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DLB.N - Q4 2022 Dolby Laboratories Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Dolby Laboratories conference call discussing fiscal fourth quarter results. (Operator Instructions) As a reminder, this call is being recorded, Thursday, November 17, 2022.

I would now like to turn the conference over to Ashley Schwenoha, Senior Manager, Investor Relations for Dolby Laboratories. Please go ahead, Ashley.

Ashley Schwenoha - *Dolby Laboratories, Inc. - Senior Manager of IR*

Good afternoon. Welcome to Dolby Laboratories Fourth Quarter 2022 Earnings Conference Call. Joining me today are Kevin Yeaman, Dolby Laboratories CEO; Robert Park, CFO; and Maggie O'Donnell, Head of Investor Relations.

As a reminder, today's discussion will include forward-looking statements, including our first quarter and fiscal 2023 outlook and our assumptions underlying that outlook. These statements are subject to risks and uncertainties that may cause actual results to differ materially from the statements made today, including, among other things, the impact of current macroeconomic events, COVID-19, supply chain issues, inflation, changes in consumer spending and geopolitical instability on our business. A discussion of these and additional risks and uncertainties can be found in the earnings press release that we issued today under the section captioned forward-looking statements as well as in the Risk Factors section of our most recent annual report on Form 10-K. Dolby assumes no obligation and does not intend to update any forward-looking statements made during this call as a result of new information or future events.

During today's call, we will discuss non-GAAP financial measures. A reconciliation between GAAP and non-GAAP financial measures is available in our earnings press release and in the new Interactive Analyst Center on the Investor Relations section of our website.

So with that introduction behind us, I will now turn the call over to Maggie.

Maggie O'Donnell - *Dolby Laboratories, Inc. - Head of IR*

Thank you, Ashley, and thanks, everybody, for joining us today. So last quarter, we tried something different with the format, and it seemed to be really well received. So we're going to try to do the same thing today. I'm going to be leading a conversation with both Kevin and Robert, and then we're going to turn it over to our analysts for Q&A. So let's get started.

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Kevin, obviously, this is a really dynamic environment. Can you talk about that and how it's impacting our business?

Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

Yes. The past year, and for that matter, the last few years have been a challenging environment. I don't think that's news to anybody. It's a combination of the pandemic, geopolitical issues, supply chain, inflation, all of this has come together to create an environment of uncertainty -- uncertainty and change. And most of the industries we serve have been significantly impacted by some combination of these factors.

As it relates to this quarter, it continues to be a tough environment, and our results did come in lower than what we expected. Since we last talked, estimates for consumer device shipments have continued to come down across a number of categories, particularly in PC and TV. And transaction cycles are taking longer right now. We're in an environment with a lot of challenges, that affects not just us, but our partners and our customers.

And so our customers, both current and potential, continue to be engaged, but we're seeing some of those engagements taking longer. At the same time, we've accomplished a lot over this quarter and over this last year, and we're making progress in our key focus areas. We continue to strengthen our movies and TV ecosystem. We had significant growth with Dolby Vision and Dolby Atmos in terms of increased content across services and streamed content, and we've expanded across all the device categories that people use to enjoy their favorite movie and TV content.

We have fantastic momentum across the Dolby Atmos music ecosystem. We have more artists, more studios on board. The amount of music in Dolby Atmos continues to expand, and we have more ways for people to enjoy that music across streaming services and devices and increasingly, their car. And we're building out our ecosystem for user-generated content, which is what enables the growing number of consumers to capture and share their memories in Dolby Vision across their favorite platform.

So our strategy has not changed, and we're confident in the opportunity ahead. And consumers have a seemingly insatiable demand for entertainment content. We're hard at work to bring the Dolby experience to all the ways consumers experience that content, whether it's movies, TV, gaming, sports, music, user-generated content and all the devices that those experiences are enjoyed on.

We also see audio/video content and the ability to interact digitally in audio/video increasingly become a part of everything we do online. And with Dolby.io, we can improve these experiences and bring Dolby to a far wider range of use cases. So while there are near-term headwinds, we're staying focused on what we can control, and we're confident in the opportunity ahead.

Maggie O'Donnell - *Dolby Laboratories, Inc. - Head of IR*

Great. That's great context. Let's talk a little bit about the revenue drivers. So over the last year, you've been talking about revenue drivers in the context of both foundational and Dolby Atmos, Dolby Vision, Dolby Imaging -- or sorry, imaging patents. Can you start with foundational?

Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

Yes. And maybe as a reminder for people who might be new or newer to the story, our foundational audio revenues are made up of our audio codecs and audio patents. And these technologies are deeply embedded in the ecosystem for entertainment audio, and they're delivered across a broad diversity of consumer devices. And we're included on such a significant number of those devices that this part of the business is sensitive to the macroeconomic environment, especially as it relates to consumer device shipments.

So for this year, foundational was down nearly 15% and ended up at roughly 70% of our licensing revenues. And while macro challenges continue to make it difficult to predict the near term, based on current data points, we're expecting foundational to be down, again, in FY '23. But it's important to note that these technologies are fundamental to the playback of content. They have been for decades, and they will continue to be for years to come. And this is a strong position to be in. We're going to continue to strengthen it. And once the end markets stabilize, we expect that foundational revenue will continue to be a contributor to our growth.

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Maggie O'Donnell - *Dolby Laboratories, Inc. - Head of IR*

Makes sense. And what about Dolby Atmos, Dolby Vision and imaging patents?

Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

Revenue from those areas grew roughly 30% versus last year. That is a little bit slower than we expected as of the last call. As I said, these areas are not as sensitive to the macro environment as foundational. It's more about getting on more of the devices with these relatively newer technologies, more devices that are shipping, but they're not immune to the macro.

The largest growth driver, what drove the 30%, one of the largest growth drivers was movie and TV content. We've built this incredible ecosystem of content around Dolby Vision and Dolby Atmos, and that's led to broad adoption by content services. And so we're seeing growth in living room devices like TVs, set-top boxes, sound bars and beyond. We also saw strong growth in Dolby Cinema as the box office began to improve from the pandemic lows. And we also had a lot of progress beyond that.

We've laid the foundation for new ways to experience Dolby and laying the foundation for new growth in areas like music in automotive, user-generated content with Dolby Vision capture. We're always looking for ways to bring Dolby to new experiences. So the opportunity ahead of us is significant. We are confident that we have the opportunity to double the size of these revenues in the midterm, and we're targeting 15% to 25% annual growth over the next 3 to 5 years.

Maggie O'Donnell - *Dolby Laboratories, Inc. - Head of IR*

Got it. So we're going to let Robert talk a little bit more about revenue in a few minutes. But first, let's dive into the three main focus areas that you mentioned at the beginning. First the movies and TV ecosystem in the living room, there's music and auto and there's also the user-generated content with Dolby Vision capture. So can we start with the living room?

Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

Yes. Well, with movies and TV, like I said earlier, we have very strong adoption across the creative community and great distribution across content services. And all of that means that it's easier than ever to access your favorite content in Dolby. We firmly established Dolby Vision and Dolby Atmos as the best way to enjoy movies and TV, and we have broad adoption across premium 4K models. And of course, we began to move this deeper into lineups.

And that's what we're going to be focused on, expanding more deeply into lineups like we've done with partners such as Sony and VIZIO. It also means pursuing remaining partners, and that includes the house brands at big box retailers, that makes up part of the market. So we are also focused on -- always looking for ways to become a part of more of the content that people care most about. And a great example of that is live sports, there's few examples of content that bring out more emotion than live sport.

And big events can actually drive TV purchases. So it's a way to bring Dolby into more living rooms. And so we're particularly excited that Comcast announced this morning that X1 customers are going to be able to enjoy the World Cup in Dolby Vision.

Maggie O'Donnell - *Dolby Laboratories, Inc. - Head of IR*

That's great. That's huge news. Let's also -- let's move on to the music and auto initiative. What are you seeing there?

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Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

Well, as is the case with all of our ecosystems, it starts with content. And enthusiasm from artists, the increasing availability of mastering tools and studios means an increasing amount of music available in Dolby. Universal Music Group recently said on its earnings call that 80% of its top streaming artists have tracks available in Dolby Atmos. And that makes up nearly half of streamed music consumption. They also said that 90% of consumers surveyed reported that they listened longer when they're listening in Dolby Atmos.

So once you have the content, then it's about the availability of the content to the consumer, and we made a lot of progress this year. We added Tencent's QQ to our roster of streaming partners. With Apple and Amazon, that means that we now have 3 of the top 5 global streaming services in the world. We also added a number of top regional services in markets like South Korea, the Middle East, China. And this quarter we added Gaana.com, which is a top music streaming service in India. So it's that combination of content and availability, what we at Dolby referr to as our ecosystem, that's what creates the value proposition to our device partners.

And we continue to see demand signals across all the ways consumers enjoy their music, but especially -- we're especially focused on automotive. And we've added more than half a dozen auto partners in just over a year. In just the past couple of weeks, we've added Polestar and Lotus. At the Paris Auto Show a few weeks ago, Mercedes was showcasing the Dolby Atmos music experience, and it got rave reviews. And just last week, Volvo announced the EX90, which is the soon-to-be released electric SUV, will feature Dolby Atmos.

So we're really excited about all of that. We're going to stay focused on bringing more streaming services to life, bringing on more auto partners, going deeper into lineups with the partners we brought on board, and that's what drives growth in this ecosystem. Our goal is to make Dolby Atmos Music the way everyone experiences music all the time.

Maggie O'Donnell - *Dolby Laboratories, Inc. - Head of IR*

Right. That's awesome. So on the third focus area, Dolby Vision capture. Can you talk about that?

Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

Yes. What's exciting about this is enabling consumers to engage with Dolby Vision content on a daily basis. And that significantly enhances our value across the mobile device ecosystem. It started a couple of years ago when Apple introduced Dolby Vision capture. And this year, we expanded into Android. Last quarter, Xiaomi launched the first Android smartphone with Dolby Vision capture in China.

They launched another model with Dolby Vision capture this quarter. And it's often striking when we look back at our videos that we've taken over the years, how sometimes that older content can be a little unfulfilling. It can be washed out. The colors aren't right. But with Dolby Vision, you get a giant leap in quality. And you can tell things like from the light, what time of day it was or what season was it. What was the weather. Everything looks more vivid and just like you remember it.

So this is important to smartphone makers because we all use our phones as these memory capture devices every day, and the camera is a major reason that people upgrade their phone. So we expect to see more adoption of this. And capturing the memories is one thing, well, what's even more important is sharing them. So that's why we're so excited to see the ecosystem coming together with services -- in China, we have services like WeChat, QQ, Bilibili, enabling the sharing of Dolby Vision content so that hundreds of millions of users on these platforms can experience those same vivid memories. So this year, look for us to continue to be focused on expanding this Dolby Vision capture ecosystem with more services and more devices.

Maggie O'Donnell - *Dolby Laboratories, Inc. - Head of IR*

So of course, in addition to those three main focus areas, there are a lot of other things we're working on. One of those is Dolby.io. Can you talk about that a little bit?

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Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

Yes, with Dolby.io, we've created a platform that enables developers to create experiences that are highly immersive. And audio visual content and interactivity are increasingly a part of everything we do online. Dolby.io makes it easy to integrate the Dolby experience into a wide range of use cases that have become a part of our everyday lives.

It's been a little over 2 years since we launched. We're continuing to see strong increases in developer engagement, that takes the form of developers signing up for the platform and engaging with and working with our APIs. One area we're seeing a lot of demand is in real-time streaming. So this is a use case that developers are looking for. So it's easy for them to understand. It's also easy for them to integrate. And our offering is differentiated because, of course, it brings very high quality,it can scale to a very high number of users, and we have exceptionally low delay times, and that's what brings the action and the viewer closer together. So it makes the experience as close to real time as possible, and that's critical for a number of use cases.

We're also seeing a lot of customers that are starting with or have started with real-time streaming and then expanding to enable our real-time interaction so that the audience can interact with one another, the presenter can interact with the participants and have a conversation that flows very naturally. That's made possible by things like our audio spatialization, which makes it easier to know where the sounds are coming from. And with -- combined with extremely low latency, you don't have those delays that can get caused when people are talking over one another.

Beyond that, we're having a lot of conversations with companies and developers who are focused on inventing the next generation of online immersive experiences. The audio experience is top of mind. They are creating rich and complex environments that require high-quality audio and spatialization to be realistic, to keep people in those experiences.

A lot of interest in areas like virtual performance, social events, sports, big company events. Music is also top of mind. And we just talked about the momentum we have in Dolby Atmos Music and of course, that can come into play in these worlds. But combined with spatialization, it creates the opportunity for if it's a virtual concert, for instance, then the audience can be having a realistic experience interacting with one and another. If it's some kind of a social event or a company trade show, if you have background music, the music can be high quality, but you also have the realistic ambient environment. So early days, but we're really excited about the opportunities.

Maggie O'Donnell - *Dolby Laboratories, Inc. - Head of IR*

Cool. So lastly, the macro environment is obviously going to continue to be challenging. How are you planning to manage the business throughout this period?

Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

Well, Dolby has managed through many economic downturns and many technology transitions. And we're coming at this from a position of strength, given our strong business model, balance sheet, proven ability to generate cash. And we're planning for it to continue to be a tough environment in the near term. And so we're going to be wise with our resources. Our headcount is roughly flat year-over-year.

We've paused hiring except for the most critical hires, and we've taken a number of cost savings measures. And on top of all that, the management team is regularly reviewing our resource envelope and our resource allocation to make sure that we continue to be aligned to where the opportunities are. And Robert can elaborate on this further. But we understand what it takes to go through an environment like this and come out the other side strong.

For us, the formula starts with, first and foremost, staying true to who we are. Consumers have the seemingly insatiable demand for entertainment content, and audiovisual experiences are becoming a pervasive part of everything we do. So our purpose has never been more relevant, and there's incredible opportunity to bring more Dolby experiences to more people around the world. And we're always hard at work reinventing what that means, what it means to have a Dolby experience and bringing those experiences to the content that's most important to them.

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We know that to do all this in this kind of environment requires extraordinary focus, and that's why you hear us talking about our key focus areas. And we've just talked about the momentum that we have across movies and TV, music, user-generated content, bringing more developers to io. So we're clear on what our most present opportunities are. We're going to focus on what we can control, and we're going to act with urgency to bring more Dolby experiences to more people, and that's what grows the business.

Maggie O'Donnell - *Dolby Laboratories, Inc. - Head of IR*

Great. Makes a ton of sense. Thanks, Kevin. And let's now turn to some of the numbers. Robert, can you walk us through the financials for both the fourth quarter and fiscal year '22?

Robert J. Park - *Dolby Laboratories, Inc. - Senior VP & CFO*

Thanks, Maggie, of course. Let's start with Q4. Total revenue in the fourth quarter was $278 million, which fell short of the total revenue guidance we provided on our last call. This was driven by a couple of factors. Based on what we're seeing, including data points from industry analysts, there were further declines in consumer device shipments, especially for TVs and PCs, compared to when we provided guidance in August. This negatively impacted our current quarter revenue estimate. Last quarter, we mentioned that we were seeing transaction cycles take longer in the environment, particularly in Asia and within Mobile, and this had a greater impact than we expected on Q4.

Now as a reminder, our licensing business is based on unit shipments. In general, we estimate revenues from unit shipments each quarter and true it up the following quarter based on actual reported shipments from our partners. We also have transactions that reflect revenue from units shipped in prior periods, which we call recoveries, and transactions where the customer will commit to minimum volumes for a given period where all or a portion of the revenue is recognized upfront. These transactions are all related to unit shipments. The only difference is the timing and amount of revenue in any given quarter. Our partners remain actively engaged, and we expect these transactions to close, but the process is taking longer.

Now let's get into the Q4 details. Q4 revenue was down 2% year-over-year, driven primarily by lower unit shipments in PC, Broadcast, CE and gaming. This was partially offset by growth in Dolby Atmos, Dolby Vision and imaging patents as well as an increase in products and services revenue, driven by improvements in the cinema industry. Q4 revenue comprise of $249 million in licensing revenue and $29 million in products and services revenue.

Now to our full year results. Fiscal year '22 revenues were $1.25 billion compared to $1.28 billion in fiscal year '21, resulting in a year-over-year decline of 2%. Within that, licensing revenue was $1.16 billion, while products and services revenue was $89 million. Fiscal year '22 licensing revenue was $1.16 billion, down 4% year-over-year. Foundational audio made up roughly 70% of our licensing revenue in fiscal year '22. Revenue for foundational audio declined about 15% year-over-year, primarily as a result of lower device shipments, especially in areas like Broadcast, gaming and auto, and lower recoveries in Broadcast and Mobile.

We also had a tough comp against the higher than normal true-up in fiscal year '21. Dolby Atmos, Dolby Vision and imaging patents were about 30% of total licensing revenue. This portion of our licensing revenue grew roughly 30% in fiscal year '22 compared to nearly 20% growth in fiscal '21, driven by higher adoption and new licensees as well as increased box office, which positively impacted Dolby Cinema.

Now let's get into the end markets. Broadcast represented about 37% of total licensing in fiscal year '22. Full year Broadcast revenues declined by $42 million or negative 9% on a year-over-year basis, driven by lower TV unit shipments and lower recoveries, both impacting primarily foundational audio. This was partially offset by growth in Dolby Vision and Dolby Atmos in TVs and set-top boxes. In Q4, Broadcast revenues declined year-over-year, driven by lower unit shipments, partially offset by increases in Dolby Vision and Dolby Atmos.

Mobile represented about 21% of total licensing in fiscal year '22. Full year mobile revenues declined by $22 million or negative 9% on a year-over-year basis as the prior year benefited from timing of deals, including recoveries, partially offset by increases in Dolby Atmos, Dolby Vision and imaging patents. Q4 Mobile revenues were down year-over-year, driven by lower unit shipments.

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Consumer Electronics represented about 16% of total licensing in fiscal year '22. Full year CE revenues increased by $4 million or 2% on a year-over-year basis, driven by growth in Dolby Atmos, Dolby Vision, partly offset by lower units. Q4 CE revenues were down year-over-year, driven by lower recoveries and lower unit shipments, partially offset by growth from Dolby Vision, Dolby Atmos and imaging patents.

PC represented about 13% of total licensing in the fiscal year '22. Full year PC revenues increased by $9 million or 6%, driven by Dolby Atmos, Dolby Vision and imaging patents and higher recoveries compared to fiscal year '21. This is partially offset by lower PC shipments, primarily in the back half of the year. Q4 PC revenues are down year-over-year, driven by lower unit shipments, partially offset by growth in Dolby Vision, Dolby Atmos and imaging patents.

Other markets represented about 13% of total licensing in fiscal year '22. Other markets were flat year-over-year, driven by improvements in Dolby Cinema, offset by unit declines in gaming and auto. Q4 other markets declined driven by lower gaming units and true-ups.

Beyond licensing, our products and services revenue were $89 million in fiscal year '22 compared to $67 million in fiscal year '21. The year-over-year increase was primarily driven by higher product sales as a result of improvements in the cinema industry, and we also saw revenue growth from Dolby.io.

Total non-GAAP gross margin in the fourth quarter was 87% compared to 90% in the fourth quarter of fiscal year '21. Gross margins came in lower, driven by a higher mix of products revenue. Non-GAAP operating expenses in the fourth quarter were $182 million compared to $190 million in the fourth quarter of fiscal year '21. Operating expenses were below the low end of our guidance for Q4, driven by lower variable incentive compensation expenses. Non-GAAP operating income for Q4 was $60 million or 22% of revenue compared to 23% of revenue in Q4 of last year.

Non-GAAP income tax in Q4 was within our range of guidance at 18% compared to 12.7% in last year's Q4. The year-over-year increase was primarily driven by the mix of our income between different tax jurisdictions and lower discrete benefits. Net income on a non-GAAP basis in the fourth quarter was $53 million or $0.54 per diluted share compared to $60 million or $0.58 per diluted share in Q4 of '21.

On a full year basis, non-GAAP operating income was $376 million or 30% of revenue compared to $451 million or 35% in fiscal '21. Full year net income on a non-GAAP basis was $320 million or $3.14 per diluted share compared to $383 million or $3.66 per diluted share in fiscal '21.

During the fourth quarter, we generated $51 million in cash from operations compared to $110 million generated in last year's fourth quarter. We ended the fourth quarter with just over $900 million in cash and investments.

During the fourth quarter, we bought back about 2.9 million shares of our common stock and ended the quarter with about $361 million stock repurchase authorization available going forward. We also announced today a cash dividend of $0.27 per share, an increase of $0.02 or 8% compared to the prior quarter. The dividend will be payable on December 8, 2022, to shareholders of record on November 30, 2022.

Maggie O'Donnell - *Dolby Laboratories, Inc. - Head of IR*

All right. So before you get into the numbers for fiscal year '23, how are you thinking about guidance going forward?

Robert J. Park - *Dolby Laboratories, Inc. - Senior VP & CFO*

Let's start by saying we are continuing to operate in a challenging and uncertain environment. No one in the world is -- not only is the world still dealing with repercussions from the pandemic, but there has also been supply chain imbalances, geopolitical instability, high inflation and monetary tightening to address it and the list goes on. Our customers and partners are similarly impacted by the uncertainty in the environment. And as a result, we are seeing this impact not only in our unit shipments, but the timing of some of the transactions as discussed earlier. Many companies who stopped giving guidance during the pandemic are still not providing guidance. All of this is to say that our visibility is limited, and predicting what will happen in the next year is difficult. With that -- with this as the backdrop, I'll be providing a high-level scenario for fiscal year '23.

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Based on what we're seeing right now, including data points from industry analysts, we're expecting declines in consumer device shipments, particularly for TVs in North America and Europe, and globally, for PC and CE. This mostly impacts our foundational audio revenue, which we project will decline mid-single digits during the year.

As Kevin said earlier, we are targeting 15% to 25% growth in Dolby Vision, Dolby Atmos and imaging patents, and we expect this to be driven by growth in the Broadcast, Mobile and other markets. We assume this will more than offset the declines in foundational audio that we are expecting. With these assumptions, we are projecting total revenue for fiscal year '23 to grow low single digits year-over-year. Within this, we anticipate licensing revenue to be up low single digits, with products and services revenue expected to grow high single digits.

Now let's talk about OpEx. For the full year, we are currently anticipating non-GAAP operating expenses to increase roughly 2% compared to the prior year. We will see growth in our annual merit increases and normalization of the incentive compensation for employees compared to fiscal year '22, which came in significantly below 100%. We are also seeing inflationary pressures in some areas and increased travel expenses. This is mostly offset by cost-saving measures we've taken such as organizational adjustments and reductions in infrastructure costs.

We will continue to limit hiring to the most critical roles while focusing our investments on the areas that have the largest impact towards our long-term opportunities. This would result in operating margins of roughly 30% on a non-GAAP basis for the year. We will continue to be disciplined with our spend, review our resource envelope and allocations on a regular basis and make adjustments as the year progresses. We anticipate that non-GAAP earnings per share will grow at a slightly higher rate than revenue.

Maggie O'Donnell - *Dolby Laboratories, Inc. - Head of IR*

Great. Thanks for the full year context and perspective. How about Q1?

Robert J. Park - *Dolby Laboratories, Inc. - Senior VP & CFO*

Well, let me reiterate that volatility from this economic environment has made forecasting more challenging in the near term, and that includes visibility into Q1. In addition, revenue lumpiness from timing of deals is more acute in the quarter than on the full year. That said, based on what we're seeing right now, we see Q1 revenue ranging from $300 million to $333 million.

Within that, licensing revenue is estimated to range from $280 million to $305 million, while products and services is projected to range from $20 million to $25 million. Compared to Q1 last year, we expect lower unit declines in TV and PC and lower recoveries. At the same time, we continue to see growth from Dolby Vision and Dolby Atmos. Non-GAAP gross margin is estimated to be 90% plus or minus. Operating expenses in Q1 on a non-GAAP basis are estimated to range from $180 million to $190 million.

Our effective tax rate for Q1 is projected to range from 19% to 21% on a non-GAAP basis. This is higher than fiscal year '22 as we are forecasting lower benefit from foreign tax credits. We also benefited from discrete items in fiscal year '22 that are not included in fiscal '23. We anticipate the full year tax rate will be in a similar range. So based on the combination of the factors I just covered, we estimate that non-GAAP Q1 diluted earnings per share could range from $0.76 to $0.91 -- let me restate, Q1 revenue range is $300 million to $330 million.

Maggie O'Donnell - *Dolby Laboratories, Inc. - Head of IR*

All right. Robert, do you have any closing remarks?

Robert J. Park - *Dolby Laboratories, Inc. - Senior VP & CFO*

Yes, Maggie. It remains a tough environment. And while the near term is uncertain, we are well positioned for growth in the long term. Dolby has a durable business model, strong balance sheet and healthy cash flows, even with today's tough market conditions. Our foundational audio

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technologies are broadly penetrated across a wide variety of content and devices, and much of the opportunity lays ahead for Dolby Atmos, Dolby Vision and imaging patents as we continue to expand further into new use cases like live sports, user-generated content and auto. We are also excited about Dolby.io as a long-term growth vector as it greatly expands our addressable market. All of this gives us confidence in our ability to drive revenue and earnings growth into the future.

Maggie O'Donnell - *Dolby Laboratories, Inc. - Head of IR*

Great. All right. That wraps up my portion. Let's turn it over to the operator and our analysts for some Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from Ralph Schackart with William Blair.

Ralph Edward Schackart - *William Blair & Company L.L.C., Research Division - Partner & Technology Analyst*

Kevin, just on the macro, if you could just maybe give us a perspective, that's obviously changing fairly dynamically. As you sit here in mid-November, how does the macro outlook, I guess, look today versus perhaps how you exited Q4? Just trying to get a sense of how dynamic or how things are changing at Dolby.

Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

Well, I think in terms of the macro environment, Ralph, I mean, we could talk about kind of what the economic narrative is this week versus last week, the week before. And I think the word of the day is still uncertainty, and what will be there to be next week. But I think fundamentally, we have a really strong position in our foundational revenues, and the end markets will stabilize, and that's when we expect to return to growth and better visibility.

And we continue to see -- what we continue to see is great demand for immersive experiences and specifically Dolby Atmos and Dolby Vision, and gave some examples of that a moment ago. But the World Cup in Dolby Vision, we're really excited about. Movies and TV and devices in the living room will continue to be one of the growth drivers for Dolby Atmos and Dolby Vision this year.

And of course, we're really excited about music and auto, user-generated content in Mobile. And those are things that are contributing to revenue, but they're early days. We're getting our first partners, our first models. We have yet have the time to -- what comes next is driving further into lineups, adding more partners. And so we're really confident that those are going to become big contributors to Dolby Atmos, Dolby Vision and imaging patent growth over the long term where we see the opportunity to double it.

Ralph Edward Schackart - *William Blair & Company L.L.C., Research Division - Partner & Technology Analyst*

Great. And then maybe a follow-up for Robert. Robert, can you just remind us in terms of Mobile, saw a pretty steep year-over-year decline, a little bit more color on the driver of that.

And then just sort of fast forwarding as we think about the next fiscal year, I know you have some headwinds with foundational and some growth with Atmos and Vision. But can you sort of walk us through, starting with Broadcast and Mobile and CE as we set our models, which line items would you expect to perhaps be growing year-over-year in 2023, that would be really helpful.

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Robert J. Park - *Dolby Laboratories, Inc. - Senior VP & CFO*

Yes. Ralph, Mobile decreased 9% year-over-year in fiscal '22. Last year, we benefited from timing of certain deals, including recoveries. And then we had some solid growth in Dolby Atmos and Dolby Vision. And then in Q4, we saw that the units were lower in our Mobile space.

In terms of next year, if we talk about one, the level of uncertainty, and our guidance is kind of more directional than anything that we're going to see declines in unit shipments, particularly in TVs in North America and Europe, where we have higher attach rates, and then globally, for PC and CE. More pronounced in the first quarter because there are easier comps in the back half of the year, that's why the Q1 is a little bit more acute.

As some of these markets started to decrease in fiscal year '22, we're going to be coming off those compares in fiscal year '23. So Q1 is really the first compare off of a starting to decline in Q1 of last year. So those are the markets, I would say, are going to be down next year. And then we'll see other growth in Dolby Atmos, Vision and imaging to offset those units.

Operator

Next question is from Steven Frankel with Rosenblatt.

Steven Bruce Frankel - *Rosenblatt Securities Inc., Research Division - Senior Analyst*

So as we think about the growth trajectory that you're talking about for Vision, Atmos and patents, it's a little slower. Obviously, little slower than last year, a little slower than, I think, everyone was expecting. To what extent is it this uncertain environment that's either causing design decisions to be delayed? Or customers to hesitate adding those premium technologies because it's going to raise the cost of the bill of materials?

Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

Yes. Well, we still see great demand for people that -- for adoption of the technologies. And like I said, just in the last few weeks, we've added Polestar, Lotus, Volvo on the automotive side. And yes, we did come in a little bit lower than the expectation we set last quarter. We did have a couple of engagements that it took longer, but we grew 30%, and that's on the strength of movies and TV. Remember, it was also driven by the improvement in the box office for Dolby Cinema, which we continue to expect growth next year, but probably not the level of box office improvement that we have coming off of those pandemic lows.

And so at 15% to 25%, we are allowing for a range of outcomes in that guidance because we see -- we continue to see great demand signals across each of the areas we've talked about. At the same time, we recognize that we have been seeing engagements take a little longer so we allowed for that in our range of outcomes.

Steven Bruce Frankel - *Rosenblatt Securities Inc., Research Division - Senior Analyst*

Okay. So just to define that a little further, you're not necessarily getting pushback because of the incremental cost, it's more about the demand picture and decision cycles.

Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

Yes. Yes. I think that's a fair -- so what we're not seeing is slowdown in people wanting to adopt. We're not getting slowed down by the -- price is not the reason we're slowing down. It's just an environment where everybody is affected by this in some way, shape or form, and that can affect the time it takes to get transaction cycles done. I mean for -- as Robert said earlier, as you know, our licensing business is based on unit shipments.

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And in general, where our revenue comes in, we estimate what shipped each quarter, and we true it up the next quarter, and to the extent that those engagements are delaying, more often than not, it means that we might be signing it fewer months before the first shipment than we might have. But for some of these other things like past units or deciding on minimum commitment volumes, that is where I think there's a lot of attention cycles as people look at how all of this affects their business. And so some of those engagement cycles are taking longer.

Steven Bruce Frankel - *Rosenblatt Securities Inc., Research Division - Senior Analyst*

Okay. And then for Robert, what was the true-up in the quarter?

Robert J. Park - *Dolby Laboratories, Inc. - Senior VP & CFO*

The true-up in the quarter is about $3 million.

Steven Bruce Frankel - *Rosenblatt Securities Inc., Research Division - Senior Analyst*

To the positive side?

Robert J. Park - *Dolby Laboratories, Inc. - Senior VP & CFO*

To the positive, yes.

Steven Bruce Frankel - *Rosenblatt Securities Inc., Research Division - Senior Analyst*

Yes. So similar to Q3.

Robert J. Park - *Dolby Laboratories, Inc. - Senior VP & CFO*

Yes.

Steven Bruce Frankel - *Rosenblatt Securities Inc., Research Division - Senior Analyst*

Okay. And are you getting any pushback from customers around the notion of fixed minimum payment contracts in this environment?

Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

I don't think we've seen pervasive pushback on the notion of the volume commitments. I mean, as far as we're concerned, essentially, it's about being on those devices and how many are going to ship. And whether they're doing minimum value commitments tend to affect the timing of when it comes in, right? It's pretty rare that someone would ever commit to more than they are sure they can ship.

So I think that it's not a significant driver to what we've seen, but it's -- there are some that are thinking about what minimums they want to commit to, given the uncertainty they're facing. But from a Dolby perspective, that's just a matter of the timing of when that comes in, right?

And I also want to add, Steve, to your previous question. I think it's important to understand that in any environment, as it relates to Dolby as we're building these ecosystems, it is entirely plausible that a category of revenue grows 20% one year and goes up to 30% the next year and it's 20% again. And the reason it can do that is because we're building these ecosystems, like we're doing with music, where we have this increased volume

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of content and streaming services and a more valuable proposition to autos and other devices people use to enjoy music. The same could be said for our user-generated content ecosystem.

And as those develop, we become -- we gain a sense of confidence that we're going to get on a significant percentage of devices. But as they're developing, the timing of the revenue will have a lot to do with which partners we get first, which models they decide to do first, how quickly do they decide to go into their lineups. And so when we give -- so again, we think that we're -- we feel confident in the opportunity to double the size of those revenues over the next 3 to 5 years and are targeting 15% to 25% per year.

Operator

Next question is from Paul Chung with JPMorgan.

Paul Chung - *JPMorgan Chase & Co, Research Division - VP & IT Hardware Analyst*

So just a follow-up on the revenue guidance for Q1 and the year next year. So should we expect some large Mobile quarter is maybe shifting into Q2. Is that the right way to kind of think about it? I mean just some help on the shape of revenues for licensing for the year that gets you to that kind of low single-digit growth, as Q1 has typically been your strongest for the past 2 years, fiscal years?

Robert J. Park - *Dolby Laboratories, Inc. - Senior VP & CFO*

So for Mobile and a couple of these areas, some of the Q1 declines are more pronounced in Q1 than the full year. Yes, some of the deals, some of the transactions that we talked about earlier are more pushed out beyond Q1 than they were in the prior year. So we're more heavily weighted in Q1 of last year.

Paul Chung - *JPMorgan Chase & Co, Research Division - VP & IT Hardware Analyst*

Okay. And then on Dolby.io, what's the contribution today in product sales? And is the contribution for '23 kind of product guidance, is it included in there? And then the margin profile has rebounded quite strongly on products. Where do we go as we move through the year next year. And what's the kind of io contribution on margins to products?

Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

Yes. So let me try to take that in turn. So yes, revenue from Dolby.io is included in our product and services line. It is contributing and growing. It's not large enough to highlight for you as one of the major growth factors this year. But we -- as I said earlier, we're seeing greater engagement. We're involved in a lot of conversations that we think are -- where the future is going in terms of these really immersive virtual experiences.

And so we're excited about that, and we can talk more about that. But let me get to the other part of your question, which is the margin improvement. There was -- throughout the year, we, like many, were hit with some of the supply chain challenges as it relates to the manufacturing of our products. Obviously, products is not a large part of our business, but nonetheless, we were affected. And so that affected our margins as it could be the parts, it could be shipping them to where they need to be, all of that. And the team was immediately on top of that and has come up with solutions, which have resulted in the improvement in gross margins, which is closer to what we would target on an ongoing basis.

Paul Chung - *JPMorgan Chase & Co, Research Division - VP & IT Hardware Analyst*

Got you. And then lastly, on cash flows, it's a bit lighter than expected but still generating close to $300 million. So what's the outlook for free cash as you think about '23 and kind of conversion rates there?

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And you stepped up the buybacks here materially in the quarter and for the fiscal year at $0.5 billion. So including the dividend kind of exceeding free cash flow for this year, which is fine given your cash balance. But how do we think about the pace next year? And should we expect kind of the similar buybacks and dividends to kind of exceed free cash flow next year to kind of support shareholder returns here in a difficult environment.

Robert J. Park - *Dolby Laboratories, Inc. - Senior VP & CFO*

Yes. Paul, first, I'd just say that our cash flow from operations generally correlate well with our net income, and you should see that to continue over time. There, of course, will be quarterly fluctuations in working capital, timing of payments, timing of receipts, et cetera. But that's a pretty good benchmark to hold that against.

As it relates to the buyback for '23, if you think about our policy, our policy has always been offsetting dilution from stock-based compensation. We're fortunate to have a very strong balance sheet. We've got a healthy cash flow, as you just noted. And we look at our capital allocations regularly for optimization opportunities. And you did see that we stepped it up in the second half of '22.

Going forward, we'll continue to look at our capital allocation portfolio between investing in the business and opportunities we see and return to shareholders based on the facts and circumstances at the time. But for now, our intent is to at least offset dilution from stock-based compensation, and then we'll make adjustments as needed. And you did see that we did increase the dividend 8% going forward as well. So we've got to balance that allocation between return to shareholders and investing in our business for growth.

Operator

The last question is from Jim Goss with Barrington Research.

James Charles Goss - *Barrington Research Associates, Inc., Research Division - MD*

I do like the fact that you've focused on the foundational technologies, that does give a good perspective and core business plus the growth elements. I am curious though, over time, do you recategorize certain of what are currently growth elements into foundational, for example, 10 years into it, does Atmos become Dolby Digital Plus as sort of a foundational and then you're moving on to other things? And how should we think of the mix of revenues as the growth elements take over from the foundational elements or what are currently foundational elements?

Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

Yes. Good question, Jim. I would start by saying that, we are never done at Dolby inventing what it means to have a Dolby experience. So we're always looking for the next great Dolby experience, and we're always looking for ways to bring it to more content, more experiences, the content that people most engage with.

And so clearly, I've said, for the midterm, we expect Dolby Atmos, Dolby Vision and imaging patents to be in that growth mode, and we see that opportunity to double them over that period of time, growing 15% to 25% annually. So yes, I have on occasion thought, "What am I going to do when we're on such a high percentage of devices with those experiences?" That maybe -- yes, maybe there'd be shifts. And by then, of course, we would expect of ourselves to have the next set of great Dolby experiences that we're talking about.

James Charles Goss - *Barrington Research Associates, Inc., Research Division - MD*

Okay. And since you're sort of creating the categories, it's early to decide how you redefine them over time than I think the other?

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Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

Well, again, the -- the basis for this foundational versus Dolby Vision, Dolby Atmos and imaging patents is to help you understand the growth drivers. And our audio codecs and our audio patents are so pervasive across so many consumer devices and so essential to the entertainment content ecosystem that it is more -- much more sensitive to the macro environment and what's going on with consumer devices.

And that's why we set that apart from Dolby Atmos, Dolby Vision, imaging patents, which aren't immune to the macroeconomic environment, but are much more about getting on more of those devices that are shipping, getting more licensees onboard.

James Charles Goss - *Barrington Research Associates, Inc., Research Division - MD*

Okay. And the hardware side of the TV business has been very competitive. Now VIZIO has focused on a couple of sort of a loss leader units that have been growing more rapidly. And I'm wondering if, is that phenomenon, which I'm sure they're not the only one doing that sort of thing, coming out to be a help to you in terms of growing the Atmos and Vision type products royalty revenue stream?

Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

Yes. Well, coming back to a comment I made a few minutes ago, with each of these ecosystems, and I would look at the movies and TV content ecosystem for Dolby Vision and Atmos as one that we have a lot of scale with in terms of content and distribution; music and auto is really coming along, like with 3 of the top 5 streaming services, an increasing amount of content; and then user generated content with mobile devices, we do -- there's pattern recognition here because this is really our business model for a long time around ecosystems, new experiences, new technologies for getting the content to people, new devices.

But fundamentally, we are about understanding what the creatives or the content creators, what's going to help them tell a better story, bring out more emotion in your content and then making sure that you can get that wherever you like to get that content on every device you like to enjoy it on. So when we get to a certain point in building an ecosystem, we develop a lot of confidence that we can get -- that we can significantly increase our adoption in those areas.

At that point, the rate of growth has a lot to do with which -- when partners come on board, which models do they start with, how far they go in the lineup and that kind of -- and I'm relating that to your point because, yes, VIZIO, along with Sony, those are examples of customers that have taken us deep into their lineups. And so look, some have -- there are different strategies. Some are reacting by looking for share and focusing across their lineup. Some are going to focus even more on premium.

Over time, of course, our goal is to bring the Dolby Atmos and Dolby Vision experience to everybody. But when you're in the mode that we're in with Atmos, Vision and imaging, the growth -- where we are in that range and where we've grown these in here has a lot to do with which models we're getting on first, when those are launching and shipping and which ones turn out to be the top sellers.

James Charles Goss - *Barrington Research Associates, Inc., Research Division - MD*

Okay. And one last one. I was wondering over what period of time you feel the Dolby.io revenues and profitability will become significant and would be more likely to pay attention to them in terms of that significance?

Kevin J. Yeaman - *Dolby Laboratories, Inc. - President, CEO & Director*

Yes. A fair question. I mean, we're in this because we think it's a really significant opportunity for us. I mean it significantly expands the types of experiences, it expands not only our available market, but the types of customers and companies we have the opportunity to do business with. And like I said, we're, of course, generating revenues today, and it's growing, and we are going to break that out when we get to a certain size and scale.

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So I don't think I'm going to predict exactly when that will be. But I am excited about both the progress we're making with the use cases we have in market today like real-time streaming and interactivity. And also these discussions where we believe we're finding ourselves in the heart of these discussions around what it's going to mean in the future to have a truly immersive experience.

And we made some -- again, we made some really good progress. One thing I was excited about was we made some progress with our plug-ins with the -- the Unreal engine is the environment that a lot of these worlds are built on. And in March, we made available a plug-in for this real-time streaming, which means that if you're building a virtual event, you could in real-time, with ultra-low latency stream in, whatever you want to stream into this virtual environment, a concert, a sporting event, a movie. Or you can capture what you're doing in the virtual world and stream it to the outside world.

And this quarter, we added a plug-in. It's an open beta. So it's a plug-in for adding into that the interactivity. And so that means now you can be streaming that same concert, but the audience will be able to have that fully engaging experience where they're hearing great quality music from the performance, but they can also hear the ambient noise.

They can talk to one another. The plug-ins just make it much easier for developers to build thoses experience and bring them to life and get them into the world.

Operator

That concludes today's conference call. Thank you for your participation. You may now disconnect your lines.

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