Dolby Laboratories, Inc. DLB [NYSE] | ★★

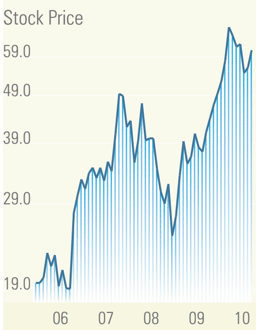
Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
67.22 USD	55.00 USD	38.50 USD	77.00 USD	Medium	Narrow	B	—	Media - Diversified

Dolby Reports 4Q Results

by Michael Holt
Senior Stock Analyst
Analysts covering this company do not own its stock.

Pricing data through November 10, 2010.
Rating updated as of
November 10, 2010.

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.



Analyst Note Nov. 05, 2010

Dolby delivered another quarter of solid results to wrap up its fiscal year. After reviewing the firm's fourth-quarter earnings and 2011 projections, we remain comfortable that Dolby's earnings power remains strong and we are maintaining our fair value estimate.

Total revenue increased 39% year over year, bringing full-year revenue growth to 28%. Sales benefited from strong growth in the broadcast market, as global TV attach rates surpassed the 50% mark. Gross margins fell 250 basis points to 86% for the fiscal year. The PC segment was a mixed bag during the quarter, with strong adoption of Dolby-related Windows 7 SKUs offsetting a decline in third party software sales and revenue from Blu-Ray related products overcoming declining revenue from traditional DVD royalties.

Looking ahead to 2011, management expects to deliver total revenue between $950 million and $990 million. However, we believe year-over-year growth of more than 10% is feasible and we are maintaining our 11% growth projections above management's guided range. Our key assumptions for the upcoming year include the company growing its global TV attach rates by another 8-10 points (on unit growth of 3%-5%) and PC shipment increases of 9%-11%.

Thesis May 04, 2010

Dolby's dominant presence in movie theaters and home audio equipment has resulted in a steady stream of royalty income. However, as a new generation of audio and video standards evolves, Dolby must expand into new markets to maintain its dominance.

Dolby's economic moat is derived from technologies that are set as industry standards. Once a standard is established, Dolby's receives patent royalties on the equipment used to package and view content. Once Dolby Digital became the audio standard for traditional DVDs, Dolby leveraged the position into royalty income on the sale of televisions, DVD players, and even computers. Dolby's impressive ability to capture income from multiple sources on a single standard has helped drive licensing revenue growth averaging 26% over the past seven years. Additionally, Dolby has become difficult to displace at the consumer level because of switching costs. Competing standards are available, but Dolby's empire remains protected from consumers that demand backward compatibility to support their existing investments in content.

As demand for traditional DVD products fades, Dolby is working to establish its place in the next generation of content delivery standards. Unlike the DVD era, where a single audio standard ruled for years, the direction of high-definition content delivery is murky. Blu-ray has emerged as the leading technology for physical media, but sales have been disappointing. Weak consumer spending has hurt adoption, but we also believe consumers are looking to alternate delivery methods such as real-time delivery via the Internet and cable or satellite. In contrast to the previous generation, there is no longer a single distribution point to lock in. We believe Dolby will still capitalize on new technologies, but with multiple delivery methods there is more room for competitors to attack. Even if Blu-ray becomes pervasive, Dolby no longer has a monopoly, as a competing technology from DTS is also required on Blu-ray discs.

Although Dolby faces a more challenging environment, we believe it is positioned to capitalize on new opportunities, given its history of innovation and strong brand recognition. Dolby is established in the United States for digital broadcast, cable, and satellite and is gaining acceptance internationally, securing a place in the digital standards for many countries including France, South Korea, and Brazil. Additionally, we are optimistic about efforts such as Dolby Mobile and Dolby Pulse, where the firm seeks to secure a position in rapidly evolving markets such as mobile phones and online content delivery. Dolby

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Close Competitors	Currency(Mil)	Market Cap	TTM Sales	Oper Income	Net Income
Dolby Laboratories, Inc.	USD	7,578	859	397	263

Morningstar data as of November 10, 2010.

is also attempting to move out of its traditional audio-only role into areas such as video, but we are concerned that the challenges outside its core audio expertise may prove difficult to navigate. Ultimately, we believe the strength of Dolby's grip on the home theater experience will provide a strong base from which the firm will be able to successfully expand into new markets.

Valuation, Growth and Profitability

We are raising our fair value estimate to $55 per share from $38. We expect double-digit revenue growth to continue during the next five years as a result of strength in the broadcast and PC markets. Dolby technologies are already shipping on half the television units in the world, and as the other half convert to digital, we expect the same pattern to emerge. We believe increased competition will limit margin expansion, but we expect operating margins will remain above 45% during the next five years. We project that Dolby will easily earn its cost of capital, with projected returns on invested capital averaging more than 50%.

Risk

Consumer electronics are discretionary purchases, leaving Dolby exposed to economic slowdowns. As new technologies like Blu-ray begin to replace traditional DVDs, Dolby may be forced to share the spotlight with competitors such as DTS. Royalties may be difficult to collect from less scrupulous manufacturers outside the U.S. As Dolby's patents expire, switching costs could be lowered if competitors offer alternative solutions to play legacy media collections.

Bulls Say

- Dolby's extensive patent portfolio, brand, and long-term customer relationships form the basis of its economic moat.
- Dolby's technologies continue to be included as new digital broadcasting standards are rolled out internationally.
- Consumers have purchased millions of DVDs with Dolby Digital encoding, ensuring demand for compatible players even as new technologies emerge.

Bears Say

- Blu-ray's emergence has been slow, and today's consumers have multiple options to bring HD content into the home.
- Some of Dolby's patents begin expiring in the next few years, which could reduce revenue from older technologies.
- The electronics using Dolby's technology are mostly discretionary products. An economic downturn could dramatically affect demand.
- Dolby struggles to enforce its intellectual property in China. As emerging markets continue to play a bigger role, the firm will have to devote more resources to royalty collection.

Financial Overview

Financial Health: Dolby has a healthy balance sheet with more than $900 million in cash and investments with minimal debt. Additionally, the firm generates free cash flow equal to more than 30% of sales.

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Company Overview

Profile: Dolby Laboratories develops audio and surround sound for cinema, broadcast, home audio systems, in-car entertainment systems, DVD players, games, televisions, and personal computers. The company generates three fourths of its revenue from licensing its technology to consumer electronics manufacturers around the world. The rest of revenue comes from equipment sales to professional producers and audio engineering services.

Management: Ray Dolby founded Dolby Laboratories in 1965. Through a series of related trusts, he holds nearly all the Class B stock and controls more than 90% of total voting power. In 2009, Peter Gotcher assumed the role of chairman and Kevin Yeaman stepped up from CFO to become president and CEO. The board appears to contain a few seasoned executives and venture capitalists that should provide a good source of advice for management. Change-of-control provisions are not shareholder-friendly, favoring management in the case of a takeover.

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Analyst Notes

Nov. 05, 2010

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Jul. 30, 2010

Dolby Reports 3Q Results

Dolby reported solid third-quarter results that were in line with our projections; our fair value estimate is unchanged.

As expected, seasonality led to a 5% sequential decline in sales, but year-over-year, revenue was up an impressive 35% for the quarter. Although Dolby's technology is most famous for its inclusion in DVD players and A/V receivers, the products driving the next stage of growth are the PC and Televisions technologies that now account for 62% of its licensing revenue. Dolby's success in securing a position as a standard for terrestrial broadcast in countries all over the world has driven extremely high attach rates with global television manufacturers. In mobile devices, the firm's position in Windows 7 SKUs is driving the bulk of revenue today, but the early success with laptops and mobile phones indicates that Dolby is beginning to cement its position as a de facto standard in a new generation of devices (tablets, smartphones, etc.) that are becoming the dominant force behind the consumer electronics market.

Operating margin dipped to 42% for the quarter, but this was largely due to a one-time impairment of assets related to the digital cinema segment. Removing this impairment, Dolby delivered an operating margin of 46%, equivalent to the same period last year.

Disclaimers & Disclosures

No Morningstar employees are officers or directors of this company. Morningstar Inc. does not own more than 1% of the shares of this company. Analysts covering this company do not own its stock. The information contained herein is not represented or warranted to be accurate, correct, complete, or timely. This report is for information purposes only, and should not be considered a solicitation to buy or sell any security.

Dolby Laboratories, Inc. DLB

Sales USD Mil	Mkt Cap USD Mil	Industry	Sector
859	7,578	Media - Diversified	Media

Dolby Laboratories develops audio and surround sound for cinema, broadcast, home audio systems, in-car entertainment systems, DVD players, games, televisions, and personal computers. The company generates three fourths of its revenue from licensing its technology to consumer electronics manufacturers around the world. The rest of revenue comes from equipment sales to professional producers and audio engineering services.

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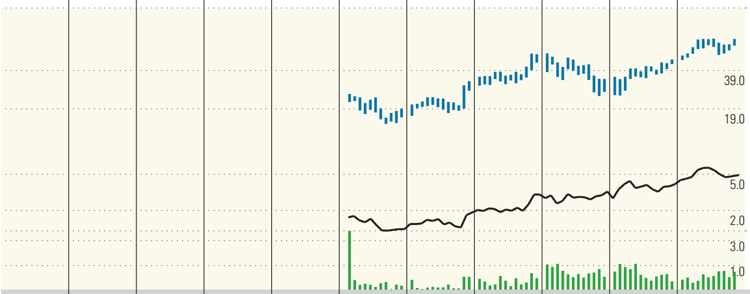
San Francisco, CA 94103-4813
Phone: 1 415 558-0200Website: http://www.dolby.com

Morningstar Rating	Last Price	Fair Value	Uncertainty	Economic Moat™	Stewardship Grade
★★	67.22	55.00	Medium	Narrow	B

per share prices in USD

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	YTD	
					25.45	32.27	53.44	53.63	47.98	70.14	Annual Price High
					14.50	16.92	29.68	24.50	24.77	47.59	Low
											Recent Splits



Price Volatility
Monthly High/Low
Rel Strength to S&P 500

52 week High/Low
70.14 - 41.67

10 Year High/Low
70.14 - 14.50

Bear-Market Rank
0 (10=worst)

Trading Volume Million

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	YTD	Stock Performance
—	—	—	—	—	—	81.9	60.3	-34.1	45.7	40.8	Total Return %
—	—	—	—	—	—	68.3	56.8	4.4	22.3	31.5	+/- Market
—	—	—	—	—	—	56.4	64.6	10.1	-22.7	21.1	+/- Industry
—	—	—	—	—	—	—	—	—	—	0.0	Dividend Yield %
—	—	—	—	—	1784	3363	5488	3688	5448	7578	Market Cap USD Mil

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM	Financials
—	125	162	217	289	328	392	482	640	720	859	Revenue USD Mil
—	59.5	64.3	66.1	68.3	75.5	80.6	84.6	89.4	91.0	85.7	Gross Margin %
—	10	1	48	68	84	130	187	287	364	397	Oper Income USD Mil
—	7.9	0.3	21.9	23.5	25.6	33.1	38.8	44.8	50.5	46.3	Operating Margin %
—	6	0	31	40	52	90	143	199	243	263	Net Income USD Mil
—	0.07	—	0.36	0.43	0.50	0.80	1.26	1.74	2.11	2.27	Earnings Per Share USD
—	—	—	—	—	—	—	—	—	—	—	Dividends USD
—	85	85	86	93	104	112	114	115	115	116	Shares Mil
—	—	—	—	—	4.66	5.96	7.86	10.01	12.36	13.07	Book Value Per Share USD
—	—	—	40	47	80	133	163	264	273	337	Oper Cash Flow USD Mil
—	—	—	-7	-13	-15	-8	-16	-14	-14	-30	Cap Spending USD Mil
—	—	—	33	34	66	124	147	251	259	308	Free Cash Flow USD Mil

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM	Profitability
—	4.5	—	15.3	17.1	12.3	13.5	16.5	17.1	16.7	16.4	Return on Assets %
—	9.3	—	33.0	33.6	17.3	17.0	20.5	21.6	20.3	19.1	Return on Equity %
—	4.5	-0.1	14.2	13.8	15.9	22.9	29.6	31.2	33.8	30.6	Net Margin %
—	0.99	—	1.07	1.24	0.77	0.59	0.56	0.55	0.49	0.53	Asset Turnover
—	2.1	—	2.2	1.8	1.3	1.2	1.2	1.3	1.2	1.2	Financial Leverage

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	06-10	Financial Health
—	—	—	54	80	381	480	590	491	744	841	Working Capital USD Mil
—	—	—	15	14	12	11	10	8	6	4	Long-Term Debt USD Mil
—	61	—	94	143	461	594	797	1049	1341	1473	Total Equity USD Mil
—	—	—	0.16	0.09	0.03	0.02	0.01	0.01	0.00	0.00	Debt/Equity

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM	Valuation
—	—	—	—	—	31.0	34.1	35.3	16.4	23.6	29.7	Price/Earnings
—	—	—	—	—	—	—	—	—	1.3	1.9	P/E vs. Market
—	—	—	—	—	5.3	8.6	10.7	5.6	7.3	9.1	Price/Sales
—	—	—	—	—	3.7	5.2	6.3	3.3	3.9	5.1	Price/Book
—	—	—	—	—	22.7	22.9	29.5	13.2	20.1	23.1	Price/Cash Flow

Growth Rates Compound Annual

Grade: B	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	12.4	22.5	20.0	—
Operating Income %	26.8	41.0	39.9	—
Earnings/Share %	21.3	38.2	37.5	—
Dividends %	—	—	—	—
Book Value/Share %	26.0	28.4	48.0	—
Stock Total Return %	58.5	13.3	33.3	—
+/- Industry	32.1	9.9	21.4	—
+/- Market	47.0	19.0	33.5	—

Profitability Analysis

Grade: C	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	19.1	19.4	-5.3	22.4
Return on Assets %	16.4	15.2	-2.6	8.6
Fixed Asset Turns	9.2	6.2	4.2	7.1
Inventory Turns	9.1	5.8	8.8	14.0
Revenue/Employee USD K	756.6	561.0*	—	872.4
Gross Margin %	85.7	84.2	35.0	39.7
Operating Margin %	46.3	38.6	10.5	14.4
Net Margin %	30.6	26.7	-5.3	9.8
Free Cash Flow/Rev %	35.8	31.5	10.3	0.1
R&D/Rev %	9.6	0.1	—	10.0

Financial Position

Grade: A	09-09 USD Mil	06-10 USD Mil
Cash	452	519
Inventories	13	17
Receivables	23	48
Current Assets	901	1012
Fixed Assets	92	95
Intangibles	343	328
Total Assets	1581	1703
Payables	17	31
Short-Term Debt	2	2
Current Liabilities	157	172
Long-Term Debt	6	4
Total Liabilities	240	230
Total Equity	1341	1473

Valuation Analysis

	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	29.7	28.1	52.1	15.4
Forward P/E	21.5	—	—	14.4
Price/Cash Flow	23.1	21.7	19.6	8.1
Price/Free Cash Flow	25.3	23.9	25.6	16.0
Dividend Yield %	—	—	0.8	1.8
Price/Book	5.1	4.5	2.6	2.1
Price/Sales	9.1	7.5	2.6	1.3
PEG Ratio	1.4	—	—	1.6

*3Yr Avg data is displayed in place of 5Yr Avg

Quarterly Results

Revenue USD Mil	Sep 09	Dec 09	Mar 10	Jun 10
Most Recent Period	163.9	221.2	243.4	230.3
Prior Year Period	163.1	180.3	204.1	171.2

Rev Growth %	Sep 09	Dec 09	Mar 10	Jun 10
Most Recent Period	0.5	22.7	19.3	34.5
Prior Year Period	26.5	20.0	18.3	11.0

Earnings Per Share USD	Sep 09	Dec 09	Mar 10	Jun 10
Most Recent Period	0.38	0.59	0.74	0.55
Prior Year Period	0.42	0.68	0.60	0.44

Industry Peers by Market Cap

	Mkt Cap USD Mil	Rev USD Mil	P/E	ROE%
Dolby Laboratories,	7578	859	29.7	19.1

Major Fund Holders

	% of shares
T. Rowe Price Growth Stock	3.06
T. Rowe Price Mid-Cap Growth	2.76
Columbia Acorn Z	1.02

TTM data based on rolling quarterly data if available; otherwise most recent annual data shown.

Morningstar's Approach to Rating Stocks

Our Key Investing Concepts

- Economic Moat™ Rating
- Discounted Cash Flow
- Discount Rate
- Fair Value
- Uncertainty
- Margin of Safety
- Consider Buying/Consider Selling
- Stewardship Grades

At Morningstar, we evaluate stocks as pieces of a business, not as pieces of paper. We think that purchasing shares of superior businesses at discounts to their intrinsic value and allowing them to compound their value over long periods of time is the surest way to create wealth in the stock market.

We rate stocks 1 through 5 stars, with 5 the best and 1 the worst. Our star rating is based on our analyst's estimate of how much a company's business is worth per share. Our analysts arrive at this "fair value estimate" by forecasting how much excess cash--or "free cash flow"--the firm will generate in the future, and then adjusting the total for timing and risk. Cash generated next year is worth more than cash generated several years down the road, and cash from a stable and consistently profitable business is worth more than cash from a cyclical or unsteady business.

Stocks trading at meaningful discounts to our fair value estimates will receive high star ratings. For high-quality businesses, we require a smaller discount than for mediocre ones, for a simple reason: We have more confidence in our cash-flow forecasts for strong companies, and thus in our value estimates. If a stock's market price is significantly above our fair value estimate, it will receive a low star rating, no matter how wonderful we think the business is. Even the best company is a bad deal if an investor overpays for its shares.

Our fair value estimates don't change very often, but market prices do. So, a stock may gain or lose stars based just on movement in the share price. If we think a stock's fair value is $50, and the shares decline to $40 without much change in the value of the business, the star rating will go up. Our estimate of what the business is worth hasn't changed, but the shares are more attractive as an investment at $40 than they were at $50.

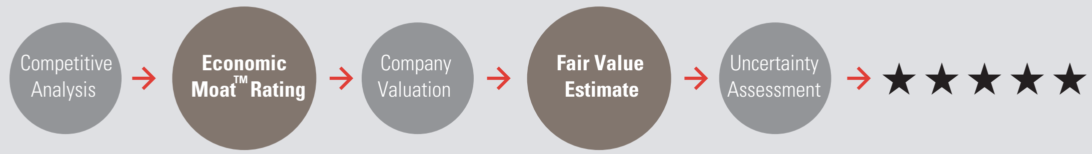
Because we focus on the long-term value of businesses, rather than short-term movements in stock prices, at times we may appear out of step with the overall stock market. When stocks are high, relatively few will receive our highest rating of 5 stars. But when the market tumbles, many more will likely garner 5 stars. Although you might expect to see more 5-star stocks as the market rises, we find assets more attractive when they're cheap.

We calculate our star ratings nightly after the markets close, and issue them the following business day, which is why the rating date on our reports will always be the previous business day. We update the text of our reports as new information becomes available, usually about once or twice per quarter. That is why you'll see two dates on every Morningstar stock report. Of course, we monitor market events and all of our stocks every business day, so our ratings always reflect our analyst's current opinion.

Economic Moat™ Rating

The Economic Moat™ Rating is our assessment of a firm's ability to earn returns consistently above its cost of capital in the future, usually by virtue of some competitive advantage. Competition tends to drive down such

Morningstar Research Methodology for Valuing Companies



Analyst conducts company and industry research:

- Management interviews
- Conference calls
- Trade-show visits
- Competitor, supplier, distributor, and customer interviews

The depth of the firm's competitive advantage is rated:

- None
- Narrow
- Wide

Analyst considers company financial statements and competitive position to forecast future cash flows.

Assumptions are input into a discounted cash-flow model.

DCF model leads to the firm's Fair Value Estimate, which anchors the rating framework.

An uncertainty assessment establishes the margin of safety required for the stock rating.

★
★★
★★★
★★★★
★★★★★

The current stock price relative to fair value, adjusted for uncertainty, determines the rating.

economic profits, but companies that can earn them for an extended time by creating a competitive advantage possess an Economic Moat. We see these companies as superior investments.

Discounted Cash Flow

This is a method for valuing companies that involves projecting the amount of cash a business will generate in the future, subtracting the amount of cash that the company will need to reinvest in its business, and using the result to calculate the worth of the firm. We use this technique to value nearly all of the companies we cover.

Discount Rate

We use this number to adjust the value of our forecasted cash flows for the risk that they may not materialize. For a profitable company in a steady line of business, we'll use a lower discount rate, also known as "cost of capital," than for a firm in a cyclical business with fierce competition, since there's less risk clouding the firm's future.

Fair Value

This is the output of our discounted cash-flow valuation models, and is our per-share estimate of a company's intrinsic worth. We adjust our fair values for off-balance sheet liabilities or assets that a firm might have--for example, we deduct from a company's fair value if it has issued a lot of stock options or has an under-funded pension plan. Our fair value estimate differs from a "target price" in two ways. First, it's an estimate of what the business is worth, whereas a price target typically reflects what other investors may pay for the stock. Second, it's a long-term estimate, whereas price targets generally focus on the next two to 12 months.

Uncertainty

To generate the Morningstar Uncertainty Rating, analysts consider factors such as sales predictability, operating leverage, and financial leverage. Analysts then classify their ability to bound the fair value estimate for the stock into one of several uncertainty levels: Low, Medium, High, Very High, or Extreme. The greater the level of uncertainty, the greater the discount to fair value required before a stock can earn 5 stars, and the greater the premium to fair value before a stock earns a 1-star rating.

Margin of Safety

This is the discount to fair value we would require before recommending a stock. We think it's always prudent to buy stocks for less than they're worth.The margin of safety is like an insurance policy that protects investors from bad news or overly optimistic fair value estimates. We require larger margins of safety for less predictable stocks, and smaller margins of safety for more predictable stocks.

Consider Buying/Consider Selling

The consider buying price is the price at which a stock would be rated 5 stars, and thus the point at which we would consider the stock an extremely attractive purchase. Conversely, consider selling is the price at which a stock would have a 1 star rating, at which point we'd consider the stock overvalued, with low expected returns relative to its risk.

Stewardship Grades

We evaluate the commitment to shareholders demonstrated by each firm's board and management team by assessing transparency, shareholder friendliness, incentives, and ownership. We aim to identify firms that provide investors with insufficient or potentially misleading financial information, seek to limit the power of minority shareholders, allow management to abuse its position, or which have management incentives that are not aligned with the interests of long-term shareholders. The grades are assigned on an absolute scale--not relative to peers--and can be interpreted as follows: A means "Excellent," B means "Good," C means "Fair," D means "Poor," and F means "Very Poor."