UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 25, 2010

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	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
100 Potrero Avenue	
San Francisco, CA	**94103-4813**
(Address of principal executive offices)	**(Zip Code)**

(415) 558-0200

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted 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 and post such files). Yes x No ¨

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

Large accelerated filer x	Accelerated filer ¨
Non accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

On July 15, 2010 the registrant had 53,138,401 shares of Class A common stock, par value $0.001 per share, and 59,590,126 shares of Class B common stock, par value $0.001 per share, outstanding.

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DOLBY LABORATORIES, INC.

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PART I FINANCIAL INFORMATION

ITEM 1 CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

DOLBY LABORATORIES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	September 25, 2009	June 25, 2010 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 451,678	$ 519,098
Short-term investments	283,808	303,771
Accounts receivable, net	22,981	47,650
Inventories	12,975	16,989
Deferred taxes	83,438	101,723
Prepaid expenses and other current assets	45,958	23,007
Total current assets	900,838	1,012,238
Long-term investments	205,938	222,664
Property, plant, and equipment, net	92,178	95,486
Intangible assets, net	82,035	69,322
Goodwill	261,121	258,853
Deferred taxes	23,755	29,272
Other non-current assets	15,450	15,351
Total assets	**$ 1,581,315**	**$ 1,703,186**
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 12,921	$ 13,284
Accrued liabilities	100,901	126,775
Income taxes payable	3,934	17,841
Current portion of long-term debt	1,624	1,675
Deferred revenue	37,204	12,041
Total current liabilities	156,584	171,616
Long-term debt, net of current portion	5,825	4,470
Long-term deferred revenue	10,759	11,758
Deferred taxes	13,573	12,919
Other non-current liabilities	31,469	29,316
Total liabilities	218,210	230,079
Stockholders equity:		
Class A common stock	53	53
Class B common stock	60	60
Additional paid-in capital	478,979	375,241
Retained earnings	852,475	1,070,911
Accumulated other comprehensive income	9,541	4,558

Total stockholders equity Dolby Laboratories, Inc.	1,341,108	1,450,823
Controlling interest	21,997	22,284
Total stockholders equity	1,363,105	1,473,107
Total liabilities and stockholders equity	**$ 1,581,315**	**$ 1,703,186**

See accompanying notes to condensed consolidated financial statements

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DOLBY LABORATORIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 26, 2009	June 25, 2010	June 26, 2009	June 25, 2010
	(unaudited)			
Revenue:				
Licensing	$ 142,141	$ 170,326	$ 456,076	$ 532,045
Products	21,790	52,651	75,744	140,147
Services	7,313	7,292	23,806	22,714
Total revenue	171,244	230,269	555,626	694,906
Cost of revenue:				
Cost of licensing	3,362	3,719	11,223	13,282
Cost of products (1)	13,142	23,336	46,776	72,042
Cost of services (1)	3,246	3,407	9,546	10,554
Gain from amended patent licensing agreement			(20,041)	
Impairment of products provided under operating leases		9,594		9,594
Total cost of revenue	19,750	40,056	47,504	105,472
Gross margin	151,494	190,213	508,122	589,434
Operating expenses:				
Research and development (1)	20,871	27,513	59,831	75,561
Sales and marketing (1)	24,403	36,527	68,963	93,635
General and administrative (1)	26,523	29,165	76,912	86,677
Restructuring charges, net	1,278	1,068	4,012	1,371
Total operating expenses	73,075	94,273	209,718	257,244
Operating income	78,419	95,940	298,404	332,190
Interest income	2,431	1,879	9,183	5,665
Interest expense	(187)	(392)	(599)	(589)
Other (expenses)/income, net	(1,644)	655	(2,790)	1,124
Income before provision for income taxes	79,019	98,082	304,198	338,390
Provision for income taxes	(27,502)	(34,394)	(104,555)	(118,890)
Net income including controlling interest	51,517	63,688	199,643	219,500
Less: net income attributable to controlling interest	(371)	(236)	(951)	(1,064)
Net income attributable to Dolby Laboratories, Inc.	**$ 51,146**	**$ 63,452**	**$ 198,692**	**$ 218,436**
Earnings per share attributable to Dolby Laboratories, Inc. (basic)	$ 0.45	$ 0.56	$ 1.76	$ 1.92
Earnings per share attributable to Dolby Laboratories, Inc. (diluted)	$ 0.44	$ 0.55	$ 1.73	$ 1.89
Weighted-average shares outstanding (basic)	113,261	113,254	112,907	113,775
Weighted-average shares outstanding (diluted)	115,528	115,282	115,153	115,780

Related party rent expense included in general and administrative expenses	$	378	$	343	$	1,059	$	1,029

(1) Stock-based compensation was classified as follows:

Cost of products	$	93	$	126	$	471	$	305
Cost of services		29		36		85		99
Research and development		1,447		1,869		3,788		4,613
Sales and marketing		2,006		2,573		4,746		6,522
General and administrative		2,980		3,540		6,885		9,476

See accompanying notes to condensed consolidated financial statements

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DOLBY LABORATORIES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Fiscal Year-to-Date Ended	
	June 26, 2009	June 25, 2010
	(unaudited)	
Operating activities:		
Net income including controlling interest	$ 199,643	$ 219,500
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	21,501	25,545
Stock-based compensation expense	15,551	20,501
Amortization of premium on investments	3,942	6,384
Excess tax benefit from exercise of stock options	(3,548)	(16,890)
Provision for doubtful accounts	1,148	(181)
Deferred taxes	19,832	(21,782)
Unrealized losses/(gains) on Put Rights	(9,452)	6,506
Unrealized losses/(gains) on auction rate certificates	10,854	(7,601)
Gain from amended patent licensing agreement	(20,041)	
Impairment of products provided under operating leases		9,594
Other non-cash items affecting net income	1,795	2,007
Changes in operating assets and liabilities:		
Accounts receivable	(24,694)	(24,595)
Inventories	145	(4,087)
Prepaid expenses and other assets	3,163	15,730
Accounts payable and accrued liabilities	(24,244)	24,273
Income taxes, net	248	31,903
Deferred revenue	4,788	(24,282)
Other liabilities	(2,367)	(74)
Payment on litigation settlement	(3,000)	(3,000)
Net cash provided by operating activities	195,264	259,451
Investing activities:		
Purchases of available-for-sale securities	(304,723)	(556,172)
Proceeds from sale of available-for-sale and trading securities	97,985	519,857
Purchases of property, plant, and equipment	(9,236)	(24,882)
Purchase of intangible assets	(8,321)	(825)
Acquisitions, net of cash acquired	(16,621)	
Net cash used in investing activities	(240,916)	(62,022)
Financing activities:		
Payments on debt	(1,121)	(1,192)
Proceeds from the exercise of stock options	9,410	32,948
Issuance of Class A common stock (Employee Stock Purchase Plan)	3,465	4,060
Repurchase of common stock		(177,648)
Excess tax benefit from the exercise of stock options	3,548	16,890
Net cash provided by/(used in) financing activities	15,302	(124,942)

Effect of foreign exchange rate changes on cash and cash equivalents	(1,035)	(5,067)
Net increase/(decrease) in cash and cash equivalents	(31,385)	67,420
Cash and cash equivalents at beginning of period	394,761	451,678
Cash and cash equivalents at end of period	**$ 363,376**	**$ 519,098**
Supplemental disclosure:		
Cash paid for income taxes	$ 84,397	$ 108,598
Cash paid for interest	782	546

See accompanying notes to condensed consolidated financial statements

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DOLBY LABORATORIES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Basis of Presentation

Unaudited Interim Financial Statements

The accompanying interim condensed consolidated balance sheets as of September 25, 2009 and June 25, 2010, and the condensed consolidated statements of operations for the fiscal quarters and fiscal year-to-date periods ended June 26, 2009 and June 25, 2010, and the condensed consolidated statements of cash flows for the fiscal year-to-date periods ended June 26, 2009 and June 25, 2010 are unaudited. The September 25, 2009 condensed consolidated balance sheet was derived from our audited financial statements included in our Annual Report on Form 10-K for the fiscal year ended September 25, 2009. These interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (U.S. GAAP). In our opinion, the interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements for the fiscal year ended September 25, 2009 and include all adjustments necessary for fair presentation.

The results for the fiscal quarter and fiscal year-to-date period ended June 25, 2010 are not necessarily indicative of the results to be expected for any subsequent quarterly or annual financial period, including the fiscal year ending September 24, 2010.

The accompanying interim condensed consolidated financial statements are prepared in accordance with Securities and Exchange Commission (SEC) rules and regulations, which allow for certain information and footnote disclosures that are normally included in annual financial statements to be condensed or omitted. The accompanying interim condensed consolidated financial statements should be read in conjunction with our consolidated financial statements for the fiscal year ended September 25, 2009, which are included in our Annual Report on Form 10-K filed with the SEC. We have evaluated the impact of subsequent events up to the filing date of these interim condensed consolidated financial statements.

Principles of Consolidation

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

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 estimated selling prices for elements sold in multiple-element revenue arrangements, valuation allowances for accounts receivable, carrying values of inventories, products provided under operating leases, goodwill, intangible assets, stock-based compensation, fair values of investments, put rights, accrued expenses, including liabilities for unrecognized tax benefits and deferred income tax assets. Actual results could differ from our estimates.

Reclassifications

We have changed the presentation of our operating expenses categories from prior years. To provide additional detail, we have separated the selling, general, and administrative category presented in prior years into two categories: sales and marketing and general and administrative. We have also reclassified certain prior period amounts within our condensed consolidated statements of operations to conform to current period presentation. Prior year research and development-related facilities and other expenses that were previously presented within the selling, general, and administrative category of operating expenses were reclassified to the research and development category of operating expenses. In addition, we reclassified gain on settlements, which was presented in prior years as a separate category within operating expenses, into the sales and marketing category of operating expenses.

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2. Summary of Significant Accounting Policies

Except for the changes listed below, there have been no material changes in our significant accounting policies since our Annual Report on Form 10-K for the fiscal year ended September 25, 2009.

Recently Adopted Accounting Pronouncements

Business Combinations

In December 2007, the Financial Accounting Standards Board (FASB) amended the accounting standards for business combinations to require an entity to recognize the assets acquired, liabilities assumed, contractual contingencies, and contingent consideration at their fair value on the acquisition date. Subsequent changes to the estimated fair value of contingent consideration will be reflected in earnings until the contingency is settled. Acquisition-related costs and restructuring costs will be expensed as incurred rather than treated as part of the purchase price. The adoption of this accounting guidance changes our accounting treatment prospectively for business combinations initiated after September 25, 2009.

Controlling Interests

In December 2007, the FASB amended the accounting standards for the consolidation of controlling interests, which changed the presentation requirements for our controlling interest. Our adoption of this accounting standard did not change our accounting for our controlling interest. The amended standards resulted in changes to the presentation of net income in our condensed consolidated statements of operations and the reclassification of controlling interest from the mezzanine to the equity section of our condensed consolidated balance sheets for all periods presented.

Fair Value Measurements and Disclosures

In January 2010, the FASB amended the accounting standard for fair value measurements to require new disclosures for transfers of financial assets and liabilities into and out of Levels 1 and 2 in the fair value hierarchy and for activity in Level 3 in the fair value hierarchy. The amendments are effective for interim and annual reporting periods beginning with our fiscal quarter ended March 26, 2010, except for the disclosures for Level 3 activity, which are effective for interim and annual reporting periods for our fiscal year ending September 28, 2012, with early adoption permitted. We adopted the amended disclosure requirements for Levels 1 and 2 beginning in our fiscal quarter ended March 26, 2010. The adoption of the amended disclosure requirements for fair value measurements did not affect our disclosures because we did not transfer financial assets or liabilities between levels in the fair value hierarchy.

Revenue Recognition

In October 2009, the FASB amended the revenue recognition accounting standards to exclude sales of qualifying tangible products that contain essential software elements from the scope of the software revenue recognition standards. In the first quarter of fiscal 2010, we adopted this accounting standard for revenue arrangements entered into or materially modified after September 25, 2009. Due to this adoption, we no longer account for product sales that contain software elements under the software revenue recognition standards.

Also in October 2009, the FASB amended the accounting standards for multiple-element (ME) revenue arrangements to:

- Provide updated guidance on whether these arrangements exist, how the elements should be separated, and what consideration should be allocated to each element;

- Require an entity to allocate consideration using the estimated selling price (ESP) of each element if the entity does not have vendor specific objective evidence (VSOE) of the selling price or third-party evidence (TPE) of the selling price; and,

- Require a vendor to allocate consideration using the relative selling price method.

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In the first quarter of fiscal 2010, we adopted the amended accounting standards for ME revenue arrangements entered into or materially modified after September 25, 2009. Prior to adoption, we were not able to establish VSOE of the standalone selling price for the undelivered support and maintenance elements for a majority of our ME arrangements. The previous accounting standards required VSOE in order to allocate the arrangement consideration to each individual element. Since we had not established VSOE, we allocated the entire arrangement consideration to the undelivered element and ratably recognized the revenue over its estimated support period.

Under the new accounting guidance, we allocate the arrangement consideration to each element based on its relative selling price, which we establish using a selling price hierarchy. We determine the selling price of each element based on its VSOE, if available, TPE, if VSOE is not available, or ESP, if neither VSOE nor TPE is available. We typically are not able to establish VSOE or TPE for the individual elements in our ME arrangements; therefore, we estimate the selling price for these elements.

We determine our best estimate of the selling price for an individual element within a ME revenue arrangement using the same methods utilized to determine the selling price of an element sold on a standalone basis. If we sell the element on a standalone basis, we estimate the selling price by considering actual sales prices. Otherwise, we estimate the selling price by considering internal factors such as pricing practices and margin objectives. Consideration is also given to market conditions such as competitor pricing strategies, customer demands, and industry technology lifecycles. Management applies judgment to establish margin objectives, pricing strategies, and technology lifecycles.

We evaluate each element in a ME arrangement to determine whether it represents a separate unit of accounting. An element constitutes a separate unit of accounting when it has standalone value and delivery of an undelivered element is probable and within our control. When these criteria are not met, the delivered and undelivered elements are combined and the arrangement consideration is allocated to this combined single unit. Our adoption of the amended guidance changed our units of accounting for our revenue transactions by allowing us to use ESP to allocate the total consideration amongst the delivered and undelivered elements in an arrangement.

If the unit separation criteria are met, we account for each element within a ME arrangement (such as hardware, software, maintenance, and other services) separately and we allocate consideration based on the relative selling price of each element. For some arrangements, customers receive certain elements over a period after delivery of the initial product. These elements may include support and maintenance and/or the right to receive upgrades. Revenue allocated to the undelivered element is recognized over either its estimated service period or when the upgrade is delivered. We do not recognize revenue that is contingent upon the future delivery of products or services or upon future performance obligations. We recognize revenue for delivered elements only when we have completed all contractual obligations.

We account for the majority of our digital cinema server sales as ME arrangements that have two separate units, or elements, of accounting. The first element consists of our digital cinema server hardware and the accompanying software, which is essential to the functionality of the hardware. This element is typically delivered at the time of sale. The second element is the right to receive support and maintenance, which is included with the purchase of the hardware element and is typically delivered over a service period subsequent to the initial sale. The application of the new revenue accounting standards to our digital cinema server sales typically results in the allocation of a substantial majority of the arrangement consideration to the delivered hardware element based on its ESP, which we recognize as revenue at the time of sale. A small portion of the arrangement consideration is allocated to the undelivered support and maintenance element, based on its ESP, and is recognized as revenue ratably over the estimated service period, which is typically one year.

For ME product arrangements entered into or materially modified in the fiscal quarter ended June 25, 2010 and in the fiscal year-to-date period ended June 25, 2010, we recognized revenue of $24.1 million and $56.1 million. At June 25, 2010, the deferred revenue balance from these transactions was $0.9 million, representing the estimated selling price of our support and maintenance obligation bundled with our hardware sales.

Our adoption of the amended guidance did not change the accounting for product arrangements entered into on or before September 25, 2009 and we continue to recognize revenue for such arrangements ratably over the estimated support period for the undelivered element. For product arrangements entered into on or before September 25, 2009, we recognized $5.1 million and $27.1 million in previously deferred revenue in the fiscal quarter ended June 25, 2010 and the fiscal year-to-date period ended June 25, 2010. At June 25, 2010, the remaining deferred revenue balance from these transactions was $3.7 million. We expect to recognize the majority of this deferred revenue in fiscal 2010.

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The following is a summary of our products revenue and the associated deferred revenue balances:

	Revenue		Deferred Revenue
	Fiscal quarter ended	Fiscal year-to-date ended	
	June 25, 2010	June 25, 2010	June 25, 2010
	(in thousands)		
Products sold during fiscal 2010:			
Multiple-element arrangements	$ 24,103	$ 56,139	$ 907
Standalone arrangements (1)	23,496	56,917	160
Products sold in prior periods for which revenue was deferred (2)	5,052	27,091	3,687
Total	**$ 52,651**	**$ 140,147**	**$ 4,754**

(1) These arrangements were not affected by the changes in revenue accounting standards.
(2) Represents revenue attributable to multiple-element arrangements entered into on or before September 25, 2009.

3. Composition of Certain Financial Statement Captions

Cash, Cash Equivalents, and Investments

Cash, cash equivalents, and investments as of September 25, 2009 and June 25, 2010 consisted of the following:

	September 25, 2009	June 25, 2010
	(in thousands)	
Cash and cash equivalents:		
Cash	$ 132,772	$ 163,345
Cash equivalents:		
Money market funds	318,906	324,772
Municipal debt securities		30,981
Total cash and cash equivalents	451,678	519,098
Short-term investments:		
Auction rate certificates	57,254	23,155
Corporate bonds		1,001
Municipal debt securities	105,963	168,884
U.S. agency securities	20,367	80,756
U.S. government bonds	19,995	29,975
Variable rate demand notes	80,229	
Total short-term investments	283,808	303,771
Long-term investments (1):		
Corporate bonds	22,655	21,671
Municipal debt securities	130,006	164,959
U.S. agency securities	22,628	36,034
U.S. government bonds	30,649	

Total long-term investments	205,938	222,664
Total cash, cash equivalents and investments	**$ 941,424**	**$ 1,045,533**

(1) Our long-term investments have maturities that range from one to three years.

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As of June 25, 2010, we held tax-exempt auction rate certificates with a par value of $26.4 million. Auctions for these investments have failed, and the investments have been illiquid as a result, since February 2008. In November 2008, we elected to accept a rights offering from UBS AG, (collectively with its wholly owned subsidiaries UBS Financial Services, Inc. and UBS Securities LLC, referred to as UBS). The rights offering (Put Rights) provides us with an option to sell to UBS, at par value, our auction rate certificates purchased through UBS at any time during a two-year sale period beginning June 30, 2010. We elected to measure the Put Rights at fair value with gains and losses recognized as a component of net income. Simultaneous with the acceptance of the rights offering, we reclassified our auction rate certificates from the available-for-sale to the trading securities category, with unrealized gains and losses reported as a component of net income, within long-term investments in our consolidated balance sheet.

As of June 25, 2010, our Put Rights are classified as financial assets within prepaid and other current assets and our auction rate certificates are classified as short-term investments. Of the $68.1 million in par value of auction rate securities that we held as of September 25, 2009, $33.6 million and $41.7 million were redeemed at par by the issuers during the fiscal quarter ended June 25, 2010 and fiscal year-to-date period ended June 25, 2010. As a result, we recognized gains of $4.7 million and $7.6 million in the fiscal quarter ended June 25, 2010 and fiscal year-to-date period ended June 25, 2010. These gains represented the excess of the par value redeemed over the fair market value of the auction rate certificates. Concurrently, we recognized net losses from the associated Put Rights of $3.8 million and $6.5 million for the fiscal quarter ended June 25, 2010 and fiscal year-to-date period ended June 25, 2010.

Subsequent to June 25, 2010, we exercised the Put Rights and received cash from UBS in the amount of $26.5 million, representing the par value plus accrued interest related to our auction rate certificates held as of June 25, 2010. See Note 12 *Subsequent Event* for details.

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

	September 25, 2009			
	Cost	**Unrealized Gain**	**Unrealized Loss**	**Estimated Fair Value**
		(in thousands)		
Auction rate certificates	$ 57,254	$	$	$ 57,254
Corporate bonds	22,403	252		22,655
Money market funds	318,906			318,906
Municipal debt securities	233,320	2,667	(18)	235,969
U.S. agency securities	42,515	480		42,995
U.S. government bonds	50,431	213		50,644
Variable rate demand notes	80,229			80,229
Cash equivalents and investments	**$ 805,058**	**$ 3,612**	**$ (18)**	**$ 808,652**

	June 25, 2010			
	Cost	**Unrealized Gain**	**Unrealized Loss**	**Estimated Fair Value**
		(in thousands)		
Auction rate certificates	$ 23,155	$	$	$ 23,155
Corporate bonds	22,269	403		22,672
Money market funds	324,772			324,772
Municipal debt securities	363,023	1,870	(69)	364,824
U.S. agency securities	116,286	504		116,790
U.S. government bonds	29,946	29		29,975
Cash equivalents and investments	**$ 879,451**	**$ 2,806**	**$ (69)**	**$ 882,188**

We have classified all of our investments listed in the tables above, with the exception of our auction rate certificates, as available-for-sale securities recorded at fair market value on the condensed consolidated balance sheets, with unrealized gains and losses reported as a component of accumulated other comprehensive income. We have classified our auction rate certificates as trading securities recorded at fair market value on the condensed consolidated balance sheets, with unrealized gains and losses reported as a component of net income.

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The following tables show the gross unrealized losses and the fair value for those available-for-sale securities that were in an unrealized loss position:

	September 25, 2009					
	Less than 12 months		12 months or greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Values	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in thousands)					
Municipal debt securities	$ 8,405	$ (18)	$	$	$ 8,405	$ (18)
Total	**$ 8,405**	**$ (18)**	**$**	**$**	**$ 8,405**	**$ (18)**

	June 25, 2010					
	Less than 12 months		12 months or greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Values	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in thousands)					
Municipal debt securities	$ 92,264	$ (69)	$	$	$ 92,264	$ (69)
Total	**$ 92,264**	**$ (69)**	**$**	**$**	**$ 92,264**	**$ (69)**

The unrealized losses on our available-for-sale securities were primarily a result of unfavorable changes in interest rates subsequent to the initial purchase of these securities. As of June 25, 2010, we owned twenty-seven municipal debt securities that were in an unrealized loss position. We do not intend to sell, nor will we need to sell, these securities before we recover the associated unrealized losses. 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 September 25, 2009 and June 25, 2010 to be an other-than-temporary impairment, nor do we consider any of the unrealized losses to be credit losses.

Accounts Receivable

Accounts receivable consists of the following:

	September 25, 2009	June 25, 2010
	(in thousands)	
Trade accounts receivable	$ 21,991	$ 38,445
Accounts receivable related to patent administration program	3,212	10,660
Accounts receivable, gross	25,203	49,105
Less: Allowance for doubtful accounts	(2,222)	(1,455)
Accounts receivable, net	**$ 22,981**	**$ 47,650**

Inventories

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

	September 25, 2009	June 25, 2010
	(in thousands)	
Raw materials	$ 3,670	$ 5,309
Work in process	1,207	2,778
Finished goods	8,098	8,902
Inventories	**$ 12,975**	**$ 16,989**

Property, Plant and Equipment

Property, plant and equipment are recorded at cost and consist of the following:

	September 25, 2009	June 25, 2010
	(in thousands)	
Land	$ 14,004	$ 13,736
Buildings	29,694	29,017
Leasehold improvements	48,325	50,581
Machinery and equipment	27,022	28,617
Computer systems and software	32,750	49,124
Furniture and fixtures	17,991	15,345
Products provided under operating leases	20,025	9,806
	189,811	196,226
Less: Accumulated depreciation	(97,633)	(100,740)
Property, plant and equipment, net	**$ 92,178**	**$ 95,486**

Depreciation expense for our property, plant and equipment was $3.4 million and $4.5 million in the fiscal quarters ended June 26, 2009 and June 25, 2010, and is included in cost of products, cost of services, research and development expenses, sales and marketing expenses and general and administrative expenses in the accompanying condensed consolidated statements of operations. Depreciation expense for our property, plant and equipment was $10.0 million and $12.8 million for the fiscal year-to-date periods ended June 26, 2009 and June 25, 2010.

Our products provided under operating leases represent digital cinema equipment that we leased to exhibitors beginning in fiscal 2005 in an effort to encourage the motion picture industry to transition to digital cinema. In conjunction with our exhibitor lease arrangements, we receive a virtual print fee from participating film studios for each digital print delivered for exhibition on the leased equipment.

We review our long-lived assets for impairment whenever events or changes in circumstances indicate an asset s carrying value may not be recoverable. During the fiscal quarter ended June 25, 2010, certain events occurred that indicated that the carrying value of our products provided under operating leases may not be recoverable. These events included a reduction in expected virtual print fees and a reduction in market prices for digital cinema equipment. As a result, we concluded that sufficient indicators existed to require an impairment analysis during the fiscal quarter ended June 25, 2010.

Based on our estimates of the undiscounted future cash flows from virtual print fees and the potential sale value of the equipment, our analysis determined that the equipment was impaired. Accordingly, we estimated the fair market value of the equipment based on potential sale price estimates and recorded the excess of the carrying value over the fair market value as an impairment charge. For the fiscal quarter ended June 25, 2010, we recorded an impairment charge of $9.6 million from our products provided under operating leases, which is included in the

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impairment of products provided under operating leases line item in the accompanying condensed consolidated statements of operations. As of June 25, 2010 management had not committed to a plan to sell our products provided under operating leases; accordingly, these assets are classified as held for use. We believe that the remaining carrying value of our products provided under operating leases is recoverable as of June 25, 2010.

Goodwill and Intangible Assets

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

	(in thousands)
Balance at September 25, 2009	$ 261,121
Translation adjustments and other	(2,268)
Balance at June 25, 2010	$ 258,853

Intangible assets consist of the following:

	September 25, 2009	June 25, 2010
	(in thousands)	
Amortized intangible assets:		
Acquired patents and technology	$ 59,964	$ 60,201
Customer relationships	30,851	30,281
Customer contracts	6,073	5,973
Other intangibles	20,184	20,307
Intangible assets, gross	117,072	116,762
Less: Accumulated amortization	(35,037)	(47,440)
Intangible assets, net	**$ 82,035**	**$ 69,322**

Amortization expense for our intangible assets was $3.5 million and $3.7 million in the fiscal quarters ended June 26, 2009 and June 25, 2010, respectively, and is included in cost of licensing, cost of products, and sales and marketing expenses in the accompanying condensed consolidated statements of operations. Amortization expense for our intangible assets was $11.5 million and $12.7 million for the fiscal year-to-date periods ended June 26, 2009 and June 25, 2010, respectively.

The decrease in intangible assets, gross from September 25, 2009 to June 25, 2010 was due to foreign currency translation.

Accrued Liabilities

Accrued liabilities consist of the following:

	September 25, 2009	June 25, 2010
	(in thousands)	
Accrued royalties	$ 2,070	$ 3,836
Amounts payable to joint licensing program partners	28,906	37,614
Accrued compensation and benefits	40,952	50,280
Accrued professional fees	4,392	7,320

Current portion of litigation settlement (see Note 7)	2,785	2,854
Other accrued liabilities	21,796	24,871
Accrued liabilities	**$ 100,901**	**$ 126,775**

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Accumulated Other Comprehensive Income

Accumulated foreign currency translation gains, net of tax, were $7.3 million at September 25, 2009, compared to $2.9 million at June 25, 2010. Accumulated unrealized gains on investments, net of tax, were $2.2 million at September 25, 2009, compared to $1.7 million at June 25, 2010.

Per Share Data

We compute basic earnings per share by dividing net income attributable to Dolby Laboratories, Inc. by the weighted average number of shares of Class A and Class B common stock outstanding during the period. For diluted earnings per share, we divide net income attributable to Dolby Laboratories, Inc. by the sum of the weighted average number of shares of Class A and Class B common stock outstanding and the potential number of dilutive shares of Class A and Class B common stock outstanding during the period.

The following table sets forth the computation of basic and diluted earnings per share attributable to Dolby Laboratories, Inc.:

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 26, 2009	June 25, 2010	June 26, 2009	June 25, 2010
	(in thousands, except per share amounts)			
Numerator:				
Net income attributable to Dolby Laboratories, Inc.	$ 51,146	$ 63,452	$ 198,692	$ 218,436
Denominator:				
Weighted average shares outstanding (basic)	113,261	113,254	112,907	113,775
Potential common shares from options to purchase Class A and Class B common stock	2,198	1,817	2,209	1,835
Potential common shares from restricted stock units	69	211	37	170
Weighted average shares outstanding (diluted)	115,528	115,282	115,153	115,780
Earnings per share attributable to Dolby Laboratories, Inc. (basic)	**$ 0.45**	**$ 0.56**	**$ 1.76**	**$ 1.92**
Earnings per share attributable to Dolby Laboratories, Inc. (diluted)	**$ 0.44**	**$ 0.55**	**$ 1.73**	**$ 1.89**

We have excluded 3,121,320 options and 209,581 restricted stock units from the calculation of potential common shares for the fiscal quarter ended June 26, 2009 and we have excluded 1,414,260 options and 28,615 restricted stock units from the calculation of potential common shares for the fiscal quarter ended June 25, 2010, because their inclusion would have been anti-dilutive. We have excluded 3,545,485 options and 627,413 restricted stock units from the calculation of potential common shares for the fiscal year-to-date period ended June 26, 2009 and we have excluded 1,949,549 options and 403,080 restricted stock units from the calculation of potential common shares for the fiscal year-to-date period ended June 25, 2010, because their inclusion would have been anti-dilutive.

Withholding and Sales Tax

We recognize licensing revenue gross of withholding taxes, which our licensees remit directly to their local tax authorities. Withholding tax remittances were $4.9 million and $8.0 million in the fiscal quarters ended June 26, 2009 and June 25, 2010, respectively. Withholding taxes were $17.0 million and $24.1 million in the fiscal year-to-date periods ended June 26, 2009 and June 25, 2010, respectively. We account for sales tax on a net basis by excluding sales tax from our revenue.

4. Fair Value Measurements

Fair value is the exchange price that would be received for an asset or that would be 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 that are accessible by us at the measurement date for identical assets and liabilities.

Level 2: Prices not directly accessible by us. Such prices may be based upon quoted prices in active markets or inputs not quoted on active markets but are corroborated by market data.

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

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Financial assets and liabilities carried at fair value as of September 25, 2009 are classified below:

	Level 1	Level 2	Level 3	Total
		(in thousands)		
Assets:				
Investments held in supplemental retirement plan	$ 3,935	$	$	$ 3,935
Money market funds	318,906			318,906
Corporate bonds		22,655		22,655
Forward currency contract		14		14
Municipal debt securities		235,969		235,969
U.S. agency securities		42,995		42,995
U.S. government bonds		50,644		50,644
Variable rate demand notes		80,229		80,229
Auction rate certificates			57,254	57,254
Put Rights			9,508	9,508
Total	**$ 322,841**	**$ 432,506**	**$ 66,762**	**$ 822,109**

	Level 1	Level 2	Level 3	Total
		(in thousands)		
Liabilities:				
Investments held in supplemental retirement plan	$ 3,935	$	$	$ 3,935
Interest rate derivative		279		279
Total	**$ 3,935**	**$ 279**	**$**	**$ 4,214**

Financial assets and liabilities carried at fair value as of June 25, 2010 are classified below:

	Level 1	Level 2	Level 3	Total
		(in thousands)		
Assets:				
Investments held in supplemental retirement plan	$ 2,070	$	$	$ 2,070
Money market funds	324,772			324,772
Corporate Bonds		22,672		22,672
Municipal debt securities		364,824		364,824
U.S. agency securities		116,790		116,790
U.S. government bonds		29,975		29,975
Auction rate certificates			23,155	23,155
Put Rights			3,002	3,002
Total	**$ 326,842**	**$ 534,261**	**$ 26,157**	**$ 887,260**

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	Level 1	Level 2	Level 3	Total
		(in thousands)		
Liabilities:				
Investments held in supplemental retirement plan	$ 2,070	$	$	$ 2,070
Interest rate derivative		255		255
Total	**$ 2,070**	**$ 255**	**$**	**$ 2,325**

We base the fair value of our Level 1 financial instruments on active quoted market prices for identical instruments. Our Level 1 financial instruments include money market funds and mutual fund investments held in our supplemental retirement plan. We obtain the fair value of our Level 2 financial instruments from professional pricing sources for identical or comparable instruments, rather than direct observations of quoted prices in active markets. Our Level 2 financial instruments include corporate bonds, municipal debt securities, U.S. agency securities, U.S. government bonds, variable rate demand notes, and an interest rate derivative. We classify our auction rate certificates and Put Rights as Level 3 financial assets because quoted prices are unobservable or no market data is available.

The following table provides a reconciliation between the beginning and ending balances of items measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

	Auction rate certificates and Put Rights (in thousands)
Balances at September 25, 2009	$ 66,762
Gains or losses included in earnings:	
Unrealized gains from auction rate certificates	7,601
Realized gain from release of credit risk discount on Put Rights	1,095
Unrealized losses from Put Rights	(7,601)
Redemptions at par of auction rate certificates	(41,700)
Balances at June 25, 2010	**$ 26,157**

Observable market information is insufficient to determine the fair value of our auction rate certificates and Put Rights. We estimated the fair value of our auction rate certificates by using a discounted cash flow model, which incorporates assumptions that market participants would use in their estimates of fair value. Some of the inputs used to determine the fair value of our auction rate certificates include the interest yield of the securities, market volatility, the expected liquidity of the securities, the collateral underlying the securities, the creditworthiness of the counterparty, the timing of expected future cash flows, the likelihood of a successful future auction, and the final stated maturities of the securities. We estimated the fair value of our Put Rights as the difference between par value and fair value of the underlying auction rate certificates, discounted for counterparty credit risk. Some of the inputs used to determine the fair value of our Put Rights include the value of the underlying auction rate certificates and the credit risk associated with the Put Rights issuer, UBS.

Unrealized gains/losses from auction rate certificates, realized gains on redemptions, and unrealized gains/losses from our Put Rights are included in the other expense, net line item in our condensed consolidated statement of operations for the fiscal year-to-date period ended June 25, 2010.

5. Stock-Based Compensation

We have adopted compensation plans that provide for grants of stock-based awards as a form of compensation to employees, officers, and directors. We have issued stock-based awards in the form of stock options, restricted stock units, stock appreciation rights, and shares issued under our employee stock purchase plan. Stock-based compensation expense was $6.6 million and $8.1 million for the fiscal quarters ended June 26, 2009 and June 25, 2010. Stock-based compensation expense was $16.0 million and $21.0 million for the fiscal year-to-date periods ended June 26, 2009 and June 25, 2010.

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Our stock-based compensation expense in the fiscal quarter ended June 26, 2009 was primarily comprised of $4.8 million and $1.7 million for stock options and restricted stock units. Our stock-based compensation expense in the fiscal quarter ended June 25, 2010 was primarily comprised of $5.1 million for stock options, $2.7 million for restricted stock units, and $0.1 million for stock appreciation rights. Our stock-based compensation expense in the fiscal year-to-date period ended June 26, 2009 was primarily comprised of $12.1 million and $3.4 million for stock options and restricted stock units. Our stock-based compensation expense in the fiscal year-to-date period ended June 25, 2010 was primarily comprised of $13.3 million for stock options, $6.7 million for restricted stock units, and $0.5 million for stock appreciation rights.

During the year-to-date period ended June 26, 2009, we granted 1,453,650 stock options at a weighted average exercise price of $32.89 per share and 443,670 restricted stock units at a weighted average grant price of $32.47 per share. During the fiscal year-to-date period ended June 25, 2010, we granted 1,446,881 stock options at a weighted average exercise price of $51.91 per share and 406,030 restricted stock units at a weighted average price of $51.82 per share.

6. Restructuring

In fiscal 2009, we undertook a restructuring project to reallocate our global manufacturing resources. As part of this restructuring project, we consolidated our Wootton Bassett, U.K. manufacturing operations into our Brisbane, California facility in the second quarter of fiscal 2009, which resulted in a reduced manufacturing workforce. In addition, we reduced our workforce in our Brisbane, California manufacturing facility. These activities resulted in severance and other charges attributable to the termination of employees.

During the fiscal quarter ended June 25, 2010, we informed approximately 60 general and administrative employees of our plans to reorganize certain aspects of our global business infrastructure. As a result of this action, we have offered severance benefits to the affected employees. The majority of these employees are required to render service through November 15, 2010 to receive these severance benefits. We have begun to recognize the total estimated severance and other associated costs of approximately $5.0 million for these employees on a ratable basis through this date.

Changes in our restructuring accruals, which are included within accrued liabilities on our condensed consolidated balance sheets, were as follows:

	Severance	Facilities and contract termination costs	Fixed assets write-off (in thousands)	Other associated costs	Total
Balance at September 25, 2009	$ 1,103	$ 88	$	$ 20	$ 1,211
Restructuring charges	1,046		10	315	1,371
Cash payments	(936)	(19)		(208)	(1,163)
Non-cash charges			(10)		(10)
Balance at June 25, 2010	**$ 1,213**	**$ 69**	**$**	**$ 127**	**$ 1,409**

7. Legal Proceedings

In March 1997, an unrelated third party filed a lawsuit against us alleging breach of a written agreement. In April 2002, we settled the dispute and agreed to pay a total of $30.0 million, without interest, in ten equal annual installments of $3.0 million per year beginning in June 2002. We recorded this liability at its present value of $24.2 million on the consolidated balance sheet. Interest related to this liability is recorded quarterly and is included in interest expense on the accompanying consolidated statements of operations. Other than such payments, neither party has any material obligations as a result of the settlement. As of June 25, 2010, we had $3.0 million remaining to be paid under this settlement.

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

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8. Geographic Data

Revenue by geographic region, which was determined based on the location of our licensees for licensing revenue, the location of our direct customers or distributors for products revenue, and the location where we perform our services for services revenue, was as follows:

	Revenue by Geographic Region			
	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 26, 2009	June 25, 2010	June 26, 2009	June 25, 2010
	(in thousands)			
United States	$ 58,398	$ 78,009	$ 192,122	$ 232,963
International	112,846	152,260	363,504	461,943
Total revenue	**$ 171,244**	**$ 230,269**	**$ 555,626**	**$ 694,906**

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

	Concentration of Revenue by Geographic Region			
	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 26, 2009	June 25, 2010	June 26, 2009	June 25, 2010
Americas	35%	35%	36%	35%
APAC	52%	50%	48%	49%
EMEA	13%	15%	16%	16%

In the fiscal quarters ended June 26, 2009 and June 25, 2010, revenue from one customer was $25.0 million and $28.9 million or 15% and 13% of total revenue. In the fiscal year-to-date periods ended June 26, 2009 and June 25, 2010, revenue from the same customer was $57.8 million and $84.2 million, or 10% and 12% of total revenue.

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

	Long-Lived Tangible Assets by Geographic Region	
	September 25, 2009	June 25, 2010
	(in thousands)	
United States	$ 71,703	$ 74,528
International	20,475	20,958
Total long-lived tangible assets, net of accumulated depreciation	**$ 92,178**	**$ 95,486**

9. Contingencies

We are party to certain contractual agreements under which we have agreed to provide indemnifications of varying scope and duration to the other party relating to our licensed intellectual property. Historically, we have made no payments for these indemnification obligations and no amounts have been accrued in our consolidated financial statements with respect to these obligations. Due to their varying terms and conditions, we are unable to make a reasonable estimate of the maximum potential amount we could be required to pay.

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10. Common Stock Repurchase Program

In November 2009, we announced a stock repurchase program, whereby we may repurchase up to $250 million of our Class A common stock. Stock repurchases under this 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, and other market conditions. We may limit, suspend, or terminate the stock repurchase program at any time without prior notice. This program does not have a specified expiration date. Shares repurchased under the program will be returned to the status of authorized but unissued shares of Class A common stock. Stock repurchases under the stock repurchase program commenced in the fiscal quarter ended December 25, 2009.

Stock repurchase activity under the stock repurchase program during the fiscal year-to-date period ended June 25, 2010 is summarized as follows:

	Shares Repurchased	Cost (in thousands)	Average Price Paid per Share
Repurchase activity for the fiscal quarter ended December 25, 2009	345,400	$ 15,661	$ 45.33
Repurchase activity for the fiscal quarter ended March 26, 2010	1,262,085	67,463	53.45
Repurchase activity for the fiscal quarter ended June 25, 2010	1,491,691	94,524	63.37
Total	**3,099,176**	**$ 177,648**	**$ 57.32**

11. Comprehensive Income and Supplemental Equity Information

Comprehensive Income

The components of comprehensive income were as follows:

	Fiscal Quarter Ended		Fiscal Year-to-Date Ended	
	June 26, 2009	June 25, 2010	June 26, 2009	June 25, 2010
	(in thousands)			
Net income including controlling interest	$ 51,517	$ 63,688	$ 199,643	$ 219,500
Other comprehensive income (loss):				
Foreign currency translation adjustment, net of tax	15,707	(975)	(9,514)	(5,101)
Unrealized gains (losses) on available-for-sale securities, net of tax	(39)	91	1,796	(532)
Reversal of unrealized losses on auction rate certificates, net of tax			3,727	
Comprehensive income	67,185	62,804	195,652	213,867
Less: comprehensive loss (income) attributable to controlling interest	(1,997)	(361)	382	(414)
Comprehensive income attributable to Dolby Laboratories, Inc.	**$ 65,188**	**$ 62,443**	**$ 196,034**	**$ 213,453**

In the fiscal quarter ended December 26, 2008, we reclassified our auction rate certificates from the available-for-sale category to the trading securities category. As a result of this reclassification, we reversed the unrealized losses on our auction rate certificates within other comprehensive income and recognized the losses as a component of net income.

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Supplemental Equity Information

The following tables present the consolidated statements of changes in stockholders equity attributable to Dolby Laboratories, Inc. and the controlling interest:

	Dolby Laboratories, Inc.							
	Shares of common stock	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss) (in thousands)	Total Dolby Laboratories, Inc.	Controlling Interest	Total
Balance at September 26, 2008	**112,474**	**$ 112**	**$ 434,907**	**$ 609,495**	**$ 4,739**	**$ 1,049,253**	**$ 22,098**	**$ 1,071,351**
Net income				198,692		198,692	951	199,643
Retirement of treasury stock			11	(11)				
Adjustment to controlling interest							575	575
Translation adjustments, net of taxes of $6,103					(8,181)	(8,181)	(1,333)	(9,514)
Unrealized gains on available-for-sale securities, net of taxes of $(3,449)					5,523	5,523		5,523
Distributions to controlling interest							(121)	(121)
Stock-based compensation expense			15,514			15,514		15,514
Tax benefit from the exercise of Class A and Class B stock options and vesting of restricted stock units			2,966			2,966		2,966
Class A common stock issued under employee stock plans, net of stock withheld for taxes	544	1	11,724			11,725		11,725
Exercise of Class B stock options	462		1,175			1,175		1,175
Balance at June 26, 2009	**113,480**	**$ 113**	**$ 466,297**	**$ 808,176**	**$ 2,081**	**$ 1,276,667**	**$ 22,170**	**$ 1,298,837**

	Dolby Laboratories, Inc.							
	Shares of common stock	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss) (in thousands)	Total Dolby Laboratories, Inc.	Controlling Interest	Total
Balance at September 25, 2009	**113,849**	**$ 113**	**$ 478,979**	**$ 852,475**	**$ 9,541**	**$ 1,341,108**	**$ 21,997**	**$ 1,363,105**
Net income				218,436		218,436	1,064	219,500
Translation adjustments, net of taxes of $2,882					(4,451)	(4,451)	(650)	(5,101)
Unrealized losses on available-for-sale securities, net of taxes of $324					(532)	(532)		(532)
Distributions to controlling interest							(127)	(127)
Stock-based compensation expense			20,501			20,501		20,501
Repurchase of common stock	(3,099)		(177,648)			(177,648)		(177,648)

Tax benefit from the exercise of Class A and Class B stock options and vesting of restricted stock units			16,401			16,401		16,401
Class A common stock issued under employee stock plans, net of stock withheld for taxes	1,289		34,814			34,814		34,814
Exercise of Class B stock options	887		2,194			2,194		2,194
Balance at June 25, 2010	**112,926**	**$ 113**	**$ 375,241**	**$ 1,070,911**	**$ 4,558**	**$ 1,450,823**	**$ 22,284**	**$ 1,473,107**

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12. Subsequent Event

As of June 25, 2010, we held tax-exempt auction rate certificates with a par value of $26.4 million. Auctions for these investments have failed, and as a result, since February 2008, the investments have been illiquid. In November 2008, we elected to accept a rights offering from UBS. The rights offering (Put Rights) provides us with an option to sell to UBS, at par value, our auction rate certificates purchased through UBS at any time during a two-year sale period beginning June 30, 2010.

On June 30, 2010, we exercised the Put Rights. As a result, UBS purchased our remaining auction rate certificates and we subsequently received cash in the amount of $26.5 million, representing the par value and accrued interest for these auction rate certificates.

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ITEM 2 MANAGEMENT S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our interim condensed consolidated financial statements and the related notes that appear elsewhere in this Form 10-Q. These discussions contain forward-looking statements reflecting our current expectations that involve risks and uncertainties. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expects, plans, anticipates, believes, estimates, predicts, potential, continue or the negative of these terms or other comparable terminology. Forward-looking statements include, but are not limited to: statements regarding the extent and timing of future licensing, products and services revenue levels and mix, expenses, margins, net income per diluted share, income taxes, tax benefits, acquisition costs and related amortization, and other measures of results of operations; our expectations regarding demand and acceptance for our technologies; growth opportunities and trends in the market in which we operate; our plans, strategies and expected opportunities; the deployment of and demand for our products and products incorporating our technologies; and future competition. 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 the section entitled Risk Factors in Part II, Item 1A of this Quarterly Report on Form 10-Q and elsewhere in this filing. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of these forward-looking statements. We are under no duty to update any of the forward-looking statements after the date of this Quarterly Report on Form 10-Q to conform our prior statements to actual results.

Overview

Since Ray Dolby founded Dolby Laboratories in 1965, we have been at the forefront of delivering audio technologies used throughout the creation, distribution, and playback processes to enhance the entertainment experience. We have introduced a number of innovative audio technologies, including noise reduction for the recording and cinema industries and surround sound for the cinema and the home, and as a result, we believe professionals and consumers view the Dolby brand as symbolizing a superior entertainment experience.

We generate revenue by licensing our technologies to manufacturers of consumer electronics (CE) products and software vendors and by selling our products and related services to entertainment content creators and distributors. We have licensed our technologies to CE manufacturers in approximately 30 countries and our licensees distribute their products incorporating our technologies throughout the world. We sell our products and provide services in over 85 countries. In fiscal 2008, 2009 and in the fiscal year-to-date period ended June 25, 2010, revenue from outside of the United States was 66%, 65% and 66% of our total revenue, respectively. We base geographical data for our licensing, products, and services revenue on the location of our licensees headquarters, the end location where we ship our products, or the location where we perform our services.

We generate the majority of our revenue by licensing technologies and selling products that allow for the efficient distribution of high-quality audio content to a broad range of entertainment devices and cinemas. We provide products and services to creators and distributors of audio content that enable them to encode this content using our technologies. Customers of these products and services include film studios, television broadcasters, cable television operators, and satellite television operators. We then license our technologies, such as Dolby Digital, Dolby Digital Plus, and Dolby Pulse, to CE manufacturers and software providers. These technologies enable CE products to decode and playback audio content previously encoded using the same technologies. Today, our technologies are standard in a wide range of consumer entertainment devices, including virtually all DVD players, audio/video receivers, and personal computer (PC) software DVD players. In addition, the majority of cinemas around the world use our products to playback audio content.

We believe our well-recognized brand, our customer relationships, and our well-established history of introducing successful innovative technologies enable us to capitalize on important trends in digital entertainment and to expand into existing and new markets. The transition to digital television, high-definition home theater systems, portable media devices, and downloadable content services has resulted in increased consumer expectations for the quality and convenience of entertainment content. As a result, our technologies are increasingly included in digital televisions, set-top boxes, mobile handsets, and other portable media devices. We also offer products, software, and services for digital cinema video presentation as the cinema industry transitions from film to digital content. This includes our 3D Digital Cinema solution, which now enables over 4,000 screens around the world.

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We also believe that our brand and our expertise enable us to introduce technologies that improve the quality of audio and video entertainment. We have introduced audio enhancement technologies, such as Dolby Volume, that improve the audio quality of CE devices, regardless of whether the audio content was encoded using our technologies. We are developing and marketing video technologies that we believe can improve the quality of video presentation in consumer and professional devices. Further, we are developing and marketing voice technologies for use in online gaming and Bluetooth headsets. We view the video and voice markets as early-stage opportunities.

Opportunities, Challenges, and Risks

Our revenue increased 25% in the fiscal year-to-date period ended June 25, 2010 when compared to the same period in the prior fiscal year and we are optimistic about the prospects for our business. However, our business could be affected by adverse changes in general economic conditions because our technologies are incorporated in entertainment-oriented products, which are generally discretionary goods, such as DVD players, Blu-ray Disc players, DVD recorders, PCs, digital televisions, mobile devices, video game consoles, set-top boxes, home-theaters-in-a-box, camcorders, portable media devices, audio/video receivers, and in-car entertainment systems. Deterioration in economic conditions could suppress consumer demand and harm our business in the markets in which we license our technologies and sell our products.

Licensing revenue constitutes the majority of our total revenue, representing 84%, 83%, and 77% of total revenue in fiscal 2008, 2009, and the fiscal year-to-date period ended June 25, 2010, respectively. We categorize our licensing revenue into the following markets (items listed in each market incorporate our technologies):

- PC market: primarily comprised of software DVD players, Microsoft Windows operating systems, and consumer notebooks
- Broadcast market: primarily comprised of televisions and set-top boxes
- CE market: primarily comprised of DVD players, DVD recorders, audio/video receivers, home-theaters-in-a-box, and Blu-ray Disc players
- Other markets:
  - Gaming primarily comprised of video game consoles
  - Mobile primarily comprised of cell phones and other mobile devices
  - Automotive primarily comprised of in-car DVD players
  - Licensing services revenue from the administration of joint licensing programs

Our PC market represented approximately 40% of our licensing revenue in fiscal 2008, 35% in fiscal 2009 and 36% in the fiscal year-to-date period ended June 25, 2010. Our PC market was driven primarily by the inclusion of our technologies in media applications or operating systems often included in PC shipments. These media applications and operating systems include DVD playback and/or DVD authoring functionality that use our technologies. Our PC market also includes revenue from our PC Entertainment Experience (PCEE) program, a suite of technologies that enhances the audio quality of media on entertainment-oriented PCs.

Windows 7, Microsoft s newest operating system, incorporates Dolby technologies, including Dolby Digital Plus, in four of the six available editions, Home Premium, Ultimate, Professional, and Enterprise. Prior to the release of Windows 7, our technologies were only included in premium consumer editions of Microsoft operating systems. Almost half of the world s PC shipments are to the business market. The inclusion of our technologies in the Professional and Enterprise editions of Windows 7, typically purchased by the business market, increases the potential for us to receive royalties on a greater percentage of PC shipments.

There are several uncertainties associated with the Windows 7 opportunity, including the following:

- The inclusion of our technologies in Windows 7 Professional and Enterprise editions could result in our technologies residing in a greater percentage of PCs, though the benefit from this potential significant increase in reported units will be partially offset by substantial discounts, thereby reducing the average per unit royalty we would receive from Microsoft over time.

We currently receive royalties from PCs that ship with third-party DVD software applications containing our technologies. As Windows 7 provides enhanced DVD playback and incorporates some of the functionality found in these third-party software applications, some PC manufacturers have excluded, and others may exclude in the future, third-party DVD software applications from their offerings.

Business customers may take several years to upgrade to Windows 7 given the longer adoption cycles associated with enterprise customers.

Consumers are increasingly purchasing low-cost PCs, particularly netbooks and tablet PCs, and this trend could continue in the future. We expect these PCs to be sold with Windows 7 Starter or Home Basic editions or other non-Windows operating systems, which do not contain our technologies.

Our broadcast market, driven by demand for our technologies in televisions and set-top boxes, represented approximately 20% of our licensing revenue in fiscal 2008, 25% in fiscal 2009, and 26% in the fiscal year-to-date period ended June 25, 2010. Our broadcast market has benefited from increased global shipments of digital televisions containing our technologies in the current fiscal year-to-date period. We view the broadcast market as an area for continued growth, primarily driven by broadcast markets outside of the United States. We also view broadcast services, such as terrestrial broadcast or IPTV services, which operate under particular bandwidth constraints, as another area of opportunity for us to offer Dolby Digital Plus, HE AAC, and Dolby Pulse, which enable the delivery of high-quality audio content at reduced bit rates. Notwithstanding our success in the broadcast market to date, we may not be able to capitalize on these opportunities and actual results may differ from our expectations.

Our CE market, which was driven primarily by revenue attributable to sales of Blu-ray Disc and DVD players, represented approximately 25% of licensing revenue in fiscal 2008 and 2009, and 23% in the fiscal year-to-date period ended June 25, 2010. Within our CE market in the fiscal year-to-date period ended June 25, 2010, we experienced a decrease in revenue from standard definition DVD players and an increase in revenue from Blu-ray Disc players when compared to the prior fiscal year-to-date period. Blu-ray Disc continues to represent a revenue growth opportunity within our CE market, as Blu-ray Disc players are required to support Dolby Digital for primary audio content and Dolby Digital Plus for secondary audio content, and Dolby TrueHD is an optional audio standard. However, there is a risk that revenue growth from Blu-ray Disc players may not offset future declines in revenue from standard definition DVD players.

Revenue generated from our other markets was driven by gaming, mobile, automotive, and licensing services. Gaming and automotive revenue was primarily driven by sales of video game consoles, portable gaming devices, and in-car entertainment systems with Dolby Digital, Dolby Digital Plus, ATRAC, and Dolby TrueHD technologies. Mobile revenue was primarily driven by demand for the AAC, HE AAC, and Dolby Pulse audio compression technologies incorporated into mobile devices and to a lesser extent by Dolby Mobile, our suite of postprocessing technologies optimized for mobile devices. We view the mobile market as an area of opportunity to increase revenue, however actual results may differ from our expectations. Revenue from licensing services was primarily driven by demand for standards-based audio compression technologies used in broadcast, PCs, and CE devices.

We have introduced new products and technologies that may allow further expansion of our broadcast and gaming markets, including our Professional Reference Monitor product, Dolby Volume, and Dolby Axon. Our Professional Reference Monitor is a flat-panel video reference display for imaging professionals that provides color accuracy and high contrast. Our Professional Reference Monitor uses our dynamic range imaging technologies, which enable enhanced contrast, extended brightness and dynamic range, along with reduced power consumption in LED backlit LCD televisions. Dolby Volume is a sound leveling technology providing consistent volume and quality across various programs by performing measurement and analysis of signals according to a model based on the characteristics of human hearing. Dolby Axon is a surround sound voice technology that enables online gamers to perceive the location of other players, thus making the online gaming experience more real and immersive. We do not anticipate generating significant revenue from these products and technologies in fiscal 2010.

Digital entertainment products throughout the world incorporate our technologies. We expect that sales of products incorporating our technologies in emerging economies, such as Brazil, China, India, and Russia, will increase as consumers in these markets have more disposable income to purchase entertainment products, although

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there can be no assurance that this will occur. We also expect that manufacturers from lower cost manufacturing countries, including China, will increase production of digital entertainment products in the future to satisfy this increased demand. There are risks associated with the opportunities of doing business in emerging economies that have affected, and will continue to affect, our operating results, such as manufacturers failing to report or underreporting product shipments containing our technologies.

Products revenue consists primarily of sales of equipment to cinema operators and broadcasters representing 11%, 13%, and 20% of our total revenue in fiscal 2008, 2009, and in the fiscal year-to-date period ended June 25, 2010, respectively.

Our cinema products represented approximately 68% of total products revenue in fiscal 2008, 82% in fiscal 2009, and 91% in the fiscal year-to-date period ended June 25, 2010. This increase in cinema products revenue as a percentage of total revenue and total product revenue in the fiscal year-to-date period ended June 25, 2010 was primarily due to increased unit sales of 3D and digital cinema products, coupled with a change in revenue recognition accounting standards. See Note 2 *Summary of Significant Accounting Policies* for additional details about the changes in revenue recognition accounting standards.

There is a trend in the cinema industry to transition to digital cinema. Digital cinema offers the motion picture industry a possible means to achieve cost savings in printing and distributing movies, to combat piracy, and to enable repeated movie playback without degradation in image and audio quality. We offer our Dolby Digital Cinema server, which allows for the storage and playback of digital content. We expect most exhibitors, which are either constructing new theatres or upgrading existing theatres, to choose digital cinema over traditional film cinema.

Our digital 3D products provide 3D image capabilities when combined with a digital cinema projector and server. We believe the success of recent 3D cinema releases is leading to the creation and distribution of more 3D cinema content. We expect the increased 3D cinema releases to further drive the transition to 3D enabled screens because more 3D screens will be needed to accommodate the increasing number of 3D motion pictures. We view the transition to 3D enabled screens as a growth opportunity; however, actual results may differ from our expectations.

Digital cinema is based on open standards, which, unlike traditional cinema standards, do not include our proprietary audio technologies. We are facing more pricing and other competitive pressures in the digital cinema products market than we have historically experienced in our traditional cinema market.

During the quarter ending March 26, 2010, strong market demand for 3D and digital cinema units, combined with component constraints within the electronics industry and supplier manufacturing capacity constraints limited our ability to ship 3D and digital cinema products and accessories, creating a backlog of orders. The backlog of orders declined during the quarter ending June 25, 2010 and we believe that we will fulfill the majority of the remaining backlog by the end of our fiscal 2010.

Several competitors have introduced digital cinema solutions into the market that support the presentation of movies with higher resolution 4K digital cinema projectors. Certain major U.S. exhibitors have begun installing 4K digital cinema equipment into their theatres. In the future, other exhibitors may feel that they need to outfit some or all of their theatres with 4K digital cinema equipment to compete in the same markets where competitors are promoting 4K solutions. Dolby currently does not offer a 4K digital cinema solution. If we do not offer a solution that supports 4K presentation, our future prospects in digital cinema may be limited and our business could be adversely affected.

Our traditional cinema products are primarily used to read and decode a film s soundtrack, to calibrate cinema sound systems, and to adapt analog cinema audio systems to digital audio formats. Revenue from our traditional cinema products has declined as a percentage of total cinema products revenue in the fiscal year-to-date period ended June 25, 2010 as the cinema industry transitions to digital cinema and we expect this decline to continue.

Our broadcast products represented approximately 24% of products revenue in fiscal 2008, 13% in fiscal 2009, and 8% in the fiscal year-to-date period ended June 25, 2010. Our broadcast products are used to encode, transmit, and decode multiple channels of high-quality audio content for DTV and HDTV program production and broadcast distribution and to measure the subjective loudness of audio content within broadcast programming. The decrease in broadcast product revenue as a percentage of total product revenue in the fiscal year-to-date period ended June 25, 2010 was primarily due to the increase in 3D and digital cinema product revenue noted above.

Our services revenue, which represented approximately 5%, 4%, and 3% of total revenue in fiscal 2008, 2009, and in the fiscal year-to-date period ended June 25, 2010, respectively, is primarily tied to the motion picture production industry and, in particular, to the number of films being made by studios and independent filmmakers. Several factors influence the number of films produced in a given fiscal period, including strikes and work stoppages within the motion picture industry as well as tax incentive arrangements that many governments provide filmmakers to promote local filmmaking.

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Critical Accounting Policies and Estimates

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

We consider the following to be critical accounting policies and estimates because we believe they are both important to the portrayal of our financial condition and results of operations and they require management judgments about matters that are uncertain. If actual results or events differ materially, our reported financial condition and results of operation for future periods could be materially affected. See our *Risk Factors* for further information on the potential risks to our future results of operations.

Revenue Recognition

We enter into transactions to license technologies, trademarks, and expertise and to sell products and services. We recognize revenue when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller s price to the buyer is fixed or determinable, and collectibility is probable. Judgment is required to assess whether collectibility is probable. We determine collectibility based on an evaluation of our customer s recent payment history, the existence of a standby letter of credit between the customer s financial institution and our financial institution, and other factors.

In October 2009, the FASB amended the revenue recognition accounting standards to exclude sales of qualifying tangible products that contain essential software elements from the scope of the software revenue recognition standards. In the first quarter of fiscal 2010, we adopted this accounting standard for revenue arrangements entered into or materially modified after September 25, 2009. Due to this adoption, we no longer account for product sales that contain software elements under the software revenue recognition standards.

Also in October 2009, the FASB amended the accounting standards for multiple-element (ME) revenue arrangements to:

- Provide updated guidance on whether these arrangements exist, how the elements should be separated, and what consideration should be allocated to each element;

- Require an entity to allocate consideration using the estimated selling price (ESP) of each element if the entity does not have vendor specific objective evidence (VSOE) of the selling price or third-party evidence (TPE) of the selling price; and,

- Require a vendor to allocate consideration using the relative selling price method.

In the first quarter of fiscal 2010, we adopted the amended accounting standards for ME revenue arrangements entered into or materially modified after September 25, 2009. Prior to adoption, we were not able to establish VSOE of the standalone selling price for the undelivered support and maintenance elements for a majority of our ME arrangements. The previous accounting standards required VSOE in order to allocate the arrangement consideration to each individual element. Since we had not established VSOE, we allocated the entire arrangement consideration to the undelivered element and ratably recognized the revenue over its estimated support period.

Under the new accounting guidance, we allocate the arrangement consideration to each element based on its relative selling price, which we establish using a selling price hierarchy. We determine the selling price of each element based on its VSOE, if available, TPE, if VSOE is not available, or ESP, if neither VSOE nor TPE is available. We typically are not able to establish VSOE or TPE for the individual elements in our ME arrangements; therefore, we estimate the selling price for these elements.

We determine our best estimate of the selling price for an individual element within a ME revenue arrangement using the same methods utilized to determine the selling price of an element sold on a standalone basis. If we sell the element on a standalone basis, we estimate the selling price by considering actual sales prices. Otherwise, we estimate the selling price by considering internal factors such as pricing practices and margin objectives. Consideration is also given to market conditions such as competitor pricing strategies, customer demands, and industry technology lifecycles. Management applies judgment to establish margin objectives, pricing strategies, and technology lifecycles.

We evaluate each element in a ME arrangement to determine whether it represents a separate unit of accounting. An element constitutes a separate unit of accounting when it has standalone value and delivery of an undelivered element is probable and within our control. When these criteria are not met, the delivered and undelivered elements are combined and the arrangement consideration is allocated to this combined single unit. Our adoption of the amended guidance changed our units of accounting for our revenue transactions by allowing us to use ESP to allocate the total consideration amongst the delivered and undelivered elements in an arrangement.

If the unit separation criteria are met, we account for each element within a ME arrangement (such as hardware, software, maintenance, and other services) separately and we allocate consideration based on the relative selling price of each element. For some arrangements, customers receive certain elements over a period after delivery of the initial product. These elements may include support and maintenance and/or the right to receive upgrades. Revenue allocated to the undelivered element is recognized over either its estimated service period or when the upgrade is delivered. We do not recognize revenue that is contingent upon the future delivery of products or services or upon future performance obligations. We recognize revenue for delivered elements only when we have completed all contractual obligations.

We account for the majority of our digital cinema server sales as ME arrangements that have two separate units, or elements, of accounting. The first element consists of our digital cinema server hardware and the accompanying software, which is essential to the functionality of the hardware. This element is typically delivered at the time of sale. The second element is the right to receive support and maintenance, which is included with the purchase of the hardware element and is typically delivered over a service period subsequent to the initial sale. The application of the new revenue accounting standards to our digital cinema server sales typically results in the allocation of a substantial majority of the arrangement consideration to the delivered hardware element based on its ESP, which we recognize as revenue at the time of sale. A small portion of the arrangement consideration is allocated to the undelivered support and maintenance element, based on its ESP, and is recognized as revenue ratably over the estimated service period, which is typically one year.

Goodwill, Intangible Assets, and Impairment of Long-Lived Assets

We evaluate and test our goodwill for impairment at a reporting-unit level. A reporting unit is an operating segment or one level below. Our operating segments are aligned with the management principles of our business. The goodwill impairment test is a two-step process. In the first step, we compare the carrying value of the net assets of a reporting unit, including goodwill, to its fair value. If we determine that the fair value of the reporting unit is less than its carrying value, we move to the second step to determine the implied fair value of the reporting unit s goodwill. If the carrying value of a reporting unit s goodwill exceeds its implied fair value, we would record an impairment loss equal to the difference. We test goodwill for impairment annually during our third fiscal quarter and if an event occurs or circumstances change such that there is an indication of a reduction in the fair value of a reporting unit below its carrying value.

We use the income approach to determine the fair value of our reporting units, which is based on the present value of estimated future cash flows for each reporting unit. Fair value reflects the price a market participant would be willing to pay in a potential sale of the reporting unit. We have two reporting units Via which has no assigned goodwill and Dolby Entertainment Technology (DET) with goodwill of $258.9 million at the end of our third quarter of fiscal 2010. The cash flow model was based on our best estimate of future revenue and operating costs. We estimated our future revenue by applying growth rates, consistent with those used in our internal forecasts, to our current revenue forecasts. The revenue and cost estimates were based on several sources including our historical information, third-party industry data, and review of our internal operations. The cash flow forecasts were adjusted

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by a discount rate of approximately 13% based on our weighted average cost of capital derived by using the capital asset pricing model. The primary components of this model include weighting our total asset structure between our equity and debt, the risk-free rate of return on U.S. Treasury bonds, market risk premium based on a range of historical returns and forward-looking estimates, and the beta of our common stock. Our model utilized an effective tax rate of approximately 35%.

Based on the methodology described above, the fair value of our DET reporting unit exceeds its carrying value; therefore, we did not recognize an impairment charge related to goodwill in the third quarter of fiscal 2010. Our market capitalization at the end of our third quarter of fiscal 2010 was approximately $7.5 billion, which exceeded the aggregate carrying value of our reporting units by approximately 400%.

Intangible assets with definite lives are amortized over their estimated useful lives. Our intangible assets principally consist of acquired technology, patents, trademarks, customer relationships, and contracts, which are amortized on a straight-line basis over their useful lives ranging from two to fifteen years.

We review long-lived assets, including intangible assets, for impairment whenever events or a change in circumstances indicate an asset s carrying value may not be recoverable. Recoverability of an asset is measured by comparison of its carrying amount to the total future undiscounted cash flows that the asset is expected to generate. If it is determined that an asset is not recoverable, an impairment loss is recorded in the amount by which the carrying amount of the asset exceeds its estimated fair value. See Note 3 *Composition of Certain Financial Statement Captions* for a discussion of an impairment charge recognized in the third quarter of fiscal 2010.

Accounting for Income Taxes

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

Our policy is to recognize a tax benefit from an uncertain tax position only if it is more likely than not that the tax position is sustainable upon examination by tax authorities. We include interest and penalties related to gross unrecognized tax benefits within our provision for income taxes. When accrued interest and penalties do not ultimately become payable, amounts accrued are reduced in the period and are reflected as a reduction of the overall income tax provision.

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

Stock-Based Compensation

We determine the expense for all employee stock-based compensation awards by estimating their fair value and by recognizing that value as an expense, on a ratable basis, in the condensed consolidated financial statements over the requisite service period in which our employees earn the awards. We utilize the Black-Scholes option pricing model to determine the fair value of employee stock options at the date of the grant. To determine the fair value of a stock-based award using the Black-Scholes option pricing model we make assumptions regarding the expected term of the award, the expected future volatility of our stock price over the expected term of the award, and the risk-free interest rate over the expected term of the award. We estimate the expected term of our stock-based awards by evaluating historical exercise patterns of our employees. We utilize a blend of the historical volatility of our common stock and the implied volatility of our traded options as an estimate of the expected volatility of our stock price over the expected term of the awards. We use an average interest rate based on U.S. Treasury instruments with terms consistent with the expected term of our awards to estimate the risk-free interest rate. We reduce the stock-based compensation expense for estimated forfeitures based on our historical experience. We are required to estimate forfeitures at the time of the grant and revise our estimate, if necessary, in subsequent periods if actual forfeitures differ from our estimate.

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Investments

Investments that have original maturities of 91 days or more at the date of purchase and with a current maturity of less than one year are classified as short-term investments. Investments that have maturities of more than one year are classified as long-term investments. All of our investments, except for our auction rate certificates, are classified as available-for-sale securities. Our investments are recorded at fair value in the condensed consolidated balance sheets. Unrealized gains and losses on our available-for-sale securities, except for credit losses, are reported as a component of accumulated other comprehensive income, while realized gains and losses and credit losses are reported as a component of net income. Our auction rate certificates are classified as trading securities. Unrealized gains or losses on trading securities are reported as a component of net income.

Results of Operations

Revenue

	Fiscal Quarter Ended		Change		Fiscal Year-to-Date Ended		Change	
	June 26, 2009	June 25, 2010	$	%	June 26, 2009	June 25, 2010	$	%
	($ in thousands)							
Revenue:								
Licensing	$ 142,141	$ 170,326	$ 28,185	20%	$ 456,076	$ 532,045	$ 75,969	17%
Percentage of total revenue	*83%*	*74%*			*82%*	*77%*		
Products	21,790	52,651	30,861	142%	75,744	140,147	64,403	85%
Percentage of total revenue	*13%*	*23%*			*14%*	*20%*		
Services	7,313	7,292	(21)	0%	23,806	22,714	(1,092)	(5)%
Percentage of total revenue	*4%*	*3%*			*4%*	*3%*		
Total revenue	**$ 171,244**	**$ 230,269**	**$ 59,025**	**34%**	**$ 555,626**	**$ 694,906**	**$ 139,280**	**25%**

Licensing. The 20% increase in licensing revenue from the third quarter of fiscal 2009 to the third quarter of fiscal 2010 was primarily driven by an increase in revenue from our PC and broadcast markets, partially offset by a decrease in revenue from our CE and other markets. The increase in revenue from our PC market was primarily driven by a greater number of computers sold containing Windows operating systems that incorporate our technologies in the third quarter of fiscal 2010 when compared to the third quarter of fiscal 2009. The increase in revenue from our broadcast market was primarily attributable to an increase in the number of digital televisions that incorporate our technologies sold in Europe in the third quarter of fiscal 2010 when compared to the third quarter of fiscal 2009. The decrease in revenue from our CE market was primarily driven by higher revenue recognized in the third quarter of fiscal 2009 related to camcorders and Blu-ray Disc players incorporating our technologies sold in prior periods. The decrease in revenue from our other markets was primarily due to a decrease in mobile revenue, which was driven by higher revenue recognized in the third quarter of fiscal 2009 attributable to mobile devices incorporating our technologies sold in prior periods.

The 17% increase in licensing revenue from the fiscal year-to-date period ended June 26, 2009 to the fiscal year-to-date period ended June 25, 2010 was primarily driven by increases in our broadcast, PC, and CE markets. The increases in revenue from our broadcast and PC markets are due to the same reasons discussed above with respect to the changes from the third quarter of fiscal 2009 to the third quarter of fiscal 2010. The increase in revenue from our CE market was primarily driven by an increase in revenue from Blu-ray Disc players incorporating our technologies in the fiscal year-to-date period ended June 25, 2010 when compared to the fiscal year-to-date period ended June 26, 2009.

Products. The 142% increase in products revenue from the third quarter of fiscal 2009 to the third quarter of fiscal 2010 was due to increases in 3D and digital cinema units sold, coupled with our adoption of new revenue recognition accounting standards in the beginning of fiscal 2010. We sold a greater number of digital cinema and 3D units in the third quarter of fiscal 2010 when compared with the third quarter of fiscal 2009 due to strong market demand driven by the success of recent 3D cinema releases. In addition, the new revenue recognition accounting standards allow us to recognize substantially all of the revenue associated with our digital cinema products sold in the period of sale. See Note 2 *Summary of Significant Accounting Policies* for additional details.

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The 85% increase in product revenue from the fiscal year-to-date period ended June 26, 2009 to the fiscal year-to-date period ended June 25, 2010 was due to increases in 3D and digital cinema unit sales, coupled with our adoption of the new revenue recognition accounting standards. See Note 2 *Summary of Significant Accounting Policies* for additional details on our adoption of the new revenue recognition standards. We sold a greater number of 3D and digital cinema units in the fiscal year-to-date period ended June 25, 2010 when compared with the fiscal year-to-date period ended June 26, 2009 as a result of strong market demand driven by the success of recent 3D cinema releases and promotions that offered certain price discounts for various bundled sets of digital cinema units, 3D units, and 3D glasses in the fiscal year-to-date period ended June 25, 2010. This increase was partially offset by the fact that our second quarter of fiscal 2009 results included the benefit of recognizing previously deferred revenue as a result of achieving compliance with the Digital Cinema Initiative (DCI) specifications in that period. Prior to the second quarter of fiscal 2009, we had not yet achieved compliance with the DCI specifications, thus we had deferred the majority of the revenue from our digital cinema products sold.

Services. Services revenue from the third quarter of fiscal 2009 to the third quarter of fiscal 2010 was relatively flat. Services revenue from the fiscal year-to-date period ended June 26, 2009 to the fiscal year-to-date period ended June 25, 2010 decreased 5%. This decrease was primarily attributable to a $1.2 million benefit in the second quarter of fiscal 2009 from recognizing virtual print fees that were previously deferred. Prior to the second quarter of fiscal 2009, these virtual print fees were deferred because we had not yet achieved compliance with the DCI specifications.

Gross Margin

	Fiscal Quarter Ended		**Fiscal Year-to-Date Ended**	
	June 26, 2009	**June 25, 2010**	**June 26, 2009**	**June 25, 2010**
		($ in thousands)		
Gross margin:				
Cost of licensing	3,362	3,719	11,223	13,282
Gain from amended patent licensing agreement			(20,041)	
Licensing gross margin percentage	*98%*	*98%*	*102%*	*98%*
Licensing gross margin percentage excluding gain from amended patent licensing	*98%*	*98%*	*98%*	*98%*
Cost of products	13,142	23,336	46,776	72,042
Products gross margin percentage	*40%*	*56%*	*38%*	*49%*
Cost of services	3,246	3,407	9,546	10,554
Services gross margin percentage	*56%*	*53%*	*60%*	*54%*
Impairment of products provided under operating leases		9,594		9,594
Total gross margin percentage	**88%**	**83%**	**91%**	**85%**

Licensing Gross Margin. We license intellectual property to our customers that may be internally developed, acquired by us, or licensed from third parties. Our cost of licensing consists principally of amortization expenses associated with purchased intangible assets and intangible assets acquired in business combinations. Our cost of licensing also includes third-party royalty obligations paid to license intellectual property that we then sublicense to our customers.

Licensing gross margin was unchanged from the third quarter of fiscal 2009 to the third quarter of fiscal 2010. Licensing gross margin decreased four points from the fiscal year-to-date period ended June 26, 2009 to the fiscal year-to-date period ended June 25, 2010, due primarily to a gain from an amended patent licensing agreement that we recorded within cost of revenue in our consolidated statement of operations in the first quarter of fiscal 2009. Excluding the gain from the amended patent licensing agreement, our licensing gross margin was unchanged from the fiscal year-to-date period ended June 26, 2009 to the fiscal year-to-date period ended June 25, 2010.

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Products Gross Margin. Cost of products primarily consists of the cost of materials related to the products sold, applied labor, manufacturing overhead and, to a lesser extent, amortization of certain intangible assets. Products gross margin increased 16 points in the third quarter of fiscal 2010 when compared to the third quarter of fiscal 2009 due to a greater proportion of higher margin 3D and digital cinema products sold in the third quarter of fiscal 2010. These products carried a higher gross margin in the third quarter of fiscal 2010 due, in part, to cost reductions and to the restructuring of our manufacturing operations in the third quarter of fiscal 2009.

Products gross margin increased 11 points from the fiscal year-to-date period ended June 26, 2009 to the fiscal year-to-date period ended June 25, 2010, due to the same reason discussed above with respect to the changes from the third quarter of fiscal 2009 to the third quarter of fiscal 2010. This increase was also due to the recognition of significant amounts of low margin digital cinema-related products revenue as a result of achieving compliance with the DCI specifications in the second quarter of fiscal 2009.

Services Gross Margin. Cost of services primarily consists of payroll and benefits costs for employees performing our professional services, the cost of outside consultants, and reimbursable expenses incurred on behalf of customers. Services gross margin decreased three points in the third quarter of fiscal 2010 when compared to the third quarter of fiscal 2009 due to a higher percentage of virtual print fees, which have a higher gross margin due to lower associated costs, in the third quarter of fiscal 2009. Services gross margin decreased six points from the fiscal year-to-date period ended June 26, 2009 to the fiscal year-to-date period ended June 25, 2010 for the same reason.

Impairment of Products Provided Under Operating Leases. Our products provided under operating leases represent digital cinema equipment that we leased to exhibitors beginning in fiscal 200