

Dolby Laboratories (DLB)

\$66.10 (As of 06/09/20)

Price Target (6-12 Months): **\$56.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 05/28/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM: C

Value: D

Growth: B

Momentum: C

Summary

The escalating cost of sales has been a cause of concern for Dolby in the past few quarters. Volatile cinema product sales and the price-sensitive entertainment industry are headwinds. Increased adoption of proprietary sound technologies could lead to severe competition in the global arena, threatening Dolby's market share. Higher licensing expenses further dent its profitability. Untimely deliveries from suppliers may lead to production cost hikes. Moreover, the COVID-19 pandemic has compelled various governments to impose restrictions on movie theatres for social distancing, which are likely to affect Dolby's revenues. It has not been able to provide a definitive financial outlook for fiscal 2020. However, the company has diligent capital allocation strategies to maintain a flexible capital structure and ensure growth in the long run.

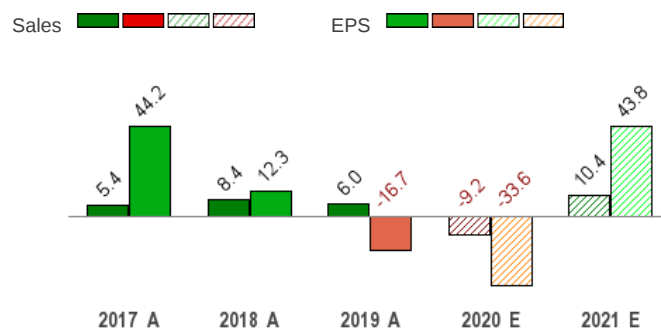
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$73.20 - \$44.68
20 Day Average Volume (sh)	431,852
Market Cap	\$6.7 B
YTD Price Change	-3.9%
Beta	0.86
Dividend / Div Yld	\$0.88 / 1.3%
Industry	Audio Video Production
Zacks Industry Rank	Bottom 23% (195 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-6.5%
Last Sales Surprise	-0.9%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	08/06/2020
Earnings ESP	0.0%
P/E TTM	30.9
P/E F1	40.8
PEG F1	3.1
P/S TTM	5.4

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	288 E	365 E	295 E	308 E	1,245 E
2020	292 A	352 A	232 E	253 E	1,129 E
2019	302 A	338 A	302 A	299 A	1,242 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.36 E	\$0.92 E	\$0.49 E	\$0.53 E	\$2.33 E
2020	\$0.47 A	\$0.86 A	\$0.07 E	\$0.22 E	\$1.62 E
2019	\$0.74 A	\$1.04 A	\$0.38 A	\$0.43 A	\$2.44 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/09/2020. The reports text is as of 06/10/2020.

Overview

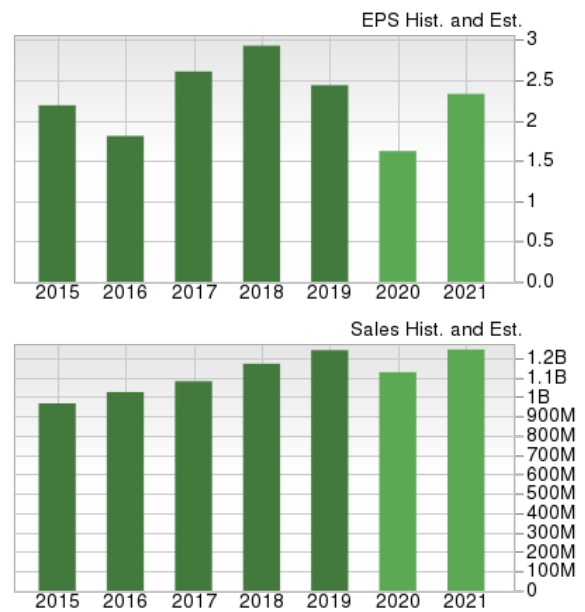
Founded in 1965, the San Francisco, CA-based company Dolby Laboratories, Inc. specializes in audio noise reduction and audio encoding/compression. The company offers state-of-the-art audio, imaging, and voice technologies that revolutionize entertainment and communications at theaters, home, work and mobile devices. Also, the company designs and manufactures audio and imaging products including digital cinema servers and other products for film production, cinema, television, broadcast and other entertainment industries.

Moreover, Dolby offers a host of services for supporting theatrical and television production for cinema exhibition, broadcast and home entertainment. This apart, it serves film studios, content creators, post-production facilities, cinema operators, broadcasters and video game designers. The products of the company are sold directly to the end users and through dealers and distributors as well.

A majority of the company's revenues are derived from the licensing of audio technologies. The company operates on various licensing models including a two-tier model, an integrated licensing model, a patent licensing model and a revenue-sharing model. It offers core licensing to broadcasters, personal computers, consumer electronics and mobile customers.

Currently, Dolby is focusing on expanding its product portfolio and has already developed new applications for voice conferencing and imaging solutions that enable HDR picture quality in televisions and cinemas. Some of the newly introduced products include Dolby Voice, Dolby Vision and Dolby Cinema.

The company reports under two operating segments — Licensing (93.5% of total revenues in the second quarter of fiscal 2020), and Products and Services (6.5%).



Reasons To Sell:

- ▼ Escalating cost of sales has been a major cause of concern for Dolby over the past quarters, primarily on account of increased product cost and higher licensing expenses. The market for consumer entertainment products is highly competitive and price sensitive, which exposes Dolby to the risks of reduced revenues owing to lower prices. The company's profitability is subject to timing of payments from clients. Moreover, OEMs continually focus on reducing product costs, which in turn will exert pressure on the company's licensing fees. Of late, free and proprietary sound technologies are being increasingly adopted by clients and Dolby apprehends that competitors will soon freely enter this space with other offerings, threatening its market share.
- ▼ A large section of Dolby's sales depends on OEMs and other licensees who incorporate the company's technology into their offerings. Also, the company's sales depend on a handful of customers and losing any of them will significantly impact revenues. These license agreements do not require minimum purchases, minimum royalty fees and do not prohibit licensees from using competitor's offerings, which adds to Dolby's concerns. In addition, the company's cinema product sales are subject to fluctuations based on general conditions in the industry, such as the construction of new screens or upgrade of existing screens. Though the company's relatively new offering Dolby Cinema is experiencing exceptional market traction, there is no denying the fact that its success is hitched to the pipeline and the performance of motion pictures at Dolby Cinema locations.
- ▼ Dolby's profits largely depend on timely deliveries from suppliers. The risks pertaining to the procurement of the key materials used in Dolby's products include limited control over price, timely delivery and quality of the components provided by the suppliers. Additionally, the company has no formal agreements with suppliers that can ensure continued supply of materials and components. This makes Dolby vulnerable to delay in obtaining raw materials from suppliers, which poses risk of production cost hikes. This apart, the company's success largely depends on its ability to retain patents, trademarks, trade secrets, copyrights and other intellectual property rights. Unfortunately, a few countries in which the company operates do not have stringent laws to protect against unauthorized use of its products and services. In the past, Dolby has often experienced problems with non-licensee OEMs and software vendors, particularly in China and other emerging countries like Taiwan and India that have incorporated Dolby's technologies and trademarks into their products without authorization. These factors are quite commonplace and frequent, which poses a grave concern.
- ▼ The market for broadcast technologies has been heavily dependent on industry standards, often mandated by governments. This exposes Dolby to regulatory risk. The success of Dolby's endeavors is subject to its ability to comply with industry standards to ensure compatibility across delivery platforms and consumer entertainment products. Going forward, unhindered revenue growth from the broadcast market will depend upon both the continued global adoption of digital television and incorporation of Dolby's technologies in them. Also, the fast-evolving industry calls for constant technological innovation, which necessitates Dolby to continuously come up with state-of-the-art technology to stay ahead of the curve. The global coronavirus pandemic has forced several governments to impose restrictions on movie theaters for social distancing, which are likely to dent its revenues. Due to certain macroeconomic factors like unemployment and supply chain disruptions coupled with the turmoil of the pandemic on global financial markets, Dolby has not been able to provide a definitive financial outlook for fiscal 2020.

Of late, free and proprietary sound technologies are being increasingly adopted by clients and Dolby apprehends that competitors will soon easily enter this space with other offerings.

Risks

- Dolby's long-term growth strategy stands on three pillars, namely advancing the science of sight and sound, providing creative solutions, and delivering superior experiences. Successful execution in each of these areas has led to decent growth over the past quarters. Dolby has three impressive projects, namely, Dolby Vision, Dolby Voice and Dolby Cinema, that will likely accelerate growth going forward. Coming to Dolby Vision, Disney joined the bandwagon of other major Hollywood studios such as Warner Brothers and Paramount to create Dolby Vision content for home. The company is enjoying widespread industry adoption of Dolby Vision and Dolby Atmos, the latest in the list being Apple. Also, Dolby Vision saw further adoption in Blu-ray players as Sony and Panasonic announced their first Dolby Vision players, joining LG, Phillips and OPPO. The company's Dolby Voice technology, an audio conferencing solution, is witnessing solid growth opportunities that are adding to the company's strength. Apart from expanding its foothold in the traditional audio conferencing market, Dolby Voice is also making concerted efforts to bolster its footprint in the budding video conferencing market. Dolby Voice is gearing up for some interesting product launch, in collaboration with its partner, BlueJeans. It had launched a partnership with audio conferencing provider, West, to expand this business.
 - Netflix, one of Dolby's first partners, had started streaming in Dolby Atmos, and offers combined Dolby Vision and Dolby Atmos experience to its global subscriber base. LG also announced that it would expand the combined Dolby Vision and Dolby Atmos experience to its OLED and super UHD televisions. The company's Dolby Vision is being adopted in the mainstream TV models. Based on present industry trends, the company is confident that Dolby Vision's growth momentum will keep accelerating, going forward. Lenovo, Huawei and Xiaomi have launched PCs with Dolby Atmos. Also, Amazon expanded its Dolby Atmos support beyond the Fire HDX tablets and into the new Fire TV and Fire TV Cube in addition to other compatible devices like TV, sound bars and home theater systems. Earlier, both Sony and LG announced their new Dolby Atmos sound bars. In addition, Dolby rolled out Dolby Atmos for headphones. Dolby Atmos content has now expanded beyond premium movie and TV content to gaming and live sports. In gaming, the first Dolby Atmos game for Xbox, Gears of War 4, was also released. In live sports, BT commenced broadcasting in Dolby Atmos, and delivered the entire season of Premier League Soccer in Dolby Atmos. Also, Microsoft started supporting Dolby Vision on the Xbox One. This is the first gaming console to support both Dolby Vision and Dolby Atmos.
 - Dolby Cinema technology is considered to be a major profit churner for the company. Earlier, Dolby Cinema had added two new partners including Jinyi, one of the largest cinema chains in China and Pathé Cinemas, the largest cinema chain operation in France, the Netherlands and Switzerland. Dolby Cinemas' client list includes AMC in the United States, Wanda and Jackie Chan in China, Cineplexx in Austria, REEL in Middle East and Vue in the Netherlands. Dolby Cinemas is enjoying exponential market traction and the company brought Dolby Cinema to the U.K. for the first time with Odeon Cinemas Group. The content pipeline for Dolby Cinema continues to grow with about 190 titles in Dolby Vision and Dolby Atmos announced or released. Combined with Dolby's existing partners in China, Wanda and Jackie Chan, the company has more than 140 screens open or committed in the country. However, with the emergence of COVID-19 pandemic, majority of screens around the world have been closed, including Dolby Cinema screens. This has negatively impacted the demand for cinema products. Nevertheless, the company believes that surging demand for premium viewing experiences will fuel growth for Dolby Cinema in the long haul. Overall, it has about 250 Dolby Cinema sites across 11 countries with more than 20 exhibitor partners. In the last reported quarter, Dolby inked agreements with two new exhibitor partners that will bring the first Dolby Cinema to South Korea and Saudi Arabia. Market reports suggest that consumers are increasingly viewing video content on smartphones, tablets and computers, which in turn is expected to unlock opportunities for Dolby.
 - Dolby, with its robust financials, employs diligent capital deployment strategies for ensuring growth. The capital allocation strategies are designed to maintain a flexible capital structure, deliver value to shareholders through sustainable growth, solid margins, strong cash flows and returning capital. Moreover, the company dedicatedly follows a balanced capital deployment strategy and continually rewards its shareholders through share repurchases and dividend increases. As of Mar 27, 2020, the company had \$909 million in cash and equivalents with \$204 million of non-current liabilities. This signifies that the company is likely to pay back its obligations. Dolby's debt-to-capital ratio and long-term debt has always been zero. Although Dolby's dividend payout rate has reduced sequentially from 39.9% to 38.3%, the times interest earned has increased sequentially from 1,333.5 to 1,386.7, which suggests that the company is likely to meet its interest obligations in the near future.
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Last Earnings Report

Dolby Misses Q2 Earnings Estimates, Withdraws View

Dolby reported unimpressive second-quarter fiscal 2020 (ended Mar 27, 2020) results, with the top and the bottom line missing the Zacks Consensus Estimate. However, higher Licensing revenues along with increased adoption of Dolby Atmos and Dolby Vision technology contributed to its quarterly performance.

Net Income

On a GAAP basis, net income was \$88.5 million or 86 cents per share compared with \$73.4 million or 70 cents per share in the year-ago quarter. The year-over-year increase in earnings was primarily driven by top-line growth and lower income tax provision. However, the bottom line missed the Zacks Consensus Estimate by 6 cents.

Non-GAAP net income came in at \$106.6 million or \$1.04 per share compared with \$109 million or \$1.04 per share in the prior-year quarter.

Revenues

Total GAAP revenues were \$351.8 million, up 4% from \$338.3 million in the year-ago quarter. The upside can be attributed to increase in the Licensing segment revenues. However, total revenues were \$30 million below the midpoint of the guidance provided at the beginning of the quarter. The decline was primarily caused by the COVID-19 pandemic, which led to temporary business shutdowns and lower consumer activity globally. Moreover, the top line lagged the Zacks Consensus Estimate of \$355 million.

Segmental Performance

Revenues from **Licensing** were \$328.9 million, up 6% year over year, driven by higher revenues in Broadcast business. Markedly, Broadcast business witnessed a 5% year-over-year increase in revenues, driven by higher adoption of Dolby Vision and Dolby Atmos coupled with higher recoveries. Sales from Consumer Electronics increased 10%, driven by higher volume of Dolby Vision and Dolby Atmos technology. Revenues from Mobile Devices were up nearly 13% from prior-year quarter's figure, driven by robust growth in patent programs. Sales from PC surged 11% year over year, mainly driven by higher recoveries. However, it was partially offset by lower volumes stemming from the coronavirus pandemic. Meanwhile, revenues from Other Markets fell nearly 16% owing to a decline in revenues from Dolby Cinema coupled with lower recoveries in automotive.

Products and services revenues came in at \$23 million, down 17.9% year over year. The downside was primarily caused by the impact of COVID-19 pandemic on the Cinema business.

Other Details

Gross profit in the fiscal second quarter was \$315 million compared with \$301.7 million in the year-earlier quarter. Total operating expenses increased 5.2% to \$209 million, primarily due to higher general and administrative charges. Operating income was \$105.9 million compared with \$102.9 million in the year-ago quarter.

Cash Flow & Liquidity

Dolby generated \$96.9 million of net cash from operating activities in the quarter compared with \$105.8 million in the year-ago quarter. As of Mar 27, 2020, the company had \$724.9 million in cash and equivalents with \$178.8 million of non-current liabilities.

Q3 Guidance Issued & 2020 Guidance Withdrawn

Despite uncertainties pertaining to the ongoing virus outbreak, Dolby has provided guidance for third-quarter fiscal 2020. The company expects GAAP earnings per share in the range of 1-18 cents and non-GAAP earnings per share in the range of 18-35 cents, while revenues are anticipated to be \$225-\$250 million. Moreover, unit volume shipments across various end markets and devices are likely to be lower by 15-25%. On a GAAP basis, operating expenses are expected in the \$191-\$201 million band, whereas on a non-GAAP basis, operating expenses are anticipated in the range of \$170-\$180 million.

However, due to certain macroeconomic factors like unemployment and supply chain disruptions coupled with the current turmoil of the deadly pandemic on global financial markets, Dolby is unable to provide a definitive financial outlook for fiscal 2020. Consequently, the company has withdrawn its previous guidance for 2020. Although its licensing as well as products and services revenues are likely to be affected by the catastrophic impact of coronavirus, Dolby is committed to support business operations in this crisis.

Quarter Ending **03/2020**

Report Date	May 04, 2020
Sales Surprise	-0.90%
EPS Surprise	-6.52%
Quarterly EPS	0.86
Annual EPS (TTM)	2.14

Recent News

On May 12, 2020, Dolby announced that it has introduced an avant-garde API platform — Dolby.io — that delivers immersive conferencing and collaboration experience in the enterprise and application development domain. Embedded in more than 10 billion devices, this one-of-a-kind platform enables developers and content creators to leverage scalable and easy-to-use media processing APIs to deliver spectacular audiovisual experiences at an affordable cost. Markedly, Dolby.io supports multi-party audio and video communications and can be used in various industries such as online training, healthcare, social media and digital collaboration to name a few.

On Mar 10, Dolby announced that it has been recognized as one of the World's Most Innovative Companies for its latest innovation in Dolby Atmos Music by a renowned American business magazine — Fast Company. Markedly, Dolby Atmos Music is an immersive audio experience, which allows sounds to be precisely placed, thereby adding dimensionality to create a full audio atmosphere. Known for a rich listening experience, Dolby had previously leveraged its Atmos Music platform to collaborate with eminent record labels, music artists and streaming services.

On Jan 7, Dolby exhibited new features for its Dolby Vision immersive entertainment technology, Dolby Vision IQ, at Consumer Electronics Show 2020. The latest addition to its portfolio extends the benefits of Dolby Vision beyond HDR by optimizing picture quality for viewers in any room. It can inform the TV what is being watched so when the channel is switched, the TV will modify its settings accordingly. Dolby also exhibited its Dolby Atmos sound technology at CES, particularly demonstrating its effectiveness in the music industry.

Valuation

Dolby shares are up 5.8% over the trailing 12-month period. Stocks in the Zacks sub-industry are up 29% over the past year, but stocks in the Zacks Consumer Discretionary sector are down 0.5% in the same time frame.

The S&P 500 Index is up 11.1% in the past year.

The stock is currently trading at 2.81X trailing 12-month book value, which compares to 1.51X for the Zacks sub-industry, 3.12X for the Zacks sector and 4.41X for the S&P 500 Index.

Over the past five years, the stock has traded as high as 3.53X and as low as 1.70X, with a 5-year median of 2.64X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$56 price target reflects 19.93X trailing 12-month book value.

The table below shows summary valuation data for DLB

Valuation Multiples - DLB					
		Stock	Sub-Industry	Sector	S&P 500
P/B TTM	Current	2.81	1.51	3.12	4.41
	5-Year High	3.53	1.91	5.05	4.56
	5-Year Low	1.7	0.98	2.2	2.83
	5-Year Median	2.64	1.46	4.22	3.66
P/S F12M	Current	5.5	0.91	2.34	3.63
	5-Year High	6.15	0.91	3.19	3.63
	5-Year Low	2.97	0.13	1.67	2.53
	5-Year Median	4.73	0.66	2.51	3.02
EV/EBITDA TTM	Current	17.68	4.54	10.61	11.97
	5-Year High	22.19	10.45	17.63	12.85
	5-Year Low	7.84	3.38	8.29	8.25
	5-Year Median	13.25	5.07	12.24	10.81

As of 06/09/2020

Industry Analysis Zacks Industry Rank: Bottom 23% (195 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Turtle Beach Corporation (HEAR)	Outperform	1
GoPro, Inc. (GPRO)	Neutral	3
IMAX Corporation (IMAX)	Neutral	3
LiveXLive Media, Inc. (LIVX)	Neutral	3
Nikon Corp. (NINYO)	Neutral	4
Panasonic Corp. (PCRFY)	Neutral	3
Sony Corporation (SNE)	Neutral	3
Sonos, Inc. (SONO)	Neutral	3

Industry Comparison Industry: Audio Video Production				Industry Peers		
	DLB	X Industry	S&P 500	GPRO	SNE	SONO
Zacks Recommendation (Long Term)	Underperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	5	-	-	3	3	3
VGM Score	C	-	-	F	B	D
Market Cap	6.65 B	73.95 M	22.74 B	797.32 M	85.61 B	1.41 B
# of Analysts	4	2	14	4	4	3
Dividend Yield	1.33%	0.00%	1.81%	0.00%	0.50%	0.00%
Value Score	D	-	-	F	A	D
Cash/Price	0.14	0.25	0.06	0.16	0.37	0.24
EV/EBITDA	15.61	5.36	13.04	33.46	5.36	30.25
PEG Ratio	3.05	5.36	3.12	NA	7.58	NA
Price/Book (P/B)	2.81	1.62	3.14	4.23	1.94	4.69
Price/Cash Flow (P/CF)	19.43	9.26	12.32	26.07	9.32	43.37
P/E (F1)	39.69	22.74	22.61	NA	22.74	NA
Price/Sales (P/S)	5.35	0.67	2.46	0.74	1.13	1.09
Earnings Yield	2.45%	3.30%	4.26%	-5.93%	4.40%	-2.87%
Debt/Equity	0.00	0.05	0.76	1.19	0.13	0.07
Cash Flow (\$/share)	3.40	0.16	7.01	0.19	7.35	0.30
Growth Score	B	-	-	F	C	D
Hist. EPS Growth (3-5 yrs)	7.02%	8.80%	10.87%	NA	86.71%	NA
Proj. EPS Growth (F1/F0)	-33.50%	-30.77%	-10.76%	-225.00%	-29.01%	-640.00%
Curr. Cash Flow Growth	-0.04%	-0.04%	5.48%	-197.78%	-21.35%	33.24%
Hist. Cash Flow Growth (3-5 yrs)	3.73%	-4.84%	8.55%	-27.97%	33.38%	NA
Current Ratio	4.75	1.25	1.29	1.74	0.92	2.18
Debt/Capital	0.00%	21.47%	44.75%	54.40%	11.83%	6.70%
Net Margin	17.74%	-3.65%	10.54%	-5.02%	7.05%	-1.95%
Return on Equity	9.45%	-9.75%	16.08%	-19.12%	12.38%	-8.14%
Sales/Assets	0.43	1.09	0.55	1.53	0.37	1.77
Proj. Sales Growth (F1/F0)	-9.11%	0.00%	-2.59%	-42.60%	-5.14%	-0.53%
Momentum Score	C	-	-	C	F	C
Daily Price Chg	-0.87%	0.00%	-2.13%	-2.50%	-0.16%	2.62%
1 Week Price Chg	6.92%	2.47%	7.51%	3.18%	3.94%	1.75%
4 Week Price Chg	19.01%	19.76%	16.33%	48.82%	4.36%	35.90%
12 Week Price Chg	33.05%	27.39%	28.71%	120.96%	24.00%	75.65%
52 Week Price Chg	5.83%	-15.95%	1.59%	-15.95%	37.40%	14.45%
20 Day Average Volume	431,852	36,499	2,644,123	4,290,693	1,477,690	2,303,187
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	-4.09%	0.00%	0.00%	-14.43%	0.00%
(F1) EPS Est 12 week change	-39.80%	-40.43%	-15.96%	-556.00%	-36.50%	-344.00%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	NA	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	B
Momentum Score	C
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

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