

# DTS, INC.

## FORM 10-Q (Quarterly Report)

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**Form 10-Q**

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

For the Quarterly Period Ended March 31, 2012

Commission File Number 000-50335



**DTS, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**77-0467655**

(I.R.S. Employer  
Identification No.)

**5220 Las Virgenes Road  
Calabasas, California 91302**  
(Address of principal executive  
offices and zip code)

**(818) 436-1000**  
(Registrant's telephone number,  
including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller  
reporting company)

Smaller reporting  
company

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

As of April 27, 2012 a total of 16,505,484 shares of the Registrant's Common Stock, \$0.0001 par value, were outstanding.



**DTS, INC.**  
**FORM 10-Q**  
**TABLE OF CONTENTS**

PART I	FINANCIAL INFORMATION	1
Item 1.	Financial Statements (unaudited):	1
	Consolidated Balance Sheets	1
	Consolidated Statements of Income	2
	Consolidated Statements of Comprehensive Income	3
	Consolidated Statements of Cash Flows	4
	Notes to Consolidated Financial Statements	5
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	20
Item 4.	Controls and Procedures	21
PART II.	OTHER INFORMATION	22
Item 1.	Legal Proceedings	22
Item 1A.	Risk Factors	22
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	40
Item 3.	Defaults Upon Senior Securities	40
Item 4.	Mine Safety Disclosures	40
Item 5.	Other Information	40
Item 6.	Exhibits	41
	SIGNATURES	43

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## DTS, INC.

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## DTS, INC.

## CONSOLIDATED BALANCE SHEETS

	As of March 31, 2012	As of December 31, 2011
	(Unaudited)	
	(Amounts in thousands, except per share amounts)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 37,564	\$ 46,944
Short-term investments	41,508	38,697
Accounts receivable, net of allowance for doubtful accounts of \$252 and \$251 at March 31, 2012 and December 31, 2011, respectively	6,744	5,322
Deferred income taxes	1,290	1,296
Prepaid expenses and other current assets	1,909	1,823
Income taxes receivable, net	2,320	2,591
Total current assets	91,335	96,673
Property and equipment, net	32,082	32,800
Intangible assets, net	6,377	6,549
Goodwill	1,257	1,257
Deferred income taxes	14,232	13,574
Long-term investments	18,531	6,922
Other assets	2,291	1,695
Total assets	<u>\$ 166,105</u>	<u>\$ 159,470</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 1,735	\$ 1,056
Accrued expenses	4,724	3,605
Deferred revenue	485	1,121
Total current liabilities	6,944	5,782
Other long-term liabilities	8,169	7,886
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Preferred stock—\$0.0001 par value, 5,000 shares authorized at March 31, 2012 and December 31, 2011; no shares issued and outstanding	—	—
Common stock—\$0.0001 par value, 70,000 shares authorized at March 31, 2012 and December 31, 2011; 20,571 and 20,536 shares issued at March 31, 2012 and December 31, 2011, respectively; 16,500 and 16,536 shares outstanding at March 31, 2012 and December 31, 2011, respectively	3	3
Additional paid-in capital	195,962	192,819
Treasury stock, at cost—4,072 and 4,000 shares at March 31, 2012 and December 31, 2011, respectively	(109,257)	(107,222)
Accumulated other comprehensive income	681	644
Retained earnings	63,603	59,558
Total stockholders' equity	150,992	145,802
Total liabilities and stockholders' equity	<u>\$ 166,105</u>	<u>\$ 159,470</u>

See accompanying notes to consolidated financial statements.



## DTS, INC.

## CONSOLIDATED STATEMENTS OF INCOME

	For the Three Months Ended March 31,	
	2012	2011
	(Unaudited)	
	(Amounts in thousands, except per share amounts)	
Revenue	\$ 26,885	\$ 26,779
Cost of revenue	194	211
Gross profit	26,691	26,568
Operating expenses:		
Selling, general and administrative	15,283	13,949
Research and development	4,510	3,252
Total operating expenses	19,793	17,201
Operating income	6,898	9,367
Interest and other income (expense), net	(88)	(74)
Income before provision for income taxes	6,810	9,293
Provision for income taxes	2,765	3,604
Net income	\$ 4,045	\$ 5,689
Net income per common share:		
Basic	\$ 0.25	\$ 0.33
Diluted	\$ 0.24	\$ 0.32
Weighted average shares used to compute net income per common share:		
Basic	16,465	17,205
Diluted	16,933	17,903

See accompanying notes to consolidated financial statements.

**DTS, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	For the Three Months Ended March 31,	
	2012	2011
	(Unaudited)	
	(Amounts in thousands)	
Net income	\$ 4,045	\$ 5,689
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments, net	39	38
Other, net	(2)	—
Total comprehensive income	<u>\$ 4,082</u>	<u>\$ 5,727</u>

See accompanying notes to consolidated financial statements.

## DTS, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Three Months Ended March 31,	
	2012	2011
	(Unaudited)	
	(Amounts in thousands)	
Cash flows from operating activities:		
Net income	\$ 4,045	\$ 5,689
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,333	1,263
Stock-based compensation charges	2,598	1,972
Deferred income taxes	(652)	507
Tax benefits from stock-based awards	1,010	182
Excess tax benefits from stock-based awards	(1,136)	(138)
Other	56	150
Changes in operating assets and liabilities:		
Accounts receivable	(2,022)	(1,737)
Prepaid expenses and other assets	(82)	(698)
Accounts payable, accrued expenses and other liabilities	2,032	(1,992)
Deferred revenue	(636)	(1,027)
Income taxes receivable	271	(307)
Net cash provided by operating activities	<u>6,817</u>	<u>3,864</u>
Cash flows from investing activities:		
Purchases of held-to-maturity investments	(3,335)	(21,159)
Purchases of available-for-sale investments	(31,105)	—
Maturities of held-to-maturity investments	12,720	18,995
Maturities of available-for-sale investments	7,300	—
Purchase of property and equipment	(311)	(355)
Purchase of intangible assets	(102)	(140)
Net cash used in investing activities	<u>(14,833)</u>	<u>(2,659)</u>
Cash flows from financing activities:		
Proceeds from the issuance of common stock under stock-based compensation plans	456	1,478
Repurchase and retirement of common stock for restricted stock tax withholdings	(921)	(1,430)
Excess tax benefits from stock-based awards	1,136	138
Purchase of treasury stock	(2,035)	—
Net cash provided by (used in) financing activities	<u>(1,364)</u>	<u>186</u>
Net increase (decrease) in cash and cash equivalents	<u>(9,380)</u>	<u>1,391</u>
Cash and cash equivalents, beginning of period	46,944	41,744
Cash and cash equivalents, end of period	<u>\$ 37,564</u>	<u>\$ 43,135</u>

See accompanying notes to consolidated financial statements.

**DTS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(Amounts in thousands, except per share data)**

**Note 1—Basis of Presentation**

The accompanying unaudited consolidated financial statements of DTS, Inc. (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, the unaudited consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair statement of the Company's financial position at March 31, 2012, and the results of operations and cash flows for the periods presented. All significant intercompany transactions have been eliminated in consolidation. Operating results for the three months ended March 31, 2012 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2012. The information included in this Form 10-Q should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, filed on March 2, 2012.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Pending Acquisition of SRS Lab, Inc.*

On April 16, 2012, the Company, DTS Merger Sub, Inc., a Delaware corporation and a wholly owned subsidiary of the Company ("Merger Sub"), DTS LLC, a single member Delaware limited liability company and a wholly owned subsidiary of the Company ("Merger LLC"), and SRS Labs, Inc., a Delaware corporation ("SRS") entered into an Agreement and Plan of Merger and Reorganization (the "Merger Agreement"). The Merger Agreement provides that, upon the terms and subject to the conditions set forth therein, Merger Sub will merge with and into SRS, with SRS surviving as a wholly owned subsidiary of the Company, and immediately thereafter, SRS will merge with and into Merger LLC, with Merger LLC surviving as a wholly owned subsidiary of the Company (together, the "Merger"). For additional information, refer to Footnote 10 of the consolidated financial statements, "Subsequent Events."

All discussions and amounts in the consolidated financial statements and related notes exclude the financial condition and results of operations of SRS.

**Note 2—Cash and Investments**

Cash and investments consist of the following:

The Company had no material gross realized or unrealized holding gains or losses from its investments in securities classified as available-for-sale or held-to-maturity for the periods presented within this quarterly report.

## DTS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Amounts in thousands, except per share data)

## Note 2—Cash and Investments (Continued)

The contractual maturities of investments at March 31, 2012 are as follows:

	As of March 31, 2012	As of December 31, 2011
<b>Cash and cash equivalents:</b>		
Cash	\$ 13,372	\$ 11,330
Money market accounts	24,192	35,383
Municipal securities	—	231
Total cash and cash equivalents	<u>\$ 37,564</u>	<u>\$ 46,944</u>
<b>Short-term investments:</b>		
<b>Available-for-sale securities:</b>		
Commercial paper	\$ 2,036	\$ —
U.S. government and agency securities	19,109	11,391
Municipal securities	7,883	4,329
<b>Held-to-maturity securities:</b>		
Certificates of deposit	724	1,543
Commercial paper	430	429
U.S. government and agency securities	2,010	11,628
Municipal securities	9,316	9,377
Total short-term investments	<u>\$ 41,508</u>	<u>\$ 38,697</u>
<b>Long-term investments:</b>		
<b>Available-for-sale securities:</b>		
U.S. government and agency securities	\$ 14,506	\$ 4,010
<b>Held-to-maturity securities:</b>		
Certificates of deposit	391	—
Municipal securities	3,634	2,912
Total long-term investments	<u>\$ 18,531</u>	<u>\$ 6,922</u>

The Company had no material gross realized or unrealized holding gains or losses from its investments in securities classified as available-for-sale or held-to-maturity for the periods presented within this quarterly report.

## DTS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Amounts in thousands, except per share data)

**Note 2—Cash and Investments (Continued)**

The contractual maturities of investments at March 31, 2012 are as follows:

Available-for-sale securities:	
Due within one year	\$ 29,028
Due after one year and through five years	14,506
	<u>43,534</u>
Held-to-maturity securities:	
Due within one year	12,480
Due after one year and through five years	4,025
	<u>16,505</u>
Total investments	<u>\$ 60,039</u>

For additional information on investments classified as available-for-sale, refer to Footnote 3 of the consolidated financial statements, "Fair Value Measurements."

**Note 3—Fair Value Measurements**

The Company purchased and classified certain investments as available-for-sale, and thus, these securities are required to be measured at fair value on a recurring basis. All other investments are classified as held-to-maturity and reported at amortized cost.

The Company obtained the fair value of its available-for-sale securities, which are not in active markets, from a third-party professional pricing service using quoted market prices for identical or comparable instruments, rather than direct observations of quoted prices in active markets. The Company's professional pricing service gathers observable inputs for all of its fixed income securities from a variety of industry data providers (e.g. large custodial institutions) and other third-party sources. Once the observable inputs are gathered, all data points are considered and the fair value is determined.

The Company validates the quoted market prices provided by its primary pricing service by comparing their assessment of the fair values against the fair values provided by its investment managers. The Company's investment managers use similar techniques to its professional pricing service to derive pricing as described above.

As all significant inputs were observable, derived from observable information in the marketplace or supported by observable levels at which transactions are executed in the marketplace, the Company has classified its available-for-sale securities within Level 2 of the fair value hierarchy as of March 31, 2012 and December 31, 2011.

## DTS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Amounts in thousands, except per share data)

## Note 3—Fair Value Measurements (Continued)

The Company's financial assets, measured at fair value on a recurring basis as of March 31, 2012 and December 31, 2011, were as follows:

Available-for-sale securities	Total	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
As of March 31, 2012				
Commercial paper	\$ 2,036	\$ —	\$ 2,036	\$ —
U.S. government and agency securities	33,615	—	33,615	—
Municipal securities	7,883	—	7,883	—
	<u>\$ 43,534</u>	<u>\$ —</u>	<u>\$ 43,534</u>	<u>\$ —</u>
As of December 31, 2011				
U.S. government and agency securities	\$ 15,401	\$ —	\$ 15,401	\$ —
Municipal securities	4,329	—	4,329	—
	<u>\$ 19,730</u>	<u>\$ —</u>	<u>\$ 19,730</u>	<u>\$ —</u>

## Note 4—Property and Equipment

Property and equipment consist of the following:

	As of March 31, 2012	As of December 31, 2011
Land	\$ 6,600	\$ 6,600
Building and improvements	21,233	21,233
Machinery and equipment	3,687	3,481
Office furniture and fixtures	5,541	5,445
Leasehold improvements	2,393	2,386
Software	5,922	5,959
	<u>45,376</u>	<u>45,104</u>
Less: Accumulated depreciation	(13,294)	(12,304)
Property and equipment, net	<u>\$ 32,082</u>	<u>\$ 32,800</u>

**DTS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**(Amounts in thousands, except per share data)**

**Note 5—Commitments and Contingencies**

**Indemnities, Commitments and Guarantees**

In the normal course of business, the Company makes certain indemnities, commitments and guarantees under which the Company may be required to make payments in relation to certain transactions. These indemnities, commitments and guarantees include, among others, intellectual property indemnities to customers in connection with the sale of products and licensing of technologies, indemnities for liabilities associated with the infringement of other parties' technology based upon the Company's products and technologies, guarantees of timely performance of the Company's obligations, and indemnities to the Company's directors and officers to the maximum extent permitted by law. The duration of these indemnities, commitments and guarantees varies, and in certain cases, is indefinite. The majority of these indemnities, commitments and guarantees do not provide for any limitation of the maximum potential future payments that the Company could be obligated to make. The Company has not recorded a liability for these indemnities, commitments or guarantees in the accompanying consolidated balance sheets, as future payment is currently not probable.

**Note 6—Income Taxes**

For the three months ended March 31, 2012, the Company recorded an income tax provision of \$2,765 on pre-tax income of \$6,810, which resulted in an annualized effective tax rate of 41%. This rate differed from the U.S. statutory rate of 35% primarily due to state income taxes, reserves for U.S. federal and state tax audits and certain non-deductible transaction costs associated with our pending acquisition of SRS, partially offset by the effects of foreign operations, as the tax rates for the Company's foreign operations are generally lower than the U.S. statutory rate.

Other long-term liabilities at March 31, 2012 and December 31, 2011, included unrecognized tax benefits of \$7,735 and \$7,459, respectively, which was recorded in other long-term liabilities. The net increase of \$276 was primarily due to uncertainties relating to the Company's transfer pricing with its foreign licensing subsidiary and California income apportionment methodology, partially offset by the reversal of reserves for a U.S. federal audit issue that has been effectively settled. The Company believes that its accruals for uncertain tax positions are adequate for all open years, based on the assessment of many factors including past experience and interpretations of tax law applied to the facts of each matter. Inherent uncertainties exist in estimating accruals for uncertain tax positions due to the progress of income tax audits and changes in tax law, both legislated and concluded through the various jurisdictions' tax court systems.

The Company may, from time to time, be assessed interest or penalties by major tax jurisdictions, although any such assessments historically have been minimal and immaterial to the Company's financial results. In accordance with the Company's accounting policy, interest expense and penalties related to income taxes are included in income tax expense.

The Company, or one of its subsidiaries, files income tax returns in the U.S. and other foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal income tax examinations by tax authorities for the years prior to 2007. The Internal Revenue Service ("IRS") is examining the Company's 2007 federal income tax return, including certain prior period carryforwards. In addition, the California Franchise Tax Board ("FTB") is conducting a state tax examination for the

## DTS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Amounts in thousands, except per share data)

**Note 6—Income Taxes (Continued)**

years 2004 and 2005. The Company disagrees with and has protested certain adjustments proposed by the IRS and FTB, and thus, has filed separate appeals. The timing of the ultimate resolution of these matters cannot be reasonably estimated.

Licensing revenue is recognized gross of withholding taxes that are remitted by the Company's licensees directly to their local tax authorities. For the three months ended March 31, 2012 and 2011, withholding taxes were \$1,250 and \$1,684, respectively.

**Note 7—Geographic Information**

The Company's revenue by geographical area, based on the customer's country of domicile, was as follows:

	For the Three Months Ended March 31,	
	2012	2011
United States	\$ 4,246	\$ 2,863
International	22,639	23,916
Total revenue	\$ 26,885	\$ 26,779

The following table sets forth net long-lived tangible assets by geographic area:

	As of March 31, 2012	As of December 31, 2011
United States	\$ 29,930	\$ 30,496
International	2,152	2,304
Total long-lived tangible assets, net	\$ 32,082	\$ 32,800

**Note 8—Net Income Per Common Share**

Basic net income per common share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share is calculated by dividing net income by the sum of the weighted average number of common shares outstanding plus the dilutive effect of unvested restricted stock, outstanding stock options and the employee stock purchase plan ("ESPP") using the "treasury stock" method.

## DTS, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Amounts in thousands, except per share data)

**Note 8—Net Income Per Common Share (Continued)**

The following table sets forth the computation of basic and diluted net income per common share:

	For the Three Months Ended March 31,	
	2012	2011
Basic net income per common share:		
Numerator:		
Net income	\$ 4,045	\$ 5,689
Denominator:		
Weighted average common shares outstanding	16,465	17,205
Basic net income per common share	\$ 0.25	\$ 0.33
Diluted net income per common share:		
Numerator:		
Net income	\$ 4,045	\$ 5,689
Denominator:		
Weighted average shares outstanding	16,465	17,205
Effect of dilutive securities:		
Common stock options	387	572
Restricted stock	80	121
ESPP	1	5
Diluted shares outstanding	16,933	17,903
Diluted net income per common share	\$ 0.24	\$ 0.32

For the three months ended March 31, 2012 and 2011, 1,001 and 130 shares, respectively, of the Company's stock options and restricted stock were excluded from the calculation of diluted earnings per share because their inclusion would have been anti-dilutive.

**Note 9—Common Stock Repurchases**

In February 2012, the Company's Board of Directors authorized, subject to certain business and market conditions, the purchase of up to 2,000 shares of the Company's common stock in the open market or in privately negotiated transactions. As of March 31, 2012, the Company has repurchased 72 shares of its common stock, for an aggregate of \$2,035, under this authorization.

All shares repurchased under this authorization are accounted for as treasury stock.

**Note 10—Subsequent Events***The Merger Agreement*

On April 16, 2012, the Company, DTS Merger Sub, Inc., a Delaware corporation and a wholly owned subsidiary of the Company, DTS LLC, a single member Delaware limited liability company and

**DTS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**(Amounts in thousands, except per share data)**

**Note 10—Subsequent Events (Continued)**

a wholly owned subsidiary of the Company, and SRS Labs, Inc., a Delaware corporation entered into an Agreement and Plan of Merger and Reorganization. The Merger Agreement provides that, upon the terms and subject to the conditions set forth therein, Merger Sub will merge with and into SRS, with SRS surviving as a wholly owned subsidiary of the Company, and immediately thereafter, SRS will merge with and into Merger LLC, with Merger LLC surviving as a wholly owned subsidiary of the Company.

At the effective time of the Merger, each outstanding share of SRS common stock will be converted into the right to receive (i) \$9.50 in cash (the "Cash Consideration"), (ii) 0.31127 shares of the Company's common stock (the "Stock Consideration") or (iii) a combination of both cash and shares of common stock in certain circumstances. In total, the combination of cash and shares is expected to be approximately \$148,000 (including payout to holders of SRS options and restricted stock units). SRS stockholders may elect to receive their payment in cash or stock, subject to the requirement that the Cash Consideration and the Stock Consideration will each equal 50% of the aggregate consideration paid for the SRS common stock, with shares of the Company's common stock valued at \$30.52 per share for purposes of this calculation. No fractional shares of the Company's common stock will be issued in the Merger, with holders receiving cash (without interest) in lieu of fractional shares. At the effective time of the Merger, each outstanding stock option to acquire SRS common stock will fully vest and become exercisable, and to the extent not exercised prior to the effective time, will be canceled in exchange for the right to receive a cash payment equal to the product of (i) the excess, if any, of the Cash Consideration over the exercise price of each such option and (ii) the number of shares of SRS common stock underlying such option. Outstanding SRS restricted stock units will fully vest and be canceled in exchange for a cash payment equal to the product of (i) the Cash Consideration and (ii) the number of shares of SRS common stock subject to such cancelled restricted stock units.

Consummation of the Merger is subject to certain conditions, including (i) the adoption of the Merger Agreement by SRS' stockholders, (ii) the absence of any applicable law or order prohibiting the closing, (iii) the termination or expiration of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended and receipt of certain other regulatory approvals, (iv) the effectiveness of a registration statement on Form S-4 relating to the Company's common stock to be issued in the Merger and (v) certain other customary closing conditions.

The Merger Agreement includes customary representations, warranties and covenants of the Company, Merger Sub, Merger LLC and SRS. Among other things, SRS has agreed (i) subject to limited exceptions, to cause a stockholder meeting to be held to consider adoption of the Merger Agreement and approval of the Merger, (ii) subject to certain exceptions, that its board of directors will recommend adoption of the Merger Agreement by SRS' stockholders and approval of the Merger by SRS stockholders, (iii) not to solicit proposals relating to alternative business combination transactions and (iv) subject to limited exceptions, not to enter into discussions concerning or provide information to third parties in connection with alternative business combination transactions. Consummation of the Merger is not subject to a financing condition.

**DTS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**(Amounts in thousands, except per share data)**

**Note 10—Subsequent Events (Continued)**

The Merger Agreement contains certain termination rights for both the Company and SRS, including the right of each party to terminate the Merger Agreement if the Merger has not been consummated by December 31, 2012, subject to each party's right to extend the Merger Agreement for an additional 180 days if all closing conditions other than receipt of antitrust approvals have been satisfied by December 31, 2012. If the Merger Agreement is terminated under certain circumstances, including a determination by the board of directors of SRS to enter into a definitive agreement with respect to a Superior Proposal, SRS is required to pay the Company a termination fee of \$7,495,000.

The foregoing description of the Merger Agreement does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement, a copy of which is filed herewith as Exhibit 2.1 and incorporated herein by reference.

*The Voting Agreement*

On April 16, 2012, as an inducement for the Company and Merger Sub to enter into the Merger Agreement, SRS' Chairman of the Board, Chief Executive Officer and President, Thomas C.K. Yuen, who has the power to vote, or direct the vote, of approximately 20% of the outstanding shares of SRS common stock, entered into a Voting Agreement with the Company. The Voting Agreement provides that, subject to certain exceptions, Mr. Yuen, Misako Yuen, Mr. Yuen's family trust and family foundation will vote (or cause to be voted) all of the shares of SRS common stock beneficially owned by them (i) in favor of, among other things, the adoption of the Merger Agreement and (ii) against, among other things, any alternative business combination transaction involving SRS. The Voting Agreement will terminate upon the earlier of (i) consummation of the Merger and (ii) the termination of the Merger Agreement in accordance with its terms.

The foregoing description of the Voting Agreement does not purport to be complete and is qualified in its entirety by reference to the Voting Agreement, as amended pursuant to Amendment No. 1 to Voting Agreement, dated April 26, 2012, copies of which are filed herewith as Exhibit 2.2 and Exhibit 2.3, respectively, and incorporated herein by reference.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Forward-Looking Statements May Prove Inaccurate**

This quarterly report on Form 10-Q and the documents incorporated herein by reference contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Words such as "believes," "anticipates," "estimates," "expects," "projections," "may," "potential," "plan," "continue" and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying forward-looking statements in this report. All statements, other than statements of historical fact, are statements that could be deemed forward-looking statements, including, but not limited to, statements regarding our future financial performance or position, our business strategy, plans, expectations, and our objectives for future operations, including those relating to our products and services, as well as statements about the benefits of the transaction involving us and SRS Labs, Inc., including future financial and operating results and the combined company's plans, objectives, expectations and intentions. Although forward-looking statements in this report reflect our good faith judgment, such statements can only be based on facts and factors currently known by us. Consequently, forward-looking statements contained herein are inherently subject to risks and uncertainties and our actual results and outcomes may be materially different than those expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences in results and outcomes include, without limitation, those discussed under the "Risk Factors" section contained in Part II Item 1A and elsewhere in this report and in other documents we file with the Securities and Exchange Commission, or SEC. We cannot guarantee future results, levels of activity, performance or achievements. You should read the following discussion of our financial condition and results of operations in conjunction with the consolidated financial statements and the notes to those statements included elsewhere in this report. You are urged not to place undue reliance on the forward-looking statements contained in this report, which speak only as of the date of this report. We do not undertake any obligation to revise or update these forward-looking statements to reflect future events or circumstances.

### **Overview**

We are a leading provider of high-definition audio technologies that are incorporated into an array of consumer electronics devices by hundreds of licensee customers around the world. Our audio technologies enable the delivery and playback of clear, compelling high-definition audio and are currently used in a variety of product applications, including audio/video receivers, soundbars, Blu-ray Disc players, DVD based products, personal computers or PCs, car audio products, video game consoles, network capable televisions, digital media players or DMPs, set-top-boxes or STBs, mobile phones, tablets and home theater systems. In addition, we provide products and services to motion picture studios, radio and television broadcasters, game developers and other content creators to facilitate the inclusion of compelling, realistic DTS-encoded soundtracks in their content. We also provide a suite of audio processing technologies designed to enhance the entertainment experience for users of consumer electronics products subject to physical limitations, such as TVs, PCs and mobile electronics.

We derive revenues from licensing our audio technologies, copyrights, trademarks, and know-how under agreements with substantially all of the major consumer audio electronics manufacturers. Our business model provides for these manufacturers to pay us a per-unit amount for DTS-enabled products that they manufacture.

Generally, we actively engage in intellectual property compliance and enforcement activities focused on identifying third parties who have either incorporated our technologies, copyrights, trademarks or know-how without a license or who have under-reported the amount of royalties owed

under license agreements with us. We continue to invest in our compliance and enforcement infrastructure to support the value of our intellectual property to us and our licensees and to improve the long-term realization of revenue from our intellectual property. As a result of these activities, from time to time, we recognize royalty revenues that relate to consumer electronics manufacturing activities from prior periods. These royalty recoveries may cause revenues to be higher than expected during a particular reporting period and may not occur in subsequent periods. While we consider such revenues to be a regular part of our normal operations, we cannot predict such recoveries or the amount or timing of such revenues.

Our cost of revenues consists primarily of amounts paid for products and materials, salaries and related benefits for operations personnel, amortization of acquired intangibles and payments to third parties for copyrighted material.

Our selling, general and administrative expenses consist primarily of salaries and related benefits for personnel engaged in sales and licensee support, as well as costs associated with promotional and other selling and licensing activities. Selling, general and administrative expenses also include professional fees, facility-related expenses and other general corporate expenses, including salaries and related benefits for personnel engaged in corporate administration, finance, human resources, information systems and legal.

Our research and development costs consist primarily of salaries and related benefits for research and development personnel, engineering consulting expenses associated with new product and technology development and quality assurance and testing costs. Research and development costs are expensed as incurred.

*Pending Acquisition of SRS Labs, Inc.*

On April 16, 2012, we, DTS Merger Sub, Inc., our wholly owned subsidiary ("Merger Sub"), DTS LLC, our wholly owned subsidiary, and SRS Labs, Inc., entered into an Agreement and Plan of Merger and Reorganization (the "Merger Agreement"). The Merger Agreement provides that, after receipt of all required regulatory approvals, stockholder approval and satisfaction of the other closing conditions set forth in the Merger Agreement, Merger Sub will merge with and into SRS, with SRS surviving as our wholly owned subsidiary, and immediately thereafter, SRS will merge with and into Merger LLC, with Merger LLC surviving as our wholly owned subsidiary (together, the "Merger"). Subject to the terms and conditions of the Merger Agreement, the stockholders of SRS will receive aggregate consideration valued at \$9.50 per share (based on the closing price per share of our common stock of \$30.52), or approximately \$148 million (including payout to holders of SRS options and restricted stock units). Each outstanding share of SRS common stock will be exchanged for (i) \$9.50 in cash (the "Cash Consideration"), (ii) 0.31127 shares of our common stock (the "Stock Consideration") or (iii) a combination of both cash and shares of common stock in certain circumstances. SRS stockholders may elect to receive their payment in cash or stock, subject to the requirement that the Cash Consideration and the Stock Consideration will each equal 50% of the aggregate consideration paid for the SRS common stock. In addition, at the effective time of the Merger, each outstanding stock option to acquire SRS common stock will fully vest and become exercisable, and to the extent not exercised prior to the effective time, will be canceled in exchange for the right to receive a cash payment equal to the product of (i) the excess, if any, of the Cash Consideration over the exercise price of each such option and (ii) the number of shares of SRS common stock underlying such option. Outstanding SRS restricted stock units will fully vest and be canceled in exchange for a cash payment equal to the product of (i) the Cash Consideration and (ii) the number of shares of SRS common stock subject to such cancelled restricted stock units.

Consummation of the Merger is subject to certain conditions, including (i) the adoption of the Merger Agreement by SRS' stockholders, (ii) the absence of any applicable law or order prohibiting the

closing, (iii) the termination or expiration of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended and receipt of certain other regulatory approvals, (iv) the effectiveness of a registration statement on Form S-4 relating to the Company's common stock to be issued in the Merger and (v) certain other customary closing conditions. For additional information relating to the Merger, refer to Note 10 of the condensed consolidated financial statements, "Subsequent Events."

SRS is an industry leader in audio signal processing for consumer electronics across the four screens: TV; PCs; Mobile Phones; and Automotive Entertainment Systems. SRS holds approximately 150 worldwide registered and pending patents and is recognized by the industry as an authority in research and application of audio post processing technologies based on the human auditory principles. Through partnerships with leading global consumer electronics companies, semiconductor manufacturers, software developers, and content aggregators, SRS is recognized as a leader in audio enhancement, surround sound, volume leveling, audio streaming, and voice processing technologies.

All discussions and amounts in Management's Discussion and Analysis exclude the financial condition and results of operations of SRS.

## **Executive Summary**

### ***Financial Highlights***

- Revenues increased \$0.1 million for the three months ended March 31, 2012, compared to the same prior year period.
- Royalty recoveries from intellectual property compliance and enforcement activities increased \$2.3 million for the three months ended March 31, 2012, respectively, compared to the same prior year period.
- Royalties from Blu-ray product markets comprised over 40% of revenue for the three months ended March 31, 2012 and 2011.
- Royalties from network connected markets increased 13% for the three months ended March 31, 2012, compared to the same prior year period.

### ***Trends, Opportunities, and Challenges***

Historically, our revenue has been primarily dependent upon the DVD based home theater market. The success of DVD based systems and products has fueled a demand for higher quality entertainment in the home, and this demand is extending into the car audio, personal computer, portable electronics, on-line networked devices, broadcast, video game console, mobile handset and tablet markets, as well. We have seen the acceleration of the market for high-definition televisions drive demand for Blu-ray Disc players and advanced home theater systems. Consumers are more broadly embracing the Blu-ray technology as prices decline and approach DVD pricing, content availability increases and as customers realize the value of the advanced features that Blu-ray provides, such as the ability to connect to the internet and ultimately playback 3D content.

Because we are a mandatory technology in the Blu-ray Disc standard, our revenue growth from this market is closely tracking the growth in sales of Blu-ray equipped players, game consoles and PCs. Further, we believe that this mandatory position in the Blu-ray Disc standard will give us the ability to extend the reach of a broad array of our technologies in several large markets, such as applications beyond optical media. For example, we have signed agreements with a number of digital media player, network-connected digital television and mobile handset manufacturers to incorporate DTS decoders into their products. Also, we recently joined forces with Deluxe Digital Distribution to enhance audio experiences across the digital entertainment marketplace.

One of the largest challenges that we face is the growing consumer trend toward open platform, on-line entertainment consumption and the need to constantly and rapidly evolve our technologies to address the emerging markets. We believe that although the trend has begun, any transition to such open platform, on-line entertainment will take many years. Further, we believe that this trend demands that playback devices be capable of processing content originating in any form, whether disk-based or on-line, which creates a substantial opportunity for our technologies to extend into network-connected products that may not have an optical drive. During the transition period, we expect that both optical media and on-line entertainment formats will continue to thrive.

Further, we currently face challenges regarding the impact of the ongoing global economic downturn on consumer buying patterns. While we do not have visibility into the timing or extent of an economic recovery, we continue to remain optimistic that our revenues from both Blu-ray enabled products and our newer markets will continue to grow.

### Critical Accounting Policies and Estimates

Management's Discussion and Analysis of Financial Condition and Results of Operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of our consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. On an on-going basis, estimates and judgments are evaluated, including those related to revenue recognition, allowance for doubtful accounts, impairment of long-lived assets, stock-based compensation and income taxes. These estimates and judgments are based on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. By their nature, estimates are subject to an inherent degree of uncertainty. Actual results may differ from these estimates. There has been no material change to our critical accounting policies and estimates from the information provided in our Form 10-K filed on March 2, 2012.

### Results of Operations

#### Revenues

	2012	2011	Change	
			\$	%
Three months ended March 31,	\$ 26,885	\$ 26,779	\$ 106	0%

Revenues for the three months ended March 31, 2012, compared to the same prior year period, included an increase of \$2.3 million in royalties recovered through intellectual property compliance and enforcement activities, which we characterize as "royalty recoveries." Royalty recoveries may cause revenues to be higher than expected during a particular period and may not occur in subsequent periods. Therefore, unless otherwise noted, the impact of royalty recoveries has been excluded from our revenue discussions in order to provide a more meaningful and comparable analysis.

Excluding royalty recoveries, the decrease in revenues for the three months ended March 31, 2012, compared to the same prior year period, was largely attributable to declines in royalties from the broadcast, DVD and Blu-ray markets. The decline in royalties from the broadcast market relates to the termination of an arrangement with a certain customer. These royalties comprised about five percent or less of revenue for the three months ended March 31, 2012 and 2011. DVD related royalties continue to decline as Blu-ray and network connected devices become more mainstream. In dollar terms, DVD related royalties declined 13% for the three months ended March 31, 2012, compared to the same prior year period. In dollar terms, Blu-ray related royalties declined 6% for the three months ended

March 31, 2012, compared to the same prior year period as a result of supply chain disruptions caused by the flooding in Thailand last year. In total, Blu-ray related royalties comprised over 40% of revenue for the three months ended March 31, 2012 and 2011. Partially offsetting these declines was an increase in royalties from network connected markets. In dollar terms, these royalties increased 13% for the three months ended March 31, 2012, compared to the same prior year period. Also, these royalties comprised nearly 20% and 15% of revenue for the three months ended March 31, 2012 and 2011, respectively. The growth in network connected markets was primarily driven by increased royalties from connected TVs and mobile devices. We remain cautious regarding the outlook for the consumer electronics industry as a whole and the revenues we derive from that industry, in light of ongoing global economic challenges. However, we expect technology licensing revenues to grow as we expect to see continued growth from the network connected markets as we expand our footprint in terms of type of products, quantity of products and geographies served, and as Blu-ray adoption continues to expand globally.

### **Gross Profit**

	<u>2012</u>	<u>%</u>	<u>2011</u>	<u>%</u>	<u>Percentage point change in gross profit margin relative to prior period</u>
	(\$ in thousands)				
Three months ended March 31,	\$ 26,691	99%	\$ 26,568	99%	0%

Gross profit percentage for the three months ended March 31, 2012 and 2011, remained consistent.

We expect consolidated gross margins to remain in this range for 2012.

### **Selling, General and Administrative ("SG&A")**

	<u>2012</u>	<u>2011</u>	<u>Change</u>		
	(\$ in thousands)			<u>\$</u>	<u>%</u>
Three months ended March 31,	\$ 15,283	\$ 13,949	\$ 1,334	10%	
% of Revenue	57 %	52 %			

The dollar increase in SG&A for the three months ended March 31, 2012, compared to the same prior year period, was primarily due to an increase in advertising and related activities, which resulted from a 2012 brand marketing campaign and tradeshow related activities. Also included in SG&A for the three months ended March 31, 2012 were costs associated with our pending acquisition of SRS. Employee related costs were relatively flat, which resulted from increases in headcount and stock-based compensation, partially offset by a decrease in our accrual for certain incentive compensation costs.

We expect SG&A expenses to continue to increase, primarily to support activities such as new technology initiatives, international expansion and intellectual property enforcement.

### **Research and Development ("R&D")**

	<u>2012</u>	<u>2011</u>	<u>Change</u>		
	(\$ in thousands)			<u>\$</u>	<u>%</u>
Three months ended March 31,	\$ 4,510	\$ 3,252	\$ 1,258	39%	
% of Revenue	17 %	12 %			

The dollar increase in R&D for the three months ended March 31, 2012, compared to the same prior year period, was primarily due to an increase in employee related costs. The increase in employee

related costs was primarily due to an increase in headcount to support our expanded operations and stock-based compensation. Other increases include travel and consultant related expenses to support our growth.

We intend to continue to invest in R&D to support the activities mentioned above, and thus expect to see sequential growth through the remainder of the year.

***Interest and Other Income (Expense), Net***

	2012	2011	Change	
			\$	%
Three months ended March 31,	\$ (88)	\$ (74)	\$ (14)	(19)%

Interest and other income (expense), net, for the three months ended March 31, 2012 and 2011 is comprised mostly of the effects of translation for certain foreign subsidiaries to the U.S. dollar or functional currency, partially offset by interest income.

***Income Taxes***

	2012	2011
	(\$ in thousands)	
Three months ended March 31,	\$ 2,765	\$ 3,604
<i>Effective tax rate</i>	41 %	39 %

Our effective tax rate is based upon a projection of annual fiscal year results. These rates differed from the U.S. statutory rate of 35% primarily due to state income taxes and reserves for U.S. federal and state audits, partially offset by the effects of foreign operations, as our tax rates on those operations are generally lower than the U.S. statutory rate. Our effective tax rate for the three months ended March 31, 2012 was also higher due to certain non-deductible transaction costs associated with our pending acquisition of SRS. Our effective tax rate for the three months ended March 31, 2011 was also partially offset by the reversal of a reserve for a foreign transfer pricing issue that has been effectively settled.

**Liquidity and Capital Resources**

At March 31, 2012, we had cash, cash equivalents and short-term investments of \$79.1 million, compared to \$85.6 million at December 31, 2011. At March 31, 2012, \$43.2 million of cash, cash equivalents and short-term investments was held by our foreign subsidiaries. If these funds are needed for our operations in the U.S., they would be subject to U.S. federal and state income taxes, less applicable foreign tax credits. However, our intent is to permanently reinvest funds outside of the U.S. and our current plans do not demonstrate a need to repatriate them to fund our U.S. operations.

Net cash provided by operating activities was \$6.8 million and \$3.9 million for the three months ended March 31, 2012 and 2011, respectively. Cash flows from operating activities consisted of net income adjusted for certain non-cash items, including stock-based compensation, depreciation and amortization and the effect of changes in working capital and other operating activities. The operating cash flows during the three months ended March 31, 2012 and 2011, were largely impacted by income from operations, partially offset by certain non-cash items. These cash flows were also impacted by the cash flows from accounts receivable due to the timing of collections and the timing of payment for certain liabilities.

The cash used in investing activities is typically used to purchase office equipment, fixtures, computer hardware and software and engineering and certification equipment, for business and

technology acquisitions, for securing patent and trademark protection for our proprietary technologies and brand name and to purchase short-term and long-term investments such as bank certificates of deposit and municipal bonds. Net cash used in investing activities totaled \$14.8 million and \$2.7 million for the three months ended March 31, 2012 and 2011, respectively, and these cash flows were primarily impacted by investment purchases, partially offset by investment maturities.

Net cash used in financing activities totaled \$1.4 million for the three months ended March 31, 2012, which resulted primarily from the purchase of treasury stock, partially offset by the net effect of other financing activities. Net cash provided by financing activities totaled \$0.2 million for the three months ended March 31, 2011, which resulted from the proceeds from the exercise of equity awards, including the related tax benefits, partially offset by amounts used to satisfy statutory withholding requirements upon the vesting of restricted stock.

#### *Common Stock Repurchases*

In February 2012, our Board of Directors authorized, subject to certain business and market conditions, the purchase of up to two million shares of our common stock in the open market or in privately negotiated transactions. As of March 31, 2012, we have repurchased 0.1 million shares of our common stock, for an aggregate of \$2.0 million, under this authorization.

We believe that our cash, cash equivalents, short-term investments and cash flows from operations will be sufficient to satisfy our working capital and capital expenditure requirements for at least the next twelve months. However, in anticipation of our planned acquisition of SRS, we expect to enter into a new credit facility during the second quarter of 2012. We expect this credit facility to be in the range of \$30.0 million to \$50.0 million. Changes in our operating plans, including lower than anticipated revenues, increased expenses, acquisition of companies, products or technologies or other events, including those described in "Risk Factors" included elsewhere herein and in other filings, may cause us to seek additional debt or equity financing on an accelerated basis. Financing may not be available on acceptable terms, or at all, particularly given current economic conditions, including lack of confidence in the financial markets and limited availability of capital and demand for debt and equity securities. Our failure to raise capital when needed could negatively impact our growth plans and our financial condition and results of operations. Additional equity financing may be dilutive to the holders of our common stock and debt financing, if available, and may involve significant cash payment obligations and financial or operational covenants that restrict our ability to operate our business.

#### *Contractual obligations*

There have been no material changes to our contractual obligations since December 31, 2011, with the exception of the increased obligations associated with our gross unrecognized tax benefits. As of March 31, 2012, our total amount of unrecognized tax benefits was \$7.7 million and was considered a long-term obligation. We are currently unable to make reasonably reliable estimates of the periods of cash settlements associated with these obligations.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Market risk represents the risk of loss arising from adverse changes in market rates and foreign exchange rates.

Our interest income is sensitive to changes in the general level of U.S. interest rates, particularly since a significant portion of our investments are and will be in short-term and long-term marketable securities, U.S. government securities and corporate bonds. Due to the nature and maturity of our short-term investments, we have concluded that there is no material market risk exposure to our principal at March 31, 2012. The estimated average maturity of our investment portfolio is less than

one year. As of March 31, 2012, a one percentage point change in interest rates throughout a one-year period would have an annual effect of approximately \$1.0 million on our income before income taxes.

During the three months ended March 31, 2012, we derived nearly 85% of our revenues from sales outside the United States, and maintain international research, sales, marketing and business development offices. Therefore, our results could be negatively affected by such factors as changes in foreign currency exchange rates, trade protection measures, longer accounts receivable collection patterns and changes in regional or worldwide economic or political conditions. The risks of our international operations are mitigated in part by the extent to which our revenues are denominated in U.S. dollars and, accordingly, we are not exposed to significant foreign currency risk on these items. We do have foreign currency risk on certain revenues and operating expenses such as salaries and overhead costs of our foreign operations and cash maintained by these operations. Revenues denominated in foreign currencies accounted for approximately 7% of total revenues during the three months ended March 31, 2012. Operating expenses, including cost of sales, of our foreign subsidiaries were approximately \$4.5 million for the three months ended March 31, 2012. Based upon the expenses for the three months ended March 31, 2012, a 10% or greater change in foreign currency rates throughout a one-year period could have a material impact on our operating income.

Our international business is subject to risks, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures, other regulations and restrictions and foreign exchange rate volatility when compared to the United States dollar. Accordingly, our future results could be materially impacted by changes in these or other factors.

We are also affected by exchange rate fluctuations as the financial statements of our foreign subsidiaries are translated into the United States dollar in consolidation. As exchange rates fluctuate, these results, when translated, may vary from expectations and could adversely or positively impact overall profitability. During the three months ended March 31, 2012, the impact of foreign exchange rate fluctuations related to translation of our foreign subsidiaries' financial statements was immaterial to comprehensive income.

#### **Item 4. Controls and Procedures**

##### **Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) that are designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

We carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on such evaluation, our chief executive officer and chief financial officer concluded that as of the end of the period covered by this report our disclosure controls and procedures were effective.

##### **Changes in Internal Control over Financial Reporting**

There has been no change in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

In the ordinary course of our business, we actively pursue legal remedies to enforce our intellectual property rights and to stop unauthorized use of our technologies and trademarks.

We are not currently a party to any material legal proceedings. We may, however, become subject to lawsuits from time to time in the course of our business.

### Item 1A. Risk Factors

Set forth below and elsewhere in this report and in other documents we file with the SEC are risks and uncertainties that could cause our actual results to differ materially from the results contemplated by the forward-looking statements contained in this report and other public statements we make. If any of the following risks actually occurs, our business, financial condition, or results of operations could suffer. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment. Except as set forth below under "Risks Relating to our Potential Merger with SRS," there have been no material changes to our risk factors during the three-month period ended March 31, 2012.

#### Risks Relating to our Potential Merger with SRS

***Completion of the Merger is subject to many conditions and if these conditions are not satisfied or waived, the Merger will not be completed. Failure to complete the Merger could have material and adverse effects on our business and the trading price of shares of our common stock.***

The Merger Agreement is subject to many conditions which must be satisfied or waived in order to complete the Merger. The mutual conditions of the parties include, among others (i) adoption of the Merger Agreement by the affirmative vote of the holders representing a majority of the outstanding shares of SRS common stock entitled to vote thereon at the special meeting, (ii) the expiration or termination of any waiting period applicable to the Merger under the HSR Act, (iii) the effectiveness of the registration statement on Form S-4 to be filed by us for purposes of registering our common stock to be issued in connection with the Merger and (iv) the absence of any law or order, writ, injunction, judgment, decree or ruling in effect, or pending or threatened by the DOJ or the FTC, which prohibits, renders illegal or enjoins or threatens to prohibit, render illegal or enjoin, the consummation of the transactions contemplated by the Merger Agreement. In addition, each party's obligation to consummate the Merger is subject to certain other conditions, including, among others, (w) the accuracy of the other party's representations and warranties in the Merger Agreement (subject to customary materiality qualifiers and other customary exceptions), (x) the other party's compliance with its covenants and agreements contained in the Merger Agreement (subject to customary materiality qualifiers), (y) the absence of any event arising during the period from the date of the Merger Agreement until the effective time of the Merger that, individually or in the aggregate, has had or is reasonably likely to have a material adverse effect on the other party and (z) the receipt of an opinion of counsel to the effect that the transactions effected pursuant to the Merger Agreement will qualify as a "reorganization" within the meaning of Section 368(a) of the Internal Revenue Code. SRS' obligation to consummate the Merger is also subject to the approval for listing on The NASDAQ Global Select Market of our common stock to be issued as consideration to SRS' stockholders in the Merger.

In addition, the Merger Agreement contains certain termination rights for both us and SRS, including the right of each party to terminate the Merger Agreement if the Merger has not been consummated by December 31, 2012, subject to each party's right to extend such date for an additional 180 days if, among other things, all closing conditions other than receipt of antitrust approvals under

the HSR Act have been satisfied by December 31, 2012. In some circumstances, upon termination of the Merger Agreement, SRS will be required to pay to us a termination fee of \$7,495,000.

If the Merger is not completed on a timely basis, or at all, our ongoing business may be adversely affected. Additionally, in the event the Merger is not completed, we will be subject to a number of risks without realizing any of the benefits of having completed the Merger, including (i) the payment of certain fees and costs relating to the Merger, such as legal, accounting, financial advisor and printing fees, (ii) the potential decline in the market price of our common stock and (iii) the loss of time and resources.

***Although we and SRS expect to realize certain benefits as a result of the Merger, there is the possibility that we following the completion of the Merger may be unable to integrate successfully the businesses of us and SRS in order to realize the anticipated benefits of the Merger or do so within the intended timeframe.***

The Merger involves SRS being operated as a wholly owned subsidiary of ours. We will be required to devote significant management attention and resources to integrating the business practices and operations of SRS with ours. Due to legal restrictions, we and SRS have been able to conduct limited planning regarding the integration of SRS into us after completion of the Merger and have not yet determined the exact nature of how the businesses and operations of SRS will be run following the completion of the Merger. Potential difficulties we may encounter as part of the integration process include the following:

- any delay in the integration of management teams, strategies, operations, products and services;
- loss in sales and customers as a result of certain of our or SRS' customers deciding not to do business with us after the merger;
- diversion of the attention of each company's management as a result of the Merger;
- differences in business backgrounds, corporate cultures and management philosophies that may delay successful integration;
- the ability to retain key employees;
- the ability to create and enforce uniform standards, controls, procedures, policies and information systems;
- complexities associated with managing SRS as our subsidiary, including the challenge of integrating complex systems, technology, networks and other assets of SRS into those of ours in a seamless manner that minimizes any adverse impact on customers, suppliers, employees and other constituencies;
- potential unknown liabilities and unforeseen increased expenses or delays associated with the Merger, including one-time cash costs to integrate SRS beyond current estimates; and
- the disruption of, or the loss of momentum in, each company's ongoing businesses or inconsistencies in standards, controls, procedures and policies,

any of which could adversely affect each company's ability to maintain relationships with customers, suppliers, employees and other constituencies or our and SRS' ability to achieve the anticipated benefits of the Merger or could reduce each company's earnings or otherwise adversely affect our business and financial results following the completion of the Merger.

***The Merger may not be accretive and may cause dilution to our earnings per share following the completion of the Merger, which may negatively affect the price of our common stock following the completion of the Merger.***

We currently anticipate that the Merger will be accretive on a GAAP basis by 2013. This expectation is based on preliminary estimates and assumes certain synergies expected to be realized by us following the completion of the Merger. Such estimates and assumptions could materially change due to additional transaction-related costs, the failure to realize any or all of the benefits expected in the Merger or other factors beyond our control or the control of SRS. All of these factors could delay, decrease or eliminate the expected accretive effect of the Merger and cause resulting dilution to our earnings per share or a reduction in the price of our common stock following the completion of the Merger.

***Our results following the completion of the Merger may suffer if we do not effectively manage our expanded operations.***

Following the Merger, the size of our business will increase significantly beyond the current size of either our or SRS' existing businesses. Our future success depends, in part, upon its ability to manage this expanded business, which will pose substantial challenges for management. There can be no assurances that we will be successful after completion of the Merger or that we will realize the expected benefits currently anticipated from the Merger.

***Uncertainties associated with the Merger may cause a loss of management personnel and other key employees which could adversely affect our stock price, future business, operations and financial results following the completion of the Merger.***

We and SRS are dependent on the experience and industry knowledge of our respective senior management and other key employees to execute our respective business plans. Our success after the Merger will depend in part upon our and SRS' ability to retain key management personnel and other key employees. Current and prospective employees of ours and SRS may experience uncertainty about their roles within our company following the completion of the Merger, which may have an adverse effect on the ability of each of us and SRS to attract or retain key management and other key personnel. Accordingly, no assurance can be given that we will be able to attract or retain key management personnel and other key employees of ours and SRS to the same extent that such each of us and SRS have previously been able to attract or retain employees. In addition, following the completion of the Merger, we might not be able to locate suitable replacements for any such key employees who leave our company within the timeframe required to avoid a negative impact on the combined business. These matters could adversely affect our stock price, future business, operations and financial results following the completion of the Merger.

***We will incur a significant amount of indebtedness to pay the cash consideration to SRS stockholders and to pay related fees and expenses. Our anticipated level of indebtedness, and covenant restrictions under such indebtedness, could adversely affect our operations and liquidity.***

While there is no financing contingency related to the completion of the Merger, we expect to finance the cash consideration of the Merger through a combination of existing cash balances and a new credit facility, which we expect to enter into during the second quarter of 2012. We expect this credit facility to be in the range of \$30.0 million to \$50.0 million.

Our increased indebtedness following consummation of the Merger could adversely affect our operations and liquidity. Our anticipated level of indebtedness could, among other things:

- make it more difficult for us to pay or refinance its debts as they become due during adverse economic and industry conditions because we may not have sufficient cash flows to make its scheduled debt payments;
- cause us to use a larger portion of its cash flow to fund interest and principal payments, reducing the availability of cash to fund working capital and capital expenditures and other business activities;
- make it more difficult for us to take advantage of significant business opportunities, such as acquisition opportunities, and to react to changes in market or industry conditions;
- cause us to be more vulnerable to adverse economic and industry conditions;
- cause us to be disadvantaged compared to competitors with less leverage;
- result in a downgrade in our credit rating or any of our indebtedness or our subsidiaries which could increase the cost of further borrowings; and
- limit our ability to borrow additional monies in the future to fund working capital, capital expenditures and other general corporate purposes.

The terms of our indebtedness following the completion of the Merger may include covenants that, among other things, restrict our ability to: (i) dispose of assets, (ii) incur additional indebtedness, (iii) incur guarantee obligations, (iv) prepay certain other indebtedness or amend other financing arrangements, (v) pay dividends, (vi) create liens on assets, (vii) enter into sale and leaseback transactions, (viii) make investments, loans or advances, (ix) make acquisitions, (x) engage in mergers or consolidations, (xi) change the business conducted and (xii) engage in certain transactions with affiliates.

***We are expected to incur substantial expenses related to the Merger.***

We are expected to incur substantial expenses in connection with the Merger, including financial advisory, legal, accounting, consulting and other advisory fees and expenses, reorganization and restructuring costs, severance/employee benefit-related expenses, filing fees, printing expenses and other related charges. Some of these costs are payable by us regardless of whether the Merger is completed. While we and SRS have assumed that a certain level of expenses would be incurred, there are many factors beyond the control of either us or SRS that could affect the total amount or the timing of the expenses. Moreover, many of the expenses that will be incurred are, by their nature, difficult to estimate accurately.

There may also be additional unanticipated significant costs in connection with the Merger that we may not recoup. These costs and expenses could, particularly in the near term, exceed the savings that we expect to achieve from the elimination of duplicative expenses and the realization of economies of scale, other efficiencies and cost savings. Although we expect that these savings will offset these integration and implementation costs over time, this net benefit may not be achieved in the near term or at all.

## Risks Related to Our Business

***We may not be able to evolve our technologies, products, and services or develop new technology, products, and services that are acceptable to our customers or the changing market.***

The market for our technologies, products, and services is characterized by:

- rapid technological change;
- new and improved product introductions;
- changing customer demands;
- evolving industry standards; and
- product obsolescence.

Our future success depends upon our ability to enhance our existing technologies, products, and services and to develop acceptable new technologies, products, and services on a timely basis. The development of enhanced and new technologies, products, and services is a complex and uncertain process requiring high levels of innovation, highly-skilled engineering and development personnel, and the accurate anticipation of technological and market trends. We may not be able to identify, develop, market, or support new or enhanced technologies, products, or services on a timely basis, if at all. Furthermore, our new technologies, products, and services may never gain market acceptance, and we may not be able to respond effectively to evolving consumer demands, technological changes, product announcements by competitors, or emerging industry standards. Any failure to respond to these changes or concerns would likely prevent our technologies, products, and services from gaining market acceptance or maintaining market share and could lead to our technologies, products and services becoming obsolete.

***If we fail to protect our intellectual property rights, our ability to compete could be harmed.***

Protection of our intellectual property is critical to our success. Copyright, trademark, patent, and trade secret laws and confidentiality and other contractual provisions afford only limited protection and may not adequately protect our rights or permit us to gain or keep any competitive advantage. We face numerous risks in protecting our intellectual property rights, including the following:

- our competitors may produce competitive products or services that do not unlawfully infringe upon our intellectual property rights;
- the laws of foreign countries may not protect our intellectual property rights to the same extent as the laws of the United States, and mechanisms for enforcement of intellectual property rights may be inadequate in foreign countries;
- we may be unable to successfully identify or prosecute unauthorized uses of our technologies;
- efforts to identify and prosecute unauthorized uses of our technologies are time consuming, expensive, and divert resources from the operation of our business;
- our patents may be challenged, found unenforceable or invalidated by our competitors;
- our pending patent applications may not issue, or if issued, may not provide meaningful protection for related products or proprietary rights;
- we may not be able to practice our trade secrets as a result of patent protection afforded a third-party for such product, technique or process; and
- we may not be able to prevent the unauthorized disclosure or use of our technical knowledge or other trade secrets by employees, consultants, and advisors.

As a result, our means of protecting our intellectual property rights and brands may not be adequate. Furthermore, despite our efforts, third parties may violate, or attempt to violate, our intellectual property rights. Enforcement, including infringement claims and lawsuits would likely be expensive to resolve and would require management's time and resources. In addition, we have not sought, and do not intend to seek, patent and other intellectual property protections in all foreign countries. In countries where we do not have such protection, products incorporating our technology may be lawfully produced and sold without a license.

***We have limited control over existing and potential customers' and licensees' decisions to include our technologies in their product offerings.***

Except for Blu-ray products, where our technology is mandatory, we are dependent upon our customers and licensees—including consumer electronics product manufacturers, semiconductor manufacturers, producers and distributors of content for music, videos, and games—to incorporate our technologies into their products, purchase our products and services, or release their content in our proprietary DTS audio format. Although we have contracts and license agreements with many of these companies, these agreements do not require any minimum purchase commitments, are on a non-exclusive basis, and do not typically require incorporation or use of our technologies, trademarks or services. Furthermore, the decision by a party dominant in the entertainment value chain to provide audio technology at very low or no cost could impact a licensee's decision to use our technology. Our customers, licensees and other manufacturers might not utilize our technologies or services in the future.

***If we are unable to maintain a sufficient amount of entertainment content released with DTS audio soundtracks, demand for the technologies, products, and services that we offer to consumer electronics product manufacturers may significantly decline.***

We expect to derive a significant percentage of our revenues from the technologies, products, and services that we offer to manufacturers of consumer electronics products. To date, the most significant driver for the use of our technologies in the home theater market has been the release of major movie titles with DTS audio soundtracks. We also believe that demand for our DTS audio technologies in growing markets for multi-channel audio, including cars, personal computers, video game consoles, digital media players and mobile handsets will be based on the number, quality, and popularity of the Blu-ray Disc titles, computer software programs, and video games either released with DTS audio soundtracks or capable of being coded and played in DTS format. Although we have existing relationships with many leading providers of movie, music, computer, and video game content, we generally do not have contracts that require these parties to develop and release content with DTS audio soundtracks. In addition, we may not be successful in maintaining existing relationships or developing relationships with other existing providers or new market entrants that provide content. As a result, we cannot assure you that a significant amount of content in movies, Blu-ray Disc titles, computer software programs, video games, or other entertainment mediums will be released with DTS audio soundtracks. If the amount, variety, and popularity of entertainment content released with DTS audio soundtracks do not increase, consumer electronics products manufacturers that pay us per-unit licensing fees may discontinue offering DTS playback capabilities in the consumer electronics products that they sell.

***The on-line content delivery market could impact our ability to grow.***

Movie and music content for the last 15 years has been primarily purchased and consumed via optical media, such as Blu-ray, DVD, and CD. Today, these are still the dominant way consumers purchase and watch or listen to their favorite content. However, the growth of the internet and home computer usage, and a shift to home network and cloud-based content acquisition has occurred,

including the recent trend to full movie download and streaming services becoming mainstream with consumers in various parts of the world.

The services that provide movie content from the cloud are not generally governed by international or national standards and are thus free to choose any media format(s) in order to deliver their product and/or service. This freedom of choice on the part of the content provider could limit DTS' ability to grow if such content providers do not incorporate DTS' technologies into their movies.

***Our ability to develop proprietary technology in markets in which "open standards" are adopted may be limited, which could adversely affect our ability to generate revenue.***

Standards-setting bodies may require the use of so-called "open standards," meaning that the technologies necessary to meet those standards are publicly available free of charge and often on an "open source" basis. These standards are a relatively recent and limited occurrence and have primarily been focused on markets and regions traditionally adverse to the notion of intellectual property ownership and the associated royalties. If the concept of "open standards" gains industry momentum in the future, the use of open standards may reduce our opportunity to generate revenue, as open standards technologies are based upon non-proprietary technology platforms in which no one company maintains ownership over the dominant technologies.

***Our business is partially dependent upon the growth in Blu-ray Disc products, and to the extent that consumer adoption of Blu-ray Disc products fails to materialize, our business will be adversely affected.***

Past growth in our business has been due in large part to the rapid growth in sales of DVD based products and home theater systems incorporating our technologies. As the markets for DVD based products mature, we are seeing sales of these products declining and growth in our business shifting to Blu-ray Disc based products. While the release and consumer adoption of Blu-ray Disc players continues to ramp up, potentially slow adoption by consumers of Blu-ray Disc players, particularly in the PC market, could adversely affect our business. In addition, if new technologies, including content streaming on direct downloads of content, are developed or deployed that substantially compete with or replace Blu-ray Disc products as a dominant medium for consumer video entertainment, our business, operating results and prospects could be adversely affected.

***We may have difficulty managing any growth that we might experience.***

As a result of a combination of internal growth and growth through acquisitions, we expect to continue to experience growth in the scope of our operations and the number of our employees. If our growth continues, it may place a significant strain on our management team and on our operational and financial systems, procedures, and controls. Our future success will depend in part upon the ability of our management team to manage any growth effectively. This will require our management to:

- hire and train additional personnel in the United States and internationally;
- implement and improve our operational and financial systems, procedures, and controls;
- maintain our cost structure at an appropriate level based on the revenues we generate;
- manage multiple concurrent development projects; and
- manage operations in multiple time zones with different cultures and languages.

Any failure to successfully manage our growth could distract management's attention, and result in our failure to execute our business plan.

***Our business and prospects depend upon the strength of our brand, and if we do not maintain and strengthen our brand, our business will be materially harmed.***

Establishing, maintaining and strengthening our "DTS" brand is critical to our success. Our brand identity is key to maintaining and expanding our business and entering new markets. Our success depends in large part upon our reputation for providing high-quality products, services and technologies to the consumer electronics products industry and the entertainment industry. If we fail to promote and maintain our brand successfully, our business and prospects may suffer. Moreover, we believe that the likelihood that our technologies will be adopted in industry standards depends, in part, upon the strength of our brand, because professional organizations and industry participants are more likely to incorporate technologies developed by a well-respected and well-known brand into standards.

***Unanticipated changes in our tax provisions or adverse outcomes resulting from examination of our income tax returns could adversely affect our net income.***

We are subject to income taxes in both the United States and foreign jurisdictions. Our effective income tax rates could in the future be adversely affected by changes in tax laws or interpretations of those tax laws, by changes in the mix of earnings in countries with differing statutory tax rates, or by changes in the valuation of our deferred tax assets and liabilities. Significant judgment is required in determining our worldwide provision for income taxes. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. We may come under audit by tax authorities. For instance, the Internal Revenue Service is examining our 2007 federal income tax return, including certain prior period carryforwards, and the State of California is examining our 2004 and 2005 corporate tax returns. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation could be materially different from our historical income tax provisions and accruals. Based on the results of an audit or litigation, a material effect on our income tax provision, net income or cash flows in the period or periods for which that determination is made could result. In addition, changes in tax rules may adversely affect our future reported financial results or the way we conduct our business. For example, we consider the operating earnings of our foreign subsidiaries to be invested indefinitely outside the United States. We have not provided for United States federal or foreign withholding taxes that may result on future remittances of undistributed earnings of foreign subsidiaries. Our future reported financial results may be adversely affected if tax or accounting rules regarding unrepatriated earnings change.

***Current and future governmental and industry standards may significantly limit our business opportunities.***

Technology standards are important in the audio and video industry as they help to assure compatibility across a system or series of products. Generally, standards adoption occurs on either a mandatory basis, requiring a particular technology to be available in a particular product or medium, or an optional basis, meaning that a particular technology may be, but is not required to be, utilized. For example, both our digital multi-channel audio technology and Dolby's have optional status in Blu-ray Disc, while both our two-channel output and Dolby's technologies have been selected as mandatory standards in Blu-ray Disc. However, if either or both of these standards are re-examined or a new standard is developed, we may not be included as mandatory in any such new or revised standard which would cause revenue growth in our consumer business to be significantly lower than expected and could have a material adverse affect on our business.

Various national governments have adopted or are in the process of adopting standards for all digital television broadcasts, including cable, satellite, and terrestrial. In the United States, Dolby's audio technology has been selected as the sole, mandatory audio standard for terrestrial digital television broadcasts. As a result, the audio for all digital terrestrial television broadcasts in the United States must include Dolby's technology and must exclude any other format, including ours. We do not

know whether this standard will be reopened or amended. If it is not, our audio technology may never be included in that standard. Certain large and developing markets, such as China, have not fully developed their digital television standards. Our technology may or may not ultimately be included in these standards.

As new technologies and entertainment media emerge, new standards relating to these technologies or media may develop. New standards may also emerge in existing markets that are currently characterized by competing formats, such as the market for personal computers. We may not be successful in our efforts to include our technology in any such standards.

***We are dependent upon our management team and technical talent.***

Our success depends, in part, upon the continued availability and contributions of our management team and engineering and technical personnel because of the complexity of our products and services. Important factors that could cause the loss of key personnel include:

- our existing employment agreements with the members of our management team allow such persons to terminate their employment with us at any time;
- we do not have employment agreements with a majority of our key engineering and technical personnel;
- significant portions of the equity awards held by the members of our management team are vested; and
- equity awards held by some of our executive officers provide for accelerated vesting in the event of a sale or change of control of our company.

The loss of key personnel or an inability to attract qualified personnel in a timely manner could slow our technology and product development and harm our ability to execute our business plan.

***Our technologies and products are complex and may contain errors that could cause us to lose customers, damage our reputation, or incur substantial costs.***

Our technologies or products could contain errors that could cause our products or technologies to operate improperly and could cause unintended consequences. If our products or technologies contain errors we, could be required to replace them, and if any such errors cause unintended consequences, we could face claims for product liability. Although we generally attempt to contractually limit our exposure to incidental and consequential damages, as well as provide insurance coverage for such events, if these contract provisions are not enforced or are unenforceable for any reason, if liabilities arise that are not effectively limited, or if our insurance coverage is inadequate to satisfy the liability, we could incur substantial costs in defending and/or settling product liability claims.

***We may be sued by third parties for alleged infringement of their proprietary rights, and we may be subject to litigation proceedings that could harm our business.***

Companies that participate in the digital audio, digital image processing, consumer electronics, and entertainment industries hold a large number of patents, trademarks, and copyrights, and are frequently involved in litigation based on allegations of patent infringement or other violations of intellectual property rights. Intellectual property disputes frequently involve highly complex and costly scientific matters, and each party generally has the right to seek a trial by jury which adds additional costs and uncertainty. Accordingly, intellectual property disputes, with or without merit, could be costly and time consuming to litigate or settle, and could divert management's attention from executing our business plan. In addition, our technologies and products may not be able to withstand any third-party claims or rights against their use. If we were unable to obtain any necessary license following a determination of

infringement or an adverse determination in litigation or in interference or other administrative proceedings, we may need to redesign some of our products to avoid infringing a third party's rights and could be required to temporarily or permanently discontinue licensing our products.

In the past, we have been a party to litigation related to protection and enforcement of our intellectual property, and we may be a party to additional litigation in the future. Litigation is subject to inherent uncertainties, and unfavorable rulings could occur. An unfavorable ruling could include monetary damages (including treble damages under the Clayton Act) and an injunction prohibiting us from licensing our technologies in particular ways or at all. Were an unfavorable ruling to occur, our business and results of operations could be materially harmed. In addition, any protracted litigation could divert management's attention from our day-to-day operations, disrupt our business and cause our operating results to suffer.

***We rely on the accuracy of our customers' manufacturing reports for reporting and collecting our revenues, and if these reports are untimely or incorrect, our revenues could be delayed or inaccurately reported.***

Most of our revenues are generated from consumer electronics product manufacturers who license and incorporate our technology in their consumer electronics products. Under our existing agreements, these customers pay us per-unit licensing fees based on the number of consumer electronics products manufactured that incorporate our technology. We rely on our customers to accurately report the number of units manufactured in collecting our license fees, preparing our financial reports, projections, budgets, and directing our sales and product development efforts. Most of our license agreements permit us to audit our customers, but audits are generally expensive, time consuming, difficult to manage effectively, dependent in large part upon the cooperation of our licensees and the quality of the records they keep, and could harm our customer relationships. If any of our customer reports understate the number of products they manufacture, we may not collect and recognize revenues to which we are entitled, or may endure significant expense to obtain compliance.

***A loss of one or more of our key customers or licensees in any of our markets could adversely affect our business.***

From time to time, one or a small number of our customers or licensees may represent a significant percentage of our revenue. For instance, in 2011, two customers accounted for 16% and 12%, respectively, of revenues from our continuing operations. Although we have agreements with many of our customers, these agreements typically do not require any material minimum purchases or minimum royalty fees and do not prohibit customers from purchasing products and services from competitors. A decision by any of our major customers or licensees not to use our technologies, or their failure or inability to pay amounts owed to us in a timely manner, or at all, could have a significant adverse effect on our business.

***We face intense competition. Certain of our competitors have greater resources than we do.***

The digital audio, consumer electronics and entertainment markets are intensely competitive, subject to rapid change, and significantly affected by new product introductions and other market activities of industry participants. Our principal competitor is Dolby Laboratories, Inc., who competes with us in most of our markets. We also compete with other companies offering digital audio technology incorporated into consumer electronics product and entertainment mediums, including Fraunhofer Institut Integrierte Schaltungen, Koninklijke Philips Electronics N.V. (Philips), Microsoft Corporation, Sony Corporation, Thomson and SRS Labs, Inc.

Certain of our current and potential competitors may enjoy substantial competitive advantages, including:

- greater name recognition;
- a longer operating history;
- more developed distribution channels and deeper relationships with our common customer base;
- a more extensive customer base;
- digital technologies that provide features that ours do not;
- broader product and service offerings;
- greater resources for competitive activities, such as research and development, strategic acquisitions, alliances, joint ventures, sales and marketing, and lobbying industry and government standards;
- more technicians and engineers;
- greater technical support; and
- open source or free codecs.

As a result, these current and potential competitors may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards, or customer requirements.

In addition to the competitive advantages described above, Dolby also enjoys other unique competitive strengths relative to us. For example, it introduced multi-channel audio technology before we did. It has also achieved mandatory standard status in product categories that we have not, including terrestrial digital television broadcasts in the United States. As a result of these factors, Dolby has a competitive advantage in selling its digital multi-channel audio technology to consumer electronics products manufacturers.

***We have a limited operating history in certain new and evolving markets.***

Our technologies have only recently been incorporated into certain markets, such as digital media players, televisions, personal computers, digital satellite and cable broadcast products, portable electronics devices and mobile handsets. We do not have the same experience in these markets as in our traditional consumer electronics business, nor do we have as much operating history as companies such as Dolby Laboratories, Inc., SRS Labs, Inc. and BBE Sound, Inc. As a result, the demand for our technologies, products, and services and the income potential of these businesses is unproven. In addition, because our participation in these markets is relatively new and rapidly evolving, we may have limited insight into trends that may emerge and affect our business. We may make errors in predicting and reacting to relevant business trends, which could harm our business. Before investing in our common stock, you should consider the risks, uncertainties, and difficulties frequently encountered by companies in new and rapidly evolving markets such as ours. We may not be able to successfully address any or all of these risks.

***Declining retail prices for consumer electronics products could force us to lower the license or other fees we charge our customers.***

The market for consumer electronics products is intensely competitive and price sensitive. Retail prices for consumer electronics products that include our DTS audio technologies have decreased significantly and we expect prices to continue to decrease for the foreseeable future. Declining prices for consumer electronics products could create downward pressure on the licensing fees we currently

charge our customers who integrate our technologies into the consumer electronics products that they sell and distribute. Most of the consumer electronics products that include our audio technologies also include Dolby's multi-channel audio technology. As a result of pricing pressure, consumer electronics products manufacturers who manufacture products in which our audio technologies are not a mandatory standard could decide to exclude our DTS audio technologies from their products altogether.

***Economic downturns could disrupt and materially harm our business.***

Negative trends in the general economy could cause a downturn in the market for our technologies, products and services. The recent financial disruption affecting the global financial markets and the concern whether investment banks and other financial institutions will continue operations in the foreseeable future have resulted in a tightening in the credit markets, a low level of liquidity in many financial markets and extreme volatility in credit and equity markets. The recent financial crisis may adversely affect our operating results if it results, for example, in the insolvency of a key licensee or other customer, the inability of our licensees and/or other customers to obtain credit to finance their operations, including to finance the manufacture of products containing our technologies, and delays in reporting and/or payments from our licensees. Tight credit markets could also delay or prevent us from acquiring or making investments in other technologies, products or businesses that could enhance our technical capabilities, complement our current products and services, or expand the breadth of our markets. If we are unable to execute such acquisitions and/or strategic investments, our operating results and business prospects may suffer.

In addition, global economic conditions, including the credit crisis, increased cost of commodities, widespread employee layoffs, actual or threatened military action by the United States and the continued threat of terrorism, have resulted in decreased consumer spending and may continue to negatively impact consumer confidence and spending. Any reduction in consumer confidence or disposable income, in general, may negatively affect the demand for consumer electronics products that incorporate our digital audio technologies.

We cannot predict other negative events that may have adverse effects on the global economy in general and the consumer electronics industry specifically. However, the factors described above and such unforeseen events could negatively affect our revenues and operating results.

***Natural or other disasters could disrupt our business and negatively impact our operating results and financial condition.***

Natural or other disasters such as earthquakes, hurricanes, tsunamis or other adverse weather and climate conditions, whether occurring in the U.S. or abroad, and the consequences and effects thereof, including energy shortages and public health issues, could disrupt our operations, or the operations of our business partners and customers, or result in economic instability that may negatively impact our operating results and financial condition. Our corporate headquarters and many of our operations are located in California, a seismically active region, potentially exposing us to greater risk of natural disasters.

***Our licensing revenue depends in large part upon semiconductor manufacturers incorporating our technologies into integrated circuits, or ICs, for sale to our consumer electronics product licensees and if, for any reason, our technologies are not incorporated in these ICs or fewer ICs are sold that incorporate our technologies, our operating results would be adversely affected.***

Our licensing revenue from consumer electronics product manufacturers depends in large part upon the availability of ICs that implement our technologies. IC manufacturers incorporate our technologies into these ICs, which are then incorporated into consumer electronics products. We do not

manufacture these ICs, but rather depend upon IC manufacturers to develop, produce and then sell them to licensed consumer electronics product manufacturers. We do not control the IC manufacturers' decisions whether or not to incorporate our technologies into their ICs, and we do not control their product development or commercialization efforts. If these IC manufacturers are unable or unwilling, for any reason, to implement our technologies into their ICs, or if, for any reason, they sell fewer ICs incorporating our technologies, our operating results will be adversely affected.

***We may not successfully address problems encountered in connection with any acquisitions.***

We expect to consider opportunities to acquire or make investments in other technologies, products, and businesses that could enhance our technical capabilities, complement our current products and services, or expand the breadth of our markets. We have a limited history of acquiring and integrating businesses. Acquisitions and strategic investments involve numerous risks, including:

- problems assimilating the purchased technologies, products, or business operations;
- significant future charges relating to in-process research and development and the amortization of intangible assets;
- significant amount of goodwill that is not amortizable and is subject to annual impairment review;
- problems maintaining uniform standards, procedures, controls, and policies;
- unanticipated costs associated with the acquisition, including accounting and legal charges, capital expenditures, and transaction expenses;
- diversion of management's attention from our core business;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which we have no or limited prior experience;
- unanticipated or unknown liabilities relating to the acquired businesses;
- the need to integrate accounting, management information, manufacturing, human resources and other administrative systems to permit effective management; and
- potential loss of key employees of acquired organizations.

If we fail to properly evaluate and execute acquisitions and strategic investments, our management team may be distracted from our day-to-day operations, our business may be disrupted, and our operating results may suffer. In addition, if we finance acquisitions by issuing equity or convertible debt securities, our existing stockholders would be diluted. Foreign acquisitions involve unique risks in addition to those mentioned above, including those related to integration of operations across different geographies, cultures and languages, currency risks and risks associated with the particular economic, political and regulatory environment in specific countries. Also, the anticipated benefit of our acquisitions may not materialize, whether because of failure to obtain stockholder approval or otherwise. Future acquisitions could result in potentially dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities or amortization expenses, or write-offs of goodwill, any of which could harm our operating results or financial condition. Future acquisitions may also require us to obtain additional equity or debt financing, which may not be available on favorable terms or at all.

***We are subject to additional risks associated with our international operations.***

Our licensing headquarters are located in Limerick, Ireland, and we market and sell our products and services outside the United States. We currently have employees located in eight countries, and many of our customers and licensees are located outside the United States. As a key component of our

business strategy, we intend to expand our international sales and customer support. During the three months ended March 31, 2012, nearly 85% of our revenues were derived internationally. We face numerous risks in doing business outside the United States, including:

- unusual or burdensome foreign laws or regulatory requirements or unexpected changes to those laws or requirements;
- tariffs, trade protection measures, import or export licensing requirements, trade embargos, and other trade barriers;
- difficulties in attracting and retaining qualified personnel and managing foreign operations;
- competition from foreign companies;
- dependence upon foreign distributors and their sales channels;
- longer accounts receivable collection cycles and difficulties in collecting accounts receivable;
- less effective and less predictable protection and enforcement of our intellectual property;
- changes in the political or economic condition of a specific country or region, particularly in emerging markets;
- fluctuations in the value of foreign currency versus the U.S. dollar and the cost of currency exchange;
- potentially adverse tax consequences; and
- cultural differences in the conduct of business.

Such factors could cause our future international sales to decline.

Our business practices in international markets are also subject to the requirements of the Foreign Corrupt Practices Act. If any of our employees is found to have violated these requirements, we and our employees could be subject to significant fines, criminal sanctions and other penalties.

Our international revenue is mostly denominated in U.S. dollars. As a result, fluctuations in the value of the U.S. dollar and foreign currencies may make our technology, products, and services more expensive for international customers, which could cause them to decrease their purchases from us. Expenses for our subsidiaries are denominated in their respective local currencies. As a result, if the U.S. dollar weakens against the local currency, the translation of our foreign-currency-denominated expenses will result in higher operating expense without a corresponding increase in revenue. Significant fluctuations in the value of the U.S. dollar and foreign currencies could have a material impact on our consolidated financial statements. The main foreign currencies we encounter in our operations are the Yen, Euro, RMB, KRW, HKD, TWD, SGD and GBP. We do not currently engage in currency hedging activities to limit the risk of exchange rate fluctuations.

***We expect our operating expenses to increase in the future, which may impact profitability.***

We expect our operating expenses to increase as we, among other things:

- expand our sales and marketing activities, including the continued development of our international operations;
- adopt a more customer-focused business model which is expected to entail additional hiring;
- acquire businesses or technologies and integrate them into our existing organization;
- increase our research and development efforts to advance our existing technologies, products, and services and develop new technologies, products, and services;

- hire additional personnel, including engineers and other technical staff;
- expand and defend our intellectual property portfolio;
- upgrade our operational and financial systems, procedures, and controls; and
- continue to assume the responsibilities of being a public company.

As a result, we will need to grow our revenues and manage our costs in order to positively impact profitability. In addition, we may fail to accurately estimate and assess our increased operating expenses as we grow.

***Compliance with changing securities laws, regulations and financial reporting standards will increase our costs and pose challenges for our management team.***

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Sarbanes-Oxley Act of 2002, and the rules and regulations promulgated thereunder have created uncertainty for public companies and significantly increased the costs and risks associated with operating as a publicly traded company in the United States. Our management team will need to devote significant time and financial resources to comply with both existing and evolving standards for public companies, which will lead to increased general and administrative expenses and a diversion of management time and attention from revenue generating activities to compliance activities. Furthermore, with such uncertainties, we cannot assure you that our system of internal control will be effective or satisfactory to our independent registered public accounting firm. As a result, our financial reporting may not be timely and/or accurate and we may be issued an adverse or qualified opinion by our independent registered public accounting firm. If reporting delays or errors actually occur, we could be subject to sanctions or investigation by regulatory authorities, such as the SEC, and could adversely affect our financial results or result in a loss of investor confidence in the reliability of our financial information, which could materially and adversely affect the market price of our common stock.

Further, the SEC has passed, promulgated and proposed new rules on a variety of subjects including the requirement that we must file our financial statements with the SEC using the interactive data format eXtensible Business Reporting Language, or XBRL, and the possibility that we would be required to adopt International Financial Reporting Standards, or IFRS. In order to comply with XBRL and IFRS requirements, we may have to add additional accounting staff, engage consultants or change our internal practices, standards and policies which could significantly increase our costs.

We believe that these new and proposed laws and regulations could make it more difficult for us to attract and retain qualified members of our Board of Directors, particularly to serve on our audit committee, and qualified executive officers.

***Our licensing of industry standard technologies can be subject to limitations that could adversely affect our business and prospects.***

When a standards-setting body adopts our technologies as explicit industry standards, we generally must agree to license such technologies on a fair, reasonable and non-discriminatory basis, which we believe means that we treat similarly situated licensees similarly. In these situations, we may be required to limit the royalty rates we charge for these technologies, which could adversely affect our business. Furthermore, we may have limited control over whom we license such technologies to, and may be unable to restrict many terms of the license. From time to time, we may be subject to claims that our licenses of our industry standard technologies may not conform to the requirements of the standards-setting body. Claimants in such cases could seek to restrict or change our licensing practices or our ability to license our technologies in ways that could injure our reputation and otherwise materially and adversely affect our business, operating results and prospects.

***We may experience fluctuations in our operating results.***

We have historically experienced moderate seasonality in our business due to our business mix and the nature of our products. Consumer electronics manufacturing activities are generally lowest in the first calendar quarter of each year, and increase progressively throughout the remainder of the year. Manufacturing output is generally strongest in the third and fourth quarters as our technology licensees increase manufacturing to prepare for the holiday buying season. Since recognition of revenues generally lags manufacturing activity by one quarter, our revenues and earnings are generally lowest in the second quarter. The introduction of new products and inclusion of our technologies in new and rapidly growing markets can distort and amplify the seasonality described above. Our revenues may continue to be subject to fluctuations, seasonal or otherwise, in the future. Unanticipated fluctuations, whether due to seasonality, economic downturns, product cycles, or otherwise, could cause us to miss our earnings projections, or could lead to higher than normal variation in short-term earnings, either of which could cause our stock price to decline.

In addition, we actively engage in intellectual property compliance and enforcement activities focused on identifying third parties who have either incorporated our technologies, trademarks, or know-how without a license or who have underreported to us the amount of royalties owed under license agreements with us. As a result of these activities, from time to time, we may recognize royalty revenues that relate to manufacturing activities from prior periods and we may incur expenditures related to enforcement activity. These royalty recoveries and expenditures, as applicable, may cause revenues to be higher than expected, or net profit to be lower than expected, during a particular reporting period and may not recur in future reporting periods. Such fluctuations in our revenues and operating results may cause declines in our stock price.

***The licensing of patents constitutes a significant source of our revenue. If we do not replace expiring patents with new patents or proprietary technologies, our revenue could decline.***

We hold patents covering much of the technologies that we license to system licensees, and our licensing revenue is tied in large part to the life of those patents. Our right to receive royalties related to our patents terminates with the expiration of the last patent covering the relevant technologies. Accordingly, to the extent that we do not replace licensing revenue from technologies covered by expiring patents with licensing revenue based on new patents and proprietary technologies, our revenue could decline.

***Our future capital needs are uncertain and we may need to raise additional funds in the future, and such funds may not be available on acceptable terms or at all.***

Our capital requirements will depend upon many factors, including:

- acceptance of, and demand for, our products and technologies;
- the costs of developing new products or technologies;
- the extent to which we invest in new technologies and research and development projects;
- the number and timing of acquisitions and other strategic transactions;
- the costs associated with our expansion, if any; and
- the costs of litigation and enforcement activities to defend our intellectual property.

In the future, we may need to raise additional funds, and such funds may not be available on favorable terms, or at all, particularly given the continuing credit crisis and downturn in the overall global economy. Furthermore, if we issue equity or debt securities to raise additional funds, our existing stockholders may experience dilution, and the new equity or debt securities may have rights, preferences, and privileges senior to those of our existing stockholders. If we cannot raise funds on acceptable terms, or at all, we may not be able to develop or enhance our products and services, execute our business plan, take advantage of future opportunities, or respond to competitive pressures or unanticipated customer requirements. This may materially harm our business, results of operations, and financial condition.

***Our business and operations could suffer in the event of security breaches.***

Attempts by others to gain unauthorized access to information technology systems are becoming more sophisticated and successful. These attempts can include introducing malware to computers and networks, impersonating authorized users, overloading systems and servers and data theft. While we seek to detect and investigate any security issue, in some cases, we might be unaware of an incident or its magnitude and effects. The theft, unauthorized use or publication of our intellectual property and/or confidential business information could harm our competitive position, reduce the value of our investment in research and development and other strategic initiatives or otherwise adversely affect our business. To the extent that any security breach results in inappropriate disclosure of our customers' or licensees' confidential information, we may incur liability as a result.

**Risks Related to Our Common Stock**

***Anti-takeover provisions under our charter documents and Delaware law could delay or prevent a change of control and could also limit the market price of our stock.***

Our Restated Certificate of Incorporation and Restated Bylaws contain provisions that could delay or prevent a change of control of our company or changes in our Board of Directors that our stockholders might consider favorable. Some of these provisions:

- authorize the issuance of preferred stock which can be created and issued by the Board of Directors without prior stockholder approval, with rights senior to those of the common stock;
- provide for a classified Board of Directors, with each director serving a staggered three-year term;
- prohibit stockholders from filling Board vacancies, calling special stockholder meetings, or taking action by written consent; and
- require advance written notice of stockholder proposals and director nominations.

In addition, we are governed by the provisions of Section 203 of the Delaware General Corporate Law, which may prohibit certain business combinations with stockholders owning 15% or more of our outstanding voting stock. These and other provisions in our Restated Certificate of Incorporation, Restated Bylaws and Delaware law could make it more difficult for stockholders or potential acquirors to obtain control of our Board or initiate actions that are opposed by the then-current Board, and could delay or impede a merger, tender offer, or proxy contest involving our company. Any delay or prevention of a change of control transaction or changes in our Board could cause the market price of our common stock to decline.

***We expect that the price of our common stock will fluctuate substantially.***

The market price of our common stock is likely to be highly volatile and may fluctuate substantially due to many factors, including:

- actual or anticipated fluctuations in our results of operations;
- market perception of our progress toward announced objectives;
- announcements of technological innovations by us or our competitors or technology standards;
- announcements of significant contracts by us or our competitors;
- changes in our pricing policies or the pricing policies of our competitors;
- developments with respect to intellectual property rights;
- the introduction of new products or product enhancements by us or our competitors;
- the commencement of or our involvement in litigation;
- resolution of significant litigation in a manner adverse to our business;
- our sale or purchase of common stock or other securities in the future;
- conditions and trends in technology industries;
- changes in market valuation or earnings of our competitors;
- the trading volume of our common stock;
- announcements of potential acquisitions;
- the adoption rate of new products incorporating our or our competitors' technologies, including Blu-ray Disc players;
- changes in the estimation of the future size and growth rate of our markets; and
- general economic conditions.

In addition, the stock market in general, and the NASDAQ Global Select Market and the market for technology companies in particular, has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. Further, the market prices of securities of technology companies have been particularly volatile. These broad market and industry factors may materially harm the market price of our common stock, regardless of our operating performance. In the past, following periods of volatility in the market price of a company's securities, securities class- action litigation has often been instituted against that company. Such litigation, if instituted against us, could result in substantial costs and a diversion of management's attention and resources.

***Shares of our common stock are relatively illiquid.***

As a result of our relatively small public float, our common stock may be less liquid than the common stock of companies with broader public ownership. Among other things, trading of a relatively small volume of our common shares may have a greater impact on the trading price for our shares than would be the case if our public float were larger.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

**(c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

Stock repurchase activity during the quarter ended March 31, 2012 was as follows:

<u>Period</u>	<u>Total Number of Shares Purchased(1)</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plan</u>	<u>Maximum Number of Shares that May Yet Be Purchased Under the Plan</u>
January 1, 2012 through January 31, 2012	—	—	—	—
February 1, 2012 through February 29, 2012	32,495	\$ 27.55	—	2,000,000
March 1, 2012 through March 31, 2012	72,458	\$ 28.44	71,600	1,928,400
<b>Total</b>	<u>104,953</u>	<u>\$ 28.17(2)</u>	<u>71,600</u>	<u>1,928,400</u>

**Notes:**

- (1) Consists of (i) shares repurchased in open market transactions pursuant to a Board of Directors authorization, which we announced on February 22, 2012, for us to repurchase up to two million shares of our common stock in the open market or in privately negotiated transactions, depending upon market conditions and other factors, and (ii) shares repurchased from employees and effectively retired to satisfy statutory withholding requirements upon the vesting of restricted stock.
- (2) Represents weighted average price paid per share during the quarter ended March 31, 2012.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

None.

**Item 5. Other Information**

None.

## Item 6. Exhibits

Exhibit Number	Exhibit Title	Filed with this Form 10-Q	Incorporated by Reference		
			Form	File No.	Date Filed
2.1	Agreement and Plan of Merger and Reorganization, dated as of April 16, 2012, by and among DTS, Inc., DTS Merger Sub, Inc, DTS LLC, and SRS Labs, Inc.		8-K	000-50335-12764511	4/17/12
2.2	Voting Agreement, dated as of April 16, 2012, by and among DTS, Inc., Mr. Thomas C. K. Yuen, Misako Yuen, The Thomas and Misako Yuen Family Foundation, and Thomas Yuen Family Trust		8-K	000-50335-12764511	4/17/12
2.3	Amendment No. 1 to Voting Agreement, dated April 26, 2012, by and among DTS, Inc., Mr. Thomas C. K. Yuen, Misako Yuen, The Thomas and Misako Yuen Family Foundation, and Thomas Yuen Family Trust		13D	005-49103-12784432	4/26/12
10.1*	Employment Agreement, dated March 1, 2012, between DTS, Inc. and Patrick J. Watson		10-K	000-50335-12662201	3/2/12
10.2*	Employment Agreement, dated March 26, 2012, between DTS, Inc. and Kris M. Graves	X			
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14 (a)/15d-14(a) of the Securities Exchange Act of 1934, as amended	X			
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14 (a)/15d-14(a) of the Securities Exchange Act of 1934, as amended	X			
32.1‡	Certification of the Chief Executive Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. section 1350	X			

Exhibit Number	Exhibit Title	Filed with this Form 10-Q	Incorporated by Reference		
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32.2‡	Certification of the Chief Financial Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. section 1350	X			
101.INS**	XBRL Instance Document	X			
101.SCH**	XBRL Taxonomy Extension Schema Document	X			
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document	X			
101.DEF**	XBRL Extension Definition	X			
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document	X			
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document	X			

\* Indicates management contract, arrangement or compensatory plan.

‡ This certification is being furnished solely to accompany this report pursuant to 18 U.S.C. 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

\*\* XBRL information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934, and is not subject to liability under those sections, is not part of any registration statement or prospectus to which it relates and is not incorporated or deemed to be incorporated by reference into any registration statement, prospectus or other document.



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**EXECUTIVE EMPLOYMENT AGREEMENT**

This Executive Employment Agreement ("Agreement") is made effective as of March 26, 2012 ("Effective Date"), by and between DTS, Inc. ("Company") and Kris Graves ("Executive") with respect to the following facts:

- A. The Company desires to retain the services of Executive as Senior Vice President, Human Resources of the Company.
- B. Executive is willing to be employed by the Company on the terms and subject to the conditions set forth in this Agreement.

THEREFORE, in consideration of the promises and mutual agreements hereinafter set forth, it is agreed by and between the undersigned as follows:

1. *Employment.* Company hereby employs Executive, and Executive hereby accepts such employment, upon the terms and conditions set forth herein.

2. *Duties.*

2.1 *Position.* Executive shall be employed as Senior Vice President, Human Resources and shall have the duties and responsibilities set forth in the Company's job description for the position or as otherwise assigned by Company's Chief Executive Officer ("CEO") from time to time. Executive shall perform faithfully and diligently all duties assigned to Executive. Subject to Section 7.3, Company reserves the right to modify Executive's duties at any time in its sole and absolute discretion provided that the duties assigned are consistent with the position of Senior Vice President, Human Resources.

2.2 *Best Efforts/Full-time.* Executive will expend Executive's best efforts on behalf of Company, and will abide by all policies and decisions made by Company, as well as all applicable federal, state and local laws, regulations or ordinances. Executive will act in the best interest of Company at all times. Executive shall devote Executive's full business time and efforts to the performance of Executive's assigned duties for Company, unless Executive notifies CEO in advance of Executive's intent to engage in other paid work and receives the CEO's express written consent to do so.

2.3 *Work Location.* Executive's principal place of work shall be located in Calabasas, California, or such other location as Company may direct from time to time, subject to Section 7.3.

3. *Term.*

3.1 *Initial Term.* The Agreement shall be for an initial term commencing on the Effective Date set forth above and continuing for a period of three (3) years following such date ("Initial Term").

3.2 *Renewal.* On expiration of the Initial Term specified in subsection 3.1 above, this Agreement will automatically renew for subsequent one year terms ("Renewal Terms") unless Company provides Executive with advance written notice of its intent not to renew at least 180 days prior to the scheduled expiration date. In the event Company gives notice of nonrenewal pursuant to this subsection 3.2, this Agreement will (a) expire at the end of the then current term and (b) provided that Executive continues to fulfill his duties set forth in this Agreement in all material respects prior to expiration, Executive shall (x) be paid six (6) months of Executive's Base Salary then in effect on the date of expiration and (y) receive up to six (6) months of senior executive level outplacement services paid by the Company provided, however, that no cash payment will be made to Executive in lieu of such services .

3.3 Both the Initial Term or any subsequent Renewal Terms may be earlier terminated in accordance with section 7 below.

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#### 4. *Compensation.*

4.1 *Base Salary.* As compensation for Executive's performance of Executive's duties hereunder, Company shall pay to Executive a Base Salary of Two Hundred Fifty Five Thousand dollars per year (\$255,000.00), payable in accordance with the normal payroll practices of Company, less required deductions for state and federal withholding tax, social security and all other employment taxes and payroll deductions. In the event Executive's employment under this Agreement is terminated by either party, for any reason, Executive will earn the Executives' then in effect Base Salary prorated to the date of termination.

4.2 *Incentive Compensation.* Executive will be eligible to participate in Company's annual cash incentive compensation plan. Executive will also be eligible to participate in any equity incentive programs established for senior executives by the Board of Directors and/or Compensation Committee. The Company reserves the right to modify such incentive plans from time to time.

4.3 *Performance and Salary Review.* The Company will periodically review Executive's performance and salary on no less than an annual basis. Adjustments to salary or other compensation, if any, will be made by the Company in its sole and absolute discretion.

5. *Customary Fringe Benefits.* Executive will be eligible for all customary and usual fringe benefits generally available to senior executives of Company subject to the terms and conditions of Company's benefit plan documents. Company reserves the right to change or eliminate the fringe benefits on a prospective basis, at any time, effective upon notice to Executive. Executive will be eligible to take up to 160 hours of vacation per year and shall be credited with 160 hours of accrued vacation at all times.

6. *Business Expenses.* Executive will be reimbursed promptly for all reasonable, out-of-pocket business expenses incurred in the performance of Executive's duties on behalf of Company. To obtain reimbursement, expenses must be submitted promptly with appropriate supporting documentation and will be reimbursed in accordance with Company's policies. Any reimbursement Executive is entitled to receive shall (a) be paid no later than the last day of Executive's tax year following the tax year in which the expense was incurred, (b) not be affected by any other expenses that are eligible for reimbursement in any tax year and (c) not be subject to liquidation or exchange for another benefit.

#### 7. *Termination of Executive's Employment.*

7.1 *Termination for Cause by Company.* Although Company anticipates a mutually rewarding employment relationship with Executive, Company may terminate Executive's employment immediately at any time for Cause. For purposes of this Agreement, "Cause" is defined as: (a) acts or omissions constituting negligence, recklessness or willful misconduct on the part of Executive with respect to Executive's obligations or otherwise relating to the business of Company; (b) any acts or conduct by Executive that are materially adverse to Company's interests; (c) Executive's material breach of this Agreement; (d) Executive's breach of Company's Proprietary Information and Inventions Agreement; (e) Executive's conviction or entry of a plea of *nolo contendere* for fraud, misappropriation or embezzlement, or any felony or crime of moral turpitude or that otherwise negatively impacts Executive's ability to effectively perform Executive's duties hereunder; (f) Executive's willful neglect of duties as determined in the sole and exclusive discretion of the Board of Directors; (g) Executive's inability to perform the essential functions of Executive's position due to a mental or physical disability; or (h) Executive's death. In the event of termination based on (b), (c) or (f), Executive will have fifteen (15) days from receipt of notice from Company to cure the issue, if curable. In the event Executive's employment is terminated in accordance with this subsection 7.1, Executive shall be entitled to receive only Executive's Base Salary then in effect, prorated to the date of termination and all benefits accrued through the date of termination, including any vested equity compensation awards ("Accrued Benefits"). All other Company obligations to Executive pursuant to this Agreement will become automatically terminated and completely extinguished. In the event of Executive's termination of employment by

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the Company for Cause, Executive will not be entitled to receive the Severance Package described in subsection 7.2 below.

*7.2 Termination by Company without Cause or a Forced Relocation after a Change in Control/Severance.* Company may terminate Executive's employment under this Agreement without Cause at any time. In the event of Termination without Cause, Executive will receive Executive's Base Salary then in effect, prorated to the date of termination, and Accrued Benefits. In addition, Executive will receive a "Severance Package" that shall include (a) a "Severance Payment" equivalent to nine (9) months of Executive's Base Salary then in effect on the date of termination, payable in a lump sum 60 days following the termination date; (b) payment by Company of the premiums required to continue Executive's group health care coverage for a period of nine (9) months following Executive's termination, under the applicable provisions of the Consolidated Omnibus Budget Reconciliation Act ("COBRA"), provided that Executive elects to continue and remains eligible for these benefits under COBRA, and does not become eligible for health coverage through another employer during this period; (c) full acceleration of vesting of Executive's then outstanding stock options, and an extension of the exercise period of Executive's stock options or stock appreciation rights grants until the earlier of (i) three (3) years from the date of Executive's termination, or (ii) the remaining life of the equity grants; and (d) six (6) months of senior executive outplacement services provided by an outplacement vendor selected by Company, provided, however, that no cash payment will be made to Executive in lieu of such services. In no event will Executive receive a Severance Package unless Executive: (x) complies with all surviving provisions of this Agreement as specified in subsection 12.9 below; (y) executes a full, unilateral, general release of all claims, known or unknown, that Executive may have against Company arising out of or any way related to Executive's employment or termination of employment with Company (in a form substantially similar to that attached as Exhibit A), and such release has become effective in accordance with its terms prior to the 60th day following the termination date and (z) agrees as part of the release agreement to not make any voluntary statements, written or oral, or cause or encourage others to make any such statements that defame, disparage or in any way criticize the personal and/or business reputations, practices or conduct of Company ((x)-(z) are collectively referred to as "Severance Conditions"). All other Company obligations to Executive will be automatically terminated and completely extinguished.

In the event of Executive's voluntary resigns due to a Forced Relocation after a Change of Control, Executive will: (1) receive Executive's Base Salary then in effect, prorated to the date of termination, (2) Accrued Benefits, (3) the Severance Package (as defined and subjected to the Severance Conditions set forth above), (4) full acceleration of vesting of Executive's then outstanding restricted stock units or equity awards with performance based vesting subject to the applicable documents governing such awards, and (5) an extension of the exercise period of Executive's stock options or stock appreciation rights grants until the earlier of (i) three (3) years from the date of Executive's termination, or (ii) the remaining life of the equity grants. All other Company obligations to Executive will be automatically terminated and completely extinguished.

A "Change of Control" is defined as any one of the following occurrences: (i) any person or entity, including a "group" as contemplated by Section 13(d)(3) of the Exchange Act, acquires securities holding 30% or more of the total combined voting power or value of the Company, (ii) a merger or consolidation in which the Company is not the surviving corporation (other than a merger or consolidation with a wholly-owned subsidiary, a reincorporation of the Company in a different jurisdiction, or other transaction in which there is no substantial change in the stockholders of the Company or their relative stock holdings, or (iii) as a result of or in connection with a contested election of Company Directors, the persons who were Company Directors immediately before the election cease to constitute a majority of the Board of Directors.

A "Forced Relocation" is defined as the non-voluntary relocation of Executive's principal place of employment, post a Change in Control (as defined above) to a location more than 30 miles from the Executive's principal place of employment immediately prior to a Change in Control requiring Executive to be based anywhere other than such principal place of employment

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(or permitted relocation thereof) except for required travel on the Company's business to an extent substantially consistent with Executive's present business travel obligations.

*7.3 Voluntary Resignation by Executive.* Executive may voluntarily resign Executive's position with Company at any time on thirty (30) days' advance written notice. In the event of Executive's resignation, Executive will be entitled to receive only Executive's Base Salary and Accrued Benefits through the thirty-day notice period and no other amount. All other Company obligations to Executive pursuant to this Agreement will become automatically terminated and completely extinguished. In addition, Executive will not be entitled to receive the Severance Package described in subsection 7.2 above.

*7.4 Pay in Lieu of Notice Period.* Should Executive resign Executive's employment upon thirty (30) days' advance written notice in accordance with subsection 7.3 above, Company reserves the right to immediately relieve Executive of all job duties, positions and responsibilities and provide Executive with payment of Executive's then current Base Salary in lieu of any portion of the notice period.

*7.5 Resignation of Board or Other Positions.* Should Executive's employment terminate for any reason, Executive agrees to immediately resign all other positions (including board membership) Executive may hold on behalf of Company.

*7.6 Termination of Employment Upon Nonrenewal.* In the event Company decides not to renew this Agreement for a subsequent one year term in accordance with subsection 3.2 above, this Agreement will expire, Executive's employment with Company will terminate and Executive will only be entitled to Executive's Base Salary and Accrued Benefits through the last day of the current term, together with any payments required under Section 3.2. All other Company obligations to Executive pursuant to this Agreement will become automatically terminated and completely extinguished. Executive will not be entitled to receive the Severance Package described in subsection 7.2 above.

*7.7 Application of Section 409A.*

(a) Notwithstanding anything set forth in this Agreement to the contrary, no amount payable pursuant to this Agreement which constitutes a "deferral of compensation" within the meaning of the Treasury Regulations issued pursuant to Section 409A of the Code (the "Section 409A Regulations") shall be paid unless and until Executive has incurred a "separation from service" within the meaning of the Section 409A Regulations. Furthermore, to the extent that Executive is a "specified employee" within the meaning of the Section 409A Regulations as of the date of Executive's separation from service, no amount that constitutes a deferral of compensation which is payable on account of Executive's separation from service shall be paid to Executive before the date (the "Delayed Payment Date") which is first day of the seventh month after the date of Executive's separation from service or, if earlier, the date of Executive's death following such separation from service. All such amounts that would, but for this Section, become payable prior to the Delayed Payment Date will be accumulated and paid on the Delayed Payment Date.

(b) Company intends that income provided to Executive pursuant to this Agreement will not be subject to taxation under Section 409A of the Code. The provisions of this Agreement shall be interpreted and construed in favor of satisfying any applicable requirements of Section 409A of the Code. **However, Company does not guarantee any particular tax effect for income provided to Executive pursuant to this Agreement.** In any event, except for Company's responsibility to withhold applicable income and employment taxes from compensation paid or provided to Executive, Company shall not be responsible for the payment of any applicable taxes on compensation paid or provided to Executive pursuant to this Agreement.

(c) Notwithstanding anything herein to the contrary, the reimbursement of expenses or in-kind benefits provided pursuant to this Agreement shall be subject to the following conditions: (1) the expenses eligible for reimbursement or in-kind benefits in one taxable year shall not affect the expenses eligible for reimbursement or in-kind benefits in any other taxable year; (2) the

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reimbursement of eligible expenses or in-kind benefits shall be made promptly, subject to Company's applicable policies, but in no event later than the end of the year after the year in which such expense was incurred; and (3) the right to reimbursement or in-kind benefits shall not be subject to liquidation or exchange for another benefit.

(d) For purposes of Section 409A of the Code, the right to a series of installment payments under this Agreement shall be treated as a right to a series of separate payments.

8. *No Conflict of Interest.* During the term of Executive's employment with Company, Executive must not engage in any work, paid or unpaid, or other activities that create a conflict of interest which materially and substantially disrupt the operations of Company. Such work and/or activities shall include, but is not limited to, directly or indirectly competing with Company in any way, or acting as an officer, director, employee, consultant, stockholder, volunteer, lender, or agent of any business enterprise of the same nature as, or which is in direct competition with, the business in which Company is now engaged or in which Company becomes engaged during the term of Executive's employment with Company, as may be determined by the Board of Directors in its sole discretion. If the Board of Directors believes such a conflict exists during the term of this Agreement, the Board of Directors may ask Executive to choose to discontinue the other work and/or activities or resign employment with Company.

9. *Confidentiality and Proprietary Rights.* As a condition of continuing employment, Executive agrees to read, sign and abide by Company's Proprietary Information and Inventions Agreement, which is provided with this Agreement and incorporated herein by reference.

10. *Nonsolicitation of Company's Employees.* Executive agrees that during the term of this Agreement and for a period of one (1) year after the termination of this Agreement, Executive will not, either directly or indirectly, separately or in association with others, interfere with, impair, disrupt or damage Company's business by soliciting, encouraging or recruiting any of Company's employees or causing others to solicit or encourage any of Company's employees to discontinue their employment with Company.

11. *Injunctive Relief.* Executive acknowledges that Executive's breach of the covenants contained in sections 8-10 (collectively "Covenants") would cause irreparable injury to Company and agrees that in the event of any such breach, Company shall be entitled to seek temporary, preliminary and permanent injunctive relief, without the necessity of proving actual damages or posting any bond or other security.

12. *General Provisions.*

12.1 *Successors and Assigns.* The rights and obligations of Company under this Agreement shall inure to the benefit of and shall be binding upon the successors and assigns of Company. Executive shall not be entitled to assign any of Executive's rights or obligations under this Agreement.

12.2 *Waiver.* Either party's failure to enforce any provision of this Agreement shall not in any way be construed as a waiver of any such provision, or prevent that party thereafter from enforcing each and every other provision of this Agreement.

12.3 *Attorneys' Fees.* Each side will bear its own attorneys' fees in any dispute unless a statutory section at issue, if any, authorizes the award of attorneys' fees to the prevailing party.

12.4 *Severability.* In the event any provision of this Agreement is found to be unenforceable by an arbitrator or court of competent jurisdiction, such provision shall be deemed modified to the extent necessary to allow enforceability of the provision as so limited, it being intended that the parties shall receive the benefit contemplated herein to the fullest extent permitted by law. If a deemed modification is not satisfactory in the judgment of such arbitrator or court, the unenforceable provision shall be deemed deleted, and the validity and enforceability of the remaining provisions shall not be affected thereby.

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12.5 *Interpretation; Construction.* The headings set forth in this Agreement are for convenience only and shall not be used in interpreting this Agreement. This Agreement has been drafted by legal counsel representing Company, but Executive has participated in the negotiation of its terms. Furthermore, Executive acknowledges that Executive has had an opportunity to review and revise the Agreement and have it reviewed by legal counsel, if desired, and, therefore, the normal rule of construction to the effect that any ambiguities are to be resolved against the drafting party shall not be employed in the interpretation of this Agreement.

12.6 *Governing Law.* This Agreement will be governed by and construed in accordance with the laws of the United States and the State of California.

12.7 *Arbitration.* Executive and the Company agree that any dispute arising under or in connection with this Agreement, including any dispute involving Executive's employment or the termination of that employment (whether based on contract, tort or statutory duty or prohibition, including any prohibition against discrimination or harassment), shall be submitted to binding arbitration in accordance with California Code of Civil Procedure §§ 1280 - 1294.2 before a single neutral arbitrator. Executive and the Company understand that each is waiving its rights to a jury trial. The party demanding arbitration shall submit a written claim to the other party setting out the basis of the claim. Demands shall be presented in the same manner as notices under this Agreement. Executive and the Company will attempt to reach agreement on an arbitrator within ten (10) business days of delivery of the arbitration demand. After this ten (10) business day period, either Executive or the Company may request a list of seven professional arbitrators from the American Arbitration Association or another mutually agreed service. Executive and the Company will alternately strike names until only one person remains and that person shall be designated as the arbitrator. The party demanding arbitration shall make the first strike. The arbitration shall take place in or within five miles of Calabasas, California, at a time and place determined by the arbitrator. Each party shall be entitled to discovery of essential documents and witnesses and to deposition discovery, as determined by the arbitrator, taking into account the mutual desire to have a fast, cost-effective, dispute-resolution mechanism. Executive and the Company will attempt to cooperate in the discovery process before seeking the determination of the arbitrator. Except as otherwise determined by the arbitrator, Executive and the Company will each be limited to no more than three (3) depositions. The arbitrator shall have the powers provided in California Code of Civil Procedure §§ 1282.2 - 1284.2 and may provide all appropriate remedies at law or equity. The arbitrator will have the authority to entertain a motion to dismiss and/or a motion for summary judgment by either Executive or the Company and shall apply the standards governing such motions under California law. The Arbitrator shall render, within sixty (60) days of the completion of the arbitration, an award and a written, reasoned opinion in support of that award. Judgment on the award may be entered in any court having jurisdiction. The Company and Executive will each pay one-half of (a) the arbitrator's expenses and fees and (b) all meeting room charges. Unless otherwise ordered by the arbitrator pursuant to law or this Agreement, each party shall pay its own attorney fees, witness fees and other expenses incurred by the party for his or her own benefit.

12.8 *Notices.* Any notice required or permitted by this Agreement shall be in writing and shall be delivered as follows with notice deemed given as indicated: (a) by personal delivery when delivered personally; (b) by overnight courier upon written verification of receipt; (c) by telecopy or facsimile transmission upon acknowledgment of receipt of electronic transmission; or (d) by certified or registered mail, return receipt requested, upon verification of receipt. Notice shall be sent to the addresses set forth below, or such other address as either party may specify in writing.

12.9 *Survival.* Sections 8 ("No Conflict of Interest"), 9 ("Confidentiality and Proprietary Rights"), 10 ("Nonsolicitation"), 11 ("Injunctive Relief"), 12 ("General Provisions") and 13 ("Entire Agreement") of this Agreement shall survive Executive's employment by Company.

13. *Entire Agreement.* This Agreement, including the Proprietary Information and Inventions Agreement incorporated herein by reference, constitutes the entire agreement between the parties

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relating to this subject matter and supersedes all prior or simultaneous representations, discussions, negotiations, and agreements, whether written or oral. This agreement may be amended or modified only with the written consent of Executive and the Board of Directors of Company. No oral waiver, amendment or modification will be effective under any circumstances whatsoever.

THE PARTIES TO THIS AGREEMENT HAVE READ THE FOREGOING AGREEMENT AND FULLY UNDERSTAND EACH AND EVERY PROVISION CONTAINED HEREIN. WHEREFORE, THE PARTIES HAVE EXECUTED THIS AGREEMENT ON THE DATES SHOWN BELOW.

Dated: 3/8/12

\_\_\_\_\_

/s/ JON KIRCHNER

\_\_\_\_\_  
Jon Kirchner  
Chairman of the Board of Directors &  
Chief Executive Officer  
DTS, Inc.

Dated: 3/1/12

\_\_\_\_\_

By: /s/ KRIS GRAVES

\_\_\_\_\_  
Kris Graves  
535 Nobletree Court  
Oak Park, CA 91377

\_\_\_\_\_

## Exhibit A

1. *General Release by Employee.* Employee unconditionally, irrevocably and absolutely releases and discharges Company, and any parent and subsidiary corporations, divisions and affiliated corporations, partnerships or other affiliated entities of Company, past and present, as well as Company's employees, officers, directors, agents, successors and assigns (collectively, "Released Parties"), from all claims related in any way to the transactions or occurrences between them to date, to the fullest extent permitted by law, including, but not limited to, Employee's employment with Company, the termination of Employee's employment, and all other losses, liabilities, claims, charges, demands and causes of action, known or unknown, suspected or unsuspected, arising directly or indirectly out of or in any way connected with Employee's employment with Company. This release is intended to have the broadest possible application and includes, but is not limited to, any tort, contract, common law, constitutional or other statutory claims arising under local state or federal law, including, but not limited to alleged violations of the California Labor Code, the California Fair Employment and Housing Act, Title VII of the Civil Rights Act of 1964, the Americans with Disabilities Act, and the Age Discrimination in Employment Act of 1967, as amended, and all claims for attorneys' fees, costs and expenses. Employee expressly waives Employee's right to recovery of any type, including damages or reinstatement, in any administrative or court action, whether state or federal, and whether brought by Employee or on Employee's behalf, related in any way to the matters released herein. However, this general release is not intended to bar any claims that, by statute, may not be waived, such as claims for workers' compensation benefits, unemployment insurance benefits, statutory indemnity, any challenge to the validity of Employee's release of claims under the Age Discrimination in Employment Act of 1967, as amended, as set forth in this Separation Agreement; any claims for payment or benefits under the Separation Agreement; any claim or cause of action for indemnification pursuant to any applicable indemnification agreement, any D&O insurance policy applicable to Executive and/or Company's certificates of incorporation, charter and by-laws or any claim for contribution or any rights Executive may have to vested benefits under any health and welfare plans or other employee benefit plans or programs sponsored by the Company.

Employee acknowledges that Employee may discover facts or law different from, or in addition to, the facts or law that Employee knows or believes to be true with respect to the claims released in this Separation Agreement and agrees, nonetheless, that this Separation Agreement and the release contained in it shall be and remain effective in all respects notwithstanding such different or additional facts or the discovery of them.

Employee declares and represents that Employee intends this Separation Agreement to be complete and not subject to any claim of mistake, and that the release herein expresses a full and complete release and Employee intends the release herein to be final and complete. Employee executes this release with the full knowledge that this release covers all possible claims against the Released Parties, to the fullest extent permitted by law.

2. *California Civil Code Section 1542 Waiver.* Employee expressly acknowledges and agrees that all rights under Section 1542 of the California Civil Code are expressly waived. That section provides:

A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS OR HER FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM OR HER MUST HAVE MATERIALLY AFFECTED HIS OR HER SETTLEMENT WITH THE DEBTOR.

3. *Representation Concerning Filing of Legal Actions.* Employee represents that, as of the date of this Separation Agreement, Employee has not filed any lawsuits, charges, complaints, petitions, claims or other accusatory pleadings against Company or any of the other Released Parties in any court or with any governmental agency.

4. *Nondisparagement.* Employee agrees that Employee will not make any voluntary statements, written or oral, or cause or encourage others to make any such statements that defame, disparage or in any way criticize the personal and/or business reputations, practices or conduct of Company or any of

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the other Released Parties. Company agrees that Company, will direct its officers and directors not to make any voluntary statements, written or oral, or cause or encourage others to make any such statements that defame, disparage or in any way criticize the personal and/or business reputation, practices or conduct of Executive.

5. *Confidentiality and Return of Company Property.* Employee understands and agrees that as a condition of receiving the Severance Package, all Company property must be returned to Company on or before the Separation Date. By signing this Separation Agreement, Employee represents and warrants that Employee has returned to Company on or before the Separation Date, all Company property, data and information belonging to Company and agrees that Employee will not use or disclose to others any confidential or proprietary information of Company or the Released Parties. In addition, Employee agrees to keep the terms of this Separation Agreement confidential between Employee and Company, except that Employee may tell Employee's immediate family and attorney or accountant, if any, as needed, but in no event should Employee discuss this Separation Agreement or its terms with any current or prospective employee of Company.

6. *Continuing Obligations.* Employee further agrees to comply with the continuing obligations regarding confidentiality set forth in the surviving provisions of Company's Proprietary Information and Inventions Agreement previously signed by Employee.

7. *No Admissions.* By entering into this Separation Agreement, the Released Parties make no admission that they have engaged, or are now engaging, in any unlawful conduct. The parties understand and acknowledge that this Separation Agreement is not an admission of liability and shall not be used or construed as such in any legal or administrative proceeding.

8. *Older Workers' Benefit Protection Act.* This Separation Agreement is intended to satisfy the requirements of the Older Workers' Benefit Protection Act, 29 U.S.C. sec. 626(f). Employee is advised to consult with an attorney before executing this Separation Agreement.

8.1 *Acknowledgments/Time to Consider.* Employee acknowledges and agrees that (a) Employee has read and understands the terms of this Separation Agreement; (b) Employee has been advised in writing to consult with an attorney before executing this Separation Agreement; (c) Employee has obtained and considered such legal counsel as Employee deems necessary; (d) Employee has been given twenty-one (21) days to consider whether or not to enter into this Separation Agreement (although Employee may elect not to use the full 21-day period at Employee's option); and (e) by signing this Separation Agreement, Employee acknowledges that Employee does so freely, knowingly, and voluntarily.

8.2 *Revocation/Effective Date.* This Separation Agreement shall not become effective or enforceable until the eighth day after Employee signs this Separation Agreement. In other words, Employee may revoke Employee's acceptance of this Separation Agreement within seven (7) days after the date Employee signs it. Employee's revocation must be in writing and received by DTS, Inc. on or before the seventh day in order to be effective. If Employee does not revoke acceptance within the seven (7) day period, Employee's acceptance of this Separation Agreement shall become binding and enforceable on the eighth day ("Effective Date"). The Severance Package will become due and payable after the Effective Date, provided Employee does not revoke.

8.3 *Preserved Rights of Employee.* This Separation Agreement does not waive or release any rights or claims that Employee may have under the Age Discrimination in Employment Act that arise after the execution of this Separation Agreement. In addition, this Agreement does not prohibit Employee from challenging the validity of this Separation Agreement's waiver and release of claims under the Age Discrimination in Employment Act of 1967, as amended.

9. *Severability.* In the event any provision of this Separation Agreement shall be found unenforceable, the unenforceable provision shall be deemed deleted and the validity and enforceability of the remaining provisions shall not be affected thereby.

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10. *Full Defense.* This Separation Agreement may be pled as a full and complete defense to, and may be used as a basis for an injunction against, any action, suit or other proceeding that may be prosecuted, instituted or attempted by Employee in breach hereof.

11. *Applicable Law.* The validity, interpretation and performance of this Separation Agreement shall be construed and interpreted according to the laws of the United States of America and the State of California.

12. *Entire Agreement; Modification.* This Separation Agreement, including the surviving provisions of Company's Proprietary Information and Invention Agreement previously executed by Employee, is intended to be the entire agreement between the parties and supersedes and cancels any and all other and prior agreements, written or oral, between the parties regarding this subject matter. This Separation Agreement may be amended only by a written instrument executed by all parties hereto.

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QuickLinks

EXHIBIT 10.2

EXECUTIVE EMPLOYMENT AGREEMENT  
Exhibit A

**CERTIFICATION PURSUANT TO SECURITIES ACT RULES 13a-14(a) OR 15d-14(a)**

I, Jon E. Kirchner, certify that:

1. I have reviewed this quarterly report on Form 10-Q of DTS, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 9, 2012

By:           /s/ JON E. KIRCHNER          

Jon E. Kirchner  
*Chairman and Chief Executive Officer*

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QuickLinks

[EXHIBIT 31.1](#)

**CERTIFICATION PURSUANT TO SECURITIES ACT RULES 13a-14(a) OR 15d-14(a)**

I, Melvin L. Flanigan, certify that:

1. I have reviewed this quarterly report on Form 10-Q of DTS, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 9, 2012

By: /s/ MELVIN L. FLANIGAN

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Melvin L. Flanigan  
*Chief Financial Officer*

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QuickLinks

EXHIBIT 31.2

CERTIFICATION PURSUANT TO SECURITIES ACT RULES 13a-14(a) OR 15d-14(a)

**CERTIFICATION PURSUANT TO SECURITIES EXCHANGE ACT RULES 13a-14(b) OR 15d-14(b)  
AND 18 U.S.C. SECTION 1350**

In connection with the quarterly report on Form 10-Q of DTS, Inc. (the "Company") for the quarterly period ended March 31, 2012 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Jon E. Kirchner, Chairman and Chief Executive Officer of the Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 9, 2012

By:           /s/ JON E. KIRCHNER          

Jon E. Kirchner  
*Chairman and Chief Executive Officer*

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to DTS, Inc. and will be retained by DTS, Inc. and furnished to the Securities and Exchange Commission upon request.

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QuickLinks

EXHIBIT 32.1

CERTIFICATION PURSUANT TO SECURITIES EXCHANGE ACT RULES 13a-14(b) OR 15d-14(b) AND 18 U.S.C. SECTION 1350

**CERTIFICATION PURSUANT TO SECURITIES EXCHANGE ACT RULES 13a-14(b) OR 15d-14(b)  
AND 18 U.S.C. SECTION 1350**

In connection with the quarterly report on Form 10-Q of DTS, Inc. (the "Company") for the quarterly period ended March 31, 2012 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Melvin L. Flanigan, Chief Financial Officer of the Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 9, 2012

By:           /s/ MELVIN L. FLANIGAN          

Melvin L. Flanigan  
*Chief Financial Officer*

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to DTS, Inc. and will be retained by DTS, Inc. and furnished to the Securities and Exchange Commission upon request.

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QuickLinks

[EXHIBIT 32.2](#)

[CERTIFICATION PURSUANT TO SECURITIES EXCHANGE ACT RULES 13a-14\(b\) OR 15d-14\(b\) AND 18 U.S.C. SECTION 1350](#)