we have no issued patents. Furthermore, there is always the possibility, despite our efforts, that the scope of the protection gained will be insufficient or that an issued patent may later be found to be invalid or unenforceable. Moreover, we seek to maintain select intellectual property as trade secrets. These trade secrets could be compromised by third parties, or intentionally or accidentally by our employees, which would cause us to lose the competitive advantage resulting from them.

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Our investments in auction rate certificates are subject to risks which have and may in the future cause losses and affect the liquidity of these investments.

At June 27, 2008, we held tax-exempt auction rate certificates (ARC), which are classified as available-for-sale securities and reflected at fair value on the condensed consolidated balance sheet. Auctions for these instruments began failing during the second quarter of fiscal 2008 and continued to fail in the third quarter of fiscal 2008. A liquid secondary market has not developed for these instruments and there is no assurance that auctions on these ARCs will succeed in the future. An auction failure means that the parties wishing to sell their ARCs could not do so. As a result, our ability to liquidate and fully recover the carrying value of our ARCs in the near term may be limited or not exist. As a result of these developments, we have recorded unrealized losses to accumulated other comprehensive income in fiscal 2008. Additionally, we have classified these investments as long-term investments on the condensed consolidated balance sheet at June 27, 2008. If the issuers of these ARCs are unable to successfully close future auctions and their credit ratings deteriorate, we may in the future be required to record further unrealized losses, or realized losses, on these investments. We may be required to wait until market stability is restored for these instruments or until the final maturity of the underlying notes to realize our investments recorded value.

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

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

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

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

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

Our performance is largely dependent on the talents and efforts of highly skilled individuals. Our future success depends on our continuing ability to identify, hire, develop, motivate and retain highly skilled personnel for all areas of our organization. In this regard, we currently plan to hire a number of employees throughout fiscal 2008 in response to our growth and our current initiatives. We have maintained a rigorous, highly selective and time-consuming hiring process, which we believe has significantly contributed to our success to date, but has made it more difficult for us to hire a sufficient number of qualified employees. As we grow, our hiring process may prevent us from hiring the personnel we need in a timely manner. In addition, we are aware that some of our competitors have directly targeted our employees. If we are unable to hire and train a sufficient number of qualified employees or retain and motivate existing employees, our existing operations may suffer and we may be unable to grow effectively.

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

We have a complex business organization that is international in scope. Ensuring that we have adequate internal financial and accounting controls and procedures in place to help ensure that we can produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. On an ongoing basis, we document, review and, if appropriate, improve our internal controls and procedures in connection with Section 404 of the Sarbanes-Oxley Act, which requires annual management assessments of the effectiveness of

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our internal controls over financial reporting and a report by our independent auditors addressing these assessments. Both we and our independent auditors periodically test our internal controls in connection with the Section 404 requirements and could, as part of that documentation and testing, identify areas for further attention or improvement. Implementing any appropriate changes to our internal controls may require specific compliance training of our directors, officers and employees, entail substantial costs in order to modify our existing accounting systems, and take a significant period of time to complete. Such changes may not, however, be effective in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and could materially impair our ability to operate our business. In addition, investors perceptions that our internal controls are inadequate or that we are unable to produce accurate financial statements may seriously affect our stock price.

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

At June 27, 2008, Ray Dolby and his affiliates owned 100 shares of our Class A common stock and 60,000,000 shares of our Class B common stock. As of June 27, 2008, Ray Dolby and his affiliates, including his family members, had voting power of approximately 99% of our outstanding Class B common stock, which in the aggregate represented approximately 91% of the combined voting power of our outstanding Class A and Class B common stock. Under our certificate of incorporation, holders of Class B common stock are entitled to ten votes per share while holders of Class A common stock are entitled to one vote per share. Generally, shares of Class B common stock automatically convert into shares of Class A common stock upon transfer of such Class B common stock, other than transfers to certain specified persons and entities, including the spouse and descendents of Ray Dolby and the spouses and domestic partners of such descendents. Because of this dual class structure, Ray Dolby, his affiliates, and his family members and descendents will, for the foreseeable future, have significant influence over our management and affairs, and will be able to control virtually all matters requiring stockholder approval, including the election of directors and significant corporate transactions such as mergers or other sales of our company or assets, even if they come to own considerably less than 50% of the total number of outstanding shares of our Class A and Class B common stock. Ray Dolby, his affiliates, his family members and descendents will maintain this control even if in the future they come to own considerably less than 50% of the total number of outstanding shares of our Class A and Class B common stock. Moreover, these persons may take actions in their own interests that you or our other stockholders do not view as beneficial. Absent a transfer of Class B common stock that would trigger an automatic conversion as described above, there is no threshold or time deadline at which the shares of Class B common stock will automatically convert into shares of Class A common stock. Assuming conversion of all shares of Class B common stock held by persons not affiliated with Ray Dolby into shares of Class A common stock, so long as Ray Dolby and his affiliates, his family members and descendents continue to hold shares of Class B common stock representing approximately 10% or more of the total number of outstanding shares of our Class A and Class B common stock, they will hold a majority of the combined voting power of the Class A and Class B common stock.

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

If our founder, officers, directors or employees sell, or indicate an intention to sell, substantial amounts of our Class A common stock in the public market, including shares of Class A common stock issuable upon conversion of shares of Class B common stock, the trading price of our Class A common stock could decline. As of June 27, 2008, we had a total of 112,189,090 shares of Class A and Class B common stock outstanding. Of these shares, 31,625,000 shares of Class A common stock were sold in our initial public offering by us and the selling stockholders, and an additional 8,000,000 shares of Class A common stock were sold in a secondary offering in May 2007 by our principal stockholder.

As of June 27, 2008, our directors and executive officers beneficially held 60,282,750 shares of Class B common stock, 4,483 shares of Class A common stock, vested options to purchase 617,034 shares of Class B common stock and vested options to purchase 281,411 shares of Class A common stock. We expect that any sale of our Class A common stock by our directors and executive officers would be subject to compliance with Rule 144 under the Securities Act.

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

Sales of Unregistered Securities

In the fiscal quarter ended June 27, 2008, we issued an aggregate of 713,652 shares of our Class B common stock to certain employees, officers and directors upon the exercise of options awarded under our 2000 Stock Incentive Plan and since June 28, 2008 through July 17, 2008, we issued an aggregate of 32,620 shares of our Class B common stock to certain employees and officers upon the exercise of options awarded under our 2000 Stock Incentive Plan. We received aggregate proceeds of approximately $1.5 million in the fiscal quarter ended June 27, 2008, and approximately $65,000 in the period since June 28, 2008 through July 17, 2008 as a result of the exercise of these options. We believe these transactions were exempt from the registration requirements of the Securities Act in reliance on Rule 701 thereunder as transactions pursuant to compensatory benefit plans and contracts relating to compensation as provided under Rule 701. As of July 17, 2008 options to purchase an aggregate of 2,556,981 shares of our Class B common stock remain outstanding. All issuances of shares of our Class B common stock pursuant to the exercise of these options will be made in reliance on Rule 701. All option grants made under the 2000 Stock Incentive Plan were made prior to the effectiveness of our initial public offering. No further option grants will be made under our 2000 Stock Incentive Plan.

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

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

Issuer Purchases of Equity Securities

The following table sets forth information relating to repurchases of our equity securities during the quarter ended June 27, 2008.

	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plan or Programs
April (March 29 April 25, 2008)				
May (April 26 May 23, 2008)	221	$ 45.85		
June (May 24 June 27, 2008)				
Total	221	$ 45.85		

(1) Comprised of shares added to treasury stock related to activity under our equity plans as the result of the surrender by a former employee of 221 shares of already owned Class A common stock to pay the exercise price in connection with the exercise of employee stock options.

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ITEM 6. EXHIBITS

Exhibit		Incorporated by Reference Herein	
Number	Description	Form	Date
31.1	Certification by the Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.		
31.2	Certification by the Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.		
32.1	Certification by the Chief Executive Officer and the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.		

Furnished herewith

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SIGNATURES

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

Date: July 31, 2008

DOLBY LABORATORIES, INC.

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

INDEX TO EXHIBITS

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Furnished herewith