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FORM 10-Q

DTS, INC. - DTSI

Filed: May 10, 2010 (period: March 31, 2010)

Quarterly report which provides a continuing view of a company's financial position

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, 2010

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)

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

77-0467655
(I.R.S. Employer
Identification No.)

(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 30, 2010 a total of 17,389,298 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 Cash Flows	3
	Notes to Consolidated Financial Statements	4
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	12
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	18
Item 4.	Controls and Procedures	19
PART II.	OTHER INFORMATION	20
Item 1.	Legal Proceedings	20
Item 1A.	Risk Factors	20
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	34
Item 3.	Defaults Upon Senior Securities	34
Item 4.	(Removed and Reserved)	34
Item 5.	Other Information	34
Item 6.	Exhibits	35
	SIGNATURES	36

DTS, INC.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

DTS, INC.

CONSOLIDATED BALANCE SHEETS

	As of March 31, 2010	As of December 31, 2009
(Unaudited) (Amounts in thousands, except per share amounts)		
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 31,877	\$ 42,222
Short-term investments	46,941	33,129
Accounts receivable, net of allowance for doubtful accounts of \$224 and \$229 at March 31, 2010 and December 31, 2009, respectively	6,737	5,731
Deferred income taxes	4,926	4,945
Prepaid expenses and other current assets	1,736	1,617
Income taxes receivable, net	2,360	2,613
Total current assets	94,577	90,257
Property and equipment, net	34,490	33,885
Intangible assets, net	6,280	6,565
Goodwill	1,257	1,257
Deferred income taxes	13,579	13,152
Long-term investments	6,044	8,515
Other assets	713	587
Total assets	\$ 156,940	\$ 154,218
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,040	\$ 826
Accrued expenses	5,138	5,663
Deferred revenue	3,669	43
Total current liabilities	9,847	6,532
Other long-term liabilities	6,184	5,862
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Preferred stock—\$0.0001 par value, 5,000 shares authorized at March 31, 2010 and December 31, 2009; no shares issued and outstanding	—	—
Common stock—\$0.0001 par value, 70,000 shares authorized at March 31, 2010 and December 31, 2009; 19,770 and 19,652 shares issued at March 31, 2010 and December 31, 2009, respectively; 17,385 and 17,522 shares outstanding at March 31, 2010 and December 31, 2009, respectively	2	2
Additional paid-in capital	165,517	161,710
Treasury stock, at cost—2,385 and 2,130 shares at March 31, 2010 and December 31, 2009, respectively	(53,953)	(45,498)
Accumulated other comprehensive income	345	362
Retained earnings	28,998	25,248
Total stockholders' equity	140,909	141,824

Total liabilities and stockholders' equity	\$ 156,940	\$ 154,218
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See accompanying notes to consolidated financial statements.

DTS, INC.

CONSOLIDATED STATEMENTS OF INCOME

	For the Three Months Ended March 31,	
	2010	2009
	(Unaudited)	
	(Amounts in thousands, except per share amounts)	
Revenue	\$ 21,736	\$ 17,262
Cost of revenue	450	445
Gross profit	21,286	16,817
Operating expenses:		
Selling, general and administrative	12,399	12,788
Research and development	2,473	2,183
Total operating expenses	14,872	14,971
Income from operations	6,414	1,846
Interest and other income, net	212	144
Income from continuing operations before income taxes	6,626	1,990
Provision for income taxes	2,706	1,800
Income from continuing operations	3,920	190
Loss from discontinued operations, net of tax	(170)	(3)
Net income	\$ 3,750	\$ 187
Net income per common share:		
Basic:		
Continuing operations	\$ 0.23	\$ 0.01
Discontinued operations	(0.01)	—
Net income	\$ 0.22	\$ 0.01
Diluted:		
Continuing operations	\$ 0.22	\$ 0.01
Discontinued operations	(0.01)	—
Net income	\$ 0.21	\$ 0.01
Weighted average shares used to compute net income per common share:		
Basic	17,216	17,067
Diluted	17,950	17,322

See accompanying notes to consolidated financial statements.

DTS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Three Months Ended March 31,	
	2010	2009
	(Unaudited)	
	(Amounts in thousands)	
Cash flows from operating activities:		
Net income	\$ 3,750	\$ 187
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,240	909
Stock-based compensation charges	1,968	1,511
Deferred income taxes	(408)	(697)
Tax benefits (shortfalls) from stock-based awards	524	(98)
Excess tax shortfalls (benefits) from stock-based awards	(521)	100
Other	(17)	104
Changes in operating assets and liabilities:		
Accounts receivable	(1,006)	2,296
Prepaid expenses and other assets	(245)	39
Accounts payable, accrued expenses and other liabilities	(77)	925
Deferred revenue	3,626	295
Income taxes receivable	253	71
Net cash provided by operating activities	<u>9,087</u>	<u>5,642</u>
Cash flows from investing activities:		
Purchases of held-to-maturity investments	(24,898)	(9,681)
Maturities of held-to-maturity investments	13,307	17,775
Sales of available for sale investments	250	2,950
Cash paid for business acquisition, net	—	(24)
Purchase of property and equipment	(1,356)	(1,164)
Payment for patents and trademarks in process	(116)	(91)
Net cash provided by (used in) investing activities	<u>(12,813)</u>	<u>9,765</u>
Cash flows from financing activities:		
Proceeds from the issuance of common stock under stock-based compensation plans	2,035	—
Repurchase and retirement of common stock for restricted stock award withholdings	(720)	(254)
Excess tax benefits (shortfalls) from stock-based awards	521	(100)
Purchase of treasury stock	(8,455)	—
Net cash used in financing activities	<u>(6,619)</u>	<u>(354)</u>
Net increase in cash and cash equivalents	<u>(10,345)</u>	<u>15,053</u>

Cash and cash equivalents, beginning of period		<u>42,222</u>		<u>25,658</u>
Cash and cash equivalents, end of period	\$	<u>31,877</u>	\$	<u>40,711</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, 2010, 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, 2010 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2010. 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, 2009, filed on March 3, 2010.

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.

Discontinued Operations

All discussions and amounts in the consolidated financial statements and related notes, except for cash flows, for all periods presented relate to continuing operations only, unless otherwise noted. For additional information, refer to Footnote 9 of the consolidated financial statements, "Discontinued Operations."

Subsequent Events

The Company has evaluated subsequent events through the date that the consolidated financial statements were issued. During this period, there were no material subsequent events that required recognition or disclosure.

Note 2—Significant Accounting Policies

Revenue Recognition

Deferred revenues arise primarily from payments for licensing audio technology received in advance of the culmination of the earnings process. Deferred revenues expected to be recognized within the next twelve months are classified within current liabilities. Deferred revenues will be recognized as revenue in future periods when the applicable revenue recognition criteria are met. For additional information regarding the Company's significant accounting policies for revenue recognition, refer to Footnote 2 of the Company's Annual Report on Form 10-K for the year ended December 31, 2009, filed on March 3, 2010, "Significant Accounting Policies."

DTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Amounts in thousands, except per share data)

Note 2—Significant Accounting Policies (Continued)

Recent Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2009-13, "Revenue Recognition: Multiple-Deliverable Revenue Arrangements" and ASU 2009-14, "Software: Certain Revenue Arrangements That Include Software Elements." ASU 2009-13 requires entities to allocate revenue in an arrangement using estimated selling prices of the delivered goods and services based on a selling price hierarchy. ASU 2009-13 also eliminates the residual method of revenue allocation and requires revenue to be allocated using the relative selling price method. In addition, ASU 2009-13 expands the disclosure requirements for revenue recognition. ASU 2009-14 removes tangible products from the scope of software revenue guidance and provides guidance on determining whether software deliverables in an arrangement that includes a tangible product are covered by the scope of the software revenue guidance. ASU 2009-13 and ASU 2009-14 will be effective for the first annual reporting period beginning on or after June 15, 2010, with early adoption permitted provided that the revised guidance is retroactively applied to the beginning of the year of adoption. The Company is currently evaluating the future impact of this new accounting update on its consolidated financial statements.

In January 2010, the FASB issued ASU 2010-6, "Fair Value Measurements and Disclosures: Improving Disclosures About Fair Value Measurements," which requires entities to make new disclosures about recurring or nonrecurring fair value measurements including significant transfers into and out of Level 1 and Level 2 fair value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair value measurements. ASU 2010-6 is effective for annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures which are effective for annual periods beginning after December 15, 2010. The adoption of ASU 2010-6, with respect to Level 1 and Level 2 guidance, did not have a material impact on the Company's consolidated financial statements. The Company is currently evaluating the future impact of this new accounting update, with respect to Level 3 guidance, on its consolidated financial statements.

Note 3—Fair Value Measurements

As of March 31, 2010 and December 31, 2009, the Company held certain financial assets that are required to be measured at fair value on a recurring basis. These financial assets are the Company's auction rate security instruments, which are classified as available-for-sale investments. The auction rate securities held at March 31, 2010 and December 31, 2009 are tax-exempt municipal bonds issued by governmental entities located within the United States that are insured and have a AAA rating.

Liquidity for these auction rate security instruments is typically provided by a Dutch auction process that resets the applicable interest rate at pre-determined intervals, usually every 7, 28, or 35 days. Historically, auction rate security instruments would also be purchased or sold at these pre-determined intervals, creating a liquid market. Investment earnings paid during a given period are based upon the reset interest rate determined during the prior auction. For each unsuccessful auction, the interest rate moves to a maximum rate defined for each security, which is generally higher than

DTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Amounts in thousands, except per share data)

Note 3—Fair Value Measurements (Continued)

short-term interest indices. To date, the Company has collected all interest receivable on its auction rate security instruments when due.

On October 24, 2008, the Company accepted an offer from UBS AG ("UBS") to liquidate its auction rate securities held in UBS accounts on February 13, 2008. The terms or rights of the UBS offer were publicly filed in a prospectus, dated October 7, 2008. As of March 31, 2010 and December 31, 2009, the Company owned \$2,000 and \$2,250, respectively, par value of these securities. From January 2, 2009 and ending January 4, 2011, the Company has the right, but not the obligation, to sell, at par, these auction rate securities to UBS, and such a transaction would be initiated by UBS. Prior to January 4, 2011, the Company will continue to earn and receive all interest that is payable for these auction rate securities. Furthermore, prior to January 4, 2011, UBS, at its sole discretion, may sell, or otherwise dispose of, and/or enter orders in the auctions process with respect to these securities on the Company's behalf so long as it receives par value for the auction rate securities sold. UBS has also agreed to use its best efforts to facilitate issuer redemptions and/or to resolve the liquidity concerns of holders of their auction rate securities through restructurings and other means. In addition, UBS has agreed to provide "no net cost" loans to holders of the illiquid securities that are subject to bank repurchase, thereby providing the Company with short-term liquidity on its auction rate securities portfolio at no additional cost. As a result of this arrangement with UBS, the Company believes that it has Level 2 inputs within the fair value hierarchy as of March 31, 2010 and December 31, 2009, and par value or cost is a reasonable approximation of fair value.

Due to the Company's belief that it may take until January 2011 to liquidate the remaining securities, its auction rate security instruments have been classified as long-term investments on the consolidated balance sheet as of December 31, 2009. As of March 31, 2010, the Company has classified its auction rate security instruments as short-term investments on the consolidated balance sheet.

Any future fluctuation in fair value related to these securities that the Company deems to be temporary, including any recoveries of previous write-downs, will be recorded to accumulated other comprehensive income. If the Company determines that any future valuation adjustment is other than temporary, it will record a charge to earnings.

The Company's financial assets measured at fair value on a recurring basis were as follows:

<u>Auction Rate Securities</u>	<u>Total</u>	<u>Fair Value Measurements at Reporting Date Using</u>		
		<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
As of March 31, 2010	\$ 2,000	\$ —	\$ 2,000	\$ —
As of December 31, 2009	\$ 2,250	\$ —	\$ 2,250	\$ —

DTS, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****(Amounts in thousands, except per share data)****Note 4—Property and Equipment**

Property and equipment consist of the following:

	As of March 31, 2010	As of December 31, 2009
Land	\$ 6,600	\$ 6,600
Building and improvements	20,823	19,946
Machinery and equipment	2,827	2,647
Office furniture and fixtures	5,580	5,300
Leasehold improvements	1,152	1,156
Software	5,689	5,608
	<u>42,671</u>	<u>41,257</u>
Less: Accumulated depreciation	(8,181)	(7,372)
Property and equipment, net	<u>\$ 34,490</u>	<u>\$ 33,885</u>

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 technology, indemnities for liabilities associated with the infringement of other parties' technology based upon the Company's products and technology, 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, 2010, the Company recorded an income tax provision of \$2,706 on pre-tax income from continuing operations of \$6,626. This resulted in an effective tax rate of 41% for the quarter. This rate differed from the U.S. statutory rate of 35% primarily due to state income taxes and reserves for federal and state tax audits.

In the first quarter of 2009, the Company's management identified an adjustment in its reserve for unrecognized tax benefits. This adjustment primarily related to imputed interest on inter-company balances for the years 2003 through 2008, that was recorded during the quarter. The adjustment had the effect of increasing income tax expense in the quarter by \$882. The adjustment has decreased

DTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Amounts in thousands, except per share data)

Note 6—Income Taxes (Continued)

income from continuing operations by \$882 and net income by \$882. The Company's management determined that the effect on previously filed reports was not material.

Other long-term liabilities at March 31, 2010 and December 31, 2009, include unrecognized tax benefits of \$5,877 and \$5,578, respectively, for both domestic and foreign issues. The net increase of \$299 was due primarily for uncertainties relating to the Company's transfer pricing with its foreign licensing subsidiaries and the California franchise tax sourcing methodology. 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 2004. The Internal Revenue Service is examining the Company's 2005 through 2007 federal income tax returns, including certain prior period carry forwards. In addition, the California Franchise Tax Board is conducting a state tax examination for the years 2004 and 2005.

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, 2010 and 2009, withholding taxes were \$1,318 and \$1,189, respectively.

Note 7—Comprehensive Income

At March 31, 2010 and December 31, 2009, accumulated other comprehensive income was comprised mostly of foreign currency translation.

Comprehensive income for the three months ended March 31, 2010 and 2009 was \$3,733 and \$164, respectively.

DTS, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****(Amounts in thousands, except per share data)****Note 8—Operating Segment and 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,	
	2010	2009
United States	\$ 1,732	\$ 1,703
International	20,004	15,559
Total revenue	\$ 21,736	\$ 17,262

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

	As of March 31, 2010	As of December 31, 2009
	United States	\$ 33,123
International	1,367	1,391
Total long-lived tangible assets	\$ 34,490	\$ 33,885

Note 9—Discontinued Operations

The following table presents expense and tax information for discontinued operations during the three months ended March 31, 2010 and 2009.

	For the Three Months Ended March 31,	
	2010	2009
Pre-tax loss	\$ (275)(1)	\$ (3)
Income tax benefit	(105)	—
Loss from discontinued operations, net of tax	\$ (170)	\$ (3)

(1)

The loss from discontinued operations resulted primarily from legal fees associated with the Company's efforts to collect certain amounts due and contingent consideration from Datasat Digital Entertainment, Inc., previously known as Beaufort California, Inc. and Beaufort International Group Plc.

Note 10—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

DTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Amounts in thousands, except per share data)

Note 10—Net Income Per Common Share (Continued)

outstanding plus the dilutive effect of unvested restricted stock, outstanding stock options, and the employee stock purchase plan ("ESPP") using the "treasury stock" method.

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

	For the Three Months Ended March 31,	
	2010	2009
Basic net income per common share:		
Numerator:		
Income from continuing operations	\$ 3,920	\$ 190
Loss from discontinued operations	(170)	(3)
Net income	\$ 3,750	\$ 187
Denominator:		
Weighted average common shares outstanding	17,216	17,067
Continuing operations	\$ 0.23	\$ 0.01
Discontinued operations	(0.01)	—
Basic net income per common share	\$ 0.22	\$ 0.01
Diluted net income per common share:		
Numerator:		
Income from continuing operations	\$ 3,920	\$ 190
Loss from discontinued operations	(170)	(3)
Net income	\$ 3,750	\$ 187
Denominator:		
Weighted average shares outstanding	17,216	17,067
Effect of dilutive securities:		
Common stock options	600	202
Restricted stock	114	53
ESPP	20	—
Diluted shares outstanding	17,950	17,322
Continuing operations	\$ 0.22	\$ 0.01
Discontinued operations	(0.01)	—
Diluted net income per common share	\$ 0.21	\$ 0.01

For the three months ended March 31, 2010 and 2009, 247 and 1,777 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.

DTS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Amounts in thousands, except per share data)

Note 11—Common Stock Repurchases

In November 2009, the Company's Board of Directors authorized, subject to certain business and market conditions, the purchase of up to 1,000 shares of the Company's common stock in the open market or in privately negotiated transactions. During the first quarter of 2010, the Company repurchased 255 shares of common stock under this authorization for an aggregate of \$8,455.

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

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 or expectations, and our objectives for future operations, including relating to our products and services. 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 from 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 quality branded entertainment technologies, which are incorporated into an array of entertainment products by hundreds of licensee customers around the world. Our core DTS digital multi-channel audio technology enables the delivery and playback of compelling surround sound and is currently used in a variety of product applications, including audio/video receivers, Blu-ray Disc players, DVD based products, personal computers or PCs, car audio products, video game consoles, network capable televisions, digital media players, home theater systems and mobile handsets. In addition, we provide products and services to studios, radio and television broadcasters, game developers and other content creators to facilitate the inclusion of compelling, realistic DTS-encoded soundtracks in movies, sporting events, television shows and music content.

We derive revenues from licensing our audio technology, 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.

We actively engage in intellectual property compliance and enforcement activities focused on identifying third parties who have either incorporated our technology, 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

[Table of Contents](#)

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 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.

Executive Summary

Financial Highlights

- Revenues increased 26% for the three months ended March 31, 2010, compared to the same prior year period.
- Royalties from Blu-ray product markets increased 77% for the three months ended March 31, 2010, compared to the same prior year period.
- Royalties from newer markets, including televisions and digital media players, comprised over 10% and less than 5% of total revenue for the three months ended March 31, 2010 and 2009, respectively.
- Income from operations increased to 30% of revenues for the three months ended March 31, 2010, compared to 11% for the same prior year period. This increase results largely from professional fees associated with the Zoran litigation matters in the 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, online networked devices, broadcast, video game console and mobile handset 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 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 3-D content.

Because we are a mandatory technology in the Blu-ray Disc standard, our revenue growth 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.

[Table of Contents](#)

Gross Profit

	2010		2009		Percentage point change in gross profit margin relative to prior period
		%		%	
	(\$ in thousands)				
Three months ended					
March 31,	\$ 21,286	98%	\$ 16,817	97%	1%

Consolidated gross profit percentage for the three months ended March 31, 2010, compared to the same prior year period, increased as a result of an increase in revenues.

We expect consolidated gross margins in the 97% to 98% range for 2010.

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

	2010		2009		Change	
					\$	%
	(\$ in thousands)					
Three months ended						
March 31,	\$ 12,399		\$ 12,788		\$ (389)	(3)%
% of Revenue		57%		74%		

The decrease for the three months ended March 31, 2010, compared to the same prior year period, was primarily due to a \$2.6 million decrease in professional fees. This decrease results largely from the fees associated with the Zoran litigation matters in the prior year period. Partially offsetting this decrease was a \$1.6 million increase in employee related costs and a \$0.5 million increase in advertising expenses. The increase in employee related costs is primarily attributable to expanded operations and stock-based compensation for the three months ended March 31, 2010, compared to the same prior year period. The increase in advertising expenses is primarily attributable to increased tradeshow advertising and related activities.

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")

	2010		2009		Change	
					\$	%
	(\$ in thousands)					
Three months ended						
March 31,	\$ 2,473		\$ 2,183		\$ 290	13%
% of Revenue		11%		13%		

The dollar increase for the three months ended March 31, 2010, compared to the same prior year period, was primarily due to an increase in employee related costs, including expanded operations and stock-based compensation.

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, Net

	2010		2009		Change	
					\$	%
	(\$ in thousands)					
Three months ended						
March 31,	\$ 212		\$ 144		\$ 68	47%

[Table of Contents](#)

The increase for the three months ended March 31, 2010, compared to the same prior year period, was due to interest and other income associated with certain royalty recoveries.

We expect interest and other income for the year to be in the range of \$0.8 to \$1.0 million, based on the current interest rate environment and current investment balances.

Income Taxes

	2010	2009
	(\$ in thousands)	
Three months ended March 31,	\$ 2,706	\$ 1,800
Effective tax rate	41%	90%

Our effective tax rate is based upon a projection of annual fiscal year results, and these rates differed from the U.S. statutory rate of 35% primarily due to state income taxes and reserves for federal and state audits. Also, in the first quarter of 2009, the Company's management identified an adjustment in its reserve for unrecognized tax benefits. This adjustment primarily related to imputed interest on inter-company balances for the years 2003 through 2008, that was recorded during the quarter. The adjustment has the effect of increasing income tax expense in the quarter by \$882. The adjustment has decreased income from continuing operations by \$882 and net income by \$882. The Company's management determined that the effect on previously filed reports was not material.

Results of Discontinued Operations

The loss from discontinued operations for the three months ended March 31, 2010, resulted primarily from legal fees associated with the Company's efforts to collect certain contingent consideration from the buyer of the cinema business.

As further relevant information becomes available relating to the contingent consideration or further obligations of ours, if any, additional adjustments and expenses may be recorded through discontinued operations in future periods. As a result of the business sales in 2008, the periods presented are not comparable.

Liquidity and Capital Resources

At March 31, 2010, we had cash, cash equivalents and short-term investments of \$78.8 million, compared to \$75.4 million at December 31, 2009.

Net cash provided by operating activities was \$9.1 million and \$5.6 million for the three months ended March 31, 2010 and 2009, 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 increase in operating cash flows during the three months ended March 31, 2010, compared to the same prior year period, results largely from increases in deferred revenue arising primarily from payments for licensing audio technology received in advance of the culmination of the earnings process and income from operations. Partially offsetting these increases for the three months ended March 31, 2010, compared to the same prior year period, was a decrease in cash flows from accounts receivable due to the timing of collections.

We typically use cash in investing activities primarily to purchase office equipment, fixtures, computer hardware and software, engineering and manufacturing test and certification equipment, for business and technology acquisitions, for securing patent and trademark protection for our proprietary technology and brand name, and to purchase short-term and long-term investments such as bank certificates of deposit and municipal bonds. Cash used in investing activities totaled \$12.8 million for the three months ended March 31, 2010. Cash provided by investing activities totaled \$9.8 million for

[Table of Contents](#)

the three months ended March 31, 2009. Investing activities for the three months ending March 31, 2010 and 2009 were primarily impacted by the net impact of investment purchases, sales and maturities. Also impacting investing activities for the three months ending March 31, 2010 and 2009 were capital expenditures to support our growth.

Cash used in financing activities totaled \$6.6 million and \$0.4 million for the three months ended March 31, 2010 and 2009, respectively, which results primarily from the purchase of treasury stock during the three months ended March 31, 2010 and restricted stock award withholdings during the three months ended March 31, 2010 and 2009. Partially offsetting the cash used in financing activities for the three months ended March 31, 2010, were proceeds from the issuance of common stock under stock-based compensation plans.

Auction Rate Securities

As of March 31, 2010, we held approximately \$2.0 million in auction rate securities. The auction rate securities held at March 31, 2010 are tax-exempt municipal bonds issued by governmental entities located within the United States that are insured and have a AAA rating.

On October 24, 2008, we accepted an offer from UBS AG, or UBS, to liquidate our auction rate securities held in UBS accounts on February 13, 2008. The terms or rights of the UBS offer were publicly filed in a prospectus, dated October 7, 2008. As of March 31, 2010, we owned \$2.0 million par value of these securities. From January 2, 2009 and ending January 4, 2011, we have the right, but not the obligation, to sell, at par, these auction rate securities to UBS, and such transaction would be initiated by UBS. Prior to January 4, 2011, we will continue to earn and receive all interest that is payable for these auction rate securities. Furthermore, prior to January 4, 2011, UBS, at its sole discretion, may sell, or otherwise dispose of, and/or enter orders in the auctions process with respect to these securities on our behalf so long as we receive par value for the auction rate securities sold. UBS has also agreed to use its best efforts to facilitate issuer redemptions and/or to resolve the liquidity concerns of holders of their auction rate securities through restructurings and other means. In addition, UBS has agreed to provide "no net cost" loans to holders of the illiquid securities that are subject to bank repurchase, thereby providing us with short-term liquidity on our auction rate securities portfolio at no additional cost to us. As a result of this arrangement with UBS, we believe par value or cost is a reasonable approximation of fair value.

Due to our belief that our auction rate security instruments will be liquidated by or before January 2011, we have classified these instruments as short-term investments on the consolidated balance sheet as of March 31, 2010.

To date, we have collected all interest receivable on our auction rate security instruments when due and expect to continue to do so in the future. Based on current cash, cash equivalents and short-term investment balances and expected operating cash flows, we do not anticipate a lack of liquidity associated with our auction rate securities to adversely affect our ability to conduct business, and we believe that we have the ability and intent to hold these securities throughout the estimated recovery period.

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. 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, in our Form 10-K filed on March 3, 2010 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, 2009, with the exception of the increased obligations associated with our gross unrecognized tax benefits. As of March 31, 2010, our total amount of unrecognized tax benefits was \$5.9 million and is considered a long-term obligation. We are currently unable to make reasonably reliable estimates of the periods of cash settlements associated with these obligations.

Recently Issued Accounting Standards

Refer to Footnote 2 of the consolidated financial statements, "Significant Accounting Policies."

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, 2010. Based on current cash, cash equivalents and short-term investment balances and expected operating cash flows, we do not anticipate a lack of liquidity associated with our auction rate security instruments to adversely affect our ability to conduct business, and we believe that we have the ability and intent to hold these securities throughout the estimated recovery period. In the event that we are unable to sell the underlying securities at or above our carrying value, these securities may not provide us a liquid source of cash. The estimated average maturity of our investment portfolio is less than one year. As of March 31, 2010, a one percentage point change in interest rates throughout a one-year period would have an annual effect of approximately \$0.8 million on our income before income taxes.

During the three months ended March 31, 2010, we derived approximately 92% of our revenues from continuing operations 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 4% of total revenues during the three months ended March 31, 2010. Operating expenses, including cost of sales, for our foreign subsidiaries were approximately \$3.5 million for the three months ended March 31, 2010. Based upon the expenses for the three months ended March 31, 2010, a one percentage point change in foreign currency rates throughout a one-year period would have an immaterial annual effect on income from continuing operations before income taxes.

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 vary, these results, when translated, may vary from expectations and could adversely or positively impact overall profitability. During the three months ended March 31, 2010, 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 technology and trademarks.

The description of legal matters with Datasat Digital Entertainment, Inc., Beaufort International Group Plc and Datasat Communications Limited referred to in our Annual Report on Form 10-K for the year ended December 31, 2009, filed with the Securities and Exchange Commission on March 3, 2010, is incorporated herein by reference.

We are not currently a party to any other 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. The risk factors described below include any material changes to and supersede the risk factors previously disclosed in Part I, Item 1A of our most recent Annual Report on Form 10-K.

Risks Related to Our Business

We do not expect sales of DVD based products to sustain their past growth rates. Our business is highly dependent on the growth in Blu-ray Disc products, and we do not have near-term visibility into the precise timing of this expected growth or how smooth or linear this growth will be. To the extent that sales of DVD based products and home theater systems level off or decline, consumer adoption of Blu-ray Disc products fails to materialize or does not materialize as quickly or extensively as we expect, or alternative technologies in which we do not participate replace DVD based products as a dominant medium for consumer video entertainment, 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 expect sales of these products to decline. To the extent that sales of DVD based products and home theater systems level off or decline, our business will be adversely affected. Additionally, the release and consumer adoption of Blu-ray Disc players has only just begun to ramp up. A potentially slow adoption by consumers of Blu-ray Disc players, as well as the inability of DVD based products to sustain their past growth rates, could adversely affect our business, as revenue and earnings derived from these new players and associated home theater system sales may not fully replace the anticipated decline in revenue and earnings associated with DVD based products and home theater systems. Even with the resolution of the competing disc format conflict in early 2008, the rate of consumer adoption and ultimate penetration of Blu-ray Disc players is uncertain and may be slower than past growth rates of DVD based products. In addition, if new technologies are developed for use with DVDs or new technologies, including direct downloads of content, are developed or deployed that substantially compete with or replace DVDs as a dominant medium for consumer video entertainment, our business, operating results and prospects could be adversely affected.

Economic downturns could disrupt and materially harm our business.

Negative trends in the general economy could cause a downturn in the market for our technology, products and services. The current and continuing financial disruption affecting the global financial

[Table of Contents](#)

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 ongoing 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 technology.

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.

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. Patent, trademark, copyright, 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 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 prevent the unauthorized disclosure or use of our technical knowledge or other trade secrets by employees, consultants, and advisors;
- 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;
- 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;
- our competitors may produce competitive products or services that do not unlawfully infringe upon our intellectual property rights;
- efforts to identify and prosecute unauthorized uses of our technology are time consuming, expensive, and divert resources from the operation of our business; and
- we may be unable to successfully identify or prosecute unauthorized uses of our technology.

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.

Our business and prospects depend on 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 on 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.

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

The market for our technology, 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 on our ability to enhance our existing technology, products, and services and to develop acceptable new technology, products, and services on a timely basis. The development of enhanced and new technology, 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 technology, products, or services on a timely basis, if at all. Furthermore, our new technology, 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 technology, products, and services from gaining market acceptance or maintaining market share and could lead to our technology, products and services becoming obsolete.

We may be sued by third parties for alleged infringement of their proprietary rights.

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 technology 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

[Table of Contents](#)

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.

We may be subject to litigation proceedings that could harm our business.

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 technology 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 face intense competition. Certain of our competitors have greater brand recognition and 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; and
- greater technical support.

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. Its technology has been incorporated in significantly more DVD based products than our technology. It has also achieved mandatory standard status in product categories that we have not, including DVD based products, for its stereo technology and 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 limited control over existing and potential customers' and licensees' decisions to include our technology in their product offerings.

Except for Blu-ray enabled products, where our technology is mandatory, we are dependent on our customers and licensees—including consumer electronics product manufacturers, semiconductor manufacturers, producers and distributors of content for music, videos, and games—to incorporate our technology 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 technology, trademarks or services. Our customers, licensees and other manufacturers might not utilize our technology or services in the future.

If we are unable to maintain and increase the amount of entertainment content released with DTS audio soundtracks, demand for the technology, 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 technology, products, and services that we offer to manufacturers of consumer electronics products. To date, the most significant driver for the use of our technology 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 technology 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 do not have contracts that require any of 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.

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 technology 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 technology into the consumer electronics products that they sell and distribute. Most of the consumer electronics products that include our audio technology 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 technology is not a mandatory standard could decide to exclude our DTS audio technology from their products altogether.

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 on 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 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 on 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.

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 technology, products, and services and develop new technology, 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.

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

Our technology has only recently been incorporated into other consumer electronics markets, such as personal computers, video game consoles, portable electronics devices, digital satellite and cable broadcast products, digital media players and mobile handsets. Recently, we have also entered into the "virtual" surround space with the internal development of technology that we have branded DTS Surround Sensation. We do not have experience in this specific segment of the market and it is dominated by existing technologies from companies including Dolby Laboratories, Inc., SRS Labs, Inc. and BBE Sound, Inc. As a result, the demand for our technology, products, and services and the income potential of these businesses are unproven. In addition, because the market for digital audio technology is relatively new and rapidly evolving, we 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.

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

Our technology or products could contain errors that could cause our products or technology to operate improperly and could cause unintended consequences. If our products or technology 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 cannot be certain of the future effectiveness of our internal control over financial reporting or the impact thereof on our operations or the market price of our common stock.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we are required to include in our annual reports on Form 10-K our assessment of the effectiveness of our internal control over financial reporting. We cannot assure you that our system of internal control will be effective in the future as our operations and control environment change. If we cannot adequately maintain the effectiveness of our internal control over financial reporting, our financial reporting may not be timely and/or accurate. If reporting delays or errors actually occur, we could be subject to sanctions or investigation by regulatory authorities, such as the SEC. Moreover, even if we conclude that our internal control is effective, our independent registered public accounting firm may disagree. If our independent registered public accounting firm is not satisfied with our internal control over financial reporting or the level at which our internal control over financial reporting is documented, designed, operated or reviewed, or if the independent registered public accounting firm interprets the requirements, rules or regulations differently than we do, then it may issue an adverse or qualified opinion. Any of the above outcomes 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.

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. For the quarter

[Table of Contents](#)

ended March 31, 2010, approximately 92% 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 on 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, CAD, RMB and GBP. We do not currently engage in currency hedging activities to limit the risk of exchange rate fluctuations.

We face risks in expanding our business operations in China.

An important strategy of ours is to expand our business operations in China. However, we may be unsuccessful in implementing this strategy as planned or at all. Factors that could inhibit our successful expansion into China include its historically poor recognition of intellectual property rights and poor performance in stopping counterfeiting and piracy activity as well as enforcing judgments. If we are unable to successfully stop unauthorized use of our intellectual property and assure compliance by our Chinese licensees, we could experience increased operational and enforcement costs both inside and outside China.

Even if we are successful in expanding into China, we may be greatly impacted by the political, economic, and military conditions in China, Taiwan, North Korea, and South Korea. Such disputes may continue or escalate, resulting in economic embargos, disruptions in shipping, or even military hostilities. This could severely harm our business by interrupting or delaying production or shipment of our products or products that incorporate our technology.

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. For example, the introduction of Blu-ray Disc players may result in an overall near-term slowdown in our business as sales of DVD based products slow in anticipation of purchasing Blu-ray Disc products, but purchases of Blu-ray Disc products are in an early phase market adoption. Our revenues may continue to be subject to fluctuations, seasonal or otherwise, in the future. Unanticipated fluctuations, whether due to seasonality, economic down turns, 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 technology, 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 expenditures and royalty recoveries, 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.

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 on many factors, including:

- acceptance of, and demand for, our products and technology;
- the costs of developing new products or technology;
- the extent to which we invest in new technology 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.

Even if our technologies are adopted as an industry standard for a particular market, manufacturers may not widely adopt our technologies.

Even if a standards-setting body mandates our technologies for a particular market, our technologies may not be the sole technologies adopted for that market as an industry standard. Further, even when inclusion of certain of our technologies is mandated by a particular standard, market participants may choose not to implement or adopt any of our technologies beyond those required by the mandate. Our revenues and operating results depend on manufacturers choosing to adopt our technologies instead of or along with competitive technologies that may also be acceptable under industry standards. For example, the continued growth of our revenue from the Blu-ray Disc market depends upon both the continued growth of the format generally and manufacturers' choosing to incorporate our multi-channel technologies where they are an optional industry standard.

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 could limit our control over the use of these technologies. 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, 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.

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. 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.

We are dependent on 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.

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 2009, one customer accounted for 15% 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.

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 have recently been and 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 2005 to 2007 federal income tax returns, 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 DVD based products and Blu-ray Disc. In the standard for Blu-ray Disc, both DTS and Dolby technologies have been selected as mandatory standards for two-channel output. 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

[Table of Contents](#)

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 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 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 on 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.

Risks Related to Our Common Stock

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.

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, including 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.

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, 2010 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, 2010 through January 31, 2010	—	—	—	870,000
February 1, 2010 through February 28, 2010	26,336	\$ 26.36	—	870,000
March 1, 2010 through March 31, 2010	255,735	\$ 33.16	255,000	615,000
Total	<u>282,071</u>	<u>\$ 32.53(2)</u>	<u>255,000</u>	<u>615,000</u>

Notes:

- (1) Consists of shares repurchased in open-market transactions pursuant to an authorization by our Board of Directors that we previously announced. In November 2009, our Board of Directors authorized us to repurchase up to one million shares of our common stock in the open market or in privately negotiated transactions, depending upon market conditions and other factors. Also consists of shares repurchased and retired from employees 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, 2010.

Item 3. Defaults Upon Senior Securities

None.

Item 4. (Removed and Reserved)**Item 5. Other Information**

None.

Item 6. Exhibits

Exhibit Number	Exhibit Description
10.1	Employment Agreement, executed on March 3, 2010, effective as of February 26, 2010, by and between Frederick L. Kitson and the Company#
10.2	2003 Equity Incentive Plan, as amended on May 9, 2005, May 15, 2008, February 19, 2009 and February 15, 2010#
10.3	Form of Restricted Stock Unit Grant Notice and Restricted Stock Unit Agreement under 2003 Equity Incentive Plan#
31.1	Certification of the Chief Executive Officer under Securities Exchange Act Rules 13a-14(a) or 15d-14(a)
31.2	Certification of the Chief Financial Officer under Securities Exchange Act Rules 13a-14(a) or 15d-14(a)
32.1	Certification of the Chief Executive Officer under Securities Exchange Act Rules 13a-14(b) or 15d-14(b) and 18 U.S.C. 1350*
32.2	Certification of the Chief Financial Officer under Securities Exchange Act Rules 13a-14(b) or 15d-14(b) and 18 U.S.C. 1350*

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.

EXHIBIT INDEX

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February 18, 2010

Fred Kitson
5336 Via Quinto
Newbury Park, CA 91320

Re: Employment Agreement

Dear Fred:

DTS, Inc. ("DTS" or the "Company") is pleased to extend to you the following employment Agreement. Unless otherwise set forth in this Agreement, you acknowledge that your employment with DTS is "at-will".

Title: Executive Vice President and Chief Technology Officer

Duties: You agree to serve the Company as its Executive Vice President and Chief Technology Officer. Your duties are as defined in Company's job description for the position or as otherwise specified by the Chairman and Chief Executive Officer of the Company. During the Term of this Agreement, you will devote full time to, and use your best efforts to advance, the business and welfare of the Company.

Status: Salary Exempt.

Effective Date: February 26, 2010.

Base Salary: \$320,000 per year payable biweekly and subject to payroll deductions as may be necessary or customary in respect of the Company's salaried employees in general.

Bonus: Participation in the bonus plan will be on a level commensurate with other executives, and subject to completion of individual and company milestone achievements per mutual agreement on targets.

Stock Options: All Stock options granted to you are conditioned on Board of Directors approval and shall vest over four consecutive 12-month periods as per your **Stock Option Agreement** with the Company and administered under the respective Company's **Stock Option Plan**.

Vacation: You shall be provided with One Hundred Sixty (160) hours of vacation, which shall be automatically replenished upon use. However, vacation hours will not be replenished during any period where you are not actively working for the Company, until you have resumed actively working for at least one full workweek.

Holidays: Per Company's annual published schedule (commonly 12 days per year); plan is subject to change. The salary includes holiday pay and you are not entitled to any additional salary or compensation for work on a holiday.

Severance: Upon the termination of this Agreement by the Company for other than good cause, including constructive termination: (A) the Company shall for a period of twelve (12) months; (I) pay to Employee in monthly installments, as severance pay, Employee's full Salary, and (II) provide Employee the same level of benefits Employee was receiving as of the time of termination of this Agreement, unless otherwise required by law, (B) all options, restricted stock, or other Company issued equity incentives granted to you (incentive and nonstatutory) shall (I) immediately vest and (II) where applicable, be exercisable for five (5) years from such termination (but not in excess of the specified maximum term of such option). Constructive Termination shall mean any material failure by the Company to fulfill its obligations under this Agreement which is not cured within thirty (30) days after receipt of written notice from you specifying the nature of the failure, including, but not limited to, (a) your removal, other than removal as a result of a termination for cause or your voluntary termination, as Executive Vice President and Chief Technology Officer of the Company, (b) any material change by the Company in your functions, duties or responsibilities from those in which you were engaged under this Agreement without your consent, or (c) a material, non-voluntary reduction in your base salary and eligibility for bonus amounts.

Benefits: The following are the Company supplied Benefits as of the date of this Agreement. Benefit coverage is subject to change at company election that may result in elimination of benefits or increased co-pay. Unless otherwise set forth below, eligibility begins the first day of the month after hire date. Please see the applicable plan documents for additional information. In the event of any conflict between this description and the plan document, the plan document will prevail.

Insurance:
Health

Long Term Disability

Dental
Vision
Life: \$50,000 coverage

Long Term Care
Section 125:
401k Plan:
ESPP:

Available for dependent and health care.
Enrollment dates 1/1 4/1, 7/1 & 10/1.
Enrollment — May and November

Death or Disability of Employee. If you die or become disabled prior to the termination of this Agreement, your employment under this Agreement will automatically terminate upon your death or the determination that you are disabled. “Disability” means any physical or mental illness that renders you unable to perform your agreed-upon services under this Agreement for ninety (90) consecutive days or an aggregate of one-hundred twenty (120) days, whether or not consecutive, during any consecutive twelve (12)-month period. Disability shall be determined by a licensed physician selected by the Company that is not affiliated with you or the Company. In the event of your death or disability, the amounts due you pursuant to this Agreement through the date of your death or disability will be paid to you or your beneficiaries.

Termination for Cause. Your employment under this Agreement may be terminated immediately by the Company for “good cause”. Upon such termination you will be provided notice specifying the reasons for the termination. You shall have ten (10) business days from the date such termination to cure such cause, if curable. Absent such cure within the cure period, your employment shall be deemed terminated for good cause on the date of your termination. The term “good cause” is defined as any one or more of the following occurrences:

- (I) Negligence or a material violation by you of any duty or any other material or repetitive misconduct or failure on your part;
- (II) Your conviction by, or entry of a plea of guilty or nolo contendere in, a court of competent and final jurisdiction for any crime punishable by imprisonment in the jurisdiction involved; or
- (III) Your commission of an act of fraud, prior to or subsequent to the date of this Agreement, upon the Company.
- (IV) Failure to execute and deliver to the Company any document(s) required by all employees of the Company, or employees of a similar position, at the location you are employed.

Nothing in this section or the availability of termination for good cause is intended to alter the at-will status of employment with the Company. Either you or the company may terminate the employment relationship at any time, with or without cause.

Employee’s Consideration for Severance. As consideration for receiving severance pay and benefits provided hereunder, during the period that Employee is receiving severance pay or benefits hereunder, Employee shall:

- (I) **Consulting.** Be reasonably available, by telephone, as a consultant to the Company on projects or task you have previously been involved in. It is agreed that eight (8) hours per week of consultation, by phone, shall be reasonable.
- (II) **Non-Compete.** You agree that for the period commencing on the date of this Agreement and ending upon the date of the last severance payment hereunder, Employee shall not, directly or indirectly, as employee, agent, consultant, stockholder, director, partner or in any other individual or representative capacity, own, operate, manage, control, engage in, invest in or participate in any manner in, act as a consultant or advisor to, render services for (alone or in association with any person, firm, corporation or entity), or otherwise assist, for compensation or otherwise, any person or entity that engages in or owns, invests in, operates, manages or controls any venture or enterprise that is a direct competitor of DTS; provided, however, that nothing contained in this Agreement shall be construed to prevent you from investing in the stock of any competing corporation listed on a national securities exchange or traded in the over-the-counter market, but only if: (1) you are not involved in the business of said corporation, and (2) if you and your affiliates collectively do not own more than an aggregate of 5% of the stock of such corporation, and (3) such investment does not violate the Company’s Insider Trading Policy.
- (III) **Non-Solicitation.** You agree that you will not interfere with or disrupt or attempt to disrupt the Company’s business relationship with its customers or suppliers or solicit any of the employees of the Company to leave the employment of the Company.
- (IV) **Severance Agreement.** You shall enter into a severance agreement and general release with the company in the form designated by the Company which shall become effective in accordance with its terms no later than sixty (60) days following your termination.

Section 409A Compliance. This Agreement is intended to comply with, or otherwise be exempt from, Section 409A of the Internal Revenue Code (“Section 409A”). The Company and the Employee agree that they will execute any and all amendments to this Agreement as they mutually agree in good faith may be necessary to ensure compliance with the provisions of Section 409A. The preceding provisions, however, shall not be construed as a guarantee by the Company of any particular tax effect to the Employee under this Agreement.

For purposes of Section 409A, the right to a series of installment payments under this Agreement shall be treated as a right to a series of separate payments. With respect to any reimbursement of expenses of, or any provision of in-kind benefits to, the Employee, as specified under this Agreement, such reimbursement of expenses or provision of in-kind benefits shall be subject to the following conditions: (1) the expenses eligible for reimbursement or the amount of in-kind benefits provided in one taxable year shall not affect the expenses eligible for reimbursement or the amount of in-kind benefits provided in any other taxable year, except for any medical reimbursement arrangement providing for the reimbursement of expenses referred to in Section 105(b) of the Internal Revenue Code; (2) the reimbursement of an eligible expense shall be made no 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.

No amount payable pursuant to this Agreement which constitutes a “deferral of compensation” subject to Section 409A shall be paid unless and until the Employee first incurs a “separation from service” for purposes of Section 409A. Further, to the extent that the Employee is a “specified employee” (as defined in Section 409A) as of the date of Employee’s separation from service, no amount

that constitutes a deferral of compensation which is payable on account of Employee's separation from service shall be paid to Employee before the date (the "Delayed Payment Date") which is first day of the seventh month after the date of Employee's separation from service or, if earlier, the date of Employee'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.

Arbitration. You and the Company agree that any dispute arising under or in connection with this Agreement, including any dispute involving your 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. You 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. You 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 you or the Company may request a list of seven professional arbitrators from the American Arbitration Association or another mutually agreed service. You 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. You and company will attempt to cooperate in the discovery process before seeking the determination of the arbitrator. Except as otherwise determined by the arbitrator, you 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 you or the Company and shall apply the standards governing such motions under California law, unless the standards of another judicial forum supercede 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 will pay the arbitrator's expenses and fees, all meeting room charges and any other expenses that would not have been incurred if the case were litigated in the judicial forum having jurisdiction over it. 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. Employee's share of any filing, administration or similar fee shall be no more than the then current filing or other applicable fee in California Superior Court or, if applicable, other appropriate tribunal with jurisdiction.

Modification and Waiver of Breach. No waiver or modification of this Agreement shall be binding unless it is in writing signed by you and the Company. No waiver of a breach of this Agreement shall be deemed to constitute a waiver of a future breach, whether of a similar or dissimilar nature.

Notices. All notices and other communications required or permitted under this Agreement shall be in writing, served personally on, or mailed by nationally recognized express mail courier. Notices and other communications served by express mail courier shall be deemed given 72 hours after deposit with such express mail courier duly addressed to whom such notice or communication is to be given. In the case of (a) the Company, 5220 Las Virgenes Road, Calabasas, California 91302, Attention: General Counsel, or (b) to you, at the address of record provided by you to the Company's Human Resources department. Either party may change their address for purposes of this Section by giving written notice, in the manner stated herein. You agree to promptly update the Company's Human Resources department with any changes to your contact information.

Counterparts and Facsimile Signatures. This instrument may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same Agreement. The parties agree that a signature delivered by facsimile transmission will be treated in all respects as having the same effect as an original signature.

Construction of Agreement. This Agreement shall be construed in accordance with, and governed by, the internal laws of the State of California and both parties irrevocably agree to the exclusive jurisdiction and venue of the state and local courts of the County of Los Angeles, California.

Legal Fees. If any legal action, arbitration or other proceeding is brought for the enforcement of this Agreement, or because of any alleged dispute, breach, default or misrepresentation in connection with this Agreement, the successful or prevailing party shall be entitled to recover reasonable attorneys' fees and other costs it incurred in that action or proceeding, in addition to any other relief to which it may be entitled.

Severability Clause. If any provision of this Agreement or the application thereof is held invalid, the invalidity shall not affect other provisions or applications of the Agreement which can be given effect without the invalid provisions or applications and to this end the provisions of this Agreement are declared to be severable.

Complete Agreement. This instrument constitutes and contains the entire agreement and understanding concerning your employment and the other subject matters addressed in this Agreement between you and the Company, and supersedes and replaces all prior negotiations and all agreements proposed or otherwise, whether written or oral, concerning the subject matters hereof. This is an integrated document.

Third Party Beneficiaries. This Agreement does not create, and shall not be construed as creating, any rights enforceable by any person not a party to this Agreement, except as expressly contemplated herein.

Non-transferability of Interest. None of the rights of Employee to receive any form of compensation payable pursuant to this Agreement shall be assignable or transferable except through a testamentary disposition or by the laws of descent and distribution upon the death of Employee. Any attempted assignment, transfer, conveyance, or other disposition (other than as set forth herein) of any interest in the rights of Employee to receive any form of compensation to be made by the Company pursuant to this Agreement shall be void.

Other Agreements. A condition of employment with DTS is a signed Confidentiality and Non-Disclosure Agreement, Employee Invention Agreement, the DTS Worldwide Business Conduct Policy, and receiving satisfactory confirmation of an employee background check. Your failure to agree to these conditions and complete these documents in a timely manner may result in your termination for good

cause. You also understand and agree that, except as expressly provided in this Agreement, you are subject to all of the Company's general business and human resources policies and procedures as they presently exist or as they may exist in the future and failure to abide by such provisions may result in your termination for good cause. Provided, however, that the at-will status of employment may only be changed as provided below.

At-Will. By signing this letter, you understand and agree that your employment with DTS is "**at-will.**" Your employment with DTS is voluntarily entered into and we recognize you are free to resign at any time. Similarly, it is recognized that DTS is free to conclude an employment relationship at any time we feel is appropriate. While other terms of your employment may change with or without notice, this at-will relationship can be changed only in a written agreement signed by you and the Chairman and Chief Executive Officer of DTS.

Sincerely,

/s/ Jon E. Kirchner

Jon Kirchner
Chairman and Chief Executive Officer

/s/ Sharon K. Faltemier

Sharon Faltemier
Senior Vice President, Human Resources

Acceptance:

/s/ Frederick Kitson

Frederick Kitson

3-3-10

Date

AGREEMENT OF AT WILL EMPLOYMENT

I understand and agree that my employment with DTS is on an **at-will** basis. This means that either DTS or I or may terminate the employment relationship at any time at their sole discretion without cause.

I further understand that while other personnel policies, procedures, and benefits of DTS may change from time to time in DTS's discretion, this at-will employment relationship can only be changed by an express written employment agreement signed by me and an officer of DTS.

Frederick Kitson

<u>/s/ Frederick Kitson</u>	<u>3-3-10</u>
Frederick Kitson Signature	Date

**2003 EQUITY INCENTIVE PLAN
OF
DTS, INC.**

1. Purpose of this Plan

The purpose of this 2003 Equity Incentive Plan is to enhance the long-term stockholder value of DTS, Inc. by offering opportunities to eligible individuals to participate in the growth in value of the equity of DTS, Inc.

2. Definitions and Rules of Interpretation

2.1 Definitions

This Plan uses the following defined terms:

(a) **“Administrator”** means the Board, the Committee, or any officer or employee of the Company to whom the Board or the Committee delegates authority to administer this Plan.

(b) **“Affiliate”** means a “parent” or “subsidiary” (as each is defined in Section 424 of the Code) of the Company and any other entity that the Board or Committee designates as an “Affiliate” for purposes of this Plan.

(c) **“Applicable Law”** means any and all laws of whatever jurisdiction, within or without the United States, and the rules of any stock exchange or quotation system on which Shares are listed or quoted, applicable to the taking or refraining from taking of any action under this Plan, including the administration of this Plan and the issuance or transfer of Awards or Award Shares.

(d) **“Award”** means a Stock Award, SAR, Cash Award, or Option granted in accordance with the terms of this Plan.

(e) **“Award Agreement”** means the document evidencing the grant of an Award.

(f) **“Award Shares”** means Shares covered by an outstanding Award or purchased under an Award.

(g) **“Awardee”** means: (i) a person to whom an Award has been granted, including a holder of a Substitute Award, (ii) a person to whom an Award has been transferred in accordance with all applicable requirements of Sections 6.5, 7(h), and 17.

(h) **“Board”** means the Board of Directors of the Company.

(i) **“Cash Award”** means the right to receive cash as described in Section 8.3.

(j) **“Change in Control”** means any transaction or event that the Board specifies as a Change in Control under Section 10.4.

(k) **“Code”** means the Internal Revenue Code of 1986.

(l) **“Committee”** means a committee composed of Company Directors appointed in accordance with the Company’s charter documents and Section 4.

(m) **“Company”** means DTS, Inc., a Delaware corporation.

(n) **“Company Director”** means a member of the Board.

(o) **“Consultant”** means an individual who, or an employee of any entity that, provides bona fide services to the Company or an Affiliate not in connection with the offer or sale of securities in a capital-raising transaction, but who is not an Employee.

- (p) **“Director”** means a member of the Board of Directors of the Company or an Affiliate.
- (q) **“Divestiture”** means any transaction or event that the Board specifies as a Divestiture under Section 10.5.
- (r) **“Domestic Relations Order”** means a “domestic relations order” as defined in, and otherwise meeting the requirements of, Section 414(p) of the Code, except that reference to a “plan” in that definition shall be to this Plan.
- (s) **“Effective Date”** means the first date of the sale by the Company of shares of its capital stock in an initial public offering pursuant to a registration statement on Form S-1 filed with the SEC.
- (t) **“Employee”** means a regular employee of the Company or an Affiliate, including an officer or Director, who is treated as an employee in the personnel records of the Company or an Affiliate, but not individuals who are classified by the Company or an Affiliate as: (i) leased from or otherwise employed by a third party, (ii) independent contractors, or (iii) intermittent or temporary workers. The Company’s or an Affiliate’s classification of an individual as an “Employee” (or as not an “Employee”) for purposes of this Plan shall not be altered retroactively even if that classification is changed retroactively for another purpose as a result of an audit, litigation or otherwise. An Awardee shall not cease to be an Employee due to transfers between locations of the Company, or between the Company and an Affiliate, or to any successor to the Company or an Affiliate that assumes the Awardee’s Options under Section 10. Neither service as a Director nor receipt of a director’s fee shall be sufficient to make a Director an “Employee”.
- (u) **“Exchange Act”** means the Securities Exchange Act of 1934.
- (v) **“Executive”** means, if the Company has any class of any equity security registered under Section 12 of the Exchange Act, an individual who is subject to Section 16 of the Exchange Act or who is a “covered employee” under Section 162(m) of the Code, in either case because of the individual’s relationship with the Company or an Affiliate. If the Company does not have any class of any equity security registered under Section 12 of the Exchange Act, “Executive” means any (i) Director, (ii) officer elected or appointed by the Board, or (iii) beneficial owner of more than 10% of any class of the Company’s equity securities.
- (w) **“Expiration Date”** means, with respect to an Award, the date stated in the Award Agreement as the expiration date of the Award or, if no such date is stated in the Award Agreement, then the last day of the maximum exercise period for the Award, disregarding the effect of an Awardee’s Termination or any other event that would shorten that period.
- (x) **“Fair Market Value”** means the value of Shares as determined under Section 18.2.
- (y) **“Fundamental Transaction”** means any transaction or event described in Section 10.3.
- (z) **“Grant Date”** means the date the Administrator approves the grant of an Award. However, if the Administrator specifies that an Award’s Grant Date is a future date or the date on which a condition is satisfied, the Grant Date for such Award is that future date or the date that the condition is satisfied.
- (aa) **“Incentive Stock Option”** means an Option intended to qualify as an incentive stock option under Section 422 of the Code and designated as an Incentive Stock Option in the Award Agreement for that Option.
- (bb) **“Nonstatutory Option”** means any Option other than an Incentive Stock Option.
- (cc) **“Non-Employee Director”** means any person who is a member of the Board but is not an Employee of the Company or any Affiliate of the Company and has not been an Employee of the Company or any Affiliate of the Company at any time during the preceding twelve months. Service as a Director does not in itself constitute employment for purposes of this definition.
- (dd) **“Objectively Determinable Performance Condition”** shall mean a performance condition (i) that is established (A) at the time an Award is granted or (B) no later than the earlier of (1) 90 days after the beginning of the period of service to which it relates, or (2) before the elapse of 25% of the period of service to which it relates, (ii) that is uncertain of achievement at the time it is established, and (iii) the achievement of which is determinable by a third party with knowledge of the relevant facts. Examples of measures that may be used in Objectively Determinable Performance Conditions include net order dollars, net profit dollars, net profit growth, net revenue dollars, revenue growth, individual performance, earnings per share, return on assets, return on equity, and other financial objectives, objective customer
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satisfaction indicators and efficiency measures, each with respect to the Company and/or an Affiliate or individual business unit.

(ee) **“Officer”** means an officer of the Company as defined in Rule 16a-1 adopted under the Exchange Act.

(ff) **“Option”** means a right to purchase Shares of the Company granted under this Plan.

(gg) **“Option Price”** means the price payable under an Option for Shares, not including any amount payable in respect of withholding or other taxes.

(hh) **“Option Shares”** means Shares covered by an outstanding Option or purchased under an Option.

(ii) **“Plan”** means this 2003 Equity Incentive Plan of DTS, Inc.

(jj) **“Prior Plans”** means the Company’s 1997 Stock Option Plan and the 2002 Stock Option Plan in effect.

(kk) **“Purchase Price”** means the price payable under a Stock Award for Shares, not including any amount payable in respect of withholding or other taxes.

(ll) **“Rule 16b-3”** means Rule 16b-3 adopted under Section 16(b) of the Exchange Act.

(mm) **“SAR” or “Stock Appreciation Right”** means a right to receive cash based on a change in the Fair Market Value of a specific number of Shares pursuant to an Award Agreement, as described in Section 8.1.

(nn) **“Securities Act”** means the Securities Act of 1933.

(oo) **“Share”** means a share of the common stock of the Company or other securities substituted for the common stock under Section 10.

(pp) **“Stock Award”** means an offer by the Company to sell shares subject to certain restrictions pursuant to the Award Agreement as described in Section 8.2.

(qq) **“Substitute Award”** means a Substitute Option, Substitute SAR or Substitute Stock Award granted in accordance with the terms of this Plan.

(rr) **“Substitute Option”** means an Option granted in substitution for, or upon the conversion of, an option granted by another entity to purchase equity securities in the granting entity.

(ss) **“Substitute SAR”** means a SAR granted in substitution for, or upon the conversion of, a stock appreciation right granted by another entity with respect to equity securities in the granting entity.

(tt) **“Substitute Stock Award”** means a Stock Award granted in substitution for, or upon the conversion of, a stock award granted by another entity to purchase equity securities in the granting entity.

(uu) **“Termination”** means that the Awardee has ceased to be, with or without any cause or reason, an Employee, Director or Consultant. However, unless so determined by the Administrator, or otherwise provided in this Plan, “Termination” shall not include a change in status from an Employee, Consultant or Director to another such status. An event that causes an Affiliate to cease being an Affiliate shall be treated as the “Termination” of that Affiliate’s Employees, Directors, and Consultants.

2.2 Rules of Interpretation

Any reference to a “Section,” without more, is to a Section of this Plan. Captions and titles are used for convenience in this Plan and shall not, by themselves, determine the meaning of this Plan. Except when otherwise indicated by the context, the singular includes the plural and vice versa. Any reference to a statute is also a reference to the applicable rules and regulations adopted under that statute. Any reference to a statute, rule or regulation, or to a section of a statute, rule or regulation, is a reference to that statute, rule, regulation, or section as amended from time to time, both before and after the Effective Date and including any successor provisions.

3. Shares Subject to this Plan; Term of this Plan

3.1 Number of Award Shares

The Shares issuable under this Plan shall be authorized but unissued or reacquired Shares, including Shares repurchased by the Company on the open market. The number of Shares initially reserved for issuance over the term of this Plan shall not exceed 3,000,000 Shares. Such reserve shall consist of (i) the number of Shares available for issuance, as of the Effective Date, under the Prior Plans as last approved by the Company's stockholders, including the Shares subject to outstanding options under the Prior Plans, plus (ii) those Shares issued under the Prior Plans that are forfeited or repurchased by the Company or that are issuable upon exercise of options granted pursuant to the Prior Plans that expire or become unexercisable for any reason without having been exercised in full after the Effective Date, plus (iii) an additional increase of approximately 928,949 Shares to be approved by the Company's stockholders prior to the Effective Date. The maximum number of Shares shall be cumulatively increased on the first January 1 after the Effective Date and each January 1 thereafter for 10 years, by a number of Shares equal to the least of (a) 4% of the number of Shares issued and outstanding on the immediately preceding December 31, (b) 1,500,000 Shares, and (c) a number of Shares set by the Board. When an Award is granted, the maximum number of Shares that may be issued under this Plan shall be reduced by the number of Shares covered by that Award. However, if an Award later terminates or expires without having been exercised in full, the maximum number of shares that may be issued under this Plan shall be increased by the number of Shares that were covered by, but not purchased under, that Award. By contrast, the repurchase of Shares by the Company shall not increase the maximum number of Shares that may be issued under this Plan. Notwithstanding anything in this Plan to the contrary, at no time during the eighteen (18) months following the Effective Date may the sum of the number of Shares subject to Awards under this Plan and the number of Shares subject to options under the Prior Plans exceed 15% of the outstanding Shares on a "fully diluted" basis. For the purposes of this Section 3.1, outstanding Shares on a "fully diluted" basis shall be the number of Shares that is equal to (x) the number of Shares issued and outstanding plus (y) all Shares subject to or available for Awards or options under this Plan and the Prior Plans, respectively, and 50% of the Shares then issuable upon the exercise of warrants that were outstanding on the Effective Date of the Plan.

3.2 Source of Shares

Award Shares may be: (a) Shares that have never been issued, (b) Shares that have been issued but are no longer outstanding, or (c) Shares that are outstanding and are acquired to discharge the Company's obligation to deliver Award Shares.

3.3 Term of this Plan

(a) This Plan shall be effective on, and Awards may be granted under this Plan on and after, the earliest the date on which the Plan has been both adopted by the Board and approved by the Company's stockholders.

(b) Subject to the provisions of Section 14, Awards may be granted under this Plan for a period of ten years from the earlier of the date on which the Board approves this Plan and the date the Company's stockholders approve this Plan. Accordingly, Awards may not be granted under this Plan after the earlier of those dates.

4. Administration

4.1 General

(a) The Board shall have ultimate responsibility for administering this Plan. The Board may delegate certain of its responsibilities to a Committee, which shall consist of at least two members of the Board. The Board or the Committee may further delegate its responsibilities to any Employee of the Company or any Affiliate. Where this Plan specifies that an action is to be taken or a determination made by the Board, only the Board may take that action or make that determination. Where this Plan specifies that an action is to be taken or a determination made by the Committee, only the Committee may take that action or make that determination. Where this Plan references the "Administrator," the action may be taken or determination made by the Board, the Committee, or other Administrator. However, only the Board or the Committee may approve grants of Awards to Executives, and an Administrator other than the Board or the Committee may grant Awards only within guidelines established by the Board or Committee. Moreover, all actions and determinations by any Administrator are subject to the provisions of this Plan.

(b) So long as the Company has registered and outstanding a class of equity securities under Section 12 of

the Exchange Act, the Committee shall consist of Company Directors who are “Non-Employee Directors” as defined in Rule 16b-3 and, after the expiration of any transition period permitted by Treasury Regulations Section 1.162-27(h)(3), who are “outside directors” as defined in Section 162(m) of the Code.

4.2 Authority of the Board or the Committee

Subject to the other provisions of this Plan, the Board or the Committee shall have the authority to:

- (a) grant Awards, including Substitute Awards;
- (b) determine the Fair Market Value of Shares;
- (c) determine the Option Price and the Purchase Price of Awards;
- (d) select the Awardees;
- (e) determine the times Awards are granted;
- (f) determine the number of Shares subject to each Award;
- (g) determine the methods of payment that may be used to purchase Award Shares;
- (h) determine the methods of payment that may be used to satisfy withholding tax obligations;
- (i) determine the other terms of each Award, including but not limited to the time or times at which Awards may be exercised, whether and under what conditions an Award is assignable, and whether an Option is a Nonstatutory Option or an Incentive Stock Option;
- (j) modify or amend any Award;
- (k) authorize any person to sign any Award Agreement or other document related to this Plan on behalf of the Company;
- (l) determine the form of any Award Agreement or other document related to this Plan, and whether that document, including signatures, may be in electronic form;
- (m) interpret this Plan and any Award Agreement or document related to this Plan;
- (n) correct any defect, remedy any omission, or reconcile any inconsistency in this Plan, any Award Agreement or any other document related to this Plan;
- (o) adopt, amend, and revoke rules and regulations under this Plan, including rules and regulations relating to sub-plans and Plan addenda;
- (p) adopt, amend, and revoke special rules and procedures which may be inconsistent with the terms of this Plan, set forth (if the Administrator so chooses) in sub-plans regarding (for example) the operation and administration of this Plan and the terms of Awards, if and to the extent necessary or useful to accommodate non-U.S. Applicable Laws and practices as they apply to Awards and Award Shares held by, or granted or issued to, persons working or resident outside of the United States or employed by Affiliates incorporated outside the United States;
- (q) determine whether a transaction or event should be treated as a Change in Control, a Divestiture or neither;
- (r) determine the effect of a Fundamental Transaction and, if the Board determines that a transaction or event should be treated as a Change in Control or a Divestiture, then the effect of that Change in Control or Divestiture; and
- (s) make all other determinations the Administrator deems necessary or advisable for the administration of this Plan.

4.3 Scope of Discretion

Subject to the provisions of this Section 4.3, on all matters for which this Plan confers the authority, right or power on the Board, the Committee, or other Administrator to make decisions, that body may make those decisions in its sole and absolute discretion. Those decisions will be final, binding and conclusive. In making its decisions, the Board, Committee or other Administrator need not treat all persons eligible to receive Awards, all Awardees, all Awards or all Award Shares the same way. Notwithstanding anything herein to the contrary, and except as provided in Section 14.3, the discretion of the Board, Committee or other Administrator is subject to the specific provisions and specific limitations of this Plan, as well as all rights conferred on specific Awardees by Award Agreements and other agreements.

5. Persons Eligible to Receive Awards

5.1 Eligible Individuals

Awards (including Substitute Awards) may be granted to, and only to, Employees, Directors and Consultants, including to prospective Employees, Directors and Consultants conditioned on the beginning of their service for the Company or an Affiliate. However, Incentive Stock Options may only be granted to Employees, as provided in Section 7(g).

5.2 Section 162(m) Limitation

(a) **Options and SARs** Subject to the provisions of this Section 5.2, for so long as the Company is a “publicly held corporation” within the meaning of Section 162(m) of the Code: (i) no Employee may be granted one or more SARs and Options within any fiscal year of the Company under this Plan to purchase more than 1,500,000 Shares under Options or to receive compensation calculated with reference to more than that number of Shares under SARs, subject to adjustment pursuant to Section 10, (ii) Options and SARs may be granted to an Executive only by the Committee (and, notwithstanding anything to the contrary in Section 4.1(a), not by the Board). If an Option or SAR is cancelled without being exercised or if the Option Price of an Option is reduced, that cancelled or repriced Option or SAR shall continue to be counted against the limit on Awards that may be granted to any individual under this Section 5.2. Notwithstanding anything herein to the contrary, a new Employee of the Company or an Affiliate shall be eligible to receive up to a maximum of 2,000,000 Shares under Options in the calendar year in which they commence employment, or such compensation calculated with reference to such number of Shares under SARs, subject to adjustment pursuant to Section 10.

(b) **Cash Awards and Stock Awards** Any Cash Award or Stock Award intended as “qualified performance-based compensation” within the meaning of Section 162(m) of the Code must vest or become exercisable contingent on the achievement of one or more Objectively Determinable Performance Conditions. The Committee shall have the discretion to determine the time and manner of compliance with Section 162(m) of the Code.

6. Terms and Conditions of Option

The following rules apply to all Options:

6.1 Price

No Nonstatutory Option may have an Option Price less than 85% of the Fair Market Value of the Shares on the Grant Date. No Option intended as “qualified incentive-based compensation” within the meaning of Section 162(m) of the Code may have an Option Price less than 100% of the Fair Market Value of the Shares on the Grant Date. In no event will the Option Price of any Option be less than the par value of the Shares issuable under the Option if that is required by Applicable Law. The Option Price of an Incentive Stock Option shall be subject to Section 7(f).

6.2 Term

No Option shall be exercisable after its Expiration Date. No Option may have an Expiration Date that is more than ten years after its Grant Date. Additional provisions regarding the term of Incentive Stock Options are provided in Sections 7(a) and 7(e).

6.3 Vesting

Options shall be exercisable: (a) on the Grant Date, or (b) in accordance with a schedule related to the Grant Date, the date the Optionee’s directorship, employment or consultancy begins, or a different date specified in the Option

Agreement. Additional provisions regarding the vesting of Incentive Stock Options are provided in Section 7(c). No Option granted to an individual who is subject to the overtime pay provisions of the Fair Labor Standards Act may be exercised before the expiration of six months after the Grant Date.

6.4 Form and Method of Payment

- (a) The Board or Committee shall determine the acceptable form and method of payment for exercising an Option.
- (b) Acceptable forms of payment for all Option Shares are cash, check or wire transfer, denominated in U.S. dollars except as specified by the Administrator for non-U.S. Employees or non-U.S. sub-plans.
- (c) In addition, the Administrator may permit payment to be made by any of the following methods:
 - (i) other Shares, or the designation of other Shares, which (A) are “mature” shares for purposes of avoiding variable accounting treatment under generally accepted accounting principles (generally mature shares are those that have been owned by the Optionee for more than six months on the date of surrender), and (B) have a Fair Market Value on the date of surrender equal to the Option Price of the Shares as to which the Option is being exercised;
 - (ii) provided that a public market exists for the Shares, consideration received by the Company under a procedure under which a licensed broker-dealer advances funds on behalf of an Optionee or sells Option Shares on behalf of an Optionee (a “*Cashless Exercise Procedure*”), provided that if the Company extends or arranges for the extension of credit to an Optionee under any Cashless Exercise Procedure, no Officer or Director may participate in that Cashless Exercise Procedure;
 - (iii) with respect only to Optionees who are neither Officers nor Directors as of the date of exercise, one or more promissory notes meeting the requirements of Section 6.4(e) provided, however, that promissory notes may not be used for any portion of an Award which is not vested at the time of exercise;
 - (iv) cancellation of any debt owed by the Company or any Affiliate to the Optionee by the Company including without limitation waiver of compensation due or accrued for services previously rendered to the Company; and
 - (v) any combination of the methods of payment permitted by any paragraph of this Section 6.4.
- (d) The Administrator may also permit any other form or method of payment for Option Shares permitted by Applicable Law.
- (e) The promissory notes referred to in Section 6.4(c)(iii) shall be full recourse. Unless the Committee specifies otherwise after taking into account any relevant accounting issues, the promissory notes shall bear interest at a fair market value rate when the Option is exercised. Interest on the promissory notes shall also be at least sufficient to avoid imputation of interest under Sections 483, 1274, and 7872 of the Code. The promissory notes and their administration shall at all times comply with any applicable margin rules of the Federal Reserve. The promissory notes may also include such other terms as the Administrator specifies. Payment may not be made by promissory note by Officers or Directors if Shares are registered under Section 12 of the Exchange Act.

6.5 Nonassignability of Options

Except as determined by the Administrator, no Option shall be assignable or otherwise transferable by the Optionee except by will or by the laws of descent and distribution. However, Options may be transferred and exercised in accordance with a Domestic Relations Order and may be exercised by a guardian or conservator appointed to act for the Optionee. Incentive Stock Options may only be assigned in compliance with Section 7(h).

6.6 Substitute Options

The Board may cause the Company to grant Substitute Options in connection with the acquisition by the Company or an Affiliate of equity securities of any entity (including by merger, tender offer, or other similar transaction) or of all or a portion of the assets of any entity. Any such substitution shall be effective on the effective date of the acquisition. Substitute Options may be Nonstatutory Options or Incentive Stock Options. Unless and to the extent specified otherwise by

the Board, Substitute Options shall have the same terms and conditions as the options they replace, except that (subject to the provisions of Section 10) Substitute Options shall be Options to purchase Shares rather than equity securities of the granting entity and shall have an Option Price determined by the Board.

6.7 Repricings

In furtherance of, and not in limitation of the provisions of Section 10, Options may be repriced, replaced or regranted through cancellation or modification without stockholder approval.

7. Incentive Stock Options

The following rules apply only to Incentive Stock Options and only to the extent these rules are more restrictive than the rules that would otherwise apply under this Plan. With the consent of the Optionee, or where this Plan provides that an action may be taken notwithstanding any other provision of this Plan, the Administrator may deviate from the requirements of this Section, notwithstanding that any Incentive Stock Option modified by the Administrator will thereafter be treated as a Nonstatutory Option.

(a) The Expiration Date of an Incentive Stock Option shall not be later than ten years from its Grant Date, with the result that no Incentive Stock Option may be exercised after the expiration of ten years from its Grant Date.

(b) No Incentive Stock Option may be granted more than ten years from the date this Plan was approved by the Board.

(c) Options intended to be incentive stock options under Section 422 of the Code that are granted to any single Optionee under all incentive stock option plans of the Company and its Affiliates, including incentive stock options granted under this Plan, may not vest at a rate of more than \$100,000 in Fair Market Value of stock (measured on the grant dates of the options) during any calendar year. For this purpose, an option vests with respect to a given share of stock the first time its holder may purchase that share, notwithstanding any right of the Company to repurchase that share. Unless the administrator of that option plan specifies otherwise in the related agreement governing the option, this vesting limitation shall be applied by, to the extent necessary to satisfy this \$100,000 rule, treating certain stock options that were intended to be incentive stock options under Section 422 of the Code as Nonstatutory Options. The stock options or portions of stock options to be reclassified as Nonstatutory Options are those with the highest option prices, whether granted under this Plan or any other equity compensation plan of the Company or any Affiliate that permits that treatment. This Section 7(c) shall not cause an Incentive Stock Option to vest before its original vesting date or cause an Incentive Stock Option that has already vested to cease to be vested.

(d) In order for an Incentive Stock Option to be exercised for any form of payment other than those described in Section 6.4(b), that right must be stated at the time of grant in the Option Agreement relating to that Incentive Stock Option.

(e) Any Incentive Stock Option granted to a Ten Percent Stockholder, must have an Expiration Date that is not later than five years from its Grant Date, with the result that no such Option may be exercised after the expiration of five years from the Grant Date. A “**Ten Percent Stockholder**” is any person who, directly or by attribution under Section 424(d) of the Code, owns stock possessing more than ten percent of the total combined voting power of all classes of stock of the Company or of any Affiliate on the Grant Date.

(f) The Option Price of an Incentive Stock Option shall never be less than the Fair Market Value of the Shares at the Grant Date. The Option Price for the Shares covered by an Incentive Stock Option granted to a Ten Percent Stockholder shall never be less than 110% of the Fair Market Value of the Shares at the Grant Date.

(g) Incentive Stock Options may be granted only to Employees. If an Optionee changes status from an Employee to a Consultant, that Optionee’s Incentive Stock Options become Nonstatutory Options if not exercised within the time period described in Section 7(i) (determined by treating that change in status as a Termination solely for purposes of this Section 7(g)).

(h) No rights under an Incentive Stock Option may be transferred by the Optionee, other than by will or the laws of descent and distribution. During the life of the Optionee, an Incentive Stock Option may be exercised only by the Optionee. The Company’s compliance with a Domestic Relations Order, or the exercise of an Incentive Stock Option

by a guardian or conservator appointed to act for the Optionee, shall not violate this Section 7(h).

(i) An Incentive Stock Option shall be treated as a Nonstatutory Option if it remains exercisable after, and is not exercised within, the three-month period beginning with the Optionee's Termination for any reason other than the Optionee's death or disability (as defined in Section 22(e) of the Code). In the case of Termination due to death, an Incentive Stock Option shall continue to be treated as an Incentive Stock Option if it remains exercisable after, and is not exercised within, the three-month period after the Optionee's Termination provided it is exercised before the Expiration Date. In the case of Termination due to disability, an Incentive Stock Option shall be treated as a Nonstatutory Option if it remains exercisable after, and is not exercised within, one year after the Optionee's Termination.

(j) An Incentive Stock Option may only be modified by the Board.

8. Stock Appreciation Rights, Stock Awards and Cash Awards

8.1 Stock Appreciation Rights

The following rules apply to SARs:

(a) **General.** SARs may be granted either alone, in addition to, or in tandem with other Awards granted under this Plan. The Administrator may grant SARs to eligible participants subject to terms and conditions not inconsistent with this Plan and determined by the Administrator. The specific terms and conditions applicable to the Awardee shall be provided for in the Award Agreement. SARs shall be exercisable, in whole or in part, at such times as the Administrator shall specify in the Award Agreement. The grant or vesting of a SAR may be made contingent on the achievement of Objectively Determinable Performance Conditions.

(b) **Exercise of SARs.** Upon the exercise of an SAR, in whole or in part, an Awardee shall be entitled to a payment in an amount equal to the excess of the Fair Market Value of a fixed number of Shares covered by the exercised portion of the SAR on the date of exercise, over the Fair Market Value of the Shares covered by the exercised portion of the SAR on the Grant Date. The amount due to the Awardee upon the exercise of a SAR shall be paid in cash, Shares or a combination thereof, over the period or periods specified in the Award Agreement. An Award Agreement may place limits on the amount that may be paid over any specified period or periods upon the exercise of a SAR, on an aggregate basis or as to any Awardee. A SAR shall be considered exercised when the Company receives written notice of exercise in accordance with the terms of the Award Agreement from the person entitled to exercise the SAR. If a SAR has been granted in tandem with an Option, upon the exercise of the SAR, the number of shares that may be purchased pursuant to the Option shall be reduced by the number of shares with respect to which the SAR is exercised.

(c) **Nonassignability of SARs.** Except as determined by the Administrator, no SAR shall be assignable or otherwise transferable by the Awardee except by will or by the laws of descent and distribution. Notwithstanding anything herein to the contrary, SARs may be transferred and exercised in accordance with a Domestic Relations Order.

(d) **Substitute SARs.** The Board may cause the Company to grant Substitute SARs in connection with the acquisition by the Company or an Affiliate of equity securities of any entity (including by merger) or all or a portion of the assets of any entity. Any such substitution shall be effective on the effective date of the acquisition. Unless and to the extent specified otherwise by the Board, Substitute SARs shall have the same terms and conditions as the options they replace, except that (subject to the provisions of Section 10) Substitute SARs shall be exercisable with respect to the Fair Market Value of Shares rather than equity securities of the granting entity and shall be on terms that, as determined by the Board in its sole and absolute discretion, properly reflects the substitution.

(e) **Repricing.** A SAR may be repriced, replaced or regranted, through cancellation or modification without stockholder approval.

8.2 Stock Awards

The following rules apply to all Stock Awards:

(a) **General.** The specific terms and conditions of a Stock Award applicable to the Awardee shall be provided for in the Award Agreement. The Award Agreement shall state the number of Shares that the Awardee shall be entitled to receive or purchase, the terms and conditions on which the Shares shall vest, the price to be paid and, if applicable,

the time within which the Awardee must accept such offer. The offer shall be accepted by execution of the Award Agreement. The Administrator may require that all Shares subject to a right of repurchase or risk of forfeiture be held in escrow until such repurchase right or risk of forfeiture lapses. The grant or vesting of a Stock Award may be made contingent on the achievement of Objectively Determinable Performance Conditions.

(b) **Right of Repurchase.** If so provided in the Award Agreement, Award Shares acquired pursuant to a Stock Award may be subject to repurchase by the Company or an Affiliate if not vested in accordance with the Award Agreement.

(c) **Form of Payment.** The Administrator shall determine the acceptable form and method of payment for exercising a Stock Award. Acceptable forms of payment for all Award Shares are cash, check or wire transfer, denominated in U.S. dollars except as specified by the Administrator for non-U.S. Employees or non-U.S. sub-plans. In addition, the Administrator may permit payment to be made by any of the methods permitted with respect to the exercise of Options pursuant to Section 6.4.

(d) **Nonassignability of Stock Awards.** Except as determined by the Administrator, no Stock Award shall be assignable or otherwise transferable by the Awardee except by will or by the laws of descent and distribution. Notwithstanding anything to the contrary herein, Stock Awards may be transferred and exercised in accordance with a Domestic Relations Order.

(e) **Substitute Stock Award.** The Board may cause the Company to grant Substitute Stock Awards in connection with the acquisition by the Company or an Affiliate of equity securities of any entity (including by merger) or all or a portion of the assets of any entity. Unless and to the extent specified otherwise by the Board, Substitute Stock Awards shall have the same terms and conditions as the stock awards they replace, except that (subject to the provisions of Section 10) Substitute Stock Awards shall be Stock Awards to purchase Shares rather than equity securities of the granting entity and shall have a Purchase Price that, as determined by the Board in its sole and absolute discretion, properly reflects the substitution. Any such Substituted Stock Award shall be effective on the effective date of the acquisition.

8.3 Cash Awards

The following rules apply to all Cash Awards:

Cash Awards may be granted either alone, in addition to, or in tandem with other Awards granted under this Plan. After the Administrator determines that it will offer a Cash Award, it shall advise the Awardee, by means of an Award Agreement, of the terms, conditions and restrictions related to the Cash Award.

9. Exercise of Awards

9.1 In General

An Award shall be exercisable in accordance with this Plan and the Award Agreement under which it is granted.

9.2 Time of Exercise

Options and Stock Awards shall be considered exercised when the Company receives: (a) written notice of exercise from the person entitled to exercise the Option or Stock Award, (b) full payment, or provision for payment, in a form and method approved by the Administrator, for the Shares for which the Option or Stock Award is being exercised, and (c) with respect to Nonstatutory Options, payment, or provision for payment, in a form approved by the Administrator, of all applicable withholding taxes due upon exercise. An Award may not be exercised for a fraction of a Share. SARs shall be considered exercised when the Company receives written notice of the exercise from the person entitled to exercise the SAR.

9.3 Issuance of Award Shares

The Company shall issue Award Shares in the name of the person properly exercising the Award. If the Awardee is that person and so requests, the Award Shares shall be issued in the name of the Awardee and the Awardee's spouse. The Company shall endeavor to issue Award Shares promptly after an Award is exercised or after the Grant Date of a Stock Award, as applicable. Until Award Shares are actually issued, as evidenced by the appropriate entry on the stock

register of the Company or its transfer agent, the Awardee will not have the rights of a stockholder with respect to those Award Shares, even though the Awardee has completed all the steps necessary to exercise the Award. No adjustment shall be made for any dividend, distribution, or other right for which the record date precedes the date the Award Shares are issued, except as provided in Section 10.

9.4 Termination

(a) **In General** Except as provided in an Award Agreement or in writing by the Administrator, including in an Award Agreement, and as otherwise provided in Sections 9.4(b), (c), (d) and (e) after an Awardee's Termination, the Awardee's Awards shall be exercisable to the extent (but only to the extent) they are vested on the date of that Termination and only during the three months after the Termination, but in no event after the Expiration Date. To the extent the Awardee does not exercise an Award within the time specified for exercise, the Award shall automatically terminate.

(b) **Leaves of Absence** Unless otherwise provided in the Award Agreement, no Award may be exercised more than three months after the beginning of a leave of absence, other than a personal or medical leave approved by an authorized representative of the Company with employment guaranteed upon return. Awards shall not continue to vest during a leave of absence, unless otherwise determined by the Administrator with respect to an approved personal or medical leave with employment guaranteed upon return.

(c) **Death or Disability** Unless otherwise provided by the Administrator, if an Awardee's Termination is due to death or disability (as determined by the Administrator with respect to all Awards other than Incentive Stock Options and as defined by Section 22(e) of the Code with respect to Incentive Stock Options), all Awards of that Awardee to the extent exercisable at the date of that Termination may be exercised for one year after that Termination, but in no event after the Expiration Date. In the case of Termination due to death, an Award may be exercised as provided in Section 17. In the case of Termination due to disability, if a guardian or conservator has been appointed to act for the Awardee and been granted this authority as part of that appointment, that guardian or conservator may exercise the Award on behalf of the Awardee. Death or disability occurring after an Awardee's Termination shall not cause the Termination to be treated as having occurred due to death or disability. To the extent an Award is not so exercised within the time specified for its exercise, the Award shall automatically terminate.

(d) **Divestiture** If an Awardee's Termination is due to a Divestiture, the Board may take any one or more of the actions described in Section 10.3 or 10.4 with respect to the Awardee's Awards.

(e) **Termination for Cause** In the discretion of the Administrator, which may be exercised on the date of grant, or at a date later in time, if an Awardee's Termination is due to Cause, all of the Awardee's Awards shall automatically terminate and cease to be exercisable at the time of Termination and the Administrator may rescind any and all exercises of Awards by the Awardee that occurred after the first event constituting Cause. "Cause" means employment-related dishonesty, fraud, misconduct or disclosure or misuse of confidential information, or other employment-related conduct that is likely to cause significant injury to the Company, an Affiliate, or any of their respective employees, officers or directors (including, without limitation, commission of a felony or similar offense), in each case as determined by the Administrator. "Cause" shall not require that a civil judgment or criminal conviction have been entered against or guilty plea shall have been made by the Awardee regarding any of the matters referred to in the previous sentence. Accordingly, the Administrator shall be entitled to determine "Cause" based on the Administrator's good faith belief. If the Awardee is criminally charged with a felony or similar offense, that shall be a sufficient, but not a necessary, basis for such a belief.

(f) **Administrator Discretion** Notwithstanding the provisions of Section 9.4 (a)-(e), the Plan Administrator shall have complete discretion, exercisable either at the time an Award is granted or at any time while the Award remains outstanding, to:

(i) Extend the period of time for which the Award is to remain exercisable, following the Awardee's Termination, from the limited exercise period otherwise in effect for that Award to such greater period of time as the Administrator shall deem appropriate, but in no event beyond the Expiration Date; and/or

(ii) Permit the Award to be exercised, during the applicable post-Termination exercise period, not only with respect to the number of vested Shares for which such Award may be exercisable at the time of the Awardee's Termination but also with respect to one or more additional installments in which the Awardee would have vested had the Awardee not been subject to Termination.

(g) **Consulting or Employment Relationship** Nothing in this Plan or in any Award Agreement, and no Award or the fact that Award Shares remain subject to repurchase rights, shall: (A) interfere with or limit the right of the Company or any Affiliate to terminate the employment or consultancy of any Awardee at any time, whether with or without cause or reason, and with or without the payment of severance or any other compensation or payment, or (B) interfere with the application of any provision in any of the Company's or any Affiliate's charter documents or Applicable Law relating to the election, appointment, term of office,

or removal of a Director.

10. Certain Transactions and Events

10.1 In General

Except as provided in this Section 10, no change in the capital structure of the Company, merger, sale or other disposition of assets or a subsidiary, change in control, issuance by the Company of shares of any class of securities or securities convertible into shares of any class of securities, exchange or conversion of securities, or other transaction or event shall require or be the occasion for any adjustments of the type described in this Section 10. Additional provisions with respect to the foregoing transactions are set forth in Section 14.3.

10.2 Changes in Capital Structure

In the event of any stock split, reverse stock split, recapitalization, combination or reclassification of stock, stock dividend, spin-off, or similar change to the capital structure of the Company (not including a Fundamental Transaction or Change in Control), the Board shall make whatever adjustments it concludes are appropriate to: (a) the number and type of Awards that may be granted under this Plan, (b) the number and type of Options that may be granted to any individual under this Plan, (c) the terms of any SAR, (d) the Purchase Price of any Stock Award, (e) the Option Price and number and class of securities issuable under each outstanding Option, and (f) the repurchase price of any securities substituted for Award Shares that are subject to repurchase rights. The specific adjustments shall be determined by the Board. Unless the Board specifies otherwise, any securities issuable as a result of any such adjustment shall be rounded down to the next lower whole security. The Board need not adopt the same rules for each Award or each Awardee.

10.3 Fundamental Transactions

Except for grants to Non-Employee Directors pursuant to Section 11 herein, in the event of (a) 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 and the Awards granted under this Plan are assumed, converted or replaced by the successor corporation, which assumption shall be binding on all Participants), (b) a merger in which the Company is the surviving corporation but after which the stockholders of the Company immediately prior to such merger (other than any stockholder that merges, or which owns or controls another corporation that merges, with the Company in such merger) cease to own their shares or other equity interest in the Company, (c) the sale of all or substantially all of the assets of the Company, or (d) the acquisition, sale, or transfer of more than 50% of the outstanding shares of the Company by tender offer or similar transaction (each, a “*Fundamental Transaction*”), any or all outstanding Awards may be assumed, converted or replaced by the successor corporation (if any), which assumption, conversion or replacement shall be binding on all participants under this Plan. In the alternative, the successor corporation may substitute equivalent Awards or provide substantially similar consideration to participants as was provided to stockholders (after taking into account the existing provisions of the Awards). The successor corporation may also issue, in place of outstanding Shares held by the participants, substantially similar shares or other property subject to repurchase restrictions no less favorable to the participant. In the event such successor corporation (if any) does not assume or substitute Awards, as provided above, pursuant to a transaction described in this Subsection 10.3, the vesting with respect to such Awards shall fully and immediately accelerate or the repurchase rights of the Company shall fully and immediately terminate, as the case may be, so that the Awards may be exercised or the repurchase rights shall terminate before, or otherwise in connection with the closing or completion of the Fundamental Transaction or event, but then terminate. Notwithstanding anything in this Plan to the contrary, the Committee may, in its sole discretion, provide that the vesting of any or all Award Shares subject to vesting or a right of repurchase shall accelerate or lapse, as the case may be, upon a transaction described in this Section 10.3. If the Committee exercises such discretion with respect to Options, such Options shall become exercisable in full prior to the consummation of such event at such time and on such conditions as the Committee determines, and if such Options are not exercised prior to the consummation of the Fundamental Transaction, they shall terminate at such time as determined by the Committee. Subject to any greater rights granted to participants under the foregoing provisions of this Section 10.3, in the event of the occurrence of any Fundamental Transaction, any outstanding Awards shall be treated as provided in the applicable agreement or plan of merger, consolidation, dissolution, liquidation, or sale of assets.

10.4 **Changes of Control**

The Board may also, but need not, specify that other transactions or events constitute a “**Change in Control** “. The Board may do that either before or after the transaction or event occurs. Examples of transactions or events that the Board may treat as Changes of Control are: (a) 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, or (b) 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. In connection with a Change in Control, notwithstanding any other provision of this Plan, the Board may, but need not, take any one or more of the actions described in Section 10.3. In addition, the Board may extend the date for the exercise of Awards (but not beyond their original Expiration Date). The Board need not adopt the same rules for each Award or each Awardee. Notwithstanding anything in this Plan to the contrary, in the event of a Termination of services for any reason other than death, disability or Cause, within 18 months following the consummation of a Fundamental Transaction or Change in Control, any Awards, assumed or substituted in a Fundamental Transaction or Change in Control, which are subject to vesting conditions and/or the right of repurchase in favor of the Company or a successor entity, shall accelerate fully so that such Award Shares are immediately exercisable upon Termination or, if subject to the right of repurchase in favor of the Company, such repurchase rights shall lapse as of the date of Termination. Such Awards shall be exercisable for a period of three (3) months following termination.

10.5 **Divestiture**

If the Company or an Affiliate sells or otherwise transfers equity securities of an Affiliate to a person or entity other than the Company or an Affiliate, or leases, exchanges or transfers all or any portion of its assets to such a person or entity, then the Board may specify that such transaction or event constitutes a “**Divestiture** “. In connection with a Divestiture, notwithstanding any other provision of this Plan, the Board may, but need not, take one or more of the actions described in Section 10.3 or 10.4 with respect to Awards or Award Shares held by, for example, Employees, Directors or Consultants for whom that transaction or event results in a Termination. The Board need not adopt the same rules for each Award or each Awardee.

10.6 **Dissolution**

If the Company adopts a plan of dissolution, the Board may cause Awards to be fully vested and exercisable (but not after their Expiration Date) before the dissolution is completed but contingent on its completion and may cause the Company’s repurchase rights on Award Shares to lapse upon completion of the dissolution. The Board need not adopt the same rules for each Award or each Awardee. Notwithstanding anything herein to the contrary, in the event of a dissolution of the Company, to the extent not exercised before the earlier of the completion of the dissolution or their Expiration Date, Awards shall terminate immediately prior to the dissolution.

10.7 **Cut-Back to Preserve Benefits**

If the Administrator determines that the net after-tax amount to be realized by any Awardee, taking into account any accelerated vesting, termination of repurchase rights, or cash payments to that Awardee in connection with any transaction or event set forth in this Section 10 would be greater if one or more of those steps were not taken or payments were not made with respect to that Awardee’s Awards or Award Shares, then, at the election of the Awardee, to such extent, one or more of those steps shall not be taken and payments shall not be made.

11. **Automatic Option Grants to Non-Employee Directors and Non-Employee Director Fee Option Grants**

11.1 **Automatic Option Grants to Non-Employee Directors**

(a) **Grant Dates** Option grants to Non-Employee Directors shall be made on the dates specified below:

(i) Each Non-Employee Director who is then serving as a member of the Board on the Effective Date (the “**Current Directors** “) and each Non-Employee Director who is first elected or appointed to the Board at any time after the effective date of this Plan shall automatically be granted, on the date of such initial election or appointment, a Nonstatutory Option to purchase 7,500 Shares (the “**Initial Grant** “).

(ii) Commencing in 2004, on the date of each annual stockholders meeting, each individual who is to continue to serve as a Non-Employee Director shall automatically be granted a Nonstatutory Option to purchase 3,750 Shares (the “**Annual Grant**”), provided, however, that such individual has served as a Non-Employee Director for at least six (6) months.

(b) **Exercise Price**

(i) The Option Price shall be equal to one hundred percent (100%) of the Fair Market Value of the Shares on the Option grant date.

(ii) The Option Price shall be payable in one or more of the alternative forms authorized pursuant to Section 6.4. Except to the extent the sale and remittance procedure specified thereunder is utilized, payment of the Option Price must be made on the date of exercise.

(c) **Option Term** Each Option shall have a term of ten (10) years measured from the Option grant date.

(d) **Exercise and Vesting of Options** Except as otherwise determined by the whole Board, the Shares underlying each Option granted pursuant to Section 11.1 shall vest and be exercisable as set forth below.

(i) **Initial Grant.** The Shares underlying each Option issued pursuant to the Initial Grant shall vest and be exercisable as to 4.1666% of the Shares at the end of each full succeeding month from the date of grant, rounded down to the nearest whole Share, for so long as the Non-Employee Director continuously remains a Director of, or a Consultant to, the Company provided, however, that the Shares underlying each Option issued to Current Directors, pursuant to the Initial Grant, shall be fully vested and immediately exercisable on the grant date.

(ii) **Annual Grant.** The Shares underlying each Option issued pursuant to the Annual Grant shall vest and be exercisable as to 8.3333% of the Shares at the end of each full succeeding month from the date of grant, rounded down to the nearest whole Share, for so long as the Non-Employee Director continuously remains a Director of, or a Consultant to, the Company.

(e) **Termination of Board Service** The following provisions shall govern the exercise of any Options held by the Awardee at the time the Awardee ceases to serve as a Non-Employee Director:

(i) **In General** Except as otherwise provided in Section 11.3, after cessation of service as a Director (the “**Cessation Date**”), the Awardee’s Options shall be exercisable to the extent (but only to the extent) they are vested on the Cessation Date and only during the three months after such Cessation Date, but in no event after the Expiration Date. To the extent the Awardee does not exercise an Option within the time specified for exercise, the Option shall automatically terminate.

(ii) **Death or Disability** If an Awardee’s cessation of service on the Board is due to death or disability (as determined by the Board), all Options of that Awardee, to the extent exercisable upon such Cessation Date, may be exercised for one year after the Cessation Date, but in no event after the Expiration Date. In the case of a cessation of service due to death, an Option may be exercised as provided in Section 17. In the case of a cessation of service due to disability, if a guardian or conservator has been appointed to act for the Awardee and been granted this authority as part of that appointment, that guardian or conservator may exercise the Option on behalf of the Awardee. Death or disability occurring after an Awardee’s cessation of service shall not cause the cessation of service to be treated as having occurred due to death or disability. To the extent an Option is not so exercised within the time specified for its exercise, the Option shall automatically terminate.

11.2 **Director Fee Option Grants**

(a) **Option Grants.** The Board shall have the sole and exclusive authority to determine the calendar year or years for which the Director fee option grant program (the “**Director Fee Option Program**”) is to be in effect. For each such calendar year the program is in effect, each Non-Employee Director may elect to apply all or any portion of the annual retainer fee otherwise payable in cash, for his or her service on the Board for that year, to the acquisition of a special Option grant under this Director Fee Option Program. Such election must be filed with the Company’s Chief Financial Officer prior to first day of the calendar year for which the annual retainer fee which is the subject of that election is otherwise payable. Each Non-Employee Director who files such a timely election shall automatically be granted an Option

under this Director Fee Option Program on the first trading day in January in the calendar year for which the annual retainer fee which is the subject of that election would otherwise be payable in cash.

(b) **Option Terms** Each Option shall be a Nonstatutory Option governed by the terms and conditions specified below.

(i) **Exercise Price**

A. The Purchase Price shall be thirty-three and one-third percent (33-1/3%) of the Fair Market Value per Share on the Option grant date.

B. The Purchase Price shall become immediately due upon exercise of the Option and shall be payable in one or more of the alternative forms authorized pursuant to Section 6.4 of this Plan. Except to the extent the sale and remittance procedure specified thereunder is utilized, payment of the Purchase Price must be made on the date that the Option is exercised.

(ii) **Number of Option Shares.** The number of Shares subject to the Option shall be determined pursuant to the following formula (rounded down to the nearest whole number):

$$X = A \div (B \times 66-2/3\%), \text{ where}$$

X is the number of Option Shares,

A is the portion of the annual retainer fee subject to the Non-Employee Director's election, and

B is the Fair Market Value of a Share on the option grant date.

(iii) **Exercise and Term of Options** The Option shall become exercisable in a series of twelve (12) equal monthly installments upon the Awardee's completion of each month of Board service over the twelve (12)-month period measured from the grant date. Each Option shall have a maximum term of ten (10) years measured from the Option grant date.

(iv) **Termination of Board Service** Should the Awardee cease Board service for any reason (other than death or permanent disability) while holding one or more Options under this Director Fee Option Program, then each such Option shall remain exercisable, for any or all of the Shares for which the Option is exercisable at the time of such cessation of Board service, until the earlier of (x) the expiration of the ten (10)-year Option term or (y) the expiration of the three (3)-year period measured from the date of such cessation of Board service. However, each Option held by the Awardee under this Director Fee Option Program at the time of his or her cessation of Board service shall immediately terminate and cease to remain outstanding with respect to any and all Shares for which the Option is not otherwise at that time exercisable.

(v) **Death or Permanent Disability** Should the Awardee's service as a Board member cease by reason of death or permanent disability, then each Option held by such Awardee under this Director Fee Option Program shall immediately become exercisable for all the Shares at the time subject to that Option, and the Option may be exercised for any or all of those Shares as fully-vested Shares until the earlier of (x) the expiration of the ten (10)-year option term or (y) the expiration of the three (3)-year period measured from the date of such cessation of Board service.

Should the Awardee die after cessation of his or her Board service but while holding one or more Options under this Director Fee Option Program, then each such Option may be exercised, for any or all of the shares for which the Option is exercisable at the time of the Awardee's cessation of Board service (less any Shares subsequently purchased by the Awardee prior to death), by the personal representative of the Awardee's estate or by the person or persons to whom the Option is transferred pursuant to the Awardee's will or in accordance with the laws of descent and distribution or by the designated beneficiary or beneficiaries of such option. Such right of exercise shall lapse, and the Option shall terminate, upon the earlier of (xx) the expiration of the ten (10)-year Option term or (yy) the three (3)-year period measured from the date of the Awardee's cessation of Board service.

11.3 **Certain Transactions and Events**

(a) In the event of a Fundamental Transaction while the Awardee remains a Non-Employee

Director, the Shares at the time subject to each outstanding Option held by such Awardee pursuant to Section 11, but not otherwise vested, shall automatically vest in full so that each such Option shall, immediately prior to the effective date of the Fundamental Transaction, become exercisable for all the Shares as fully vested Shares and may be exercised for any or all of those vested Shares. Immediately following the consummation of the Fundamental Transaction, each Option shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or Affiliate thereof).

(b) In the event of a Change in Control while the Awardee remains a Non-Employee Director, the Shares at the time subject to each outstanding Option held by such Awardee pursuant to Section 11, but not otherwise vested, shall automatically vest in full so that each such Option shall, immediately prior to the effective date of the Change in Control, become exercisable for all the Shares as fully vested Shares and may be exercised for any or all of those vested Shares. Each such Option shall remain exercisable for such fully vested Shares until the expiration or sooner termination of the Option term in connection with a Change in Control.

(c) Each Option which is assumed in connection with a Fundamental Transaction shall be appropriately adjusted, immediately after such Fundamental Transaction, to apply to the number and class of securities which would have been issuable to the Awardee in consummation of such Fundamental Transaction had the Option been exercised immediately prior to such Fundamental Transaction. Appropriate adjustments shall also be made to the Option Price payable per share under each outstanding Option, provided the aggregate Option Price payable for such securities shall remain the same. To the extent the actual holders of the Company's outstanding Common Stock receive cash consideration for their Common Stock in consummation of the Fundamental Transaction, the successor corporation may, in connection with the assumption of the outstanding Options granted pursuant to Section 11, substitute one or more shares of its own common stock with a fair market value equivalent to the cash consideration paid per share of Common Stock in such Fundamental Transaction.

(d) The grant of Options pursuant to Section 11 shall in no way affect the right of the Company to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

(e) The remaining terms of each Option granted pursuant to Section 11 shall, as applicable, be the same as terms in effect for Awards granted under this Plan. Notwithstanding the foregoing, the provisions of Section 9.4 and Section 10 shall not apply to Options granted pursuant to Section 11.

11.4 Limited Transferability of Options

Each Option granted pursuant to Section 11 may be assigned in whole or in part during the Awardee's lifetime to one or more members of the Awardee's family or to a trust established exclusively for one or more such family members or to an entity in which the Awardee is majority owner or to the Awardee's former spouse, to the extent such assignment is in connection with the Awardee's estate or financial plan or pursuant to a Domestic Relations Order. The assigned portion may only be exercised by the person or persons who acquire a proprietary interest in the Option pursuant to the assignment. The terms applicable to the assigned portion shall be the same as those in effect for the Option immediately prior to such assignment and shall be set forth in such documents issued to the assignee as the Administrator may deem appropriate. The Awardee may also designate one or more persons as the beneficiary or beneficiaries of his or her outstanding Options under Section 11, and those Options shall, in accordance with such designation, automatically be transferred to such beneficiary or beneficiaries upon the Awardee's death while holding those Options. Such beneficiary or beneficiaries shall take the transferred Options subject to all the terms and conditions of the applicable Award Agreement evidencing each such transferred Option, including (without limitation) the limited time period during which the Option may be exercised following the Awardee's death.

12. Withholding and Tax Reporting

12.1 Tax Withholding Alternatives

(a) **General** Whenever Award Shares are issued or become free of restrictions, the Company may require the Awardee to remit to the Company an amount sufficient to satisfy any applicable tax withholding requirement, whether the related tax is imposed on the Awardee or the Company. The Company shall have no obligation to deliver Award Shares or release Award Shares from an escrow or permit a transfer of Award Shares until the Awardee has satisfied those tax withholding obligations. Whenever payment in satisfaction of Awards is made in cash, the payment will be reduced by an amount sufficient to satisfy all tax withholding requirements.

(b) **Method of Payment** The Awardee shall pay any required withholding using the forms of consideration described in Section 6.4(b), except that, in the discretion of the Administrator, the Company may also permit the Awardee to use any of the forms of payment described in Section 6.4(c). The Administrator, in its sole discretion, may also permit Award Shares to be withheld to pay required withholding. If the Administrator permits Award Shares to be withheld, the Fair Market Value of the Award Shares withheld, as determined as of the date of withholding, shall not exceed the amount determined by the applicable minimum statutory withholding rates.

12.2 Reporting of Dispositions

Any holder of Option Shares acquired under an Incentive Stock Option shall promptly notify the Administrator, following such procedures as the Administrator may require, of the sale or other disposition of any of those Option Shares if the disposition occurs during: (a) the longer of two years after the Grant Date of the Incentive Stock Option and one year after the date the Incentive Stock Option was exercised, or (b) such other period as the Administrator has established.

13. Compliance with Law

The grant of Awards and the issuance and subsequent transfer of Award Shares shall be subject to compliance with all Applicable Law, including all applicable securities laws. Awards may not be exercised, and Award Shares may not be transferred, in violation of Applicable Law. Thus, for example, Awards may not be exercised unless: (a) a registration statement under the Securities Act is then in effect with respect to the related Award Shares, or (b) in the opinion of legal counsel to the Company, those Award Shares may be issued in accordance with an applicable exemption from the registration requirements of the Securities Act and any other applicable securities laws. The failure or inability of the Company to obtain from any regulatory body the authority considered by the Company's legal counsel to be necessary or useful for the lawful issuance of any Award Shares or their subsequent transfer shall relieve the Company of any liability for failing to issue those Award Shares or permitting their transfer. As a condition to the exercise of any Award or the transfer of any Award Shares, the Company may require the Awardee to satisfy any requirements or qualifications that may be necessary or appropriate to comply with or evidence compliance with any Applicable Law.

14. Amendment or Termination of this Plan or Outstanding Awards

14.1 Amendment and Termination

The Board may at any time amend, suspend, or terminate this Plan.

14.2 Stockholder Approval

The Company shall obtain the approval of the Company's stockholders for any amendment to this Plan if stockholder approval is necessary or desirable to comply with any Applicable Law or with the requirements applicable to the grant of Awards intended to be Incentive Stock Options. The Board may also, but need not, require that the Company's stockholders approve any other amendments to this Plan.

14.3 Effect

No amendment, suspension, or termination of this Plan, and no modification of any Award even in the absence of an amendment, suspension, or termination of this Plan, shall impair any existing contractual rights of any Awardee unless the affected Awardee consents to the amendment, suspension, termination, or modification. Notwithstanding anything herein to the contrary, no such consent shall be required if the Board determines, in its sole and absolute discretion, that the amendment, suspension, termination, or modification: (a) is required or advisable in order for the Company, this Plan or the Award to satisfy Applicable Law, to meet the requirements of any accounting standard or to avoid any adverse accounting treatment, or (b) in connection with any transaction or event described in Section 10, is in the best interests of the Company or its stockholders. The Board may, but need not, take the tax or accounting consequences to affected Awardees into consideration in acting under the preceding sentence. Those decisions shall be final, binding and conclusive. Termination of this Plan shall not affect the Administrator's ability to exercise the powers granted to it under this Plan with respect to Awards granted before the termination of Award Shares issued under such Awards even if those Award Shares are issued after the termination.

15. Reserved Rights

15.1 Nonexclusivity of this Plan

This Plan shall not limit the power of the Company or any Affiliate to adopt other incentive arrangements including, for example, the grant or issuance of stock options, stock, or other equity-based rights under other plans.

15.2 Unfunded Plan

This Plan shall be unfunded. Although bookkeeping accounts may be established with respect to Awardees, any such accounts will be used merely as a convenience. The Company shall not be required to segregate any assets on account of this Plan, the grant of Awards, or the issuance of Award Shares. The Company and the Administrator shall not be deemed to be a trustee of stock or cash to be awarded under this Plan. Any obligations of the Company to any Awardee shall be based solely upon contracts entered into under this Plan, such as Award Agreements. No such obligations shall be deemed to be secured by any pledge or other encumbrance on any assets of the Company. Neither the Company nor the Administrator shall be required to give any security or bond for the performance of any such obligations.

16. Special Arrangements Regarding Award Shares

16.1 Escrow of Stock Certificates

To enforce any restrictions on Award Shares, the Administrator may require their holder to deposit the certificates representing Award Shares, with stock powers or other transfer instruments approved by the Administrator endorsed in blank, with the Company or an agent of the Company to hold in escrow until the restrictions have lapsed or terminated. The Administrator may also cause a legend or legends referencing the restrictions to be placed on the certificates.

16.2 Repurchase Rights

(a) **General** If a Stock Award is subject to vesting conditions, the Company shall have the right, during the seven months after the Awardee's Termination, to repurchase any or all of the Award Shares that were unvested as of the date of that Termination. The repurchase price shall be determined by the Administrator in accordance with this Section 16.2 which shall be either (i) the Purchase Price for the Award Shares (minus the amount of any cash dividends paid or payable with respect to the Award Shares for which the record date precedes the repurchase) or (ii) the lower of (A) the Purchase Price for the Shares or (B) the Fair Market Value of those Award Shares as of the date of the Termination. The repurchase price shall be paid in cash. The Company may assign this right of repurchase.

(b) **Procedure** The Company or its assignee may choose to give the Awardee a written notice of exercise of its repurchase rights under this Section 16.2. However, the Company's failure to give such a notice shall not affect its rights to repurchase Award Shares. The Company must, however, tender the repurchase price during the period specified in this Section 16.2 for exercising its repurchase rights in order to exercise such rights.

17. Beneficiaries

An Awardee may file a written designation of one or more beneficiaries who are to receive the Awardee's rights under the Awardee's Awards after the Awardee's death. An Awardee may change such a designation at any time by written notice. If an Awardee designates a beneficiary, the beneficiary may exercise the Awardee's Awards after the Awardee's death. If an Awardee dies when the Awardee has no living beneficiary designated under this Plan, the Company shall allow the executor or administrator of the Awardee's estate to exercise the Award or, if there is none, the person entitled to exercise the Option under the Awardee's will or the laws of descent and distribution. In any case, no Award may be exercised after its Expiration Date.

18. Miscellaneous

18.1 Governing Law

This Plan, the Award Agreements and all other agreements entered into under this Plan, and all actions taken under this Plan or in connection with Awards or Award Shares, shall be governed by the laws of the State of Delaware.

18.2 Determination of Value

Fair Market Value shall be determined as follows:

(a) **Listed Stock.** If the Shares are traded on any established stock exchange or quoted on a national market system, Fair Market Value shall be the closing sales price for the Shares as quoted on that stock exchange or system for the date the value is to be determined (the “**Value Date**”) as reported in *The Wall Street Journal* or a similar publication. If no sales are reported as having occurred on the Value Date, Fair Market Value shall be that closing sales price for the last preceding trading day on which sales of Shares are reported as having occurred. If no sales are reported as having occurred during the five trading days before the Value Date, Fair Market Value shall be the closing bid for Shares on the Value Date. If Shares are listed on multiple exchanges or systems, Fair Market Value shall be based on sales or bid prices on the primary exchange or system on which Shares are traded or quoted.

(b) **Stock Quoted by Securities Dealer** If Shares are regularly quoted by a recognized securities dealer but selling prices are not reported on any established stock exchange or quoted on a national market system, Fair Market Value shall be the mean between the high bid and low asked prices on the Value Date. If no prices are quoted for the Value Date, Fair Market Value shall be the mean between the high bid and low asked prices on the last preceding trading day on which any bid and asked prices were quoted.

(c) **No Established Market** If Shares are not traded on any established stock exchange or quoted on a national market system and are not quoted by a recognized securities dealer, the Administrator (following guidelines established by the Board or Committee) will determine Fair Market Value in good faith. The Administrator will consider the following factors, and any others it considers significant, in determining Fair Market Value: (i) the price at which other securities of the Company have been issued to purchasers other than Employees, Directors, or Consultants, (ii) the Company’s stockholder’s equity, prospective earning power, dividend-paying capacity, and non-operating assets, if any, and (iii) any other relevant factors, including the economic outlook for the Company and the Company’s industry, the Company’s position in that industry, the Company’s goodwill and other intellectual property, and the values of securities of other businesses in the same industry.

18.3 **Reservation of Shares**

During the term of this Plan, the Company shall at all times reserve and keep available such number of Shares as are still issuable under this Plan.

18.4 **Electronic Communications**

Any Award Agreement, notice of exercise of an Award, or other document required or permitted by this Plan may be delivered in writing or, to the extent determined by the Administrator, electronically. Signatures may also be electronic if permitted by the Administrator.

18.5 **Notices**

Unless the Administrator specifies otherwise, any notice to the Company under any Option Agreement or with respect to any Awards or Award Shares shall be in writing (or, if so authorized by Section 18.4, communicated electronically), shall be addressed to the Secretary of the Company, and shall only be effective when received by the Secretary of the Company.

**Amendment to
2003 Equity Incentive Plan
of DTS, Inc.**

Notwithstanding the provisions of Section 11 of the 2003 Equity Incentive Plan (the “*Plan*”) of DTS, Inc. (the “*Company*”), the Plan was amended on May 9, 2005 to provide as follows:

Any automatic option grant to newly elected or appointed non-employee directors under the Plan made during the period from May 19, 2005 to December 31, 2005 shall consist of an option to purchase 30,000 shares of the Company’s common stock, vesting monthly over a three year period starting on the date of the grant.

Any annual automatic option grant to non-employee directors under the Plan made during the period from May 19, 2005 to December 31, 2005 shall consist of an option to purchase 10,000 shares of the Company’s common stock, vesting monthly over a one year period starting on the date of the grant, provided that such individual has served as a non-employee director for at least 6 months.

Any automatic option grant to newly elected or appointed non-employee directors under the Plan made at any time on or after January 1, 2006 shall consist of an option to purchase 15,000 shares of the Company’s common stock, vesting monthly over a three year period starting on the date of the grant.

Any annual automatic option grant to non-employee directors under the Plan made at any time on or after January 1, 2006 shall consist of an option to purchase 5,000 shares of the Company’s common stock, vesting monthly over a one year period starting on the date of the grant, provided that such individual has served as a non-employee director for at least 6 months.

Each non-employee director first elected or appointed to the Board at any time on or after January 1, 2006 shall automatically be granted on the date of such initial election or appointment, 7,500 shares of restricted stock under the Plan, which shall vest over a period of three years in equal installments at the end of each full month from the date of the grant for so long as the non-employee director continuously remains a director of, or a consultant to, the Company.

On the date of each annual stockholders’ meeting held on or after January 1, 2006, each individual who is to continue to serve as a non-employee director shall automatically be granted 2,500 shares of restricted stock under the Plan, provided that such individual has served as a non-employee director for at least 6 months. Such restricted stock shall vest over a period of one year in equal installments at the end of each full month from the date of grant for so long as the non-employee director continuously remains a director of, or a consultant to, the Company.

None of the above-referenced compensation shall be paid to any member of the Board (or committees thereof) who is an employee of the Company.

**Amendment to
2003 Equity Incentive Plan
of DTS, Inc.**

The 2003 Equity Incentive Plan of DTS, Inc., as amended on May 9, 2005, was further amended on May 15, 2008, by adding a new Section 5.2(c). The new Section 5.2(c) reads in its entirety as follows:

(c) **Cash Awards.** Subject to the provisions of this Section 5.2, so long as the Company is a “publicly held corporation” within the meaning of Code Section 162(m), no Employee may be granted one or more Cash Awards within a single fiscal year of the Company having an aggregate amount of more than \$3,000,000, considered without regard to any number of Options, SARs or Stock Awards that may have been granted or awarded to such Employee during the applicable fiscal year. With respect to any Cash Award that is granted with the intent of having it qualify as “qualified performance-based compensation” under Code Section 162(m), such Cash Awards may be granted to an Executive only by the Committee (and, notwithstanding anything to the contrary in Section 4.1(a), not by the Board). Any Cash Award intended as “qualified performance-based compensation” within the meaning of Section 162(m) of the Code must be awarded, vest or become exercisable contingent on the achievement of one or more Objectively Determinable Performance Conditions. If a Cash Award is cancelled, the cancelled Cash Award shall continue to be counted toward the foregoing limitation.

**Amendment to
2003 Equity Incentive Plan
of DTS, Inc.**

Notwithstanding the provisions of Section 11 of the 2003 Equity Incentive Plan (the "**Plan**") of DTS, Inc., as previously amended on May 9, 2005 and May 15, 2008, on February 19, 2009 Section 11 of the Plan was further amended to provide as follows:

Any annual automatic option grant to non-employee directors under the Plan made at any time after February 19, 2009 shall consist of an option to purchase 7,500 shares of the Company's common stock, vesting monthly over a one year period starting on the date of the grant, provided that such individual has served as a non-employee director for at least 6 months.

Each non-employee director first elected or appointed to the Board at any time after February 19, 2009 shall automatically be granted on the date of such initial election or appointment, 5,000 shares of restricted stock under the Plan, which shall vest over a period of three years in equal installments on each annual anniversary of the date of grant for so long as the non-employee director continuously remains a director of, or a consultant to, the Company.

Each restricted stock award automatically granted to a non-employee director on the date of each annual stockholders' meeting shall vest in a single installment on the one-year anniversary of the date of grant so long as the non-employee director continuously remains a director of, or a consultant to, the Company.

Except as set forth above, the terms and conditions of Section 11 of the Plan, as amended on May 9, 2005, shall remain in effect.

The above-referenced equity compensation shall not be paid to any member of the Board (or committees thereof) who is an employee of the Company.

**Amendment to
2003 Equity Incentive Plan
of DTS, Inc.**

The 2003 Equity Incentive Plan of DTS, Inc., as amended on May 9, 2005, May 15, 2008 and February 19, 2009 (as amended, the “Plan”), was further amended on February 15, 2010 to provide as follows:

1. Section 2.1(d) shall be amended in its entirety to read as follows:

(d) **“Award”** means a Stock Award, SAR, Cash Award, Option, or Restricted Stock Unit granted in accordance with the terms of this Plan.

2. Section 2.1 shall be amended by the addition of a new Section 2.11(vv) as follows:

(vv) **“Restricted Stock Unit”** means a right granted to a Participant pursuant to Section 8.4 to receive on a future date a Share.

3. Section 8 of the Plan shall be amended by the addition of a new Section 8.4 as follows:

8.4 The following rules apply to Restricted Stock Units Awards:

Restricted Stock Units may be granted under this Plan. Restricted Stock Unit Awards shall be evidenced by Award Agreements specifying the number of Restricted Stock Units subject to the Award, in such form as the Administrator shall from time to time establish. Award Agreements evidencing Restricted Stock Units may incorporate all or any of the terms of the Plan by reference and shall comply with and be subject to the following terms and conditions:

(a) **Grant of Restricted Stock Unit Awards**

Restricted Stock Unit Awards may be granted upon such conditions as the Administrator shall determine, including, without limitation, upon the attainment of one or more Objectively Determinable Performance Conditions.

(b) **Purchase Price**

No monetary payment (other than applicable tax withholding, if any) shall be required as a condition of receiving a Restricted Stock Unit Award, the consideration for which shall be services actually rendered to the Company or an Affiliate. Notwithstanding the foregoing, if required by applicable state corporate law, the Participant shall furnish consideration in the form of cash or past services having a value not less than the par value of the Shares issued upon settlement of the Restricted Stock Unit Award.

(c) **Vesting**

Restricted Stock Unit Awards may (but need not) be made subject to vesting conditions based upon the satisfaction of such service requirements, conditions, restrictions or performance criteria set forth in the Award Agreement evidencing such Award.

(d) **Voting Rights, Dividend Equivalent Rights and Distributions**

Participants shall have no voting rights with respect to Shares represented by Restricted Stock Units until the date of the issuance of such Shares (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company). However, the Award Agreement evidencing any Restricted Stock Unit Award may provide that the Participant shall be entitled to dividend equivalent rights with respect to the payment of cash dividends on Shares during the period beginning on the date such Award is granted and ending, with respect to each Share subject to the Award, on the earlier of the date the Award is settled or the date on which it is terminated. Such

dividend equivalent rights, if any, shall be paid by crediting the Participant with additional whole Restricted Stock Units as of the date of payment of such cash dividends on Shares. The number of additional Restricted Stock Units (rounded to the nearest whole number) to be so credited shall be determined by dividing (i) the amount of cash dividends paid on such date with respect to the number of Shares represented by the Restricted Stock Units previously credited to the Participant by (ii) the Fair Market Value per Share on such date. Such additional Restricted Stock Units shall be subject to the same terms and conditions and shall be settled in the same manner and at the same time as the Restricted Stock Units originally subject to the Restricted Stock Unit Award. In the event of a dividend or distribution paid in Shares or other property or any other adjustment made upon a change in the capital structure of the Company as described in Section 10.2, appropriate adjustments shall be made in the Participant's Restricted Stock Unit Award so that it represents the right to receive upon settlement any and all new, substituted or additional securities or other property (other than regular, periodic cash dividends) to which the Participant would be entitled by reason of the Shares issuable upon settlement of the Award, and all such new, substituted or additional securities or other property shall be immediately subject to the same vesting conditions as are applicable to the Award.

(e) Effect of Termination of Service

Unless otherwise set forth in the Award Agreement evidencing a Restricted Stock Unit Award, if a Participant's service terminates for any reason, whether voluntary or involuntary (including the Participant's death or disability), then the Participant shall forfeit to the Company any Restricted Stock Units pursuant to the Award which remain subject to vesting conditions as of the date of the Participant's termination of service.

(f) Settlement of Restricted Stock Unit Awards

The Company shall issue to a Participant on the date on which Restricted Stock Units subject to the Participant's Restricted Stock Unit Award vest or on such other date set forth in the Award Agreement one (1) Share (and/or any other new, substituted or additional securities or other property pursuant to an adjustment described above) for each Restricted Stock Unit then becoming vested or otherwise to be settled on such date, subject to the withholding of applicable taxes, if any. If permitted by the Administrator, the Participant may elect, consistent with the requirements of Section 409A of the Code, to defer receipt of all or any portion of the Shares or other property otherwise issuable to the Participant, and such deferred issuance date(s) and amount(s) elected by the Participant shall be set forth in the Award Agreement.

(g) Nontransferability of Restricted Stock Unit Awards

The right to receive Shares pursuant to a Restricted Stock Unit Award shall not be subject in any manner to anticipation, alienation, sale, exchange, transfer, assignment, pledge, encumbrance, or garnishment by creditors of the Participant or the Participant's beneficiary, except transfer by will or by the laws of descent and distribution. All rights with respect to a Restricted Stock Unit Award granted to a Participant hereunder shall be exercisable during his or her lifetime only by such Participant or the Participant's guardian or legal representative.

Except as set forth above, the terms and conditions of the Plan, as amended hereby, shall remain in effect.

**DTS, INC.
NOTICE OF GRANT OF RESTRICTED STOCK UNITS**

The Awardee has been granted an award of Restricted Stock Units (the “*Award*”) pursuant to the DTS, Inc. 2003 Equity Incentive Plan (the “*Plan*”), each of which represents the right to receive on the applicable Settlement Date one (1) Share common stock of DTS, Inc. (the “*Company*”), as follows:

Awardee: _____ **Employee ID:** _____
Grant Date: _____
Number of Restricted Stock Units: _____, subject to adjustment as provided by the Restricted Stock Units Agreement.
Settlement Date: _____ For each Restricted Stock Unit, except as otherwise provided by the Restricted Stock Units Agreement, the date on which such unit becomes a Vested Unit in accordance with the vesting schedule set forth below.
Vested Units: _____ Except as provided by the Restricted Stock Units Agreement and provided that the Awardee’s service has not terminated prior to the relevant date, the number of Vested Units shall cumulatively increase on each respective date set forth below by the number of units set forth opposite such date, as follows:

Vesting Date	Number of Units Vesting

By their signatures below or by electronic acceptance or authentication in a form authorized by the Company, the Company and the Awardee agree that the Award is governed by this Notice and by the provisions of the Plan and the Restricted Stock Units Agreement, both of which are made a part of this document. The Awardee acknowledges that copies of the Plan, Restricted Stock Units Agreement and the prospectus for the Plan are available on the Company’s internal web site and may be viewed and printed by the Awardee for attachment to the Awardee’s copy of this Grant Notice. The Awardee represents that the Awardee has read and is familiar with the provisions of the Plan and Restricted Stock Units Agreement, and hereby accepts the Award subject to all of their terms and conditions.

DTS, INC.	AWARDEE
By: _____	_____
Its: _____	Signature
Address: _____	_____
	Date

	Address

ATTACHMENTS: 2003 Equity Incentive Plan, as amended to the Grant Date; Restricted Stock Units Agreement and Plan Prospectus

DTS INC.
RESTRICTED STOCK UNITS AGREEMENT

DTS, Inc. has granted to the Awardee named in the *Notice of Grant of Restricted Stock Units* (the “**Grant Notice**”) to which this Restricted Stock Units Agreement (the “**Agreement**”) is attached an Award consisting of Restricted Stock Units (the “**Units**”) subject to the terms and conditions set forth in the Grant Notice and this Agreement. The Award has been granted pursuant to and shall in all respects be subject to the terms conditions of the DTS, Inc. 2003 Equity Incentive Plan (the “**Plan**”), as amended to the Grant Date attached as Exhibit A, the provisions of which are incorporated herein by reference. By signing the Grant Notice, the Awardee: (a) acknowledges receipt of and represents that the Awardee has read and is familiar with the Grant Notice, this Agreement, the Plan and a prospectus for the Plan prepared in connection with the registration with the Securities and Exchange Commission of the shares issuable pursuant to the Award (the “**Plan Prospectus**”), (b) accepts the Award subject to all of the terms and conditions of the Grant Notice, this Agreement and the Plan and (c) agrees to accept as binding, conclusive and final all decisions or interpretations of the Committee upon any questions arising under the Grant Notice, this Agreement or the Plan.

1. **Definitions and Construction.**

1.1 **Definitions.** Unless otherwise defined herein, capitalized terms shall have the meanings assigned in the Grant Notice or the Plan.

1.2 **Construction.** Captions and titles contained herein are for convenience only and shall not affect the meaning or interpretation of any provision of this Agreement. Except when otherwise indicated by the context, the singular shall include the plural and the plural shall include the singular. Use of the term “or” is not intended to be exclusive, unless the context clearly requires otherwise.

2. **Administration.**

All questions of interpretation concerning the Grant Notice, this Agreement and the Plan shall be determined by the Committee or its designee. All such determinations shall be final and binding upon all persons having an interest in the Award as provided by the Plan. Any Officer shall have the authority to act on behalf of the Company with respect to any matter, right, obligation, or election which is the responsibility of or which is allocated to the Company herein, provided the Officer has apparent or actual authority with respect to such matter, right, obligation, or election.

3. **The Award.**

3.1 **Grant of Units.** On the Grant Date, the Awardee shall acquire, subject to the provisions of this Agreement, the Number of Restricted Stock Units set forth in the Grant Notice, subject to adjustment as provided in Section 0. Each Unit represents a right to receive on a date determined in accordance with the Grant Notice and this Agreement one (1) Share.

3.2 **No Monetary Payment Required.** The Awardee is not required to make any monetary payment (other than applicable tax withholding, if any) as a condition to receiving the Units or Shares issued upon settlement of the Units, the consideration for which shall be past services actually rendered and/or future services to be rendered to the Company or an Affiliate. Notwithstanding the foregoing, if required by applicable state corporate law, the Awardee shall furnish consideration in the form of cash or past services rendered having a value not less than the par value of the Shares issued upon settlement of the Units.

4. **Vesting of Units.**

Normal Vesting. The Units shall vest and become Vested Units as provided in the Grant Notice. In the event that a Vesting Date as provided by the Grant Notice (an “**Original Settlement Date**”) would occur on a date on which a sale by the Awardee of the shares to be issued in settlement of the Units becoming Vested Units on such Original Settlement Date would violate the Insider Trading Policy of the Company, the Settlement of such Vested Units shall be deferred until the first to occur of (a) the next business day on which a sale by the Awardee of such shares would not violate the Insider Trading Policy or (b) the later of (i) the last day of the calendar year in which the Original Vesting Date occurred or (ii) the last day of the Company’s taxable year in which the Original Vesting Date occurred.

5. **Company Reacquisition Right.**

5.1 Grant of Company Reacquisition Right. Except to the extent otherwise provided in an employment agreement between the Company or an Affiliate and the Awardee, in the event that the Awardee's Service terminates for any reason or no reason, with or without cause, the Awardee shall forfeit and the Company shall automatically reacquire all Units which are not, as of the time of such termination, Vested Units ("*Unvested Units*"), and the Awardee shall not be entitled to any payment therefor (the "*Company Reacquisition Right*").

5.2 Dividends, Distributions and Adjustments. Upon a dividend or distribution to the stockholders of the Company paid in shares of Stock or other property, or any other adjustment upon a change in the capital structure of the Company as described in Section 10.2 of the Plan, any and all new, substituted or additional securities or other property (other than regular, periodic dividends paid on Shares pursuant to the Company's dividend policy) to which the Awardee is entitled by reason of the Awardee's ownership of Unvested Units shall be immediately subject to the Company Reacquisition Right and included in the terms "Units" and "Unvested Units" for all purposes of the Company Reacquisition Right with the same force and effect as the Unvested Units immediately prior to the dividend, distribution or adjustment, as the case may be. For purposes of determining the number of Vested Units following a dividend, distribution or adjustment, credited Service shall include all service with the Company or an Affiliate at the time the service is rendered.

6. **Settlement of the Award.**

6.1 Issuance of Shares. Subject to the provisions of Section 0 below, the Company shall issue to the Awardee on the settlement date with respect to each Vested Unit to be settled on such date one (1) Share. Shares issued in settlement of Units shall not be subject to any restriction on transfer other than any such restriction as may be required pursuant to Section 0, Section 7 or the Company's Insider Trading Policy.

6.2 Beneficial Ownership of Shares; Certificate Registration. The Awardee hereby authorizes the Company, in its sole discretion, to deposit for the benefit of the Awardee with the broker designated by the Company with which the Awardee has an account, any or all Shares acquired by the Awardee pursuant to the settlement of the Award. Except as provided by the preceding sentence, a certificate for the Shares as to which the Award is settled shall be registered in the name of the Awardee, or, if applicable, in the names of the heirs of the Awardee.

6.3 Restrictions on Grant of the Award and Issuance of Shares. The grant of the Award and issuance of Shares upon settlement of the Award shall be subject to compliance with all applicable requirements of federal, state or foreign law with respect to such securities. No Shares may be issued hereunder if the issuance of such Shares would constitute a violation of any applicable federal, state or foreign securities laws or other law or regulations or the requirements of any stock exchange or market system upon which the Shares may then be listed. The inability of the Company to obtain from any regulatory body having jurisdiction the authority, if any, deemed by the Company's legal counsel to be necessary to the lawful issuance of any shares subject to the Award shall relieve the Company of any liability in respect of the failure to issue such Shares as to which such requisite authority shall not have been obtained. As a condition to the settlement of the Award, the Company may require the Awardee to satisfy any qualifications that may be necessary or appropriate, to evidence compliance with any applicable law or regulation and to make any representation or warranty with respect thereto as may be requested by the Company.

6.4 Fractional Shares. The Company shall not be required to issue fractional Shares upon the settlement of the Award.

7. **Tax Withholding.**

7.1 In General. At the time the Grant Notice is executed, or at any time thereafter as requested by the Company, the Awardee hereby authorizes withholding from payroll and any other amounts payable to the Awardee, and otherwise agrees to make adequate provision for, any sums required to satisfy the federal, state, local and foreign tax (including any social insurance) withholding obligations of the Company and its Affiliates, if any, which arise in connection with the Award, the vesting of Units or the issuance of Shares in settlement thereof. The Company shall have no obligation to deliver shares of Stock until such tax withholding obligations of the Company have been satisfied by the Awardee.

7.2 Assignment of Sale Proceeds; Payment of Tax Withholding by Check. Subject to compliance with applicable law and the Company's Insider Trading Policy, the Company may permit the Awardee to satisfy the tax withholding obligations in accordance with procedures established by the Company providing for either (i) delivery by the Awardee to the Company or a broker approved by the Company of properly executed instructions, in a form approved by the Company, providing for the assignment to the Company of the proceeds of a sale with respect to some or all of the Shares being acquired upon settlement of Units, or (ii) payment by check.

7.3 **Withholding in Shares.** The Company may require the Awardee to satisfy all or any portion of the Company's or Affiliate's tax withholding obligations by deducting from the Shares otherwise deliverable to the Awardee in settlement of the Award a number of whole Shares having a fair market value, as determined by the Company as of the date on which the tax withholding obligations arise, not in excess of the amount of such tax withholding obligations determined by the applicable minimum statutory withholding rates.

7.4 **Default Withholding Provision.** Except as otherwise provided by the Company, if the Awardee does not deliver to the Company at least five (5) days prior to a Settlement Date a written notice of Awardee's election to satisfy by cash, check, or other manner agreeable to the Company, all federal, state, local or foreign tax withholding obligations related to such Shares, Awardee and the Company agree that the Company shall retain that number of the Shares, based on the fair market value of the Company's common stock on such Settlement Date, with an aggregate value equal to the amount of all federal, state, local or foreign tax withholding obligations that Awardee, the Company, or an Affiliate would incur as a result of the Settlement of such Shares.

8. **Effect of Fundamental Transaction on Award.**

In the event of a Fundamental Transaction, except to the extent that the Committee determines to cash out the Award, the surviving, continuing, successor, or purchasing corporation or other business entity or parent thereof, as the case may be (the "**Acquiror**"), may, without the consent of the Awardee, assume or continue the Company's rights and obligations with respect to all or any portion of the outstanding Units or substitute for all or any portion of the outstanding Units substantially equivalent rights with respect to the Acquiror's stock. For purposes of this Section, a Unit shall be deemed assumed if, following the Fundamental Transaction, the Unit confers the right to receive, subject to the terms and conditions of the Plan and this Agreement, the consideration (whether stock, cash, other securities or property or a combination thereof) to which a holder of a Share on the effective date of the Change in Control was entitled; provided, however, that if such consideration is not solely common stock of the Acquiror, the Committee may, with the consent of the Acquiror, provide for the consideration to be received upon settlement of the Unit to consist solely of common stock of the Acquiror equal in Fair Market Value to the per share consideration received by holders of Share pursuant to the Fundamental Transaction.

9. **Adjustments for Changes in Capital Structure.**

Subject to any required action by the stockholders of the Company and the requirements of Section 409A of the Code to the extent applicable, in the event of any change in the Shares effected without receipt of consideration by the Company, whether through merger, consolidation, reorganization, reincorporation, recapitalization, reclassification, stock dividend, stock split, reverse stock split, split-up, split-off, spin-off, combination of shares, exchange of shares, or similar change in the capital structure of the Company, or in the event of payment of a dividend or distribution to the stockholders of the Company in a form other than Shares (excepting normal cash dividends) that has a material effect on the Fair Market Value of Shares, appropriate and proportionate adjustments shall be made in the number of Units subject to the Award and/or the number and kind of shares to be issued in settlement of the Award, in order to prevent dilution or enlargement of the Awardee's rights under the Award. For purposes of the foregoing, conversion of any convertible securities of the Company shall not be treated as "effected without receipt of consideration by the Company." Any fractional Share resulting from an adjustment pursuant to this Section shall be rounded down to the nearest whole number. Such adjustments shall be determined by the Committee, and its determination shall be final, binding and conclusive.

10. **Rights as a Stockholder or Employee.**

The Awardee shall have no rights as a stockholder with respect to any Shares which may be issued in settlement of this Award until the date of the issuance of a certificate for such Shares (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company). No adjustment shall be made for dividends, distributions or other rights for which the record date is prior to the date such certificate is issued, except as provided in Section 0. If the Awardee is an Employee, the Awardee understands and acknowledges that, except as otherwise provided in a separate, written employment agreement between the Company or an Affiliate and the Awardee, the Awardee's employment is "at will" and is for no specified term. Nothing in this Agreement shall confer upon the Awardee any right to continue in the service of the Company or an Affiliate or interfere in any way with any right to terminate the Awardee's service at any time.

11. **Legends.**

The Company may at any time place legends referencing any applicable federal, state or foreign securities law restrictions on all certificates representing Shares issued pursuant to this Agreement. The Awardee shall, at the request

of the Company, promptly present to the Company any and all certificates representing Shares acquired pursuant to this Award in the possession of the Awardee in order to carry out the provisions of this Section.

12. Miscellaneous Provisions.

12.1 Termination or Amendment. The Committee may terminate or amend the Plan or this Agreement at any time; provided, however, that except as provided in Section 8 in connection with a Fundamental Transaction, no such termination or amendment may adversely affect the Awardee's rights under this Agreement without the consent of the Awardee unless such termination or amendment is necessary to comply with applicable law or government regulation, including, but not limited to, Section 409A. No amendment or addition to this Agreement shall be effective unless in writing.

12.2 Nontransferability of the Award. Prior to the issuance of Shares on the applicable Settlement Date, neither this Award nor any Units subject to this Award shall be subject in any manner to anticipation, alienation, sale, exchange, transfer, assignment, pledge, encumbrance, or garnishment by creditors of the Awardee or the Awardee's beneficiary, except transfer by will or by the laws of descent and distribution. All rights with respect to the Award shall be exercisable during the Awardee's lifetime only by the Awardee or the Awardee's guardian or legal representative.

12.3 Further Instruments. The parties hereto agree to execute such further instruments and to take such further action as may reasonably be necessary to carry out the intent of this Agreement.

12.4 Binding Effect. This Agreement shall inure to the benefit of the successors and assigns of the Company and, subject to the restrictions on transfer set forth herein, be binding upon the Awardee and the Awardee's heirs, executors, administrators, successors and assigns.

12.5 Delivery of Documents and Notices. Any document relating to participation in the Plan or any notice required or permitted hereunder shall be given in writing and shall be deemed effectively given (except to the extent that this Agreement provides for effectiveness only upon actual receipt of such notice) upon personal delivery, electronic delivery at the e-mail address, if any, provided for the Awardee by the Company or any Affiliate, or upon deposit in the U.S. Post Office or foreign postal service, by registered or certified mail, or with a nationally recognized overnight courier service, with postage and fees prepaid, addressed to the other party at the address shown below that party's signature to the Grant Notice or at such other address as such party may designate in writing from time to time to the other party.

(a) **Description of Electronic Delivery.** The Plan documents, which may include but do not necessarily include: the Plan, the Grant Notice, this Agreement, the Plan Prospectus, and any reports of the Company provided generally to the Company's stockholders, may be delivered to the Awardee electronically. In addition, the Awardee may deliver electronically the Grant Notice to the Company or to such third party involved in administering the Plan as the Company may designate from time to time. Such means of electronic delivery may include but do not necessarily include the delivery of a link to a Company intranet or the Internet site of a third party involved in administering the Plan, the delivery of the document via e-mail or such other means of electronic delivery specified by the Company.

(b) **Consent to Electronic Delivery.** The Awardee acknowledges that the Awardee has read Section 0 of this Agreement and consents to the electronic delivery of the Plan documents and Grant Notice, as described in Section 0. The Awardee acknowledges that he or she may receive from the Company a paper copy of any documents delivered electronically at no cost to the Awardee by contacting the Company by telephone or in writing. The Awardee further acknowledges that the Awardee will be provided with a paper copy of any documents if the attempted electronic delivery of such documents fails. Similarly, the Awardee understands that the Awardee must provide the Company or any designated third party administrator with a paper copy of any documents if the attempted electronic delivery of such documents fails. The Awardee may revoke his or her consent to the electronic delivery of documents described in Section 0 or may change the electronic mail address to which such documents are to be delivered (if Awardee has provided an electronic mail address) at any time by notifying the Company of such revoked consent or revised e-mail address by telephone, postal service or electronic mail. Finally, the Awardee understands that he or she is not required to consent to electronic delivery of documents described in Section 0.

12.6 Integrated Agreement. The Grant Notice, this Agreement and the Plan, together with any employment, service or other agreement between the Awardee and the Company or an Affiliate referring to the Award, shall constitute the entire understanding and agreement of the Awardee and the Company or an Affiliate with respect to the subject matter contained herein or therein and supersede any prior agreements, understandings, restrictions, representations, or warranties among the Awardee and the Company or an Affiliate with respect to such subject matter other than those as set

forth or provided for herein or therein. To the extent contemplated herein or therein, the provisions of the Grant Notice, this Agreement and the Plan shall survive any settlement of the Award and shall remain in full force and effect.

12.7 **Applicable Law.** This Agreement shall be governed by the laws of the State of California as such laws are applied to agreements between California residents entered into and to be performed entirely within the State of California.

12.8 **Counterparts.** The Grant Notice may be executed in counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

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 10, 2010

By: /s/ JON E. KIRCHNER

Jon E. Kirchner
Chairman and Chief Executive Officer

QuickLinks

[EXHIBIT 31.1](#)

[CERTIFICATION PURSUANT TO SECURITIES ACT RULES 13a-14\(a\) OR 15d-14\(a\)](#)

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 10, 2010

By: /s/ MELVIN L. FLANIGAN

Melvin L. Flanigan
Chief Financial Officer

QuickLinks

[EXHIBIT 31.2](#)

[CERTIFICATION PURSUANT TO SECURITIES ACT RULES 13a-14\(a\) OR 15d-14\(a\)](#)

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, 2010 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 10, 2010

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.

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](#)

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