

Dolby Laboratories, Inc.
Form 10-Q
January 31, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Quarterly Period Ended December 28, 2007

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
(State or other jurisdiction of incorporation or organization)

100 Potrero Avenue

San Francisco, CA

90-0199783
(I.R.S. Employer Identification No.)

94103-4813

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(Address of principal executive offices)

(415) 558-0200

(Zip Code)

(Registrant's telephone number, including area code)

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

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

On January 17, 2008 the registrant had 50,187,528 shares of Class A common stock, par value \$0.001 per share, and 60,858,768 shares of Class B common stock, par value \$0.001 per share, outstanding.

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1 CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****DOLBY LABORATORIES, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS***(in thousands)*

	September 28, 2007	December 28, 2007 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 368,467	\$ 280,246
Short-term investments	231,217	200,727
Accounts receivable, net of allowance	28,165	37,955
Inventories	14,883	14,585
Deferred income taxes	73,686	76,086
Prepaid expenses and other current assets	17,000	19,585
Total current assets	733,418	629,184
Property, plant and equipment, net	85,552	85,079
Intangible assets, net	35,389	93,672
Goodwill	39,364	258,967
Long-term investments	73,224	29,301
Non-current deferred income taxes	12,393	17,887
Other non-current assets	12,357	12,541
Total assets	\$ 991,697	\$ 1,126,631
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 119,068	\$ 138,488
Income taxes payable	9,051	15,155
Current portion of debt	1,563	1,571
Deferred revenue	13,522	18,358
Total current liabilities	143,204	173,572
Long-term debt	9,691	9,209
Long-term deferred revenue	5,073	4,932
Deferred income tax liability		17,694
Other non-current liabilities	14,294	32,015
Total liabilities	172,262	237,422
Controlling interest	22,279	22,031
Stockholders' equity:		
Class A common stock	49	50
Class B common stock	61	61
Additional paid-in capital	375,830	392,999
Retained earnings	409,749	457,710
Accumulated other comprehensive income	11,467	16,358

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Total stockholders' equity	797,156	867,178
Total liabilities and stockholders' equity	\$ 991,697	\$ 1,126,631

See accompanying notes to unaudited condensed consolidated financial statements

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	Fiscal Quarter Ended	
	December 29, 2006	December 28, 2007
	(unaudited)	
Revenue:		
Licensing	\$ 82,375	\$ 122,430
Product sales	15,210	20,010
Services	6,857	7,787
Total revenue	104,442	150,227
Cost of revenue:		
Cost of licensing	7,660	3,263
Cost of product sales (1)	8,686	11,648
Cost of services (1)	2,683	3,055
Total cost of revenue	19,029	17,966
Gross margin	85,413	132,261
Operating expenses:		
Selling, general and administrative (1)	37,311	50,986
Research and development (1)	8,836	13,907
Total operating expenses	46,147	64,893
Operating income	39,266	67,368
Interest income	6,086	5,821
Interest expense	(453)	(363)
Other (expense), net	(206)	(254)
Income before provision for income taxes and controlling interest	44,693	72,572
Provision for income taxes	14,452	24,607
Income before controlling interest	30,241	47,965
Controlling interest in net income, net of tax	(348)	(292)
Net income	\$ 29,893	\$ 47,673
Earnings per share (basic)	\$ 0.28	\$ 0.43
Earnings per share (diluted)	\$ 0.27	\$ 0.42
Weighted-average shares outstanding (basic)	107,947	110,592
Weighted-average shares outstanding (diluted)	112,767	114,700
Expense for rent payable to related party included in selling, general and administrative expenses	337	340
(1) Stock-based compensation included above was classified as follows:		
Cost of product sales	218	241
Cost of services	37	40

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Selling, general and administrative	3,859	4,295
Research and development	747	890

See accompanying notes to unaudited condensed consolidated financial statements

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	Fiscal Quarter Ended	
	December 29, 2006	December 28, 2007
	(unaudited)	
Operating activities:		
Net income	\$ 29,893	\$ 47,673
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	3,331	5,246
Stock-based compensation expense	4,861	5,466
Accretion of discounts on debt securities	(107)	(115)
Tax benefit from exercise of stock options	9,131	6,412
Excess tax benefit from exercise of stock options	(8,567)	(6,309)
Provision for doubtful accounts	54	192
Deferred income taxes	675	(7,035)
Other non-cash items affecting net income	532	229
Changes in operating assets and liabilities:		
Accounts receivable	6,860	(8,123)
Inventories	(265)	(462)
Prepaid expenses and other assets	(2,035)	(300)
Accounts payable and accrued liabilities	1,411	10,425
Income taxes, net	415	17,664
Deferred revenue	1,040	4,678
Other non-current liabilities	(64)	625
Cash flows from operating activities	47,165	76,266
Investing activities:		
Purchases of available-for-sale securities	(123,790)	(66,255)
Proceeds from sale of available-for-sale securities	61,112	140,610
Purchases of property, plant and equipment	(1,798)	(1,477)
Acquisitions, net of cash acquired		(248,715)
Other investing activities	54	7
Cash flows from investing activities	(64,422)	(175,830)
Financing activities:		
Payments on debt	(359)	(379)
Proceeds from the exercise of stock options	3,743	5,134
Issuance of Class A common stock (ESPP)	479	505
Excess tax benefit from exercise of stock options	8,567	6,309
Cash flows from financing activities	12,430	11,569
Effect of foreign exchange rate changes on cash and cash equivalents	2,095	(226)
Net decrease in cash and cash equivalents	(2,732)	(88,221)
Cash and cash equivalents at beginning of period	363,537	368,467

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Cash and cash equivalents at end of period	\$ 360,805	\$ 280,246
Supplemental disclosure:		
Cash paid for income taxes	\$ 4,232	\$ 7,063
Cash paid for interest	295	209

See accompanying notes to unaudited condensed consolidated financial statements

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DOLBY LABORATORIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Summary of Business and Significant Accounting Policies

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

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

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

Unaudited Interim Financial Statements

The accompanying interim condensed consolidated balance sheets as of September 28, 2007 and December 28, 2007 and the condensed consolidated statements of operations and cash flows for the fiscal quarters ended December 29, 2006 and December 28, 2007 are unaudited. These interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). In our opinion, the interim consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements for the year ended September 28, 2007 and include all adjustments necessary for fair presentation. The results for the fiscal quarter ended December 28, 2007 are not necessarily indicative of the results to be expected for any subsequent quarterly or annual financial period, including the fiscal year ending September 26, 2008.

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

Use of Estimates

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

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

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

	Fiscal Quarter Ended	
	December 29, 2006	December 28, 2007
(in thousands, except per share amounts)		
Numerator:		
Net income	\$ 29,893	\$ 47,673
Denominator:		
Weighted-average shares outstanding (basic)	107,947	110,592
Potential common shares from options to purchase Class A common stock and Class B common stock	4,820	4,108
Weighted-average shares outstanding (diluted)	112,767	114,700
Earnings per share (basic)	\$ 0.28	\$ 0.43
Earnings per share (diluted)	\$ 0.27	\$ 0.42

A total of 948,353 and 525,538 options were excluded from the calculation of potential common shares for the first quarter of fiscal 2007 and the first quarter of fiscal 2008, respectively, because their inclusion would have been anti-dilutive.

Cash and Cash Equivalents

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

Investments