Dolby Laboratories (DLB)

$58.80 (As of 04/24/20)

Price Target (6-12 Months): **$62.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 07/02/19) Prior Recommendation: Outperform	Neutral
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	3-Hold
	Zacks Style Scores:	VGM:D
	Value: D | Growth: D | Momentum: B	

Summary

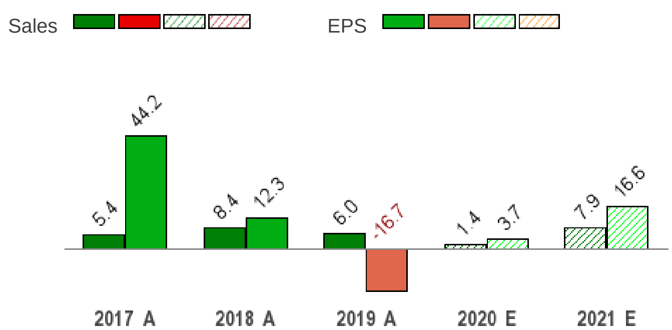
Dolby has diligent capital allocation strategies to maintain a flexible capital structure and boost shareholders' value, thereby ensuring growth. The company's enduring partnerships with industry giants like Apple, Google and Netflix enable it to offer best-in-class services and fend off competition. It believes that surging demand for premium viewing experience will fuel growth for Dolby Cinema. However, escalating cost of sales has been a concern for Dolby over the past quarters. Also, the coronavirus pandemic is likely to dent revenues with movie theater restrictions. Stiff competition, fluctuations of cinema product sales and price-sensitive nature of the entertainment industry are headwinds. Delay in procuring raw materials from suppliers poses risk of production cost hikes. Escalating cost of sales weigh on profitability.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	$73.20 - $44.68
20 Day Average Volume (sh)	444,531
Market Cap	$5.9 B
YTD Price Change	-14.5%
Beta	0.88
Dividend / Div Yld	$0.88 / 1.5%
Industry	Audio Video Production
Zacks Industry Rank	Top 25% (64 out of 252)
Last EPS Surprise	56.7%
Last Sales Surprise	2.0%
EPS F1 Est- 4 week change	-2.5%
Expected Report Date	05/06/2020
Earnings ESP	-3.5%
P/E TTM	25.3
P/E F1	23.2
PEG F1	1.8
P/S TTM	4.8

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	308 E	378 E	324 E	336 E	1,359 E
2020	292 A	355 E	303 E	309 E	1,259 E
2019	302 A	338 A	302 A	299 A	1,242 A

EPS Estimates

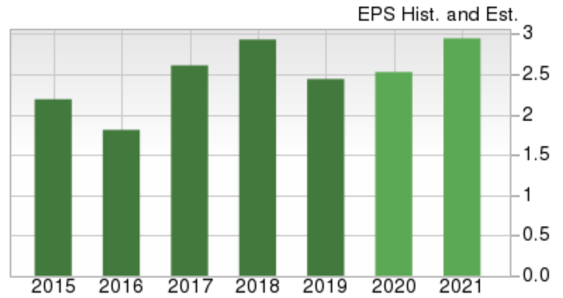
	Q1	Q2	Q3	Q4	Annual*
2021	$0.53 E	$1.07 E	$0.66 E	$0.74 E	$2.95 E
2020	$0.47 A	$0.92 E	$0.53 E	$0.57 E	$2.53 E
2019	$0.74 A	$1.04 A	$0.38 A	$0.43 A	$2.44 A

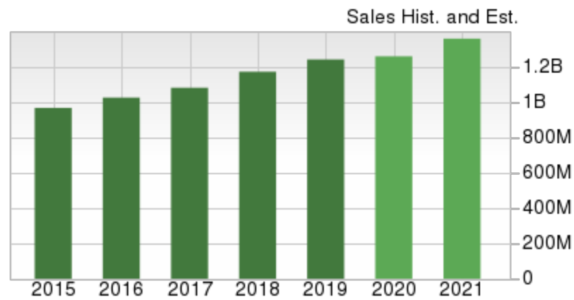
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 04/24/2020. The reports text is as of 04/27/2020.

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 (88.3% of total revenues in the first quarter of fiscal 2020), and Products and Services (11.7%).

Reasons To Buy:

> Dolby has maintained its long-standing partnerships with industry frontrunners like Apple, Google, Amazon and Netflix to offer best-in-class services and fend off competition.

- 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 Xiomi 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 proving 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. Dolby Cinema continues to add new partners in China. Combined with Dolby's existing partners in China, Wanda and Jackie Chan, the company now has more than 140 screens open or committed in the country. Overall, it has about 250 Dolby Cinema sites across 11 countries with more than 20 exhibitor partners. The company believes that surging demand for premium viewing experiences will fuel growth for Dolby Cinema over the long haul. 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 Dec 27, 2019, the company had $923 million in cash and equivalents with $264 million of current liabilities compared with the respective tallies of $975 million and $285 million a year ago. Dolby currently has a debt-to-capital ratio of zero compared with 21.5% of the sub-industry. It has an interest coverage ratio of 1,333.5 in relative to 85.8 for the sub-industry. This clearly shows that the company is most likely to clear its debt. Dolby has a dividend yield of 1.5% compared with 0.5% of the sub-industry. It has a dividend payout ratio of 39.9% compared with 6.8% of the sub-industry. The ratio has increased steadily over the past five years, indicating that the company is sharing more of its earnings with stockholders. It is to be seen whether Dolby can maintain the momentum in the coming days despite disruptions caused by COVID-19 pandemic.

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.

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.

- 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 stiff restrictions on movie theaters for social distancing, which are likely to dent its revenues.

Last Earnings Report

Dolby Q1 Earnings & Revenues Beat Estimates, Down Y/Y

Quarter Ending	12/2019
Report Date	Jan 29, 2020
Sales Surprise	1.99%
EPS Surprise	56.67%
Quarterly EPS	0.47
Annual EPS (TTM)	2.32

Dolby reported relatively lackluster first-quarter fiscal 2020 (ended Dec 27, 2019) results with year-over-year decrease in revenues and earnings on higher operating expenses. However, both the bottom and top lines surpassed the Zacks Consensus Estimate.

Net Income

On a GAAP basis, net income was $48.8 million or 47 cents per share compared with $98.2 million or 93 cents per share in the year-ago quarter. The significant decline in earnings was primarily attributable to lower revenues, higher operating expenses and income tax benefit in the year-ago quarter. However, the bottom line surpassed the Zacks Consensus Estimate by 17 cents.

Non-GAAP net income came in at $65.5 million or 64 cents per share compared with $78.7 million or 74 cents per share in the prior-year quarter.

Revenues

Total revenues were $291.9 million, down from $302.4 million in the year-ago quarter, primarily due to decline in revenues in Licensing and Products and services segments despite higher adoption of Dolby Vision and Dolby Atmos technology. However, the top line surpassed the Zacks Consensus Estimate of $286 million.

Segmental Performance

Revenues from **Licensing** were $257.7 million, down 1% year over year, owing to lower revenues in Broadcast business. Sales from Consumer Electronics increased 12%, driven by higher adoption of Dolby Vision and Dolby Atmos coupled with higher volume. Mobile Devices represented 13% of total licensing. Sales from PC surged 38% year over year, mainly driven by higher recoveries with increased adoption of Dolby technologies, but the same from Licensing in other markets fell nearly 32% due to lower recoveries in automotive.

Products and services revenues came in at $34.2 million, down 18.8%, primarily due to the impact of hybrid deals in the Cinema business in the prior-year quarter.

Other Details

Gross profit in the fiscal first quarter was $254.6 million compared with $263.7 million in the year-earlier quarter. Total operating expenses increased 5.6% to $206 million, primarily due to restructuring charges. Operating income was $48.6 million compared with $68.7 million a year ago.

Cash Flow & Liquidity

In the first three months of fiscal 2020, Dolby generated $31.2 million of net cash from operating activities compared with $57 million in the year-ago quarter. As of Dec 27, 2019, the company had $741.4 million in cash and equivalents with $179.2 million of non-current liabilities.

Guidance

Dolby has provided guidance for second-quarter fiscal 2020. The company expects GAAP earnings per share in the range of 97 cents to $1.03 and non-GAAP earnings per share in the range of $1.15-$1.21, while revenues are anticipated to be $370-$390 million.

In addition, the company offered guidance for fiscal 2020. It currently estimates total revenues to be in the $1.30-$1.35 billion band. While GAAP gross margin is expected to be in the range of 87-88%, non-GAAP gross margin is projected to be 88-89%. The company expects GAAP earnings per share in the range of $2.64-$2.74 and non-GAAP earnings per share of $3.40-$3.50.

Recent News

On Jan 7, 2020, 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 down 8.3% over the trailing 12-month period. Stocks in the Zacks sub-industry are up 15.7% over the past year, but stocks in the Zacks Consumer Discretionary sector are down 20.2% in the same time frame.

The S&P 500 Index is down 4.2% in the past year.

The stock is currently trading at 2.54X trailing 12-month book value, which compares to 1.42X for the Zacks sub-industry, 2.62X for the Zacks sector and 3.76X 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 2.63X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our $62 price target reflects 24.41X 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	2.54	1.42	2.62	3.76
	5-Year High	3.53	1.91	5.04	4.55
	5-Year Low	1.7	0.98	2.18	2.84
	5-Year Median	2.63	1.47	4.23	3.64
P/S F12M	Current	4.27	0.82	1.9	4.79
	5-Year High	6.15	0.91	3.19	4.79
	5-Year Low	2.97	0.13	1.67	2.54
	5-Year Median	4.73	0.63	2.52	3.01
EV/EBITDA TTM	Current	15.55	4.74	9.45	10.37
	5-Year High	22.19	10.45	17.6	12.87
	5-Year Low	7.84	3.38	8.27	8.27
	5-Year Median	13.04	5.15	12.25	10.78

As of 04/24/2020

Industry Analysis **Zacks Industry Rank:** Top 25% (64 out of 252)

Top Peers

Company (Ticker)	Rec	Rank
LiveXLive Media, Inc. **(LIVX)**	Outperform	2
Panasonic Corp. **(PCRFY)**	Outperform	2
GoPro, Inc. **(GPRO)**	Neutral	3
Turtle Beach Corporation **(HEAR)**	Neutral	3
IMAX Corporation **(IMAX)**	Neutral	3
Nikon Corp. **(NINOY)**	Neutral	3
Sony Corporation **(SNE)**	Neutral	3
Sonos, Inc. **(SONO)**	Neutral	3

Industry Comparison Industry: Audio Video Production

	DLB	X Industry	S&P 500	GPRO	SNE	SONO
				Industry Peers		
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	D	-	-	B	B	A
Market Cap	5.94 B	95.33 M	19.57 B	463.31 M	78.75 B	979.02 M
# of Analysts	4	3	14	4	3	3
Dividend Yield	1.50%	0.00%	2.2%	0.00%	0.43%	0.00%
Value Score	D	-	-	C	A	C
Cash/Price	0.16	0.34	0.05	0.38	0.34	0.44
EV/EBITDA	13.63	4.54	11.66	19.30	4.54	15.69
PEG Ratio	1.84	1.79	2.27	NA	NA	NA
Price/Book (P/B)	2.54	1.75	2.60	1.87	1.75	2.67
Price/Cash Flow (P/CF)	17.29	7.07	10.50	15.30	6.74	29.90
P/E (F1)	23.89	14.06	18.25	NA	16.36	NA
Price/Sales (P/S)	4.82	0.47	2.02	0.39	0.99	0.74
Earnings Yield	4.30%	5.21%	5.35%	-8.42%	6.11%	-1.80%
Debt/Equity	0.00	0.05	0.72	0.91	0.13	0.06
Cash Flow ($/share)	3.40	0.16	7.01	0.19	9.34	0.30
Growth Score	D	-	-	A	D	A
Hist. EPS Growth (3-5 yrs)	7.05%	9.00%	10.92%	NA	96.59%	NA
Proj. EPS Growth (F1/F0)	3.59%	-10.95%	-5.06%	-204.17%	-12.76%	-213.34%
Curr. Cash Flow Growth	-0.04%	7.99%	5.92%	-197.78%	55.73%	33.24%
Hist. Cash Flow Growth (3-5 yrs)	3.73%	-4.84%	8.55%	-27.97%	35.90%	NA
Current Ratio	4.77	1.29	1.23	1.64	0.88	1.84
Debt/Capital	0.00%	21.54%	43.90%	47.56%	11.59%	5.94%
Net Margin	16.71%	-1.36%	11.32%	-1.23%	7.62%	0.33%
Return on Equity	8.82%	-2.02%	16.60%	2.11%	14.29%	1.42%
Sales/Assets	0.43	1.12	0.55	1.68	0.40	1.87
Proj. Sales Growth (F1/F0)	1.43%	0.00%	-0.78%	-37.65%	-0.48%	6.12%
Momentum Score	B	-	-	F	C	D
Daily Price Chg	1.29%	0.06%	1.38%	2.77%	1.45%	0.11%
1 Week Price Chg	1.75%	0.00%	0.42%	4.06%	4.64%	-7.72%
4 Week Price Chg	2.94%	0.00%	5.63%	10.00%	4.07%	-5.52%
12 Week Price Chg	-14.78%	-25.71%	-20.44%	-27.03%	-11.50%	-36.25%
52 Week Price Chg	-8.34%	-37.34%	-13.44%	-50.91%	34.93%	-16.82%
20 Day Average Volume	444,531	28,300	2,802,273	3,603,034	1,490,392	1,089,878
(F1) EPS Est 1 week change	0.00%	0.00%	-0.10%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-2.51%	0.00%	-6.64%	-648.00%	0.07%	0.00%
(F1) EPS Est 12 week change	-5.95%	-13.96%	-11.78%	-434.15%	-18.31%	-30.56%
(Q1) EPS Est Mthly Chg	-14.17%	0.00%	-10.38%	NA	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	D
Momentum Score	B
VGM Score	D

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.

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