Dolby Laboratories, Inc.
Form 10-Q
February 01, 2019
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the Quarterly Period Ended December 28, 2018
OR

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

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

DOLBY LABORATORIES, INC.
(Exact name of registrant as specified in its charter)

Delaware	90-0199783	
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)	
1275 Market Street San Francisco, CA	94103-1410	(415) 558-0200
(Address of principal executive offices)	(Zip Code)	(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer ý	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company ¨
	Emerging growth company ¨

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

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

On January 25, 2019, the registrant had 64,386,897 shares of Class A common stock, par value $0.001 per share, and 38,229,820 shares of Class B common stock, par value $0.001 per share, outstanding.

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GLOSSARY OF TERMS

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

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

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

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PART I - FINANCIAL INFORMATION
ITEM 1. UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

DOLBY LABORATORIES, INC.
INTERIM CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share amounts)
(unaudited)

	December 28, 2018	September 28, 2018 (as adjusted)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 790,787	$ 918,063
Restricted cash	8,999	7,187
Short-term investments	175,557	178,138
Accounts receivable, net of allowance for doubtful accounts of $6,860 and $5,258	181,614	200,933
Contract assets	199,480	165,959
Inventories	27,765	26,206
Prepaid expenses and other current assets	39,601	34,890
Total current assets	1,423,803	1,531,376
Long-term investments	201,428	187,782
Property, plant, and equipment, net	523,193	514,182
Intangible assets, net	189,476	184,019
Goodwill	326,856	327,982
Deferred taxes	107,313	74,766
Other non-current assets	50,991	42,280
Total assets	$ 2,823,060	$ 2,862,387
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 9,811	$ 21,922
Accrued liabilities	265,091	272,967
Income taxes payable	121	2,680
Contract liabilities	19,562	20,502
Total current liabilities	294,585	318,071
Non-current contract liabilities	23,115	22,853
Other non-current liabilities	156,406	150,960
Total liabilities	474,106	491,884
Stockholders' equity:		
Class A, $0.001 par value, one vote per share, 500,000,000 shares authorized: 64,270,978 shares issued and outstanding at December 28, 2018 and 63,978,752 at September 28, 2018	60	61
Class B, $0.001 par value, ten votes per share, 500,000,000 shares authorized: 38,229,820 shares issued and outstanding at December 28, 2018 and 39,261,035 at September 28, 2018	41	41
Additional paid-in capital	—	66,127
Retained earnings	2,361,843	2,313,539
Accumulated other comprehensive (loss)	(18,639)	(15,832)

Total stockholders' equity – Dolby Laboratories, Inc.	2,343,305	2,363,936
Controlling interest	5,649	6,567
Total stockholders' equity	2,348,954	2,370,503
Total liabilities and stockholders' equity	$ 2,823,060	$ 2,862,387

See accompanying notes to unaudited interim condensed consolidated financial statements

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

	Fiscal Quarter Ended	
	December 28, 2018	December 29, 2017
Revenue:		
Licensing	$260,279	$ 270,172
Products and services	42,097	29,355
Total revenue	302,376	299,527
Cost of revenue:		
Cost of licensing	11,397	9,259
Cost of products and services	27,232	21,634
Total cost of revenue	38,629	30,893
Gross margin	263,747	268,634
Operating expenses:		
Research and development	58,647	56,444
Sales and marketing	85,602	70,149
General and administrative	50,813	48,285
Restructuring charges/(credits)	14	(197)
Total operating expenses	195,076	174,681
Operating income	68,671	93,953
Other income/expense:		
Interest income	5,185	3,781
Interest expense	(45)	(35)
Other income/(expense), net	443	(1,152)
Total other income	5,583	2,594
Income before income taxes	74,254	96,547
Provision for income tax (expense)/benefit	24,104	(149,705)
Net income/(loss) including controlling interest	98,358	(53,158)
Less: net (income) attributable to controlling interest	(139)	(144)
Net income/(loss) attributable to Dolby Laboratories, Inc.	$98,219	$ (53,302)
Net income/(loss) per share:		
Basic	$0.96	$ (0.52)
Diluted	$0.93	$ (0.52)
Weighted-average shares outstanding:		
Basic	102,677	102,552
Diluted	106,130	102,552

Related party rent expense:		
Included in operating expenses	$880	$ 784
Included in net income attributable to controlling interest	$176	$ 177
Cash dividend declared per common share	$0.19	$ 0.16
Cash dividend paid per common share	$0.19	$ 0.16

See accompanying notes to unaudited interim condensed consolidated financial statements

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

	Fiscal Quarter Ended	
	December 28, 2018	December 29, 2017 (as adjusted)
Net income/(loss) including controlling interest	$98,358	$(53,158)
Other comprehensive income:		
Currency translation adjustments, net of tax	(3,728)	1,218
Unrealized gains/(losses) on investments, net of tax	770	(1,593)
Comprehensive income/(loss)	95,400	(53,533)
Less: comprehensive (income)/loss attributable to controlling interest	12	(138)
Comprehensive income/(loss) attributable to Dolby Laboratories, Inc.	$95,412	$(53,671)

See accompanying notes to unaudited interim condensed consolidated financial statements

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

	Dolby Laboratories, Inc.						
	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total Dolby Laboratories, Inc.	Controlling Interest	Total
Balance at September 28, 2018 (as adjusted)	$102	$66,127	$2,313,539	$ (15,832)	$2,363,936	$ 6,567	$2,370,503
Net income			98,219		98,219	139	98,358
Currency translation adjustments, net of tax of $0				(3,577)	(3,577)	(151)	(3,728)
Unrealized losses on investments, net of tax of $40				770	770		770
Distributions to controlling interest					—	(906)	(906)
Stock-based compensation expense		21,482			21,482		21,482
Repurchase of common stock		(82,203)	(30,342)		(112,545)		(112,545)
Cash dividends declared and paid on common stock			(19,573)		(19,573)		(19,573)
Common stock issued under employee stock plans		14,272			14,272		14,272
Tax withholdings on vesting of restricted stock	(1)	(19,678)			(19,679)		(19,679)
Balance at December 28, 2018	$101	$—	$2,361,843	$ (18,639)	$2,343,305	$ 5,649	$2,348,954

	Dolby Laboratories, Inc.						
	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Total Dolby Laboratories, Inc.	Controlling Interest	Total
Balance at September 29, 2017 (as adjusted)	$101	$61,331	$2,337,948	$ (7,753)	$2,391,627	$ 7,100	$2,398,727
Net income/(loss)			(53,302)		(53,302)	144	(53,158)
Currency translation adjustments, net of tax of $(274)				1,224	1,224	(6)	1,218
Unrealized losses on investments, net of tax of $83				(1,593)	(1,593)		(1,593)
Distributions to controlling interest					—	(1,021)	(1,021)
Stock-based compensation expense		18,684			18,684		18,684
Repurchase of common stock		(29,993)			(29,993)		(29,993)
Cash dividends declared and paid on common stock			(16,377)		(16,377)		(16,377)
Common stock issued under employee stock plans	1	41,462			41,463		41,463
		(18,821)			(18,821)		(18,821)

Tax withholdings on vesting of restricted stock							
Balance at December 29, 2017 (as adjusted)	$102	$72,663	$2,268,269	$ (8,122)	$2,332,912	$ 6,217	$2,339,129

See accompanying notes to unaudited interim condensed consolidated financial statements

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

	Fiscal Quarter-To-Date Ended	
	December 28, 2018	December 29, 2017
Operating activities:		
Net income/(loss) including controlling interest	$98,358	$ (53,158)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	20,029	19,882
Stock-based compensation	21,482	18,684
Amortization of premium on investments	309	742
Provision for doubtful accounts	1,605	1,119
Deferred income taxes	(32,571)	32,725
Other non-cash items affecting net income	3,393	587
Changes in operating assets and liabilities:		
Accounts receivable	17,736	(41,526)
Inventories	(2,709)	(1,491)
Contract assets	(33,519)	(22,449)
Prepaid expenses and other assets	(13,157)	(6,591)
Accounts payable and other liabilities	(26,332)	(33,006)
Income taxes, net	1,546	99,551
Contract liabilities	(678)	1,984
Other non-current liabilities	1,460	96
Net cash provided by operating activities	56,952	17,149
Investing activities:		
Purchases of investment securities	(63,329)	(74,479)
Proceeds from sales of investment securities	32,582	28,383
Proceeds from maturities of investment securities	19,785	49,476
Purchases of PP&E	(18,539)	(19,275)
Purchase of intangible assets	(12,065)	(11,198)
Net cash used in investing activities	(41,566)	(27,093)
Financing activities:		
Proceeds from issuance of common stock	14,272	41,463
Repurchase of common stock	(112,545)	(29,993)
Payment of cash dividend	(19,573)	(16,377)
Distribution to controlling interest	(906)	(1,021)
Shares repurchased for tax withholdings on vesting of restricted stock	(19,679)	(15,346)
Net cash used in financing activities	(138,431)	(21,274)
Effect of foreign exchange rate changes on cash, cash equivalents, and restricted cash	(2,419)	870
Net decrease in cash, cash equivalents, and restricted cash	(125,464)	(30,348)
Cash, cash equivalents, and restricted cash at beginning of period	925,250	634,368
Cash, cash equivalents, and restricted cash at end of period	$799,786	$ 604,020

Supplemental disclosure:		
Cash paid for income taxes, net of refunds received	$10,722	$ 17,355
Non-cash investing activities:		
Net change in PP&E purchased and unpaid at period-end	$6,642	$ 2,333

See accompanying notes to unaudited interim condensed consolidated financial statements

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

1. Basis of Presentation

Unaudited Interim Condensed Consolidated Financial Statements

We have prepared the accompanying unaudited interim condensed consolidated financial statements in accordance with U.S. GAAP, and with SEC rules and regulations, which allow for certain information and footnote disclosures that are normally included in annual financial statements prepared in accordance with U.S. GAAP to be condensed or omitted. In our opinion, these unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements for the fiscal year ended September 28, 2018 and include all adjustments necessary for fair presentation. The accompanying unaudited interim condensed consolidated financial statements should be read in conjunction with our consolidated financial statements for the fiscal year ended September 28, 2018, which are included in our Annual Report on Form 10-K filed with the SEC.

The results for the fiscal quarter ended December 28, 2018 are not necessarily indicative of the results to be expected for any subsequent quarterly or annual financial period, including the fiscal year ending September 27, 2019.

Principles of Consolidation

The unaudited interim condensed consolidated financial statements include the accounts of Dolby Laboratories, Inc. and our wholly owned subsidiaries. In addition, we have consolidated the financial results of jointly owned affiliated companies in which our principal stockholder has a controlling interest. We report these controlling interests as a separate line in our consolidated statements of operations as net income attributable to controlling interest and in our consolidated balance sheets as a controlling interest. We eliminate all intercompany accounts and transactions upon consolidation.

Operating Segments

Since we operate as a single reporting segment, all required financial segment information is included in our unaudited interim condensed consolidated financial statements. This reflects the fact that our CODM, our Chief Executive Officer, evaluates our financial information and resources, and assesses the performance of these resources on a consolidated basis.

Use of Estimates

The preparation of our financial statements in accordance with U.S. GAAP requires management to make certain estimates and assumptions that affect the amounts reported and disclosed in our unaudited interim condensed consolidated financial statements and accompanying notes. Significant items subject to such estimates and assumptions include estimated shipments by our licensees for which we are owed a sales–based royalty, estimated selling prices for performance obligations within revenue arrangements; valuation allowances for accounts receivable; carrying values of inventories and certain property, plant, and equipment, goodwill and intangible assets; fair values of investments; accrued liabilities including liabilities for unrecognized tax benefits, deferred income tax assets and liabilities, and stock-based compensation. Actual results could differ from our estimates.

Fiscal Year

Our fiscal year is a 52 or 53 week period ending on the last Friday in September. The fiscal periods presented herein include the 13 week periods ended December 28, 2018 and December 29, 2017. Our fiscal year ending September 27, 2019 (fiscal 2019) and our fiscal year ended September 28, 2018 (fiscal 2018) both consist of 52 weeks.

Reclassifications

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

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2. Summary of Significant Accounting Policies

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

Recently Issued Accounting Standards

Adopted Standards

During the first quarter of fiscal 2019, we adopted the following standards:

Revenue Recognition. In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers ("ASC 606"), which outlines a comprehensive revenue recognition model. The standard requires revenue recognition to account for the transfer of promised goods or services to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services, and in our case, requires the use of more judgment and estimates than the previous accounting requirements. ASC 606 also includes Subtopic 340-40, Other Assets and Deferred Costs - Contracts with Customers, under which the incremental costs associated with obtaining a contract are required to be capitalized and amortized as expense as the contract's performance obligations are satisfied. We do not capitalize sales commission costs because our performance obligations on which we pay commissions are complete at contract execution.

We adopted ASC 606 utilizing the full retrospective method of transition which requires a recast of each prior reporting period presented. The most significant impacts of adopting ASC 606 are as follows:

- We estimate and record per-unit royalty-based revenue earned from our licensees' shipments in the same period in which those shipments occur, instead of recognizing our per-unit royalty-based revenue in the quarter in which it is reported to us by our licensees, which is generally in the quarter after those shipments have occurred. To the extent that our revenues are influenced by seasonal trends, the trends will impact revenue one fiscal quarter earlier than was previously the case;
- We record a favorable or unfavorable adjustment based on the difference between estimated and actual sales when we receive reporting of sales–based royalties on royalty statements from the licensees, generally in the subsequent fiscal quarter;
- For certain transactions that have extended payment and minimum commitment terms with no further performance obligations, we recognize licensing revenues on the later of contract execution or effective date regardless of when the amounts are due and payable;
- We recorded a one-time adjustment of $174.4 million to the period ending September 29, 2018 retained earnings to reflect the full impact of the accounting upon adoption.

We adjusted our condensed consolidated financial statements from amounts previously reported to reflect the adoption of the new standard. Select unaudited condensed consolidated statement of income line items, which reflect the adoption of the new standard, are as follows (in thousands, except per share data):

	Fiscal Quarter Ended December 29, 2017 (as previously reported)	Effect of Adopting ASC 606	Fiscal Quarter Ended December 29, 2017 (as adjusted)
Revenue	$287,797	$ 11,730	$299,527
Gross margin	256,921	11,713	268,634
Provision for income taxes	(166,312)	16,607	(149,705)
Net income/(loss) attributable to Dolby Laboratories, Inc.	(81,622)	28,320	(53,302)

Diluted earnings per share	$ (0.80)	$ 0.28	$ (0.52)

Select condensed consolidated balance sheet line items, which reflect the adoption of the new standard, are as follows (in thousands):

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	September 28, 2018 (as previously reported)	Effect of Adopting ASC 606	September 28, 2018 (as adjusted)
ASSETS			
Accounts receivable, net	$ 137,151	$ 63,782	$ 200,933
Contract assets	—	165,959	165,959
Prepaid expenses and other current assets	35,209	(319)	34,890
Deferred taxes	101,070	(26,304)	74,766
LIABILITIES AND STOCKHOLDERS' EQUITY			
Accrued liabilities	223,594	49,373	272,967
Contract liabilities	23,931	(3,429)	20,502
Non-current contract liabilities	40,064	(17,211)	22,853
Retained earnings	2,139,154	174,385	2,313,539

Select condensed consolidated statement of cash flows line items, which reflect the adoption of the new standard, are as follows (in thousands):

	Fiscal Quarter Ended December 29, 2017 (as previously reported)[1]	Effect of Adopting ASC 606	Fiscal Quarter Ended December 29, 2017 (as adjusted)
Operating activities:			
Net income/(loss) including controlling interest	$ (81,478)	$ 28,320	$ (53,158)
Adjustments to reconcile net income to net cash provided by operating activities:			
Deferred income taxes	51,074	(18,349)	32,725
Changes in operating assets and liabilities:			
Accounts receivable	(50,268)	8,742	(41,526)
Contract assets	—	(22,449)	(22,449)
Prepaid expenses and other assets	(6,609)	18	(6,591)
Accounts payable and other liabilities	(35,390)	2,384	(33,006)
Deferred revenue	650	1,334	1,984
Net cash provided by operating activities	17,149	—	17,149

[1] Previously reported statement of cash flows in the table above reflects the adoption of ASU 2016-18. The impact to our previously reported condensed consolidated statement of cash flows is not material. Refer to disclosure below for further detail.

In our adoption and as allowed by ASC 606, we:

- used the transaction price at the date on which the contract was completed rather than estimating variable consideration amounts in the comparative reporting period;
- did not disclose the amount of the transaction price allocated to the remaining performance obligations or provide an explanation of when we expect to recognize that amount as revenue for reporting periods presented before the date of initial adoption;
-

reflected the aggregate effect of contract modifications in accounting for the contracts open as of the earliest reporting period presented;

- did not adjust transaction prices for the effects of a significant financing component, if at contract inception, we expected the period between customer payment and the transfer of goods or services to be one year or less.

In March 2016, the FASB also issued Accounting Standards Update No. 2016-08, Revenue from Contracts with Customers ("ASC 606"), Principal versus Agent Considerations (Reporting Revenue Gross versus Net) ("ASU 2016-08"), which amended the principal-versus-agent implementation guidance and illustrations in ASU 2014-09. ASU 2016-08 clarifies that an entity should evaluate when it is the principal or agent for each specified good or service promised in a contract with a customer. We evaluated our contracts executed with and on our behalf with VIA Licensing Corporation, our wholly-owned subsidiary that manages patent pools on behalf of third party patent owners and concluded that VIA performs its functions as an agent to the patent pool licensors, which includes Dolby.

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Accordingly, we recognize our administrative fees and royalties net of the consideration paid to the patent licensors in the pool.

Cash Flow Classification. During the first quarter of fiscal 2019, we adopted ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. The new standard addresses eight specific cash flow issues related to the classification and presentation of cash receipts and payments in the statement of cash flows. The adoption of these updates did not have a material impact on Dolby’s consolidated financial statements.

Income Taxes: Intra-Entity Asset Transfers. During the first quarter of fiscal 2019, we adopted ASU 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory. The new standard requires the recognition of the income tax consequences of an intercompany asset transfer, other than transfers of inventory, when the transfer occurs. For intercompany transfers of inventory, the income tax effects will continue to be deferred until the inventory has been sold to a third party. The adoption of the guidance did not have a material impact on Dolby's consolidated financial statements.

Restricted Cash. During the first quarter of fiscal 2019, we adopted ASU 2016-18, Restricted Cash - a consensus of the FASB Emerging Issues Task Force, which clarifies how entities should present restricted cash and restricted cash equivalents in the statement of cash flows. The new standard requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. We adopted the new guidance using the retrospective transition approach. The reclassified restricted cash balances from investing activities to changes in cash, cash equivalents, and restricted cash on the condensed consolidated statements of cash flows were not material for all periods presented. The adjusted condensed consolidated statement of cash flows for the prior comparative period conforms with the new standard.

Accounting for Hedging Activities. During the first quarter of fiscal 2019, we adopted ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The new standard eliminates the requirement to separately measure and report hedge ineffectiveness. The adoption of the standard did not have a material impact on Dolby's consolidated financial statements.

Standards Not Yet Effective

Leases. In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which amends the existing accounting standards for leases. Under the new standard, a lessee will be required to recognize a lease liability and right-of-use asset for most leases. The new standard also modifies the classification criteria and accounting for sales-type and direct financing leases, and requires additional disclosures to enable users of financial statements to understand the amount, timing, and uncertainty of cash flows arising from leases. Topic 842 must be applied using a modified retrospective approach. Upon adoption, we will recognize a lease liability and right-of-use asset for each of our lease arrangements. We anticipate adoption of the standard will not have a material impact on our consolidated income statements. We plan to elect the practice expedients upon transition that will retain the lease classification and initial direct costs for any leases that exist prior to adoption of the standard. We will not reassess whether any contracts entered into prior to adoption are leases. We are in the process of evaluating our existing lease contracts and implementing changes to our systems. ASU 2016-02 is effective for Dolby beginning September 28, 2019, and we do not currently plan to early adopt.

Income Taxes: Comprehensive Income. On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act ("Tax Act"). In February 2018, the FASB issued ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income, which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Act and requires entities to provide certain disclosures regarding stranded tax effects. The ASU is effective for Dolby beginning September 28, 2019, and we do not currently plan to early adopt. We are currently evaluating the timing and impact of the standard on our consolidated financial statements.

Collaborative Arrangements. In November 2018, the FASB issued ASU 2018-18, Collaborative Arrangements (Topic 808): Clarifying the Interaction between Topic 808 and Topic 606, which clarifies that certain transactions between participants in a collaborative arrangement should be accounted for under ASC 606 when the counterparty is a

customer. In addition, ASU 2018-18 precludes an entity from presenting consideration from a transaction in a collaborative arrangement as revenue from contracts with customers if the counterparty is not a customer for that transaction. This standard will be effective for Dolby beginning September 29, 2020, and we do not currently plan to early adopt. We do not believe that this standard will have a material impact on our consolidated financial position, results of operation, and cash flows.

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3. Revenue Recognition

We enter into revenue arrangements with our customers to license technologies, trademarks and patents for sound, imaging and voice solutions, and to sell products and services. We recognize revenue when we satisfy a performance obligation by transferring control over the use of a license, product, or service to a customer.

A. Identification of the Contract or Contracts with Customers

We generally determine that a contract with a customer exists upon the execution of an agreement and after consideration of collectability, which could include an evaluation of the customer's payment history, the existence of a standby letter-of-credit between the customer’s financial institution and our financial institution, public financial information, and other factors. At contract inception, we also evaluate whether two or more non-standard agreements with a customer should be combined and accounted for as a single contract.

B. Identification of Performance Obligations in a Contract

We generate revenues principally from the following sources, which represent performance obligations in our contracts with customers:

- Licensing. We license our technologies, including patents, to a range of customers who incorporate them into their products for enhanced audio, imaging and voice functionality across broadcast, mobile, CE, PC, gaming, and other markets.
- Product Sales. We design and provide audio and imaging products for the cinema, television, broadcast, communications, and entertainment industries.
- Services. We provide various services to support theatrical and television production for cinema exhibition, broadcast, and home entertainment, including equipment training, mixing room alignment, equalization, as well as audio, color and light image calibration.
- PCS. We provide PCS for products sold and for the equipment leased, and we support the implementation of our licensing technologies in our licensees’ products.
- Equipment Leases. We collaborate with established cinema exhibitors to offer Dolby Cinema, a branded premium cinema offering for movie audiences by leasing equipment and licensing our intellectual property.
- Licensing Administration Fees. We generate service fees for managing patent pools on behalf of third party patent owners through our wholly-owned subsidiary, Via Licensing Corporation.

Some of our revenue arrangements include multiple performance obligations, such as hardware, software, support and maintenance, and extended warranty services. We evaluate whether promised products and services are distinct performance obligations.

The majority of our arrangements with multiple performance obligations pertain to our digital cinema server and processor sales that include the following distinct performance obligations to which we allocate portions of the transaction price based on their stand-alone selling price:

- Digital cinema server hardware and embedded software, which is highly dependent on and highly interrelated with the hardware. Accordingly, the hardware and embedded software represent a single performance obligation.
- The right to support and maintenance, which is included with the purchase of the digital cinema server hardware, is a distinct performance obligation.
- The right to receive commissioning services is a distinct performance obligation within the sale of the Dolby Atmos Cinema Processor. These services consist of the review of venue designs specifying proposed speaker placement as well as calibration services performed for installed speakers to ensure optimal playback.

C. Determination of Transaction Price for Performance Obligations in a Contract

After identifying the distinct performance obligations, we determine the transaction price in accordance with the terms of the underlying executed contract which may include variable consideration such as discounts, rebates, refunds, rights of returns, and incentives. We assess and update, if necessary, the amount of variable consideration to

which we are entitled for each reporting period. At the end of each reporting period, we estimate and accrue a liability for returns and adjustments as a reduction to revenue based on several factors, including past returns history.

With the exception of our sales-based royalties, we evaluate whether a significant financing component exists when we recognize revenue in advance of customer payments that occur over time. For example, some of our licensing arrangements include payment terms greater than one year from when we transfer control of our IP to a licensee and the receipt of the final payment for that IP. If a significant financing component exists, we classify a portion of the transaction price as interest income, instead of recognizing all the transaction price as revenue. We do not adjust the transaction price for the effects of financing if, at contract inception, the period between the transfer of control to a customer and final payment is expected to be one year or less.

D. Allocation of Transaction Price to Distinct Performance Obligations in a Contract

For our sales-based royalties where the license is the predominant item to which the royalties relate, we present all revenues as licensing.

For revenue arrangements that include multiple performance obligations, we determine the stand-alone selling price for each distinct performance obligation based on the actual selling prices made to customers. If the performance obligation is not sold separately, we estimate the stand-alone selling price. We do so by considering market conditions such as competitor pricing strategies, customer specific information and industry technology lifecycles, internal conditions such as cost and pricing practices, or applying the residual approach method when the selling price of the good, most commonly a license, is highly variable or uncertain.

Once the transaction price - including any variable consideration - has been determined, we allocate the transaction price to the performance obligations identified in the contract, and recognize revenue as or when control is transferred for each distinct performance obligation.

E. Revenue Recognition as Control is Transferred to a Customer

We generate our licensing revenue by licensing our technologies and patents to various types of licensees, such as chip manufacturers ("implementation licensees"), consumer product manufacturers, software vendors, and communications service providers. Our revenue recognition policies for each of these arrangements are summarized below.

Initial fees from implementation licensees. Implementation licensees incorporate our technologies into their chipsets that, once approved by Dolby, are available for purchase by OEMs for use in end-user products. Implementation licensees only pay us a nominal initial fee on contract execution as consideration for the ongoing services that we provide to assist in their implementation process. Revenues from these initial fees are recognized ratably over the contractual term as a component of licensing revenue.

Sales-based licensing fees. In our royalty bearing licensing agreements with OEMs, control is transferred upon the later of contract execution or the contract’s effective date. We apply the royalty exception, which requires that we recognize sales-based royalties at the later of when the sales occur based on our estimates or the completion of our performance obligations. These estimates involve the use of historical data and judgment for several key attributes including industry estimates of expected shipments, the percentage of markets using our technologies, and average sale prices. Generally, our estimates represent the current period’s shipments to which we expect our licensees to submit royalty statements in the following quarter. Upon receipt of royalty statements from the licensees with the actual reporting of sales-based royalties that we estimated previously, we record a favorable or unfavorable adjustment based on the difference between estimated and actual sales.

Fixed and guaranteed licensing fees. In certain cases, our arrangements require the licensee to pay fixed, non-refundable fees independent of the actual number of units they may distribute in the future. In these cases, control is transferred and fees are recognized upon the later of contract execution or the effective date. Additionally and separate from initial fees from implementation licensees, our sales- and usage-based licensing agreements include a nominal fee, which is also recognized at a point in time in which control of the IP has been transferred. Revenues from these arrangements are included as a component of licensing revenue.

Recoveries. Through compliance efforts, we identify under-reported licensed activity related to non-current periods. We may record a favorable or unfavorable revenue adjustment in connection with the findings from these compliance

efforts generally upon resolution with the licensee through agreement of the findings, or upon receipt of the licensee's correction statement. Revenues from these arrangements are included as a component of licensing

revenue.
We undertake activities aimed at identifying potential unauthorized uses of our technologies, which when successful result in the recognition of revenue. Recoveries stem from third parties who agree to remit payments to us based on past use of our technology. In these scenarios, a legally binding contract did not exist at time of use of our technology, and therefore, we recognize revenue recoveries upon execution of the settlement contract as that is the point in time to which control is transferred. These revenues are classified as licensing revenue.
In general, we classify legal costs associated with activities aimed at identifying potential unauthorized uses of our technologies, auditing existing licensees, and on occasion, pursuing litigation as S&M in our consolidated statements of operations.
We recognize licensing revenue gross of withholding taxes, which our licensees remit directly to their local tax authorities, and for which we receive a partial foreign tax credit in our income tax provision.
In addition to our licensing arrangements, we also enter into arrangements to deliver products and services.
Product Sales. Revenue from the sale of products is recognized when the risk of ownership is transferred to the customer, which is generally upon shipment. Payments are generally made within 90 days of sale.
Services. We provide various services, such as engineering services related to movie soundtrack print mastering, equipment training and maintenance, mixing room alignment, equalization, and image calibration, which we bill on a fixed fee and time and materials basis. Most of these services are of a short duration and are recognized as control of the performance obligations are transferred which is when the related services are performed.
Collaborative Arrangements. We collaborate with established cinema exhibitors to offer Dolby Cinema, a branded premium cinema offering for movie audiences. Under such collaborations, Dolby and the exhibitor are both active participants, and share the risks and rewards associated with the business. Accordingly, these collaborations are governed by revenue sharing arrangements under which Dolby receives revenue based on monthly box office reports from exhibitors in exchange for the use of our imaging and sound technologies, our proprietary designs and trademark as well as for the use of our equipment at the exhibitor’s venue. The use of our equipment meets the definition of a lease, and for the related portion of Dolby's share of revenue, we apply ASC 840, Leases, and recognize revenue based on monthly box office reports from exhibitors. In subsequent periods, for the portion of revenue share that we estimated, we record a favorable or unfavorable adjustment for the difference between our estimated and actual share of box office receipts once the box office receipts reports become available from exhibitor partners. Our revenue share is recognized as licensing revenue in our consolidated statements of operations.
In addition, we also enter into agreements where a portion involves guaranteed payments, which in some cases result in classifying the payments as a sales-type lease. In such arrangements, we consider control to transfer at the point in time to which we have installed and tested the equipment, at which point we record such guaranteed payments as product revenue.
VIA Administration Fee. We generate service fees for managing patent pools on behalf of third party patent owners through our wholly-owned subsidiary, Via Licensing Corporation. As an agent to licensors in the patent pool, Via receives a share of the sales-based royalty that the patent pool licensors earn from licensees. As such, we apply the sales-based royalty exception as the service provided is directly related to the patent pool licensors’ provision of IP, which results in recognition based on estimates of the licensee’s quarter shipments that use the pool’s patents. In addition to sales-based royalties, Via also has contracts where the fees are fixed. The revenue share Via receives from licensors on fixed fee contracts is recognized over the term in which we are providing services associated with the fixed fee contract. We recognize our administrative fees net of the consideration paid to the patent licensors in the pool as licensing revenue.
Deferred revenue, which is a component of Contract liabilities, represents amounts that are ultimately expected to be recognized as revenue, but for which we have yet to satisfy the performance obligation. On December 28, 2018, we had $40.1 million of remaining performance obligations, 33% of which we expect to recognize as revenue in fiscal 2019, 22% in fiscal 2020, and the balance of 45% in fiscal years beyond 2020.
F. Disaggregation of revenue
The following table presents a summary of the composition of our revenue for all periods presented:

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	Fiscal Quarter Ended					
	December 28, 2018			December 29, 2017		
Revenue				(as adjusted)		
Licensing	$260,279	86	%	$270,172	90	%
Products and services	42,097	14	%	29,355	10	%
Total revenue	$302,376	100	%	$299,527	100	%

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

	Fiscal Quarter Ended					
	December 28, 2018			December 29, 2017		
Market				(as adjusted)		
Broadcast	$100,138	38	%	$110,484	41	%
PC	23,157	9	%	20,351	8	%
Mobile	34,173	13	%	58,645	22	%
CE	43,750	17	%	37,730	14	%
Other	59,061	23	%	42,962	15	%
Total licensing revenue	$260,279	100	%	$270,172	100	%

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

	Fiscal Quarter Ended					
	December 28, 2018			December 29, 2017		
Revenue By Geographic Location				(as adjusted)		
United States	$119,799	40	%	$78,746	26	%
International	182,577	60	%	220,781	74	%
Total revenue	$302,376	100	%	$299,527	100	%

G. Contract assets and liabilities

Our contract assets represent rights to consideration from licensees for the use of our IP that we have estimated and recognized as revenue in a given quarter in the absence of receiving actual royalty statements from licensees. These estimates reflect our best judgment at that time, and are developed using a number of inputs, including historical experience, anticipated performance, and third-party data. In the event that our estimates differ from actual amounts reported, we record an appropriate adjustment in the quarter in which the report is received which is typically the quarter following our estimate. Actual amounts reported are typically paid within sixty days. Our contract liabilities consist of advance payments and billings in excess of amounts earned, deferred revenue that is typically satisfied within one year, and deferred interest where we have significant financing. The non-current portion of contract liabilities is separately disclosed in our consolidated balance sheets. We present the net contract asset or liability when we have both contract assets and contract liabilities for a single contract.

The following table presents a summary of the balances to which contract assets and liabilities related to revenue are recorded for all periods presented:

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	December 28, 2018	September 28, 2018 (as adjusted)	Change ($)	Change (%)
Accounts receivable, net	$ 181,614	$ 200,933	$ (19,319)	(10)%
Contract assets	199,480	165,959	33,521	20 %
Contract liabilities - current	19,562	20,502	(940)	(5)%
Contract liabilities - non-current	23,115	22,853	262	1 %

4. Composition of Certain Financial Statement Captions

The following tables present detailed information from our consolidated balance sheets as of December 28, 2018 and September 28, 2018 (amounts displayed in thousands, except as otherwise noted).

Accounts Receivable

	December 28, 2018	September 28, 2018 (as adjusted)
Trade accounts receivable	$ 115,333	$ 108,929
Accounts receivable from patent administration program licensees	73,141	97,262
Accounts receivable, gross	188,474	206,191
Less: allowance for doubtful accounts	(6,860)	(5,258)
Total	$ 181,614	$ 200,933

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

Inventories

	December 28, 2018	September 28, 2018
Raw materials	$ 8,087	$ 6,095
Work in process	4,116	4,044
Finished goods	15,562	16,067
Total	$ 27,765	$ 26,206

Inventories are stated at the lower of cost and net realizable value. Inventory with a consumption period expected to exceed twelve months is recorded within other non-current assets in our consolidated balance sheets. We have included $3.0 million and $2.6 million of raw materials inventory within other non-current assets in our consolidated balance sheets as of December 28, 2018 and September 28, 2018, respectively. Based on anticipated inventory consumption rates, and aside from existing write-downs due to excess inventory, we do not believe that material risk of obsolescence exists prior to ultimate sale.

Prepaid Expenses And Other Current Assets

	December 28, 2018	September 28, 2018 (as adjusted)
Prepaid expenses	$ 22,316	$ 18,508
Other current assets	14,936	13,946
Income tax receivable	2,349	2,436
Total	$ 39,601	$ 34,890

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Accrued Liabilities

	December 28, 2018	September 28, 2018 (as adjusted)
Accrued royalties	$ 3,257	$ 2,648
Amounts payable to patent administration program partners	75,458	98,900
Accrued compensation and benefits	56,662	84,491
Accrued professional fees	14,252	9,749
Unpaid PP&E additions	20,253	13,956
Other accrued liabilities	95,209	63,223
Total	$ 265,091	$ 272,967

Other Non-Current Liabilities

	December 28, 2018	September 28, 2018
Supplemental retirement plan obligations	$ 3,190	$ 3,388
Non-current tax liabilities	133,322	129,253
Other liabilities	19,894	18,319
Total	$ 156,406	$ 150,960

5. Investments & Fair Value Measurements

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

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

	December 28, 2018						
		Unrealized			Estimated Fair Value		
	Cost	Gains	Losses	Total	Level 1	Level 2	Level 3
Cash and cash equivalents:							
Cash	$676,484			$676,484	$676,484		
Cash equivalents:							
Commercial paper	1,996	—	—	1,996		1,996	
Money market funds	112,307	—	—	112,307	112,307		
Cash and cash equivalents	790,787	—	—	790,787	788,791	1,996	—
Short-term investments:							
Certificate of deposit (1)	12,645	8	(1)	12,652		12,652	
U.S. agency securities	15,498	—	(147)	15,351		15,351	
Government bonds	10,394	2	(11)	10,385	10,385		
Commercial paper	8,450	1	(1)	8,450		8,450	
Corporate bonds	100,814	5	(384)	100,435		100,435	
Municipal debt securities	28,343	1	(60)	28,284		28,284	
Short-term investments	176,144	17	(604)	175,557	10,385	165,172	—
Long-term investments:							
Certificate of deposit (1)	430	—		430		430	
U.S. agency securities	6,791	23	(74)	6,740		6,740	
Government bonds	14,673	4	(184)	14,493	14,493		
Corporate bonds	158,367	152	(1,493)	157,026		157,026	
Municipal debt securities	21,852	42	(37)	21,857		21,857	
Other long-term investments (2)	783	99		882	99	—	
Long-term investments	202,896	320	(1,788)	201,428	14,592	186,053	—
Total cash, cash equivalents, and investments	$1,169,827	$337	$(2,392)	$1,167,772	$813,768	$353,221	$ —
Investments held in supplemental retirement plan:							
Assets	3,288			3,288	3,288		
Included in prepaid expenses and other current assets & other non-current assets							
Liabilities	3,288			3,288	3,288		
Included in accrued liabilities & other non-current liabilities							

(1) Certificates of deposit include marketable securities, while those with a maturity in excess of one year as of December 28, 2018 are classified within long-term investments.

(2) Other long-term investments as of December 28, 2018 include a marketable equity security of $0.1 million, and other investments that are not carried at fair value including an equity method investment of $0.8 million.

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	September 28, 2018						
		Unrealized			Estimated Fair Value		
	Cost	Gains	Losses	Total	Level 1	Level 2	Level 3
Cash and cash equivalents:							
Cash	$905,660			$905,660	$905,660		
Cash equivalents:							
Commercial paper	5,058	—	—	5,058		5,058	
Corporate bonds	1,005		—	1,005		1,005	
Money market funds	3,301			3,301	3,301		
Municipal debt securities	545		(1)	544		544	
Government bonds	2,495	—		2,495	2,495		
Cash and cash equivalents	918,064	—	(1)	918,063	911,456	6,607	—
Short-term investments:							
Certificate of deposit (1)	12,875	14		12,889		12,889	
U.S. agency securities	11,997		(135)	11,862		11,862	
Government bonds	7,970	—	(15)	7,955	7,955		
Commercial paper	4,276	—	—	4,276		4,276	
Corporate bonds	111,245	50	(494)	110,801		110,801	
Municipal debt securities	30,475		(120)	30,355		30,355	
Short-term investments	178,838	64	(764)	178,138	7,955	170,183	—
Long-term investments:							
U.S. agency securities	9,791		(166)	9,625		9,625	
Government bonds	15,966		(317)	15,649	15,649		
Corporate bonds	146,561	33	(1,810)	144,784		144,784	
Municipal debt securities	17,235		(112)	17,123		17,123	
Other long-term investments (2)	355	246		601	246		
Long-term investments	189,908	279	(2,405)	187,782	15,895	171,532	—
Total cash, cash equivalents, and investments	$1,286,810	$343	$(3,170)	$1,283,983	$935,306	$348,322	$ —
Investments held in supplemental retirement plan:							
Assets	3,486			3,486	3,486		
Included in prepaid expenses and other current assets & other non-current assets							
Liabilities	3,486			3,486	3,486		
Included in accrued liabilities & other non-current liabilities							

(1) Certificates of deposit include marketable securities, while those with a maturity in excess of one year as of September 28, 2018 are classified within long-term investments.

(2) Other long-term investments as of September 28, 2018 include a marketable equity security of $0.2 million, and other investments that are not carried at fair value including an equity method investment of $0.4 million. During fiscal 2018, we recorded write-off charges to reduce the carrying value of two cost method equity investments to zero in recognition of an other-than-temporary impairment for each investment.

Fair Value Hierarchy. Fair value is the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability, in an orderly transaction between

market participants at the measurement date. We minimize the use of unobservable inputs and use observable market data, if available, when determining fair value. We classify our inputs to measure fair value using the following three-level hierarchy:

Level 1: Quoted prices in active markets at the measurement date for identical assets and liabilities. We base the fair value of our Level 1 financial instruments, which are traded in active markets, using quoted market prices for identical instruments.

Level 2: Prices may be based upon quoted prices in active markets or inputs not quoted on active markets but are corroborated by market data. We obtain the fair value of our Level 2 financial instruments from a professional pricing service, which may use quoted market prices for identical or comparable instruments, or model driven valuations using observable market data or inputs corroborated by observable market data. To validate the fair value determination provided by our primary pricing service, we perform quality controls over values received which include comparing our pricing service provider's assessment of the fair values of our investment securities against the fair values of our investment securities obtained from another independent source, reviewing the pricing movement in the context of overall market trends, and reviewing trading information from our investment managers. In addition, we assess the inputs and methods used in determining the fair value in order to determine the classification of securities in the fair value hierarchy.

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

Securities In Gross Unrealized Loss Position. We periodically evaluate our investments for other-than- temporary declines in fair value. The unrealized losses on our AFS securities were primarily the result of unfavorable changes in interest rates subsequent to the initial purchase of these securities. The following table presents the gross unrealized losses and fair value for those AFS securities that were in an unrealized loss position for less than twelve months and for twelve months or greater as of December 28, 2018 and September 28, 2018 (in thousands):

	December 28, 2018				September 28, 2018			
	Less Than 12 Months		12 Months Or Greater		Less Than 12 Months		12 Months Or Greater	
Investment Type	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Certificate of deposit	$1,299	$ —	$—	$ —	$—	$ —	$—	$ —
U.S. agency securities	—	—	20,069	(221)	—	—	21,486	(302)
Government bonds	5,455	(37)	9,519	(157)	16,633	(332)	—	—
Commercial paper	7,047	(1)	—	—	5,737	(1)	—	—
Corporate bonds	80,200	(381)	124,808	(1,497)	143,051	(1,680)	52,162	(624)
Municipal debt securities	17,250	(29)	18,731	(67)	41,058	(191)	6,965	(41)
Total	$111,251	$ (448)	$173,127	$ (1,942)	$206,479	$ (2,204)	$80,613	$ (967)

Although we had certain securities that were in an unrealized loss position as of December 28, 2018, we expect to recover the full carrying value of these securities. As a result, we do not consider any portion of the unrealized losses at either December 28, 2018 or September 28, 2018 to represent an other–than–temporary impairment, nor do we consider any of the unrealized losses to be credit losses.

Investment Maturities. The following table summarizes the amortized cost and estimated fair value of the AFS securities within our investment portfolio based on stated maturities as of December 28, 2018 and September 28, 2018, which are recorded within cash equivalents and both short and long-term investments in our consolidated balance sheets (in thousands):

	December 28, 2018		September 28, 2018	
Range of maturity	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within 1 year	$290,447	$289,860	$191,241	$190,541
Due in 1 to 2 years	138,303	136,797	122,131	120,545
Due in 2 to 3 years	63,810	63,749	67,423	66,637
Total	$492,560	$490,406	$380,795	$377,723

6. Property, Plant, & Equipment

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

	December 28, 2018	September 28, 2018
Land	$ 43,292	$ 43,342
Buildings and building improvements	283,519	283,474
Leasehold improvements	68,015	66,866
Machinery and equipment	118,045	111,603
Computer equipment and software	196,724	194,079

Furniture and fixtures	30,592	30,556
Equipment provided under operating leases	147,653	139,201
Construction-in-progress	10,721	7,342
Property, plant, and equipment, gross	898,561	876,463
Less: accumulated depreciation	(375,368)	(362,281)
Property, plant, & equipment, net	$ 523,193	$ 514,182

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7. Goodwill & Intangible Assets

Goodwill

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

	Goodwill
Balance at September 28, 2018	$327,982
Acquired goodwill	—
Translation adjustments	(1,126)
Balance at December 28, 2018	$326,856

Intangible Assets

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

	December 28, 2018			September 28, 2018		
Intangible Assets	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Acquired patents and technology	$330,705	$(158,107)	$172,598	$319,082	$(152,775)	$166,307
Customer relationships	58,327	(41,812)	16,515	58,342	(41,012)	17,330
Other intangibles	22,723	(22,360)	363	22,742	(22,360)	382
Total	$411,755	$(222,279)	$189,476	$400,166	$(216,147)	$184,019

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

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

Fiscal Period	Total Purchase Consideration (1)	Weighted-Average Useful Life
	(in millions)	(in years)
Fiscal 2018		
Q1 - Quarter ended December 29, 2017	$12.0	14.1
Fiscal 2019		
Q1 - Quarter ended December 28, 2018	$12.1	11.6

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

Amortization expense for our intangible assets is included in cost of licensing, cost of products, R&D, S&M, and G&A expenses in our consolidated statements of operations. Amortization expense was $6.6 million and $6.5 million in the first quarter of fiscal 2019 and 2018, respectively. As of December 28, 2018, estimated amortization expense in future fiscal periods was as follows (in thousands):

Fiscal Year	Amortization Expense
	(in thousands)
Remainder of 2019	$ 21,402
2020	28,227
2021	28,201
2022	25,630
2023	22,284
Thereafter	63,732

Total	$ 189,476

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8. Stockholders' Equity & Stock-Based Compensation

We provide stock-based awards as a form of compensation for employees, officers, and directors. We have issued stock-based awards in the form of stock options and RSUs under our equity incentive plans, as well as shares under our ESPP.

Common Stock - Class A and Class B

Our Board of Directors has authorized two classes of common stock, Class A and Class B. At December 28, 2018, we had authorized 500,000,000 Class A shares and 500,000,000 Class B shares. At December 28, 2018, we had 64,270,978 shares of Class A common stock and 38,229,820 shares of Class B common stock issued and outstanding. Holders of our Class A and Class B common stock have identical rights, except that holders of our Class A common stock are entitled to one vote per share and holders of our Class B common stock are entitled to ten votes per share. Shares of Class B common stock can be converted to shares of Class A common stock at any time at the option of the stockholder and automatically convert upon sale or transfer, except for certain transfers specified in our amended and restated certificate of incorporation.

Stock Incentive Plans

2005 Stock Plan. In January 2005, our stockholders approved our 2005 Stock Plan, which our Board of Directors adopted in November 2004. The 2005 Stock Plan became effective on February 16, 2005, the day prior to the completion of our initial public offering. Our 2005 Stock Plan, as amended and restated, provides for the ability to grant incentive stock options, non-qualified stock options, restricted stock, RSUs, stock appreciation rights, deferred stock units, performance units, performance bonus awards, and performance shares. A total of 46.0 million shares of our Class A common stock is authorized for issuance under the 2005 Stock Plan. For awards granted prior to February 2011, any shares subject to an award with a per share price less than the fair market value of our Class A common stock on the date of grant and any shares subject to an outstanding RSU award will be counted against the authorized share reserve as two shares for every one share subject to the award, and if returned to the 2005 Stock Plan, such shares will be counted as two shares for every one share returned. For those awards granted from February 2011 onward, any shares subject to an award with a per share price less than the fair market value of our Class A common stock on the date of grant and any shares subject to an outstanding RSU award will be counted against the authorized share reserve as 1.6 shares for every one share subject to the award, and if returned to the 2005 Stock Plan, such shares will be counted as 1.6 shares for every one share returned.

Stock Options. Stock options are granted at fair market value on the date of grant. Options granted to employees and officers prior to June 2008 generally vested over four years, with equal annual cliff-vesting and expire on the earlier of ten years after the date of grant or three months after termination of service. Options granted to employees and officers from June 2008 onward generally vest over four years, with 25% of the shares subject to the option becoming exercisable on the one-year anniversary of the date of grant and the balance of the shares vesting in equal monthly installments over the following 36 months. These options expire on the earlier of ten years after the date of grant or three months after termination of service. All options granted vest over the requisite service period and upon the exercise of stock options, we issue new shares of Class A common stock under the 2005 Stock Plan. Our 2005 Stock Plan also allows us to grant stock awards which vest based on the satisfaction of specific performance criteria.

Performance-Based Stock Options (PSOs). In fiscal 2016, we began granting PSOs to our executive officers with shares of our Class A common stock underlying such options. The contractual term for the PSOs is seven years, with vesting contingent upon market-based performance conditions, representing the achievement of specified Dolby annualized TSR targets at the end of a three-year measurement period following the date of grant. If the minimum conditions are met, the PSOs earned will cliff vest on the third anniversary of the grant date, upon certification of achievement of the performance conditions by our Compensation Committee. Anywhere from 0% to 125% of the shares subject to a PSO may vest based on achievement of the performance conditions at the end of the three-year performance period.

In valuing the PSOs which will be recognized as compensation cost, we used a Monte Carlo valuation model. Aside from the use of an expected term for the PSOs commensurate with their shorter contractual term, the nature of the valuation inputs used in the Monte Carlo valuation model were consistent with those used to value our

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

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On December 15, 2018, we granted PSOs to our executive officers exercisable for an aggregate of 241,100 shares at the target award amount, which would be exercisable up to an aggregate of 301,375 shares at 125% of the target award amount. On December 15, 2017, we granted PSOs to our executive officers exercisable for an aggregate of 264,000 shares at the target award amount, which would be exercisable up to an aggregate of 330,000 shares at 125% of the target award amount. On December 15, 2016, we granted PSOs to our executive officers exercisable for an aggregate of 276,199 shares at the target award amount, which would be exercisable up to an aggregate of 345,248 shares at 125% of the target award amount. On December 15, 2015, we granted PSOs to our executive officers, which vested in December 2018 at 125% of the target award amount, for an aggregate of 334,623 shares. As of December 28, 2018, PSOs which would be exercisable for an aggregate of 758,299 shares at the target award amount (1,282,496 at 125% of the target award amount) were outstanding.

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

	Shares (in thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (1) (in thousands)
Options outstanding at September 28, 2018	7,365	$ 43.61		
Grants	1,241	64.60		
Exercises	(190)	38.43		
Forfeitures and cancellations	(34)	48.93		
Options outstanding at December 28, 2018	8,382	46.73	6.75	$ 125,013
Options vested and expected to vest at December 28, 2018	7,867	45.79	6.63	123,860
Options exercisable at December 28, 2018	4,579	$ 39.07	5.50	100,025

(1) Aggregate intrinsic value is based on the closing price of our Class A common stock on December 28, 2018 of $60.83 and excludes the impact of options that were not in-the-money.

Restricted Stock Units. Beginning in fiscal 2008, we began granting RSUs to certain directors, officers, and employees under our 2005 Stock Plan. Awards granted to employees and officers generally vest over four years, with equal annual cliff-vesting. Awards granted to directors prior to November 2010 generally vested over three years, with equal annual cliff-vesting. Awards granted after November 2010 and prior to fiscal 2014 to new directors vested over approximately two years, with 50% vesting per year, while awards granted from November 2010 onward to ongoing directors generally vest over approximately one year. Awards granted to new directors from fiscal 2014 onward vest on the earlier of the first anniversary of the award's date of grant, or the day immediately preceding the date of the next annual meeting of stockholders that occurs after the award's date of grant. Our 2005 Stock Plan also allows us to grant RSUs that vest based on the satisfaction of specific performance criteria, although no such awards had been granted as of December 28, 2018. At each vesting date, the holder of the award is issued shares of our Class A common stock. Compensation expense from these awards is equal to the fair market value of our Class A common stock on the date of grant and is recognized on a straight-line basis over the requisite service period.

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

	Shares (in thousands)	Weighted-Average Grant Date Fair Value
Non-vested at September 28, 2018	2,806	$ 51.62
Granted	1,155	65.08
Vested	(876)	46.82
Forfeitures	(36)	50.29
Non-vested at December 28, 2018	3,049	$ 58.11

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

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

Stock Option Valuation Assumptions

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

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

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

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

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

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

	Fiscal Quarter Ended	
	December 28, 2018	December 29, 2017
Expected life (in years)	4.90	5.06
Risk-free interest rate	2.7 %	2.2 %
Expected stock price volatility	22.9 %	22.6 %
Dividend yield	1.1 %	1.1 %

Stock-Based Compensation Expense

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

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

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Expense - By Award Type

	Fiscal Quarter Ended	
	December 28, 2018	December 29, 2017
Compensation expense - by type		
Stock options	$5,022	$ 6,964
Restricted stock units	15,375	10,780
Employee stock purchase plan	1,085	940
Total stock-based compensation	21,482	18,684
Benefit from income taxes	(3,760)	(3,896)
Total stock-based compensation, net of tax	$17,722	$ 14,788

Expense - By Income Statement Line Item Classification

	Fiscal Quarter Ended	
	December 28, 2018	December 29, 2017
Compensation expense - by classification		
Cost of products and services	$488	$ 380
Research and development	6,241	4,877
Sales and marketing	8,217	5,951
General and administrative	6,536	7,476
Total stock-based compensation expense	21,482	18,684
Benefit from income taxes	(3,760)	(3,896)
Total stock-based compensation, net of tax	$17,722	$ 14,788

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

	Fiscal Quarter Ended	
	December 28, 2018	December 29, 2017
Tax benefit - shares issued under ESPP	$ 142	$ 305

Unrecognized Compensation Expense. At December 28, 2018, total unrecorded compensation expense associated with employee stock options expected to vest was approximately $37.3 million, which is expected to be recognized over a weighted-average period of 2.6 years. At December 28, 2018, total unrecorded compensation expense associated with RSUs expected to vest was approximately $143.8 million, which is expected to be recognized over a weighted-average period of 2.9 years.

Common Stock Repurchase Program

In November 2009, we announced a stock repurchase program ("program"), providing for the repurchase of up to $250.0 million of our Class A common stock. The following table summarizes the initial amount of authorized repurchases as well as additional repurchases approved by our Board of Directors as of December 28, 2018 (in thousands):

Authorization Period	Authorization Amount
Fiscal 2010: November 2009	$ 250,000
Fiscal 2010: July 2010	300,000
Fiscal 2011: July 2011	250,000
Fiscal 2012: February 2012	100,000
Fiscal 2015: October 2014	200,000
Fiscal 2017: January 2017	200,000

Fiscal 2018: July 2018	350,000
Total	$ 1,650,000

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Stock repurchases under the program may be made through open market transactions, negotiated purchases, or otherwise, at times and in amounts that we consider appropriate. The timing of repurchases and the number of shares repurchased depend upon a variety of factors, including price, regulatory requirements, the rate of dilution from our equity compensation plans, and other market conditions. The program does not have a specified expiration date, and can be limited, suspended or terminated at our discretion at any time without prior notice. Shares repurchased under the program will be returned to the status of authorized but unissued shares of Class A common stock. As of December 28, 2018, the remaining authorization to purchase additional shares is approximately $239.0 million.
The following table provides information regarding share repurchase activity under the program during fiscal 2019:

Quarterly Repurchase Activity	Shares Repurchased	Cost in thousands (1)	Average Price Paid Per Share (2)
Q1 - Quarter ended December 28, 2018	1,642,107	$ 112,570	$ 68.54

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

Dividend Program

The following table summarizes dividends declared under the program in relation to fiscal 2019:

Fiscal Period	Announcement Date	Record Date	Payment Date	Cash Dividend Per Common Share	Dividend Payment	
Fiscal 2019						
Q1 - Quarter ended December 28, 2018	January 30, 2019	February 12, 2019	February 21, 2019	$ 0.19	$19.5 million	(1)

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

9. Accumulated Other Comprehensive Income

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

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

	Fiscal Quarter Ended December 28, 2018		
	Investment Securities	Currency Translation Adjustments	Total
Beginning Balance	$(2,948)	$ (12,884)	$(15,832)
Other comprehensive income before reclassifications:			—
Unrealized gains/(losses) - investment securities	931		931
Foreign currency translation gains/(losses) (1)		(3,577)	(3,577)
Income tax effect - benefit/(expense)	—	—	—
Net of tax	931	(3,577)	(2,646)
Amounts reclassified from AOCI into earnings:			
Realized gains/(losses) - investment securities (1)	(201)		(201)
Income tax effect - benefit/(expense) (2)	40		40
Net of tax	(161)	—	(161)
Net current-period other comprehensive income/(loss)	770	(3,577)	(2,807)
Ending Balance	$(2,178)	$ (16,461)	$(18,639)

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

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

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

10. Earnings Per Share

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

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

Potentially dilutive shares represent the hypothetical number of incremental shares issuable under the assumed exercise of outstanding stock options (both vested and non-vested) and vesting of outstanding RSUs. The calculation of dilutive shares outstanding excludes out-of-the-money stock options.

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

	Fiscal Quarter Ended	
	December 28, 2018	December 29, 2017 (as adjusted)
Numerator:		
Net income/(loss) attributable to Dolby Laboratories, Inc.	$98,219	$(53,302)
Denominator:		
Weighted-average shares outstanding—basic	102,677	102,552
Potential common shares from options to purchase common stock	2,251	—
Potential common shares from restricted stock units	1,202	—
Weighted-average shares outstanding—diluted	106,130	102,552
Net income/(loss) per share attributable to Dolby Laboratories, Inc.:		
Basic	$0.96	$(0.52)
Diluted	$0.93	$(0.52)
Antidilutive awards excluded from calculation:		
Stock options	1,583	2,424
Restricted stock units	10	1,358

11. Income Taxes

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

Tax Act Enacted in 2017

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

Our accounting for the impact of the Tax Act has been completed in the first quarter of fiscal 2019 in accordance with the Staff Accounting Bulletin No. 118 measurement period. As of September 28, 2018, we had recorded a provisional amount for the Tax Act of $121.4 million. During the period ended December 28, 2018, we recorded a $35.0 million reduction to our provisional Tax Act amount resulting from completion of our evaluation of the income tax effects of indirect taxes related to the Deemed Repatriation Transition Tax ("Transition Tax") on our deferred tax assets. We also recorded a $1.0 million reduction to our provisional Tax Act amount due to finalizing our total estimate of the Transition Tax obligation. The final recorded amount related to the Tax Act was $85.4 million as of the period ended December 28, 2018.

On January 18, 2019, the U.S. Department of the Treasury issued final regulations on the Transition Tax related to deemed paid foreign taxes eliminating a benefit we previously expected to realize. We will record an additional $18.9 million tax expense in the quarter of enactment which is our quarter ending March 29, 2019.

Even though the accounting for the tax effects of the Tax Act is complete, there may be additional tax effects of the Tax Act that may impact the Company's future financial statement upon finalization of law, regulations, and additional guidance.

We have included the impact of new provisions effective in our fiscal 2019 in our effective tax rate. The Tax Act imposes a minimum tax on certain foreign earnings in excess of 10 percent of the foreign subsidiaries' tangible assets ("minimum foreign tax") in the year earned. Our accounting policy is to treat the minimum foreign tax as a current

expense in the year incurred and have not provided deferred taxes on temporary differences related to such minimum foreign tax.

As a result of the adoption of ASC 606, we reduced our deferred tax assets by $26.3 million at the beginning of our first quarter of fiscal 2019.

Unrecognized Tax Benefit

As of December 28, 2018, the total amount of gross unrecognized tax benefits was $103.8 million, of which $64.6 million, if recognized, would reduce our effective tax rate. As of September 28, 2018, the total amount of gross unrecognized tax benefits was $102.0 million, of which $96.9 million, if recognized, would reduce our effective tax rate. The decrease in the amount which would reduce our effective tax rate from fiscal 2018 is primarily due to the $35.0 million deferred tax asset established in fiscal 2019 for the indirect effects of Transition Tax discussed previously. Our net liability for unrecognized tax benefits is classified within other non-current liabilities in our consolidated balance sheets.

Effective Tax Rate

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

Our effective tax rate in the first quarter of fiscal 2019 was (32.5)%, compared with our Federal statutory rate of 21% and with our effective tax rate in the first quarter of fiscal 2018 of 155.1%. The decrease from the Federal statutory rate and effective tax rate from fiscal 2018 was primarily due to the large, one-time impact of the Tax Act in the prior year adjusted for new regulations.

12. Restructuring

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

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

	Severance and associated costs
Restructuring charges	$ 12,856
Cash payments	(168)
Non-cash and other adjustments	—
Balance at September 29, 2017	$ 12,688
Restructuring charges	23
Cash payments	(12,054)
Non-cash and other adjustments	(537)
Balance at December 28, 2018	$ 120

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

13. Legal Matters

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

14. Commitments & Contingencies

In the ordinary course of business, we enter into contractual agreements with third parties that include non-cancelable payment obligations, for which we are liable in future periods. These arrangements can include terms binding us to minimum payments and/or penalties if we terminate the agreement for any reason other than an event of default as described by the agreement. The following table presents a summary of our contractual obligations and commitments as of December 28, 2018 (in thousands):

	Payments Due By Fiscal Period						
	Remainder of Fiscal 2019	Fiscal 2020	Fiscal 2021	Fiscal 2022	Fiscal 2023	Thereafter	Total
Naming rights	$3,906	$7,909	$8,008	$8,108	$8,209	$ 78,656	$114,796
Operating leases	14,558	14,545	11,314	9,749	9,028	19,475	78,669
Purchase obligations	45,906	69,418	1,284	367	—	—	116,975
Donation commitments	8,245	297	97	97	97	761	9,594
Total	$72,615	$92,169	$20,703	$18,321	$17,334	$ 98,892	$320,034

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

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

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Purchase Obligations. Purchase obligations primarily consist of our commitments made under agreements to purchase goods and services related to Dolby Cinema and for purposes that include IT and telecommunications, marketing and professional services, and manufacturing and other R&D activities.
Donation Commitments. Our donation commitments relate to non-cancelable obligations to the Museum of the Academy of Motion Picture Arts and Sciences in Los Angeles, California, and the Smithsonian Institution in Washington, DC. Our commitment to the Museum of the Academy of Motion Picture Arts and Sciences is for 15 years from its expected opening date in fiscal 2019, and the Smithsonian Institution is for the next 5 years. Both donation commitments consist of the installation of imaging and audio products in its theaters and providing maintenance services in exchange for various marketing, branding, and publicity benefits.
Indemnification Clauses. On a limited basis, our contractual agreements contain a clause under which we agree to provide indemnification to the counterparty, most commonly to licensees in connection with licensing arrangements that include our IP. We have also entered into indemnification agreements with our officers, directors, and certain employees, and our certificate of incorporation and bylaws contain similar indemnification obligations. Additionally, and although not a contractual requirement, we have at times elected to defend our licensees from third party IP infringement claims. Since the terms and conditions of our contractual indemnification clauses do not explicitly specify our obligations, we are unable to reasonably estimate the maximum potential exposure for which we could be liable. Furthermore, we have not historically made any payments in connection with any such obligation and believe there to be a remote likelihood that any potential exposure in future periods would be of a material amount. As a result, no amounts have been accrued in our consolidated financial statements with respect to the contingent aspect of these indemnities.

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

The following discussion and analysis should be read in conjunction with our unaudited interim condensed consolidated financial statements and the related notes that appear elsewhere in this Quarterly Report on Form 10-Q. This discussion contains forward-looking statements reflecting our current expectations and are subject to risks and uncertainties, including, but not limited to statements regarding: operating results and underlying measures; demand and acceptance for our technologies and products; market growth opportunities and trends; our plans, strategies and expected opportunities; future competition; our stock repurchase plan; and our dividend policy. Use of words such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential," "continue" or similar expr indicates a forward-looking statement. Actual results may differ materially from those discussed in these forward-looking statements due to a number of factors, including the risks set forth in Part II, Item 1A, "Risk Factors." Such forward-looking statements are based on management's reasonable current assumptions and expectations. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We are under no duty to update any of the forward-looking statements after the date of this Quarterly Report on Form 10-Q to conform our prior statements to new developments or actual results.
Investors and others should note that we disseminate information to the public about our company, our products, services and other matters through various channels, including our website (www.dolby.com), our investor relations website (http://investor.dolby.com), SEC filings, press releases, public conference calls, and webcasts, in order to achieve broad, non-exclusionary distribution of information to the public. We encourage investors and others to review the information we make public through these channels, as such information could be deemed to be material information.

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OVERVIEW

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

OUR STRATEGY

Key elements of our strategy include:

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

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

Delivering Superior Experiences. Our technologies and solutions optimize playback and communications so that users may enjoy richer, clearer, and more immersive sound and sight experiences.

REVENUE GENERATION

We have active licensing arrangements with over 500 electronics product OEMs and software developers. As of December 28, 2018, we had approximately 9,900 issued patents relating to technologies from which we derive a significant portion of our licensing revenue. We have approximately 1,100 trademark registrations throughout the world for a variety of wordmarks, logos, and slogans. These trademarks are an integral part of our technology licensing program as licensees typically place them on their products which incorporate our technologies to inform consumers that they have met our quality specifications.

Licensing

We license our technologies to a range of customers who incorporate them into their products for enhanced audio and imaging functionality whether it be at home, at work, on mobile devices, or at the cinema. Our key technologies are summarized in the table below. As it relates to AAC, HE-AAC, and HEVC, we jointly participate in patent licensing programs with other patent owners.

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

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

Market	Fiscal Quarter Ended December 28, 2018	December 29, 2017	Main Offerings Incorporating Our Technologies
Broadcast	38%	41%	STBs & Televisions
Mobile	13%	22%	Smartphones & Tablets
CE	17%	14%	DMAs, Blu-ray Disc devices, AVRs, Soundbars, DVDs, & HTIBs
PC	9%	8%	Windows and macOS operating systems
Other	23%	15%	Gaming consoles, Auto DVD, Dolby Cinema, Dolby Voice
Total	100%	100%	

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

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

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

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

Integrated Licensing Model. We also license our technologies to software operating system vendors and to certain other OEMs that act as combined implementation and system licensees. These licensees incorporate our technologies in their software used on PCs, in mobile applications, or in ICs they manufacture and incorporate into

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their products. As with the two-tier licensing model, the combined implementation and system licensee pays us an initial licensing fee in addition to royalties as determined by the mix of Dolby technologies used, the nature of the implementations, and the volume of products using our technologies that are shipped, and is subject to the same quality control evaluation process.

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

Collaboration Arrangements.

Dolby Cinema: We partner with exhibitors to deliver a premium cinema offering with Dolby Vision and Dolby Atmos at new and pre-existing venues. We receive a share of revenue at Dolby Cinema sites through box office receipts at the installed theaters, which is recognized as licensing revenue. In some instances, we also receive fixed or minimum amounts upfront, which are accounted for in our products and services revenue.

Dolby Voice: We enter into arrangements with audio and video conferencing providers where, in return for licensing our IP and know-how, we earn revenue based on access to our technology and services. In addition, we sell hardware that facilitates the Dolby conferencing experience, including the Dolby Conference Phone for audio use only, and the Dolby Voice Room, our integrated solution that provides a video camera and a control hub integrated with the Dolby Conference Phone.

Recoveries: Licensing revenue recognized in any given quarter may include non–current quarter revenue from licensees and or settlements with third parties. Within the Results of Operations section of Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations," settlements and non-current quarter revenues are collectively referred to as "recoveries." Such recoveries have become a recurring element of our business and are particularly subject to fluctuation and unpredictability.

Products and Services

We design and manufacture audio and imaging products for the cinema, television, broadcast, and entertainment industries. Distributed in over 90 countries, these products are used in content creation, distribution, and playback to enhance image and sound quality, and improve transmission and playback. We also market and sell products, as discussed above, which help improve the conference call experience when using Dolby Voice. We also earn revenue from Dolby Cinema arrangements that have fixed or minimum amounts, which are included in products sales.

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

Products and services revenue is derived primarily from sales of the following:

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Product		Description
Cinema	Cinema Imaging Products	Digital Cinema Servers used to load, store, decrypt, decode, watermark, and playback digital film files for presentation on digital cinema projectors and software used to encrypt, encode, and package digital media files for distribution.
	Cinema Audio Products	Cinema Processors, amplifiers, and loudspeakers used to decode, render, and optimally playback digital cinema soundtracks including those using Dolby Atmos.
Other	Dolby Conference Phone	An integral hardware component of the Dolby Voice conferencing solution that enhances full-room voice capture, spatial voice separation, and playback.
	Dolby Voice Room	Video conferencing solution for huddle rooms and small conference rooms that combines a camera product with the Dolby Conference Phone.
	Dolby Dimension™	Wireless headphones designed for the home featuring Dolby LifeMix™ technology that allows users the ability to control the volume of sound from their surroundings while also listening to content.
	Other Products	3-D glasses and kits, broadcast hardware and software used to encode, transmit, and decode multiple channels of high quality audio for DTV and HDTV distribution, monitors, and accessibility solutions for hearing and visually impaired consumers.

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EXECUTIVE SUMMARY

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

EXPANDING OUR LEADERSHIP IN AUDIO AND IMAGING ENTERTAINMENT EXPERIENCES

AUDIO AND IMAGING LICENSING

The majority of our licensing revenue is derived from the licensing of audio and imaging technologies for premium entertainment playback. Our audio technologies are primarily comprised of DD+, Dolby Atmos, AC-4, and our AAC and HE-AAC technologies and related patent licensing programs. Our imaging technologies are primarily comprised of Dolby Vision and our AVC and HEVC technologies and related patent licensing programs. The following are highlights of our first quarter of fiscal 2019 and key challenges related to audio and imaging licensing, by market.

Broadcast

Highlights: We have an established presence in developed markets with respect to our DD+ and HE-AAC audio technologies in broadcast services and devices. In recent years, we have expanded our offerings in the broadcast market through the introduction of newer technologies, including our Dolby Atmos and AC-4 audio technologies, Dolby Vision, as well as AVC, and HEVC imaging technologies which we jointly participate in through patent pools. We continue to see new products introduced in the broadcast market that incorporate our technologies, such as TVs that feature the combined experience of Dolby Atmos and Dolby Vision. At CES in January 2019, Panasonic announced that they will be offering TVs with Dolby Atmos and Dolby Vision. Panasonic joins the growing list of TV partners offering both Dolby Atmos and Dolby Vision, such as LG, Sony, TCL, Skyworth, and Hisense.

The distribution of content available in either Dolby Atmos, or Dolby Vision, or the combined format of Dolby Atmos and Dolby Vision also continues to grow with support from leading OTT providers around the world, including Netflix, iTunes, Amazon, Tencent, Rakuten, and iQiYi. Currently, iTunes has over 400 titles available in Dolby Vision.

Key Challenges: Our pursuit of growth and further adoption of our technologies may be impacted by a number of factors. In some emerging growth countries, such as China, we face difficulties enforcing our contractual and IP rights, including instances in which our licensees fail to accurately report the shipment of products using our technologies. We must continue to present compelling reasons for consumers to demand our audio and imaging technologies, including ensuring that there is a breadth of available content in our formats, and such content is being widely distributed. To the extent that OEMs do not incorporate our technologies in current and future products, our revenue could be impacted. Additionally, in the broadcast market, as well as other markets, we also face geopolitical challenges including changes in diplomatic and trade relationships, trade protection measures, and import or export licensing requirements.

Consumer Electronics

Highlights: We have an established presence in the home theater market across devices, such as AVRs, Blu-Ray players, and DMAs, through the inclusion of our DD+ technology and increasingly through the inclusion of our Dolby Atmos technology. These hardware offerings can be paired with a growing array of Dolby enabled content via OTT services and Blu-ray discs. Apple currently supports Dolby Atmos and Dolby Vision on Apple TV 4K and iTunes, while Amazon supports Dolby Atmos and Dolby Vision on the 4K Fire TV and Amazon Prime Video. Many of these devices are available at lower price points, making the technology available to a broader range of consumers.

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

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Mobile

Highlights: We continue to focus on adoption of our technologies across major mobile ecosystems such as Apple, Android, and Amazon. HE-AAC and HEVC are de facto audio and video standards across mobile devices, respectively. We offer these technologies through our patent licensing programs.

Dolby Vision is included in mobile devices such as Apple's iPhone X, iPhone 8, and iPad Pro. There are several Dolby Atmos-enabled mobile devices available in the market from a growing list of partners such as Samsung, Huawei, Amazon, and Lenovo.

Key Challenges: Growth in this market is dependent on several factors. Due to short product life cycles, mobile device OEMs can easily add or remove certain of our technologies from their devices. Our success depends on our ability to address the rapid pace of change in mobile devices, and we must continuously collaborate with mobile device OEMs to incorporate our technologies. Finally, we must continue to support the development and distribution of Dolby content via various ecosystems. To the extent that OEMs do not incorporate our technologies in current and future products, our revenue could be impacted.

Personal Computers

Highlights: DD+ continues to enhance playback in both Mac and Windows operating systems, including native support in their respective Safari and Microsoft Edge browsers. Dolby's presence in these browsers enables us to reach more users through new types of content, including streaming video entertainment. A number of PCs are available with Dolby Atmos from partners such as Huawei, Xiaomi, and Lenovo. Dell recently announced its first PC model to support Dolby Vision, and Lenovo recently expanded their lineup of PCs that support both Dolby Vision and Dolby Atmos.

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

Other

Highlights: DD+ is incorporated in both the Xbox and PlayStation gaming consoles and platforms. In addition, Dolby Atmos is enabled for Xbox One, which enables playback on devices such as Dolby Atmos soundbars and AVRs. In the first quarter of fiscal 2019, Xbox released the first gaming console supporting the combined experience of Dolby Atmos and Dolby Vision. Customers can purchase an OEM gaming headset bundled with Dolby Atmos for Headphones, or an app on the Microsoft app store to enable Dolby Atmos on their headphones.

We also generate revenue from the automotive industry primarily through disc playback devices as well as other elements of the entertainment system.

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

CINEMA AND OTHER

Cinema Products & Services

Highlights: To help enable the playback of content in Dolby formats, we offer a range of servers and audio processors to cinema exhibitors globally. We continue to see adoption of Dolby Atmos by studios, content creators, post-production facilities, and exhibitors. As of the end of first quarter of fiscal 2019, there were over 4,300 Dolby Atmos-enabled screens installed, and over 1,000 Dolby Atmos theatrical titles announced or released.

We also offer a variety of newer cinema products, which include the IMS3000, an integrated imaging and audio server with Dolby Atmos, the Dolby Multichannel Amplifier, and our 3-Axis speaker. These products allow us to offer exhibitors a more complete Dolby Atmos solution that is often more cost effective than what was previously available to them.

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Key Challenges: Demand for our cinema products is dependent upon industry and economic cycles and box office performance generally, along with our ability to develop and introduce new technologies, further our relationships with content creators, and promote new cinematic audio and imaging experiences. A significant portion of our growth opportunity lies in the China market, which is subject to economic risks as well as geo-political risks. To the extent that we do not make progress in these areas, or are faced with pricing pressures or competing technologies, our revenue may be affected.

Dolby Cinema

Highlights: During the first quarter of fiscal 2019, we continued to expand our global presence for Dolby Cinema. At the end of the quarter, we had approximately 190 Dolby Cinema locations in operation, compared to approximately 130 a year ago. We have over 400 Dolby Cinema locations open or committed around the world with more than 20 exhibitor partners. The breadth of motion pictures for Dolby Cinema continues to grow with over 200 theatrical titles with Dolby Vision and Dolby Atmos having been announced or released from every major studio.

Key Challenges: Although the premium large format market for the cinema industry is currently growing, Dolby Cinema is in competition with other existing offerings. Our success depends on our ability to differentiate our offering, deploy new sites in accordance with plans, and attract and retain a global viewing audience. In addition, the success of our Dolby Cinema offering will be tied to the success of motion pictures available at Dolby Cinema locations and box office performance generally.

Dolby Voice

Highlights: In the first quarter of fiscal 2019, we continued to see growth in our newest audio and video conferencing offering, Dolby Voice Room, which is aimed at customers in the growing huddle room space. Currently, we have two Dolby Voice Room partners shipping units, BlueJeans and Highfive. We continue to focus on expanding Dolby Voice's availability to the global market for audio and video conferencing services.

Key Challenges: Our success in this market will depend on the number of service providers and enterprise customers we are able to attract from competing conferencing service providers, the volume of products that we are able to sell, and the volume of usage of the service.

Dolby Dimension

In the first quarter of fiscal 2019, we introduced Dolby Dimension, a wireless headphone that provides consumers with an innovative way to experience shows, movies, and music at home.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We adopted Accounting Standards Update 2014-09, Revenue from Contracts with Customers ("ASC 606") on September 29, 2018 resulting in a material change to the "Revenue Recognition" critical accounting policy in fiscal 2019. In accordance with ASC 606, we estimate and record royalty-based revenue earned from our licensees' shipments in the same period in which those shipments occur, instead of recognizing our royalty-based revenue in the quarter in which it is reported to us by our licensees, which is typically in the quarter after those shipments have occurred. These estimates involve the use of historical data and judgment for several key attributes including industry estimates of expected shipments, the percentage of markets using our technologies, and average sale prices. Generally, our estimates are adjusted in the subsequent quarter by recording a favorable or unfavorable adjustment based on the difference between estimated and actual sales when we receive royalty statements from licensees.

There have been no material changes to the other critical accounting policies and estimates from those included in the 2018 Form 10-K as per Management's Discussion and Analysis of Financial Condition and Results of Operations-Critical Accounting Policies and Estimates included therein.

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RESULTS OF OPERATIONS

For each line item included on our consolidated statements of operations described and analyzed below, the significant factors identified as the leading drivers contributing to the overall fluctuation are presented in descending order of their impact on the overall change (from an absolute value perspective). Note that adjustments related to previously under–reported sales–based royalties as well as unlicensed settlement activity, are collectively referred to as "recoveries."

Revenue and Gross Margin

Licensing

Licensing revenue consists of fees earned from licensing our technologies to customers who incorporate them into their products and services to enable and enhance audio, imaging, and voice capabilities. The technologies that we license are either internally developed, acquired, or licensed from third parties. A significant portion of our licensing revenue pertains to customer-shipment royalties that we recognize based on estimates of our licensees' shipments in the current period. Within the current period, to the extent that shipment data reported by licensees differs from estimates we made and recorded in the prior quarter, we recognize an adjustment to revenue for such difference. As we adopted ASC 606 in the first quarter of fiscal 2019, the current period's licensing revenue includes the first estimated royalty-based revenue earned from our customers. Accordingly, no adjustment pertaining to a prior period's estimate was necessary, as the recast of all prior quarters' revenue was informed by actual statements received prior to the completion of the recast. Our comparison fiscal 2018 quarters as recast under ASC 606 will reflect the impact of certain contract modifications which results in a reduction of our previously reported revenues in those periods.

Our cost of licensing consists mainly of amortization of purchased intangible assets and intangible assets acquired in business combinations, depreciation, third party royalty obligations, and associated fees.

Licensing	Fiscal Quarter Ended		Change	
	December 28, 2018	December 29, 2017 (as adjusted)	$	%
Revenue	$260,279	$270,172	$(9,893)	(4)%
Percentage of total revenue	86%	90%		
Cost of licensing	11,397	9,259	2,138	23%
Gross margin	248,882	260,913	(12,031)	(5)%
Gross margin percentage	96%	97%		

Current Quarter: Q1 2019 vs. Q1 2018

Factor		Revenue	Gross Margin
Mobile	â	Lower revenues from recoveries	
Other	á	Higher revenues from automotive recoveries, Dolby Cinema, and gaming, partially offset by lower revenues from patent licensing	
CE	á	Higher patent licensing, timing of payments, and higher adoption of our technologies in soundbars	ßà No significant fluctuations
PC	á	Higher revenues due to the timing of payments, higher patent licensing, partially offset by lower ASP from decreasing number of PCs with optical disc functionality	
Broadcast	â	Lower recoveries and timing of payments, offset by higher patent licensing	

Products and Services

Products revenue is generated from the sale of audio, imaging, and voice products for the cinema, television broadcast, communications, and consumer products industries. Also in product revenue are amounts relating to Dolby Cinema arrangements that involve fixed or minimum amounts. Cost of products consists of materials, labor, and manufacturing overhead, amortization of certain intangible assets, as well as third party royalty obligations.

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

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Products and Services	Fiscal Quarter Ended		Change	
	December 28, 2018	December 29, 2017 (as adjusted)	$	%
Revenue	$42,097	$29,355	$12,742	43%
Percentage of total revenue	14%	10%		
Cost of products and services	27,232	21,634	5,598	26%
Gross margin	14,865	7,721	7,144	93%
Gross margin percentage	35%	26%		

Current Quarter: Q1 2019 vs. Q1 2018

Factor		Revenue		Gross Margin
Products	á	Higher revenues from Dolby Cinema, cinema equipment, and higher units of Dolby Voice products	á	Improved mix of products and lower excess & obsolete charges
Services	ßà	No significant fluctuations	á	Higher utilization of available capacity

Operating Expenses

Research & Development

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

	Fiscal Quarter Ended		Change	
	December 28, 2018	December 29, 2017	$	%
Research and development	$58,647	$56,444	$2,203	4%
Percentage of total revenue	19%	19%		

Current Quarter: Q1 2019 vs. Q1 2018

Category		Key Drivers
Stock-Based Compensation	á	Higher fair value of award grants
Compensation & Benefits	á	Higher costs related to merit increases across employee base

Sales & Marketing

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

	Fiscal Quarter Ended		Change	
	December 28, 2018	December 29, 2017	$	%
Sales and marketing	$85,602	$70,149	$15,453	22%
Percentage of total revenue	28%	23%		

Current Quarter: Q1 2019 vs. Q1 2018

Category		Key Drivers
Marketing Programs	á	Higher costs related to marketing programs and new product launches
Compensation & Benefits	á	Higher headcount and merit increases across the existing employee base
Stock-Based Compensation	á	Higher fair value of award grants

General & Administrative

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

	Fiscal Quarter Ended		Change	
	December 28, 2018	December 29, 2017	$	%
General and administrative	$50,813	$48,285	$2,528	5%
Percentage of total revenue	17%	16%		

Current Quarter: Q1 2019 vs. Q1 2018

Category	Key Drivers
Legal, Professional, & Consulting	á Higher costs associated with various legal activities, and patent filings
Compensation & Benefits	á Higher headcount and merit increases across the existing employee base

Other Income/Expense

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

	Fiscal Quarter Ended		Change	
	December 28, 2018	December 29, 2017	$	%
Other income/(expense)	$5,583	$2,594	$2,989	115%
Percentage of total revenue	2%	1%		

Current Quarter: Q1 2019 vs. Q1 2018

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

Income Taxes

Our effective tax rate is based on our annual fiscal year results and is affected each period-end by several factors. These include changes in our projected fiscal year results, recurring items such as tax rates and relative income earned in foreign jurisdictions, as well as discrete items such as changes to our uncertain tax positions that may occur in, but are not necessarily consistent, between periods. For additional information related to effective tax rates, see Note 11 “Income Taxes” to our unaudited interim condensed consolidated financial statements.

	Fiscal Quarter Ended	
	December 28, 2018	December 29, 2017 (as adjusted)
Provision for income taxes	$24,104	$(149,705)
Effective tax rate	(32.5)%	155.1%

Current Quarter: Q1 2019 vs. Q1 2018

Factor	Impact On Effective Tax Rate
Enactment of Tax Act	á Lower tax expense due to the large, one-time impact of US tax reform in the prior year, tax credits recognized in the current year related to new regulations, and the reduction of the federal statutory rate

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LIQUIDITY, CAPITAL RESOURCES, AND FINANCIAL CONDITION

Our principal sources of liquidity are cash, cash equivalents, and investments, as well as cash flows from operations. We believe that these sources will be sufficient to satisfy our currently anticipated cash requirements through at least the next twelve months. As of December 28, 2018, we had cash and cash equivalents of $790.8 million, which mainly consisted of cash and highly-liquid money market funds. In addition, we had short and long-term investments of $377.0 million, which consisted primarily of municipal debt securities, certificates of deposit, government bonds, commercial paper, corporate bonds, and U.S. agency securities.

Of our total cash, cash equivalents, and investments held as of December 28, 2018, approximately $560.7 million, or 48%, was held by our foreign subsidiaries. This represented a $16.0 million increase from the approximately $544.7 million that was held by our foreign subsidiaries as of September 28, 2018.

The following table presents selected financial information as of December 28, 2018 and September 28, 2018 (amounts displayed are in thousands):

	December 28, 2018	September 28, 2018 (as adjusted)
Cash and cash equivalents	$ 790,787	$ 918,063
Short-term investments	175,557	178,138
Long-term investments	201,428	187,782
Accounts receivable, net	181,614	200,933
Accounts payable and accrued liabilities	274,902	294,889
Working capital	1,129,218	1,213,305

Capital Expenditures and Uses of Capital

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

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

Shareholder Return

We have returned cash to stockholders through repurchases of Class A common stock under our repurchase program initiated in fiscal 2010 and our quarterly dividend program initiated in fiscal 2015. Refer to Note 8 "Stockholders' Equity & Stock-Based Compensation" to our unaudited interim condensed consolidated financial statements for a summary of dividend payments made under the program during fiscal 2019 and additional information regarding our stock repurchase program.

Stock Repurchase Program. Our stock repurchase program was approved in fiscal 2010, and since then we have completed approximately $1.4 billion of stock repurchases.

Quarterly Dividend Program. During the first quarter of fiscal 2015, we initiated a recurring quarterly cash dividend program for our stockholders. Under the program, current quarterly dividends of $0.19 per share are paid on our Class A and Class B common stock to eligible stockholders of record for each respective dividend record date.

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Cash Flows Analysis

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

Operating Activities

	Fiscal Quarter Ended	
	December 28, 2018	December 29, 2017
Net cash provided by operating activities	$56,952	$ 17,149

Net cash provided by operating activities increased $39.8 million in the fiscal quarter-to-date period ended December 28, 2018 as compared to the fiscal quarter-to-date period ended December 29, 2017, primarily due to the following:

Factor	Impact On Cash Flows
Net Income	á Net loss in Q1 fiscal 2018 due to impact of the Tax Act
Income Taxes, Net	â Lower long term tax liabilities due to the Tax Act

Investing Activities

	Fiscal Quarter Ended	
	December 28, 2018	December 29, 2017
Net cash used in investing activities	$(41,566)	$ (27,093)

Net cash used investing activities was $14.5 million greater in the fiscal quarter-to-date period ended December 28, 2018 as compared to the fiscal quarter-to-date period ended December 29, 2017, primarily due to the following:

Factor	Impact On Cash Flows
Proceeds From Investments	â Lower inflows from the sale & maturity of marketable investment securities
Purchase Of Investments	á Lower outflows for the purchase of marketable investment securities

Financing Activities

	Fiscal Quarter Ended	
	December 28, 2018	December 29, 2017
Net cash used in financing activities	$(138,431)	$ (21,274)

Net cash used in financing activities was $117.2 million greater in the fiscal quarter-to-date period ended December 28, 2018 as compared to the fiscal quarter-to-date period ended December 29, 2017, primarily due to the following:

Factor	Impact On Cash Flows
Common Stock Issuance	â Lower inflows from employee stock option exercises
Share Repurchases	â Higher outflows from increases in common stock repurchases

Off-Balance Sheet Arrangements and Contractual Obligations

Our liquidity is not dependent upon the use of off-balance sheet financing arrangements, and we have not entered into any arrangements that are expected to have a material effect on liquidity or the availability of capital resources. Since the end of our most recent fiscal year ended September 28, 2018, there have been no material changes in either our off-balance sheet financing arrangements or contractual obligations outside the ordinary course of business. For additional details regarding our contractual obligations, see Note 14 “Commitments & Contingencies” to our unaudited interim condensed consolidated financial statements.

Indemnification Clauses

We are party to certain contractual agreements under which we have agreed to provide indemnification of varying scope and duration to the other party relating to our licensed IP. Historically, we have not made any payments for these indemnification obligations and no amounts have been accrued in our consolidated financial statements with respect to these obligations. Since the terms and conditions of the indemnification clauses do not explicitly specify our obligations, we are unable to reasonably estimate the maximum potential exposure for which we could be liable. For additional details regarding indemnification clauses within our contractual agreements, see Note 14 “Commitments & Contingencies” to our unaudited interim condensed consolidated financial statements.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Sensitivity

As of December 28, 2018, we had cash and cash equivalents of $790.8 million, which consisted of cash and highly liquid money market funds. In addition, we had both short and long-term investments of $377.0 million, which consisted primarily of municipal debt securities, corporate bonds, government bonds, and U.S. agency securities. Our investment policy is focused on the preservation of capital and support for our liquidity requirements. Under the policy, we invest in highly rated securities with a minimum credit rating of A- while limiting the amount of credit exposure to any one issuer other than the U.S. government. At December 28, 2018, the weighted-average credit quality of our investment portfolio was AA, with a weighted-average maturity of approximately thirteen months. We do not invest in financial instruments for trading or speculative purposes, nor do we use leveraged financial instruments. We utilize external investment managers who adhere to the guidelines of our investment policy.

The investments within our fixed-income portfolio are subject to fluctuations in interest rates, which could affect our financial position, and to a lesser extent, results of operations. Based on our investment portfolio balance as of December 28, 2018, hypothetical changes in interest rates of 1% and 0.5% would have an impact on the carrying value of our portfolio of approximately $3.8 million and $1.9 million, respectively.

Foreign Currency Exchange Risk

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

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

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

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

instruments, these foreign currency forward contracts are used to reduce the exchange rate risk associated primarily with intercompany receivables and payables. These contracts do not subject us to material balance sheet risk due to exchange rate movements as gains and losses on these derivatives are intended to offset gains and losses on the related receivables and payables for which we have foreign currency exchange rate exposure. As of December 28, 2018 and September 28, 2018, the outstanding derivative instruments had maturities of equal to or less

than 31 days, and the total notional amounts of outstanding contracts were $26.7 million and $25.1 million, respectively. The fair values of these contracts were nominal as of December 28, 2018 and September 28, 2018, and were included within prepaid expenses and other current assets and within accrued liabilities in our consolidated balance sheets. For additional information related to our foreign currency forward contracts, see Note 2 "Summary of Significant Accounting Policies" to our consolidated financial statements.

A sensitivity analysis was performed on all of our foreign currency forward contracts as of December 28, 2018. This sensitivity analysis was based on a modeling technique that measures the hypothetical market value resulting from a 10% shift in the value of exchange rates relative to the U.S. dollar. For these forward contracts, duration modeling was used where hypothetical changes are made to the spot rates of the currency. A 10% increase in the value of the U.S. dollar would lead to an increase in the fair value of our financial instruments by $0.8 million. Conversely, a 10% decrease in the value of the U.S. dollar would result in a decrease in the fair value of these financial instruments by $0.8 million.

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ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

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

Changes in Internal Control Over Financial Reporting

The Company adopted ASC 606, “Revenue from Contracts with Customers” beginning September 29, 2018. As a result of this adoption, we implemented new processes and internal controls related to the estimation of licensing revenues. There were no other changes in our internal control over financial reporting during the fiscal quarter ended December 28, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION
ITEM 1. LEGAL PROCEEDINGS
We are involved in various legal proceedings from time to time arising from the normal course of business activities, including claims of alleged infringement of IP rights, commercial, employment, and other matters. In our opinion, resolution of these pending matters is not expected to have a material adverse impact on our operating results or financial condition. Given the unpredictable nature of legal proceedings, it is possible that an unfavorable resolution of one or more such proceedings could materially affect our future operating results or financial condition in a particular period; however, based on the information known by us as of the date of this filing and the rules and regulations applicable to the preparation of our consolidated financial statements, any such amounts are either immaterial or it is not possible to provide an estimated amount of any such potential losses.
ITEM 1A. RISK FACTORS
The following risk factors and other information included in this Quarterly Report on Form 10-Q should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not currently known to us or that we currently deem less significant may also affect our business operations or financial results. If any of the following risks actually occur, our business, operating results and financial condition could be materially adversely affected.

REVENUE GENERATION

Markets We Target
Dependence on Sales by Licensees. Our licensing businesses depend on OEMs and other licensees to incorporate our technologies into their products. Our license agreements generally do not have minimum purchase commitments, are typically non-exclusive, and frequently do not require incorporation or use of our technologies. Our revenue will decline if our licensees choose not to incorporate our technologies into their products or if they sell fewer products incorporating our technologies.
Trends in Optical Disc Media. For many years, movies have been distributed, purchased, and consumed through optical disc media, such as DVD and Blu-ray Disc. However, the rapid advancement of online and mobile content delivery has resulted in a trend toward movie downloading and streaming services. We expect the shift away from optical disc media to online media content consumption to continue, resulting in decreased revenue from DVD and Blu-ray Disc players.
Additionally, the number of PCs that include optical disc drives has decreased significantly in recent years. Because PC OEMs are required to pay us a higher per-unit royalty for Windows PCs that include optical disc playback functionality than Windows PCs that do not include such functionality, the continued decreasing inclusion of optical disc drives in PCs will result in lower per-unit royalties. Revenue from our PC market depends on several factors, including underlying PC unit shipment growth, the extent to which our technologies are included on computers, through operating systems or otherwise, and the terms of any royalties or other payments we receive.
Mobile Industry Risks. Successful penetration of the mobile device market is important to our future growth. The mobile device market, particularly smartphones and tablets, is characterized by rapidly changing market conditions, frequent product introductions and intense competition based on features and price. Our technologies are not mandated as an industry standard for mobile devices. We must continually convince mobile device OEMs and end users of mobile devices of the value of our technologies. With shorter product lifecycles, it is easier for mobile device OEMs to add or remove our technologies from mobile devices than it is for TV OEMs and other hardware OEMs.
In order to increase the value of our technologies in the mobile market, we have worked with online and mobile media content service providers to encode their content with our technologies, which could affect OEM and software vendor demand for our decoding technologies. However, the online and mobile media content services markets are also characterized by intense competition, evolving industry standards and business and distribution models, disruptive software and hardware technology developments, frequent product and service introductions and short life cycles, and price sensitivity on the part of consumers, all of which may result in downward pressure on pricing or the removal of

our technologies by these providers.

Cinema Industry Risks. Revenue from Dolby Cinema and cinema product sales is subject to the pace of construction or upgrade of screens, the advent of new or competing technologies, the willingness of movie studios to

produce films in our Dolby Atmos and Dolby Vision formats, consumer trends, box-office performance generally, and other events or conditions in the cinema industry. Although we have invested, and expect to continue to invest, a substantial amount of time and resources developing Dolby Cinema and building our partnerships in connection with the launch of Dolby Cinema locations, this is a relatively new market for us and we may not recognize a meaningful amount of revenue from these efforts in the near future, or at all, if new Dolby Cinema locations are not ultimately successful, or if there is a decrease in the performance of our existing locations. Additionally, we have collaborations with multiple exhibitors in foreign markets, including Asia, Europe, and the Middle East, and we may face a number of risks in expanding Dolby Cinema in these and other new international markets. The revenue we receive from Dolby Cinema exhibitors are based on a portion of box-office receipts from the installed theaters, and the timing of such theater installations is dependent upon a number of factors beyond our control. In addition, the success of our Dolby Cinema offering will be tied to the pipeline and success of motion pictures available at Dolby Cinema locations generally. The success of Dolby Cinema depends in large part on our ability to differentiate our offering, deploy new sites in accordance with plans, provide a compelling experience, and attract and retain a viewing audience. In addition, a decrease in our ability to develop and introduce new cinema products and services successfully could affect licensing of our consumer technologies, because the strength of our brand and our ability to use professional product developments to introduce new consumer technologies would be negatively impacted.
Our revenue and associated demand from cinema product sales is dependent upon industry and economic cycles, along with our ability to develop and introduce new technologies, further our relationships with content creators, and promote new cinematic audio and imaging experiences. A significant portion of our growth opportunity lies in the China market, which is subject to economic risks as well as geo-political risks. Furthermore, future growth of our cinema products business also depends upon new theater construction and entering into an equipment replacement cycle whereby previously purchased cinema products are upgraded or replaced. To the extent that we do not make progress in these areas, or are faced with pricing pressures, competing technologies, or other global macroeconomic challenges our revenue may be adversely impacted.

Customers and Distributors
Loss of Key Licensee or Customer. A small number of our licensees or customers may represent a significant percentage of our licensing, products, or services revenue. Although we generally have agreements with these licensees or customers, these agreements typically do not require any minimum purchases or minimum royalty fees and do not prohibit licensees from using competing technologies or customers from purchasing products and services from competitors. Customer demand for our technologies and products can shift quickly as many of our markets are rapidly evolving. As a result of our increased presence across consumer electronic device markets where our technologies are not mandated and are subject to significant competition, the risk that a large licensee may reduce or eliminate its use of our technologies has increased.
Reliance on Semiconductor Manufacturers. Our licensing revenue from system licensees depends in large part upon the availability of ICs that implement our technologies. IC manufacturers incorporate our technologies into these ICs, which are then incorporated in consumer entertainment products. We do not manufacture these ICs, but rather depend on IC manufacturers to develop, produce, and then sell them to system licensees in accordance with their agreements. We do not control the IC manufacturers' decisions on whether or not to incorporate our technologies into their ICs, and we do not control their product development or commercialization efforts.
Consumer Spending Weakness. Weakness in general economic conditions may suppress consumer demand in our markets. Many of the products in which our technologies are incorporated are discretionary goods, such as PCs, TVs, STBs, Blu-ray Disc players, video game consoles, AVRs, mobile devices, in-car entertainment systems, and home-theater systems. Weakness in general economic conditions may also lead to licensees and customers becoming delinquent on their obligations to us or being unable to pay, resulting in a higher level of write-offs. Economic conditions may increase underreporting and non-reporting of royalty-bearing revenue by our licensees as well as increase the unauthorized use of our technologies.

Reliance on Distributors. We rely significantly on a global network of independent, regional distributors to market and distribute our cinema and broadcast products. Our distributor arrangements are non-exclusive and our distributors are not obligated to buy our products and can represent competing products, and they may be unwilling or unable to dedicate the resources necessary to promote our portfolio of products. Our distributors could retain product channel inventory levels that exceed future anticipated sales, which could affect our future sales to those distributors. In addition, failure of our distributors to adhere to our policies designed to promote compliance with global anticorruption laws, export controls, and local laws, could subject us to criminal or civil penalties and stockholder

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litigation.

Marketing and Branding

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

Industry Standards

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

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

Participants May Choose Among Alternative Technologies within Standards. Even when a standards-setting organization incorporates our technologies in an industry standard for a particular market, our technologies may not be the sole technologies adopted for that market. Furthermore, different standards may be adopted for different markets. Our operating results depend upon participants in that market choosing to adopt our technologies instead of competitive technologies that also may be acceptable under such standard. For example, the continued growth of our revenue from the broadcast market will depend upon both the continued global adoption of digital television generally, including in emerging markets, and the choice to use our technologies where it is one of several accepted industry standards.

Being Part of a Standard May Limit Our Licensing Practices. When a standards-setting organization mandates our technologies, we generally must agree to license such technologies on a fair, reasonable, and non-discriminatory basis, which could limit our control over the use of these technologies. In these situations, we must often limit the royalty rates we charge for these technologies, and we may be unable to limit to whom we license such technologies or to restrict many terms of the license. We have in the past, and may in the future, be subject to claims that our licensing of industry standard technologies may not conform to the requirements of the standards-setting organization. Allegations such as these could be asserted in private actions seeking monetary damages and injunctive relief, or in regulatory

actions. Claimants in such cases could seek to restrict or change our licensing practices or our ability to license our technologies.

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

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- Royalty reports including positive or negative corrective adjustments;
- Retroactive royalties that cover extended periods of time; and
- Timing of revenue recognition under licensing agreements and other contractual arrangements, including recognition of unusually large amounts of revenue in any given quarter.

Inaccurate Licensee Royalty Reporting. We generate licensing revenue primarily from OEMs who license our technologies and incorporate those technologies into their products. Our license agreements generally obligate our licensees to pay us a specified royalty for every product they ship that incorporates our technologies, and we rely on our licensees to report their shipments accurately. However, we have difficulty independently determining whether our licensees are reporting shipments accurately, particularly with respect to software incorporating our technologies because unauthorized copies of such software can be made relatively easily. A third party may disagree with our interpretation of the terms of a license agreement or, as a result of an audit, a third party could challenge the accuracy of our calculation. We are regularly involved in discussions with third party technology licensees regarding license terms. Most of our license agreements permit us to audit our licensees' records, and we routinely exercise these rights, but audits are generally expensive, time-consuming, and potentially detrimental to our ongoing business relationships with our licensees. In the past, licensees have understated or failed to report the number of products incorporating our technologies that they shipped, and we have not been able to collect and recognize revenue to which we were entitled. We expect that we will continue to experience understatement and non-reporting of royalties by our licensees. We have been able to obtain certain recovery payments from licensees (either in the form of back payments or settlements), and such recoveries have become a recurring element of our business; however, we are unable to predict with certainty the revenue that we may recover in the future or our ability to continue to obtain such recoveries at all.
Royalties We Owe Others. In some cases, the products we sell and the technologies we license to our customers include IP that we have licensed from third parties. Our agreements with these third parties generally require us to pay them royalties for that use, and give the third parties the right to audit our calculation of those royalties. A third party may disagree with our interpretation of the terms of a license agreement or, as a result of an audit, a third party could challenge the accuracy of our calculation. We are regularly involved in discussions with third party technology licensors regarding license terms. A successful challenge by a third party could result in the termination of a license agreement or an increase in the amount of royalties we have to pay to the third party.
Estimation of sales-based royalties. As disclosed in Note 2 "Summary of Significant Accounting Policies," beginning in the first quarter of fiscal 2019, we adopted ASC 606. The transition from ASC 605 to ASC 606 most significantly impacts two key areas of Dolby's revenue accounting, as described below.

The first topic related to ASC 606 that will significantly impact us involves multi-year contracts. Most of our licensing arrangements with customers currently involve multi-year contracts, and in the past under ASC 605, it would have been unusual for all revenue from a multi-year contract to be recognized upfront (i.e., upon execution of the contract). Under ASC 606, the accounting framework has shifted, and now, certain terms and conditions (such as "minimum volume commitments") are more likely to result in upfront revenue recognition.

The second topic related to ASC 606 that will significantly impact us involves our estimation of shipments on which we generate sales–based royalties. Under ASC 606, we recognize a material portion of our licensing revenue based on our estimate of shipments to which we expect our licensees to submit royalty statements. Upon receipt of actual reporting of sales based royalties that we estimated previously, we record a favorable or unfavorable adjustment based on the difference between estimated and actual sales. The change may cause more volatility in our quarterly figures because of the estimation process and the corresponding true-up adjustments, which we plan to disclose each quarter as appropriate.

Such changes to our reporting practices could significantly affect our results of operations to the extent that actual revenues differ significantly from estimated revenues, or that we are required to accelerate recognition of revenue under certain arrangements, potentially causing the amount of revenue we recognize to vary materially from quarter to

quarter. While the adoption of the new standard will not change the cash flows or total revenues we receive from our contracts with customers, the new standard could result in changes to the timing of our reported revenue and income, which in turn could cause volatility in the price of our common stock.

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TECHNOLOGY TRENDS AND DEVELOPMENTS

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

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

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

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

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

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

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

INTELLECTUAL PROPERTY

Our business is dependent upon protecting our patents, trademarks, trade secrets, copyrights, and other IP rights, the loss or expiration of which may significantly impact our results of operations and financial condition. Effective IP rights protection, however, may not be available under the laws of every country in which our products and services and those of our licensees are distributed. The efforts we have taken to protect our proprietary rights may not be sufficient or effective. We also seek to maintain select IP as trade secrets, and third parties or our employees could intentionally or accidentally compromise the IP that we maintain as trade secrets. In addition, protecting our IP rights

is costly and time consuming. We have taken steps in the past to enforce our IP rights and expect to do so in the future. However, it may not be practicable or cost effective for us to enforce our IP rights fully, particularly in some countries or where the initiation of a claim might harm our business relationships.

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

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

Patent Royalties and Expiration. Many of the technologies that we license to our system licensees are covered by patents, and the licensing revenue that we receive from those licenses depends in large part upon the life of such patents. In general, our agreements with our licensees require them to pay us a full royalty with respect to a particular technology only until the last patent covering that technology expires in a particular country. As of December 28, 2018, we had approximately 9,900 issued patents in addition to approximately 4,100 pending patent applications in more than 100 jurisdictions throughout the world. Our currently issued patents expire at various times through September 2043.

We seek to mitigate this risk in a variety of ways. We regularly look for opportunities to expand our patent portfolio through organic development and acquisitions. We develop proprietary technologies to replace licensing revenue from technologies covered by expiring patents with licensing revenue supported by patents with a longer remaining life. And we develop and license our technologies in a manner designed to minimize the chance that a system licensee would develop competing technologies that do not include any Dolby IP.

In the case of our patent coverage related to DD, some of our relevant patents have expired, but others continue to apply. DD is our solution that includes technology necessary to implement AC-3 as it has been updated over time. We have continued to innovate and develop intellectual property to support the standard and its implementation. Our customers use our DD implementation for quality, reliability, and performance, even in locations where we have not had applicable patent coverage. While in the past, we derived a significant portion of our licensing revenue from our DD technologies, this is no longer the case as revenues attributed to DD technologies have declined and are expected to continue to decline.

Many of our partners have adopted newer generations of our offerings such as DD+, and the range of products incorporating DD solutions is now limited to DVD players (but not Blu-ray players) and some TVs, STBs and soundbars. To continue to be successful in our audio licensing business, we must keep transitioning our DD licensees to our newer technologies, including our DD+ and Dolby AC-4 technologies.

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

Intellectual Property Litigation. Companies in the technology and entertainment industries frequently engage in litigation based on allegations of infringement or other violations of IP rights. We have faced such claims in the past, and we expect to face similar claims in the future. Any IP claims, with or without merit, could be time-consuming, expensive to litigate or settle, and could divert management resources and attention. In the past, we have settled claims relating to infringement allegations and agreed to make payments in connection with such settlements. An adverse determination in any IP claim could require that we pay damages or stop using technologies found to be in violation of a third party’s rights and could prevent us from offering our products and services to others. In order to avoid these restrictions, we may have to seek a license for the technology, which may not be available on reasonable terms or at all. Licensors could also require us to pay significant royalties. As a result, we may be required to develop alternative non-infringing technologies, which could require significant effort and expense. If we cannot license or develop

technologies for any aspects of our business found to be infringing, we may be forced to limit our product and service offerings and may be unable to compete effectively.

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

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

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

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

OPERATIONS

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

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

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

Production Processes and Production. Production difficulties or inefficiencies can interrupt production, resulting in our inability to deliver products on time in a cost effective manner, which could harm our competitive position. While

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

Data Security. We rely on information technology systems in the conduct of our business, including systems designed and managed by third parties. Many of these systems contain sensitive and confidential information, including our trade secrets and proprietary business information, and personal data, as well as content and information of or pertaining to our customers, suppliers and business partners. The secure maintenance of this information is critical to our operations and business strategy. Increasingly, companies are subject to a wide variety of attacks on their networks and systems on an ongoing basis. Our information technology and infrastructure may be vulnerable to penetration or attacks by hackers, malware, software bugs or other technical malfunctions, or other disruptions. If we use a vendor that stores information as part of their service or product offerings, we assess the security of such services prior to using the service. Nevertheless, our sensitive, confidential or proprietary information may be misappropriated by that vendor or others who may inappropriately access the vendor’s system.

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

A variety of provincial, state, national, and international laws and regulations apply to the collection, use, retention, protection, disclosure, transfer and other processing of personal data. These laws and regulations are evolving and may result in ever-increasing regulatory and public scrutiny and escalating levels of enforcement and sanctions. Our actual or perceived failure to adequately comply with applicable laws and regulations relating to privacy and data protection could result in regulatory fines, investigations and enforcement actions, penalties and other liabilities, claims for damages by affected individuals, and damage to our reputation, any of which could have a material adverse effect on our operations, financial performance and business.

Fluctuations in Foreign Currency Exchange Rates. We earn revenues, pay expenses, own assets and incur liabilities in foreign countries using several currencies other than the U.S. dollar. As a result, we face exposure to adverse movements in currency exchange rates as the financial results of our international operations are translated from local currency into U.S. dollars upon consolidation. The majority of our revenue generated from international markets is denominated in U.S. dollars, while the operating expenses of our foreign subsidiaries are predominantly denominated in local currencies. Therefore, our operating expenses will increase when the U.S. dollar weakens against the local currency and decrease when the U.S. dollar strengthens against the local currency. Additionally, foreign exchange rate fluctuations on transactions denominated in currencies other than the functional currency result

in gains or losses that are reflected in our consolidated statements of operations. Additional risks related to fluctuations in foreign currency exchange rates are described in the Foreign Currency Exchange Risk section of Part I, Item 3 "Quantitative and Qualitative Disclosures About Market Risk."

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

COMPETITION

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

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

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

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

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

affect our operating results.

Competition for Employees. In order to be successful, we must attract, develop, and retain employees, including employees to work on our growth initiatives where our current employees may lack experience with the business models and markets we are pursuing. Competition for experienced employees in our markets can be intense. In order to attract and retain employees, we must provide a competitive compensation package, including cash and equity

compensation. Our equity awards include stock options and restricted stock units. The future value of these awards is uncertain, and depends on our stock price performance over time. In order for our compensation packages to be viewed as competitive, prospective employees must perceive our equity awards to be a valuable benefit.

STRATEGIC ACTIVITIES

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

- Content creators, such as film directors, studios, mobile and online content producers, and music producers;
- Content distributors, such as studios, film exhibitors, broadcasters, operators, and OTT video service providers and video game publishers;
- Leading companies in the audio and video conferencing markets; and
- Device manufacturers.

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

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

We face various risks in integrating acquired businesses, including:

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

LEGAL AND REGULATORY COMPLIANCE

International Business and Compliance. We are dependent on international sales for a substantial amount of our total revenue. Approximately 60% and 74% of our revenue was derived outside of the U.S. in the fiscal quarter

December 28, 2018 and December 29, 2017, respectively. We are subject to a number of risks related to conducting business internationally, including:

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- U.S. and foreign government trade restrictions, including those which may impose restrictions on importation of programming, technology, or components to or from the U.S.;
- U.S. government trade restrictions, including those which may impose restrictions, including prohibitions, on the exportation, reexportation, sale, shipment or other transfer of programming, technology, components, and/or services to foreign persons;
- Changes in diplomatic and trade relationships, including new tariffs, trade protection measures, import or export licensing requirements, trade embargoes and other trade barriers;
- Tariffs imposed by the U.S. on goods from other countries and tariffs imposed by other countries on U.S. goods, including the tariffs imposed in July and September 2018 by the U.S. government on various imports from China and by the Chinese government on certain U.S. goods, the scope and duration of which remain uncertain;
- Compliance with applicable international laws and regulations, including antitrust and other competition laws, that may change unexpectedly, differ, or conflict with laws in other countries where we conduct business, or are otherwise not harmonized with one another;
- Foreign government taxes, regulations, and permit requirements, including foreign taxes that we may not be able to offset against taxes imposed upon us in the U.S., and other laws limiting our ability to repatriate funds to the U.S.;
- Potential adverse changes in the political and/or economic stability of foreign countries or in their diplomatic relations with the U.S.;
- Difficulty in establishing, staffing, and managing foreign operations, including but not limited to restrictions on the ability to obtain or retain licenses required for operation, relationships with local labor unions and works councils, investment restrictions and/or requirements, and restrictions on foreign ownership of subsidiaries;
- Adverse fluctuations in foreign currency exchange rates and interest rates, including risks related to any interest rate swap or other hedging activities we undertake;
- Poor recognition of IP rights;
- Difficulties in enforcing contractual rights;
- Multi-jurisdictional data protection and privacy laws, including the European Union's General Data Protection Regulation and restrictions on transferring personally identifiable information outside of a jurisdiction;
- Political or social instability in the U.K. and Europe (including but not limited to uncertainty resulting from the Brexit referendum in the U.K.) and in Russia, the Middle East, North Africa, Latin America and other emerging markets;
- Uncertainties related to any geopolitical, economic and regulatory effects or changes due to the current political climate in the U.S.;
- Natural disasters, war or events of terrorism; and
- The global macroeconomic environment and potential slowing of key markets we serve, such as the current economic challenges in China.

Any or all of these factors may impact the demand for, and profitability of, our technologies and products, as well as our customers' products that incorporate our technologies.

Certain foreign governments, particularly in China, have advanced arguments under their competition laws that exert downward pressure on royalties for IP. The regulatory enforcement activities in such jurisdictions can be unpredictable, in some cases because these jurisdictions have only recently implemented competition laws. From time to time, we are the subject of requests for information, market conduct examinations, inquires or investigations by industry groups and/or regulatory agencies in these jurisdictions. For instance, in October 2018, the Korean Fair Trade Commission (“KFTC”) requested information relating to the company’s business practices in Korea, and we are cooperating with such request. In the event that we are involved in significant disputes or are the subject of a formal action by a regulatory agency, our results could be negatively impacted and we could be exposed to costly and time-consuming legal proceedings.

In many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by U.S. regulations applicable to us such as the FCPA and U.S. export controls. Although

we implement policies and procedures designed to ensure compliance with the FCPA and U.S. export controls, there can be no assurance that all of our employees, distributors, dealers, and agents will not take actions in violation of our policies or these regulations.

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

Conflict Minerals. SEC rules require the disclosure of the use of tantalum, tin, tungsten, and gold (commonly referred to as "conflict minerals") that are sourced from the Democratic Republic of the Congo and surrounding countries. This requirement could affect the sourcing, availability and pricing of materials used in our products as well as the companies we use to manufacture our products. In circumstances where sources of conflict minerals from the Democratic Republic of the Congo or surrounding countries are not validated as conflict free, Dolby may take actions to change materials, designs or manufacturers to reduce the possibility that Dolby's contracts to manufacture products that contain conflict minerals finance or benefit local armed groups in the region. The SEC disclosure requirements could adversely affect the sourcing, supply and pricing of materials used in our products. As there may be only a limited number of suppliers that can certify to us that they are offering “conflict free” conflict minerals, we cannot be sure that we will be able to obtain necessary conflict minerals from such suppliers in sufficient quantities or at competitive prices. These actions could also add engineering and other costs in connection with the manufacturing of our products.

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

Tax Rates and Liabilities. We are a U.S. multi-national company that is subject to tax in multiple U.S. and foreign jurisdictions. We must use judgment to determine our worldwide tax provision. We receive significant tax benefits from a portion of our foreign sales, and realizability of these benefits are contingent upon existing current tax laws and regulations in the U.S. and countries where we operate. The following could materially affect our effective tax rate:

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

The recent U.S. tax law changes enacted through the Tax Act require us to exercise significant judgment in interpreting its provisions. As we evaluate the full impact of current and future guidance that is introduced, our results may materially differ from previous estimates, and those differences may materially affect our financial position. In addition, the Tax Act includes certain international provisions that are effective for us beginning in fiscal 2019. The application of the Tax Act and any changes that we make to our corporate tax structure could adversely affect our tax rate and cash flow in future years.

The Organization of Economic Cooperation and Development (“OECD”), an international association of many countries including the United States, has made changes to many long-standing transfer pricing and cross-border taxation rules. In addition, the European Union and its European Commission are proposing model legislation and investigating

companies that might be in violation of European Union competition rules against unjustified state aid. Further, the OECD, European Union and European Commission could conceivably make competing jurisdictional claims over the taxes owed on earnings of multinational companies in their respective countries or regions. To the extent these actions take place in the countries that we operate, it is possible that in the future, these efforts may increase uncertainty and have an adverse impact on our effective tax rates or operations.

We are subject to the periodic examination of our income tax returns by tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes, but an adverse decision by tax authorities exceeding our reserves, could significantly impact our financial results.

STOCK-RELATED ISSUES

Controlling Stockholder. At December 28, 2018, the Dolby family and their affiliates owned 2,055,100 shares of our Class A common stock and 38,146,233 shares of our Class B common stock. As of December 28, 2018, the Dolby family and their affiliates had voting power of 99.8% of our outstanding Class B common stock, which combined with their shares of our Class A common stock, represented 85.9% of the combined voting power of our outstanding Class A and Class B common stock. Under our certificate of incorporation, holders of Class B common stock are entitled to ten votes per share while holders of Class A common stock are entitled to one vote per share. Generally, shares of Class B common stock automatically convert into shares of Class A common stock upon transfer of such Class B common stock, other than transfers to certain specified persons and entities, including the spouse and descendants of Ray Dolby and the spouses and domestic partners of such descendants.

As a result of this dual class structure, the Dolby family and their affiliates will, for the foreseeable future, have significant influence over our management and affairs, and will be able to control virtually all matters requiring stockholder approval, including the election of directors and significant corporate transactions such as mergers or other sales of our company or assets, even if they come to own considerably less than 50% of the total number of outstanding shares of our Class A and Class B common stock. Absent a transfer of Class B common stock that would trigger an automatic conversion as described above, there is no threshold or time deadline at which the shares of Class B common stock will automatically convert into shares of Class A common stock.

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

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

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

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

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

Sales of Unregistered Securities

None.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Our Board of Directors announced a $250.0 million stock repurchase program on November 3, 2009. The program, which has no expiration date, approved the repurchase of shares of our Class A common stock, $0.001 par value per share. The authorized maximum was subsequently increased by $300.0 million, $250.0 million, $100.0 million, $200.0 million, $200.0 million, and $350.0 million as announced on July 27, 2010, August 4, 2011, February 8, 2012, October 23, 2014, January 25, 2017, and July 25, 2018, respectively. Stock repurchases under this program may be made through open market transactions, negotiated purchases, or otherwise, at times and in such amounts as we consider appropriate.

The following table provides information regarding our share repurchases made under the program during the first quarter of fiscal 2019:

Repurchase Activity	Total Shares Repurchased	Average Price Paid Per Share (1)	Total Shares Purchased As Part Of Publicly Announced Programs	Remaining Authorized Share Repurchases (2)
September 29, 2018 - October 26, 2018	—	—	—	$351.5 million
October 27, 2018 - November 23, 2018	1,308,026	68.38	1,308,026	$262.1 million
November 24, 2018 - December 28, 2018	334,081	69.17	334,081	$239.0 million
Total	1,642,107		1,642,107	

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

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

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ITEM 6. EXHIBITS

Exhibit Number	Description	Incorporated By Reference Herein			Provided Herewith
		Form	File Number	Date	
10.1*	2019 Dolby Executive Bonus Plan	Form 8-K	001-32431	November 16, 2018	
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act				X
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act				X
32.1+	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act				X
101.INS	XBRL Instance Document				X
101.SCH	XBRL Taxonomy Extension Schema Document				X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document				X
101.DEF	XBRL Extension Definition				X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document				X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document				X

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

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SIGNATURES

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

Date: January 31, 2019

DOLBY LABORATORIES, INC.

By: /S/ LEWIS CHEW

Lewis Chew

Executive Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)