# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**Washington, D.C. 20549**

# FORM 10-K

**(Mark One)**

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

**For the fiscal year ended December 3, 2021**
**or**

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

**For the transition period from_________to_________**

**Commission File Number: 0-15175**

# ADOBE INC.
(Exact name of registrant as specified in its charter)

**Delaware**
(State or other jurisdiction of incorporation or organization)

**345 Park Avenue, San Jose, California 95110-2704**
(Address of principal executive offices)

**(408) 536-6000**
(Registrant's telephone number, including area code)

**Securities registered pursuant to Section 12(b) of the Act:**

| Title of Each Class | Trading Symbol |
|---|---|
| Common Stock, $0.0001 par value per share | ADBE |

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

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

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Large accelerated filer | ☒ | Accelerated filer | ☐ | Non-accelerated filer | ☐ | Smaller reporting company | ☐ | Emerging growth company | ☐ |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☒

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

The aggregate market value of the registrant's common stock, $0.0001 par value per share, held by non-affiliates of the registrant on June 4, 2021, the last business day of the registrant's most recently completed second fiscal quarter, was $188.31 billion (based on the closing sales price of the registrant's common stock on that date). Shares of the registrant's common stock held by each officer and director and each person who owns 5% or more of the outstanding common stock of the registrant have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes. As of January 14, 2022, 471.7 million shares of the registrant's common stock, $0.0001 par value per share, were issued and outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the registrant's 2022 Annual Meeting of Stockholders (the "Proxy Statement"), to be filed within 120 days of the end of the fiscal year ended December 3, 2021, are incorporated by reference in Part III hereof. Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part hereof.

**ADOBE INC.**
**FORM 10-K**

**TABLE OF CONTENTS**

**Forward-Looking Statements**

*In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements, including statements regarding product plans, future growth, market opportunities, strategic initiatives, industry positioning, customer acquisition and retention, the amount of annualized recurring revenue, revenue growth and anticipated impacts on our business of the ongoing COVID-19 pandemic and related public health measures. In addition, when used in this report, the words "will," "expects," "could," "would," "may," "anticipates," "intends," "plans," "believes," "seeks," "targets," "estimates," "looks for," "looks to," "continues" and similar expressions, as well as statements regarding our focus for the future, are generally intended to identify forward-looking statements. Each of the forward-looking statements we make in this report involves risks and uncertainties that could cause actual results to differ materially from these forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section titled "Risk Factors" in Part I, Item 1A of this report. The risks described herein and in other documents we file from time to time with the U.S. Securities and Exchange Commission (the "SEC"), including our Quarterly Reports on Form 10-Q to be filed in fiscal 2022, should be carefully reviewed. Undue reliance should not be placed on these forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document, except as required by law.*

## PART I

## ITEM 1. BUSINESS

### OVERVIEW

Founded in 1982, Adobe is one of the largest and most diversified software companies in the world. We offer a line of products and services used by creative professionals, including photographers, video editors, graphic and experience designers and game developers; communicators, including content creators, students, marketers and knowledge workers; businesses of all sizes; and consumers for creating, managing, delivering, measuring, optimizing, engaging and transacting with compelling content and experiences across personal computers, smartphones, other electronic devices and digital media formats.

We market our products and services directly to enterprise customers through our sales force and local field offices. We license our products to end users through app stores and our own website at www.adobe.com. We offer many of our products via a Software-as-a-Service ("SaaS") model or a managed services model (both of which are referred to as hosted or cloud-based) as well as through term subscription and pay-per-use models. We also distribute certain products and services through a network of distributors, value-added resellers ("VARs"), systems integrators ("SIs"), independent software vendors ("ISVs"), retailers, software developers and original equipment manufacturers ("OEMs"). In addition, we license our technology to hardware manufacturers, software developers and service providers for use in their products and solutions. Our products run on desktop and laptop computers, smartphones, tablets, other devices and the web, depending on the product. We have operations in the Americas; Europe, Middle East and Africa ("EMEA"); and Asia-Pacific ("APAC").

Adobe was originally incorporated in California in October 1983 and was reincorporated in Delaware in May 1997. Our executive offices and principal facilities are located at 345 Park Avenue, San Jose, California 95110-2704. Our telephone number is 408-536-6000 and our website is www.adobe.com. Investors can obtain copies of our SEC filings from our website free of charge, as well as from the SEC website at www.sec.gov. The information posted to our website is not incorporated into this Annual Report on Form 10-K.

### OFFERINGS

For almost 40 years, Adobe's innovations have transformed how individuals, teams, businesses and governments engage and interact across all types of media. We deliver tools and services to empower individuals to create, collaborate and express their vision, transform businesses with compelling, personalized experiences in streamlined workflows and connect communities with new levels of collaboration.

While we continue to offer a broad portfolio of products, services and solutions, we focus our investments in two areas of strategic growth:

**Digital Media.** We provide products, services and solutions that enable individuals, teams and enterprises to create, publish and promote their content anywhere and accelerate their productivity by modernizing how they view, share, engage with and collaborate on documents and creative content. Our Digital Media segment is centered around Adobe Creative Cloud and Adobe Document Cloud, which include Creative Cloud Express, Photoshop, Illustrator, Lightroom, Premiere Pro, Acrobat, Adobe Sign and many more products, offering a variety of tools for creative professionals, communicators and other consumers. This is the core of what we have delivered to users for decades, and we have continually evolved and expanded our business model to provide our customers with a range of flexible solutions that allow them to reach their full creative potential anytime, anywhere, on any device and on projects of all types.

**Digital Experience.** We provide an integrated platform and set of applications and services through Adobe Experience Cloud that enable brands and businesses to create, manage, execute, measure, monetize and optimize customer experiences that span from analytics to commerce. Our customers include marketers, advertisers, agencies, publishers, merchandisers, merchants, web analysts, data scientists, developers and executives across the C-suite. The foundation of our offering is Adobe Experience Platform, which provides businesses and brands with an open and extensible system for customer experience management that transforms customer data into robust customer profiles that update in real time and uses insights driven by artificial intelligence (“AI”) to enable the delivery of personalized digital experiences across various channels in milliseconds.

With the creative power of our Digital Media business and the data-based tools of our Digital Experience business, we are able to offer a comprehensive suite of offerings to our customers. Through these tools and services, we help our customers more efficiently and effectively make, manage, measure and monetize their content across channels and devices with an end-to-end workflow and feedback loop. We believe we are uniquely positioned to be a leader in both of these areas, where our mission to change the world through digital experiences has never been more relevant, as people seek new ways to communicate and businesses continue to invest in digital transformation. In addition, our ability to deliver innovation and productivity improvements across customer workflows involving the creation, management, delivery, measurement and optimization of engaging content favorably positions Adobe as our customers continue to invest in delivering digital experiences.

## SEGMENTS

Our business is organized into three reportable segments:

- Digital Media;
- Digital Experience; and
- Publishing and Advertising.

These segments provide Adobe’s senior management with a comprehensive financial view of our key businesses. Our segments are aligned around our two strategic growth opportunities further described below, and our legacy products and solutions are contained within the third segment, Publishing and Advertising.

## MARKET OVERVIEW

This overview provides an explanation of our markets and a discussion of strategic opportunities in fiscal 2022 and beyond for each of our segments. *See the section titled “Results of Operations” in Part II, Item 7 titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of this report and Note 2 of our Notes to Consolidated Financial Statements for further segment information.*

### Digital Media

*Opportunity*

In today’s digital world, design and creativity have never been more relevant, providing a significant market opportunity for Adobe in digital media. Everyone has a story to tell—from creative professionals, to communicators, to consumers, to first-time creators—and they need the tools, services and capabilities at their fingertips to tell those stories on an ever-increasing number of canvasses. In a creator economy that is continually expanding, creators are looking for tools to help them easily make and share unique and beautiful content without complexity. At the same time, creativity is becoming increasingly collaborative, more critical to every company’s success and more complex. We believe Adobe is in a strong position to capitalize on these trends with innovation that will accelerate the creative process to empower individuals to create wherever inspiration strikes and enable more effective collaboration between creators and stakeholders.

The flagship of our Digital Media business is Adobe Creative Cloud, a subscription service that allows members to use our creative products integrated with cloud-delivered services across desktop, web and mobile devices. We believe in creativity for all, and Creative Cloud addresses the needs of all content creators, from creative professionals, such as artists, designers, developers, students and administrators, to knowledge workers, marketers, educators, enthusiasts and communicators and to consumers. Our customers rely on our products for content creation, photo editing, design, video and animation production, mobile app and gaming development and more. In this era of connected creativity, we envision Creative Cloud functioning as a creative system, keeping our users connected to everything and everyone they need to make a project successful. We believe we have significant opportunities to grow by expanding content-first, task-based creativity, advancing every creative category across desktop, web and mobile, expanding 3D and immersive content creation, enabling seamless collaboration across all stakeholders and inspiring and empowering the creative community through sharing and monetization.

Adobe's Digital Media segment also includes our Adobe Document Cloud business, a unified, cloud-based document services platform, which integrates Adobe's pioneering PDF technology with our Acrobat and Adobe Sign applications to deliver fully digital document workflows. Digital documents have a mission-critical role in powering modern businesses with hundreds of millions of communicators worldwide interacting with documents every day. With this digital transformation, we have the opportunity to continue to accelerate document productivity with Adobe Document Cloud, modernizing how people view, share and engage with documents. In our Adobe Document Cloud business, Adobe Acrobat has achieved strong market adoption and a leadership position in document-intensive industries such as government, financial services, pharmaceutical, legal, aerospace, insurance and technical publishing. Trillions of PDF documents are created every year, which reflects the growing role PDF plays across practically every segment of the economy, and there are hundreds of millions of users that engage with PDF files on a daily basis, in industries such as legal, financial services and publishing, as well as a broader array of communicators and Acrobat Reader users, who can also use the expanded capabilities provided by our Acrobat applications and the document services platform found in Document Cloud.

*Strategy*

Our goal for our Digital Media business is to be the leading platform for creativity and digital document solutions, where we offer a range of products and services that allow individuals, teams, small and medium businesses, enterprises and government institutions, including both professionals and enthusiasts, to design and deliver content seamlessly. With content creation, consumption and monetization happening across all surfaces and media types, we aim to deliver new ways to unleash creativity and accelerate document productivity, and we believe this is an area of significant opportunity for growth through expansion of our customer base. We aim to achieve this by using data-driven customer engagement, driving product-led growth through innovation to make our creative applications more accessible and easier to learn and meeting customer needs holistically to increase the value of our products.

We continue to redefine the creative process with Creative Cloud, so that our customers can connect with everything and everyone they need to create, collaborate and be inspired. We are empowering content-first, task-based creativity with our launch of Creative Cloud Express, a web and mobile application with a content- and template-first experience to enable a broad spectrum of users, including novice content creators, communicators and creative professionals, to create, edit and customize content quickly and easily, in December 2021. We aim to continue to advance every creative category across desktop, web and mobile. We have delivered our flagship applications, including Photoshop, Illustrator and Lightroom, on desktop and mobile devices to allow users the ability to work from anywhere on any device and to collaborate with stakeholders. We are building collaboration deeply into our applications and workflows to enable seamless collaboration across stakeholders. We are taking Creative Cloud to the web, beginning with a public beta version of Photoshop, which will allow Creative Cloud subscribers to make edits to and collaborate on their files directly in their browser. We are continuing to focus on democratizing 3D and immersive content creation with Adobe Aero and our Substance suite of products, as well as through integrating our Substance 3D capabilities into our other applications. We continue to introduce new features and solutions in our products, such as auto-masking and new and improved neural filters in Photoshop, auto-captioning in Premiere, adjustment layers and perspective grids in Adobe Fresco and additional motion features in Adobe XD. We are pursuing new ways to inspire, empower and connect the creative community, such as through our Create Change series, our creative residency program and supporting live, interactive tutorials with creators on Behance. We also offer a range of other creative tools and services, including hobbyist products, such as Photoshop Elements and Premiere Elements; libraries of creative assets, such as Adobe Stock and Adobe Fonts; mobile-first apps, such as Photoshop Camera; and Creative Cloud Libraries, a central place for users to store their assets. Further descriptions of our Digital Media products are included below under "Principal Products and Services."

On October 7, 2021, Adobe acquired Frame.io and began integrating its leading cloud-based video collaboration platform into Adobe Creative Cloud. With the acquisition of Frame.io, we aim to make the creative process even more collaborative, productive and efficient by enhancing Adobe Creative Cloud with Frame.io's cloud-native collaboration workflows, while continuing to enable third-party applications. As a first step in this direction, we are more deeply integrating and enhancing Frame.io's review and approval capabilities in Premiere Pro and After Effects to deliver a native collaborative platform for video editing.

In our Creative Cloud business, we continue to employ a pricing strategy, as appropriate, to move our customers to better-value offerings as well as attract past customers and potential users to try out our products and ultimately subscribe. As part of our strategy, we use a data-driven operating model and our Digital Experience solutions offered through Adobe

Experience Cloud to drive and optimize customer awareness, engagement and licensing of our creative products and services at every stop of the customer journey through our website and across other channels. Adobe.com is the central destination where we engage individual and small business customers to sign up for and renew Creative Cloud subscriptions. Our customers have the flexibility to subscribe to over twenty of our Creative Cloud products through a single subscription or, for many of our applications, through various collections of our individual subscriptions to point products. To better serve our current users and potential users, we offer free and premium levels for certain applications, such as Creative Cloud Express, and targeted packages and suites, such as our Photography Plan and Substance 3D Collection. We use our data-driven operating model to optimize conversion of our users of free apps and trials to paid subscribers. Our collaboration tools and services help us to further expand our universe of business customers beyond creative professionals to other stakeholders who use our products for review and approval purposes, copywriting or leveraging templates for social media marketing. We utilize channel partners to target mid-size creative customers with our Creative Cloud for teams offering. Our direct sales force is focused on building relationships with our largest customers and driving adoption of our Creative Cloud for enterprise offering. Overall, our strategy with Creative Cloud is designed to enable us to increase our revenue with existing users, attract new customers and grow a recurring and predictable revenue stream that is recognized ratably.

In our Adobe Document Cloud business, we expect to drive sustained long-term revenue growth through a continued expansion of our customer base by continuing to deliver the best PDF experience on and across every platform, improve Acrobat web's functionality and single-click ease of use, expand the number of task-based actions in Acrobat, integrate Adobe Sign into Acrobat across all surfaces, drive innovation with Adobe Sensei (machine-learning/AI) to make both new and legacy documents more intelligent and responsive, unlock business workflows through PDF and Adobe Sign APIs, and leverage diversified go-to-market motions to reach all segments. With over 50 million searches for PDF-related actions per month, we intend to harness that demand and attract new users to our Document Cloud services through Acrobat web, which allows anyone to quickly access tools to create, edit, convert, sign and compress PDFs through their web browser. As with our Creative Cloud strategy, we utilize a data-driven operating model to market our Document Cloud solutions and optimize our subscription-based pricing for individuals as well as small and medium-sized businesses, large enterprises and government institutions around the world. We aim to increase our reach in our key markets through the utilization of our corporate and volume licensing programs. We also intend to increase our focus on marketing and licensing Acrobat in targeted vertical markets such as education, financial services, telecommunications and government, as well as on expanding into emerging markets. We will continue to engage in strategic partnerships to help drive the enterprise business, including our partnerships with Microsoft, Workday, ServiceNow and Notarize.

As our Document Cloud customers increasingly expect business processes to be seamless across devices and the web, we are expanding our Document Cloud capabilities to meet this need. Acrobat Reader is available on mobile devices, with many of its standard features available on the go, and features "Liquid Mode" to automatically reformat PDFs for quick navigation and easier consumption on smaller screens. Acrobat is also available on the web, delivering quick results for common PDF actions with a single click. Adobe Scan powers mobile devices with scanning capabilities, transforming paper documents into full-featured PDFs. Adobe Sign also provides a green alternative to costly, paper-based solutions and offers a modern, convenient solution for customers to digitally manage their documents, automate processes and contract workflows. We believe that by growing the awareness of electronic signatures in the broader contract delivery and signing market, utilizing Adobe Sensei to enhance customer experiences through machine learning and AI and continuing to add new capabilities to our Acrobat, Adobe Scan and Adobe Sign offerings, we can help our customers continue to migrate away from paper-based processes and adopt our solutions to modernize and digitize document experiences, growing our revenue with this business in the process.

**Digital Experience**

*Opportunity*

Digital transformation is a macro trend that affects every business, government and educational institution today—every business is a digital business. Consumers today buy experiences, not just products, and they demand personalized digital experiences that are relevant, engaging, seamless and secure across an ever-expanding range of channels and devices. Business customers increasingly have the same expectations, which drives business-to-business ("B2B") companies to deliver business-to-consumer ("B2C") experiences with a "business-to-everyone" ("B2E") strategy. Delivering the best, personalized experience to a consumer at a given moment requires the right combination of data, insights and content across multiple channels in real time and at scale. In turn, executives, including those at the world's leading brands, are increasingly seeking solutions that enable real-time personalization at scale. Marketing and IT teams are looking for a return on investment to demonstrate the business impact of their transformation initiatives.

Adobe Experience Cloud is powering digital businesses by providing exceptional experiences to their customers via a comprehensive suite of solutions. We continue to believe that addressing the challenges of customer experience management is a large and growing opportunity and we are in position to help businesses and enterprises invest in solutions that aid their goals to transform how they engage with their customers and constituents digitally.

*Strategy*

Our goal is to be the leading provider of cloud-based solutions for delivering digital experiences and enabling digital transformation. The Adobe Experience Cloud applications and services are designed to manage customer journeys, enable personalized experiences at scale and deliver intelligence for businesses of any size in any industry. The Adobe Experience Platform further strengthens our differentiation and competitive advantage offering a way to connect our comprehensive set of solutions.

Adobe Experience Cloud delivers solutions for our customers across the following strategic growth pillars:

- *Data insights and audiences*. Our solutions, including Adobe Analytics, Adobe Experience Platform, Customer Journey Analytics, Adobe Audience Manager and our Real-time Customer Data Platform, deliver robust customer profiles and AI-powered analytics across the customer journey to assist our customers in providing timely, relevant experiences across platforms.

- *Content and commerce*. Our solutions help customers manage, deliver and optimize content delivery, through Adobe Experience Manager and to enable shopping experiences that scale from mid-market to enterprise businesses, with Adobe Commerce.

- *Customer journeys*. Our solutions help businesses manage, test, target, personalize and orchestrate campaigns and customer journeys across B2E use cases, including through Marketo Engage, Adobe Campaign, Adobe Target and Journey Optimizer.

- *Marketing workflow*. We offer Adobe Workfront, a work management platform directed toward marketers to orchestrate campaign workflows.

We also believe the AI and machine learning framework enabled by our strategy with Adobe Sensei enhances the delivery of digital experiences. Adobe Experience Cloud offers domain-specific AI services powered by Adobe Sensei that work with Adobe Experience Platform to augment existing Experience Cloud product offerings. These AI services help provide domain-specific intelligence in areas such as attribution and automated insights, customer journey management, lead management, sentiment analysis, one-click personalization, enhanced anomaly detection and more. By building on existing features and these AI-powered services, we believe Adobe Sensei will increase the value we provide our customers and create a competitive differentiation in the market.

Adobe Experience Cloud also offers an open platform and ecosystem through the Adobe Experience Platform, AI services and developer services through Adobe I/O. Adobe Experience Platform provides the underlying infrastructure to make customer experience management possible by standardizing data into an easily sharable format consumable by Adobe Sensei and provides an open and extensible cloud infrastructure for Adobe Experience Cloud that allows data to flow freely within the Adobe Experience Platform and between Adobe Experience Cloud solutions and third-party software. This open architecture offers scalability with a wide variety of supporting products and services, empowers users to quickly develop innovative applications to interact with consumers and enables a broad industry ecosystem.

To drive growth of Adobe Experience Cloud, we are focused on delivering the best customer experience management solutions for B2E, enterprise and mid-market through our applications, services and platform. We also intend to focus on customer engagement, growth within existing customer accounts and product differentiation. We are continuing to add new services, such as Adobe Developer App Builder and Adobe Experience Cloud for Healthcare, and add new functionality and features to our current offerings, such as a new B2B edition of Adobe Real-Time Customer Data Platform, Adobe Experience Manager Screens and new personalization features in Adobe Experience Cloud. To give our customers increased flexibility, better functionality and expand our reach, we are also delivering new and improved integrations, such as increased synergy between our Experience Cloud products and Creative Cloud and Adobe Sign. Within our established base of customers, we intend to pursue growth through continued expansion of mid-market and enterprise customer accounts by encouraging such customers to take advantage of our suite of end-to-end products. We utilize a direct sales force to market and license our Experience Cloud solutions, as well as an extensive ecosystem of partners, including marketing agencies, SIs and ISVs that help license and deploy our solutions to their customers. Strategic partnerships, such as the ones we have formed with

Microsoft, IBM, Fluent Commerce and Dentsu, continue to increase our market reach. We have made significant investments to broaden the scale and size of all of these routes to market and believe these investments will result in continued growth in revenue in our Digital Experience segment in fiscal 2022 and beyond.

### Publishing and Advertising

Our Publishing and Advertising segment contains legacy products and services that address diverse market opportunities including eLearning solutions, technical document publishing, web conferencing, document and forms platform, web application development, high-end printing and our Adobe Advertising Cloud offerings. Graphics professionals and professional publishers continue to require quality, reliability and efficiency in production printing, and our Adobe PostScript and Adobe PDF printing technologies provide advanced functionality to meet the sophisticated requirements of this marketplace. As high-end printing systems evolve and transition to fully digital, composite workflows, we believe we are well positioned to be a supplier of software and technology based on the Adobe PostScript and Adobe PDF standards for this industry.

Adobe Advertising Cloud delivers an end-to-end, demand-side platform for managing advertising across digital formats and simplifies the delivery of video, display and search advertising across channels and screens.

We generate revenue in our legacy Publishing products and services by licensing our technology to OEMs that manufacture workflow software, printers and other output devices, and we generally generate revenue in Advertising through usage-based offerings.

## COMPETITION

### Overview

Adobe participates in a highly competitive environment globally, where our competitors vary by industry segment and range from large multinational enterprises to smaller entities with a more narrowly focused product offering. Across our business, we recognize hundreds of competitors worldwide. The markets for our products and services are characterized by new industry standards, evolving distribution models, technology innovation, frequent product introductions, short product life cycles, price cutting with resulting downward pressure on gross margins and price sensitivity on the part of consumers. Our future success will depend on our ability to enhance and better integrate our existing products, introduce new products on a timely and cost-effective basis, meet changing customer needs, provide best-in-class information security to build customer confidence and combat cyber-attacks, extend our core technology into new applications and anticipate emerging standards, business models, software delivery methods and other technological changes.

A summary of the competitive environment for each of our business segments is included below:

### Digital Media

Our Digital Media segment faces competition from large, established companies as well as a variety of point offerings, free products and downloadable apps. We compete in a constantly evolving market and face significant direct or indirect competition from desktop software companies; device, hardware and camera manufacturers; operating system developers that integrate digital imaging and image management features with their operating systems; smartphone and tablet manufacturers that integrate imaging and video software; proprietary and open source web-authoring tools; mobile-first applications; social media platforms that provide imaging and video offerings, including editing capabilities; stock content marketplaces; and digital document creation, storage, collaboration and signing providers.

We believe competitive factors in our markets include brand leadership, product features and functionalities; integration with related tools and third-party applications; the intuitiveness and visual appeal of user interfaces; demonstrable cost-effective benefits to customers; pricing; the flexibility of services to match changing business demands; usability and accessibility on multiple devices, including mobile and desktop; and success in educating customers in how to utilize services effectively. We believe our greatest advantage in this space is the performance and scope of our integrated solutions, which work together as part of Creative Cloud or Document Cloud. We are a leader through our ability to offer a very broad and comprehensive array of products and services through our Adobe Creative Cloud. With Creative Cloud, we believe we compete well with our features and functionality, ease of use, product reliability, value and performance characteristics. With Document Cloud, we believe we compete well based on the global use of PDF, our features and functionalities, which are critical tools for millions of business communicators, and our brand leadership.

**Digital Experience**

Our Digital Experience business unit competes in markets that are growing rapidly and characterized by intense competition. Our Adobe Experience Cloud solutions face competition from large, established companies, including large enterprise software, internet and database management companies, in addition to point product solutions and focused competitors, and new competitors are constantly entering these markets. Some of these competitors provide SaaS solutions to customers, generally through a web browser, while others provide software that is installed by customers directly on their servers. In addition, we compete at times with our customers' or potential customers' internally-developed applications.

We believe competitive factors in our markets include the proven performance, security, scalability, flexibility and reliability of services; the strategic relationships and integration with third-party applications; the intuitiveness and visual appeal of user interfaces; demonstrable cost-effective benefits to customers; pricing; the flexibility of services to match changing business demands; enterprise-level customer service and training; brand leadership; the usability of services; real-time data and reporting; independence from portals and search engines; the ability to deploy the services globally; and success in educating customers in how to utilize services effectively. We believe we compete well with both enterprise and low-cost alternatives based on many of these competitive factors including our strong feature set, the breadth of our offerings, our focus on global, multi-brand companies, our superior user experience, tools for building multi-screen, cross-channel applications, standards-based architecture, scalability and performance and leadership in industry standards efforts.

**Publishing and Advertising**

Our Publishing and Advertising product offerings faces competition from large-scale publishing systems and XML-based publishing companies, as well as lower-end desktop publishing products. Our web conferencing product faces competition from a number of established products from other large software companies. Competition involves a number of factors, including product features, ease-of-use, the level of customization and integration supported, the number of hardware platforms supported, service and price. We believe we can successfully compete based upon the quality and features of our products, integrations with our Creative Cloud, Document Cloud and Digital Experience products and our strong brand among users.

## PRINCIPAL PRODUCTS AND SERVICES

**Digital Media Offerings**

***Creative Cloud***

Adobe Creative Cloud is a cloud-based subscription app that enables creative professionals and enthusiasts alike to express themselves with apps and services for photography, design, video, web and more that connect across devices, platforms and geographies. Members have access to a vibrant creative community, publishing services to deliver apps and websites, cloud storage to easily sync and access their work, files and assets across apps, platforms and devices using Creative Cloud Libraries, collaboration capabilities with team members and new products and exclusive updates as they are developed. Creative Cloud members can build a Creative Profile that moves with them via Creative Cloud services from app to app and device to device, giving them immediate access to their personal files, photos, brushes, graphics, colors, fonts, text styles, desktop setting customizations and other important assets. All of the applications listed below and many more are available through subscriptions to Creative Cloud. Many of our applications are also available as a point product subscription.

*Adobe Photoshop and Adobe Lightroom*

Adobe Photoshop is the world's most advanced digital imaging and design app, with powerful editing and effects tools to transform photos. It is available on desktop and iPad, and we recently released a web version that is available in public beta to subscribers. Adobe Lightroom is our cloud-based photo service that allows subscribers to edit, organize, store and share photos across desktop, tablet and mobile devices. In addition to individual subscriptions to Photoshop and Lightroom, we offer a Photography Plan, which is a more limited cloud-based offering than Creative Cloud, targeted at photographers and photo enthusiasts and includes Photoshop, Lightroom and Lightroom Classic. For users looking for fast and powerful photo editing on mobile devices, we also offer Photoshop Express, which uses a touch-based interface for sophisticated photo editing and content creation.

*Adobe Illustrator and Adobe Fresco*

Adobe Illustrator is our industry-standard vector graphics app for desktop and iPad used worldwide by designers of all types who want to create digital graphics and illustrations for all kinds of media—print, web, interactive, video and mobile—from web and mobile graphics to product packaging to book illustrations and billboards. Adobe Fresco is our illustration app, available as a free or premium version and on iPhone, iPad, Microsoft Surface tablet and Wacom MobileStudio devices, that brings together the world's largest collection of vector and raster brushes and Live Brushes, powered by Adobe Sensei, to deliver a natural painting and drawing experience.

*Adobe InDesign*

Adobe InDesign is an industry-leading design and layout app for print and digital media. Our customers use it to create, preflight and publish a broad range of content including newspapers and magazines for print, online and tablet app delivery. Tight integration with other Adobe offerings such as Photoshop, Illustrator, Acrobat, Adobe Stock and Adobe InCopy expands InDesign's capabilities. Customers can also access Adobe's digital publishing capabilities from within InDesign to create and publish engaging apps for a broad range of devices, including iOS, Android and Amazon-based devices.

*Adobe Premiere Pro and Adobe Premiere Rush*

Adobe Premiere Pro is a leading nonlinear video editing app used by filmmakers, TV editors, YouTubers and videographers. Customers can import and combine various types of media, from video shot on a smartphone to 8K to virtual reality, and then edit in its native format without transcoding. Automated tools and workflows for color, graphics, audio and immersive 360/VR make the editing process more efficient. New features in Premiere Pro include Speech-to-Text, automatic caption generation, native support for Apple M1 chips and tools for stylizing text, among others. Adobe Premiere Rush is an all-in-one video editing app, available as a free or premium version, that simplifies video creation and direct sharing to platforms, including YouTube and Instagram, while delivering professional quality video results.

*Adobe XD*

Adobe XD is our all-in-one experience design ("XD") app on desktop and mobile used to build user experiences ("UX") and user interfaces ("UI") when designing websites, mobile apps and more. Adobe XD brings design and prototyping together with tools, such as Responsive Resize, Repeat Grid and Auto Animate, that deliver precision and performance, save time, enable seamless collaboration and make sharing easy at each step of the process, allowing individuals and teams to create everything from low-fidelity wireframes to fully interactive prototypes. Adobe XD is available as a free or premium version.

*Adobe Stock*

Adobe Stock provides designers and businesses with access to millions of high-quality, curated, royalty-free photos, vectors, illustrations, videos, templates, audio and 3D assets, for all of their creative projects. Adobe Stock is built into our Creative Cloud apps, including Photoshop, Illustrator and InDesign, enabling users to search, browse and add assets to their Creative Cloud Libraries and instantly access them across all connected devices. Adobe Stock assets include free and paid collections and may be licensed directly within Adobe's desktop apps, through stock.adobe.com or as a multi-asset subscription.

*Substance 3D*

Substance 3D is an ecosystem of desktop apps, including Substance 3D Stager, Substance 3D Painter, Substance 3D Sampler and Substance 3D Designer. Customers can build and assemble 3D scenes with Stager, use tools in Painter to texture 3D assets, from advanced brushes to Smart Materials that automatically adapt to your model and use Sampler to digitize and enrich assets. Substance 3D Assets is a 3D materials library from which users can import professional quality 3D textures into their projects and generate infinite texture variations. Substance 3D Modeler, which is currently only available in beta form, interprets spatial input from the physical world, allowing the user to sculpt a model as if in a real workshop, using natural, fluid gestures of the artistic flow, and switch between VR and desktop, at every project stage.

*Creative Cloud Express*

Creative Cloud Express is our web and mobile app directed towards first-time creators, communicators and creative professionals that enables easy-to-use, efficient content creation, featuring guided tools, one-click solutions for quick projects, simple drag and drop functions, collaboration tools, thousands of templates and access to more than 20,000 fonts and the entire Adobe Stock photo collection. Creative Cloud Express is available as a free or premium version.

*Adobe After Effects*

Adobe After Effects is our industry-standard motion graphics and visual effects app used by a wide variety of animators, designers and compositors to create cinematic movie titles, add effects and create animations. New features include real-time 3D draft preview, a 3D ground plane and improvements to collaboration tools. After Effects works together seamlessly with other Adobe apps such as Premiere Pro, Photoshop, Illustrator, Adobe XD and Adobe Audition, as well as third party software and hardware partners.

*Frame.io*

Frame.io is our cloud-native video collaboration platform that streamlines the video production process by enabling editors and key project stakeholders to collaborate with real-time upload, review and approval, frame-accurate commenting, annotations and more.

*Behance*

Behance is a social community for creators to showcase and discover creative work online and live-stream their skills and creations from Creative Cloud applications. Adobe Portfolio allows users to quickly and simply build a fully-customizable and hosted website that seamlessly syncs with Behance.

***Adobe Document Cloud***

Adobe Document Cloud is a cloud-based subscription offering that enables complete, reliable and automated digital document and signature workflows across desktop, mobile, web and third-party enterprise applications to drive business productivity for individuals, teams, small businesses and enterprises. With Document Cloud, users can create, review, approve, sign and track documents and store them in the cloud for easy access and sharing, across desktop and mobile devices. Document Cloud includes Adobe Acrobat DC, Adobe Sign, Adobe Scan and other apps and API services that work standalone or integrate with users' existing productivity apps, processes and systems.

*Adobe Acrobat DC*

At the heart of Adobe Document Cloud is Adobe Acrobat DC, the industry standard for creating, converting and editing PDFs. Acrobat enables users to create secure, reliable and compact Adobe PDF documents and enables automated, collaborative workflows with a rich set of commenting, editing and sharing tools and direct integration with Adobe Sign. In fiscal year 2021, we also released Acrobat Chrome and Edge extensions allowing users to access our Acrobat tools without leaving the web browser. Acrobat is also included in our Creative Cloud all apps subscription offering.

*Acrobat Web*

We have brought many of the tools and features of Adobe Acrobat DC to the web with Acrobat web, which offers single-click tools for users to edit, comment, convert, organize and sign PDF documents directly within the web browser. Acrobat web enables quick, easy-to-access results, while introducing users to the power of our offerings. Acrobat web includes both free and premium features.

*Adobe Acrobat Reader*

Adobe Acrobat Reader, our free software for reliable viewing, annotating and printing of Adobe PDF documents on a variety of desktop and mobile platforms, offers features to create, edit, export, combine, share and collaborate on PDF documents on mobile devices, including the "Liquid Mode" feature that automatically reformats PDFs for quick navigation and consumption on smaller screens. Users of both Acrobat and Acrobat Reader can also access, edit and save changes to their PDF files stored in the Adobe Document Cloud, or other third-party cloud storage services, including Box, Dropbox, Google Drive and Microsoft OneDrive.

*Adobe Scan*

Adobe Scan can be used for free on mobile devices to provide scanning capabilities in the pocket of every person. It captures paper documents as images and transforms them into full-featured and versatile PDFs via Adobe Document Cloud services for instant sharing with others.

*Adobe Sign*

Our cloud-based e-signature service, Adobe Sign, allows users to securely electronically send and sign any document from any device. Through web and mobile applications, Adobe Sign enables users to e-sign documents and forms, send them for signature, track responses in real time and obtain instant signatures with in-person signing. Adobe Sign also integrates with users' enterprise systems through a comprehensive set of application programming interfaces and Adobe Experience Manager Forms and Advanced Workflows for Adobe Sign, to create forms and provide seamless experiences to customers across web and mobile sites.

**Digital Experience Offerings**

Adobe Experience Cloud is a comprehensive collection of best-in-class products and solutions to manage the customer experience, all integrated onto a cloud platform, along with service, support and an open ecosystem. Experience Cloud is comprised of the following sets of solutions for our customers: Adobe Experience Platform; Data, Insights and Audiences; Content and Commerce; Customer Journeys; Marketing Workflow; and Digital Enrollment and Onboarding, which are each described below.

***Data, Insights and Audiences***

Our Data, Insights and Audiences solutions enable users to stitch together data from across the customer journey into a single view to provide insights based on every interaction in real time, share this data and analysis across the team and organization and AI and machine-learning personalization. The following is a brief description of our solutions for Customer Data and Insights.

*Adobe Analytics*

Adobe Analytics helps our customers create a holistic view of their business by turning consumer interactions into actionable insights. Driven by AI and machine learning, Adobe Analytics collects, organizes and structures vast streams of data from virtually any channel to deliver real-time insights that are easy for users to process, analyze and share to quickly identify problems and opportunities and to drive conversion and relevant consumer experiences. Our customers can use these analytics to continuously improve marketing activities and better direct their marketing spend. Our Analysis Workspace features a drag-and-drop interface that allows customers to craft an analysis, add visualizations so they can bring data to life, curate a dataset and share and schedule projects across their organization, among other features.

*Adobe Experience Platform*

Adobe Experience Platform is a purpose-built platform for customer experience management that helps users collect, connect and activate known and unknown customer data from every customer interaction across sources, channels and customer interactions in real time to create robust, unified customer profiles. Adobe Experience Platform standardizes data for intelligence and profile creation and provides an open and extensible cloud infrastructure, real-time updates, AI-driven insights and scalability, with a wide variety of supporting products and services. Adobe Experience Platform also offers Query Service and Data Science Workspace, which enable users to gain deeper insights from stored datasets, and customer journey intelligence, which leverages predefined data-driven operational best practices, AI and business intelligence to enable and optimize real-time decisions, actions and business processes. Users are able to leverage Adobe Experience Platform to activate AI-driven insights across all Adobe Experience Cloud applications in real time.

*Customer Journey Analytics*

Our Customer Journey Analytics service, built on Adobe Experience Platform, brings a powerful set of analytics tools that allow brands to interactively explore and visualize the customer journey across multiple channels and utilize AI-powered insights, while making such analytics more accessible across their organization, to ensure that customer journeys flow seamlessly regardless of channel.

*Adobe Audience Manager*

Adobe Audience Manager is a data management platform that helps digital publishers build unique audience profiles to identify the most valuable segments and use them across any digital channel. Adobe Audience Manager consolidates audience information from virtually any channel and device, unifies that data into audience profiles and activates audience segments by pushing them out to demand-side platforms, campaign management systems and other marketing platforms.

*Real-Time Customer Data Platform*

Adobe's Real-time Customer Data Platform service, built on Adobe Experience Platform, delivers real-time personalization at scale to enable brands to bring together internal and external, known and unknown customer data to activate real-time customer and account profiles that allow for B2C and B2B marketers to deliver timely, relevant experiences across channels. It does so by activating Adobe Experience Platform's unified customer profiles across channels to leverage intelligent decision making throughout the customer journey and deliver hyper-personalized experiences across all known channels and devices. The Real-time Customer Data Platform utilizes an open and extensible architecture that allows integration with a variety of data sources and activation touchpoints and provides continuous data refreshes to keep customer profiles updated in real time.

***Content and Commerce***

Our Content and Commerce solutions help customers manage, deliver, personalize and optimize content across web, mobile and application interfaces, as well as enable shopping experiences that scale from mid-market to enterprise businesses, across devices and channels. The following is a brief description of our solutions for Content and Commerce.

*Adobe Experience Manager*

Adobe Experience Manager combines digital asset management with a content management system and an end-to-end digital document solution. Adobe Experience Manager Sites provides a content management system built on a scalable, cloud-native foundation to create and deploy personalized experiences across every channel. Adobe Experience Manager Assets offers cloud-native digital asset management to create, manage, deliver and optimize personalized experiences at scale. Adobe Experience Manager Forms provides a cloud-native and scalable solution for personalized end-to-end digital customer onboarding and enrollment, enabling users to create, manage, publish and approve forms and documents.

We also recently released Adobe Experience Manager Screens, which allows customers to connect online and in-venue experiences through digital signage, and Adobe Developer App Builder, which provides a set of tools and services to developers to extend Experience Manager to customers' existing infrastructure and apply unique parameters to make the UI look and feel unique for their organizations.

*Adobe Commerce*

Adobe Commerce offers a highly customizable, end-to-end platform to manage, personalize and optimize the commerce experience for physical and digital goods across every touchpoint by bringing together digital commerce, order management and predictive intelligence to enable engaging shopping experiences across B2C, B2B and direct-to-consumer. Based on an open-source ecosystem with thousands of third-party extensions, Adobe Commerce extends beyond the web shopping cart to shoppable experiences, with actionable data analysis and automated back-end workflows, native integrations with other Adobe products, such as Analytics, Target, Experience Manager and Creative Cloud and the capability to be scalable and extensible.

***Customer Journeys***

Our Customer Journeys solutions enable our customers to manage and orchestrate individual cross-channel campaigns that encourage meaningful customer experiences, personalize content and deliver optimized experiences at scale that are meaningful to each of their customers and plan, orchestrate and measure engagement with their prospects and customers at every stage of the customer journey, across B2E use cases. The following is a brief description of our solutions for Customer Journeys.

*Marketo Engage*

Marketo Engage is a customer experience management solution optimized for B2B, cross-channel campaigns by bringing together planning, engagement and measurement capabilities into an integrated marketing platform. Capabilities include lead nurturing and management, predictive account profiling for creating account-based experiences, integrated sales application and integrations with third-party marketing apps and Adobe Experience Cloud. Marketo Engage simplifies how companies plan, orchestrate and measure engagement at each stage of the customer experience, and allows companies to better align marketing and sales to engage high priority accounts.

*Adobe Campaign*

Adobe Campaign is optimized for managing B2C cross-channel marketing campaigns. Adobe Campaign enables marketers to orchestrate the entire customer journey and use rich customer data to create, coordinate and deliver dynamic, personalized experiences that are synchronized across channels, including email, mobile and offline, and determined by each consumer's behaviors and preferences. Adobe Campaign's features also include AI-powered email management, multidimensional targeting, in-app messaging and dynamic, customizable reports to analyze success.

*Adobe Target*

Adobe Target is an AI- and machine-driven personalization engine that lets our customers test, target and optimize content across channels. With Adobe Target, our customers have the tools they need to create omnichannel personalized experiences and create A/B and multivariate tests, done at scale through AI-powered automation so they can quickly discover the best customer experience and deliver that experience across all touchpoints. New features include integration with Adobe Real-Time Customer Data Platform, same page segment qualification and enhanced AI-powered capabilities.

*Journey Optimizer*

Journey Optimizer helps brands drive engagement by providing tools to manage inbound customer engagement with outbound omnichannel campaigns, offering personalized content based on real-time profiles, data-driven insights, cloud-native scalability and API extensibility, within a single application. Users can trigger individual journeys and use real-time insights to personalize that journey, as well as visually map individual journeys across systems in an intuitive, workflow-based interface. Journey Optimizer also allows businesses to track detailed performance of executed journeys and how individuals are progressing in real time, with data automatically sent to Adobe Experience Platform to allow full-funnel analysis.

***Marketing Workflow***

*Adobe Workfront*

Adobe Workfront provides a unified work management application to enable teams to work more efficiently, with tools to strategize, plan, execute, review and deliver on complex workflows. We recently added plugins for Adobe Photoshop and Adobe XD, as well as integrations with Adobe Experience Manager Assets and Adobe Marketo Engage, to enhance our experience delivery to B2B brands and make Workfront features available to more of our users.

**Other Products and Services**

We also offer a broad range of other enterprise and digital media products and services. Information about other products not referenced here can be found on our corporate website, www.adobe.com.

## OPERATIONS

**Marketing and Sales**

We market and license our products directly using our sales force and certain local offices and through our own website at www.adobe.com. We also market and distribute our products through sales channels, which include distributors, retailers, software developers, mobile app stores, SIs, ISVs and VARs, as well as through OEM and hardware bundle customers and our local field offices.

Our local field offices include locations in Australia, Belgium, Brazil, Canada, China, Denmark, France, Germany, Hong Kong, India, Ireland, Italy, Japan, Republic of Moldova, the Netherlands, Poland, Romania, Singapore, South Africa, South Korea, Spain, Sweden, Switzerland, Taiwan, the United Kingdom and the United States.

We sell the majority of our products through a software subscription model where our customers purchase access to a product for a specific period of time during which they always have rights to use the most recent version of that product. We also license perpetual versions of certain products with maintenance and support, which includes rights to upgrades, when and if available, support, updates and enhancements.

For all periods presented, there were no customers that represented at least 10% of net revenue or that were responsible for over 10% of our trade receivables.

**Services and Support**

We provide expert consulting, customer success management, technical support and learning services across all our customer segments, which include enterprises, small and medium businesses, creative professionals and consumers. With a focus on ensuring sustained customer success and realized value, this comprehensive portfolio of services is designed to help customers and partners maximize the return on their investments in our cloud solutions and licensed products.

*Consulting Services*

We have a global professional services team dedicated to designing and implementing solutions for our largest customers. Our professional services team uses a comprehensive, customer-focused methodology that has been refined over years of capturing and analyzing best practices from numerous customer engagements across a diverse mix of solutions, industries and customer segments. Our customers continually seek to integrate across Adobe's products and cloud solutions and engage our professional services teams for their expertise in leading customers' digital strategies, multi-solution integrations and in running customer platforms. Using our methodology, our professional services teams are able to accelerate customers' time to value and maximize customers' return on their investment in Adobe solutions.

Another key component of Adobe's strategy is developing a large partner ecosystem to expand the reach and breadth of Adobe solutions in the global marketplace. To assist partners in building their respective digital practices, Adobe Global Services provides a comprehensive set of deliverables through Adobe's Solution Partner Program. The breadth of services described in the program provides system integrators, agencies and regional partners the tools required to develop core capabilities for positioning and building with Adobe technology, as well as implementing and running customer platforms. We believe that through these programmatic services and support, our joint customers benefit greatly from the combination of Adobe technology and the deep customer context that our global partners represent.

*Customer Success Account Management*

Adobe Customer Solutions provides Customer Success Managers, who work with enterprise and commercial customers on an ongoing basis to understand their current and future business needs, promote faster solution adoption and align product capabilities to customers' business objectives to maximize the return on their investment in Adobe's offerings. We engage customers to share innovative best practices, relevant industry and vertical knowledge and proven success strategies based on our extensive engagements with leading marketers and brands. The performance of these teams is directly associated with customer-focused outcomes.

*Technical Support*

Adobe provides enterprise maintenance and support services to customers of subscription products as part of the subscription entitlement and to perpetual license customers via annual fee-based maintenance and support programs. These offerings provide customers with:

- technical support on the products customers have purchased from Adobe;
- "how to" help in using our products; and
- product upgrades and enhancements during the term of the maintenance and support or subscription period, which is typically one to three years.

We provide product support through our support organization that includes several regional and global support centers, supplemented with outsourced vendors for specific services. Customers can seek help through multiple channels including phone, chat, web, social media and email, allowing quick and easy access to the information they need. These teams are responsible for providing timely, high-quality technical expertise on all our products.

Certain consumers are eligible to receive Getting Started support, to assist with easy adoption of their products. Support for some products and in some countries may vary. For enterprise customers with greater support needs, we offer personalized service options through Premium Services options, delivered by global support centers and technical account managers who can also provide proactive risk mitigation services and on-site support services for those with business-critical deployments.

We also offer delivery assurance, technical support and enablement services to partners and developer organizations. We provide developers with high-quality tools, software development kits, information and services.

*Digital Learning Services*

Adobe Customer Solutions offers a comprehensive portfolio of learning and enablement services to assist our customer and partner teams in the use of our products, including those within Digital Experience, Digital Media and other legacy products and solutions. Our training portfolio includes a large number of free online self-service learning options on www.training.adobe.com. Adobe Digital Learning Services also has an extensive portfolio of fee-based learning programs including a wide range of traditional classroom, virtual and on-demand training and certifications delivered by our team of training professionals and partners across the globe.

These core offerings are complemented by our custom learning services, which support our largest enterprise customers and their unique requirements. Solution-specific skills assessments help our enterprise customers objectively assess the knowledge and competencies within their marketing teams and tailor their learning priorities accordingly.

**Investments**

From time to time we make direct investments in privately held companies. We enter into these investments with the intent of securing financial returns as well as for strategic purposes, as they often increase our knowledge of emerging markets and technologies and expand our opportunities to provide Adobe products and services.

## PRODUCT DEVELOPMENT

A continuous high level of investment is required for the enhancement of existing solutions and the development of new solutions due to the speed of technological change that characterizes the software industry. We develop our software internally, as well as acquire products or technology developed by others by purchasing the stock or assets of the business entity that owns the technology. In other instances, we have licensed or purchased the intellectual property ownership rights of programs developed by others with license or technology transfer agreements that may obligate us to pay a flat license fee or royalties, typically based on a dollar amount per unit or a percentage of the revenue generated by those programs.

## PROTECTING AND LICENSING OUR PRODUCTS

We protect our intellectual property through a combination of patents, copyrights, trademarks and trade secrets, foreign intellectual property laws, confidentiality procedures and contractual provisions. We have U.S. and international patents and pending applications that relate to various aspects of our products and technology. Although our patents have value, no single patent is essential to any of our principal businesses. We have also registered, and applied for the registration of, U.S. and international trademarks, service marks, domain names and copyrights.

We license our desktop software and mobile apps to users under ‘click through’ or signed license agreements containing restrictions on duplication, disclosure and transfer. Similarly, cloud products and services are provided to users under ‘click through’ or signed agreements containing restrictions on access and use. Our enterprise customers license our hosted offerings as SaaS or Managed Services.

Despite our efforts to protect our proprietary technology and our intellectual property rights, unauthorized parties may attempt to copy or obtain and use our technology to develop applications with the same functionality as our applications. Policing unauthorized use of our technology and intellectual property rights is difficult. We believe that our transition from perpetual-use software licenses to a subscription-based business model combined with the increased focus on cloud-based computing has and may continue to improve our efforts to combat the pirating of our products.

## HUMAN CAPITAL

Our values—genuine, innovative, involved and exceptional—are built on the foundation that our people and the way we treat one another promote creativity, innovation and performance, which spur the Company’s success. We are continually investing in our global workforce to further drive diversity and inclusion, provide fair and market-competitive pay and benefits to support our employees’ wellbeing, and foster their growth and development. As of December 3, 2021, we employed 25,988 people, of which approximately 52% were in the United States and 48% were in our international locations. During fiscal 2021, our total attrition rate was 12%. We have not experienced work stoppages and believe our employee relations are good. Our employee listening program helps us understand employee sentiment on a wide range of topics throughout the employee lifecycle, providing insights that inform our decisions about employee programs, talent risks, management opportunities, employee networks and more. In fiscal year 2021, 76% of our employees participated in our most recent engagement survey.

We encourage you to visit our website for more detailed information regarding our Human Capital programs and initiatives. Nothing on our website shall be deemed incorporated by reference into this Annual Report on Form 10-K.

### Diversity and Inclusion

Adobe For All is our vision to advance diversity and inclusion across the Company. We recognize that everyone deserves respect and equal treatment, regardless of gender, race, ethnicity, age, disability, sexual orientation, gender identity, cultural background or religious belief. As of December 3, 2021, women represented 33.8% of our global employees, and underrepresented minorities (“URMs”, defined as those who identify as Black/African American, Hispanic/Latinx, Native American, Pacific Islander and/or two or more races) represented 10.9% of our U.S. employees. To continue to improve employee representation, we have declared a set of aspirational goals for women in leadership positions globally, underrepresented minorities in leadership positions in the United States and overall Black representation.

We have a four-pronged strategy to grow the diversity of our workforce over time, on which we have continued to drive progress during fiscal 2021:

- *Pipeline*: We help build the pipeline of future technical talent by encouraging young people of all backgrounds to learn and get excited about software coding and careers in tech. In fiscal 2021, we partnered with many visionary organizations including Braven, BRIDGEGOOD, OneSchool and ScholarMatch.

- *Candidates*: We source candidates from a variety of backgrounds and work to ensure fairness in our interview and hiring processes. In fiscal 2021, we introduced a program called Hiring at Adobe that requires hiring managers to complete a training to ensure diverse candidates are part of the interview and screening process; we sourced candidates from a variety of conferences and partnerships, such as AfroTech, BreakLine, Disability:IN and Techqueria; and we initiated the Adobe Anchor School Program, which includes partnerships with historically black colleges and universities and a Hispanic-Serving Institution.

- *Employees*: We are creating an inclusive workplace through community-building, training and internal awareness. In fiscal 2021, we continued to support our many employee resource groups ("ERGs") that build community for employees from underrepresented groups, including the recent addition of an Indigenous/First Nations ERG. We hosted our annual global diversity and inclusion event, Adobe For All Week, bringing together thousands of employees to focus on ways to strengthen inclusion and empathy every day.

- *Industry*: We join forces with our customers, partners, vendors and peers to drive broader progress on diversity. In fiscal 2021, we collaborated with industry peers to advance diversity across multiple dimensions including through our participation in the CEO Action for Diversity & Inclusion, The Valuable 500, the Ascend 5-Point Action Agenda and ParityPledge.

We invest in analysis and transparency to demonstrate our commitment to fair compensation. We define pay parity as ensuring that employees in the same job and location are paid fairly regardless of their gender or ethnicity. In fiscal 2021, we again achieved global gender pay parity and U.S. URM and non-URM pay parity. We are committed to maintaining pay parity, and we plan to continue investing in ongoing salary analysis across hiring, acquisition integrations and annual pay review processes.

Additional information on our diversity and inclusion strategy, diversity metrics and programs can be found on our website at adobe.com/diversity. Nothing on our website shall be deemed incorporated by reference into this Annual Report on Form 10-K.

**Compensation, Benefits and Wellbeing**

We offer fair, competitive compensation and benefits that support our employees' overall wellbeing. To ensure alignment with our short- and long-term objectives, our compensation programs for all employees include base pay, short-term incentives and opportunities for long-term incentives. We believe this alignment, whether through equity awards issued by Adobe or employee participation in our employee stock purchase plan, provides employee shareholders with meaningfully deeper connections to Adobe and contributes to the Company's long-term success. Our wellbeing and benefit programs focus on four key pillars: physical, emotional, financial and community. We offer a wide array of benefits including comprehensive health and welfare insurance, generous time-off and leave and retirement and financial support. We provide emotional wellbeing services through our Employee Assistance Program and a variety of interactive apps. Our wellness reimbursement of up to $600 per year for each eligible employee, lifestyle coaching, global wellbeing speaker series and ergonomic programs help to support employees' physical wellbeing. In addition, our financial education and financial wellness coaches offer employees tools and resources to reach their personal financial goals.

In response to the COVID-19 pandemic, we implemented significant changes that we determined were in the best interest of our employees and the communities in which we operate. This includes having the vast majority of our employees work from home, while implementing additional safety measures for employees continuing critical on-site work. We also provide flexible work hours and up to 20 working days per calendar year of paid time off for employees who cannot work due to circumstances related to COVID-19. We have also provided a work-from-home fund to assist employees in that transition and added several company-wide paid days off and caregiving support to help employees balance their work and life responsibilities.

**Future of Work**

Digital transformation and the COVID-19 pandemic has fundamentally changed how people work, and we are leaning into digital-first workflows, tools and resources to enable us to be productive, wherever we are. We also believe in the value of people being together—fostering trust, relationships and collaboration and innovation. We plan to embrace a hybrid model for our workforce to blend the best of what is good for our employees and what is good for our business. Flexibility will be the default for our employees going forward, with our people around the globe having the option to work from home when it makes sense for them, their team and the business. We will remain agile and continually test, learn and iterate, always ensuring our people feel valued, empowered and engaged.

### Growth and Development

Adobe seeks to attract and retain talent by offering a comprehensive range of professional development and resources. Our learning and development teams provide personalized learning paths, facilitated sessions and communities of practice that help employees achieve their career goals. Through Adobe's Learning Fund, employees are eligible to receive up to $11,000 per year toward university and short-term learning opportunities. Adobe employees also have instant access to training via several industry-leading learning platforms, which provide our global workforce with convenient, timely access to content from subject matter experts.

Adobe is committed to enabling a culture that celebrates talent sharing, career development and agility across the Company. We post all roles internally first before sharing them externally and have made several technology enhancements to make the internal job search easier for employees.

## AVAILABLE INFORMATION

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed or furnished pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge on our Investor Relations website at www.adobe.com/adbe as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information posted to our website is not incorporated into this Annual Report on Form 10-K.

## INFORMATION ABOUT OUR EXECUTIVE OFFICERS

Adobe's executive officers as of January 21, 2022 are as follows:

| Name | Age | Positions |
|---|---|---|
| Shantanu Narayen | 58 | Chairman and Chief Executive Officer |
| | | Mr. Narayen currently serves as our Chairman of the Board and Chief Executive Officer. He joined Adobe in January 1998 as Vice President and General Manager of our engineering technology group. In January 1999, he was promoted to Senior Vice President, Worldwide Products, and in March 2001 he was promoted to Executive Vice President, Worldwide Product Marketing and Development. In January 2005, Mr. Narayen was promoted to President and Chief Operating Officer, and effective December 2007, he was appointed our Chief Executive Officer and joined our Board of Directors. In January 2017, he was named our Chairman of the Board. He served as President until December 2021. Mr. Narayen serves as lead independent director on the board of directors of Pfizer Inc., a multinational pharmaceutical corporation. Mr. Narayen holds a B.S. in Electronics Engineering from Osmania University in India, a M.S. in Computer Science from Bowling Green State University and an MBA from from the University of California, Berkeley. |
| Daniel Durn | 55 | Executive Vice President and Chief Financial Officer |
| | | Mr. Durn joined Adobe in October 2021 as Executive Vice President and Chief Financial Officer. Mr. Durn most recently served as a Senior Vice President and CFO of Applied Materials from August 2017 to October 2021. Previously, he was Executive Vice President and CFO at NXP Semiconductors N.V. from December 2015 to August 2017 following its merger with Freescale Semiconductor. Before Freescale, he was CFO and Executive Vice President of Finance and Administration at GlobalFoundries, and he served as Managing Director and Head of Mergers and Acquisitions and Strategy at Mubadala Technology Fund. Prior to that, Dan was a Vice President of Mergers and Acquisitions in the technology practice at Goldman Sachs & Company. Mr. Durn received his MBA in Finance from Columbia Business School and graduated from the U.S. Naval Academy with a B.S. in Control Systems Engineering. He served in the Navy for six years, reaching the rank of lieutenant. |

Table of Contents

| Name | Age | Positions |
|---|---|---|
| Anil Chakravarthy | 54 | President, Digital Experience<br><br>Mr. Chakravarthy currently serves as President of Adobe’s Digital Experience business. Mr. Chakravarthy joined Adobe in January 2020 as Executive Vice President and General Manager, Digital Experience and was given responsibility over Worldwide Field Operations in July 2020, when he was appointed Executive Vice President and General Manager, Digital Experience Business and Worldwide Field Operations. Prior to joining Adobe, he served as Informatica’s Chief Executive Officer from August 2015 to January 2020 and Executive Vice President and Chief Product Officer from September 2013 to August 2015. Prior to joining Informatica, for over nine years, Mr. Chakravarthy held multiple leadership roles at Symantec Corporation, most recently serving as its Executive Vice President, Information Security from February 2013 to September 2013. Prior to Symantec, he was a Director of Product Management for enterprise security services at VeriSign. Mr. Chakravarthy began his career as an engagement manager at McKinsey & Company. He currently serves on the board of Ansys, Inc. and also served on the board of the Silicon Valley Leadership Group until December 2021. Mr. Chakravarthy holds a Bachelor of Technology in Computer Science and Engineering from the Institute of Technology, Varanasi, India and M.S. and Ph.D. degrees from the Massachusetts Institute of Technology. |
| David Wadhwani | 50 | President, Digital Media<br><br>Mr. Wadhwani currently serves as President of Adobe’s Digital Media business. Mr. Wadhwani rejoined Adobe in June 2021 to lead Adobe’s global Digital Media business across Adobe Creative Cloud and Adobe Document Cloud as Chief Business Officer and Executive Vice President, Digital Media. Prior to joining Adobe, he was a Venture Partner at Greylock Partners since October 2019. From September 2015 to October 2019, he was President and CEO of AppDynamics. Before that, Mr. Wadhwani previously worked at Adobe as Senior Vice President and General Manager of Adobe’s Digital Media business, having joined Adobe in 2005 through the Company’s acquisition of Macromedia, Inc., where he had been Vice President of Developer Products. Mr. Wadhwani holds a bachelor’s degree in computer science from Brown University and serves on the Brown computer science department advisory board. He is also on the digital advisory board of The Metropolitan Museum of Art and on the Board of Trustees for StoryCorps and the Fine Arts Museums of San Francisco. |
| Scott Belsky | 41 | Chief Product Officer and Executive Vice President, Creative Cloud<br><br>Mr. Belsky joined Adobe in December 2017 as Chief Product Officer and Executive Vice President, Creative Cloud. Prior to joining Adobe in December 2017, Belsky was a venture investor at Benchmark in San Francisco from February 2016 to December 2017. Prior to Benchmark, Belsky led Adobe's mobile strategy for Creative Cloud from December 2012 to January 2016, having joined the Company through the acquisition of Behance. Belsky co-founded Behance in 2006 and served as its CEO for over 6 years. He was an early advisor and investor to Pinterest, Uber and Warby Parker and other early-stage companies, and serves on the board of Globality, a referrals platform that empowers the careers of independent professionals. Mr. Belsky also serves on the advisory board of Cornell University's Entrepreneurship Program and serves on the board of trustees of the Smithsonian Cooper-Hewitt National Design Museum. |
| Gloria Chen | 57 | Chief People Officer and Executive Vice President, Employee Experience<br><br>Ms. Chen joined Adobe in 1997 and currently serves as Chief People Officer and Executive Vice President, Employee Experience. In her more than 20 years at Adobe, she has held senior leadership positions in worldwide sales operations, customer service and support, and strategic planning. In October 2009, Ms. Chen was appointed Vice President and Chief of Staff to the Chief Executive Officer. In March 2018, she was promoted to Senior Vice President, Strategy and Growth, in November 2019, she was elevated to Executive Vice President, Strategy and Growth and in January 2020, she was promoted to Chief People Officer and Executive Vice President, Employee Experience. Prior to joining Adobe, Ms. Chen was an engagement manager at McKinsey & Company. Ms. Chen holds a BS in electrical engineering from the University of Washington, an M.S. in electrical and computer engineering from Carnegie Mellon University and an MBA from Harvard Business School. |

| Name | Age | Positions |
|---|---|---|
| Ann Lewnes | 60 | Chief Marketing Officer and Executive Vice President, Corporate Strategy and Development<br><br>Ms. Lewnes joined Adobe in November 2006 and currently serves as Chief Marketing Officer and Executive Vice President, Corporate Strategy and Development. Ann has held the position of Chief Marketing Officer for over a decade and since December 2020, she also leads Adobe’s corporate strategy and strategic M&A efforts globally as Executive Vice President, Corporate Strategy and Development. Prior to joining Adobe, Ms. Lewnes spent 20 years at Intel Corporation, where she was Vice President of Sales and Marketing. Ms. Lewnes is a board member of Mattel. |
| Abhay Parasnis | 47 | Executive Vice President, Chief Technology Officer and Chief Product Officer, Document Cloud<br><br>Mr. Parasnis currently serves as Executive Vice President, Chief Technology Officer and Chief Product Officer, Document Cloud. He joined Adobe in July 2015 as Senior Vice President of Adobe's Cloud Technology & Services organization and Chief Technology Officer and in February 2020, he was appointed Chief Technology Officer and Executive Vice President, Strategy and Growth. Prior to joining Adobe, he served as President and Chief Operating Officer at Kony, Inc. from March 2013 to March 2015. From January 2012 to November 2013, Mr. Parasnis was a Senior Vice President and later Strategic Advisor for the Oracle Public Cloud at Oracle. Prior to joining Oracle, he was General Manager of Microsoft Azure AppFabric at Microsoft from April 2009 to December 2011.<br><br>As previously announced, Mr. Parasnis will remain in his current role with Adobe until early 2022 and will actively assist with the transition of his duties during that period. |
| Dana Rao | 52 | Executive Vice President, General Counsel and Corporate Secretary<br><br>Mr. Rao currently serves as our Executive Vice President, General Counsel and Corporate Secretary. He joined Adobe in April 2012 and served as our Vice President, Intellectual Property and Litigation where he spearheaded strategic initiatives including the Company’s litigation efforts, and its patent, trademark and copyright portfolio strategies until June 2018. Prior to joining Adobe, Mr. Rao was with Microsoft Corporation for 11 years, serving in a variety of roles including Associate General Counsel of Intellectual Property and Licensing. From 1997 until March 2001, he served as a patent attorney at Fenwick & West. He holds a B.S. in Electrical Engineering from Villanova University and a JD from George Washington University. |
| Mark Garfield | 51 | Senior Vice President, Chief Accounting Officer and Corporate Controller<br><br>Mr. Garfield currently serves as our Senior Vice President, Chief Accounting Officer and Corporate Controller. Prior to joining Adobe in December 2018, Mr. Garfield served as the Vice President of Finance of Cloudflare, Inc. commencing in November 2017. He served as Senior Vice President and Chief Accounting Officer at Symantec Corporation from March 2014 to October 2017. Prior to joining Symantec, he was at Brightstar Corporation where he served primarily as Senior Vice President and Chief Accounting Officer from January 2013 to February 2014. Mr. Garfield served as Director of Finance at Advanced Micro Devices from August 2010 to December 2012. Prior to Advanced Micro Devices, Mr. Garfield also served in senior level finance roles at LoudCloud and Ernst and Young. Mr. Garfield is a board member of the Adobe Foundation. Mr. Garfield holds a B.A. in Business Economics from the University of California, Santa Barbara. |

## ITEM 1A. RISK FACTORS

As previously discussed, our actual results could differ materially from our forward-looking statements. Below we discuss some of the factors that could cause these differences. These and many other factors described in this report could adversely affect our operations, performance and financial condition.

### Risks Related to Our Ability to Grow Our Business

***The effects of the COVID-19 pandemic have materially affected how we and our customers are operating our businesses, and the duration and extent to which this will impact our future results of operations and overall financial performance remains uncertain.***

The COVID-19 pandemic and related public health measures have materially affected how we and our customers are operating our businesses, and have in the past materially affected our operating results; the duration and extent to which this will impact our future results remain uncertain. Due to our subscription-based business model, the effect of the pandemic may not be fully reflected in our results of operations until future periods. If the pandemic has a substantial impact on our employees', partners' or customers' businesses and productivity, our results of operations and overall financial performance may be harmed. The global macroeconomic effects of the pandemic may persist for an indefinite period, including in specific regions of the world or sectors of the economy, even after the pandemic has subsided.

The spread of COVID-19 has caused us to modify our business practices, including implementing prolonged closures and limited reopenings of certain Adobe offices and restricting employee travel. Starting in June 2021, we began a phased reopening of all of our U.S. offices and certain of our international offices, and invited employees located near those reopened offices to return to the office on a voluntary basis. The reopening of our U.S. offices has created and may continue to create additional risks and operational challenges and may require us to make additional investments in the design, implementation and enforcement of new workplace health and safety protocols. Even if we follow what we believe to be best practices, our efforts to reopen our offices safely may not be successful and could expose our employees, partners and customers to health risks, and us to associated liability. Furthermore, additional and/or extended governmental restrictions, new regulations or other changing conditions could cause us to temporarily re-close certain offices. We have offered, and plan to continue to offer, a significant percentage of our employees flexibility in the amount of time they work in an office, which may adversely impact the productivity of certain employees and harm our business, including our future operating results. This may also present risks for our real estate portfolio and strategy and may present operational, cybersecurity and workplace culture challenges that may adversely affect our business.

We have continued to host virtual-only customer experiences, and we may deem it advisable to similarly alter, postpone or cancel entirely additional customer, employee or industry events in the future. Our virtual customer, employee and industry events may not be as successful as in-person events. Moreover, the conditions caused by the pandemic has affected the rate of IT spending and may in the future adversely affect our customers' ability or willingness to purchase our offerings. We have seen and may continue to see these conditions delay prospective customers' purchasing decisions, adversely impact our ability to provide on-site consulting services to our customers, result in extended payment terms, reduce the value or duration of their subscription contracts or affect attrition rates, all of which could adversely affect our future sales, operating results and overall financial performance. Global and regional macroeconomic effects of the COVID-19 pandemic and related impacts on our customers' business operations and their demand for our products and services may persist for an indefinite period, even after the COVID-19 pandemic has subsided.

Our operations have also been negatively affected by a range of external factors related to the pandemic that are not within our control, and COVID-19 cases (including the emergence and spread of more transmissible variants) continue to surge in certain parts of the world, including the United States. Vaccines for COVID-19 continue to be administered in the United States and other countries around the world, but the extent and rate of vaccine adoption, the long-term efficacy of these vaccines and other factors remain uncertain. Authorities throughout the world have implemented measures to contain or mitigate the spread of the virus, including physical distancing, travel bans and restrictions, closure of non-essential businesses, quarantines, work-from-home directives, mask requirements, shelter-in-place orders and vaccination programs. These measures have caused, and are continuing to cause, business slowdowns or shutdowns in affected areas, both regionally and worldwide, which have impacted our business and results of operations, may delay the provisioning of our offerings, and may impact our employees. As long as the pandemic continues, our employees will continue to be exposed to health risks, and we could be negatively impacted in the future if a significant number of our employees, or employees who perform critical functions, become ill, quarantine as a result of exposure to COVID-19 or do not comply with vaccination programs. As we continue to monitor the situation and public health guidance throughout the world, we may adjust our current policies and practices, and existing and new precautionary measures could negatively affect our operations.

The extent of the impact from the pandemic depends on future developments that cannot be accurately predicted at this time, such as the duration and spread of the pandemic, future waves of COVID-19 infections (including the spread of variants or mutant strains) resulting in additional preventive measures to contain or mitigate the spread of the virus, the extent and effectiveness of containment actions, the administration, adoption and efficacy of vaccination programs and the impact of these and other factors on our employees, customers, partners and vendors. If we are not able to respond to and manage the impact of such events effectively, our business will be harmed.

Finally, to the extent that the pandemic harms our business and results of operations, many of the other risks described in this “Risk Factors” section may be heightened.

***Our competitive position and results of operations could be harmed if we do not compete effectively.***

The markets for our products and services are characterized by intense competition, new industry standards, evolving distribution models, limited barriers to entry, disruptive technology developments, short product life cycles, customer price sensitivity, global market conditions and frequent product introductions (including alternatives with limited functionality available at lower costs or free of charge). Any of these factors could create downward pressure on pricing and gross margins and could adversely affect our renewal and upsell and cross-sell rates, as well as our ability to attract new customers. Our future success will depend on our continued ability to enhance and integrate our existing products and services, introduce new products and services in a timely and cost-effective manner, meet changing customer expectations and needs, extend our core technology into new applications, and anticipate emerging standards, business models, software delivery methods and other technological developments. Furthermore, some of our competitors and potential competitors enjoy competitive advantages such as greater financial, technical, sales, marketing and other resources, broader brand awareness and access to larger customer bases. As a result of these advantages, potential and current customers might select the products and services of our competitors, causing a loss of our market share. In addition, consolidation has occurred among some of our competitors. Further consolidations in these markets may subject us to increased competitive pressures and may harm our results of operations.

*For additional information regarding our competition and the risks arising out of the competitive environment in which we operate, see the section titled “Competition” in Part I, Item 1 of this report.*

***If we cannot continue to develop, acquire, market and offer new products and services or enhancements to existing products and services that meet customer requirements, our operating results could suffer.***

The process of developing and acquiring new technology products and services and enhancing existing offerings is complex, costly and uncertain. If we fail to anticipate customers’ rapidly changing needs and expectations or adapt to emerging technological trends, our market share and results of operations could suffer. We must make long-term investments, develop, acquire or obtain appropriate intellectual property and commit significant resources before knowing whether our predictions will accurately reflect customer demand for our products and services. If we misjudge customer needs in the future, our new products and services may not succeed and our revenues and earnings may be harmed. Additionally, any delay in the development, acquisition, marketing or launch of a new offering or enhancement to an existing offering could result in customer attrition or impede our ability to attract new customers, causing a decline in our revenue, earnings or stock price and weakening our competitive position.

Consumers continue to migrate from personal computers to tablet and mobile devices. While we offer our products on a variety of hardware platforms, if we cannot continue adapting our products to tablet and mobile devices, or if our competitors can adapt their products more quickly than us, our business could be harmed. Releases of new devices or operating systems may make it more difficult for our products to perform or may require significant cost to adapt our solutions to such devices or operating systems. These potential costs and delays could harm our business.

***Introduction of new technology could harm our business and results of operations.***

The expectations and needs of technology consumers are constantly evolving. Our future success depends on a variety of factors, including our continued ability to innovate, introduce new products and services efficiently, enhance and integrate our products and services in a timely and cost-effective manner, extend our core technology into new applications, and anticipate emerging standards, business models, software delivery methods and other technological developments. Integration of our products and services with one another and other companies' offerings creates an increasingly complex ecosystem that is partly reliant on third parties. If any disruptive technology, or competing products, services or operating systems that are not compatible with our solutions, achieve widespread acceptance, our operating results could suffer and our business could be harmed.

The introduction of, or limitations on, certain technologies may reduce the effectiveness of our products. For example, some of our products rely on tracking, third-party cookies or other identifiers to help our customers more effectively advertise and detect and prevent fraudulent activity. Consumers can control the use of these technologies through their browsers, operating systems, device settings or “ad-blocking” software or applications. Increased use of such methods, software or applications could harm our business.

***We may not realize the anticipated benefits of past or future investments or acquisitions, and integration of acquisitions may disrupt our business and management.***

We may not realize the anticipated benefits of an investment or acquisition of a company, division, product or technology, each of which involves numerous risks. These risks include:

- inability to achieve the financial and strategic goals for the acquired and combined businesses;
- difficulty in, and the cost of, effectively integrating the operations, technologies, products or services, and personnel of the acquired business;
- entry into markets in which we have minimal prior experience and where competitors in such markets have stronger market positions;
- disruption of our ongoing business and distraction of our management and other employees from other opportunities and challenges;
- inability to retain personnel of the acquired business;
- inability to retain key customers, distributors, vendors and other business partners of the acquired business;
- inability to take advantage of anticipated tax benefits;
- incurring acquisition-related costs or amortization costs for acquired intangible assets that could impact our operating results;
- elevated delinquency or bad debt write-offs related to receivables of the acquired business we assume;
- additional costs of bringing acquired companies into compliance with laws and regulations applicable to a multinational corporation;
- difficulty in maintaining controls, procedures and policies during the transition and integration;
- impairment of our relationships with employees, customers, partners, distributors or third-party providers of our technologies, products or services;
- failure of our due diligence processes to identify significant problems, liabilities or other challenges of an acquired company or technology;
- exposure to litigation or other claims in connection with, or inheritance of claims or litigation risk as a result of, an acquisition, such as claims from terminated employees, customers, former stockholders or other third parties;
- incurring significant exit charges if products or services acquired in business combinations are unsuccessful;
- inability to conclude that our internal controls over financial reporting are effective;
- inability to obtain, or obtain in a timely manner, approvals from governmental authorities, which could delay or prevent such acquisitions;
- the failure of strategic investments to perform as expected or to meet financial projections;
- delay in customer and distributor purchasing decisions due to uncertainty about the direction of our product and service offerings;
- increased accounts receivables collection times and working capital requirements associated with acquired business models; and

- incompatibility of business cultures.

Mergers and acquisitions of technology companies are inherently risky. If we do not complete an announced acquisition transaction or integrate an acquired business successfully and in a timely manner, we may not realize the benefits of the acquisition to the extent anticipated, and in certain circumstances an acquisition could harm our financial position.

Our ability to acquire other businesses or technologies, make strategic investments or integrate acquired businesses effectively may also be impaired by the effects of the COVID-19 pandemic, government actions in light of the pandemic, trade tensions and increased global scrutiny of foreign investments. For example, a number of countries, including the United States and countries in Europe and the Asia-Pacific region, are considering or have adopted restrictions on foreign investments. Governments may continue to adopt or tighten restrictions of this nature, and such restrictions could negatively impact our business and financial results.

***The success of some of our product and service offerings depends on our ability to continue to attract and retain customers of and contributors to our online marketplaces for creative content.***

The success of some of our product and service offerings, such as Adobe Stock, depends on our ability to continue to attract new customers and contributors to these online marketplaces for creative content, as well as our ability to continue to retain existing customers and contributors. An increase in paying customers has generally resulted in more content from contributors, which increases the size of our collection and in turn attracts new paying customers. We rely on the functionality and features of our online marketplaces, the size and content of our collection and the effectiveness of our marketing efforts to attract new customers and contributors and retain existing ones. New technologies may render the features of our online marketplaces obsolete, our collection may fail to grow as anticipated or our marketing efforts may be unsuccessful, any of which may adversely affect our results of operations.

***If our products or platforms are used to create or disseminate objectionable content, particularly misleading content intended to manipulate public opinion, our brand reputation may be damaged, and our business and financial results may be harmed.***

We believe that our brands have significantly contributed to the success of our business. Maintaining and enhancing the brands within Adobe increases our ability to enter new categories, launch new and innovative products to better serve our customers and expand our customer base. Our brands may be negatively affected by the use of our products or services to create or disseminate newsworthy content that is deemed to be misleading, deceptive, or intended to manipulate public opinion (e.g. “DeepFakes”), by the use of our products or services for illicit, objectionable or illegal ends, or by our failure to respond appropriately and expeditiously to such uses of our products and services. Such uses of our products and services may also cause us to face claims related to defamation, rights of publicity and privacy, illegal content, misinformation and personal injury torts. Maintaining and enhancing our brands may require us to make substantial investments and these investments may not be successful. If we fail to appropriately respond to objectionable content created using our products or services or shared on our platforms, our users may lose confidence in our brands and our business and financial results may be adversely affected.

***Social and ethical issues relating to the use of new and evolving technologies, such as AI, in our offerings may result in reputational harm and liability.***

Social and ethical issues relating to the use of new and evolving technologies such as artificial intelligence (“AI”) in our offerings, may result in reputational harm and liability, and may cause us to incur additional research and development costs to resolve such issues. We are increasingly building AI into many of our offerings. As with many innovations, AI presents risks and challenges that could affect its adoption, and therefore our business. If we enable or offer solutions that draw controversy due to their perceived or actual impact on society, we may experience brand or reputational harm, competitive harm or legal liability. Potential government regulation related to AI ethics may also increase the burden and cost of research and development in this area, subjecting us to brand or reputational harm, competitive harm or legal liability. Failure to address AI ethics issues by us or others in our industry could undermine public confidence in AI, which could slow adoption of AI in our products and services.

**Risks Related to the Operation of Our Business**

***Security breaches in data centers we manage, or third parties manage on our behalf, may compromise the confidentiality, integrity, or availability of employee and customer data, which could expose us to liability and adversely affect our reputation and business.***

We process and store significant amounts of employee and customer data, a large volume of which is hosted by third-party service providers. A security incident impacting our own data centers or those controlled by our service providers may compromise the confidentiality, integrity or availability of this data. Unauthorized access to or loss or disclosure of data stored by Adobe or our service providers may occur through physical break-ins, breaches of a secure network by an unauthorized party, software vulnerabilities or coding errors, employee theft or misuse or other misconduct. It is also possible that unauthorized access to or disclosure of employee or customer data may be obtained through inadequate use of security controls by customers or employees. Accounts created with weak or recycled passwords could allow cyber-attackers to gain access to employee or customer data. Additionally, failure by Adobe or our customers to remove the accounts of their own employees, or the granting of accounts in an uncontrolled manner, may allow for access by former employees or other unauthorized individuals. If there were an inadvertent disclosure of customer data, or unauthorized access to the data we possess on behalf of our customers, our operations could be disrupted, our reputation could be damaged and we could be subject to claims or other liabilities, regulatory investigations or fines. In addition, such perceived or actual unauthorized loss or disclosure of the information we collect, process or store, or breach of our security could damage our reputation, result in the loss of customers and harm our business.

***We rely on data centers managed both by Adobe and third parties to host and deliver our services, as well as access, collect, process, use, transmit and store data, and any interruptions or delays in these hosted services, or failures in data collection or transmission could expose us to liability and harm our business and reputation.***

Much of our business relies on hardware and services that are hosted, managed and controlled directly by Adobe or third-party service providers, including our online store at adobe.com, Creative Cloud, Document Cloud and Experience Cloud solutions. We do not have redundancy for all of our systems, many of our critical applications reside in only one of our data centers, and our disaster recovery planning may not account for all eventualities. If our business relationship with a third-party provider of hosting or content delivery services is negatively affected, or if one of our content delivery suppliers were to terminate its agreement with us without adequate notice, we might not be able to deliver the corresponding hosted offerings to our customers, which could subject us to reputational harm, costly and time-intensive notification requirements, and cause us to lose customers and future business. In addition, the COVID-19 pandemic has disrupted and may continue to disrupt the supply chain of hardware needed to maintain these third-party systems and services or to run our business. Occasionally, we migrate data among data centers and to third-party hosted environments. If a transition among data centers or to third-party service providers encounters unexpected interruptions, unforeseen complexity or unplanned disruptions despite precautions undertaken during the process, this may impair our delivery of products and services to customers and result in increased costs and liabilities, which may harm our operating results, reputation and our business.

It is also possible that hardware or software failures or errors in our systems (or those of our third-party service providers) could result in data loss or corruption, cause the information that we collect or maintain to be incomplete or contain inaccuracies that our customers regard as significant, or cause us to fail to meet committed service levels or comply with regulatory notification requirements. Furthermore, our ability to collect and report data may be delayed or interrupted by a number of factors, including access to the Internet, the failure of our network or software systems, security breaches or significant variability in visitor traffic on customer websites. In addition, computer viruses, worms, ransomware or other malware may harm our systems, causing us to lose data, and the transmission of computer viruses or other malware could expose us to litigation or regulatory investigation, and costly and time-intensive notification requirements.

We may also find, on occasion, that we cannot deliver data and reports to our customers in near real time because of a number of factors, including significant spikes in customer activity on their websites or failures of our network or software (or that of a third-party service provider). If we fail to plan infrastructure capacity appropriately and expand it proportionally with the needs of our customer base, and we experience a rapid and significant demand on the capacity of our data centers or those of third parties, service outages or performance issues could occur, which would impact our customers. Such a strain on our infrastructure capacity could subject us to regulatory and customer notification requirements, violations of service level agreement commitments, financial liabilities, result in customer dissatisfaction, or harm our business. If we supply inaccurate information or experience interruptions in our systems, our reputation could be harmed, we could lose customers, and we could be found liable for damages or incur other losses.

***Security vulnerabilities in our products and systems, or in our supply chain, could lead to reduced revenue or to liability claims.***

Maintaining the security of our products and services is a critical issue for us and our customers. Security researchers, criminal hackers and other third parties regularly develop new techniques to penetrate our end points, information systems and network security measures. Cyberthreats are constantly evolving and becoming increasingly sophisticated and complex, making it increasingly difficult to detect and successfully defend against them. Certain unauthorized parties have in the past managed, and may again in the future manage, to gain access to and misuse some of our systems and software, or that of our third-party service providers, in order to access the authentication, payment and personal information of our end users' and employees. In addition, cyber-attackers (which may include individuals or groups, as well as sophisticated groups such as nation-state and state-sponsored attackers, which can deploy significant resources to plan and carry out exploits) also develop and deploy viruses, worms, credential stuffing attack tools and other malicious software programs, some of which may be specifically designed to attack our products, services, information systems or networks. Hardware, software and operating system applications that we develop or procure from third parties have contained and may contain defects in design or manufacture, including bugs, vulnerabilities and other problems that could unexpectedly compromise the security of the system or impair a customer's ability to operate or use our products. The costs to prevent, eliminate, mitigate, or alleviate cyber- or other security problems, bugs, viruses, worms, malicious software programs and security vulnerabilities are significant, and our efforts to address these problems, including notifying affected parties, may not be successful or may be delayed and could result in interruptions, delays, cessation of service and loss of existing or potential customers. It is impossible to predict the extent, frequency or impact these problems may have on us.

Outside parties have in the past and may in the future attempt to fraudulently induce our employees or users of our products or services to disclose sensitive, personal or confidential information via illegal electronic spamming, phishing or other tactics. This existing risk is compounded given the COVID-19 pandemic, as we shifted nearly all of our workforce to more frequent work-from-home arrangements. We also expect to resume operations in our offices under a hybrid model where a large portion of our workforce will spend a portion of their time working in our offices and a portion of their time working from home. Unauthorized parties may also attempt to gain physical access to our facilities in order to infiltrate our information systems or attempt to gain logical access to our products, services, or information systems for the purpose of exfiltrating content and data. These actual and potential breaches of our security measures and the accidental loss, inadvertent disclosure or unauthorized dissemination of proprietary information or sensitive, personal or confidential data about us, our employees, our customers or their end users, including the potential loss or disclosure of such information or data as a result of hacking, fraud, trickery or other forms of deception, could expose us, our employees, our customers or the individuals affected to a risk of loss or misuse of this information. This may result in litigation and liability or fines, our compliance with costly and time-intensive notice requirements, governmental inquiry or oversight or a loss of customer confidence, any of which could harm our business or damage our brand and reputation, thereby requiring time and resources to mitigate these impacts. These risks will likely increase as we expand our hosted offerings, integrate our products and services and store and process more data, including personal information.

These issues affect our products and services in particular because cyber-attackers tend to focus their efforts on popular offerings with a large user base, and we expect them to continue to do so. From time to time we have identified, and in the future we may identify other, vulnerabilities in some of our applications and services and those of our third-party service providers. We devote significant resources to address security vulnerabilities through engineering more secure products, enhancing security and reliability features in our products and systems, code hardening, conducting rigorous penetration tests, deploying updates to address security vulnerabilities, regularly reviewing our service providers' security controls, reviewing and auditing our hosted services against independent security control frameworks (such as ISO 27001, SOC 2 and PCI), providing resources such as mandatory security training for our workforce and improving our incident response time, but security vulnerabilities cannot be totally eliminated. The cost of these steps could reduce our operating margins, and we may be unable to implement these measures quickly enough to prevent cyber-attackers from gaining unauthorized access into our systems and products. Despite our preventative efforts, actual or perceived security vulnerabilities in our products and systems may harm our reputation or lead to claims against us (and have in the past led to such claims), and could lead some customers to stop using certain products or services, to reduce or delay future purchases of products or services, or to use competing products or services. If we do not make the appropriate level of investment in our technology systems or if our systems become out-of-date or obsolete and we are not able to deliver the quality of data security our customers require or that meet our independent security control certification requirements, our business could be adversely affected. Customers may also adopt security measures designed to protect their existing computer systems from attack, which could delay adoption of new technologies. Moreover, delayed sales, lower margins or lost customers resulting from disruptions caused by cyber-attacks, preventative measures or failure to fully meet independent security control certification requirements could adversely affect our financial results, stock price and reputation.

***Some of our enterprise offerings have extended and complex sales cycles, which can make our sales cycles unpredictable.***

Sales cycles for some of our enterprise offerings, including our Adobe Experience Cloud and Adobe Experience Platform solutions and Enterprise Term License Agreements ("ETLAs") in our Digital Media business, are multi-phased and complex. The complexity in these sales cycles is due to several factors, including:

- the need for our sales representatives to educate customers about the use and benefit of large-scale deployments of our products and services, including technical capabilities, security features, potential cost savings and return on investment;
- the desire of organizations to undertake significant evaluation processes to determine their technology requirements prior to making information technology expenditures;

- the need for our representatives to spend a significant amount of time assisting potential customers in their testing and evaluation of our products and services;

- intensifying competition within the industry;

- the negotiation of large, complex, enterprise-wide contracts;

- the need for our customers to obtain requisition approvals from various decision makers within their organizations due to the complexity of our solutions touching multiple departments within customers' organizations; and

- customer budget constraints, economic conditions and unplanned administrative delays.

We spend substantial time and expense on our sales efforts without assurance that potential customers will ultimately purchase our solutions. Further, restrictions in place for the COVID-19 pandemic have resulted and could continue to result in our inability to negotiate in person, even as we return many employees to their offices. As we target our sales efforts at larger enterprise customers, these trends are expected to continue and could have a greater impact on our results of operations. Additionally, our enterprise sales pattern has historically been uneven, where a higher percentage of a quarter's total sales occur during the final weeks of each quarter, which is common in our industry. Our extended sales cycle for these products and services makes it difficult to predict when a given sales cycle will close.

***If our customers fail to renew subscriptions in accordance with our expectations, our future revenue and operating results could suffer.***

Our Adobe Experience Cloud, Creative Cloud and Document Cloud offerings typically involve subscription-based offerings pursuant to product and service agreements. Revenue from our subscription customers is generally recognized ratably over the term of their agreements, which typically range from 1 to 36 months. Our customers have no obligation to renew their subscriptions for our services after the expiration of their initial subscription period, and customers may not renew their subscriptions at the same or higher level of service, for the same number of seats or for the same duration of time, if at all. Our varied customer base combined with the flexibility we offer in the length of our subscription-based agreements complicates our ability to precisely forecast renewal rates. Therefore, we cannot provide assurance that we will be able to accurately predict future customer renewal rates.

Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their level of satisfaction with our services, our ability to continue enhancing features and functionality, the reliability (including uptime) of our subscription offerings, the prices of offerings and those offered by our competitors, the actual or perceived information security of our systems and services, decreases in the size of our customer base, reductions in our customers' spending levels or declines in customer activity as a result of economic downturns or uncertainty in financial markets, including as a result of the COVID-19 pandemic, which has affected and may continue to affect certain sectors of the economy disproportionately. If our customers do not renew their subscriptions or if they renew on terms less favorable to us, our revenue may decline.

***We face various risks associated with our operating as a multinational corporation.***

As a global business that generates approximately 43% of our total revenue from sales to customers outside of the Americas, we are subject to a number of risks, including:

- foreign currency fluctuations and controls;

- international and regional economic, political and labor conditions, including any instability or security concerns abroad, including uncertainty caused by the United Kingdom's exit from the European Union (Brexit) on January 31, 2020, including the effects of the Trade and Cooperation Agreement between the European Union, the European Atomic Energy Community and the United Kingdom signed on December 30, 2020, as well as uncertainty caused by the evolving relations between the United States and China;

- tax laws (including U.S. taxes on foreign subsidiaries);

- increased financial accounting and reporting burdens and complexities;

- changes in, or impositions of, legislative or regulatory requirements;
- changes in laws governing the free flow of data across international borders;
- failure of laws to protect our intellectual property rights adequately;

- inadequate local infrastructure and difficulties in managing and staffing international operations;
- delays resulting from difficulty in obtaining export licenses for certain technology, tariffs, quotas and other trade barriers;
- the imposition of governmental economic sanctions on countries in which we do business or where we plan to expand our business;
- costs and delays associated with developing products in multiple languages;
- operating in locations with a higher incidence of corruption and fraudulent business practices; and
- other factors beyond our control, such as terrorism, war, natural disasters, climate change and pandemics, including fluctuations in the severity and duration of the COVID-19 pandemic and resulting restrictions on business activity which may vary significantly by region.

Some of our third-party business partners have international operations and are also subject to these risks and if our third-party business partners are unable to appropriately manage these risks, our business may be harmed. If sales to any of our customers outside of the Americas are reduced, delayed or canceled because of any of the above factors, our revenue may decline.

***Our business could be harmed if we fail to effectively manage critical strategic third-party business relationships.***

As our offerings expand and our customer base grows, our relationships with strategic partners become increasingly valuable. If our contractual relationships with these third parties were to terminate, or if we were unable to renew on favorable terms, our business could be harmed. This is especially the case when the third party's offerings are integrated with our products and services, or where the third party's offerings are difficult to substitute or replace. Alternative arrangements for such products and services may not be available to us on commercially reasonable terms, and we may experience business interruptions upon a transition to an alternative partner. The failure of third parties to provide acceptable products and services or to update their technology, including during the COVID-19 pandemic, may result in a disruption to our business operations and those of our customers, which may reduce our revenues and profits, cause us to lose customers and damage our reputation.

We increasingly utilize the distribution platforms of third parties like Apple's App Store and Google's Play Store for the distribution of certain of our product offerings. Although we benefit from the strong brand recognition and large user base of these distribution platforms to attract new customers, the platform owners have wide discretion to change the pricing structure, terms of service and other policies with respect to us and other developers, and may offer or promote products that compete with our product offerings. Adverse changes by these third parties could adversely affect our financial results.

***Failure of our third-party customer service and technical support providers to adequately address customers' requests could harm our business and adversely affect our financial results.***

Our customers rely on our customer service support organization to resolve issues with our products and services. We depend heavily on third-party customer service and technical support representatives working on our behalf to provide such services, and we expect to continue to rely heavily on third parties in the future. This strategy presents risks to our business since we may not be able to influence the quality of support as directly as we would be able to do if our own employees performed these activities. Our customers may react negatively to providing information to, and receiving support from, third-party organizations, especially if these third-party organizations are based overseas. If we encounter problems with our third-party customer service and technical support providers, our reputation may be harmed, our ability to sell our offerings could be adversely affected, and we could lose customers and associated revenue.

***If we are unable to recruit and retain key personnel, our business may be harmed.***

Much of our future success depends on the continued service, availability and performance of our senior management and highly-skilled personnel across all levels of our organization. Our senior management has acquired specialized knowledge and skills with respect to our business, and the loss of any of these individuals could harm our business, especially if we are not successful in developing adequate succession plans. Our efforts to attract, develop, integrate and retain highly skilled employees with appropriate qualifications may be compounded by intensified restrictions on travel (including during the COVID-19 pandemic), immigration or the availability of work visas. Experienced personnel in the information technology industry are in high demand and competition for their talents is intense and has recently intensified further due to industry trends in many areas where our employees are located. We may experience higher compensation costs to retain senior management and experienced personnel that may not be offset by improved productivity or increased sales. If we are unable to continue to successfully attract and retain key personnel, our business may be harmed.

We continue to hire personnel in countries where exceptional technical knowledge and other expertise are offered at lower costs, which increases the efficiency of our global workforce structure and reduces our personnel related expenditures. Nonetheless, as globalization continues, competition for these employees in these countries has increased, which may impact our ability to retain these employees and increase our expenses resulting from competitive compensation. We may continue to expand our international operations and international sales and marketing activities, which would require significant management attention and resources. We may be unable to scale our infrastructure effectively or as quickly as our competitors in these markets, and our revenue may not increase to offset these expected increases in costs and operating expenses, causing our results to suffer.

We believe that a critical contributor to our success to date has been our corporate culture, which we have built to foster innovation, teamwork and employee satisfaction. As we grow, including from the integration of employees and businesses acquired in connection with previous or future acquisitions, we may find it difficult to maintain important aspects of our corporate culture, which could negatively affect our ability to retain and recruit personnel who are essential to our future success.

***Failure to manage our sales, partner and distribution channels effectively could result in a loss of revenue and harm to our business.***

We contract with a number of software distributors and other strategic partners, none of which are individually responsible for a material amount of our total net revenue for any recent period. Nonetheless, if any single agreement with one of our distributors were terminated, any prolonged delay in securing a replacement distributor could have a negative impact on our results of operations.

Successfully managing our indirect distribution channel efforts to reach various customer segments for our products and services is a complex process across the broad range of geographies where we do business or plan to do business. Our distributors and other channel partners are independent businesses that we do not control. Notwithstanding the independence of our channel partners, we face legal risk and potential reputational harm from the activities of these third parties including, but not limited to, export control violations, workplace conditions, corruption and anti-competitive behavior.

We cannot be certain that our distribution channel will continue to market or sell our products and services effectively. If our partner and distribution channels are not successful, we may lose sales opportunities, customers and revenue. Our distributors also sell our competitors' products and services, and if they favor our competitors' products or services for any reason, they may fail to market our products or services effectively or to devote resources necessary to provide effective sales, which would cause our results to suffer. We also distribute some products and services through our OEM channel, and if our OEMs decide not to bundle our applications on their devices, our results could suffer. In addition, the financial health of our distributors and partners and our continuing relationships with them are important to our success. Some of these distributors and partners may be unable to withstand adverse changes in economic conditions, which could result in insolvency, the inability of such distributors and partners to obtain credit to finance access to or purchases of our products and services, or a delay in paying their obligations to us.

We also sell some of our products and services through our direct sales force. Risks associated with this sales channel include more extended sales and collection cycles associated with direct sales efforts, challenges related to hiring, retaining and motivating our direct sales force, and substantial amounts of ongoing training for sales representatives. Moreover, recent hires may not become as productive as we would like, as in most cases it takes a significant period of time before they achieve full productivity. Our business could be seriously harmed if our expansion efforts do not generate a corresponding significant increase in revenue and we are unable to achieve the efficiencies we anticipate. In addition, the loss of key sales employees could impact our customer relationships and future ability to sell to certain accounts covered by such employees.

**Risks Related to Laws and Regulations**

***We are subject to risks associated with compliance with laws and regulations globally, which may harm our business.***

We are a global company subject to varied and complex laws, regulations and customs, both domestically and internationally. These laws and regulations relate to a number of aspects of our business, including trade protection, import and export control, anti-boycott, sanctions and embargoes, data and transaction processing security, payment card industry data security standards, records management, user-generated content hosted on websites we operate, privacy practices, data residency, corporate governance, anti-trust and competition, employee and third-party complaints, anti-corruption, gift policies, conflicts of interest, securities regulations and other regulatory requirements affecting trade and investment. The application of these laws and regulations to our business is often unclear and may at times conflict. For example, in many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by U.S. regulations applicable to us, including the Foreign Corrupt Practices Act. We cannot provide assurance that our employees, contractors, agents and business partners will not take actions in violation of our internal policies or U.S. laws. Compliance with these laws and regulations may involve significant costs or require changes in our business practices that result in reduced revenue and profitability. Non-compliance could also result in fines, damages, criminal sanctions against us, our officers or our employees, prohibitions on the conduct of our business, and damage to our reputation. In response to the COVID-19 pandemic, federal, state, local and foreign governmental authorities have imposed, and may continue to impose, protocols and restrictions intended to contain the spread of the virus, including limitations on the size of gatherings, closures of work facilities, schools, public buildings and businesses, quarantines, lockdowns and travel restrictions. Such restrictions have disrupted and may continue to disrupt our business operations and limit our ability to perform critical functions.

In addition, approximately 48% of our employees are located outside the United States. Accordingly, we are exposed to changes in laws governing our employee relationships in various U.S. and foreign jurisdictions, including laws and regulations regarding wage and hour requirements, fair labor standards, employee data privacy, unemployment tax rates, workers' compensation rates, citizenship requirements and payroll and other taxes, which likely would have a direct impact on our operating costs.

***Increasing regulatory focus on privacy and security issues and expanding laws could impact our business models and expose us to increased liability.***

As a global company, Adobe is subject to global data protection, privacy and security laws, regulations and codes of conduct that apply to our various business units and data processing activities. These laws, regulations and codes may be inconsistent across jurisdictions and are subject to evolving and differing (sometimes conflicting) interpretations. Government officials and regulators, privacy advocates and class action attorneys are increasingly scrutinizing how companies collect, process, use, store, share and transmit personal data. This increased scrutiny may result in new interpretations of existing laws, thereby further impacting Adobe's business. Globally, laws such as the General Data Protection Regulation ("GDPR") in Europe and the Personal Information Protection Law ("PIPL") in China, and new and emerging state laws in the United States on privacy, data and related technologies, such as the California Consumer Privacy Act, the California Privacy Rights Act and the Virginia Consumer Data Protection Act, as well as industry self-regulatory codes, create new compliance obligations and expand the scope of potential liability, either jointly or severally with our customers and suppliers. While we have invested in readiness to comply with applicable requirements, the dynamic nature of these laws, regulations and codes, as well as their interpretation by regulators and courts, may affect our ability (and our enterprise customers' ability) to reach current and prospective customers, to respond to both enterprise and individual customer requests under the laws (such as individual rights of access, correction and deletion of their personal information) and to implement our business models effectively. These laws, regulations and codes may also impact our innovation and business drivers in developing new and emerging technologies (e.g., artificial intelligence and machine learning). These requirements, among others, may impact demand for our offerings and force us to bear the burden of more onerous obligations in our contracts. Any perception of our practices, products or services as a violation of individual privacy or data protection rights may subject us to public criticism, class action lawsuits, reputational harm, or investigations or claims by regulators, industry groups or other third parties, all of which could disrupt or adversely impact our business and expose us to increased liability. Additionally, we collect and store information on behalf of our business customers and if our customers fail to comply with contractual obligations or applicable laws, it could result in litigation or reputational harm to us.

Transferring personal information across international borders is complex and subject to legal and regulatory requirements as well as active litigation and enforcement in a number of jurisdictions around the world, each of which could have an adverse impact to our ability to process and transfer personal data as part of our business operations. For example, European data transfers outside the European Economic Area are highly regulated and litigated. The mechanisms that we and many other companies rely upon for European data transfers (e.g., Privacy Shield and Model Clauses) are the subject of judicial decisions by the Court of Justice of the European Union resulting in the invalidation of Privacy Shield. We are closely monitoring other developments related to the remaining valid transfer mechanisms available for transferring personal data outside the European Union (including the recent issuance of updated Model Clauses) and other countries that have similar trans-border data flow requirements and adjusting our practices accordingly. The invalidation of Privacy Shield and the open questions related to the validity of Model Clauses have resulted in some changes in the obligations required to provide our services in the European Union and could expose us to potential sanctions and fines for non-compliance. Several other countries, including Australia, New Zealand, Brazil, and Japan, have also established specific legal requirements for cross-border transfers of personal information. Other countries, such as India, are considering requirements for data localization (i.e., where personal data must remain in the country). If other countries implement more restrictive regulations for cross-border data transfers (or do not permit data to leave the country of origin), such developments could adversely impact our business, financial condition and results of operations in those jurisdictions.

***Our intellectual property portfolio is a valuable asset and we may not be able to protect our intellectual property rights, including our source code, from infringement or unauthorized copying, use or disclosure.***

Our intellectual property portfolio is a valuable asset. Infringement or misappropriation of our patents, trademarks, trade secrets, copyrights and other intellectual property rights could result in lost revenues and ultimately reduce their value. Preventing unauthorized use or infringement of our intellectual property rights is inherently difficult. We actively combat software piracy as we enforce our intellectual property rights, but we nonetheless lose significant revenue due to illegal use of our software. If piracy activities continue at historical levels or increase, they may further harm our business. We apply for patents in the United States and internationally to protect our newly created technology and if we are unable to obtain patent protection for the technology described in our pending patent, or if the patent is not obtained timely, this could result in revenue loss, adverse effects on operations and harm to our business. We offer our products and services in foreign countries and we may seek intellectual property protection from those foreign legal systems. Some of those foreign countries may not have as robust or comprehensive of intellectual property protection laws and schemes as those offered in the United States In some foreign countries, the mechanisms to enforce intellectual property rights may be inadequate to protect our technology, which could harm our business. We also seek to protect our confidential information and trade secrets through the use of non-disclosure agreements with our customers, contractors, vendors and partners. However, there is a risk that our confidential information and trade secrets may be disclosed or published without our authorization, and in these situations, enforcing our rights may be difficult or costly.

If unauthorized disclosure of our source code occurs through security breach, cyber-attack or otherwise, we could lose future trade secret protection for that source code. The loss of future trade secret protection could make it easier for third parties to compete with our products by copying functionality, which could cause us to lose customers and could adversely affect our revenue and operating margins.

***We may incur substantial costs defending against third parties alleging that we infringe their proprietary rights.***

We have been, are currently and may in the future be subject to claims, negotiations and complex, protracted litigation relating to disputes regarding the validity or alleged infringement of third-party intellectual property rights, including patent rights. Intellectual property disputes and litigation are typically costly and can be disruptive to our business operations by diverting the attention of management and key personnel. We may not prevail in every lawsuit or dispute. Third-party intellectual property disputes, including those initiated by patent assertion entities, could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from licensing certain of our products or offering certain of our services, subject us to injunctions restricting our sale of products or services, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers, including contractual provisions under various license arrangements and service agreements. In addition, we may incur significant costs in acquiring the necessary third-party intellectual property rights for use in our products, in some cases to fulfill contractual obligations with our customers. Any of these occurrences could significantly harm our business.

***Changes in accounting principles, or interpretations thereof, could have a significant impact on our financial position and results of operations.***

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP"). These principles are subject to interpretation by the SEC and various bodies formed to interpret and create appropriate accounting principles. A change in these principles, how the principles are interpreted, or the adoption of new accounting standards can have a significant effect on our reported results, and could even retroactively affect previously reported transactions, and may require that we make significant changes to our systems, processes and controls.

Changes resulting from these new standards may result in materially different financial results and may require that we change how we process, analyze and report financial information and that we change financial reporting controls. *For additional information regarding new standards that may have significant impact to our consolidated financial statements, see the section titled "Recent Accounting Pronouncements Not Yet Effective" in Note 1 of our Notes to Consolidated Financial Statements.*

Such changes in accounting principles may have an adverse effect on our business, financial position and results of operations, or cause an adverse deviation from our revenue and profitability targets, which may negatively impact our financial results.

***Changes in tax rules and regulations, or interpretations thereof, may adversely affect our effective tax rates.***

We are a United States-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. The U.S. Tax Cuts and Jobs Act ("U.S. Tax Act"), enacted into law in December 2017, changed existing U.S. tax law and introduced certain international provisions applicable to us. Among other considerations, the applicability and impact of these tax provisions, and of other U.S. or international tax law changes could adversely affect our effective income tax rate and cash flows in future years.

Our income tax expense has differed from the tax computed at the U.S. federal statutory income tax rate due primarily to discrete items including, but not limited to, the effects of tax credits, net tax benefits from trading structure changes, tax benefits from stock-based compensation and settlements of tax examinations, and to net tax on earnings from foreign operations. Unanticipated changes in our tax rates could affect our future results of operations. Our future effective tax rates are likely to be unfavorably affected by changes in the tax rates in jurisdictions where our income is earned, the geographic mix of earnings, our repatriation policy or the valuation of our deferred tax assets and liabilities, by changes in or our interpretation of tax rules and regulations in the jurisdictions in which we do business, or by unexpected negative changes in business and market conditions that could reduce certain tax benefits.

In addition, in the United States and other countries where we conduct business and in jurisdictions in which we are subject to tax, including those covered by governing bodies that enact tax laws applicable to us, such as the European Commission of the European Union, we are subject to potential changes in relevant tax, accounting and other laws, regulations and interpretations, including changes to tax laws applicable to corporate multinationals such as Adobe. These countries, governmental bodies and intergovernmental economic organizations such as the Organization for Economic Cooperation and Development, have or could make unprecedented assertions about how taxation is determined in their jurisdictions that are contrary to the way in which we have interpreted and historically applied the rules and regulations described above in such jurisdictions. In the current global tax policy environment, any changes in laws, regulations and interpretations related to these assertions could adversely affect our effective tax rates, cause us to respond by making changes to our business structure, or result in other costs to us which could adversely affect our operations and financial results.

Moreover, we are subject to the examination of our income tax returns by the U.S. Internal Revenue Service and other domestic and foreign tax authorities. These tax examinations are expected to focus on our research and development tax credits, intercompany transfer pricing practices and other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from these examinations. We cannot provide assurance that the final determination of any of these examinations will not have an adverse effect on our financial position and results of operations.

***Contracting with government entities exposes us to additional risks inherent in the government procurement process.***

We provide products and services, directly and indirectly, to a variety of government entities, both domestically and internationally. Risks associated with licensing and selling products and services to government entities include more extended sales and collection cycles, varying governmental budgeting processes and adherence to complex procurement regulations and other government-specific contractual requirements. We have been, are currently and may in the future be subject to audits and investigations relating to our government contracts and any violations could result in various civil and criminal penalties and administrative sanctions, including termination of contracts, payment of fines, and suspension or debarment from future government business, as well as harm to our reputation and financial results.

**Risks Related to Financial Performance**

***Subscription offerings could create risks related to the timing of revenue recognition.***

We generally recognize revenue from subscription offerings ratably over the terms of their subscription agreements, which typically range from 1 to 36 months. As a result, most of the subscription revenue we report in each quarter is the result of subscription agreements entered into during previous quarters. Any reduction in new or renewed subscriptions in a quarter may not be reflected in our revenue results until a later quarter. Declines in new or renewed subscriptions may decrease our revenue in future quarters. Lower sales, reduced demand for our products and services, and increases in our attrition rate may not be fully reflected in our results of operations until future periods. Our subscription model could also make it difficult for us to rapidly increase our revenue from subscription-based or hosted services through additional sales in any period, as revenue from new customers will be recognized over the applicable subscription term.

Additionally, in connection with our sales efforts to enterprise customers, a number of factors could affect our revenue, including longer-than-expected sales and implementation cycles, potential deferral of revenue and alternative licensing arrangements. If any of our assumptions about revenue from our subscription-based offerings prove incorrect, our actual results may vary materially from those anticipated.

***We may incur losses associated with currency fluctuations and may not be able to effectively hedge our exposure.***

Our operating results are subject to fluctuations in foreign currency exchange rates due to the global scope of our business. Global economic events, including trade disputes, economic sanctions and emerging market volatility, and associated uncertainty may cause currencies to fluctuate, and the impact of the COVID-19 pandemic may introduce further volatility. We attempt to mitigate a portion of these risks through foreign currency hedging based on our judgment of the appropriate trade-offs among risk, opportunity and expense. We regularly review our program to partially hedge our exposure to foreign currency fluctuations and make adjustments as necessary. Our hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movement in foreign currency exchange rates, which could adversely affect our financial condition or results of operations.

***If our goodwill or amortizable intangible assets become impaired, then we could be required to record a significant charge to earnings.***

GAAP requires us to test for goodwill impairment at least annually. In addition, we review our goodwill and amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable include declines in stock price, market capitalization or cash flows, and slower growth rates in our industry. Depending on the results of our review, we could be required to record a significant charge to earnings in our consolidated financial statements during the period in which any impairment of our goodwill or amortizable intangible assets were determined, negatively impacting our results of operations.

***We have issued $4.15 billion of notes in debt offerings and may incur other debt in the future, which may adversely affect our financial condition and future financial results.***

We have $4.15 billion in senior unsecured notes and a $1 billion senior unsecured revolving credit agreement, which is currently undrawn. This debt may adversely affect our financial condition and future financial results by, among other things:

- increasing our vulnerability to adverse changes in general economic and industry conditions;
- requiring the dedication of a portion of our expected cash flows from operations to service our debt, thereby reducing the amount of expected cash flows available for other purposes, including capital expenditures and acquisitions; and
- limiting our flexibility in planning for, or reacting to, changes in our business and our industry.

Our senior unsecured notes and senior unsecured credit agreement impose restrictions on us and require us to maintain compliance with specified covenants. Our ability to comply with these covenants may be affected by events beyond our control. If we breach any of the covenants and do not obtain a waiver from the noteholders or lenders, then, subject to applicable cure periods, any outstanding debt may be declared immediately due and payable.

In addition, changes by any rating agency to our credit rating may negatively impact the value and liquidity of both our debt and equity securities, as well as the potential costs associated with a refinancing of our debt. Under certain circumstances, if our credit ratings are downgraded or other negative action is taken, the interest rate payable by us under our revolving credit facility could increase. Downgrades in our credit ratings could also restrict our ability to obtain additional financing in the future and affect the terms of any such financing.

***Our investment portfolio may become impaired by deterioration of the financial markets.***

Our cash equivalent and short-term investment portfolio as of December 3, 2021 consisted of asset-backed securities, corporate debt securities, money market funds, municipal securities, time deposits and U.S. Treasury securities. We follow an established investment policy and set of guidelines to monitor and help mitigate our exposure to interest rate and credit risk. The policy sets forth credit quality standards and limits our exposure to any one issuer, as well as our maximum exposure to various asset classes.

Should financial market conditions worsen in the future, including from impacts of the COVID-19 pandemic, investments in some financial instruments may pose risks arising from market liquidity and credit concerns. In addition, any deterioration of the capital markets could cause our other income and expense to vary from expectations. As of December 3, 2021, we had no material impairment charges associated with our short-term investment portfolio, and although we believe our current investment portfolio has little risk of material impairment, we cannot predict future market conditions, market liquidity or credit availability, and can provide no assurance that our investment portfolio will remain materially unimpaired.

## General Risk Factors

***Catastrophic events may disrupt our business.***

We are a highly automated business and rely on our network infrastructure and enterprise applications, internal technology systems and website for our development, marketing, operations, support, hosted services and sales activities. In addition, some of our businesses rely on third-party hosted services, and we do not control the operation of third-party data center facilities serving our customers from around the world, which increases our vulnerability. A disruption, infiltration or failure of these systems or third-party hosted services in the event of a major earthquake, fire, flood, tsunami or other weather event, power loss, telecommunications failure, software or hardware malfunctions, pandemics (including the COVID-19 pandemic), cyber-attack, war, terrorist attack or other catastrophic event that our disaster recovery plans do not adequately address, could cause system interruptions, reputational harm, loss of intellectual property, delays in our product development, lengthy interruptions in our services, breaches of data security and loss of critical data. Any of these events could prevent us from fulfilling our customers' orders or could negatively impact a country or region in which we sell our products, which could in turn decrease that country's or region's demand for our products. Our corporate headquarters, a significant portion of our research and development activities, certain of our data centers and certain other critical business operations are located in the San Francisco Bay Area, and additional facilities where we conduct significant operations are located in the Salt Lake Valley Area, both of which are near major earthquake faults. A catastrophic event that results in the destruction or disruption of any of our data centers or our critical business or information technology systems could severely affect our ability to conduct normal business operations and, as a result, our future operating results could be adversely affected, and the adverse effects of any such catastrophic event would be exacerbated if experienced at the same time as another unexpected and adverse event, such as the COVID-19 pandemic. For example, wildfires have resulted in power shut-offs in California and are likely to occur in the future, and this could adversely affect the work-from-home operations of our employees on the west coast.

***Climate change may have a long-term impact on our business.***

While we seek to partner with organizations that mitigate their business risks associated with climate change, we recognize that there are inherent risks wherever business is conducted. Access to clean water and reliable energy in the communities where we conduct our business, whether for our offices or for our vendors, is a priority. Our major sites in California, Utah and India are vulnerable to climate change effects. For example, in California, increasing intensity of drought throughout the state and annual periods of wildfire danger increase the probability of planned power outages in the communities where we work and live. While this danger has a low-assessed risk of disrupting normal business operations, it has the potential impact on employees' abilities to commute to work or to work from home and stay connected effectively. Climate-related events, including the increasing frequency of extreme weather events and their impact on U.S., India and other major regions' critical infrastructure, have the potential to disrupt our business, our third-party suppliers, and/or the business of our customers, and may cause us to experience higher attrition, losses, and additional costs to maintain or resume operations. To accurately assess and take potential proactive action as appropriate, Adobe is aligned with the guidelines of the Financial Stability Board's Task Force on Climate-related Financial Disclosures recommendations and the Sustainability Accounting Standards Board environmental metrics.

***Uncertainty about current and future economic conditions and other adverse changes in general political conditions in any of the major countries in which we do business could adversely affect our operating results.***

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in economic and political conditions, both domestically and globally, including trends toward protectionism and nationalism, and other events beyond our control, such as the COVID-19 pandemic. Additionally, the business downturn caused by the pandemic may adversely impact the businesses and financial health of many of our customers and hurt their creditworthiness (e.g., international travel bans impacting customers in the travel and hospitality industries). As a result, current or potential customers may be unable to fund software purchases, which could cause them to delay, decrease or cancel purchases of our products and services. Uncertainty about the effects of current and future economic and political conditions on us, our customers, suppliers and partners makes it difficult for us to forecast operating results and to make decisions about future investments. If economic growth in countries where we do business slows, customers may delay or reduce technology purchases, advertising spending or marketing spending, and we have already experienced and may continue to experience the impact of a global decline in advertising spend as the pandemic continues to unfold. This could result in reductions in sales of our products and services, more extended sales cycles, slower adoption of new technologies and increased price competition. Among our customers are government entities, including the U.S. federal government, and our revenue could decline if spending cuts impact the government's ability to purchase our products and services. Deterioration in economic conditions in any of the countries in which we do business could also cause slower or impaired collections on accounts receivable, which may adversely impact our liquidity and financial condition.

A disruption in financial markets could impair our banking partners, on which we rely for operating cash management and derivative programs. Any of these events would likely harm our business, financial condition and results of operations.

Political instability or adverse political developments in or around any of the major countries in which we do business would also likely harm our business, financial condition and results of operations.

***Revenue, margin or earnings shortfalls or the volatility of the market generally may cause the market price of our stock to decline.***

In the past, the market price for our common stock experienced significant fluctuations and it may do so in the future. A number of factors may affect the market price for our common stock, such as:

- shortfalls in, or changes in expectations about, our revenue, margins, earnings, Annualized Recurring Revenue ("ARR"), sales of our Digital Experience offerings, or other key performance metrics;
- changes in estimates or recommendations by securities analysts;
- whether our results meet analysts' expectations;
- compression or expansion of multiples used by investors and analysts to value high technology SaaS companies;
- the announcement of new products or services, product enhancements, service introductions, strategic alliances or significant agreements by us or our competitors;
- the loss of large customers or our inability to increase sales to existing customers, retain customers or attract new customers;
- recruitment or departure of key personnel;
- variations in our or our competitors' results of operations, changes in the competitive landscape generally and developments in our industry;
- general socio-economic, political or market conditions;
- macroeconomic conditions and the economic impact of the COVID-19 pandemic; and
- unusual events such as significant acquisitions by us or our competitors, divestitures, litigation, regulatory actions and other factors, including factors unrelated to our operating performance.

In addition, the market for technology stocks or the stock market in general may experience uneven investor confidence, which may cause the market price for our common stock to decline for reasons unrelated to our operating performance. Volatility in the market price of a company's securities for a period of time may increase the company's susceptibility to securities class action litigation. Oftentimes, this type of litigation is expensive and diverts management's attention and resources which may adversely affect our business.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

## ITEM 2. PROPERTIES

Our corporate headquarters is located in San Jose, California where we occupy approximately 1.1 million square feet of office space. We own a substantial portion of our San Jose, California properties which we use for research, product development, sales, marketing and administrative purposes. We own and lease properties in various locations throughout the United States which we also use for research, product development, sales, marketing and administrative purposes, and data centers. Outside of the United States, we own and lease properties throughout EMEA and APAC for research, product development, sales and administrative purposes. The largest properties we occupy outside of the United States are the Bangalore, India and Noida, India offices which are approximately 0.4 million and 0.5 million square feet, respectively. We own and lease these properties in India. As of December 3, 2021, we have not terminated any significant lease arrangements.

Additionally, we have ongoing building construction in San Jose, California and Bangalore, India which are currently targeted for completion in fiscal 2022 and 2023, respectively.

During fiscal 2021, our employees across all geographic regions continued to work from home due to the COVID-19 pandemic. Starting in June 2021, we began a phased reopening of all of our U.S. offices and certain of our international offices in areas with sustained low infection rates, and invited fully vaccinated employees located near those reopened offices to return to the office on a voluntary basis. While all our U.S. offices, including our headquarters in San Jose, California, are now open, our reopened offices are operating at reduced capacity with heightened health and safety protocols in place. As conditions continue to fluctuate around the world, our focus remains on promoting employee health and safety as we carefully evaluate reopening plans and timelines. We carefully assess, and reassess, conditions on a case-by-case basis to determine when employees can safely return to our offices.

We believe our facilities continue to be suitable for the conduct of our business should we decide to fully reopen our facilities in the next twelve months.

*See Note 18 of our Notes to Consolidated Financial Statements for further information regarding our lease obligations.*

## ITEM 3. LEGAL PROCEEDINGS

The material set forth in the section titled “Legal Proceedings” in Note 16 of our Notes to Consolidated Financial Statements is incorporated herein by reference.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

*Market Information for Common Stock*

Our common stock is traded on the Nasdaq Global Select Market under the symbol "ADBE."

*Stockholders*

According to the records of our transfer agent, there were 940 holders of record of our common stock on January 14, 2022. Because many of such shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

*Dividends*

We do not anticipate paying any cash dividends in the foreseeable future.

### Issuer Purchases of Equity Securities

Below is a summary of stock repurchases for the three months ended December 3, 2021. *See Note 14 of our Notes to Consolidated Financial Statements for information regarding our stock repurchase programs.*

| Period | Total Number of Shares Repurchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans |
|---|---|---|---|
| | | (in millions, except average price per sh | |
| Beginning repurchase authority | | | |
| September 4 — October 1, 2021 | | | |
| Shares repurchased | 0.5 | $ 656.47 | 0.5 |
| October 2 — October 29, 2021 | | | |
| Shares repurchased | 0.6 | $ 596.55 | 0.6 |
| October 30 — December 3, 2021 | | | |
| Shares repurchased | 0.5 | $ 657.07 | 0.5 |
| Total | 1.6 | | 1.6 |

(1) In December 2020, the Board of Directors granted authority to repurchase up to $15 billion in our common stock through the end of fiscal 2024.

(2) In September 2021, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of $1 billion. As of December 3, 2021, approximately $334 million of the prepayment remained under this agreement.

## ITEM 6. [RESERVED]

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion should be read in conjunction with our Consolidated Financial Statements and Notes thereto. Discussion regarding our financial condition and results of operations for fiscal 2020 as compared to fiscal 2019 is included in Item 7 of our Annual Report on Form 10-K for the fiscal year ended November 27, 2020, filed with the SEC on January 15, 2021.*

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

In preparing our Consolidated Financial Statements in accordance with GAAP and pursuant to the rules and regulations of the SEC, we make assumptions, judgments and estimates that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosures of contingent assets and liabilities. We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. We evaluate our assumptions, judgments and estimates on a regular basis. We also discuss our critical accounting policies and estimates with the Audit Committee of the Board of Directors.

We believe that the assumptions, judgments and estimates involved in the accounting for revenue recognition, business combinations and income taxes have the greatest potential impact on our Consolidated Financial Statements. These areas are key components of our results of operations and are based on complex rules requiring us to make judgments and estimates, and consequently, we consider these to be our critical accounting policies. Historically, our assumptions, judgments and estimates relative to our critical accounting policies have not differed materially from actual results.

**Revenue Recognition**

Our contracts with customers may include multiple goods and services. For example, some of our offerings include both on-premise and/or on-device software licenses and cloud services. Determining whether the software licenses and the cloud services are distinct from each other, and therefore performance obligations to be accounted for separately, or not distinct from each other, and therefore part of a single performance obligation, may require significant judgment. We have concluded that the on-premise/on-device software licenses and cloud services provided in our Creative Cloud and Document Cloud subscription offerings are not distinct from each other such that revenue from each offering should be recognized ratably over the subscription period for which the cloud services are provided. In reaching this conclusion, we considered the nature of our promise to Creative Cloud and Document Cloud customers, which is to provide a complete end-to-end creative design or document workflow solution that operates seamlessly across multiple devices and teams. We fulfill this promise by providing access to a solution that integrates cloud-based and on-premise/on-device features that, together through their integration, provide functionalities, utility and workflow efficiencies that could not be obtained from either the on-premise/on-device software or cloud services on their own.

Cloud-based features that are integral to our Creative Cloud and Document Cloud offerings and that work together with the on-premise/on-device software include, but are not limited to: Creative Cloud Libraries, which enable customers to access their work, settings, preferences and other assets seamlessly across desktop and mobile devices and collaborate across teams in real time; shared reviews which enable simultaneous editing and commenting of PDFs across desktop, mobile and web; automatic cloud rendering of a design which enables it to be worked on in multiple mediums; and Sensei, Adobe's cloud-hosted artificial intelligence and machine learning framework, which enables features such as automated photo-editing, photograph content-awareness, natural language processing, optical character recognition and automated document tagging.

**Business Combinations**

We allocate the purchase price of acquired companies to tangible and intangible assets acquired and liabilities assumed based upon their estimated fair values at the acquisition date. The purchase price allocation process requires management to make significant estimates and assumptions with respect to intangible assets and deferred revenue obligations. Although we believe the assumptions and estimates we have made are reasonable, they are based in part on historical experience, market conditions and information obtained from management of the acquired companies and are inherently uncertain. Examples of critical estimates in valuing certain of the intangible assets we have acquired or may acquire in the future include but are not limited to:

- future expected cash flows from software license sales, subscriptions, support agreements, consulting contracts and acquired developed technologies and patents;
- expected costs to develop acquired technologies and patents internally into commercially viable products;

- historical and expected customer attrition rates and anticipated growth in revenue from acquired customers;
- the acquired company's trade name and trademarks as well as assumptions about the period of time the acquired trade name and trademarks will continue to be used in the combined company's product portfolio;
- the expected use of the acquired assets; and
- discount rates.

In connection with the purchase price allocations for our acquisitions, we estimate the fair value of the deferred revenue obligations assumed. The estimated fair value of these obligations is determined utilizing a cost build-up approach. The cost build-up approach determines fair value by estimating the costs related to fulfilling the obligations plus a normal profit margin.

Unanticipated events and circumstances may occur which may affect the accuracy or validity of such assumptions, estimates or actual results.

**Accounting for Income Taxes**

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Management must make assumptions, judgments and estimates to determine our current provision for income taxes and also our deferred tax assets and liabilities.

Our assumptions, judgments and estimates relative to the current provision for income taxes take into account current tax laws, our interpretation of current tax laws and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. We have established reserves for income taxes to address potential exposures involving tax positions that could be challenged by tax authorities. In addition, we are subject to the examination of our income tax returns by the U.S. Internal Revenue Service and other domestic and foreign tax authorities. These tax examinations are expected to focus on our research and development tax credits, intercompany transfer pricing practices and other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from these examinations. We believe such estimates to be reasonable; however, we cannot provide assurance that the final determination of any of these examinations will not have a significant impact on the amounts provided for income taxes in our Consolidated Financial Statements.

**Recent Accounting Pronouncements**

*See Note 1 of our Notes to Consolidated Financial Statements for information regarding recent accounting pronouncements that are of significance, or potential significance to us.*

## ACQUISITIONS

In the fourth quarter of fiscal 2021, we completed the acquisition of Frame.io, a privately held company that provides a cloud-based video collaboration platform, for approximately $1.18 billion and we began integrating Frame.io into our Digital Media reportable segment. In the first quarter of fiscal 2021, we completed the acquisition of Workfront, a privately held company that provides a workflow platform, for approximately $1.52 billion in cash consideration and we began integrating Workfront into our Digital Experience reportable segment.

*See Note 3 of our Notes to Consolidated Financial Statements for further information regarding these acquisitions.*

## RESULTS OF OPERATIONS

### Overview of 2021

For our fiscal 2021, we experienced strong demand across our Digital Media offerings consistent with the continued execution of our long-term plans with respect to this segment. In our Digital Experience segment, we continued to experience growth in software-based subscription revenue across our portfolio of offerings. Our financial results for fiscal 2021 benefited from an extra week in the first quarter of fiscal 2021 due to our 52/53 week financial calendar whereby fiscal 2021 is a 53-week year compared with fiscal 2020 and 2019 which were 52-week years.

*Digital Media*

In our Digital Media segment, we are a market leader with Creative Cloud, our subscription-based offering which provides desktop tools, mobile apps and cloud-based services for designing, creating and publishing rich and immersive content. Creative Cloud delivers value with deep, cross-product integration, frequent product updates and feature enhancements, cloud-enabled services including storage and syncing of files across users' machines, machine learning and artificial intelligence, access to marketplace, social and community-based features with our Adobe Stock and Behance services, app creation capabilities, tools which assist with enterprise deployments and team collaboration, and affordable pricing for cost-sensitive customers.

We offer Creative Cloud for individuals, students, teams and enterprises. We expect Creative Cloud will drive sustained long-term revenue growth through a continued expansion of our customer base by attracting new users with new features and products, continuing to acquire users with our low cost of entry and delivery of additional features and value to Creative Cloud, and delivering new features and technologies to existing customers with our latest releases. We have also built out a marketplace for Creative Cloud subscribers to enable the delivery and purchase of stock content in our Adobe Stock service. Overall, our strategy with Creative Cloud is designed to enable us to increase our revenue with users, attract more new customers, and grow our recurring and predictable revenue stream that is recognized ratably.

We continue to implement strategies that are designed to accelerate awareness, consideration and purchase of subscriptions to our Creative Cloud offerings. These strategies include increasing the value Creative Cloud users receive, such as offering new desktop and mobile applications, as well as targeted promotions and offers that attract past customers and potential users to experience and ultimately subscribe to Creative Cloud. Because of the shift towards Creative Cloud subscriptions and Enterprise Term License Agreements ("ETLAs"), revenue from perpetual licensing of our Creative products has been immaterial to our business.

In October 2021, we acquired Frame.io, a privately held company that provides a cloud-based video collaboration platform, and we began integrating Frame.io into our Digital Media segment.

We are also a market leader with our Document Cloud offerings built around our Adobe Acrobat family of products, including Adobe Acrobat Reader DC, and a set of integrated mobile apps and cloud-based document services, including Adobe Scan and Adobe Sign. Acrobat provides reliable creation and exchange of electronic documents, regardless of platform or application source type. Document Cloud, which we believe enhances the way people manage critical documents at home, in the office and across devices, includes Adobe Acrobat DC and Adobe Sign, and a set of integrated services enabling users to create, review, approve, sign and track documents whether on a desktop or mobile device. Adobe Acrobat DC is offered both through subscription and perpetual licenses.

As part of our Creative Cloud and Document Cloud strategies, we utilize a data-driven operating model ("DDOM") and our Adobe Experience Cloud solutions to raise awareness of our products, drive new customer acquisition, engagement and retention, and optimize customer journeys. As a result, we observed strong growth in Digital Media revenue during fiscal 2021.

Annualized Recurring Revenue ("ARR") is currently the key performance metric our management uses to assess the health and trajectory of our overall Digital Media segment. ARR should be viewed independently of revenue, deferred revenue and remaining performance obligations as ARR is a performance metric and is not intended to be combined with any of these items. We adjust our reported ARR on an annual basis to reflect any exchange rate changes. Our reported ARR results in the

current fiscal year are based on currency rates set at the beginning of the year and held constant throughout the year. We calculate ARR as follows:

| | |
|---|---|
| Creative ARR | Annual Value of Creative Cloud Subscriptions<br>+<br>Annual Creative ETLA Contract Va |
| Document Cloud ARR | Annual Value of Document Cloud Subscription<br>+<br>Annual Document Cloud ETLA Contrac |
| Digital Media ARR | Creative ARR<br>+<br>Document Cloud ARR |

Creative ARR exiting fiscal 2021 was $10.30 billion, up from $8.78 billion at the end of fiscal 2020. Document Cloud ARR exiting fiscal 2021 was $1.93 billion, up from $1.47 billion at the end of fiscal 2020. Total Digital Media ARR grew to $12.24 billion at the end of fiscal 2021, up from $10.26 billion at the end of fiscal 2020. Revaluing our ending ARR for fiscal 2021 using currency rates at the beginning of fiscal 2022, our Digital Media ARR at the end of fiscal 2021 would be $12.15 billion or approximately $86 million lower than the ARR reported above.

Our success in driving growth in ARR has positively affected our revenue growth. Creative revenue in fiscal 2021 was $9.55 billion, up from $7.74 billion in fiscal 2020 and representing 23% year-over-year growth. Document Cloud revenue in fiscal 2021 was $1.97 billion, up from $1.50 billion in fiscal 2020 and representing 32% year-over-year growth which reflected an increase in demand driven by new user acquisition for our Document Cloud subscription offerings. Total Digital Media segment revenue grew to $11.52 billion in fiscal 2021, up from $9.23 billion in fiscal 2020 and representing 25% year-over-year growth. These increases were driven by strong net new user growth, including those resulting from the current work-from-home environment reflecting expanded digital engagement.

*Digital Experience*

We are a market leader in the fast-growing category addressed by our Digital Experience segment. The Adobe Experience Cloud applications, services and platform are designed to manage customer journeys, enable shoppable experiences and deliver intelligence for businesses of any size in any industry. Our differentiation and competitive advantage is strengthened by our ability to use the Adobe Experience Platform to connect our comprehensive set of solutions.

In December 2020, we acquired Workfront, a privately held company that provides a workflow platform, and integrated Workfront into our Digital Experience segment.

Adobe Experience Cloud delivers solutions for our customers across the following strategic growth pillars:

- *Data insights and audiences.* Our solutions, including Adobe Analytics, Adobe Experience Platform, Customer Journey Analytics, Adobe Audience Manager and our Real-time Customer Data Platform, deliver robust customer profiles and AI-powered analytics across the customer journey to provide timely, relevant experiences across platforms.

- *Content and commerce.* Our solutions help customers manage, deliver and optimize content delivery, through Adobe Experience Manager and to enable shopping experiences that scale from mid-market to enterprise businesses, with Adobe Commerce.

- *Customer journeys.* Our solutions help businesses manage, test, target, personalize and orchestrate campaigns and customer journeys across B2E use cases, including through Marketo Engage, Adobe Campaign, Adobe Target and Journey Optimizer.

- *Marketing workflow.* We offer Adobe Workfront, a work management platform directed toward marketers to orchestrate campaign workflows.

In addition to chief marketing officers, chief revenue officers and digital marketers, users of our Digital Experience solutions include advertisers, campaign managers, publishers, data analysts, content managers, social marketers, marketing executives and information management and technology executives. These customers often are involved in workflows that utilize other Adobe products, such as our Digital Media offerings. By combining the creativity of our Digital Media business with the science of our Digital Experience business, we help our customers to more efficiently and effectively make, manage, measure and monetize their content across every channel with an end-to-end workflow and feedback loop.

We utilize a direct sales force to market and license our Digital Experience solutions, as well as an extensive ecosystem of partners, including marketing agencies, systems integrators and independent software vendors that help license and deploy our solutions to their customers. We have made significant investments to broaden the scale and size of all of these routes to market, and our recent financial results reflect the success of these investments.

Digital Experience revenue was $3.87 billion in fiscal 2021, up from $3.13 billion in fiscal 2020 which represents 24% year-over-year growth. Driving this increase was the increase in subscription revenue across our offerings which grew to $3.38 billion in fiscal 2021 from $2.66 billion in fiscal 2020, representing 27% year-over-year growth. Also contributing to the increase in Digital Experience subscription revenue was revenue associated with Workfront's workflow platform offerings. We expect that the addition of Workfront, and continued demand across our portfolio of Digital Experience solutions, will drive revenue growth in future years.

## COVID-19 UPDATE

The COVID-19 pandemic continues to have widespread, rapidly-evolving and unpredictable impacts on global societies, economies, financial markets and business practices. As conditions fluctuate around the world, with vaccine administration rising in certain regions, governments and organizations have responded by adjusting their restrictions and guidelines accordingly. Our focus remains on promoting employee health and safety, serving our customers and ensuring business continuity. We carefully assess, and reassess, conditions on a case-by-case basis to determine when employees can safely return to our offices and resume business travel. As a result, we have reopened our offices in areas with sustained low infection rates and are allowing fully vaccinated employees to return on a voluntary basis. In addition, we are implementing our reimagined framework for the future of work at Adobe, which is rooted in a flexible and hybrid model enabled by a digital-first mindset.

During the pandemic, digital has become the primary way for people to connect, work, learn and be entertained, and for businesses to engage with customers. This ongoing shift to a digital-first world has increased the importance and relevance of our solutions, which has contributed to our continued growth year over year. However, while our revenue and earnings are relatively predictable as a result of our subscription-based business model, the duration of the pandemic and the broader implications of the macro-economic recovery on our business remain uncertain. *See the section titled "Risk Factors" in Part I, Item 1A of this report for further discussion of the possible impact of the pandemic on our business.*

*Financial Performance Summary for Fiscal 2021*

Our financial results for fiscal 2021 benefited from an extra week in the first quarter of fiscal 2021 due to our 52/53 week financial calendar whereby fiscal 2021 is a 53-week year compared with fiscal 2020 and 2019 which were 52-week years.

- Total Digital Media ARR of approximately $12.24 billion as of December 3, 2021 increased by $1.98 billion, or 19%, from $10.26 billion as of November 27, 2020. The change in our Digital Media ARR was primarily due to new user adoption of our Creative Cloud and Document Cloud offerings.

- Creative revenue of $9.55 billion increased by $1.81 billion, or 23%, during fiscal 2021, from $7.74 billion in fiscal 2020. Document Cloud revenue of $1.97 billion increased by $477 million, or 32%, during fiscal 2021, from $1.50 billion in fiscal 2020. The increases were primarily due to subscription revenue growth associated with our Creative Cloud and Document Cloud offerings.

- Digital Experience revenue of $3.87 billion increased by $742 million, or 24%, during fiscal 2021, from $3.13 billion in fiscal 2020. The increase was primarily due to subscription revenue growth across our offerings, including from our Workfront acquisition.

- Remaining performance obligations of $13.99 billion as of December 3, 2021 increased by $2.65 billion, or 23%, from $11.34 billion as of November 27, 2020, primarily due to new contracts and renewals for our Digital Media and Digital Experience offerings, as well as impacts from our Workfront acquisition.

- Cost of revenue of $1.87 billion increased by $143 million, or 8%, during fiscal 2021, from $1.72 billion in fiscal 2020 primarily due to increases in hosting services and data center costs, partially offset by decreases in Advertising Cloud media costs.
- Operating expenses of $8.12 billion increased by $1.21 billion, or 17%, during fiscal 2021, from $6.91 billion in fiscal 2020 primarily due to increases in base and incentive compensation and related benefits costs, as well as increased marketing spend.

- Net income of $4.82 billion decreased by $438 million, or 8%, during fiscal 2021 from $5.26 billion in fiscal 2020 primarily due to the change in provision for income taxes, which was largely driven by the non-recurring benefit from income taxes recognized in fiscal 2020 associated with our intra-entity transfers of certain intellectual property rights. To a lesser extent, net income was also impacted by increases in operating expenses, offset by increases in revenue.
- Net cash flows from operations of $7.23 billion during fiscal 2021 increased by $1.50 billion, or 26%, from $5.73 billion in fiscal 2020 primarily due to higher net income adjusted for the net effect of non-cash items and increases in deferred revenue, partially offset by increases in trade receivables.

**Revenue**

| *(dollars in millions)* | 2021 | 2020 | 2019 | % Change 2021-2020 |
|---|---|---|---|---|
| Subscription | $ 14,573 | $ 11,626 | $ 9,634 | 25 % |
| Percentage of total revenue | 92 % | 90 % | 86 % | |
| Product | 555 | 507 | 648 | 9 % |
| Percentage of total revenue | 4 % | 4 % | 6 % | |
| Services and other | 657 | 735 | 889 | (11)% |
| Percentage of total revenue | 4 % | 6 % | 8 % | |
| Total revenue | $ 15,785 | $ 12,868 | $ 11,171 | 23 % |

*Subscription*

Our subscription revenue is comprised primarily of fees we charge for our subscription and hosted service offerings, and related support, including Creative Cloud and certain of our Adobe Experience Cloud and Document Cloud services. We primarily recognize subscription revenue ratably over the term of agreements with our customers, beginning with commencement of service. Subscription revenue related to certain offerings, where fees are based on a number of transactions and invoicing is aligned to the pattern of performance, customer benefit and consumption, are recognized on a usage basis.

We have the following reportable segments: Digital Media, Digital Experience, and Publishing and Advertising. Subscription revenue by reportable segment for fiscal 2021, 2020 and 2019 is as follows:

| *(dollars in millions)* | 2021 | 2020 | 2019 | % Change 2021-2020 |
|---|---|---|---|---|
| Digital Media | $ 11,048 | $ 8,813 | $ 7,208 | 25 % |
| Digital Experience | 3,379 | 2,660 | 2,280 | 27 % |
| Publishing and Advertising | 146 | 153 | 146 | (5)% |
| Total subscription revenue | $ 14,573 | $ 11,626 | $ 9,634 | 25 % |

*Product*

Our product revenue is comprised primarily of fees related to licenses for on-premise software purchased on a perpetual basis, for a fixed period of time or based on usage for certain of our OEM and royalty agreements. We primarily recognize product revenue at the point in time the software is available to the customer, provided all other revenue recognition criteria are met.

*Services and Other*

Our services and other revenue is comprised primarily of fees related to consulting, training, maintenance and support for certain on-premise licenses that are recognized at a point in time and our advertising offerings. We typically sell our consulting contracts on a time-and-materials and fixed-fee basis. These revenues are recognized as the services are performed for time and materials contracts and on a relative performance basis for fixed-fee contracts. Training revenues are recognized as the services are performed. Our maintenance and support offerings, which entitle customers, partners and developers to receive desktop product upgrades and enhancements or technical support, depending on the offering, are generally recognized ratably over the term of the arrangement. Transaction-based advertising revenue is recognized on a usage basis as we satisfy the performance obligations to our customers.

*Segments*

In fiscal 2021, we categorized our products into the following reportable segments:

- *Digital Media*—Our Digital Media segment provides products, services and solutions that enable individuals, teams and enterprises to create, publish and promote their content anywhere and accelerate their productivity by modernizing how they view, share, engage with and collaborate on documents and creative content. Our customers include creative professionals, including photographers, video editors, graphic and experience designers and game developers, communicators, including content creators, students, marketers and knowledge workers, and consumers.

- *Digital Experience*—Our Digital Experience segment provides an integrated platform and set of applications and services that enable brands and businesses to create, manage, execute, measure, monetize and optimize customer experiences that span from analytics to commerce. Our customers include marketers, advertisers, agencies, publishers, merchandisers, merchants, web analysts, data scientists, developers and executives across the C-suite.

- *Publishing and Advertising*—Our Publishing and Advertising segment contains legacy products and services that address diverse market opportunities, including eLearning solutions, technical document publishing, web conferencing, document and forms platform, web application development, high-end printing and our Adobe Advertising Cloud offerings.

*Segment Information*

| *(dollars in millions)* | 2021 | 2020 | 2019 | % Change 2021-2020 |
|---|---|---|---|---|
| Digital Media | $ 11,520 | $ 9,233 | $ 7,707 | 25 % |
| Percentage of total revenue | 73 % | 72 % | 69 % | |
| Digital Experience | 3,867 | 3,125 | 2,795 | 24 % |
| Percentage of total revenue | 24 % | 24 % | 25 % | |
| Publishing and Advertising | 398 | 510 | 669 | (22)% |
| Percentage of total revenue | 3 % | 4 % | 6 % | |
| Total revenue | $ 15,785 | $ 12,868 | $ 11,171 | 23 % |

*Digital Media*

Revenue by major offerings in our Digital Media reportable segment for fiscal 2021, 2020 and 2019 were as follows:

| *(dollars in millions)* | 2021 | 2020 | 2019 | % Change 2021-2020 |
|---|---|---|---|---|
| Creative Cloud | $ 9,546 | $ 7,736 | $ 6,482 | 23 % |
| Document Cloud | 1,974 | 1,497 | 1,225 | 32 % |
| Total Digital Media revenue | $ 11,520 | $ 9,233 | $ 7,707 | 25 % |

Revenue from Digital Media increased $2.29 billion during fiscal 2021 as compared to fiscal 2020, driven by increases in revenue associated with our Creative and Document Cloud subscription offerings due to continued demand amid an increasingly digital environment and expanding subscription base.

Revenue associated with our Creative offerings, which includes our Creative Cloud, increased during fiscal 2021 primarily due to increases in net new subscriptions across our Creative Cloud offerings.

Document Cloud revenue, which includes our Acrobat product family and Adobe Sign service, increased during fiscal 2021 primarily due to increases in subscription revenue driven by strong new user acquisition of our Document Cloud offerings.

*Digital Experience*

Revenue from Digital Experience increased $742 million during fiscal 2021, as compared to fiscal 2020 primarily due to subscription revenue growth across our offerings including from our Workfront acquisition.

*Geographical Information*

| *(dollars in millions)* | 2021 | 2020 | 2019 | % Change 2021-2020 |
|---|---|---|---|---|
| Americas | $ 8,996 | $ 7,454 | $ 6,506 | 21 % |
| Percentage of total revenue | 57 % | 58 % | 58 % | |
| EMEA | 4,252 | 3,400 | 2,975 | 25 % |
| Percentage of total revenue | 27 % | 26 % | 27 % | |
| APAC | 2,537 | 2,014 | 1,690 | 26 % |
| Percentage of total revenue | 16 % | 16 % | 15 % | |
| Total revenue | $ 15,785 | $ 12,868 | $ 11,171 | 23 % |

Overall revenue during fiscal 2021 increased in all geographic regions as compared to fiscal 2020 primarily due to increases in Digital Media revenue and, to a lesser extent, increases in Digital Experience revenue. Within each geographic region, the fluctuations in revenue by reportable segment were attributable to the factors noted in the segment information above.

Included in the overall change in revenue for fiscal 2021 as compared to fiscal 2020 were impacts associated with foreign currency which were mitigated in part by our foreign currency hedging program. During fiscal 2021, the U.S. Dollar primarily weakened against EMEA currencies and the Australian Dollar as compared to fiscal 2020, which increased revenue in U.S. Dollar equivalents by $276 million. During fiscal 2021, the foreign currency impacts to revenue were offset in part by net hedging losses from our cash flow hedging program of $18 million.

*See Note 2 of our Notes to Consolidated Financial Statements for additional details of revenue by geography.*

**Cost of Revenue**

| *(dollars in millions)* | 2021 | 2020 | 2019 | % Change 2021-2020 |
|---|---|---|---|---|
| Subscription | $ 1,374 | $ 1,108 | $ 926 | 24 % |
| Percentage of total revenue | 9 % | 9 % | 8 % | |
| Product | 41 | 36 | 40 | 14 % |
| Percentage of total revenue | * | * | * | |
| Services and other | 450 | 578 | 707 | (22)% |
| Percentage of total revenue | 3 % | 4 % | 6 % | |
| Total cost of revenue | $ 1,865 | $ 1,722 | $ 1,673 | 8 % |

(*) Percentage is less than 1%

*Subscription*

Cost of subscription revenue consists of third-party hosting services and data center costs, including expenses related to operating our network infrastructure. Cost of subscription revenue also includes compensation costs associated with network operations, implementation, account management and technical support personnel, royalty fees, software costs and amortization of certain intangible assets.

Cost of subscription revenue increased due to the following:

| |
|---|
| Hosting services and data center costs |
| Base compensation and related benefits associated with headcount |
| Incentive compensation, cash and stock-based |
| Royalty costs |
| Total change |

*Product*

Cost of product revenue is primarily comprised of third-party royalties, amortization of certain intangible assets, localization costs and the costs associated with the manufacturing of our products.

*Services and Other*

Cost of services and other revenue is primarily comprised of compensation and contracted costs incurred to provide consulting services, training and product support, and hosting services and data center costs. Cost of services and other also includes media costs related to impressions purchased from third-party ad inventory sources for our transaction-based Adobe Advertising Cloud offerings.

Cost of services and other decreased during fiscal 2021 as compared to fiscal 2020 mainly due to lower media costs related to Advertising Cloud offerings that were discontinued beginning in the second quarter of fiscal 2020.

**Operating Expenses**

| *(dollars in millions)* | 2021 | 2020 | 2019 | % Change 2021-2020 |
|---|---|---|---|---|
| Research and development | $ 2,540 | $ 2,188 | $ 1,930 | 16 % |
| Percentage of total revenue | 16 % | 17 % | 17 % | |
| Sales and marketing | 4,321 | 3,591 | 3,244 | 20 % |
| Percentage of total revenue | 27 % | 28 % | 29 % | |
| General and administrative | 1,085 | 968 | 881 | 12 % |
| Percentage of total revenue | 7 % | 8 % | 8 % | |
| Amortization of intangibles | 172 | 162 | 175 | 6 % |
| Percentage of total revenue | 1 % | 1 % | 2 % | |
| Total operating expenses | $ 8,118 | $ 6,909 | $ 6,230 | 17 % |

*Research and Development*

Research and development expenses consist primarily of compensation and contracted costs associated with software development, third-party hosting services and data center costs, related facilities costs and expenses associated with computer equipment and software used in development activities.

Research and development expenses increased due to the following:

| | Components of % Change 2021-2020 |
|---|---|
| Incentive compensation, cash and stock-based | 8 % |
| Base compensation and related benefits associated with headcount | 6 |
| Professional and consulting fees | 2 |
| Total change | 16 % |

We believe that investments in research and development, including the recruiting and hiring of software developers, are critical to remain competitive in the marketplace and are directly related to continued timely development of new and enhanced offerings and solutions. We will continue to focus on long-term opportunities available in our end markets and make significant investments in the development of our subscription and service offerings, applications and tools.

*Sales and Marketing*

Sales and marketing expenses consist primarily of compensation costs, amortization of contract acquisition costs, including sales commissions, travel expenses and related facilities costs for our sales, marketing, order management and global supply chain management personnel. Sales and marketing expenses also include the costs of programs aimed at increasing revenue, such as advertising, trade shows and events, public relations and other market development programs.

Sales and marketing expenses increased due to the following:

| | Components of % Change 2021-2020 |
|---|---|
| Marketing spend related to campaigns, events and overall marketing efforts | 10 % |
| Incentive compensation, cash and stock-based | 5 |
| Base compensation and related benefits associated with headcount | 3 |
| Transaction fees | 2 |
| Total change | 20 % |

*General and Administrative*

General and administrative expenses consist primarily of compensation and contracted costs, travel expenses and related facilities costs for our finance, facilities, human resources, legal, information services and executive personnel. General and administrative expenses also include outside legal and accounting fees, provision for bad debts, expenses associated with computer equipment and software used in the administration of the business, charitable contributions and various forms of insurance.

General and administrative expenses increased due to the following:

| | Components of % Change 2021-2020 |
|---|---|
| Incentive compensation, cash and stock-based | 9 % |
| Base compensation and related benefits associated with headcount | 4 |
| Bad debt expense | (4) |
| Software licenses | 2 |
| Various individually insignificant items | 1 |
| Total change | 12 % |

*Amortization of Intangibles*

Amortization expense increased during fiscal 2021 as compared to fiscal 2020 primarily due to amortization expense associated with intangible assets purchased through our acquisition of Workfront. The increase in amortization expense is offset in part by the impact of certain intangible assets from previous acquisitions, including Marketo and Omniture, becoming fully amortized in fiscal 2020.

**Non-Operating Income (Expense), Net**

| *(dollars in millions)* | 2021 | 2020 | 2019 | % Change 2021-2020 |
|---|---|---|---|---|
| Interest expense | $ (113) | $ (116) | $ (157) | (3)% |
| Percentage of total revenue | (1)% | (1)% | (1)% | |
| Investment gains (losses), net | 16 | 13 | 52 | 23 % |
| Percentage of total revenue | * | * | * | |
| Other income (expense), net | — | 42 | 42 | ** |
| Percentage of total revenue | * | * | * | |
| Total non-operating income (expense), net | $ (97) | $ (61) | $ (63) | 59 % |

(*) Percentage is less than 1%.
(**) Percentage is not meaningful.

*Interest Expense*

Interest expense represents interest associated with our debt instruments. Interest on our senior notes is payable semi-annually, in arrears, on February 1 and August 1.

Interest expense decreased during fiscal 2021 as compared to fiscal 2020 primarily due to lower average interest rates on our debt instruments that were refinanced in the first quarter of fiscal 2020. *See Note 17 of our Notes to Consolidated Financial Statements for further details regarding our debt instruments.*

*Investment Gains (Losses), Net*

Investment gains (losses), net consists principally of unrealized holding gains and losses associated with our deferred compensation plan assets, and gains and losses associated with our direct and indirect investments in privately held companies.

*Other Income (Expense), Net*

Other income (expense), net consists primarily of interest earned on cash, cash equivalents and short-term fixed income investments. Other income (expense), net also includes realized gains and losses on fixed income investments and foreign exchange gains and losses.

Other income (expense), decreased during fiscal 2021 primarily due to decreases in interest income driven by lower average interest rates and increases in foreign exchange losses.

**Provision for (Benefit from) Income Taxes**

| *(dollars in millions)* | 2021 | 2020 | 2019 | % Change 2021-2020 |
|---|---|---|---|---|
| Provision for (benefit from) income taxes | $ 883 | $ (1,084) | $ 254 | ** |
| Percentage of total revenue | 6 % | (8)% | 2 % | |
| Effective tax rate | 15 % | (26)% | 8 % | |

(**) Percentage is not meaningful.

Our effective tax rate increased by approximately 41 percentage points during fiscal 2021 as compared to fiscal 2020. The higher effective tax rate was primarily due to the non-recurring tax benefits recognized during fiscal 2020 as a result of the change in our corporate tax trading structure, and the corresponding change in geographic mix of international income in fiscal 2021.

Our effective tax rate for fiscal 2021 was lower than the U.S. federal statutory tax rate of 21% primarily due to tax benefits related to stock-based compensation.

During fiscal 2020, we completed intra-entity transfers of certain IP rights to our Irish subsidiary in order to better align the ownership of these rights with how our business operates. The transfers did not result in taxable gains; however, our Irish subsidiary recognized deferred tax assets for the book and tax basis difference of the transferred IP rights. As a result of these transactions, we recorded deferred tax assets, net of valuation allowance, and related tax benefits totaling $1.35 billion, based on the fair value of the IP rights transferred. The tax-deductible amortization related to the transferred IP rights is recognized over the period of economic benefit.

We recognize deferred tax assets to the extent that we believe these assets are more likely than not to be realized. In making such a determination, we considered all available positive and negative evidence, including our past operating results, forecasted earnings, future taxable income and prudent and feasible tax planning strategies. On the basis of this evaluation, we continue to maintain a valuation allowance to reduce our deferred tax assets to the amount realizable. The total valuation allowance was $335 million as of December 3, 2021, primarily attributable to certain state credits and foreign intangible assets.

We are a United States-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. The current U.S. tax law subjects the earnings of certain foreign subsidiaries to U.S. tax and generally allows an exemption from taxation for distributions from foreign subsidiaries.

In the current global tax policy environment, the U.S. Treasury and other domestic and foreign governing bodies continue to consider, and in some cases introduce, changes in regulations applicable to corporate multinationals such as Adobe. As regulations are issued, we account for finalized regulations in the period of enactment.

*See Note 10 of our Notes to Consolidated Financial Statements for further information regarding our provision for (benefit from) income taxes.*

*Accounting for Uncertainty in Income Taxes*

The gross liabilities for unrecognized tax benefits excluding interest and penalties were $289 million, $201 million and $173 million for fiscal 2021, 2020 and 2019, respectively. If the total unrecognized tax benefits at December 3, 2021, November 27, 2020 and November 29, 2019 were recognized, $199 million, $136 million and $116 million would decrease the respective effective tax rates.

The combined amounts of accrued interest and penalties related to tax positions taken on our tax returns were approximately $22 million and $26 million for fiscal 2021 and 2020, respectively. These amounts were included in long-term income taxes payable in their respective years.

The timing of the resolution of income tax examinations is highly uncertain as are the amounts and timing of tax payments that are part of any audit settlement process. These events could cause large fluctuations in the balance sheet classification of our tax assets and liabilities. We believe that within the next 12 months, it is reasonably possible that either certain audits will conclude or statutes of limitations on certain income tax examination periods will expire, or both. Given the uncertainties described above, we can only determine a range of estimated potential decreases in underlying unrecognized tax benefits ranging from $0 to approximately $5 million over the next 12 months.

In addition, in the United States and other countries where we conduct business and in jurisdictions in which we are subject to tax, including those covered by governing bodies that enact tax laws applicable to us, such as the European Commission of the European Union, we are subject to potential changes in relevant tax, accounting and other laws, regulations and interpretations, including changes to tax laws applicable to corporate multinationals such as Adobe. These countries, other governmental bodies and intergovernmental economic organizations such as the Organization for Economic Cooperation and Development, have or could make unprecedented assertions about how taxation is determined in their jurisdictions that are contrary to the way in which we have interpreted and historically applied the rules and regulations described above in such jurisdictions. In the current global tax policy environment, any changes in laws, regulations and interpretations related to these assertions could adversely affect our effective tax rates, cause us to respond by making changes to our business structure, or result in other costs to us which could adversely affect our operations and financial results.

Moreover, we are subject to the examination of our income tax returns by the U.S. Internal Revenue Service and other domestic and foreign tax authorities. These tax examinations are expected to focus on our research and development tax credits, intercompany transfer pricing practices and other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from these examinations. We cannot provide assurance that the final determination of any of these examinations will not have an adverse effect on our operating results and financial position.

## LIQUIDITY AND CAPITAL RESOURCES

### Cash Flows

This data should be read in conjunction with our Consolidated Statements of Cash Flows.

| *(in millions)* | As of December 3, 2021 | As of November 27, 2020 |
|---|---|---|
| Cash and cash equivalents | $ 3,844 | $ 4,478 |
| Short-term investments | $ 1,954 | $ 1,514 |
| Working capital | $ 1,737 | $ 2,634 |
| Stockholders' equity | $ 14,797 | $ 13,264 |

A summary of our cash flows for fiscal 2021, 2020 and 2019 is as follows:

| *(in millions)* | 2021 | 2020 | 2019 |
|---|---|---|---|
| Net cash provided by operating activities | $ 7,230 | $ 5,727 | $ 4,422 |
| Net cash used for investing activities | (3,537) | (414) | (456) |
| Net cash used for financing activities | (4,301) | (3,488) | (2,946) |
| Effect of foreign currency exchange rates on cash and cash equivalents | (26) | 3 | (13) |
| Net increase (decrease) in cash and cash equivalents | $ (634) | $ 1,828 | $ 1,007 |

Our primary source of cash is receipts from revenue. Our primary uses of cash are our stock repurchase program as described below, payroll-related expenses, general operating expenses including marketing, travel and office rent, and cost of revenue. Other sources of cash include proceeds from participation in the employee stock purchase plan. Other uses of cash include business acquisitions, purchases of property and equipment and payments for taxes related to net share settlement of equity awards.

*Cash Flows from Operating Activities*

For fiscal 2021, net cash provided by operating activities of $7.23 billion was primarily comprised of net income adjusted for the net effect of non-cash items. The primary working capital sources of cash were net income together with increases in deferred revenue driven by Digital Media and Digital Experience offerings. The primary working capital use of cash were increases in prepaid expenses and other assets together with increases in trade receivables. The increases in prepaid expenses and other assets were driven by sales commissions paid and capitalized and the timing of billings and payments associated with certain vendors. The increases in trade receivables were attributable to the timing of billings.

*Cash Flows from Investing Activities*

For fiscal 2021, net cash used for investing activities of $3.54 billion was primarily due to our acquisition of Workfront, Frame.io and ongoing capital expenditures. *See Note 3 of our Notes to Consolidated Financial Statements for further information regarding these acquisitions.*

*Cash Flows from Financing Activities*

For fiscal 2021, net cash used for financing activities of $4.30 billion was primarily due to payments for our common stock repurchases and taxes paid related to the net share settlement of equity awards, which were offset by proceeds from re-issuance of common stock mainly for our employee stock purchase plan. *See the section titled "Stock Repurchase Program" below.*

### Liquidity and Capital Resources Considerations

Our existing cash, cash equivalents and investment balances may fluctuate during fiscal 2022 due to changes in our planned cash outlay.

Cash from operations could also be affected by various risks and uncertainties, including, but not limited to, the effects of the pandemic and other risks detailed in the section titled “Risk Factors” in Part I, Item 1A of this report. Based on our current business plan and revenue prospects, we believe that our existing cash, cash equivalents and investment balances, our anticipated cash flows from operations and our available credit facility will be sufficient to meet our working capital, operating resource expenditure and capital expenditure requirements for the next twelve months.

Our cash equivalent and short-term investment portfolio as of December 3, 2021 consisted of asset-backed securities, corporate debt securities, money market funds, municipal securities, time deposits and U.S. Treasury securities. We use professional investment management firms to manage a large portion of our invested cash.

We expect to continue our investing activities, including short-term and long-term investments, purchases of computer systems for research and development, sales and marketing, product support and administrative staff, and facilities expansion. As of December 3, 2021, we expect our capital investment to be approximately $180 million to $220 million, primarily to fund our San Jose and Bangalore construction projects during fiscal 2022. Furthermore, cash reserves may be used to repurchase stock under our stock repurchase program and to strategically acquire companies, products or technologies that are complementary to our business.

*Revolving Credit Agreement*

We have a $1 billion senior unsecured revolving credit agreement ("Revolving Credit Agreement") with a syndicate of lenders, providing for loans to us and certain of our subsidiaries through October 17, 2023. As of December 3, 2021, there were no outstanding borrowings under this credit agreement and the entire $1 billion credit line remains available for borrowing. Our Revolving Credit Agreement contains a financial covenant requiring us not to exceed a maximum leverage ratio. As of December 3, 2021, we were in compliance with this covenant. We believe this covenant will not impact our credit or cash in the coming fiscal year or restrict our ability to execute our business plan. Under the terms of our Revolving Credit Agreement, we are not prohibited from paying cash dividends unless payment would trigger an event of default or if one currently exists. We do not anticipate paying any cash dividends in the foreseeable future.

*Senior Notes*

We have $4.15 billion senior notes outstanding, which rank equally with our other unsecured and unsubordinated indebtedness. As of December 3, 2021, the carrying value of our senior notes was $4.12 billion and our maximum commitment for interest payments was $514 million for the remaining duration of our outstanding senior notes. Interest is payable semi-annually, in arrears on February 1 and August 1. Our senior notes do not contain any financial covenants. *See Note 17 of our Notes to Consolidated Financial Statements for further details regarding our debt.*

*Contractual Obligations*

Our purchase obligations consist of agreements to purchase goods and services entered into in the ordinary course of business. As of December 3, 2021, the value of our non-cancellable unconditional purchase obligations was $1.38 billion. *See Note 16 of our Notes to Consolidated Financial Statements for additional information regarding our purchase obligations.*

We lease certain facilities and data centers under non-cancellable operating lease arrangements that expire at various dates through 2031. As of December 3, 2021, the value of our obligations under operating leases was $604 million. *See Note 18 of our Notes to Consolidated Financial Statements for additional information regarding our lease obligations.*

Our transition tax liability related to historical undistributed foreign earnings, which was accrued as a result of the U.S. Tax Act, was approximately $349 million as of December 3, 2021 and is payable in installments through fiscal 2026. As we repatriate foreign earnings for use in the United States, the distributions will generally be exempt from federal income taxes under current U.S. tax law.

**Stock Repurchase Program**

To facilitate our stock repurchase program, designed to return value to our stockholders and minimize dilution from stock issuances, we may repurchase our shares in the open market or enter into structured repurchase agreements with third parties. In May 2018, our Board of Directors granted authority to repurchase up to $8 billion in our common stock, which we fully utilized during fiscal 2021. In December 2020, our Board of Directors granted additional authority to repurchase up to $15 billion in our common stock through the end of fiscal 2024.

During fiscal 2021, 2020 and 2019, we entered into several structured stock repurchase agreements with large financial institutions, whereupon we provided them with prepayments totaling $3.95 billion, $3.05 billion and $2.75 billion, respectively. We repurchased approximately 7.2 million shares at an average price of $536.17 per share in fiscal 2021, 8.0 million shares at an average price of $376.38 per share in fiscal 2020, and 9.9 million shares at an average price of $270.23 per share in fiscal 2019.

Subsequent to December 3, 2021, as part of the December 2020 stock repurchase authority, we entered into an accelerated share repurchase agreement with a large financial institution whereupon we provided them with a prepayment of $2.4 billion and received an initial delivery of 3.2 million shares, which represents approximately 75% of our prepayment. The remaining balance will be settled during our third quarter of fiscal 2022. Upon completion of the $2.4 billion accelerated share repurchase agreement, $10.7 billion remains under our December 2020 authority.

*See section titled "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities" in Part I, Item 5 of this report for stock repurchases during the quarter ended December 3, 2021 and Note 14 of our Notes to Consolidated Financial Statements for further details regarding our stock repurchase program.*

**Indemnifications**

In the ordinary course of business, we provide indemnifications of varying scope to customers and channel partners against claims of intellectual property infringement made by third parties arising from the use of our products and from time to time, we are subject to claims by our customers under these indemnification provisions. Historically, costs related to these indemnification provisions have not been significant and we are unable to estimate the maximum potential impact of these indemnification provisions on our future results of operations.

To the extent permitted under Delaware law, we have agreements whereby we indemnify our officers and directors for certain events or occurrences while the officer or director is or was serving at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the officer's or director's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that reduces our exposure and enables us to recover a portion of any future amounts paid.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

All market risk sensitive instruments were entered into for non-trading purposes.

**Foreign Currency Risk**

*Foreign Currency Exposures and Hedging Instruments*

In countries outside the United States, we transact business in U.S. Dollars and various other currencies, which subject us to exposure from movements in exchange rates. We may use foreign exchange option contracts or forward contracts to hedge a portion of our forecasted foreign currency denominated revenue. Additionally, we hedge our net recognized foreign currency monetary assets and liabilities with foreign exchange forward contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates.

Our significant foreign currency revenue exposures for fiscal 2021, 2020 and 2019 were as follows :

| *(in millions)* | | **2021** | | **2020** | | **2019** |
|---|---|---|---|---|---|---|
| Euro | € | 2,209 | € | 1,887 | € | 1,603 |
| Japanese Yen | ¥ | 104,829 | ¥ | 88,640 | ¥ | 73,158 |
| British Pounds | £ | 669 | £ | 562 | £ | 503 |
| Australian Dollars | $ | 768 | $ | 645 | $ | 538 |

As of December 3, 2021, the total notional amounts of all outstanding foreign exchange contracts, including options and forwards, were $3.03 billion, which included the notional equivalent of $1.47 billion in Euros, $480 million in British Pounds, $448 million in Japanese Yen, $338 million in Australian Dollars and $299 million in other foreign currencies. As of December 3, 2021, all contracts were set to expire at various dates through June 2022. The bank counterparties in these contracts could expose us to credit-related losses that would be largely mitigated with master netting arrangements with the same counterparty by permitting net settlement transactions. In addition, we enter into collateral security agreements that provide for collateral to be received or posted when the net fair value of these contracts fluctuates from contractually established thresholds.

A sensitivity analysis was performed on all of our foreign exchange derivatives as of December 3, 2021. This sensitivity analysis measures the hypothetical market value resulting from a 10% shift in the value of exchange rates relative to the U.S. Dollar. For option contracts, the Black-Scholes option pricing model was used. A 10% increase in the value of the U.S. Dollar and a corresponding decrease in the value of the hedged foreign currency asset would lead to an increase in the fair value of our financial hedging instruments by $172 million. Conversely, a 10%

decrease in the value of the U.S. Dollar would result in a decrease in the fair value of these financial instruments by $76 million.

As a general rule, we do not use foreign exchange contracts to hedge local currency denominated operating expenses in countries where a natural hedge exists. For example, in many countries, revenue in the local currencies substantially offsets the local currency denominated operating expenses. We also have long-term investment exposures consisting of the capitalization and retained earnings in our non-U.S. Dollar functional currency foreign subsidiaries. As of December 3, 2021 and November 27, 2020, this long-term investment exposure totaled an absolute notional equivalent of $749 million and $598 million, respectively, with the year-over-year increase primarily driven by earnings growth. At this time, we do not hedge these long-term investment exposures.

We do not use foreign exchange contracts for speculative trading purposes, nor do we hedge our foreign currency exposure in a manner that entirely offsets the effects of changes in foreign exchange rates. We regularly review our hedging program and assess the need to utilize financial instruments to hedge currency exposures on an ongoing basis.

*Cash Flow Hedges of Forecasted Foreign Currency Revenue*

We may use foreign exchange purchased options or forward contracts to hedge foreign currency revenue denominated in Euros, British Pounds, Japanese Yen and Australian Dollars. We hedge these cash flow exposures to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates. These foreign exchange contracts, carried at fair value, have maturities of up to twelve months. We enter into these foreign exchange contracts to hedge forecasted revenue in the normal course of business and accordingly, they are not speculative in nature.

We record changes in fair value of these cash flow hedges of foreign currency denominated revenue in accumulated other comprehensive income (loss) in our Consolidated Balance Sheets, until the forecasted transaction occurs. When the forecasted transaction affects earnings, we reclassify the related gain or loss on the cash flow hedge to revenue. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, we reclassify the gain or loss on the related cash flow hedge from accumulated other comprehensive income (loss) to revenue. For the fiscal year ended December 3, 2021, there were no net gains or losses recognized in revenue relating to hedges of forecasted transactions that did not occur.

*Non-Designated Hedges of Foreign Currency Assets and Liabilities*

Our derivatives not designated as hedging instruments consist of foreign currency forward contracts that we primarily use to hedge monetary assets and liabilities denominated in non-functional currencies to reduce the risk that our earnings and cash flows will be adversely affected by changes in foreign currency exchange rates. These foreign exchange contracts are carried at fair value with changes in fair value of these contracts recorded to other income (expense), net in our Consolidated Statements of Income. These contracts reduce the impact of currency exchange rate movements on our assets and liabilities. At December 3, 2021, the outstanding balance sheet hedging derivatives had maturities of 180 days or less.

*See Note 6 of our Notes to Consolidated Financial Statements for information regarding our derivative financial instruments.*

**Interest Rate Risk**

*Short-Term Investments and Fixed Income Securities*

At December 3, 2021, we had debt securities classified as short-term investments of $1.95 billion. Changes in interest rates could adversely affect the market value of these investments. A sensitivity analysis was performed on our investment portfolio as of December 3, 2021, based on an estimate of the hypothetical changes in market value of the portfolio that would result from an immediate parallel shift in the yield curve. A 150 basis point increase in interest rates would lead to a $27 million decrease in the market value of our short-term investments. Conversely, a 150 basis point decrease in interest rates would lead to a $14 million increase in the market value of our short-term investments.

*Senior Notes*

As of December 3, 2021, we had $4.15 billion of senior notes outstanding which bear interest at fixed rates, and therefore do not subject us to financial statement risk associated with changes in interest rates. As of December 3, 2021, the total carrying amount of our senior notes was $4.12 billion and the related fair value based on observable market prices in less active markets was $4.29 billion.

*See Note 17 of our Notes to Consolidated Financial Statements for information regarding our senior notes.*

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

## INDEX TO CONSOLIDATED FINANCIAL STATEMENTS



All financial statement schedules have been omitted, since the required information is not applicable or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Consolidated Financial Statements and Notes thereto.

**ADOBE INC.**

**CONSOLIDATED BALANCE SHEETS**

**(In millions, except par value)**

| | December 3, 2021 | November 27, 2020 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 3,844 | $ 4,478 |
| Short-term investments | 1,954 | 1,514 |
| Trade receivables, net of allowances for doubtful accounts of $16 and of $21, respectively | 1,878 | 1,398 |
| Prepaid expenses and other current assets | 993 | 756 |
| Total current assets | 8,669 | 8,146 |
| Property and equipment, net | 1,673 | 1,517 |
| Operating lease right-of-use assets, net | 443 | 487 |
| Goodwill | 12,668 | 10,742 |
| Other intangibles, net | 1,820 | 1,359 |
| Deferred income taxes | 1,085 | 1,370 |
| Other assets | 883 | 663 |
| Total assets | $ 27,241 | $ 24,284 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Trade payables | $ 312 | $ 306 |
| Accrued expenses | 1,736 | 1,422 |
| Deferred revenue | 4,733 | 3,629 |
| Income taxes payable | 54 | 63 |
| Operating lease liabilities | 97 | 92 |
| Total current liabilities | 6,932 | 5,512 |
| Long-term liabilities: | | |
| Debt | 4,123 | 4,117 |
| Deferred revenue | 145 | 130 |
| Income taxes payable | 534 | 529 |
| Deferred income taxes | 5 | 10 |
| Operating lease liabilities | 453 | 499 |
| Other liabilities | 252 | 223 |
| Total liabilities | 12,444 | 11,020 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, $0.0001 par value; 2 shares authorized; none issued | — | — |
| Common stock, $0.0001 par value; 900 shares authorized; 601 shares issued; 475 and 479 shares outstanding, respectively | — | — |
| Additional paid-in-capital | 8,428 | 7,357 |
| Retained earnings | 23,905 | 19,611 |
| Accumulated other comprehensive income (loss) | (137) | (158) |
| Treasury stock, at cost (126 and 122 shares, respectively) | (17,399) | (13,546) |
| Total stockholders' equity | 14,797 | 13,264 |
| Total liabilities and stockholders' equity | $ 27,241 | $ 24,284 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE INC.**

**CONSOLIDATED STATEMENTS OF INCOME**

**(In millions, except per share data)**

| | Years Ended | | |
|---|---|---|---|
| | December 3, 2021 | November 27, 2020 | November 29, 2019 |
| Revenue: | | | |
| Subscription | $ 14,573 | $ 11,626 | $ 9,634 |
| Product | 555 | 507 | 648 |
| Services and other | 657 | 735 | 889 |
| Total revenue | 15,785 | 12,868 | 11,171 |
| Cost of revenue: | | | |
| Subscription | 1,374 | 1,108 | 926 |
| Product | 41 | 36 | 40 |
| Services and other | 450 | 578 | 707 |
| Total cost of revenue | 1,865 | 1,722 | 1,673 |
| Gross profit | 13,920 | 11,146 | 9,498 |
| Operating expenses: | | | |
| Research and development | 2,540 | 2,188 | 1,930 |
| Sales and marketing | 4,321 | 3,591 | 3,244 |
| General and administrative | 1,085 | 968 | 881 |
| Amortization of intangibles | 172 | 162 | 175 |
| Total operating expenses | 8,118 | 6,909 | 6,230 |
| Operating income | 5,802 | 4,237 | 3,268 |
| Non-operating income (expense): | | | |
| Interest expense | (113) | (116) | (157) |
| Investment gains (losses), net | 16 | 13 | 52 |
| Other income (expense), net | — | 42 | 42 |
| Total non-operating income (expense), net | (97) | (61) | (63) |
| Income before income taxes | 5,705 | 4,176 | 3,205 |
| Provision for (benefit from) income taxes | 883 | (1,084) | 254 |
| Net income | $ 4,822 | $ 5,260 | $ 2,951 |
| Basic net income per share | $ 10.10 | $ 10.94 | $ 6.07 |
| Shares used to compute basic net income per share | 477 | 481 | 486 |
| Diluted net income per share | $ 10.02 | $ 10.83 | $ 6.00 |
| Shares used to compute diluted net income per share | 481 | 485 | 492 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(In millions)**

| | Years Ended | | |
|---|---|---|---|
| | **December 3, 2021** | **November 27, 2020** | **November 29, 2019** |
| | | **Increase/(Decrease)** | |
| Net income | $ 4,822 | $ 5,260 | $ 2,951 |
| Other comprehensive income (loss), net of taxes: | | | |
| Available-for-sale securities: | | | |
| Unrealized gains / losses on available-for-sale securities | (8) | 3 | 29 |
| Reclassification adjustment for recognized gains / losses on available-for-sale securities | — | (1) | — |
| Net increase (decrease) from available-for-sale securities | (8) | 2 | 29 |
| Derivatives designated as hedging instruments: | | | |
| Unrealized gains / losses on derivative instruments | 69 | (44) | — |
| Reclassification adjustment for realized gains / losses on derivative instruments | 20 | 6 | (44) |
| Net increase (decrease) from derivatives designated as hedging instruments | 89 | (38) | (44) |
| Foreign currency translation adjustments | (60) | 66 | (25) |
| Other comprehensive income (loss), net of taxes | 21 | 30 | (40) |
| Total comprehensive income, net of taxes | $ 4,843 | $ 5,290 | $ 2,911 |

*See accompanying Notes to Consolidated Financial Statements.*

# ADOBE INC.
## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
### (In millions)

| | Common Stock | | | | | Treasury Stock | | |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Shares | Amount | Total |
| Balances at November 30, 2018 | 601 | $ — | $ 5,685 | $ 11,816 | $ (148) | (113) | $ (7,991) | $ 9,362 |
| Impacts of adoption of the new revenue standard | — | — | — | 442 | — | — | — | 442 |
| Net income | — | — | — | 2,951 | — | — | — | 2,951 |
| Other comprehensive income (loss), net of taxes | — | — | — | — | (40) | — | — | (40) |
| Re-issuance of treasury stock under stock compensation plans | — | — | 48 | (380) | — | 5 | 125 | (207) |
| Repurchases of common stock | — | — | — | — | — | (10) | (2,750) | (2,750) |
| Stock-based compensation | — | — | 771 | — | — | — | — | 771 |
| Value of shares in deferred compensation plan | — | — | — | — | — | — | 1 | 1 |
| Balances at November 29, 2019 | 601 | $ — | $ 6,504 | $ 14,829 | $ (188) | (118) | $ (10,615) | $ 10,530 |
| Net income | — | — | — | 5,260 | — | — | — | 5,260 |
| Other comprehensive income (loss), net of taxes | — | — | — | — | 30 | — | — | 30 |
| Re-issuance of treasury stock under stock compensation plans | — | — | (56) | (478) | — | 4 | 123 | (411) |
| Repurchases of common stock | — | — | — | — | — | (8) | (3,050) | (3,050) |
| Stock-based compensation | — | — | 909 | — | — | — | — | 909 |
| Value of shares in deferred compensation plan | — | — | — | — | — | — | (4) | (4) |
| Balances at November 27, 2020 | 601 | $ — | $ 7,357 | $ 19,611 | $ (158) | (122) | $ (13,546) | $ 13,264 |
| Net income | — | — | — | 4,822 | — | — | — | 4,822 |
| Other comprehensive income (loss), net of taxes | — | — | — | — | 21 | — | — | 21 |
| Re-issuance of treasury stock under stock compensation plans | — | — | — | (528) | — | 3 | 100 | (428) |
| Repurchases of common stock | — | — | — | — | — | (7) | (3,950) | (3,950) |
| Equity awards assumed for acquisition | — | — | 2 | — | — | — | — | 2 |
| Stock-based compensation | — | — | 1,069 | — | — | — | — | 1,069 |
| Value of shares in deferred compensation plan | — | — | — | — | — | — | (3) | (3) |
| Balances at December 3, 2021 | 601 | $ — | $ 8,428 | $ 23,905 | $ (137) | (126) | $ (17,399) | $ 14,797 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In millions)**

| | Years Ended | | |
|---|---|---|---|
| | December 3, 2021 | November 27, 2020 | November 29, 2019 |
| Cash flows from operating activities: | | | |
| Net income | $ 4,822 | $ 5,260 | $ 2,951 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation, amortization and accretion | 788 | 757 | 757 |
| Stock-based compensation | 1,069 | 909 | 788 |
| Reduction of operating lease right-of-use assets | 73 | 87 | — |
| Deferred income taxes | 183 | (1,501) | 3 |
| Unrealized losses (gains) on investments, net | (4) | (11) | (48) |
| Other non-cash items | 7 | 40 | 14 |
| Changes in operating assets and liabilities, net of acquired assets and assumed liabilities: | | | |
| Trade receivables, net | (430) | 106 | (188) |
| Prepaid expenses and other assets | (475) | (288) | (551) |
| Trade payables | (20) | 96 | 23 |
| Accrued expenses and other liabilities | 162 | 86 | 172 |
| Income taxes payable | 2 | (72) | 4 |
| Deferred revenue | 1,053 | 258 | 497 |
| Net cash provided by operating activities | 7,230 | 5,727 | 4,422 |
| Cash flows from investing activities: | | | |
| Purchases of short-term investments | (1,533) | (1,071) | (700) |
| Maturities of short-term investments | 877 | 915 | 700 |
| Proceeds from sales of short-term investments | 191 | 167 | 86 |
| Acquisitions, net of cash acquired | (2,682) | — | (101) |
| Purchases of property and equipment | (348) | (419) | (395) |
| Purchases of long-term investments, intangibles and other assets | (42) | (15) | (49) |
| Proceeds from sales of long-term investments and other assets | — | 9 | 3 |
| Net cash used for investing activities | (3,537) | (414) | (456) |
| Cash flows from financing activities: | | | |
| Repurchases of common stock | (3,950) | (3,050) | (2,750) |
| Proceeds from re-issuance of treasury stock | 291 | 270 | 233 |
| Taxes paid related to net share settlement of equity awards | (719) | (681) | (440) |
| Proceeds from issuance of debt | — | 3,144 | — |
| Repayment of debt | — | (3,150) | — |
| Other financing activities, net | 77 | (21) | 11 |
| Net cash used for financing activities | (4,301) | (3,488) | (2,946) |
| Effect of foreign currency exchange rates on cash and cash equivalents | (26) | 3 | (13) |
| Net increase (decrease) in cash and cash equivalents | (634) | 1,828 | 1,007 |
| Cash and cash equivalents at beginning of year | 4,478 | 2,650 | 1,643 |
| Cash and cash equivalents at end of year | $ 3,844 | $ 4,478 | $ 2,650 |
| Supplemental disclosures: | | | |
| Cash paid for income taxes, net of refunds | $ 843 | $ 469 | $ 352 |
| Cash paid for interest | $ 100 | $ 88 | $ 152 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## NOTE 1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

*Operations*

Founded in 1982, Adobe is one of the largest and most diversified software companies in the world. We offer a line of products and services used by creative professionals, including photographers, video editors, graphic and experience designers and game developers; communicators, including content creators, students, marketers and knowledge workers; businesses of all sizes; and consumers for creating, managing, delivering, measuring, optimizing, engaging and transacting with compelling content and experiences across personal computers, smartphones, other electronic devices and digital media formats.

We market our products and services directly to enterprise customers through our sales force and local field offices. We license our products to end users through app stores and our own website at www.adobe.com. We offer many of our products via a Software-as-a-Service ("SaaS") model or a managed services model (both of which are referred to as hosted or cloud-based) as well as through term subscription and pay-per-use models. We also distribute certain products and services through a network of distributors, value-added resellers ("VARs"), systems integrators ("SIs"), independent software vendors ("ISVs"), retailers, software developers and original equipment manufacturers ("OEMs"). In addition, we license our technology to hardware manufacturers, software developers and service providers for use in their products and solutions. Our products run on desktop and laptop computers, smartphones, tablets, other devices and the web, depending on the product. We have operations in the Americas; Europe, Middle East and Africa ("EMEA"); and Asia-Pacific ("APAC").

*Basis of Presentation*

The accompanying Consolidated Financial Statements include those of Adobe and its subsidiaries, after elimination of all intercompany accounts and transactions. We have prepared the accompanying Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") and pursuant to the rules and regulations of the United States Securities and Exchange Commission (the "SEC").

*Use of Estimates*

In preparing Consolidated Financial Statements and related disclosures in conformity with GAAP and pursuant to the rules and regulations of the SEC, we must make estimates and judgments that affect the amounts reported in the Consolidated Financial Statements and accompanying Notes. Estimates are used for, but not limited to, sales allowances and programs, bad debts, stock-based compensation, determining the fair value of acquired assets and assumed liabilities, litigation and income taxes. Actual results may differ materially from these estimates.

*Fiscal Year*

Our fiscal year is a 52- or 53-week year that ends on the Friday closest to November 30. Our financial results for fiscal 2021 benefited from an extra week in the first quarter of fiscal 2021 due to our 52/53 week financial calendar whereby fiscal 2021 is a 53-week year compared with fiscal 2020 and 2019 which were 52-week years.

*Reclassifications*

Certain prior year amounts, which are not material, have been reclassified to conform to current year presentation in the Notes to Consolidated Financial Statements.

**Significant Accounting Policies**

*Revenue Recognition*

Our revenue is derived from the sale of cloud-enabled software subscriptions, cloud-hosted offerings, term-based, royalty, and perpetual software licenses, associated software maintenance and support plans, consulting services, training and technical support. Most of our enterprise customer arrangements involve multiple promises to our customers.

Revenue is recognized when a contract exists between us and a customer and upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We enter into contracts that can include various combinations of products and services, which may be capable of being distinct and accounted for as separate performance obligations, or in the case of offerings such as cloud-enabled Creative Cloud and Document Cloud, accounted for as a single performance obligation. Revenue is recognized net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities.

*Subscription, Product and Services Offerings*

We enter into revenue arrangements in which a customer may purchase a combination of cloud-enabled subscriptions, cloud-hosted offerings, term-based, royalty, and perpetual software licenses, associated software maintenance and support plans, consulting services, training and technical support. Certain revenue arrangements provide customers with unilateral cancellation rights, or options to either renew monthly on-premise term-based licenses or use committed funds to purchase other Adobe products or services.

Fully hosted subscription services (SaaS) allow customers to access hosted software during the contractual term without taking possession of the software. Cloud-hosted subscription services may be sold on a fee-per-subscription period basis or based on consumption or usage.

We recognize revenue ratably over the contractual service term for hosted services that are priced based on a committed number of transactions where the delivery and consumption of the benefit of the services occur evenly over time, beginning on the date the services associated with the committed transactions are first made available to the customer and continuing through the end of the contractual service term. Over-usage fees and fees based on the actual number of transactions are billed in accordance with contract terms as these fees are incurred and are included in the transaction price of an arrangement as variable consideration. Fees based on a number of transactions, where invoicing is aligned to the pattern of performance, customer benefit and consumption, are typically accounted for utilizing the “as-invoiced” practical expedient. Revenue for subscriptions sold as a fee per period is recognized ratably over the contractual term as the customer simultaneously receives and consumes the benefit of the underlying service.

When cloud-enabled services are highly integrated and interrelated with on-premise software, such as in our cloud-enabled Creative Cloud and Document Cloud offerings, the individual components are not considered distinct and revenue is recognized ratably over the subscription period for which the cloud-enabled services are provided.

The subscription support plans related to those customer arrangements whose revenues we classify as subscription revenues represent stand-ready performance obligations. Revenue from these subscription support plans is recognized ratably over their respective contractual terms and classified as subscription revenue.

Licenses for on-premise software may be purchased on a perpetual basis, as a subscription for a fixed period of time or based on usage for certain of our OEM and royalty agreements. Revenue from non-cloud enabled on-premise licenses without unilateral cancellation rights or monthly renewal options is recognized at the point in time the software is available to the customer, provided all other revenue recognition criteria are met, and classified as product revenue on our Consolidated Statements of Income. Revenue from on-premise term license or term licensing arrangements with unilateral cancellation rights or monthly renewal options, and any associated maintenance and support, is classified as subscription revenue.

Our services and other revenue is comprised primarily of fees related to consulting, training, maintenance and support for certain on-premise licenses that are recognized at a point in time and our advertising offerings. We typically sell our consulting contracts on a time-and-materials and fixed-fee basis. These revenues are recognized as the services are performed for time and materials contracts and on a relative performance basis for fixed-fee contracts. Training revenues are recognized as the services are performed. Our maintenance and support offerings, which entitle customers, partners and developers to receive desktop product upgrades and enhancements or technical support, depending on the offering, are generally recognized ratably over the term of the arrangement. Our transaction-based advertising offerings, where fees are based on a number of impressions per month and invoicing is aligned to the pattern of performance, customer benefit and consumption, are typically accounted for utilizing the "as-invoiced" practical expedient.

*Judgments*

Our contracts with customers may include multiple goods and services. For example, some of our offerings include both on-premise and/or on-device software licenses and cloud services. Determining whether the software licenses and the cloud services are distinct from each other, and therefore performance obligations to be accounted for separately, or not distinct from each other, and therefore part of a single performance obligation, may require significant judgment. We have concluded that the on-premise/on-device software licenses and cloud services provided in our Creative Cloud and Document Cloud subscription offerings are not distinct from each other such that revenue from each offering should be recognized ratably over the subscription period for which the cloud services are provided. In reaching this conclusion, we considered the nature of our promise to Creative Cloud and Document Cloud customers, which is to provide a complete end-to-end creative design or document workflow solution that operates seamlessly across multiple devices and teams. We fulfill this promise by providing access to a solution that integrates cloud-based and on-premise/on-device features that, together through their integration, provide functionalities, utility and workflow efficiencies that could not be obtained from either the on-premise/on-device software or cloud services on their own.

Cloud-based features that are integral to our Creative Cloud and Document Cloud offerings and that work together with the on-premise/on-device software include, but are not limited to: Creative Cloud Libraries, which enable customers to access their work, settings, preferences and other assets seamlessly across desktop and mobile devices and collaborate across teams in real time; shared reviews which enable simultaneous editing and commenting of PDFs across desktop, mobile and web; automatic cloud rendering of a design which enables it to be worked on in multiple mediums; and Sensei, Adobe's cloud-hosted artificial intelligence and machine learning framework, which enables features such as automated photo-editing, photograph content-awareness, natural language processing, optical character recognition and automated document tagging.

Standalone selling price is established by maximizing the amount of observable inputs, primarily actual historical selling prices for performance obligations where available, and includes consideration of factors such as go-to-market model and geography. Individual products may have multiple values for standalone selling price depending on factors such as where they are sold and what channel they are sold through. Where standalone selling price may not be directly observable (e.g., the performance obligation is not sold separately), we maximize the use of observable inputs by using information that may include reviewing pricing practices, performance obligations with similar customers and selling models.

Capitalized costs to obtain a contract are amortized over the expected period of benefit, which we have determined, based on analysis, to be 5 years. We evaluated qualitative and quantitative factors to determine the period of amortization, including contract length, renewals, customer life and the useful lives of our products and acquired products. When the expected period of benefit of an asset which would be capitalized is less than one year, we expense the amount as incurred, utilizing the practical expedient. We regularly evaluate whether there have been changes in the underlying assumptions and data used to determine the amortization period.

When revenue arrangements include components of third-party goods and services, for example in transactions which involve resale, fulfillment or providing advertising impressions to our end customer, we evaluate whether we are the principal, and report revenues on a gross basis, or an agent, and report revenues on a net basis. In this assessment, we consider if we obtain control of the specified goods or services before they are transferred to the customer by evaluating indicators such as which party is primarily responsible for fulfilling the promise to provide the goods or services, which party has discretion in establishing price and the underlying terms and conditions between the parties to the transaction.

We offer limited rights of return, rebates and price protection of our products under various policies and programs with our distributors, resellers and/or end-user customers. We estimate and record reserves for these programs as variable consideration when estimating transaction price. Returns, rebates and other offsets to transaction price are estimated at contract inception on a portfolio basis and assessed for reasonableness each reporting period when additional information becomes available.

*General Contract Provisions*

We maintain revenue reserves for rebates, rights of return and other limited price adjustments. Distributors are allowed limited rights of return of products purchased during the previous quarter. In addition, distributors are allowed to return products that have reached the end of their lives, as defined by us, and for products that are being replaced by new versions. We offer rebates to our distributors, resellers and/or end-user customers. Transaction price is reduced for these amounts based on actual performance against objectives set forth by us for a particular reporting period, such as volume and timely reporting.

On a quarterly basis, the amount of revenue that is reserved is calculated based on our historical trends and data specific to each reporting period. The primary method of establishing these reserves is to review historical data from prior periods as a percent of revenue to determine a historical reserve rate. We then apply the historical rate to the current period revenue as a basis for estimating future returns. When necessary, we also provide a specific reserve in excess of portfolio-level estimated requirements. This estimate can be affected by the amount of a particular product in the channel, the rate of sell-through, product plans and other factors.

Although our subscription contracts are generally non-cancellable, a limited number of customers have the right to cancel their contracts by providing prior written notice to us of their intent to cancel the remainder of the contract term and consumers have a period of time to terminate certain agreements without penalty. In the event a customer cancels their contract, they are generally not entitled to a refund for prior services we have provided to them. Contracts that include termination rights without substantive penalty are accounted for as contracts only for the committed period. Periods of time after the right of termination are accounted for as optional purchases when they do not represent material rights. For certain of our usage-based license agreements, typically in our royalty and OEM businesses, reporting may be received after the end of a fiscal period. In such instances, we estimate and accrue license revenue. We base our estimates on multiple factors, including historical sales information, seasonality and other business information which may impact our estimates. We do not estimate variable consideration for our sales and usage-based license royalty agreements, consistent with the associated exception for sales and usage-based royalties for the license of intellectual property under the revenue recognition standard.

*Property and Equipment*

We record property and equipment at cost less accumulated depreciation and amortization. Property and equipment are depreciated using the straight-line method over their estimated useful lives ranging from 1 to 20 years for computers and other equipment, which includes our corporate jet, 1 to 6 years for furniture and fixtures, 5 to 20 years for building improvements and up to 40 years for buildings. Leasehold improvements are amortized using the straight-line method over the lesser of the remaining respective lease term or estimated useful lives ranging from 1 to 15 years.

*Leases*

We determine if an arrangement is or contains a lease at contract inception. In certain of our lease arrangements, primarily those related to our data center arrangements, judgment is required in determining if a contract contains a lease. For these arrangements, there is judgment in evaluating if the arrangement involves an identified asset that is physically distinct or whether we have the right to substantially all of the capacity of an identified asset that is not physically distinct. In arrangements that involve an identified asset, there is also judgment in evaluating if we have the right to direct the use of that asset.

We do not have any finance leases. Operating leases are recorded in our Consolidated Balance Sheets. Right-of-use (“ROU”) assets and lease liabilities are measured at the lease commencement date based on the present value of the remaining lease payments over the lease term, determined using the discount rate for the lease at the commencement date. Because the rate implicit in our leases is not readily determinable, we use our incremental borrowing rate as the discount rate, which approximates the interest rate at which we could borrow on a collateralized basis with similar terms and payments and in similar economic environments. As of December 3, 2021, our leases had remaining lease terms of up to 10 years, some of which included options to extend the lease for up to 14 years and options to terminate the lease within 1 year. Optional periods to extend the lease, including by not exercising a termination option, are included in the lease term when it is reasonably certain that the option will be exercised. We also have one land lease that expires in 2091. Operating lease expense is recognized on a straight-line basis over the lease term. We account for lease and non-lease components, principally common area maintenance for our facilities leases, as a single lease component for our facilities and data center leases.

In accordance with accounting requirements, leases with an initial term of 12 months or less are recorded on the balance sheet, with lease expense for these leases recognized on a straight-line basis over the lease term.

*Goodwill, Intangibles and Other Long-Lived Assets*

Goodwill is assigned to one or more reporting segments on the date of acquisition. We review our goodwill for impairment annually during our second quarter of each fiscal year and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of any one of our reporting units below its respective carrying amount. In performing our goodwill impairment test, we first perform a qualitative assessment, which requires that we consider events or circumstances including macroeconomic conditions, industry and market considerations, cost factors, overall financial performance, changes in management or key personnel, changes in strategy, changes in customers, changes in the composition or carrying amount of a reporting segment's net assets and changes in our stock price. If, after assessing the totality of events or circumstances, we determine that it is more likely than not that the fair values of our reporting segments are greater than the carrying amounts, then the quantitative goodwill impairment test is not performed.

If the qualitative assessment indicates that the quantitative analysis should be performed, we then evaluate goodwill for impairment by comparing the fair value of each of our reporting segments to its carrying value, including the associated goodwill. To determine the fair values, we use the equal weighting of the market approach based on comparable publicly traded companies in similar lines of businesses and the income approach based on estimated discounted future cash flows. Our cash flow assumptions consider historical and forecasted revenue, operating costs and other relevant factors.

We completed our annual goodwill impairment test in the second quarter of fiscal 2021. We determined, after performing a qualitative review of each reporting segment, that it is more likely than not that the fair value of each of our reporting segments substantially exceeds the respective carrying amounts. Accordingly, there was no indication of impairment and the quantitative goodwill impairment test was not performed. We did not identify any events or changes in circumstances since the performance of our annual goodwill impairment test that would require us to perform another goodwill impairment test during the fiscal year.

We amortize intangible assets with finite lives over their estimated useful lives and review them for impairment whenever an impairment indicator exists. We continually monitor events and changes in circumstances that could indicate that the carrying amounts of our long-lived assets, including our intangible assets, may not be recoverable. When such events or changes in circumstances occur, we assess recoverability by determining whether the carrying value of such assets will be recovered through the undiscounted expected future cash flows. If the future undiscounted cash flows are less than the carrying amount of these assets, we recognize an impairment loss based on any excess of the carrying amount over the fair value of the assets. We did not recognize any intangible asset impairment charges for all periods presented.

During fiscal 2021, our intangible assets were amortized over their estimated useful lives ranging from 2 to 15 years. Amortization is based on the pattern in which the economic benefits of the intangible asset will be consumed or on a straight-line basis when the consumption pattern is not apparent. The weighted average useful lives of our intangible assets were as follows:

| | **Weighted Average Useful Life (years)** |
|---|---|
| Customer contracts and relationships | 10 |
| Purchased technology | 5 |
| Trademarks | 9 |
| Other | 4 |

*Income Taxes*

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. We record a valuation allowance to reduce deferred tax assets to an amount for which realization is more likely than not.

*Taxes Collected from Customers*

We net taxes collected from customers against those remitted to government authorities in our financial statements. Accordingly, taxes collected from customers are not reported as revenue.

*Treasury Stock*

Prepayments made for repurchases of our common stock are classified as treasury stock on our Consolidated Balance Sheets and only shares physically delivered to us at period ends are excluded from the computation of earnings per share.

We account for treasury stock under the cost method. When treasury stock is re-issued at a price higher than its cost, the difference is recorded as a component of additional paid-in-capital in our Consolidated Balance Sheets. When treasury stock is re-issued at a price lower than its cost, the difference is recorded as a component of additional paid-in-capital to the extent that there are previously recorded gains to offset the losses. If there are no treasury stock gains in additional paid-in-capital, the losses upon re-issuance of treasury stock are recorded as a reduction of retained earnings in our Consolidated Balance Sheets.

*Advertising Expenses*

Advertising costs are expensed as incurred. Advertising expenses for fiscal 2021, 2020 and 2019 were $540 million, $362 million and $221 million, respectively.

*Foreign Currency Translation*

We translate assets and liabilities of foreign subsidiaries, whose functional currency is their local currency, at exchange rates in effect at the balance sheet date. We translate revenue and expenses at the monthly average exchange rates. We include accumulated net translation adjustments in stockholders' equity as a component of accumulated other comprehensive income (loss).

*Derivative Financial Instruments*

In countries outside the United States, we transact business in U.S. Dollars and in various other currencies. We may use foreign exchange option contracts or forward contracts to hedge a portion of our forecasted foreign currency denominated revenue primarily in Euros, British Pounds, Japanese Yen and Australian Dollars. Additionally, we hedge our net recognized foreign currency monetary assets and liabilities with foreign exchange forward contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates.

We recognize all derivative instruments as either assets or liabilities in our Consolidated Balance Sheets and measure them at fair value. Gains and losses resulting from changes in fair value are accounted for depending on the use of the derivative and whether it is designated and qualifies for hedge accounting. Contracts that do not qualify for hedge accounting are adjusted to fair value through earnings.

Gains and losses related to changes in the fair value of interest rate swaps and foreign exchange forward contracts which hedge certain balance sheet positions are recorded each period as a component of other income (expense), net in our Consolidated Statements of Income. Foreign exchange option contracts hedging forecasted foreign currency revenue and Treasury lock agreements are designated as cash flow hedges with gains and losses recorded net of tax as a component of accumulated other comprehensive income (loss) in our Consolidated Balance Sheets until the forecasted transaction occurs. When the forecasted transaction affects earnings, we reclassify the related gain or loss on the foreign currency and Treasury lock cash flow hedges to revenue and interest expense, respectively.

*Concentration of Risk*

Financial instruments that potentially subject us to concentrations of credit risk are short-term fixed-income investments, structured repurchase transactions, foreign currency and interest rate hedge contracts and trade receivables.

Our investment portfolio consists of investment-grade securities diversified among security types, industries and issuers. Our cash and investments are held and primarily managed by recognized financial institutions that follow our investment policy. Our policy limits the amount of credit exposure to any one security issue or issuer and we believe no significant concentration of credit risk exists with respect to these investments.

We enter into master netting arrangements to mitigate credit risk in derivative transactions by permitting net settlement of transactions with the same counterparty. We also enter into collateral security agreements with certain of our counterparties to exchange cash collateral when the net fair value of certain derivative instruments fluctuates from contractually established thresholds.

Credit risk in receivables is limited to OEMs, dealers and distributors of hardware and software products to the retail market, customers to whom we license software directly and our SaaS offerings. A credit review is completed for our new distributors, dealers and OEMs. We also perform ongoing credit evaluations of our customers' financial condition and require letters of credit or other guarantees, whenever deemed necessary. The credit limit given to the customer is based on our risk assessment of their ability to pay, country risk and other factors and is not contingent on the resale of the product or on the collection of payments from their customers. Certain contracts with advertising agencies contain sequential liability provisions, under which the agency is not required to pay until payment is received from the agency's customers. In these circumstances, we evaluate the credit-worthiness of the agency's customers in addition to the agency itself. If we license our software or provide SaaS services to a customer where we have a reason to believe the customer's ability and intention to pay is not probable, the arrangement is not considered to be a revenue contract. Accordingly, we will not recognize any consideration received as revenue until termination or substantive completion of the services.

**Recently Adopted Accounting Guidance**

On June 16, 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-13, Financial Instruments-Credit Losses (Topic 326). The FASB subsequently issued ASU No. 2019-04, Codification Improvements to Topic 326, Financial Instruments-Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments. These updates require the measurement and recognition of expected credit losses for financial assets held at amortized cost, which include our trade receivables and contract assets. The standard also requires that we recognize credit impairment losses related to our available-for-sale debt securities through an allowance for credit losses instead of a reduction in the cost basis. On November 28, 2020, the beginning of our fiscal year 2021, we adopted the accounting requirements of the updated standard utilizing the modified retrospective method of transition. The adoption of this standard did not have a material impact on our Consolidated Financial Statements and related disclosures.

There have been no other new accounting pronouncements made effective during fiscal 2021 that have significance, or potential significance, to our Consolidated Financial Statements.

**Recent Accounting Pronouncements Not Yet Effective**

To date, there have been no recent accounting pronouncements not yet effective that have significance, or potential significance, to our Consolidated Financial Statements.

## NOTE 2. REVENUE

*Segment Information*

We report segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of our reportable segments.

Our Chief Executive Officer, the chief operating decision maker, reviews revenue and gross margin information for each of our reportable segments, but does not review operating expenses on a segment by segment basis. In addition, with the exception of goodwill, we do not identify or allocate our assets by the reportable segments.

Our business is organized into the following reportable segments:

- *Digital Media*—Our Digital Media segment provides products, services and solutions that enable individuals, teams and enterprises to create, publish and promote their content anywhere and accelerate their productivity by modernizing how they view, share, engage with and collaborate on documents and creative content. Our customers include creative professionals, including photographers, video editors, graphic and experience designers and game developers, communicators, including content creators, students, marketers and knowledge workers, and consumers.

- *Digital Experience*—Our Digital Experience segment provides an integrated platform and set of applications and services that enable brands and businesses to create, manage, execute, measure, monetize and optimize customer

ADOBE INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

experiences that span from analytics to commerce. Our customers include marketers, advertisers, agencies, publishers, merchandisers, merchants, web analysts, data scientists, developers and executives across the C-suite.

- *Publishing and Advertising*—Our Publishing and Advertising segment contains legacy products and services that address diverse market opportunities, including eLearning solutions, technical document publishing, web conferencing, document and forms platform, web application development, high-end printing and our Adobe Advertising Cloud offerings.

Our segment revenue and results for fiscal 2021, 2020 and 2019 were as follows:

| *(dollars in millions)* | Digital Media | Digital Experience | Publishing and Advertising | Total |
|---|---|---|---|---|
| **Fiscal 2021** | | | | |
| Revenue | $ 11,520 | $ 3,867 | $ 398 | $ 15,785 |
| Cost of revenue | 429 | 1,321 | 115 | 1,865 |
| Gross profit | $ 11,091 | $ 2,546 | $ 283 | $ 13,920 |
| Gross profit as a percentage of revenue | 96 % | 66 % | 71 % | 88 % |
| **Fiscal 2020** | | | | |
| Revenue | $ 9,233 | $ 3,125 | $ 510 | $ 12,868 |
| Cost of revenue | 352 | 1,126 | 244 | 1,722 |
| Gross profit | $ 8,881 | $ 1,999 | $ 266 | $ 11,146 |
| Gross profit as a percentage of revenue | 96 % | 64 % | 52 % | 87 % |
| **Fiscal 2019** | | | | |
| Revenue | $ 7,707 | $ 2,795 | $ 669 | $ 11,171 |
| Cost of revenue | 290 | 1,056 | 327 | 1,673 |
| Gross profit | $ 7,417 | $ 1,739 | $ 342 | $ 9,498 |
| Gross profit as a percentage of revenue | 96 % | 62 % | 51 % | 85 % |

We generally categorize revenue by geographic area based on where the customer manages their utilization of our offerings. Revenue by geographic area for fiscal 2021, 2020 and 2019 were as follows:

| *(in millions)* | 2021 | 2020 | 2019 |
|---|---|---|---|
| Americas: | | | |
| United States | $ 8,104 | $ 6,745 | $ 5,903 |
| Other | 892 | 709 | 603 |
| Total Americas | 8,996 | 7,454 | 6,506 |
| EMEA | 4,252 | 3,400 | 2,975 |
| APAC | 2,537 | 2,014 | 1,690 |
| Revenue | $ 15,785 | $ 12,868 | $ 11,171 |

Revenue by major offerings in our Digital Media reportable segment for fiscal 2021, 2020 and 2019 were as follows:

| *(in millions)* | 2021 | 2020 | 2019 |
|---|---|---|---|
| Creative Cloud | $ 9,546 | $ 7,736 | $ 6,482 |
| Document Cloud | 1,974 | 1,497 | 1,225 |
| Total Digital Media revenue | $ 11,520 | $ 9,233 | $ 7,707 |

**ADOBE INC.**

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

Subscription revenue by segment for fiscal 2021, 2020 and 2019 were as follows:

| *(in millions)* | 2021 | 2020 | 2019 |
|---|---|---|---|
| Digital Media | $ 11,048 | $ 8,813 | $ 7,208 |
| Digital Experience | 3,379 | 2,660 | 2,280 |
| Publishing and Advertising | 146 | 153 | 146 |
| Total subscription revenue | $ 14,573 | $ 11,626 | $ 9,634 |

*Contract Balances*

*Trade Receivables*

A receivable is recorded when an unconditional right to invoice and receive payment exists, such that only the passage of time is required before payment of consideration is due. Timing of revenue recognition may differ from the timing of invoicing to customers. Certain performance obligations may require payment before delivery of the license or service to the customer. Included in trade receivables on the Consolidated Balance Sheets are unbilled receivable balances which have not yet been invoiced, and are typically related to license revenue or services which are delivered prior to invoicing. As of December 3, 2021, the balance of trade receivables, net of allowances for doubtful accounts, was $1.88 billion, inclusive of unbilled receivables of $82 million. As of November 27, 2020, the balance of trade receivables, net of allowance for doubtful accounts, was $1.40 billion, inclusive of unbilled receivables of $84 million.

*Allowance for Doubtful Accounts*

We maintain an allowance for doubtful accounts which reflects our best estimate of potentially uncollectible trade receivables and is based on both specific and general reserves. We maintain general reserves on a collective basis by considering factors such as historical experience, credit-worthiness, the age of the trade receivable balances, current economic conditions and a reasonable and supportable forecast of future economic conditions.

During fiscal 2021, 2020 and 2019, our allowance for doubtful accounts activities were as follows:

| *(in millions)* | 2021 | 2020 | 2019 |
|---|---|---|---|
| Beginning balance | $ 21 | $ 10 | $ 15 |
| Increase due to acquisition | 3 | — | — |
| Adjustments to reserve balance | (3) | 31 | 5 |
| Write-offs, net of recoveries | (5) | (20) | (10) |
| Ending balance | $ 16 | $ 21 | $ 10 |

*Contract Assets*

A contract asset is recognized when a conditional right to consideration exists and transfer of control has occurred. Contract assets are typically related to subscription and hosted service contracts where the transaction price allocated to the satisfied performance obligations exceeds the value of billings to date. Contract assets are included in prepaid expenses and other current assets for the current portion and other assets for the long-term portion on the Consolidated Balance Sheets. We regularly review contract asset balances for impairment, considering factors such as historical experience, credit-worthiness, age of the balance and other economic or business factors. Contract asset impairments were not material in fiscal 2021. Contract assets were $85 million and $81 million as of December 3, 2021 and November 27, 2020, respectively.

*Deferred Revenue and Remaining Performance Obligations*

Deferred revenue primarily consists of billings or payments received in advance of revenue recognition from subscription services, including non-cancellable and non-refundable committed funds and refundable customer deposits. Deferred revenue is recognized as revenue when transfer of control to customers has occurred. Customers are typically invoiced for these agreements in regular installments and revenue is recognized ratably over the contractual subscription period. The deferred revenue balance is influenced by several factors, including the compounding effects of renewals, invoice duration, invoice timing, size and new business linearity within the quarter. Deferred revenue does not represent the total contract value of annual or multi-year non-cancellable subscription agreements.

Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 to 60 days. In instances where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts generally do not include a significant financing component. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, such as invoicing at the beginning of a subscription term with revenue recognized ratably over the contract period, and not to receive financing from our customers. Any potential financing fees are considered insignificant in the context of our contracts.

As of December 3, 2021, the balance of deferred revenue was $4.88 billion, which includes $88 million of refundable customer deposits. Refundable customer deposits represent arrangements in which the customer has a unilateral cancellation right for which we are obligated to refund amounts paid related to products or services not yet delivered or provided at the time of cancellation on a prorated basis. Arrangements with some of our enterprise customers with non-cancellable and non-refundable committed funds provide options to either renew monthly on-premise term-based licenses or use some or all funds to purchase other Adobe products or services. Non-cancellable and non-refundable committed funds related to these agreements comprised approximately 5% of the total deferred revenue.

As of November 27, 2020, the balance of deferred revenue was $3.76 billion. Significant movements in the deferred revenue balance during the period consisted of increases due to payments received prior to transfer of control of the underlying performance obligations to the customer and deferred revenue assumed through acquisition, which were offset by decreases due to revenue recognized in the period. During the year ended December 3, 2021, approximately $3.55 billion of revenue was recognized that was included in the balance of deferred revenue as of November 27, 2020.

Transaction price allocated to remaining performance obligations represents contracted revenue that has not yet been recognized, which includes deferred revenue and unbilled amounts that will be recognized as revenue in future periods. Transaction price allocated to remaining performance obligations is influenced by several factors, including the timing of renewals and average contract term. We applied practical expedients to exclude amounts related to performance obligations that are billed and recognized as they are delivered, optional purchases that do not represent material rights, sales- and usage-based royalties not yet consumed and any estimated amounts of variable consideration that are subject to constraint.

Remaining performance obligations were approximately $13.99 billion as of December 3, 2021. Non-cancellable and non-refundable committed funds related to some of our enterprise customer agreements referred to in the paragraph above comprised approximately 5% of the total remaining performance obligations. Approximately 72% of the remaining performance obligations, excluding the aforementioned enterprise customer agreements, are expected to be recognized over the next 12 months with the remainder recognized thereafter.

*Contract Acquisition Costs*

We recognize an asset for the incremental costs of obtaining a contract with a customer if we expect the benefit of those costs to be longer than one year. We have determined that certain sales incentive programs meet the requirements to be capitalized.

The costs capitalized are primarily sales commissions paid to our sales force personnel. Capitalized costs may also include portions of fringe benefits and payroll taxes associated with compensation for incremental costs to acquire customer contracts and incentive payments to partners.

Capitalized costs to obtain a contract are amortized over the expected period of benefit, which we have determined, based on analysis, to be 5 years. Amortization of capitalized costs are included in sales and marketing expense in our Consolidated Statements of Income. During fiscal 2021 and 2020, we amortized $212 million and

$186 million of capitalized contract acquisition costs into sales and marketing expense, respectively. We did not incur any impairment losses in fiscal 2021 and 2020.

Capitalized contract acquisition costs were $611 million and $530 million as of December 3, 2021 and November 27, 2020, of which $406 million and $352 million was long-term and included in other assets in the Consolidated Balance Sheets, respectively. The remaining balance of the capitalized costs to obtain contracts was current and included in prepaid expenses and other current assets.

*Refund Liabilities*

We record refund liabilities for amounts that may be subject to future refunds, which include sales returns reserves and customer rebates and credits. Refund liabilities are included in accrued expenses on the Consolidated Balance Sheets. Refund liabilities were $128 million and $127 million as of December 3, 2021 and November 27, 2020, respectively.

*Significant Customers*

For all periods presented, there were no customers that represented at least 10% of net revenue or that were responsible for over 10% of our trade receivables.

## NOTE 3. ACQUISITIONS

*Frame.io*

On October 7, 2021, we completed the acquisition of Frame.io, a privately held company that provides a cloud-based video collaboration platform, for approximately $1.18 billion, primarily in cash consideration. The financial results of Frame.io have been included in our Consolidated Financial Statements since the date of the acquisition. Frame.io is reported as part of our Digital Media reportable segment.

The table below represents the preliminary purchase price allocation to total identifiable intangible assets acquired and net liabilities assumed based on their respective estimated fair values as of October 7, 2021. The fair values assigned to assets acquired and liabilities assumed are based on management's best estimates and assumptions as of the reporting date. Fair values associated with the net tax liabilities assumed and their related impact to goodwill were pending finalization as of the reporting date.

| *(dollars in millions)* | Amount | Weighted Average Useful Life (years) |
|---|---|---|
| Purchased technology | $ 331 | 4 |
| In-process research and development [1] | 19 | N/A |
| Trademarks | 4 | 3 |
| Customer contracts and relationships | 3 | 10 |
| Total identifiable intangible assets | 357 | |
| Net liabilities assumed | (39) | N/A |
| Goodwill [2] | 865 | N/A |
| Total purchase price | $ 1,183 | |

[1] Capitalized as purchased technology and considered indefinite lived until the completion or abandonment of the associated research and development efforts.

[2] Non-deductible for tax-purposes.

Pro forma financial information has not been presented for the Frame.io acquisition as the impact to our Consolidated Financial Statements was not material.

*Workfront*

On December 7, 2020, we completed the acquisition of Workfront, a privately held company that provides a workflow platform, for approximately $1.52 billion in cash consideration. The financial results of Workfront have been included in our Consolidated Financial Statements since the date of the acquisition. Workfront is reported as part of our Digital Experience reportable segment.

The table below represents the final purchase price allocation to total identifiable intangible assets acquired and net liabilities assumed based on their respective estimated fair values as of December 7, 2020. The fair values assigned to assets acquired and liabilities assumed are based on management's best estimates and assumptions as of the reporting date. During fiscal 2021, we recorded immaterial purchase accounting adjustments based on changes to management's estimates and assumptions in regards to net tax liabilities assumed and their related impact to goodwill.

| *(dollars in millions)* | Amount | Weighted Average Useful Life (years) |
|---|---|---|
| Customer contracts and relationships | $ 290 | 10 |
| Purchased technology | 100 | 3 |
| Backlog | 40 | 2 |
| Trademarks | 30 | 5 |
| Total identifiable intangible assets | 460 | |
| Net liabilities assumed | (31) | N/A |
| Goodwill [1] | 1,095 | N/A |
| Total purchase price | $ 1,524 | |

(1) Non-deductible for tax-purposes.

Pro forma financial information has not been presented for the Workfront acquisition as the impact to our Consolidated Financial Statements was not material.

*Allegorithmic*

On January 23, 2019, we completed the acquisition of Allegorithmic, a privately held 3D editing and authoring software company for gaming and entertainment, and integrated it into our Digital Media reportable segment. Prior to the acquisition, we held an equity interest that was accounted for as an equity-method investment. We acquired the remaining equity interest for approximately $106 million in cash consideration. The total purchase price, inclusive of the acquisition-date fair-value of our pre-existing equity interest, was approximately $161 million.

In conjunction with the Allegorithmic acquisition, we separately recognized an investment gain of approximately $42 million, which represents the difference between the $55 million acquisition-date fair value of our pre-existing equity interest and our previous carrying amount.

Under the acquisition method of accounting, the total final purchase price was allocated to Allegorithmic's net tangible and intangible assets based upon their estimated fair values as of the acquisition date. The excess purchase price over the value of the net tangible and identifiable intangible assets was recorded as goodwill. Of the total purchase price, $126 million was allocated to goodwill that was non-deductible for tax purposes, $45 million to identifiable intangible assets and the remainder to net liabilities assumed.

Pro forma financial information has not been presented for the Allegorithmic acquisition as the impact to our Consolidated Financial Statements was not material.

## NOTE 4. CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

Cash equivalents consist of highly liquid marketable securities with remaining maturities of three months or less at the date of purchase. We classify our investments in marketable debt securities as "available-for-sale." We carry these investments at fair value, based on quoted market prices or other readily available market information. Unrealized gains and unrealized non-credit-related losses of marketable debt securities are included in accumulated other comprehensive income, net of taxes, in our Consolidated Balance Sheets. Unrealized credit-related losses are recorded to other income (expense), net in our Consolidated Statements of Income with a corresponding allowance for credit-related losses in our Consolidated Balance Sheets. Gains and losses are determined using the specific identification method and recognized when realized in our Consolidated Statements of Income.

Cash, cash equivalents and short-term investments consisted of the following as of December 3, 2021:

| *(in millions)* | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Current assets: | | | | |
| Cash | $ 750 | $ — | $ — | $ 750 |
| Cash equivalents: | | | | |
| Corporate debt securities | 5 | — | — | 5 |
| Money market funds | 2,914 | — | — | 2,914 |
| Time deposits | 175 | — | — | 175 |
| Total cash equivalents | 3,094 | — | — | 3,094 |
| Total cash and cash equivalents | 3,844 | — | — | 3,844 |
| Short-term fixed income securities: | | | | |
| Asset-backed securities | 124 | — | — | 124 |
| Corporate debt securities | 1,426 | 2 | (3) | 1,425 |
| Municipal securities | 28 | — | — | 28 |
| U.S. Treasury securities | 378 | — | (1) | 377 |
| Total short-term investments | 1,956 | 2 | (4) | 1,954 |
| Total cash, cash equivalents and short-term investments | $ 5,800 | $ 2 | $ (4) | $ 5,798 |

Cash, cash equivalents and short-term investments consisted of the following as of November 27, 2020:

| *(in millions)* | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Current assets: | | | | |
| Cash | $ 849 | $ — | $ — | $ 849 |
| Cash equivalents: | | | | |
| Corporate debt securities | 28 | — | — | 28 |
| Money market funds | 3,483 | — | — | 3,483 |
| Time deposits | 118 | — | — | 118 |
| Total cash equivalents | 3,629 | — | — | 3,629 |
| Total cash and cash equivalents | 4,478 | — | — | 4,478 |
| Short-term fixed income securities: | | | | |
| Asset-backed securities | 105 | 1 | — | 106 |
| Corporate debt securities | 1,378 | 8 | — | 1,386 |
| Foreign government securities | 3 | — | — | 3 |
| Municipal securities | 19 | — | — | 19 |
| Total short-term investments | 1,505 | 9 | — | 1,514 |
| Total cash, cash equivalents and short-term investments | $ 5,983 | $ 9 | $ — | $ 5,992 |

*See Note 5 for further information regarding the fair value of our financial instruments.*

The following table summarizes the estimated fair value of short-term fixed income debt securities classified as short-term investments based on stated effective maturities as of December 3, 2021:

| *(in millions)* | Estimated Fair Value |
|---|---|
| Due within one year | $ 772 |
| Due between one and two years | 693 |
| Due between two and three years | 443 |
| Due after three years | 46 |
| Total | $ 1,954 |

We review our debt securities classified as short-term investments on a regular basis for impairment. For debt securities in unrealized loss positions, we determine whether any portion of the decline in fair value below the amortized cost basis is due to credit-related factors if we neither intend to sell nor anticipate that it is more likely than not that we will be required to sell prior to recovery of the amortized cost basis. We consider factors such as the extent to which the market value has been less than the cost, any noted failure of the issuer to make scheduled payments, changes to the rating of the security and other relevant credit-related factors in determining whether or not a credit loss exists. During fiscal 2021, we did not recognize an allowance for credit-related losses on any of our investments.

## NOTE 5. FAIR VALUE MEASUREMENTS

*Assets and Liabilities Measured and Recorded at Fair Value on a Recurring Basis*

The fair value of our financial assets and liabilities at December 3, 2021 was determined using the following inputs:

| *(in millions)* | Fair Value Measurements at Reporting Date Using | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Corporate debt securities | $ 5 | $ — | $ 5 | $ — |
| Money market funds | 2,914 | 2,914 | — | — |
| Time deposits | 175 | 175 | — | — |
| Short-term investments: | | | | |
| Asset-backed securities | 124 | — | 124 | — |
| Corporate debt securities | 1,425 | — | 1,425 | — |
| Municipal securities | 28 | — | 28 | — |
| U.S. Treasury securities | 377 | — | 377 | — |
| Prepaid expenses and other current assets: | | | | |
| Foreign currency derivatives | 98 | — | 98 | — |
| Other assets: | | | | |
| Deferred compensation plan assets | 151 | 151 | — | — |
| Total assets | $ 5,297 | $ 3,240 | $ 2,057 | $ — |
| | | | | |
| Liabilities: | | | | |
| Accrued expenses: | | | | |
| Foreign currency derivatives | $ 8 | $ — | $ 8 | $ — |

**ADOBE INC.**

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

The fair value of our financial assets and liabilities at November 27, 2020 was determined using the following inputs:

| *(in millions)* | Fair Value Measurements at Reporting Date Using | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Corporate debt securities | $ 28 | $ — | $ 28 | $ — |
| Money market funds | 3,483 | 3,483 | — | — |
| Time deposits | 118 | 118 | — | — |
| Short-term investments: | | | | |
| Asset-backed securities | 106 | — | 106 | — |
| Corporate debt securities | 1,386 | — | 1,386 | — |
| Foreign government securities | 3 | — | 3 | — |
| Municipal securities | 19 | — | 19 | — |
| Prepaid expenses and other current assets: | | | | |
| Foreign currency derivatives | 15 | — | 15 | — |
| Other assets: | | | | |
| Deferred compensation plan assets | 116 | 116 | — | — |
| Total assets | $ 5,274 | $ 3,717 | $ 1,557 | $ — |
| | | | | |
| Liabilities: | | | | |
| Accrued expenses: | | | | |
| Foreign currency derivatives | $ 4 | $ — | $ 4 | $ — |

*See Note 4 for further information regarding the fair value of our financial instruments.*

Our fixed income available-for-sale debt securities consist of high quality, investment grade securities from diverse issuers with a weighted average credit rating of AA-. We value these securities based on pricing from independent pricing vendors who use matrix pricing valuation techniques including market approach methodologies that model information generated by market transactions involving identical or comparable assets, as well as discounted cash flow methodologies. Inputs include quoted prices in active markets for identical assets or inputs other than quoted prices that are observable either directly or indirectly in determining fair value, including benchmark yields, issuer spreads off benchmark yields, interest rates and U.S. Treasury or swap curves. We therefore categorize all of our fixed income available-for-sale securities as Level 2. We perform routine procedures such as comparing prices obtained from multiple independent sources to ensure that appropriate fair values are recorded.

The fair values of our money market funds, time deposits and deferred compensation plan assets, which consist of money market and other mutual funds, are based on quoted prices in active markets at the measurement date.

Our over-the-counter foreign currency derivatives are valued using pricing models and discounted cash flow methodologies based on observable foreign exchange and interest rate data at the measurement date.

Our other current financial assets and current financial liabilities have fair values that approximate their carrying values.

*Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis*

The fair value of our senior notes was $4.29 billion as of December 3, 2021, based on observable market prices in less active markets and categorized as Level 2. *See Note 17 for further details regarding our debt.*

## NOTE 6. DERIVATIVE FINANCIAL INSTRUMENTS

We may use derivatives to partially offset our business exposure to foreign currency and interest rate risk on expected future cash flows, and certain existing assets and liabilities. We do not use any of our derivative instruments for trading purposes.

We enter into master netting arrangements to mitigate credit risk in derivative transactions by permitting net settlement of transactions with the same counterparty. We do not offset fair value amounts recognized for derivative instruments under master netting arrangements. We also enter into collateral security agreements with certain of our counterparties to exchange cash collateral when the net fair value of certain derivative instruments fluctuates from contractually established thresholds. Collateral posted is included in prepaid expenses and other current assets and collateral received is included in accrued expenses on our Consolidated Balance Sheets.

*Cash Flow Hedges*

In countries outside the United States, we transact business in U.S. Dollars and in various other currencies. We may use foreign exchange option contracts or forward contracts to hedge a portion of our forecasted foreign currency denominated revenue. These foreign exchange contracts, carried at fair value, have maturities of up to twelve months. As of December 3, 2021 and November 27, 2020, total notional amounts of outstanding cash flow hedges were $2.06 billion and $1.53 billion, respectively, hedging exposures denominated in Euros, British Pounds, Japanese Yen and Australian Dollars.

In June 2019, we entered into Treasury lock agreements with large financial institutions which fixed benchmark U.S. Treasury rates for an aggregate notional amount of $1 billion of our future debt issuance. These derivative instruments hedged the impact of changes in the benchmark interest rate to future interest payments and were settled upon debt issuance in the first quarter of fiscal 2020. We incurred a loss related to the settlement of the instruments which is amortized to interest expense over the term of our debt due February 1, 2030. *See Note 17 for further details regarding our debt.*

As of December 3, 2021, we had net derivative gains on our foreign exchange option contracts expected to be recognized within the next 18 months, of which $56 million of gains are expected to be recognized into revenue within the next 12 months. In addition, we had net derivative losses on our Treasury lock agreements, of which $4 million is expected to be recognized into interest expense within the next 12 months.

To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge, and the hedges must be highly effective in offsetting changes to future cash flows on hedged transactions. We record changes in fair value of these cash flow hedges in accumulated other comprehensive income (loss) in our Consolidated Balance Sheets, until the forecasted transaction occurs. When the forecasted transaction affects earnings, we reclassify the related gain or loss on the foreign currency and Treasury lock cash flow hedges to revenue and interest expense, respectively. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, we reclassify the gain or loss on the related cash flow hedge from accumulated other comprehensive income (loss) to the same income statement line item as the hedged item. We evaluate hedge effectiveness at the inception of the hedge prospectively, and on an ongoing basis both retrospectively and prospectively. If we do not elect hedge accounting, or the contract does not qualify for hedge accounting treatment, the changes in fair value from period to period are recorded in the same income statement line item as the hedged item.

Effective in the third quarter of fiscal 2019, all changes in fair value of our foreign currency cash flow hedges are recorded in accumulated other comprehensive income (loss). Prior to this, we recorded the time value of purchased contracts in other income (expense), net in our Consolidated Statements of Income. The impact of the de-designation of our hedges due to the change in methodology in the third quarter of fiscal 2019 was not material.

For fiscal 2021, 2020 and 2019, there were no net gains or losses recognized in income relating to hedges of forecasted transactions that did not occur.

*Non-Designated Hedges*

Our derivatives not designated as hedging instruments consist of foreign currency forward contracts that we primarily use to hedge monetary assets and liabilities denominated in non-functional currencies. The changes in fair value of these contracts are recorded to other income (expense), net in our Consolidated Statements of Income. Changes in the fair value of the underlying assets and liabilities associated with the hedged risk are generally offset by the changes in the fair value of the related contracts.

As of December 3, 2021, total notional amounts of outstanding foreign currency forward contracts were $973 million, primarily hedging exposures denominated in Euros, British Pounds, Australian Dollars and Canadian Dollars. As of November 27, 2020, total notional amounts of outstanding contracts were $492 million, primarily hedging exposures denominated in Euros, British Pounds, Japanese Yen, Indian Rupees and Australian Dollars. At December 3, 2021 and November 27, 2020, the outstanding balance sheet hedging derivatives had maturities of 180 days or less.

The fair value of derivative instruments on our Consolidated Balance Sheets as of December 3, 2021 and November 27, 2020 were as follows:

| *(in millions)* | 2021 | | 2020 | |
|---|---|---|---|---|
| | **Fair Value Asset Derivatives** | **Fair Value Liability Derivatives** | **Fair Value Asset Derivatives** | **Fair Value Liability Derivatives** |
| Derivatives designated as hedging instruments: | | | | |
| Foreign exchange option contracts [(1)] | $ 91 | $ — | $ 12 | $ — |
| Derivatives not designated as hedging instruments: | | | | |
| Foreign exchange forward contracts [(1)] | 7 | 8 | 3 | 4 |
| Total derivatives | $ 98 | $ 8 | $ 15 | $ 4 |

(1) Fair value asset derivatives are included in prepaid expenses and other current assets and fair value liability derivatives are included in accrued expenses on our Consolidated Balance Sheets.

Gains (losses) on derivative instruments, net of tax, recognized in our Consolidated Statements of Comprehensive Income for fiscal 2021, 2020 and 2019 were as follows:

| *(in millions)* | 2021 | 2020 | 2019 |
|---|---|---|---|
| Derivatives in cash flow hedging relationships: | | | |
| Foreign exchange option contracts | $ 69 | $ (43) | $ 23 |
| Treasury lock | $ — | $ (1) | $ (23) |

The effects of derivative instruments on our Consolidated Statements of Income for fiscal 2021, 2020 and 2019 were as follows:

| *(in millions)* | **Financial Statement Classification** | **2021** | **2020** | **2019** |
|---|---|---|---|---|
| Derivatives in cash flow hedging relationships: | | | | |
| Foreign exchange option contracts [1] | | | | |
| Net gain (loss) reclassified from accumulated OCI into income, net of tax | Revenue | $ (16) | $ 3 | $ 39 |
| Amount excluded from effectiveness testing and ineffective portion | Other income (expense), net | $ — | $ — | $ (24) |
| Treasury lock | | | | |
| Net gain (loss) reclassified from accumulated OCI into income, net of tax | Interest expense | $ (4) | $ (3) | $ (1) |
| Derivatives not designated as hedging relationships: | | | | |
| Foreign exchange option contracts | Revenue | $ — | $ — | $ 1 |
| Foreign exchange forward contracts | Other income (expense), net | $ (3) | $ 5 | $ 4 |

(1) Starting the third quarter of fiscal 2019, all changes in fair value of our foreign currency cash flow hedges are recorded in accumulated other comprehensive income (loss) ("OCI").

## NOTE 7. PROPERTY AND EQUIPMENT

Property and equipment, net consisted of the following as of December 3, 2021 and November 27, 2020:

| *(in millions)* | 2021 | 2020 |
|---|---|---|
| Computers and other equipment | $ 1,255 | $ 1,287 |
| Buildings | 560 | 561 |
| Building improvements | 344 | 340 |
| Leasehold improvements | 268 | 284 |
| Land | 145 | 145 |
| Furniture and fixtures | 150 | 159 |
| Capital projects in-progress | 402 | 199 |
| Total | 3,124 | 2,975 |
| Less: Accumulated depreciation and amortization | (1,451) | (1,458) |
| Property and equipment, net | $ 1,673 | $ 1,517 |

Depreciation and amortization expense of property and equipment for fiscal 2021, 2020 and 2019 was $207 million, $192 million and $173 million, respectively.

Property and equipment, net, by geographic area as of December 3, 2021 and November 27, 2020 was as follows:

| *(in millions)* | 2021 | 2020 |
|---|---|---|
| Americas: | | |
| United States | $ 1,480 | $ 1,328 |
| Other | 1 | 2 |
| Total Americas | 1,481 | 1,330 |
| EMEA | 63 | 64 |
| APAC | 129 | 123 |
| Property and equipment, net | $ 1,673 | $ 1,517 |

## NOTE 8. GOODWILL AND OTHER INTANGIBLES

Goodwill by reportable segment and activity for fiscal 2021 and 2020 was as follows:

| *(in millions)* | 2019 | Reclassification[2] | Other[1] | 2020 | Acquisitions | Other[1] | 2021 |
|---|---|---|---|---|---|---|---|
| Digital Media | $ 2,865 | $ — | $ 3 | $ 2,868 | $ 865 | $ (2) | $ 3,731 |
| Digital Experience | 7,448 | (20) | 48 | 7,476 | 1,095 | (32) | 8,539 |
| Publishing and Advertising | 378 | 20 | — | 398 | — | — | 398 |
| Goodwill | $ 10,691 | $ — | $ 51 | $ 10,742 | $ 1,960 | $ (34) | $ 12,668 |

_________________

(1) Amounts consist of foreign currency translation adjustments.

(2) In the fourth quarter of fiscal 2020, we moved our Advertising Cloud offerings from our Digital Experience segment into our new Publishing and Advertising segment, which combined Advertising Cloud with our previous Publishing segment.

Other intangibles, net, as of December 3, 2021 and November 27, 2020 were as follows:

| *(in millions)* | 2021 | | | 2020 | | |
|---|---|---|---|---|---|---|
| | **Gross Carrying Amount** | **Accumulated Amortization** | **Net** | **Gross Carrying Amount** | **Accumulated Amortization** | **Net** |
| Customer contracts and relationships | $ 1,213 | $ (379) | $ 834 | $ 958 | $ (289) | $ 669 |
| Purchased technology | 1,053 | (344) | 709 | 756 | (347) | 409 |
| Trademarks | 376 | (128) | 248 | 384 | (122) | 262 |
| Other | 60 | (31) | 29 | 84 | (65) | 19 |
| Other intangibles, net | $ 2,702 | $ (882) | $ 1,820 | $ 2,182 | $ (823) | $ 1,359 |

In fiscal 2021, other intangibles increased primarily due to identifiable intangible assets acquired through Workfront and Frame.io, partially offset by certain other intangibles associated with our previous acquisitions that became fully amortized and were removed from the Consolidated Balance Sheets.

Amortization expense related to other intangibles was $354 million, $367 million and $402 million for fiscal 2021, 2020 and 2019 respectively. Of these amounts, $181 million, $205 million and $227 million were included in cost of sales for fiscal 2021, 2020 and 2019 respectively.

Other intangibles are amortized over their estimated useful lives of 2 to 15 years. As of December 3, 2021, the estimated aggregate amortization expense for each of the five succeeding fiscal years was as follows:

| *(in millions)* | **Other Intangibles[1]** |
|---|---|
| 2022 | $ 398 |
| 2023 | 367 |
| 2024 | 322 |
| 2025 | 286 |
| 2026 | 142 |
| Thereafter | 286 |
| Total expected amortization expense | $ 1,801 |

(1) Excludes $19 million of capitalized in-process research and development which is considered indefinite lived until the completion or abandonment of the associated research and development efforts.

## NOTE 9. ACCRUED EXPENSES

Accrued expenses as of December 3, 2021 and November 27, 2020 consisted of the following:

| *(in millions)* | 2021 | 2020 |
|---|---|---|
| Accrued compensation and benefits | $ 490 | $ 375 |
| Accrued bonuses | 455 | 330 |
| Refund liabilities | 128 | 127 |
| Taxes payable | 119 | 95 |
| Accrued corporate marketing | 96 | 134 |
| Royalties payable | 40 | 34 |
| Accrued hosting fees | 37 | 66 |
| Accrued interest expense | 34 | 32 |
| Other | 337 | 229 |
| Accrued expenses | $ 1,736 | $ 1,422 |

Other primarily includes accrued media costs, collateral received related to master netting arrangements and general corporate accruals for local and regional expenses, including accruals for fees associated with the cancellation of corporate events.

## NOTE 10. INCOME TAXES

Income before income taxes for fiscal 2021, 2020 and 2019 consisted of the following:

| *(in millions)* | 2021 | 2020 | 2019 |
|---|---|---|---|
| Domestic | $ 1,736 | $ 1,090 | $ 438 |
| Foreign | 3,969 | 3,086 | 2,767 |
| Income before income taxes | $ 5,705 | $ 4,176 | $ 3,205 |

The provision for (benefit from) income taxes for fiscal 2021, 2020 and 2019 consisted of the following:

| *(in millions)* | 2021 | 2020 | 2019 |
|---|---|---|---|
| Current: | | | |
| United States federal | $ 391 | $ 119 | $ 7 |
| Foreign | 197 | 222 | 211 |
| State and local | 103 | 79 | 31 |
| Total current | 691 | 420 | 249 |
| Deferred: | | | |
| United States federal | (148) | (123) | 23 |
| Foreign | 359 | (1,313) | (12) |
| State and local | (19) | (68) | (6) |
| Total deferred | 192 | (1,504) | 5 |
| Provision for (benefit from) income taxes | $ 883 | $ (1,084) | $ 254 |

*Intra-Entity Transfers of Certain Intellectual Property Rights (“IP rights”)*

During fiscal 2020, we completed intra-entity transfers of certain IP rights to our Irish subsidiary in order to better align the ownership of these rights with how our business operates. The transfers did not result in taxable gains; however, our Irish subsidiary recognized deferred tax assets for the book and tax basis difference of the transferred IP rights. As a result of these transactions, we recorded deferred tax assets, net of valuation allowance, and related tax benefits totaling $1.35 billion, based on the fair value of the IP rights transferred. The determination of the fair value involves significant judgment on future revenue growth, operating margins and discount rates. The tax-deductible amortization related to the transferred IP rights is recognized over the period of economic benefit.

**ADOBE INC.**

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

*Reconciliation of Provision for (Benefit from) Income Taxes*

Total income tax expense differed from the expected tax expense, computed by multiplying the U.S. federal statutory rate of 21% in fiscal 2021, 2020 and 2019 by income before income taxes, as a result of the following:

| *(in millions)* | 2021 | 2020 | 2019 |
|---|---|---|---|
| Computed "expected" tax expense | $ 1,198 | $ 877 | $ 673 |
| Impacts of intra-entity IP transfers | — | (1,360) | — |
| Effects of non-U.S. operations | (23) | (337) | (224) |
| Stock-based compensation | (157) | (154) | (86) |
| Tax credits | (149) | (101) | (100) |
| Resolution of income tax examinations | (58) | (23) | (39) |
| State tax expense, net of federal benefit | 66 | 10 | 24 |
| Other | 6 | 4 | 6 |
| Provision for (benefit from) income taxes | $ 883 | $ (1,084) | $ 254 |

*Deferred Tax Assets and Liabilities*

The tax effects of the temporary differences that gave rise to significant portions of the deferred tax assets and liabilities as of December 3, 2021 and November 27, 2020 were as follows:

| *(in millions)* | 2021 | 2020 |
|---|---|---|
| Deferred tax assets: | | |
| Intangible assets | $ 997 | $ 1,368 |
| Capitalized expenses | 355 | 292 |
| Credit carryforwards | 287 | 218 |
| Operating lease liabilities | 122 | 131 |
| Net operating loss carryforwards of acquired companies | 131 | 54 |
| Stock-based compensation | 91 | 92 |
| Reserves and accruals | 89 | 71 |
| Benefits relating to tax positions | 39 | 44 |
| Other | 46 | 37 |
| Total gross deferred tax assets | 2,157 | 2,307 |
| Valuation allowance | (335) | (276) |
| Total deferred tax assets | 1,822 | 2,031 |
| Deferred tax liabilities: | | |
| Acquired intangible assets | 447 | 330 |
| Operating lease right-of-use assets | 111 | 131 |
| Prepaid expenses | 123 | 107 |
| Depreciation and amortization | 49 | 52 |
| Undistributed earnings of foreign subsidiaries | 12 | 51 |
| Total deferred tax liabilities | 742 | 671 |
| Net deferred tax assets | $ 1,080 | $ 1,360 |

Deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. In assessing the realizability of deferred tax assets, management determined that it is not more likely than not that we will have sufficient taxable income in certain states and foreign jurisdictions to fully utilize available tax credits and other attributes. The deferred tax assets are offset by a valuation allowance to the extent it is more likely than not that they are not expected to be realized.

We provide U.S. income taxes on the earnings of foreign subsidiaries unless the subsidiaries' earnings are considered permanently reinvested outside the United States or are exempted from further taxation. As of December 3, 2021, the cumulative amount of foreign earnings upon which U.S. income taxes have not been provided, and the corresponding unrecognized deferred tax liability, was not material.

As of December 3, 2021, we had federal, state and foreign net operating loss carryforwards of approximately $395 million, $467 million and $61 million, respectively. We also had federal, state and foreign tax credit carryforwards of approximately $35 million, $307 million and $9 million, respectively. The majority of the federal net operating loss and state tax credit carryforwards can be carried forward indefinitely, and the remaining will expire in various years from fiscal 2022 through 2040. Certain net operating loss carryforward assets and tax credits are reduced by a valuation allowance and/or are subject to an annual limitation under Internal Revenue Code Section 382. The carrying amount of such assets and credits is expected to be fully realized.

As of December 3, 2021, a valuation allowance of $335 million was established for deferred tax assets related to certain state and foreign assets. For fiscal 2021, the increase in the valuation allowance was $59 million.

*Accounting for Uncertainty in Income Taxes*

During fiscal 2021 and 2020, the aggregate changes in our total gross amount of unrecognized tax benefits were as follows:

| *(in millions)* | 2021 | 2020 |
|---|---|---|
| Beginning balance | $ 201 | $ 173 |
| Gross increases in unrecognized tax benefits – prior year tax positions | 30 | 14 |
| Gross increases in unrecognized tax benefits – current year tax positions | 86 | 44 |
| Lapse of statute of limitations | (21) | (23) |
| Settlements with taxing authorities | (4) | (11) |
| Foreign exchange gains and losses | (3) | 4 |
| Ending balance | $ 289 | $ 201 |

The combined amount of accrued interest and penalties related to tax positions taken on our tax returns were approximately $22 million and $26 million for fiscal 2021 and 2020, respectively. These amounts were included in long-term income taxes payable in their respective years.

While we file federal, state and local income tax returns globally, our major tax jurisdictions are Ireland, California and the United States. We are subject to the examination of our income tax returns by the U.S. Internal Revenue Service and other domestic and foreign tax authorities. These tax examinations are expected to focus on our research and development tax credits, intercompany transfer pricing practices and other matters. For Ireland, California and the United States, the earliest fiscal years open for examination are 2008, 2017 and 2018, respectively. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from these examinations. We believe such estimates to be reasonable; however, we cannot provide assurance that the final determination of any of these examinations will not have an adverse effect on our operating results and financial position.

The timing of the resolution of income tax examinations is highly uncertain as are the amounts and timing of tax payments that are part of any audit settlement process. These events could cause large fluctuations in the balance sheet classification of our tax assets and liabilities. We believe that within the next 12 months, it is reasonably possible that either certain audits will conclude or statutes of limitations on certain income tax examination periods will expire, or both. Given the uncertainties described above, we can only determine a range of estimated potential decreases in underlying unrecognized tax benefits ranging from $0 to approximately $5 million over the next 12 months.

## NOTE 11. BENEFIT PLANS

*Retirement Savings Plan*

The Adobe Inc. 401(k) Retirement Savings Plan, qualified under Section 401(k) of the Internal Revenue Code, is a retirement savings plan covering substantially all of our U.S. employees. Under the plan, eligible employees may contribute up to 65% of their pretax or after-tax salary, subject to the IRS annual contribution limits. In fiscal 2021, we matched 50% of the first 6% of the employee's eligible compensation. We contributed $64 million, $59 million and $52 million in fiscal 2021, 2020 and 2019, respectively. We are under no obligation to continue matching future employee contributions and, at our discretion, may change our practices at any time.

*Deferred Compensation Plan*

The Adobe Inc. Deferred Compensation Plan is an unfunded, non-qualified, deferred compensation arrangement under which certain executives are able to defer a portion of their annual compensation. Participants may elect to contribute up to 75% of their base salary and 100% of other specified compensation, including commissions, bonuses and directors' fees. Participants are able to elect the payment of benefits to begin on a specified date at least three years after the end of the plan year in which election is made or, with respect to equity awards, vests. Members of the Board of Directors are also eligible to participate and are able to defer cash compensation and elect cash benefit distributions in the same manner as executives. Beginning January 1, 2020, only members of the Board are permitted to defer equity awards. For cash benefit elections, distributions are made in cash in the form of a lump sum, or five, ten, or fifteen-year annual installments. For equity award elections, distributions are made in stock in the form of a lump sum payment only.

As of December 3, 2021 and November 27, 2020, the invested amounts under the plan total $151 million and $117 million, respectively and were recorded as other assets on our Consolidated Balance Sheets. As of December 3, 2021 and November 27, 2020, $174 million and $137 million, respectively, were recorded as long-term liabilities to recognize undistributed deferred compensation due to participants.

## NOTE 12. STOCK-BASED COMPENSATION

Our stock-based compensation programs are long-term retention programs that are intended to attract, retain and provide incentives for employees, officers and directors, and to align stockholder and employee interests. We have the following stock-based compensation plans and programs:

*Restricted Stock Units and Performance Share Programs*

We grant restricted stock units and performance share awards to eligible employees under our 2019 Equity Incentive Plan ("2019 Plan"). Restricted stock units generally vest over four years. Certain grants have other vesting periods approved by the Executive Compensation Committee of our Board of Directors.

As of December 3, 2021, we had reserved 46.0 million shares of our common stock for issuance under our 2019 Plan and had 37.9 million shares available for grant.

Our Performance Share Programs aim to help focus key employees on building stockholder value, provide significant award potential for achieving outstanding Company performance and enhance the ability of the Company to attract and retain highly talented and competent individuals. The Executive Compensation Committee of our Board of Directors approves the terms of each of our Performance Share Programs, including the award calculation methodology. Shares under outstanding Performance Share Programs may be earned based on the achievement of an objective relative total stockholder return measured over a three-year performance period. Performance share awards will be awarded and cliff-vest upon the later of the Executive Compensation Committee's certification of the level of achievement or the three-year anniversary of each vesting commencement date. Participants can earn between 0% and 200% of the target number of performance shares.

In January 2021, the Executive Compensation Committee approved the 2021 Performance Share Program, the terms of which are similar to prior year performance share programs as discussed above.

**ADOBE INC.**

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

As of December 3, 2021, the shares awarded under our 2021, 2020 and 2019 Performance Share Programs remained outstanding and were yet to be achieved.

*Employee Stock Purchase Plan*

Our Employee Stock Purchase Plan ("ESPP") allows eligible employee participants to purchase shares of our common stock at a discount through payroll deductions. The ESPP consists of twenty-four-month offering periods with four six-month purchase periods in each offering period. Employees purchase shares in each purchase period at 85% of the market value of our common stock at either the beginning of the offering period or the end of the purchase period, whichever price is lower. The ESPP will continue until the earlier of termination by the Board of Directors or the date on which all of the shares available for issuance under the plan have been issued.

As of December 3, 2021, we had reserved 103.0 million shares of our common stock for issuance under the ESPP and approximately 11.6 million shares remain available for future issuance.

*Issuance of Shares*

Upon vesting of restricted stock units and performance shares or purchase of shares under the ESPP, we will issue treasury stock. If treasury stock is not available, common stock will be issued. In order to minimize the impact of on-going dilution from issuance of shares, we instituted a stock repurchase program. *See Note 14 for information regarding our stock repurchase programs.*

*Valuation of Stock-Based Compensation*

Stock-based compensation cost is measured at the grant date based on the fair value of the award.

Our restricted stock units are valued based on the fair market value of the award on the grant date. Our performance share awards are valued using a Monte Carlo Simulation model. The fair value of the awards are fixed at the grant date and amortized over the longer of the remaining performance or service period.

We use the Black-Scholes option pricing model to determine the fair value of ESPP shares. The determination of the fair value of stock-based payment awards on the date of grant using an option pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the expected term of the awards, actual and projected employee stock option exercise behaviors, a risk-free interest rate and any expected dividends.

*Summary of Restricted Stock Units*

Restricted stock unit activity for fiscal 2021 was as follows:

| | **Number of Shares** (in millions) | **Weighted Average Grant Date Fair Value** | **Aggregate Fair Value**[1] (in millions) | **Weighted Average Remaining Contractual Life** (years) |
|---|---|---|---|---|
| Beginning outstanding balance | 7.0 | $ 285.69 | | |
| Awarded | 3.6 | $ 504.69 | | |
| Released | (3.4) | $ 269.55 | | |
| Forfeited | (0.7) | $ 351.46 | | |
| Increase due to acquisition | 0.1 | $ 548.91 | | |
| Ending outstanding balance | 6.6 | $ 411.52 | $ 4,039 | 1.25 |
| | | | | |
| Expected to vest | 6.0 | $ 408.08 | $ 3,702 | 1.19 |

(1) The aggregate fair value is calculated using the closing stock price as of December 3, 2021 of $616.53.

The weighted average grant date fair values of restricted stock units granted during fiscal 2021, 2020 and 2019 were $504.69, $358.68 and $253.91, respectively. The total fair value of restricted stock units vested during fiscal 2021, 2020 and 2019 was $1.83 billion, $1.61 billion and $970 million, respectively.

*Summary of Performance Shares*

Performance share activity for fiscal 2021 was as follows:

| | Number of Shares (in millions) | Weighted Average Grant Date Fair Value | Aggregate Fair Value[1] (in millions) | Weighted Average Remaining Contractual Life (years) |
|---|---|---|---|---|
| Beginning outstanding balance | 0.7 | $ 333.85 | | |
| Awarded | 0.4 | $ 325.24 | | |
| Achieved | (0.4) | $ 218.55 | | |
| Forfeited | (0.1) | $ 388.11 | | |
| Ending outstanding balance | 0.6 | $ 408.84 | $ 358 | 1.04 |
| | | | | |
| Expected to vest | 0.5 | $ 404.37 | $ 333 | 0.99 |

(1) The aggregate fair value is calculated using the closing stock price as of December 3, 2021 of $616.53.

Shares awarded during fiscal 2021 include 0.2 million additional shares awarded for the final achievement of the 2018 Performance Share Program which was certified in the first quarter of fiscal 2021. The remaining awarded shares were for the 2021 Performance Share Program. Shares achieved during fiscal 2021 resulted from 200% achievement of target for the 2018 Performance Share Program.

The weighted average grant date fair values of performance awards granted during fiscal 2021, 2020 and 2019 were $325.24, $271.62 and $177.33, respectively. The total fair value of performance awards achieved during fiscal 2021, 2020 and 2019 was $212 million, $273 million and $204 million, respectively.

*Summary of Employee Stock Purchase Plan Shares*

Employees purchased 1.0 million shares at an average price of $294.15, 1.2 million shares at an average price of $218.37, and 1.5 million shares at an average price of $150.55 for fiscal 2021, 2020 and 2019, respectively. The intrinsic value of shares purchased during fiscal 2021, 2020 and 2019 was $256 million, $216 million and $179 million, respectively. The intrinsic value is calculated as the difference between the market value on the date of purchase and the purchase price of the shares.

*Compensation Costs*

We recognize the estimated compensation cost of restricted stock units, net of estimated forfeitures, on a straight-line basis over the requisite service period of the entire award, which is generally the vesting period. The estimated compensation cost is based on the fair value of our common stock on the date of grant.

We also recognize the estimated compensation cost of performance shares, net of estimated forfeitures, on a straight-line basis over the requisite performance period or service period of the entire award, whichever is longer. Our performance share awards are earned upon achievement of an objective total stockholder return measure at the end of the three-year performance period, as described above.

We estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate forfeitures and record stock-based compensation expense only for those awards that are expected to vest.

As of December 3, 2021, there was $2.26 billion of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock-based awards and purchase rights which will be recognized over a weighted average period of 2.23 years. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

Total stock-based compensation costs included in our Consolidated Statements of Income for fiscal 2021, 2020 and 2019 were as follows:

| *(in millions)* | 2021 | 2020 | 2019 |
|---|---|---|---|
| Cost of revenue | $ 70 | $ 61 | $ 55 |
| Research and development | 549 | 467 | 375 |
| Sales and marketing | 307 | 261 | 249 |
| General and administrative | 164 | 120 | 109 |
| Total [1] | $ 1,090 | $ 909 | $ 788 |

[1] During fiscal 2021, 2020 and 2019, we recorded tax benefits related to stock-based compensation costs of $395 million, $352 million and $248 million, respectively.

## NOTE 13. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The components of accumulated other comprehensive income (loss) and activity, net of related taxes, for fiscal 2021 were as follows:

| *(in millions)* | November 27, 2020 | Increase / Decrease | Reclassification Adjustments | December 3, 2021 |
|---|---|---|---|---|
| Net unrealized gains / losses on available-for-sale securities | $ 6 | $ (8) | $ — [1] | $ (2) |
| Net unrealized gains / losses on derivative instruments designated as hedging instruments | (60) | 69 | 20 [2] | 29 |
| Cumulative foreign currency translation adjustments | (104) | (60) | — | (164) |
| Total accumulated other comprehensive income (loss), net of taxes | $ (158) | $ 1 | $ 20 | $ (137) |

[1] Reclassification adjustments for gains / losses on available-for-sale securities are classified in other income (expense), net.

[2] Reclassification adjustments for gains / losses on foreign currency hedges are classified in revenue and reclassification adjustments for gains / losses on Treasury lock hedges are classified in interest expense.

Taxes related to each component of other comprehensive income (loss) were immaterial for the fiscal years presented.

## NOTE 14. STOCK REPURCHASE PROGRAM

To facilitate our stock repurchase program, designed to return value to our stockholders and minimize dilution from stock issuances, we may repurchase our shares in the open market or enter into structured repurchase agreements with third parties. In May 2018, our Board of Directors granted authority to repurchase up to $8 billion in common stock, which we fully utilized during fiscal 2021. In December 2020, our Board of Directors granted additional authority to repurchase up to $15 billion in common stock through the end of fiscal 2024.

During fiscal 2021, 2020 and 2019, we entered into several structured stock repurchase agreements with large financial institutions, whereupon we provided them with prepayments totaling $3.95 billion, $3.05 billion and $2.75 billion, respectively. We enter into these agreements in order to take advantage of repurchasing shares at a guaranteed discount to the Volume Weighted Average Price (“VWAP”) of our common stock over a specified period of time. We only enter into such transactions when the discount that we receive is expected to be higher than the foregone return on our cash prepayments to the financial institutions. There were no explicit commissions or fees on these structured repurchases. Under the terms of the agreements, there is no requirement for the financial institutions to return any portion of the prepayment to us.

The financial institutions agree to deliver shares to us at monthly intervals during the contract term. The parameters used to calculate the number of shares deliverable are: the total notional amount of the contract, the number of trading days in the contract, the number of trading days in the interval and the average VWAP of our stock during the interval less the agreed upon discount. We repurchased approximately 7.2 million shares at an average price of $536.17 per share in fiscal 2021, 8.0 million shares at an average price of $376.38 per share in fiscal 2020, and 9.9 million shares at an average price of $270.23 per share in fiscal 2019.

For fiscal 2021, 2020 and 2019, the prepayments were classified as treasury stock on our Consolidated Balance Sheets at the payment date, though only shares physically delivered to us by December 3, 2021, November 27, 2020 and November 29, 2019 were excluded from the computation of earnings per share. As of December 3, 2021, $334 million of prepayments remained under the agreement.

Subsequent to December 3, 2021, as part of the December 2020 stock repurchase authority, we entered into an accelerated share repurchase agreement with a large financial institution whereupon we provided them with a prepayment of $2.4 billion and received an initial delivery of 3.2 million shares, which represents approximately 75% of our prepayment. The remaining balance will be settled during our third quarter of fiscal 2022. Upon completion of the $2.4 billion accelerated share repurchase agreement, $10.7 billion remains under our December 2020 authority.

## NOTE 15. NET INCOME PER SHARE

Basic net income per share is computed using the weighted average number of common shares outstanding for the period, excluding unvested restricted stock units and performance awards. Diluted net income per share is based upon the weighted average common shares outstanding for the period plus dilutive potential common shares, including unvested restricted stock units, stock purchase rights, performance share awards and stock options using the treasury stock method.

The following table sets forth the computation of basic and diluted net income per share for fiscal 2021, 2020 and 2019:

| *(in millions, except per share data)* | 2021 | 2020 | 2019 |
|---|---|---|---|
| Net income | $ 4,822 | $ 5,260 | $ 2,951 |
| Shares used to compute basic net income per share | 477.3 | 480.9 | 486.3 |
| Dilutive potential common shares from stock plans and programs | 3.7 | 4.6 | 5.3 |
| Shares used to compute diluted net income per share | 481.0 | 485.5 | 491.6 |
| Basic net income per share | $ 10.10 | $ 10.94 | $ 6.07 |
| Diluted net income per share | $ 10.02 | $ 10.83 | $ 6.00 |
| Anti-dilutive potential common shares | 0.2 | 0.5 | 0.2 |

## NOTE 16. COMMITMENTS AND CONTINGENCIES

*Unconditional Purchase Obligations*

Our purchase obligations consist of agreements to purchase goods and services entered into in the ordinary course of business. The following table summarizes our non-cancellable unconditional purchase obligations for each of the next five years and thereafter as of December 3, 2021:

*(in millions)*

| Fiscal Year | Purchase Obligations |
|---|---|
| 2022 | $ 711 |
| 2023 | 471 |
| 2024 | 174 |
| 2025 | 18 |
| 2026 | 7 |
| Thereafter | — |
| Total | $ 1,381 |

*Royalties*

We have royalty commitments associated with the licensing of certain offerings and products. Royalty expense is generally based on a dollar amount per unit or a percentage of the underlying revenue. Royalty expense, which was recorded in our cost of revenue on our Consolidated Statements of Income, was approximately $202 million, $176 million and $154 million in fiscal 2021, 2020 and 2019, respectively.

*Indemnifications*

In the ordinary course of business, we provide indemnifications of varying scope to customers and channel partners against claims of intellectual property infringement made by third parties arising from the use of our products and from time to time, we are subject to claims by our customers under these indemnification provisions. Historically, costs related to these indemnification provisions have not been significant and we are unable to estimate the maximum potential impact of these indemnification provisions on our future results of operations.

To the extent permitted under Delaware law, we have agreements whereby we indemnify our officers and directors for certain events or occurrences while the officer or director is or was serving at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the officer's or director's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that reduces our exposure and enables us to recover a portion of any future amounts paid. We believe the estimated fair value of these indemnification agreements in excess of applicable insurance coverage is minimal.

*Legal Proceedings*

In connection with disputes relating to the validity or alleged infringement of third-party intellectual property rights, including patent rights, we have been, are currently and may in the future be subject to claims, negotiations or complex, protracted litigation. Intellectual property disputes and litigation may be very costly and can be disruptive to our business operations by diverting the attention and energies of management and key technical personnel. Although we have successfully defended or resolved past litigation and disputes, we may not prevail in any ongoing or future litigation and disputes. Third-party intellectual property disputes could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from licensing certain of our products or offering certain of our services, subject us to injunctions restricting our sale of products or services, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers including contractual provisions under various license arrangements and service agreements.

In addition to intellectual property disputes, we are also subject to legal proceedings, claims, including claims relating to commercial, employment and other matters, and investigations, including government investigations. Some of these disputes, legal proceedings and investigations may include speculative claims for substantial or indeterminate amounts of damages. We consider all claims on a quarterly basis in accordance with GAAP and based on known facts assess whether potential losses are considered reasonably possible or probable and estimable. Based upon this assessment, we then evaluate disclosure requirements and whether to accrue for such claims in our financial statements. This determination is then reviewed and discussed with the Audit Committee of the Board of Directors.

We make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Unless otherwise specifically disclosed in this note, we have determined that no provision for liability nor disclosure is required related to any claim against us because: (a) there is not a reasonable possibility that a loss exceeding amounts already recognized (if any) may be incurred with respect to such claim; (b) a reasonably possible loss or range of loss cannot be estimated; or (c) such estimate is immaterial.

All legal costs associated with litigation are expensed as incurred. Litigation is inherently unpredictable. However, we believe that we have valid defenses with respect to the legal matters pending against us. It is possible, nevertheless, that our consolidated financial position, cash flows or results of operations could be negatively affected by an unfavorable resolution of one or more of such proceedings, claims or investigations.

In connection with our anti-piracy efforts, conducted both internally and through organizations such as the Business Software Alliance, from time to time we undertake litigation against alleged copyright infringers. Such lawsuits may lead to counter-claims alleging improper use of litigation or violation of other laws. We believe we have valid defenses with respect to such counter-claims; however, it is possible that our consolidated financial position, cash flows or results of operations could be negatively affected in any particular period by the resolution of one or more of these counter-claims.

## NOTE 17. DEBT

The carrying value of our borrowings as of December 3, 2021 and November 27, 2020 were as follows:

| *(dollars in millions)* | **Issuance Date** | **Due Date** | **Effective Interest Rate** | **2021** | **2020** |
|---|---|---|---|---|---|
| 1.70% 2023 Notes | February 2020 | February 2023 | 1.92% | $ 500 | $ 500 |
| 1.90% 2025 Notes | February 2020 | February 2025 | 2.07% | 500 | 500 |
| 3.25% 2025 Notes | January 2015 | February 2025 | 3.67% | 1,000 | 1,000 |
| 2.15% 2027 Notes | February 2020 | February 2027 | 2.26% | 850 | 850 |
| 2.30% 2030 Notes | February 2020 | February 2030 | 2.69% | 1,300 | 1,300 |
| Total debt outstanding, at par | | | | $ 4,150 | $ 4,150 |
| Unamortized discount and debt issuance costs | | | | (27) | (33) |
| Carrying value of long-term debt | | | | $ 4,123 | $ 4,117 |

*Senior Notes*

In January 2015, we issued $1 billion of senior notes due February 1, 2025. The related discount and issuance costs are being amortized to interest expense over the term of the notes using the effective interest method. Interest is payable semi-annually, in arrears on February 1 and August 1.

In February 2020, we issued $500 million of senior notes due February 1, 2023, $500 million of senior notes due February 1, 2025, $850 million of senior notes due February 1, 2027, and $1.30 billion of senior notes due February 1, 2030. Our total proceeds of approximately $3.14 billion, net of issuance discount, were used for general corporate purposes including repayment of debt instruments due in fiscal 2020. The related discount and issuance costs are amortized to interest expense over the respective terms of the notes using the effective interest method. Interest is payable semi-annually, in arrears on February 1 and August 1.

Our senior notes rank equally with our other unsecured and unsubordinated indebtedness. We may redeem the notes at any time, subject to a make-whole premium. In addition, upon the occurrence of certain change of control triggering events, we may be required to repurchase the notes, at a price equal to 101% of their principal amount, plus accrued and unpaid interest to the date of repurchase. The notes do not contain financial covenants but include covenants that limit our ability to grant liens on assets and to enter into sale and leaseback transactions, subject to significant allowances.

*Revolving Credit Agreement*

In October 2018, we entered into a credit agreement ("Revolving Credit Agreement"), providing for a five-year $1 billion senior unsecured revolving credit facility, which replaced our previous five-year $1 billion senior unsecured revolving credit agreement dated as of March 2, 2012 (as amended, the "Prior Revolving Credit Agreement"). In addition, we incurred issuance costs of $1 million which is amortized to interest expense over the term using the straight-line method. The Revolving Credit Agreement provides for loans to Adobe and certain of its subsidiaries that may be designated from time to time as additional borrowers. Pursuant to the terms of the Revolving Credit Agreement, we may, subject to the agreement of lenders to provide additional commitments, obtain up to an additional $500 million in commitments, for a maximum aggregate commitment of $1.5 billion. At our election, loans under the Revolving Credit Agreement will bear interest at either (i) LIBOR plus a margin, based on our debt ratings, ranging from 0.585% to 1.015% or (ii) a base rate, which is defined as the highest of (a) the agent's prime rate, (b) the federal funds effective rate plus 0.500% or (c) LIBOR plus 1.00% plus a margin, based on our debt ratings, ranging from 0.000% to 0.015%. In addition, facility fees determined according to our debt ratings are payable on the aggregate commitments, regardless of usage, quarterly in an amount ranging from 0.04% to 0.11% per annum. We are permitted to permanently reduce the aggregate commitment under the Revolving Credit Agreement at any time. Subject to certain conditions stated in the Revolving Credit Agreement, Adobe and any of its subsidiaries designated as additional borrowers may borrow, prepay and re-borrow amounts at any time during the term of the Revolving Credit Agreement.

The Revolving Credit Agreement contains customary representations, warranties, affirmative and negative covenants, including a financial covenant, events of default and indemnification provisions in favor of the lenders. The negative covenants include restrictions regarding the incurrence of liens and indebtedness, certain merger and acquisition transactions, dispositions and other matters, all subject to certain exceptions. The financial covenant, based on a quarterly financial test, requires us not to exceed a maximum leverage ratio. As of December 3, 2021, we were in compliance with this covenant.

The facility will terminate and all amounts owing thereunder will be due and payable on the maturity date unless (a) the commitments are terminated earlier upon the occurrence of certain events, including an event of default, or (b) the maturity date is further extended upon our request, subject to the agreement of the lenders.

As of December 3, 2021, there were no outstanding borrowings under this Credit Agreement.

## NOTE 18. LEASES

We lease certain facilities and data centers under non-cancellable operating lease arrangements that expire at various dates through 2031. We also have one land lease that expires in 2091. Our lease agreements do not contain any material residual value guarantees, material variable payment provisions or material restrictive covenants.

Operating lease expense was $119 million for both fiscal 2021 and 2020. Prior to our adoption of ASC 842 in fiscal 2020, operating lease expense was $170 million for fiscal 2019. We recognized operating lease expense in cost of revenue and operating expenses in our Consolidated Statements of Income. Our operating lease expense is net of sublease income and includes variable lease costs, both of which are not material.

Supplemental cash flow information for fiscal 2021 and 2020 related to operating leases was as follows:

| *(in millions)* | 2021 | 2020 |
|---|---|---|
| Cash paid for amounts included in the measurement of operating lease liabilities | $ 116 | $ 99 |
| Right-of-use assets obtained in exchange for operating lease liabilities | $ 60 | $ 52 |

The weighted-average remaining lease term and weighted-average discount rate for our operating lease liabilities as of December 3, 2021 were 8 years and 2.28%, respectively.

As of December 3, 2021, the maturities of lease liabilities under operating leases were as follows:

| *(in millions)* |
|---|
| **Fiscal Year** |
| 2022 |
| 2023 |
| 2024 |
| 2025 |
| 2026 |
| Thereafter |
| Total lease liabilities |
| Less: Imputed interest |
| Present value of lease liabilities |

(1) Operating lease payments exclude $16 million of legally binding minimum lease payments for leases signed but not yet commenced.

## NOTE 19. NON-OPERATING INCOME (EXPENSE)

Non-operating income (expense) for fiscal 2021, 2020 and 2019 included the following:

| *(in millions)* | 2021 | 2020 | 2019 |
|---|---|---|---|
| Interest expense | $ (113) | $ (116) | $ (157) |
| Investment gains (losses), net: | | | |
| Realized investment gains | $ 9 | $ 5 | $ 46 |
| Realized investment losses | — | (1) | — |
| Unrealized investment gains (losses), net | 7 | 9 | 6 |
| Investment gains (losses), net | $ 16 | $ 13 | $ 52 |
| Other income (expense), net: | | | |
| Interest income | $ 17 | $ 43 | $ 68 |
| Foreign exchange gains (losses) | (17) | (2) | (26) |
| Realized gains on fixed income investments | — | 1 | — |
| Other income (expense), net | $ — | $ 42 | $ 42 |
| Non-operating income (expense), net | $ (97) | $ (61) | $ (63) |

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors
Adobe Inc.:

*Opinions on the Consolidated Financial Statements and Internal Control Over Financial Reporting*

We have audited the accompanying consolidated balance sheets of Adobe Inc. and subsidiaries (the Company) as of December 3, 2021 and November 27, 2020, the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the fiscal years in the three fiscal year period ended December 3, 2021, and the related notes (collectively, the consolidated financial statements). We also have audited the Company's internal control over financial reporting as of December 3, 2021, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 3, 2021 and November 27, 2020, and the results of its operations and its cash flows for each of the fiscal years in the three fiscal year period ended December 3, 2021, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 3, 2021 based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

*Basis for Opinions*

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Controls over Financial Reporting. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

*Definition and Limitations of Internal Control Over Financial Reporting*

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

*Critical Audit Matter*

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of a critical audit matter does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

*Performance obligations in cloud-enabled software subscriptions*

As discussed in Note 1 to the consolidated financial statements, cloud-enabled services are highly integrated and interrelated with on-premise or on-device software licenses in the Company's Creative Cloud and Document Cloud subscription offerings. Because of this, the cloud-based services and the on-premise/on-device software licenses are not considered distinct from each other and the applicable subscription is accounted for as a single performance obligation.

We identified the assessment of performance obligations in these cloud-enabled software subscription offerings as a critical audit matter. A high degree of subjective auditor judgment was required to assess the nature of the Company's Creative Cloud and Document Cloud offerings, their intended benefit to customers as an integrated offering, and the level of integration that exists between the cloud-enabled services and the on-premise/on-device licenses.

The following are the primary procedures we performed to address this critical audit matter. We evaluated the design and tested the operating effectiveness of an internal control related to the assessment of distinct performance obligations. We read the Creative Cloud and Document Cloud subscription offering agreements to understand the contractual terms and conditions. We participated in product demonstrations and performed interviews with the Company's product and engineering department to both understand and observe specific functionalities of the integrated offering and evaluate the nature of the promise made to the Company's Creative Cloud and Document Cloud customers. We evaluated the features and functionalities of the Creative Cloud and Document Cloud subscription that can be accessed only when using the on-premise/on-device software while connected to the Adobe cloud to assess that customers receive the intended benefit from each solution only as an integrated offering.

/s/ KPMG LLP

We have served as the Company's auditor since 1983.

Santa Clara, California
January 21, 2022

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

## ITEM 9A. CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of December 3, 2021. Based on their evaluation as of December 3, 2021, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective at the reasonable assurance level to ensure that the information required to be disclosed by us in this Annual Report on Form 10-K was (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Adobe have been detected.

### Management's Annual Report on Internal Controls over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal controls over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Our management assessed the effectiveness of our internal controls over financial reporting as of December 3, 2021. In making this assessment, our management used the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Our management has concluded that, as of December 3, 2021, our internal controls over financial reporting are effective based on these criteria.

KPMG LLP, the independent registered public accounting firm that audited our financial statements included in this Annual Report on Form 10-K, has issued an attestation report on our internal controls over financial reporting, which is included herein.

### Changes in Internal Controls over Financial Reporting

There were no changes in our internal controls over financial reporting during the quarter ended December 3, 2021 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## ITEM 9B. OTHER INFORMATION

None.

## PART III

### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item 10 of Form 10-K that is found in our 2022 Proxy Statement to be filed with the SEC in connection with the solicitation of proxies for the Company's 2022 Annual Meeting of Stockholders ("2022 Proxy Statement") is incorporated herein by reference to our 2022 Proxy Statement. The 2022 Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year to which this report relates. For information with respect to our executive officers, see the section titled "Executive Officers" in Part I, Item 1 of this report.

### ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item 11 of Form 10-K is incorporated herein by reference to our 2022 Proxy Statement.

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item 12 of Form 10-K is incorporated herein by reference to our 2022 Proxy Statement.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item 13 of Form 10-K is incorporated herein by reference to our 2022 Proxy Statement.

### ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item 14 of Form 10-K is incorporated herein by reference to our 2022 Proxy Statement.

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

1. Financial Statements. See Index to Consolidated Financial Statements in Part II, Item 8 of this Form 10-K.

| | | Incorporated by Reference | | | | |
|---|---|---|---|---|---|---|
| Exhibit Number | Exhibit Description | Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
| 3.1 | Restated Certificate of Incorporation of Adobe | 8-K | 4/26/11 | 3.3 | 000-15175 | |
| 3.2 | Certificate of Amendment to Restated Certificate of Adobe | 8-K | 10/9/18 | 3.1 | 000-15175 | |
| 3.3 | Amended and Restated Bylaws | 8-K | 1/18/22 | 3.1 | 000-15175 | |
| 4.1 | Specimen Common Stock Certificate | 10-K | 1/25/19 | 4.1 | 000-15175 | |
| 4.2 | Form of Indenture dated as of January 25, 2010 by and between Adobe and Wells Fargo Bank, National Association, as trustee | S-3 | 2/26/16 | 4.1 | 333-209764 | |
| 4.3 | Forms of Global Note for Adobe Inc.'s 1.700% Notes due 2023, 1.900% Notes due 2025, 2.150% Notes due 2027, and 2.300% Notes due 2030, together with an Officer's Certificate setting forth the terms of the Notes | 8-K | 2/3/20 | 4.1 | 000-15175 | |
| 4.4 | Form of Global Note for Adobe's 3.250% Notes due 2025, together with Form of Officer's Certificate setting forth the terms of the Note | 8-K | 1/26/15 | 4.1 | 000-15175 | |
| 4.5 | Description of Adobe's Common Stock | | | | | X |

Table of Contents

| Exhibit Number | Exhibit Description | Incorporated by Reference Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
|---|---|---|---|---|---|---|
| 10.1 | 2020 Employee Stock Purchase Plan, as amended* | 10-K | 1/15/21 | 10.1 | 000-15175 | |
| 10.2A | 2003 Equity Incentive Plan, as amended* | 8-K | 4/13/18 | 10.2 | 000-15175 | |
| 10.2B | Form of RSU Grant Notice and Award Agreement pursuant to 2003 Equity Incentive Plan* | 8-K | 1/26/18 | 10.6 | 000-15175 | |
| 10.2C | Form of Restricted Stock Unit Grant Notice and Award Agreement pursuant to 2003 Equity Incentive Plan* | 8-K | 1/28/19 | 10.5 | 000-15175 | |
| 10.2D | 2019 Performance Share Program pursuant to the 2003 Equity Incentive Plan* | 8-K | 1/28/19 | 10.2 | 000-15175 | |
| 10.2E | Form of 2019 Performance Share Award Grant Notice and Award Agreement pursuant to 2019 Performance Share Program and 2003 Equity Incentive Plan* | 8-K | 1/28/19 | 10.3 | 000-15175 | |
| 10.3A | 2019 Equity Incentive Plan, as amended* | 8-K | 4/12/19 | 10.1 | 000-15175 | |
| 10.3B | 2020 Performance Share Program pursuant to the 2019 Equity Incentive Plan* | 8-K | 1/30/20 | 10.2 | 000-15175 | |
| 10.3C | Form of 2020 Performance Share Award Grant Notice and Award Agreement pursuant to 2020 Performance Share Program and 2019 Equity Incentive Plan* | 8-K | 1/30/20 | 10.3 | 000-15175 | |
| 10.3D | 2021 Performance Share Program pursuant to the 2019 Equity Incentive Plan* | 8-K | 1/27/21 | 10.2 | 000-15175 | |
| 10.3E | Form of 2021 Performance Share Award Grant Notice and Award Agreement pursuant to 2021 Performance Share Program and 2019 Equity Incentive Plan* | 8-K | 1/27/21 | 10.3 | 000-15175 | |
| 10.3F | Form of Restricted Stock Unit Grant Notice and Award Agreement pursuant to 2019 Equity Incentive Plan (for awards granted prior to January 15, 2021)* | 10-Q | 6/26/19 | 10.35B | 000-15175 | |
| 10.3G | Form of Restricted Stock Unit Grant Notice and Award Agreement pursuant to 2019 Equity Incentive Plan (for awards granted on or after January 15, 2021)* | 10-K | 1/15/21 | 10.3E | 000-15175 | |
| 10.3H | Form of Director Grant Restricted Stock Unit Grant Notice and Award Agreement pursuant to 2019 Equity Incentive Plan* | 10-Q | 6/26/19 | 10.35C | 000-15175 | |
| 10.4 | Retention Agreement between Adobe and Shantanu Narayen, effective December 5, 2014* | 8-K | 12/11/14 | 10.2 | 000-15175 | |
| 10.5 | Form of Indemnity Agreement* | 10-Q | 6/26/09 | 10.12 | 000-15175 | |
| 10.6A | Adobe Deferred Compensation Plan, as Amended and Restated* | 10-K | 1/20/15 | 10.19 | 000-15175 | |

Table of Contents

| | | Incorporated by Reference | | | | |
|---|---|---|---|---|---|---|
| **Exhibit Number** | **Exhibit Description** | **Form** | **Filing Date** | **Exhibit Number** | **SEC File No.** | **Filed Herewith** |
| 10.6B | Amendment No. One to Adobe Deferred Compensation Plan* | 10-K | 1/21/20 | 10.6B | 000-15175 | |
| 10.7 | Credit Agreement, dated as of October 17, 2018, among Adobe Inc. and certain subsidiaries as Borrowers, JPMorgan Chase Bank, N.A., Wells Fargo Bank National Association, U.S Bank National Association, Société Générale S.A. as Co-Syndication Agents, Bank of America, N.A. as Administrative Agent and Swing Line Lender, and the Other Lenders Party Thereto | 8-K | 10/19/18 | 10.1 | 000-15175 | |
| 10.8 | Adobe Inc. 2020 Executive Severance Plan in the Event of a Change of Control* | 8-K | 12/10/20 | 10.1 | 000-15175 | |
| 10.10 | 2021 Executive Annual Incentive Plan, as amended and restated* | 8-K | 1/27/21 | 10.4 | 000-15175 | |
| 10.11 | Description of 2021 and 2022 Director Compensation* | 10-K | 1/15/21 | 10.12 | 000-15175 | |
| 21 | Subsidiaries of the Registrant | | | | | X |
| 23.1 | Consent of Independent Registered Public Accounting Firm, KPMG LLP | | | | | X |
| 24.1 | Power of Attorney (set forth on the signature page to this Annual Report on Form 10-K) | | | | | X |
| 31.1 | Certification of Chief Executive Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934 | | | | | X |
| 31.2 | Certification of Chief Financial Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934 | | | | | X |
| 32.1 | Certification of Chief Executive Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934† | | | | | X |
| 32.2 | Certification of Chief Financial Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934† | | | | | X |
| 101.INS | Inline XBRL Instance - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document. | | | | | X |
| 101.SCH | Inline XBRL Taxonomy Extension Schema | | | | | X |
| 101.CAL | Inline XBRL Taxonomy Extension Calculation | | | | | X |
| 101.LAB | Inline XBRL Taxonomy Extension Labels | | | | | X |
| 101.PRE | Inline XBRL Taxonomy Extension Presentation | | | | | X |
| 101.DEF | Inline XBRL Taxonomy Extension Definition | | | | | X |

| Exhibit Number | Exhibit Description | Incorporated by Reference Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
|---|---|---|---|---|---|---|
| 104 | Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101) | | | | | |

* Compensatory plan or arrangement.

† The certifications attached as Exhibits 32.1 and 32.2 that accompany this Annual Report on Form 10-K, are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Adobe Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Form 10-K, irrespective of any general incorporation language contained in such filing.

**ITEM 16. FORM 10-K SUMMARY**

None.

Table of Contents

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ADOBE INC.

By: /s/ DANIEL DURN

Daniel Durn
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: January 21, 2022

**POWER OF ATTORNEY**

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Shantanu Narayen and Daniel Durn, and each or any one of them, his or her lawful attorneys-in-fact and agents, for such person in any and all capacities, to sign any and all amendments to this report and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that either of said attorneys-in-fact and agent, or substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ SHANTANU NARAYEN<br>Shantanu Narayen | Chairman of the Board of Directors and Chief Executive Officer (Principal Executive Officer) | January 21, 2022 |
| /s/ DANIEL DURN<br>Daniel Durn | Executive Vice President, Chief Financial Officer (Principal Financial Officer) | January 21, 2022 |
| /s/ MARK GARFIELD<br>Mark Garfield | Senior Vice President, Corporate Controller and Chief Accounting Officer (Principal Accounting Officer) | January 21, 2022 |
| /s/ FRANK CALDERONI<br>Frank Calderoni | Director | January 21, 2022 |
| /s/ AMY BANSE<br>Amy Banse | Director | January 21, 2022 |
| /s/ BRETT BIGGS<br>Brett Biggs | Director | January 21, 2022 |

| Signature | Title | Date |
|---|---|---|
| /s/ MELANIE BOULDEN<br>Melanie Boulden | Director | January 21, 2022 |
| /s/ LAURA DESMOND<br>Laura Desmond | Director | January 21, 2022 |
| /s/ SPENCER NEUMANN<br>Spencer Neumann | Director | January 21, 2022 |
| /s/ KATHLEEN OBERG<br>Kathleen Oberg | Director | January 21, 2022 |
| /s/ DHEERAJ PANDEY<br>Dheeraj Pandey | Director | January 21, 2022 |
| /s/ DAVID RICKS<br>David Ricks | Director | January 21, 2022 |
| /s/ DAN ROSENSWEIG<br>Dan Rosensweig | Director | January 21, 2022 |
| /s/ JOHN WARNOCK<br>John Warnock | Director | January 21, 2022 |

**SUMMARY OF TRADEMARKS**

The following trademarks of Adobe Inc. or its subsidiaries, which may be registered in the United States and/or other countries, are referenced in this Form 10-K:

Acrobat
Acrobat Reader
Adobe
Adobe Aero
Adobe Audition
Adobe Experience Cloud
Adobe Fresco
Adobe Premiere
Adobe Premiere Rush
Adobe Sensei
After Effects
Behance
Creative Cloud
Creative Cloud Express
Document Cloud
Frame.io
Illustrator
InCopy
InDesign
Journey Optimizer
Lightroom
Marketo
Photoshop
PostScript
Premiere Pro
Premiere Rush
Reader
Sensei
Substance 3D Designer
Substance 3D Modeler
Substance 3D Painter
Substance 3D Sampler
Substance 3D Stager
Workfront

All other trademarks are the property of their respective owners.



---

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**Washington, D.C. 20549**

# FORM 10-K

**(Mark One)**

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

**For the fiscal year ended November 27, 2020**

**or**

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

**For the transition period from_________to_________**

**Commission File Number: 0-15175**

# ADOBE INC.

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**345 Park Avenue, San Jose, California 95110-2704**

(Address of principal executive offices)

**(408) 536-6000**

(Registrant's telephone number, including area code)

**Securities registered pursuant to Section 12(b) of the Act:**

| Title of Each Class | Trading Symbol |
|---|---|
| Common Stock, $0.0001 par value per share | ADBE |

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

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

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Large accelerated filer | ☒ | Accelerated filer | ☐ | Non-accelerated filer | ☐ | Smaller reporting company | ☐ | Emerging growth company | ☐ |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☒

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

The aggregate market value of the registrant's common stock, $0.0001 par value per share, held by non-affiliates of the registrant on May 29, 2020, the last business day of the registrant's most recently completed second fiscal quarter, was $143.27 billion (based on the closing sales price of the registrant's common stock on that date). Shares of the registrant's common stock held by each officer and director and each person who owns 5% or more of the outstanding common stock of the registrant have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes. As of January 8, 2021, 478.7 million shares of the registrant's common stock, $0.0001 par value per share, were issued and outstanding.

## DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the registrant’s 2021 Annual Meeting of Stockholders (the “Proxy Statement”), to be filed within 120 days of the end of the fiscal year ended November 27, 2020, are incorporated by reference in Part III hereof. Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part hereof.

**ADOBE INC.**
**FORM 10-K**

**TABLE OF CONTENTS**

### Forward-Looking Statements

*In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements, including statements regarding product plans, future growth, market opportunities, strategic initiatives, industry positioning, customer acquisition and retention, the amount of annualized recurring revenue, revenue growth and the anticipated impact on our business of the COVID-19 pandemic and related public health measures. In addition, when used in this report, the words "will," "expects," "could," "would," "may," "anticipates," "intends," "plans," "believes," "seeks," "targets," "estimates," "looks for," "looks to," "continues" and similar expressions, as well as statements regarding our focus for the future, are generally intended to identify forward-looking statements. Each of the forward-looking statements we make in this report involves risks and uncertainties that could cause actual results to differ materially from these forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Risk Factors" in Part I, Item 1A of this report. You should carefully review the risks described herein and in other documents we file from time to time with the U.S. Securities and Exchange Commission (the "SEC"), including our Quarterly Reports on Form 10-Q to be filed in 2021. You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document, except as required by law.*

## PART I

## ITEM 1. BUSINESS

Founded in 1982, Adobe Inc. is one of the largest and most diversified software companies in the world. We offer a line of products and services used by creative professionals including photographers, video editors, designers and developers; communicators including content creators, students, marketers and knowledge workers; businesses of all sizes; and consumers for creating, managing, delivering, measuring, optimizing, engaging and transacting with compelling content and experiences across personal computers, devices and media. We market our products and services directly to enterprise customers through our sales force and local field offices. We license our products to end users through app stores and our own website at www.adobe.com. We offer many of our products via a Software-as-a-Service ("SaaS") model or a managed services model (both of which are referred to as hosted or cloud-based) as well as through term subscription and pay-per-use models. We also distribute certain products and services through a network of distributors, value-added resellers ("VARs"), systems integrators ("SIs"), independent software vendors ("ISVs"), retailers, software developers and original equipment manufacturers ("OEMs"). In addition, we license our technology to hardware manufacturers, software developers and service providers for use in their products and solutions. Our products run on personal and server-based computers, as well as on smartphones, tablets and other devices, depending on the product. We have operations in the Americas; Europe, Middle East and Africa ("EMEA"); and Asia-Pacific ("APAC").

Adobe was originally incorporated in California in October 1983 and was reincorporated in Delaware in May 1997. Our executive offices and principal facilities are located at 345 Park Avenue, San Jose, California 95110-2704. Our telephone number is 408-536-6000 and our website is www.adobe.com. Investors can obtain copies of our SEC filings from this site free of charge, as well as from the SEC website at www.sec.gov. The information posted to our website is not incorporated into this Annual Report on Form 10-K.

### BUSINESS OVERVIEW

For over 35 years, Adobe's innovations have transformed how individuals, teams, businesses and governments engage and interact with their constituents in print and online. We help our customers create and deliver the most compelling experiences in streamlined workflows and optimize those experiences for greater return on investment. Our solutions turn ordinary interactions into valuable digital experiences, across media and devices, anytime, anywhere.

While we continue to offer a broad portfolio of products, services and solutions, we focus our investments in two strategic growth areas:

Digital Media – providing products, services and solutions that enable individuals, teams and enterprises to create, publish and promote their content anywhere and accelerate their productivity by modernizing how they view, share and engage with documents and creative content. Our customers include creative professionals like photographers, video editors, graphic and experience designers, and app and game developers; communicators like content creators, students, marketers and knowledge workers who create, collaborate on and distribute documents and creative content; and consumers. This is the core of what we have delivered for decades, and we have evolved our business model to provide our customers with a range of flexible solutions that allow them to reach their full creative potential anytime, anywhere, on any device, and on projects of all types.

Digital Experience – providing a comprehensive and integrated platform and set of applications and services through Adobe Experience Cloud that enable brands and businesses of all sizes to create, manage, execute, measure, monetize and optimize customer experiences that span from analytics to commerce. Our customers include marketers, advertisers, agencies, publishers, merchandisers, merchants, web analysts, data scientists, developers, marketing executives, information management and technology executives, product development executives and sales and support executives. Underpinning Adobe Experience Cloud is our Adobe Experience Platform, which provides businesses and brands with an open and extensible platform for customer experience management that transforms customer data into real-time robust customer profiles and uses insights driven by artificial intelligence ("AI") to enable the delivery of personalized digital experiences in milliseconds. By combining the creativity of our Digital Media business with the science of our Digital Experience offerings, we help our customers more efficiently and effectively make, manage, measure and monetize their content across channels and devices with an end-to-end workflow and feedback loop.

We believe we are uniquely positioned to be a leader in both the Digital Media and Digital Experience markets, where our mission to change the world through digital experiences has never been more relevant, as people seek new ways to communicate, learn and conduct business virtually. By integrating products from each of these areas, our customers are able to utilize a comprehensive suite of solutions and services that no other company currently offers. In addition, our ability to deliver innovation and productivity improvements across customer workflows involving the creation, management, delivery, measurement and optimization of engaging content favorably positions Adobe as our customers continue to invest in delivering digital experiences.

## SEGMENTS

Our business is organized into three reportable segments: Digital Media, Digital Experience and Publishing and Advertising. These segments provide Adobe's senior management with a comprehensive financial view of our key businesses. Our segments are aligned around our two strategic growth opportunities further described below, placing our Publishing and Advertising business in a third segment that contains some of our legacy products and solutions.

In the fourth quarter of fiscal 2020, we moved our Adobe Advertising Cloud offerings from our Digital Experience segment into our Publishing and Advertising segment in order to more closely align our Digital Experience business with our strategic growth priorities.

## MARKET OVERVIEW

This overview provides an explanation of our markets and a discussion of strategic opportunities in fiscal 2021 and beyond for each of our segments. *See "Results of Operations" within Part II, Item 7 titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 2 of Part II, Item 8 titled "Notes to Consolidated Financial Statements" for further segment information.*

### Digital Media

*Digital Media Opportunity*

Recent technology trends in digital communications continue to provide a significant market opportunity for Adobe in digital media. Everyone has a story to tell — from creative professionals, to communicators, to consumers — and with content creation and consumption exploding across every type of device, they need the tools to tell those stories on an ever-increasing number of canvasses. In today's world where the velocity of creation and consumption of digital content is constantly growing, design and creativity have never been more relevant and customers are looking for a way to meet demand with engaging online experiences. Adobe is in a strong position to capitalize on this opportunity with innovation that will accelerate the creative process across all platforms and devices, deepen engagement with communities and accelerate long-term revenue growth by focusing on cloud-based offerings, which are licensed on a subscription basis.

The flagship of our Digital Media business is Adobe Creative Cloud — a subscription service that allows members to use Adobe's creative products integrated with cloud-delivered services across desktop, web and mobile devices. Creative Cloud addresses the needs of creative professionals such as artists, designers, developers, students and administrators, as well as knowledge workers, marketers, educators, hobbyists, communicators and consumers, all of whom use our products to create and deliver content. Our customers rely on our products for content creation, design, video and animation production, mobile app and gaming development, and document creation and collaboration. End users of our creative products work in businesses of all sizes ranging from large publishers, media companies and global enterprises, to smaller design agencies and individual freelancers. Moreover, our creative products are used to create much of the printed and online information people see, read and interact with every day, including video, animation, mobile and advertising content. We have introduced new products, features and services to address emerging categories of content creation, such as voice-based prototyping, refined content creation tools, 3D, augmented reality ("AR"), virtual reality and user experience design across devices and platforms. Digital content creation has transcended the desktop and so we continue to expand our footprint on tablets and mobile devices with touch-first and stylus-first apps like Photoshop for iPad, Illustrator for iPad, Adobe Fresco, Adobe Spark, Adobe Aero, Premiere Rush, Photoshop Express and Photoshop Camera. Creative Cloud members can download and access the latest versions of our creative products such as Photoshop, Illustrator, Adobe Premiere Pro, Lightroom, InDesign, Adobe XD and many more creative applications. To expand our reach and improve the way we serve the needs of our customers, we create different combinations of these services, including our applications with free and paid tiers such as Adobe XD and Adobe Fresco, that have brought new customers into our franchise. In addition, members can access built-in templates and presets created by the Adobe user community to jumpstart designs and step-by-step interactive tutorials to sharpen their skills and get up to speed quickly. Through Creative Cloud, members can access online services to sync, store and share files across users' devices, access marketplace, social and community-based features within our Adobe Stock and Behance services, and create apps and websites, all at affordable subscription pricing. New projects announced and solutions offered include Illustrator on iPad and Adobe Fresco on iPhone, both of which will enable a seamless content creation experience across devices and help us continue to attract a tablet- and mobile-centric audience.

Adobe continues to redefine the creative process with Creative Cloud so that our customers can obtain everything they need to create, collaborate and be inspired. One part of our strategy is Adobe Sensei, a proprietary framework and set of intelligent services for dramatically improving the design and delivery of digital experiences. Adobe Sensei leverages Adobe's massive content and data assets, as well as its deep domain expertise in the creative, marketing and document segments, within a unified AI and machine learning framework to help customers discover hidden opportunities, reduce tedious processes and offer relevant experiences to every customer.

Adobe's Digital Media segment includes our Document Cloud business, built around our Acrobat family of products and a unified, cloud-based document services platform, which includes Acrobat, Adobe Sign and Adobe Scan. Digital documents have a mission-critical role in powering modern businesses with tens of millions of communicators worldwide interacting with documents every day. Across industries and across the world, business processes from contracting to invoicing to employee onboarding are making the change from paper to digital documents, a trend that has accelerated as businesses of all sizes shifted to remote work as a result of the pandemic. Cloud services and mobile devices are reshaping how we work, enabling greater flexibility and collaboration across global, dispersed teams. For over 25 years, Acrobat has provided for the reliable creation and exchange of digital documents, regardless of platform or application source type. Users can collaborate on documents with comments and tailor the security of a file in order to distribute reliable Adobe PDF documents that can be viewed, printed or filled out utilizing our free Acrobat Reader app on any device. Acrobat provides essential digital document capabilities and services across desktop, mobile devices and the web to help knowledge workers and communicators accomplish a wide variety of tasks ranging from simple publications and forms to mission-critical engineering documentation and architectural plans. With our Acrobat product family and its innovative cloud services, we have extended the capabilities of our Sensei-powered document actions, from view and create, to edit, secure, scan, review, embed, share and sign. Users can create a PDF with just the camera on their phone with Adobe Scan, easily read and edit PDFs on tablets and mobile devices with the Acrobat Reader app on iOS and Android, and turn slow, manual signing processes into automated experiences by collecting signatures with Adobe Sign.

*Digital Media Strategy*

Our goal is to be the leading platform for creativity where we offer a range of products and services that allow individuals, small and medium businesses, enterprises and government institutions, and both professionals and enthusiasts, to design and deliver amazing digital content.

We believe there is significant opportunity for growth across all customer segments and expect Adobe Creative Cloud will drive sustained long-term revenue growth through a continued expansion of our customer base by using our products to enable everyone to create and tell their stories on a variety of surfaces and platforms, expanding into new categories and technologies like immersive 3D and AR, making the creative process more iterative and collaborative with seamless cloud-enabled collaboration and workflows, delivering intelligent, time-saving features with Adobe Sensei's artificial intelligence and machine learning capabilities, and acquiring new users by engaging with the creative community with live tutorials and our social communities like Behance.

We will continue to deepen our relationship with existing users through data-driven customer engagement, meeting their needs holistically and delivering additional features and increased value, by offering products and features powered by AI and machine learning through Adobe Sensei. We continue to develop more applications and features like Creative Cloud Libraries that enable collaboration and allow our customers to seamlessly share and access their assets in the cloud. With solutions like

Adobe Fresco for iPhone, Illustrator for iPad, and "Liquid Mode", a breakthrough reading experience for PDFs on Acrobat for mobile devices, our customers can use our tools wherever inspiration strikes, whether on mobile, tablet, desktop or web. We are embracing new frontiers in technology and creativity such as immersive 3D and AR experiences with Adobe Aero and our Substance suite of products. We are pursuing new ways to engage and inspire our community and help our customers develop creative skills such as allowing creators to live-stream their creative process on Behance directly from native Creative Cloud applications and allowing users to learn with step-by-step, in-app, interactive tutorials from experienced creators. With our Adobe Stock and Adobe Fonts services, we offer marketplaces that are built into our Creative Cloud products for Creative Cloud subscribers to purchase stock content and fonts.

As appropriate, we plan to optimize our pricing strategy and move our customers to higher-priced and better-value offerings and continue to employ targeted promotions that attract past customers and potential users to try out and ultimately subscribe to Adobe Creative Cloud. To target new customers and better address the needs of our existing customers, we will continue to invest in driving innovation to maintain the leadership position that we have established. As part of our Creative Cloud strategy, we utilize a data-driven operating model and our Adobe Experience Cloud solutions to drive and optimize customer awareness, engagement and licensing of our creative products and services at every stop of the customer journey through our website and across other channels. Adobe.com is the central destination where we engage individual and small business customers to sign up for and renew Creative Cloud subscriptions. We offer free apps and trials, as well as our mobile and tablet apps, to attract new customers and use our data-driven operating model to optimize conversion of these customers to paid subscribers. Our collaboration services also help us expand our universe of business customers beyond creative professionals, as other stakeholders use our products for review purposes, copywriting or leveraging templates for social media marketing. We utilize channel partners to target mid-size creative customers with our Creative Cloud for teams offering. Our direct sales force is focused on building relationships with our largest customers and driving adoption of our Creative Cloud for enterprise offering. Overall, our strategy with Creative Cloud is designed to enable us to increase our revenue with users, attract more new customers, and grow a recurring and predictable revenue stream that is recognized ratably.

We offer many of the products included in Creative Cloud on a standalone basis, including subscriptions to the Creative Cloud version of certain point products. We also offer a range of other creative tools and services, including our hobbyist products such as Photoshop Elements and Premiere Elements, libraries of creative assets like Adobe Stock and Adobe Fonts and tailored, mobile-first apps such as Photoshop Camera, Adobe Aero, Adobe Capture, Adobe Fresco for iPhone, Premiere Rush and Adobe Spark that allow creators to capture, create, enhance and share content within seconds. Further descriptions of our Digital Media products are included below under "Principal Products and Services."

In our Adobe Document Cloud business, Adobe Acrobat has achieved strong market adoption and a leadership position in document-intensive industries such as government, financial services, pharmaceutical, legal, aerospace, insurance and technical publishing. Trillions of PDF documents are created every year, which reflects the growing role PDF plays across practically every segment of the economy, and we believe there remain hundreds of millions of users in industries that engage with PDF files on a daily basis like legal, financial services or publishing, as well as a broader array of communicators and Acrobat Reader users, who need the capabilities provided by our Acrobat applications and the document services platform found in Document Cloud. As digital documents and processes become central to business continuity in today's remote work environment, the paper-to-digital transformation is accelerating and we're accelerating document productivity in turn with Adobe Document Cloud, enabling individuals and businesses to operate successfully.

We expect to drive sustained long-term revenue growth in Document Cloud through a continued expansion of our customer base by delivering the best PDF experience on every platform and across platforms, expanding the number of actions and features in Acrobat, using Adobe Sensei across our document products and services to make both new and legacy documents more intelligent and responsive, and investing in embedded document services such as integrating Acrobat and Adobe Sign functionality in third-party applications. As with our Creative Cloud strategy, we utilize a data-driven operating model to market our Document Cloud solutions and optimize our subscription-based pricing for individuals as well as small and medium-sized businesses, large enterprises and government institutions around the world. We aim to increase our seat penetration in our key markets through the utilization of our corporate and volume licensing programs. We also intend to increase our focus on marketing and licensing Acrobat in targeted vertical markets such as education, financial services, telecommunications and government, as well as on expanding into emerging markets. We will continue to engage in strategic partnerships to help drive the enterprise business, including our partnerships with Microsoft, Workday, ServiceNow and Notarize.

Our Document Cloud customers increasingly expect business processes to be seamless across desktop, web and mobile devices. Acrobat Reader on mobile devices can be used to create, edit, export, combine, collaborate on and share PDFs on the go and the new “Liquid Mode” feature automatically reformats text, images and tables for quick navigation and consumption on smaller screens. The Adobe Scan app for mobile devices can be used to capture paper documents as images and transform them into full-featured PDFs via Document Cloud services that can be shared immediately, essentially putting scanning capabilities in the pocket of every person with a mobile device. We are delivering quick access to PDF document services on the web, allowing users to create, edit, convert and compress PDFs on Adobe.com. Our Adobe Sign service also provides a green alternative to costly paper-based solutions, and is a more modern and convenient way for customers to digitally manage their documents, processes and contract workflows. We believe that by growing the awareness of electronic signatures in the broader contract delivery and signing market, utilizing Adobe Sensei to enhance customer experiences through machine learning and AI, and continuing to add new capabilities to our Acrobat, Adobe Scan and Adobe Sign offerings, we can help our customers migrate away from paper-based express mailing and adopt our solution to modernize and digitize document experiences, growing our revenue with this business in the process.

**Digital Experience**

*Digital Experience Opportunity*

Digital transformation is a macro trend that affects every business, government and educational institution today – making every business a digital business. Consumers today buy experiences, not just products, and they demand compelling and personalized experiences in their digital interactions that are well-designed, context-aware, seamless and secure across channels and devices. Enterprises and brands recognize that customers have more choices and lower switching costs than ever before. In this new hyper-connected digital environment, it is the customer experience that differentiates brands and ultimately determines customer loyalty. As a result, businesses must determine how to best attract, engage, acquire and retain customers in a digital world where the reach and quality of experiences directly impact success. Business customers are consumers too, and they increasingly have the same expectations, which are driving business-to-business ("B2B") companies to deliver business-to-consumer ("B2C") experiences with a "business-to-everyone" ("B2E") strategy. Delivering the best experience to a consumer at a given moment requires the right combination of data, insights and content across multiple channels in real time. To deliver these multi-channel experiences that are personalized to every customer, executives are increasingly demanding solutions that optimize their consumers' experiences in real time and deliver the greatest return on marketing and IT spend so they can demonstrate the business impact of their programs using objective metrics.

For the past decade, Adobe Experience Cloud has helped businesses provide exceptional experiences to their customers via a comprehensive suite of solutions. We continue to believe that addressing the challenges of customer experience management is a large and growing opportunity and we are in position to help our customers digitally transform their businesses. The world's leading brands are increasingly steering their marketing, advertising and development budgets toward digital experiences. As more and more enterprises continue this move to digital, our opportunity is accelerating as brands seek vendors to help them navigate this transition. Enterprises have a mandate to deliver meaningful experiences to their consumers across digital channels where consumers expect experiences to be consistent and personalized.

Our Adobe Experience Cloud business targets this large and growing opportunity to help companies deliver the most engaging customer experiences by providing an integrated, comprehensive set of solutions for customer experience management. Together, our applications, services and platforms provide real-time data and insights, deliver personalized content and commerce at scale, enable customer journey management and provide a powerful platform for work management. Our solutions address analytics, personalization, digital experience management, marketing automation and engagement, cross-channel campaign management, content management, creative asset management, audience management, digital commerce, order management, predictive intelligence and monetization. Collectively, these comprehensive solutions enable marketers to measure, personalize and optimize digital experiences across all channels and touch points to drive stronger business performance throughout the customer journey.

We believe the market for Adobe Experience Cloud is large and rapidly growing as more businesses and enterprises invest in solutions that aid their goals to transform how they engage with their customers and constituents digitally.

*Digital Experience Strategy*

Our goal is to be the leading provider of cloud-based solutions for delivering digital experiences and enabling digital transformation. The Adobe Experience Cloud applications and services are designed to manage customer journeys, enable shoppable experiences and deliver intelligence for businesses of any size in any industry. Our differentiation and competitive advantage is strengthened by our ability to use the Adobe Experience Platform to connect our comprehensive set of solutions.

Adobe Experience Cloud delivers the following sets of solutions for our customers:

- *Customer data and insights*. Our solutions deliver real-time customer profiles and intelligence across the customer journey. Adobe Analytics provides an experience system of intelligence for real-time cross-channel data, insights and activations across every channel. Adobe Audience Manager, our data management platform, helps digital publishers build unique audience profiles to identify the most valuable segments and use them across any digital channel. Adobe Experience Platform ingests, processes and stitches data across sources, channels and customer interactions in real time to create robust unified customer profiles. Adobe's Real-time Customer Data Platform service, built on Adobe Experience Platform, delivers real-time personalization at scale to enable brands to bring together known and unknown customer data to activate customer profiles across channels and leverage intelligent decision making throughout the customer journey. Our Customer Journey Analytics service brings a powerful set of analytics tools to omnichannel data in Adobe Experience Platform, providing brands viewing data across channels an easy, interactive way to dig deeper and uncover new insights, while making analytics more accessible across their organization.

- *Content and commerce*. We offer solutions to help customers manage, deliver, test, target and optimize content delivery and enable shopping experiences that scale from mid-market to enterprise businesses. Our leading digital experience management solution, Adobe Experience Manager, helps customers organize, create, manage and deliver creative assets and other content across digital marketing channels, including web, mobile, email, communities and video, enabling customers to improve their market and brand perception and provide a personalized experience to their consumers. Adobe Target is a personalization engine that lets our customers test, target and optimize content using machine learning across multiple apps and the web. Adobe Commerce, which integrates with Adobe Experience Manager, enables our customers to create content and promotions for storefronts on every platform and provides a highly customizable and scalable end-to-end platform to manage, personalize and optimize the commerce experience across every touchpoint by bringing together digital commerce, order management and predictive intelligence to enable engaging shopping experiences across B2C and B2B.

- *Customer journey management*. Our solutions help businesses manage, personalize and orchestrate campaigns and customer journeys across B2E use cases. Adobe Campaign enables marketers to manage the B2C customer journey and use rich customer data to create, coordinate and deliver dynamic, personalized experiences that are synchronized across multiple channels and determined by each consumer's behaviors and preferences. Marketo Engage is a complete customer experience management solution optimized for B2B, cross-channel campaigns requiring lead management, account-based marketing and revenue attribution technology by bringing together planning, engagement and measurement capabilities into an integrated marketing platform. Our Journey Orchestration service, built on Adobe Experience Platform, enables businesses to tailor individual journeys for every customer based on their previous behavior and preferences.

- *Work management*. Our work management solution is powered by Workfront, a leading work management platform for marketers. Workfront helps customers orchestrate content creation and campaign workflows across marketing and creative teams.

Adobe acquired Workfront, Inc. on December 7, 2020 and began integrating its work management platform into the Adobe Experience Cloud. Workfront is a configurable cloud platform for enterprise work management that gives teams one central platform to share ideas, create content and manage complex processes.

During the second quarter of fiscal 2020, we began to discontinue our transaction-driven Advertising Cloud offerings, allowing us to focus our investment on strategic growth initiatives. We continue to offer our Advertising Cloud software solutions, but they are not expected to be areas of revenue growth. In the fourth quarter of fiscal 2020, we moved our Advertising Cloud offerings from our Digital Experience segment into our Publishing and Advertising segment, in order to more closely align our Digital Experience business with the strategic growth opportunity.

We believe the AI and machine learning framework enabled by our strategy with Adobe Sensei enhances the delivery of digital experiences. Adobe Experience Cloud offers domain-specific AI services powered by Adobe Sensei that work with Adobe Experience Platform to augment existing Experience Cloud product offerings. These AI services help provide domain-specific intelligence in areas such as attribution and automated insights, customer journey management, lead management, sentiment analysis, one-click personalization, enhanced anomaly detection and more. By building on existing features and these AI-powered services, we believe Adobe Sensei will increase the value we provide our customers and create a competitive differentiation in the market.

Adobe Experience Cloud also offers an open platform and ecosystem through its multi-cloud foundation, the Adobe Experience Platform, AI services powered by Adobe Sensei and developer services through Adobe I/O. Adobe

Experience Platform provides the underlying infrastructure to make customer experience management possible by standardizing data into an easily sharable format consumable by Adobe Sensei and provides an open and extensible cloud infrastructure for Adobe Experience Cloud that allows data to flow freely within the Adobe Experience Platform and between Adobe Experience Cloud solutions and third-party software. This open architecture offers scalability with a wide variety of supporting products and services, empowers users to quickly develop innovative applications to interact with consumers, and enables a broad industry ecosystem.

To drive growth of Adobe Experience Cloud, we are focused on delivering the best customer experience management solutions for B2E, enterprise and mid-market through our applications, services and platform. We also intend to focus on customer engagement, growing within existing customer accounts, and product differentiation. We have expanded our customers to include Chief Information Officers and are continuing to invest in Adobe Experience Platform integrations with Adobe Analytics and Adobe Audience Manager, as well as new services such as Intelligent Services, Customer Journey Analytics and our Real-time Customer Data Platform, to create a truly comprehensive customer data and insights offering. To give our customers increased flexibility and expand our reach, we are also delivering new functionality through additional services delivered on the Adobe Experience Platform such as Journey Orchestration. We utilize a direct sales force to market and license our Experience Cloud solutions, as well as an extensive ecosystem of partners, including marketing agencies, SIs and ISVs that help license and deploy our solutions to their customers. Strategic partnerships, such as the one we have formed with Microsoft, continue to increase our market reach. We have made significant investments to broaden the scale and size of all of these routes to market and believe these investments will result in continued growth in revenue in our Digital Experience segment in fiscal 2021 and beyond.

**Publishing and Advertising**

Our Publishing and Advertising segment contains legacy products and services that address diverse market opportunities including eLearning solutions, technical document publishing, web conferencing, document and forms platform, web application development, high-end printing and, starting in the fourth quarter of 2020, our Adobe Advertising Cloud offerings. Graphics professionals and professional publishers continue to require quality, reliability and efficiency in production printing, and our Adobe PostScript and Adobe PDF printing technologies provide advanced functionality to meet the sophisticated requirements of this marketplace. As high-end printing systems evolve and transition to fully digital, composite workflows, we believe we are well positioned to be a supplier of software and technology based on the Adobe PostScript and Adobe PDF standards for use by this industry.

Adobe Advertising Cloud delivers an end-to-end platform for managing advertising across digital formats, and simplifies the delivery of video, display and search advertising across channels and screens.

We generate revenue in our legacy Publishing products and services by licensing our technology to OEMs that manufacture workflow software, printers and other output devices, and generate revenue in Advertising through usage-based offerings.

## COMPETITION

The markets for our products and services are characterized by intense competition, new industry standards, evolving distribution models, disruptive technology developments, frequent product introductions, short product life cycles, price cutting with resulting downward pressure on gross margins and price sensitivity on the part of consumers. Our future success will depend on our ability to enhance and better integrate our existing products, introduce new products on a timely and cost-effective basis, meet changing customer needs, provide best-in-class information security to build customer confidence and combat cyber-attacks, extend our core technology into new applications and anticipate emerging standards, business models, software delivery methods and other technological changes.

**Digital Media**

No single company has offerings that match the capabilities of our Adobe Creative Cloud products and services, but we face collective competition from a variety of point offerings, free products and downloadable apps. Our competition includes offerings from companies such as Apple, Autodesk, Avid, Corel, Microsoft, Affinity and others, as well as from many lower-end offerings. We believe our greatest advantage in this space is the performance and scope of our integrated solutions, which work together as part of Creative Cloud. With Creative Cloud, we compete favorably on the basis of features and functionality, ease of use, product reliability, value and performance characteristics.

Professional digital imaging, drawing and illustration products are characterized by feature-rich competition, brand awareness and price sensitivity. Competition in this space is also emerging with drawing and illustration applications on tablet and smartphone platforms. The demand for professional web page layout and professional web content creation tools is constantly evolving and highly volatile. In this area, we face direct and indirect competition from desktop software companies and various proprietary and open source web-authoring tools.

We face competition from device, hardware and camera manufacturers as they try to differentiate their offerings by bundling, for free, their own digital imaging software or those of our competitors. Similarly, we face potential competition from operating system manufacturers as they integrate or offer hobbyist-level digital imaging and image management features with their operating systems. We also face competition from smartphone and tablet manufacturers that integrate imaging and video software into their devices to work with cameras that come as part of their smartphone and tablet offerings. In addition, social networking platforms such as Facebook (including Instagram), Snapchat, Twitter, TikTok and Pinterest are yet another direct means to post, edit and share digital media, allowing users to edit content directly on their platforms and apps without the use of tailored software for editing images and videos. Our software also faces competition from free or low-cost storage and synchronization products that encourage consumers to use their integrated image and video editing solutions.

In addition, the needs of digital imaging and video editing software users are constantly evolving due to rapid technology and hardware advancements in digital cameras, digital video cameras, printers, personal computers, tablets, smartphones and other new devices. Our imaging and video offerings, including Photoshop, Lightroom, After Effects, Premiere Pro and Premiere Rush, face competition from established and emerging companies offering similar products.

With the ubiquity of mobile devices and tablets, there is a growing number of image editing applications that are lightweight and mobile-first with features that compete with our professional tools. Our consumer digital imaging and video editing offerings are subject to intense competition, including customer price sensitivity and competitor brand awareness. We face direct and indirect competition in the consumer digital imaging space from a number of companies whose mobile and tablet apps compete with our offerings.

Applications and tools for experience and interface design and prototyping are still emerging and evolving as adoption of these tools by designers, design teams and larger organizations grows. Competitors to Adobe XD include Figma, InVision and Sketch. Partnerships and integrations between these companies and third parties create an increasingly competitive landscape in this space.

The universe of applications for 3D texturing and material authoring as well as other applications and tools in the areas of 3D, augmented reality and immersive design are still developing and advancing as adoption grows and new use cases emerge. Adobe’s Substance suite of applications and Adobe Aero face competition from both hardware and software players in these nascent fields and competitors include Autodesk, C4D, Foundry, Quixel and Unity.

The stock content marketplace has significant competition, especially in the microstock segment, where Adobe primarily operates today with our Adobe Stock offering. Key competitors in this segment include Shutterstock, Getty Images and a number of smaller companies. Deep product integration with Adobe Creative Cloud and superior reach and relationships with creative professionals around the world differentiate our Adobe Stock offerings.

The nature of traditional digital document creation, storage, collaboration and signing has been rapidly evolving as knowledge workers, communicators and consumers increasingly shift their behavior to non-desktop workflows. Competitors like Microsoft, Google, Box, Dropbox and DocuSign all offer competitive alternatives to our Adobe Document Cloud business for creating and managing PDFs and e-signatures. In addition, other PDF creation solutions can be found at a low cost or for free on the web or via mobile applications. To address these competitive threats, we are working to ensure our Document Cloud applications stay at the forefront of innovation in emerging opportunities such as PDF document generation, document collaboration and document security, document workflow management, easeful software integrations, enablement of paper to digital transformations, and accessibility and usability on multiple devices, including mobile and desktop.

**Digital Experience**

The markets in which our Digital Experience business unit competes are growing rapidly and characterized by intense competition. Our Adobe Experience Cloud solutions face competition from large companies such as Google, Oracle, salesforce.com, SAP, SAS, Shopify, Sitecore, BigCommerce and others, in addition to point product solutions and focused competitors. Additionally, new competitors are constantly entering these markets. Some of these competitors provide SaaS solutions to customers, generally through a web browser, while others provide software that is installed by customers directly on their servers. In addition, we compete at times with our customers’ or potential customers’ internally-developed applications. Of the competitors listed above, no single company has products identical in breadth and depth to our Adobe Experience Cloud offerings. Adobe Experience Cloud competes in a variety of areas, including reporting and analytics, cross-channel marketing and optimization, online marketing, audience management, marketing automation, customer data platforms, digital commerce enablement, order management, web experience management, customer experience management and others.

Large software, internet and database management companies have expanded their offerings in the digital experience area, either by developing competing services or by acquiring existing competitors or strategic partners of ours. We believe competitive factors in our markets include the proven performance, security, scalability, flexibility and reliability of services;

the strategic relationships and integration with third-party applications; the intuitiveness and visual appeal of user interfaces; demonstrable cost-effective benefits to customers; pricing; the flexibility of services to match changing business demands; enterprise-level customer service and training; perceived market leadership; the usability of services; real-time data and reporting; independence from portals and search engines; the ability to deploy the services globally; and success in educating customers in how to utilize services effectively. We believe we compete favorably with both the enterprise and low-cost alternatives based on many of these competitive factors including our strong feature set, the breadth of our offerings, our focus on global, multi-brand companies, our superior user experience, tools for building multi-screen, cross-channel applications, standards-based architecture, scalability and performance and leadership in industry standards efforts.

Creative and digital agencies, as well as SIs, are increasingly investing in acquiring their own digital experience technology to complement their creative services offerings. Adobe may face competition from these agencies and SIs as they come to market with best-of-breed offerings in one or more digital experience capabilities, or if agencies attempt to create a more complete technology platform offering. We believe our creative tools heritage differentiates us from our competitors. We have worked closely with marketing and creative customers for over 30 years. We also believe we have leadership in this space, with current customers representing leading global brands. Our comprehensive solutions extend more broadly than any other company in serving the needs of marketers and addressing this market opportunity; we integrate content and data, analytics, personalization, digital experience management, marketing automation, cross-channel campaign management, digital commerce, audience management and customer intelligence in our Adobe Experience Cloud enabled by the Adobe Experience Platform. Most importantly, we provide a vision for our Digital Experience customers as we engage with them across the important aspects of their business, extending from their use of Adobe Creative Cloud and Adobe Document Cloud to how they manage, deliver, measure and monetize their content, participate in digital commerce, and create highly personalized and engaging shoppable experiences with our Experience Cloud.

**Publishing and Advertising**

Our Publishing and Advertising product offerings face competition from large-scale publishing systems, XML-based publishing companies, as well as lower-end desktop publishing products. Similarly, our web conferencing product faces competition from a number of established products from other companies, including Cisco, Citrix and Microsoft. Competition involves a number of factors, including product features, ease-of-use, printer service support, the level of customization and integration with other publishing system components, the number of hardware platforms supported, service and price. We believe we can successfully compete based upon the quality and features of our products, our strong brand among users, the widespread adoption of our products among printer service bureaus, and our extensive application programming interfaces.

In printing technologies, we believe the principal competitive factors for OEMs in selecting a page description language or a printing technology are product capabilities, market leadership, reliability, price, support and engineering development assistance. We believe that our competitive advantages include our technology competency, OEM customer relationships and our intellectual property portfolio.

Our Advertising Cloud offerings face competition from other advertising platforms and networks, including Google, Facebook and The Trade Desk.

## PRINCIPAL PRODUCTS AND SERVICES

**Digital Media Offerings**

***Creative Cloud***

Adobe Creative Cloud is a cloud-based subscription offering that enables creative professionals and enthusiasts alike to express themselves with apps and services for video, design, photography and the web that connect across devices, platforms and geographies. Members have access to a vibrant creative community, publishing services to deliver apps and websites, cloud storage to easily sync and access their work, files and assets across apps, platforms and devices using Creative Cloud Libraries, collaboration capabilities with team members, and new products and exclusive updates as they are developed. Creative Cloud members can build a Creative Profile which persists wherever they are. A user’s Creative Profile moves with them via Creative Cloud services from app to app and device to device, giving them immediate access to their personal files, photos, brushes, graphics, colors, fonts, text styles, desktop setting customizations and other important assets. All of the applications listed below and many more are available through subscriptions to Creative Cloud.

*Adobe Photoshop and Adobe Lightroom*

Adobe Photoshop is the world’s most advanced digital imaging and design app. It is used by photographers, designers, animators, web professionals and video professionals, and is available to Adobe Creative Cloud subscribers on both desktop and iPad. Lightroom, our cloud-based photo service for editing, organizing, storing and sharing photos, is also available to

Creative Cloud subscribers on desktop, tablet and mobile devices. Customers can also subscribe to Photoshop or Lightroom as individual cloud-enabled subscription products, or through our Photography Plan, which is a cloud-enabled offering targeted at photographers and photo hobbyists and includes Photoshop, Lightroom, integrated cloud services, and Lightroom Classic, a desktop-only version of the photo service app. For smartphone users looking for fast and powerful photo editing, we offer Photoshop Express, which enables sophisticated photo editing and content creation using a touch-based interface on mobile devices.

*Adobe Illustrator*

Adobe Illustrator is our industry-standard vector graphics app for desktop and iPad used worldwide by designers of all types who want to create digital graphics and illustrations from web icons and product packaging to book illustrations and billboards, and for all kinds of media: print, web, interactive, video and mobile. New features powered by Adobe Sensei AI allow users to automatically extract colors from a photo and add them to their designs, auto-trace a hand-drawn sketch to turn it into a vector graphic, and more. Illustrator is available on desktop and iPad to Creative Cloud subscribers, and customers can also subscribe to use it as an individual subscription product.

*Adobe Fresco*

Adobe Fresco is an illustration app designed for the latest stylus and touch devices that brings together the world's largest collection of vector and raster brushes, and revolutionary new Live Brushes, to deliver a natural painting and drawing experience for artists, illustrators, animators, sketchers and anyone who wants to discover, or rediscover, the joy of drawing and painting. Live Brushes, powered by Adobe Sensei, are designed to look, feel and act just like real watercolors that blossom, blend and bleed in real time or oil that can be swirled and smudged on canvas. Tight integration with Adobe Creative Cloud enables customers to start their projects on tablet devices and move seamlessly to desktop or mobile, with all files, brushes, fonts and assets synced across devices through Adobe Creative Cloud. A free version of Adobe Fresco is available and a premium version is offered as part of Adobe Creative Cloud, as part of an Adobe Photoshop subscription plan, or as a standalone subscription for individuals, teams, education or enterprises. Adobe Fresco is available for iPad, iPhone, Microsoft Surface computers and Wacom Mobile Studio devices.

*Adobe InDesign*

Adobe InDesign is the industry-leading design and layout app for print and digital media. Our customers use it to create, preflight and publish a broad range of content including newspapers and magazines for print, online and tablet app delivery. From stationery, fliers and posters to brochures, annual reports, magazines and books with professional layout and typesetting tools, customers can create multicolumn pages that feature stylish typography and rich graphics, images and tables. Tight integration with other Adobe offerings such as Photoshop, Illustrator and Acrobat enables customers to work productively in print and digital workflows. InDesign integrates seamlessly with Adobe InCopy, so customers can work on layouts simultaneously with writers and editors. Customers can also access Adobe digital publishing capabilities from within InDesign to create and publish engaging apps for a broad range of devices, including iOS, Android and Amazon-based devices. InDesign is available to Adobe Creative Cloud subscribers, and customers can also subscribe to use InDesign as an individual cloud-enabled subscription product.

*Adobe XD*

Adobe XD is our all-in-one experience design (XD) solution used to build user experiences (UX) and user interfaces (UI) when designing websites, mobile apps and more; Adobe XD enables users to go from concept to prototype faster. Adobe XD brings design and prototyping together with fast, intuitive tools that deliver precision and performance using timesaving features like Responsive Resize, Repeat Grid, Auto-Animate and flexible artboards to create everything from low-fidelity wireframes to fully interactive prototypes for any size screen in minutes. Adobe XD also makes it easy to, with a single click, share and collaborate on designs and prototypes with teammates and allow multiple colleagues on multiple devices to simultaneously make changes to the same document in real time, with support for version control. Adobe XD allows designers to design, prototype and share digital experiences that extend beyond the screen, including keyboard and gamepad triggers for desktop and console-based experiences, and voice prototyping to create audio interactions for voice-based smart assistants and other similar platforms. Adobe XD also enables users to share and reuse assets with design systems that can scale as teams and organizations grow. Adobe XD is available to Adobe Creative Cloud subscribers, and individuals and teams can also subscribe to use it as an individual cloud-enabled subscription product. A free version is also available.

*Adobe Premiere Pro and Adobe Premiere Rush*

Adobe Premiere Pro is a leading nonlinear video editing tool used by filmmakers, TV editors, YouTubers and videographers. Customers can import and combine various types of media, from video shot on a smartphone to 8K to virtual reality, and then edit in its native format without transcoding. Premiere Pro supports a vast majority of formats, and customers can use multiple graphics cards to accelerate render and export times. Premiere Pro also lets users have multiple projects open while simultaneously collaborating on a single project with their team. Automated tools powered by Adobe Sensei like Auto-Reframe save time and workflows for color, graphics, audio and immersive 360/VR in Premiere Pro take customers from first edit to final credits faster than ever. Adobe Premiere Rush is an all-in-one, easy-to-use video editing app that simplifies video creation and sharing on platforms including YouTube and Instagram, while delivering professional quality video results. Premiere Rush is uniquely positioned toward social media marketers, video bloggers and video enthusiasts who are looking for an all-in-one app to create and directly share online videos. Premiere Pro and Premiere Rush tightly integrate with other Adobe creative applications and are available to Adobe Creative Cloud subscribers, and customers can also subscribe to use Premiere Pro and Premiere Rush as individual cloud-enabled subscription products, or they can download the free Premiere Rush starter plan.

*Adobe After Effects*

Adobe After Effects is our industry-standard motion graphics and visual effects app used by a wide variety of animators, designers and compositors to create cinematic movie titles, remove objects from videos, apply countless effects and create animations. It offers superior control, a wealth of creative options and integration with other post-production applications. After Effects works together seamlessly with other Adobe apps such as Premiere Pro, Photoshop, Illustrator, Adobe XD and Adobe Audition. After Effects is available to Adobe Creative Cloud subscribers, and customers can also subscribe to use it as an individual cloud-enabled subscription product.

*Adobe Dimension*

Adobe Dimension is designed to make it easy for graphic designers to compose, adjust and render high-quality, photorealistic 3D images. Users can composite 2D and 3D assets to create product shots, craft photorealistic scenes and visualize branding, packaging and logo designs in 3D with photorealistic renderings. Dimension integrates well with other Adobe apps. Users can drag and drop background images from Photoshop, geometry from Substance Painter and 3D models from Adobe Stock, all without leaving Dimension. Dimension is available to Adobe Creative Cloud subscribers, and customers can also subscribe to use it as an individual cloud-enabled subscription product.

*Adobe Aero*

Adobe Aero is our free iOS application for viewing, building and sharing immersive and interactive augmented reality experiences. Users can create augmented reality experiences using 2D and 3D assets created in other Adobe applications like Adobe Photoshop, Adobe Illustrator, Adobe Dimension and Substance by Adobe, as well as third-party applications like Cinema4D, and bring them to life with animations and interactive triggers. Adobe Aero automatically optimizes these assets for augmented reality and uses machine learning technology to mimic real-world lighting on objects without the need for complex models or time-consuming manual rendering. Adobe Aero is available for free on the iOS App Store.

*Substance by Adobe*

Substance by Adobe is a suite of tools, comprised of Substance Painter, Substance Source, Substance Alchemist and Substance Designer, for 3D texturing and materials authoring that enables users to get all the details just right in their 3D creations. Substance Painter allows users to nondestructively paint 3D textures on models in real time with smart materials that adjust to any object to show realistic wear and tear. Substance Source is a 3D materials library from which users can import professional quality 3D textures into their projects and generate infinite texture variations. Substance Alchemist allows users to create collections of 3D textures and materials, mix and tweak existing materials and even create new materials from the real world using photographs and high-resolution scans. Substance Designer is the industry standard texture authoring tool for precisely creating custom materials with complete nondestructive authoring control. Substance integrates well with other Adobe apps like Dimension, as well as game engines like Epic Games' Unreal Engine 4, Unity, Autodesk's Maya and 3ds Max and more. Customers can also subscribe to use Substance as an individual subscription product.

*Photoshop Camera*

Photoshop Camera is our new, free, AI-driven mobile camera application powered by Adobe Sensei that understands and suggests the best unique Photoshop lenses and camera effects for your photos right inside the camera. Users can scroll through AI-powered lenses and camera effects to apply to photos before or after taking a photo, and share or post photos to social media platforms direct from the application. Photoshop Camera is available for free on the iOS App Store and Google Play store.

*Adobe Stock*

Adobe Stock provides designers and businesses with access to millions of high-quality, curated, royalty-free photos, vectors, illustrations, videos, templates and 3D assets, for all their creative projects. Adobe Stock is built into Adobe Creative

Cloud apps, including Photoshop , Illustrator and InDesign, enabling users to search, browse and add images to their Creative Cloud Libraries, and obtain instant access to assets across desktop and mobile devices. Adobe Stock assets may be licensed directly within the Creative Cloud desktop apps, through stock.adobe.com or as a multi-asset subscription.

*Adobe Fonts*

Adobe Fonts brings thousands of fonts from foundry partners into one library for quick browsing, easy use on the web or on the user's desktop and endless typographic inspiration. Our full library of commercially-licensed fonts is offered through Adobe Creative Cloud. In addition, customers may subscribe to the standalone Adobe Fonts portfolio plan, or license individual fonts from the Adobe Fonts Marketplace.

*Behance*

Behance is the leading social community for creators to showcase and discover creative work online, and live-stream their skills and creations from Creative Cloud applications. Adobe Portfolio allows users to quickly and simply build a fully-customizable and hosted website that seamlessly syncs with Behance.

*Adobe Spark*

Adobe Spark is our integrated web and mobile software for creating and sharing impactful visual stories. Designed for everyday communication, Adobe Spark empowers users to transform text, photos and videos into dynamic web stories, video stories or professional-looking graphics for social media that engage audiences across multiple channels and on any device. The Adobe Spark web app seamlessly syncs with the Spark Post, Spark Page and Spark Video iOS mobile apps (with Spark Post also available as an Android app), allowing users to create, edit and share their story from any location regardless of their design experience. Adobe Spark with premium features allows users to apply custom branding to their creations. The premium product is offered as part of any Adobe Creative Cloud plan or as a standalone subscription for individuals, teams, education or enterprises. A free version is also available.

***Acrobat and Adobe Document Cloud***

Adobe Document Cloud is a cloud-based subscription offering that enables complete, reliable and automated digital document and signature workflows across desktop, mobile, web and third-party enterprise applications to drive business productivity for individuals, teams, small businesses and enterprises. With Document Cloud, users can create, review, approve, sign and track documents, and store them in Document Cloud for easy access and sharing, whether on a desktop or mobile device. Document Cloud includes Adobe Acrobat DC, Adobe Sign, Adobe Scan and other Document Cloud apps and services that work standalone or integrate with users' existing productivity apps, processes and systems.

At the heart of Adobe Document Cloud is Adobe Acrobat DC, the industry standard for creating, converting and editing PDFs. Acrobat enables users to create secure, reliable and compact Adobe PDF documents from authoring applications such as Microsoft Office software, graphics applications and more. Acrobat enables automated collaborative workflows with a rich set of commenting tools and review tracking features, and includes everything needed to create and distribute rich, secure digital documents that can be viewed easily within leading web browsers or on computer desktops via the free Adobe Acrobat Reader.

Adobe Acrobat is available to both Adobe Creative Cloud and Adobe Document Cloud subscribers. Customers can also license Acrobat Pro DC or Acrobat Standard DC (which has a subset of Acrobat Pro DC features) as individual point products available through a cloud-enabled subscription. Adobe Acrobat Reader, our free software for reliable viewing, annotating and printing of Adobe PDF documents on a variety of desktop and mobile platforms, offers additional features for subscribers to Adobe Document Cloud or Adobe Acrobat DC that enables subscribers to create, edit, export, combine, share and collaborate on PDF documents on mobile devices, including the new "Liquid Mode" feature that automatically reformats text, images and tables for quick navigation and consumption on smaller screens. Users of both Acrobat and Acrobat Reader can also access, edit and save changes to their PDF files stored in the Adobe Document Cloud, or other third-party cloud storage services, including Box, Dropbox, Google Drive and Microsoft OneDrive.

Adobe Scan can be used for free on mobile devices to provide scanning capabilities in the pocket of every person. It captures paper documents as images and transforms them into full-featured and versatile PDFs via Adobe Document Cloud services for instant sharing with others.

Our Adobe Sign cloud-based e-signature service allows users to securely electronically send and sign any document from any device. As well as being available on the web, Adobe Sign has a mobile app for iOS and Android that enables users to e-sign documents and forms, send them for signature, track responses in real time and obtain instant signatures with in-person signing. Adobe Sign also integrates with users' enterprise systems through a comprehensive set of application programming interfaces, and Adobe Experience Manager Forms and Advanced Workflows for Adobe Sign, to create forms and provide seamless experiences to customers across web and mobile sites. Adobe Sign is Microsoft's preferred e-sign solution and is integrated into Microsoft Office 365, Microsoft Dynamics 365, Microsoft SharePoint and Microsoft Teams.

**Digital Experience Offerings**

Adobe Experience Cloud is a comprehensive collection of best-in-class solutions for analytics, marketing and commerce, all integrated on a cloud platform, along with service, support and an open ecosystem. Experience Cloud is comprised of the following sets of solutions for our customers: Customer Data and Insights, Content and Commerce, and Customer Journey Management, which are each described below.

***Customer Data and Insights***

Our Customer Data and Insights solutions deliver real-time customer profiles and intelligence across the customer journey with a unified, purpose-built platform for customer experience management, a data management platform and cross-channel analytics. The following is a brief description of our solutions for Customer Data and Insights.

*Adobe Experience Platform*

Adobe Experience Platform is the industry's first purpose-built platform for customer experience management that helps users ingest, process and stitch together known and unknown customer data from every customer interaction across multiple channels in real time into robust unified customer profiles. Adobe Experience Platform standardizes data into an easily sharable format consumable by Adobe Sensei and provides an open and extensible cloud infrastructure which allows that data to flow freely within the Adobe Experience Platform and between Adobe applications and services and third-party software. This open architecture offers scalability with a wide variety of supporting products and services, empowers users to quickly develop innovative applications to interact with consumers and enables a broad industry ecosystem. Adobe Experience Platform also offers Query Service and Data Science Workspace, which enable users to gain deeper insights from stored datasets, and customer journey intelligence, which leverages predefined data-driven operational best practices, AI and business intelligence to enable and optimize real-time decisions, actions and business processes. Users are able to leverage Adobe Experience Platform to activate AI-driven insights across all Adobe Experience Cloud applications.

*Adobe Analytics*

Adobe Analytics is our industry leading solution that helps our customers create a holistic view of their business by turning consumer interactions into actionable insights. Adobe Analytics enables web, social, video, mobile, attribution and predictive analytics to continuously improve the performance of marketing activities and better direct our customers' marketing spend. Adobe Analytics welcomes data from virtually any channel, bringing all data under one roof to deliver real-time insights based on true 360-degree customer views. From attribution and predictive modeling to contribution analysis and propensity scoring, Adobe Analytics is immersed in machine learning and AI. With intuitive and interactive dashboards and reports, our customers can sift, sort and share real-time information to provide insights that can be used to identify problems and opportunities and to drive conversion and relevant consumer experiences. Our Analysis Workspace provides a robust, flexible canvas for creating and curating reusable analysis projects that are customized to their needs. Adobe Analytics lets users capture, analyze and integrate data from virtually any source, both online and offline, from web, email and CRM to voice, IoT and connected car data.

*Adobe Audience Manager*

Adobe Audience Manager is a data management platform that helps digital publishers build unique audience profiles to identify the most valuable segments and use them across any digital channel. Adobe Audience Manager consolidates audience information from all available sources. It then identifies, quantifies and optimizes high-value target audiences, which can then be offered to advertisers via an integrated, secure, privacy-friendly management system that works across all advertising distribution platforms. Adobe Audience Manager provides access to multiple data sources, offering digital publishers the ability to use a wide variety of third-party data as well as Audience Manager's private data co-op.

*Customer Journey Analytics*

Our Customer Journey Analytics service, built on Adobe Experience Platform, brings a powerful set of analytics tools that stitch and analyze cross-channel data into a single interface to deliver comprehensive customer journey insights that allow our customers to more easily deliver consistent experiences regardless of channel. This service provides brands viewing data across channels with an easy, interactive way to dig deeper and uncover new insights with omnichannel data analysis, while making analytics and data science insights more accessible across their organization. The Customer Journey Analytics interface democratizes data analysis by allowing anyone in an organization to creatively and intelligently visualize customers' journeys and gather collections of insights for different audiences in real time by manipulating layers of data.

*Real-Time Customer Data Platform*

Our Real-time Customer Data Platform, built on Adobe Experience Platform, uses customer data to instantly personalize experiences. It does so by activating Adobe Experience Platform's unified customer profiles across channels to leverage intelligent decision making throughout the customer journey and deliver hyper-personalized experiences across all known channels and devices. The Real-time Customer Data Platform utilizes an open and extensible architecture that allows integration with a variety of data sources and activation touchpoints and provides continuous data refreshes to keep customer profiles updated in real time.

*Intelligent Services*

Our Intelligent Services, built on Adobe Experience Platform, give marketers responsible for customer experience access to AI-as-a-service, allowing anyone to predict customer behavior, measure the impact of a campaign, or understand which marketing activities produce the best returns. It provides customers an advanced look at each of their customers, so they can know who is most likely to respond to a message, and then deliver an experience tailored to their preferences in real time. It enables business to understand the reasoning behind customer behaviors, how each customer interaction impacts business outcomes, and which marketing activities produce the best returns.

***Content and Commerce***

Our Content and Commerce solutions help customers manage, deliver, test, target and optimize content delivery and enable shopping experiences that scale from mid-market to enterprise businesses. The following is a brief description of our solutions for Content and Commerce.

*Adobe Experience Manager*

Adobe Experience Manager is a leading digital, cloud-native experience management solution that uses AI tools to help customers organize, create and manage the delivery of creative assets and other content across digital engagement channels, including web, mobile, email, communities and video. It enables customers to manage content on premises or in the cloud with our cloud-native enterprise-grade content management system, delivering agile and rapid deployment. With this ultimate control of content and campaigns, our customers can deliver real-time and personalized experiences to their consumers that help build customers' brands, drive demand and extend reach. Adobe Experience Manager includes digital asset management, content management and enterprise-level forms management. These tools enable customers to improve their market and brand perception and provide a personalized experience to their consumers.

*Adobe Target*

Adobe Target is a personalization engine that lets our customers test, target and optimize content using machine learning across multiple apps and the web. With Adobe Target, our customers have the tools they need to test every piece of content through virtually every channel so they can quickly discover what gets noticed and what increases conversion and engagement. It paves a path from simple testing to targeting to true segmentation and optimization through A/B and multivariate testing, AI-powered automation at scale, content targeting and automated decision making. Adobe Target capabilities also enable our customers to test and target adaptive or responsive mobile web experiences.

*Adobe Commerce*

Adobe Commerce offers digital commerce enablement and order orchestration for both physical and digital goods across a range of industries, including consumer packaged goods, retail, wholesale, manufacturing and the public sector. Adobe Commerce brings together digital commerce, order management and predictive intelligence together with a modern, user-friendly drag-and-drop interface to create shopping experiences that scale from mid-market to enterprise businesses. Based on an open-source ecosystem with thousands of third-party extensions, Adobe Commerce extends beyond the web shopping cart to shoppable experiences, including email, mobile, in-store and marketplaces. Adobe Commerce also integrates with Adobe Experience Manager to enable the user-friendly creation and deployment of content and promotions for shopping experiences that integrate seamlessly across mobile, social or in-store.

***Customer Journey Management***

Our Customer Journey Management solutions enable our customers to manage and orchestrate individual cross-channel campaigns that encourage meaningful customer experiences; personalize content and deliver optimized experiences at scale that are meaningful to each of their customers; and plan, orchestrate and measure engagement with their prospects and customers at every stage of the customer journey, across B2E use cases. The following is a brief description of our solutions for Customer Journey Management.

*Adobe Campaign*

Adobe Campaign is optimized for B2C experiences involving high volume email and cross-channel campaign management. Adobe Campaign enables marketers to manage the customer journey and use rich customer data to create, coordinate and deliver dynamic, personalized experiences that are synchronized across multiple channels, including email, mobile and offline, and determined by each consumer's behaviors and preferences. As part of its feature set, Adobe Campaign provides visual campaign orchestration, allowing for intuitive design and automated consumer experiences across channels, from one-off campaigns to triggered messages, with a graphically rich interface. Marketers can also integrate consumer data from across marketing channels to develop and deliver more relevant marketing experiences to their consumers through email, mobile, offline channels and more. Features also include targeted segmentation, multilingual email execution, real-time interaction, in-app messaging and operational reporting to easily see how well campaigns are performing.

*Marketo Engage*

Marketo Engage is a complete customer experience management solution optimized for B2B, cross-channel campaigns requiring lead management, account-based marketing and revenue attribution technology by bringing together planning, engagement and measurement capabilities into an integrated marketing platform. Marketo Engage simplifies how companies plan, orchestrate and measure engagement with prospects and customers at every stage of their experience and allows companies to better align marketing and sales at every touchpoint to engage high priority accounts. It offers a feature-rich and cloud-native platform with a set of solutions for delivering transformative customer experiences across industries and companies of all sizes.

*Journey Orchestration*

Our Journey Orchestration service, built on Adobe Experience Platform, enables businesses to design, orchestrate and measure event-driven, customer-led journeys across the entire customer lifecycle at the individual level to intelligently anticipate their needs across their personal journey. It allows businesses to trigger individual journeys, apply conditions in real time to qualify events and personalize journeys, as well as visually map individual journeys across systems in an intuitive workflow-based interface. Journey Orchestration also allows businesses to track detailed performance of executed journeys and how individuals are progressing in real time, with data automatically sent to Adobe Experience Platform to allow full-funnel analysis.

**Other Products and Services**

We also offer a broad range of other enterprise and digital media products and services. Information about other products not referenced here can be found on our corporate website, www.adobe.com.

## OPERATIONS

**Marketing and Sales**

We market and license our products directly using our sales force and certain local offices and through our own website at www.adobe.com. We also market and distribute our products through sales channels, which include distributors, retailers, software developers, SIs, ISVs and VARs, as well as through OEM and hardware bundle customers.

Our local field offices include locations in Australia, Belgium, Brazil, Canada, China, Denmark, France, Germany, Hong Kong, India, Ireland, Italy, Japan, Moldova, the Netherlands, Poland, Romania, Singapore, South Africa, South Korea, Spain, Sweden, Switzerland, Taiwan, the United Kingdom and the United States.

We sell the majority of our products through a software subscription model where our customers purchase access to a product for a specific period of time during which they always have rights to use the most recent version of that product. We also license perpetual versions of our software with maintenance and support, which includes rights to upgrades, when and if available, support, updates and enhancements.

For fiscal 2020, 2019 and 2018, there were no customers that represented at least 10% of net revenue. As of fiscal year end 2020 and 2019, no single customer was responsible for over 10% of our trade receivables.

**Services and Support**

We provide expert consulting, customer success management, technical support and learning services across all our customer segments, including enterprises, small and medium businesses, creative professionals and consumers. With a focus on ensuring sustained customer success and realized value, this comprehensive portfolio of services is designed to help customers and partners maximize the return on their investments in our cloud solutions and licensed products. Our service and support revenue consists primarily of consulting fees, software maintenance, technical support fees and training fees.

*Consulting Services*

We have a global professional services team dedicated to designing and implementing solutions for our largest customers. Our professional services team uses a comprehensive, customer-focused methodology that has been refined over years of capturing and analyzing best practices from numerous customer engagements across a diverse mix of solutions, industries and customer segments. Our customers continually seek to integrate across Adobe's products and cloud solutions, and engage our professional services teams to share their expertise in leading customers' digital strategies, multi-solution integrations and in running customer platforms. Using our methodology, our professional services teams are able to accelerate customers' time to value, and maximize the return customers earn on their investment in Adobe solutions.

A key component of Adobe's strategy is developing a large partner ecosystem to expand the reach and breadth of Adobe solutions in the global marketplace. In order to assist partners in building their respective digital practices, Adobe Global Services provides a comprehensive set of deliverables through Adobe's Solution Partner Program. The breadth of services described in the program provides system integrators, agencies and regional partners the tools required to develop core capabilities for positioning and building with Adobe technology, as well as implementing and running customer platforms. We believe that through these programmatic services and support, our joint customers benefit greatly from the combination of Adobe technology and the deep customer context that our global partners represent.

*Customer Success Account Management*

Adobe Customer Solutions provides Customer Success Managers, who work with enterprise and commercial customers on an ongoing basis to understand their current and future business needs, promote faster solution adoption, and align product capabilities to customers' business objectives to maximize the return on their investment in Adobe's offerings. We engage customers to share innovative best practices, relevant industry and vertical knowledge, and proven success strategies based on our extensive engagements with leading marketers and brands. The performance of these teams is directly associated with customer-focused outcomes.

*Technical Support*

Adobe provides enterprise maintenance and support services to customers of subscription products as part of the subscription entitlement, and to perpetual license customers via annual fee-based maintenance and support programs. These offerings provide:

- technical support on the products they have purchased from Adobe;
- "how to" help in using our products; and
- product upgrades and enhancements during the term of the maintenance and support or subscription period, which is typically one to three years.

We provide product support through a global support organization that includes several regional and global support centers, supplemented with outsourced vendors for specific services. Customers can seek help through multiple channels including phone, chat, web, social media and email, allowing quick and easy access to the information they need. These teams are responsible for providing timely, high-quality technical expertise on all our products.

Certain consumers are eligible to receive Getting Started support, to assist with easy adoption of their products. Support for some products and in some countries may vary. For enterprise customers with greater support needs, we offer personalized service options through Premium Services options, delivered by global support centers and technical account managers who can also provide proactive risk mitigation services and on-site support services for those with business-critical deployments.

Lastly, we also offer delivery assurance, technical support and enablement services to partners and developer organizations. Through the Adobe Partner Connection Reseller Program, we provide developers with high-quality tools, software development kits, information and services.

*Digital Learning Services*

Adobe Customer Solutions offers a comprehensive portfolio of learning and enablement services to assist our customer and partner teams in the use of our products, including those within Digital Experience, Digital Media and other legacy products and solutions. Our training portfolio includes a large number of free online self-service learning options on www.training.adobe.com. Adobe Digital Learning Services also has an extensive portfolio of fee-based learning programs including a wide range of traditional classroom, virtual and on-demand training and certifications delivered by our team of training professionals and partners across the globe.

These core offerings are complemented by our custom learning services, which support our largest enterprise customers and their unique requirements. Solution-specific skills assessments help our enterprise customers objectively assess the knowledge and competencies within their marketing teams and tailor their learning priorities accordingly. Finally, aligned with our cloud strategy, we have introduced a new learning subscription service that enables customers to access both business and technical Digital Experience training over a 12-month period, which is a scalable approach to supporting long-term learning.

**Investments**

From time to time we make direct investments in privately held companies. We enter into these investments with the intent of securing financial returns as well as for strategic purposes, as they often increase our knowledge of emerging markets and technologies and expand our opportunities to provide Adobe products and services.

## PRODUCT DEVELOPMENT

A continuous high level of investment is required for the enhancement of existing solutions and the development of new solutions due to the speed of technological change that characterizes the software industry. We develop our software internally, as well as acquire products or technology developed by others by purchasing the stock or assets of the business entity that owns the technology. In other instances, we have licensed or purchased the intellectual property ownership rights of programs developed by others with license or technology transfer agreements that may obligate us to pay a flat license fee or royalties, typically based on a dollar amount per unit or a percentage of the revenue generated by those programs.

## PROTECTING AND LICENSING OUR PRODUCTS

We protect our intellectual property through a combination of patents, copyrights, trademarks and trade secrets, foreign intellectual property laws, confidentiality procedures and contractual provisions. We have United States and foreign patents and pending applications that relate to various aspects of our products and technology. Although our patents have value, no single patent is essential to any of our principal businesses. We have also registered, and applied for the registration of, U.S. and international trademarks, service marks, domain names and copyrights.

Our enterprise customers license our hosted offerings as SaaS or Managed Services, and consumers primarily use our desktop software and mobile apps. We license our desktop software to users under 'click through' or signed license agreements containing restrictions on duplication, disclosure and transfer. Similarly, cloud products and services are provided to users under 'click through' or signed agreements containing restrictions on access and use.

Despite our efforts to protect our proprietary technology and our intellectual property rights, unauthorized parties may attempt to copy or obtain and use our technology to develop applications with the same functionality as our application. Policing unauthorized use of our technology and intellectual property rights is difficult. We believe that our transition from perpetual-use software licenses to a subscription-based business model combined with the increased focus on cloud-based computing has and may continue to improve our efforts to combat the pirating of our products.

## HUMAN CAPITAL

Our values — genuine, innovative, involved and exceptional — are built on the foundation that our people and the way we treat one another promote creativity, innovation and productivity, which spur the company's success. We are continually investing in our global workforce to further drive diversity and inclusion, provide fair and market-competitive pay and benefits to support our employees' well-being, and foster their growth and development. As of November 27, 2020, we employed 22,516 people, of which approximately 52% were in the United States and 48% were in our international locations. During fiscal 2020, our total attrition rate was less than 9%. We have not experienced work stoppages and believe our employee relations are good.

We encourage you to visit our website for more detailed information regarding our Human Capital programs and initiatives. Nothing on our website shall be deemed incorporated by reference into this Annual Report on Form 10-K.

**Diversity and Inclusion**

Adobe For All is our vision to advance diversity and inclusion across the company. We recognize that everyone deserves respect and equal treatment, regardless of gender, race, ethnicity, age, disability, sexual orientation, gender identity, cultural background or religious belief. As of November 27, 2020, women represent 33.5% of our global employees, and underrepresented minorities ("URMs", defined as those who identify as Black/African American, Hispanic/Latinx, Native American, Pacific Islander and/or two or more races) represent 10.7% of our U.S. employees. We have a four-pronged strategy to grow our diversity over time by (1) galvanizing youth to pursue technology careers, (2) attracting diverse talent and ensuring fair hiring, (3) creating an inclusive workplace for employees, and (4) joining forces with our customers, partners and peers to drive industry progress.

In order to create products that solve challenging problems for people all over the world, Adobe needs employees who can bring diverse perspectives and life experiences. Therefore, we are committed to bringing more women and underrepresented and underserved groups into tech careers. We partner with many visionary organizations including Braven and Reboot Representation Tech Coalition.

We employ inclusive recruitment practices to source diverse candidates and mitigate potential bias. In fiscal 2020, we formed a new Diversity Talent Acquisition team to accelerate our goals of engaging with diverse talent. We commit to building a diverse interview panel for each open role and we source candidates from a variety of conferences and partnerships, such as AfroTech, BreakLine, Techqueria, Grace Hopper Celebration of Women in Computing and Lesbians Who Tech Summit. We recruit at a broad range of colleges and universities, including historically black colleges and universities, Hispanic-serving institutions and women's colleges, and we reach out to organizations that support diverse students.

In fiscal 2020, we introduced a global, mandatory 'Building Inclusion on Your Team' learning series designed to guide employees on the actions they can take to strengthen empathy and inclusion. We also formed the Taking Action Initiative to accelerate the representation, development and success of our Black employees while creating change in the broader landscape of social injustice and economic inequality. We continue to support our seven employee resource groups that build community for employees from underrepresented groups. To help build inclusion at the individual and team level, we continue to advance our Adobe For All In Action initiative which promotes five simple actions that employees can take to foster a supportive work environment.

We also help drive diversity across our industry by actively supporting our customers, suppliers, partners and peers as they work to improve diversity and inclusion in their own workplaces, policies and practices. In fiscal 2020, we collaborated with industry peers to advance diversity across multiple dimensions including pledging our commitment to improve experiences of people with disabilities as a member of The Valuable 500, address the impacts of COVID-19 through the 5-Point Action Agenda consortium, and interview at least one qualified person of color for every open VP-and-above role through the ParityPledge.

We have invested in analysis and transparency to demonstrate our commitment to fair compensation and opportunity. We define pay parity as ensuring that employees in the same job and location are paid fairly regardless of their gender or ethnicity. We first announced that we achieved global gender pay parity in October 2018, and in September 2020 we reaffirmed gender pay parity. In September 2020, we also announced we achieved pay parity between URM employees and non-URM employees. In February 2019, we coined the term "opportunity parity" to refer to fairness in promotion and horizontal movement across demographic groups and in fiscal 2020 we shared promotion and horizontal movement metrics, by gender and U.S. race/ethnicity.

Additional information on our diversity and inclusion strategy, diversity metrics and programs can be found on our website at adobe.com/diversity. Nothing on our website shall be deemed incorporated by reference into this Annual Report on Form 10-K.

**Compensation, Benefits and Well-being**

We offer fair, competitive compensation and benefits that support our employees' overall well-being. To ensure alignment with our short- and long-term objectives, our compensation programs for all employees include base pay, short-term incentives, and opportunities for long-term incentives. Our well-being and benefit programs focus on four key pillars: physical, emotional, financial and community. We offer a wide array of benefits including comprehensive health and welfare insurance, generous time-off and leave, and retirement and financial support. We provide emotional well-being services through our Employee Assistance Program and a variety of interactive apps. Our wellness reimbursement of up to $600 per year for each eligible employee, lifestyle coaching, global well-being speaker series and ergonomic programs help to support employees' physical well-being. In addition, our financial education and financial wellness coaches offer employees tools and resources to reach their personal financial goals.

In response to the COVID-19 pandemic, we implemented significant changes that we determined were in the best interest of our employees as well as the communities in which we operate. This includes having the vast majority of our employees work from home, while implementing additional safety measures for employees continuing critical on-site work. We also provide flexible work hours and up to 20 working days per calendar year of paid time off for employees who cannot work due to circumstances related to COVID-19. We have also provided a work-from-home fund to assist employees in that transition and added several company-wide paid days off and caregiving support to help employees balance their work and life responsibilities.

**Growth and Development**

Career development is a primary reason new hires decide to join Adobe and existing employees decide to stay at Adobe. Therefore, we actively foster a learning culture where employees are empowered to drive their career progression, supporting professional development and providing on-demand learning platforms. Our Learning Fund offers each eligible employee up to $11,000 per year for long-term undergraduate and graduate studies, as well as short-term professional development. Our development programs play a critical role in engaging and retaining our employees as these programs offer opportunities to continually enhance their skills for a variety of career opportunities across the company.

## AVAILABLE INFORMATION

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed or furnished pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge on our Investor Relations website at www.adobe.com/adbe as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information posted to our website is not incorporated into this Annual Report on Form 10-K.

## INFORMATION ABOUT OUR EXECUTIVE OFFICERS

Adobe's executive officers as of January 15, 2021 are as follows:

| Name | Age | Positions |
|---|---|---|
| Shantanu Narayen | 57 | Chairman, President and Chief Executive Officer |
| | | Mr. Narayen currently serves as our Chairman of the Board, President and Chief Executive Officer. He joined Adobe in January 1998 as Vice President and General Manager of our engineering technology group. In January 1999, he was promoted to Senior Vice President, Worldwide Products, and in March 2001 he was promoted to Executive Vice President, Worldwide Product Marketing and Development. In January 2005, Mr. Narayen was promoted to President and Chief Operating Officer, and effective December 2007, he was appointed our Chief Executive Officer and joined our Board of Directors. In January 2017, he was named our Chairman of the Board. Mr. Narayen serves as lead independent director on the board of directors of Pfizer, a multinational pharmaceutical corporation. Mr. Narayen holds a B.S. in Electronics Engineering from Osmania University in India, a M.S. in Computer Science from Bowling Green State University and an M.B.A. from the Haas School of Business, University of California, Berkeley. |
| John Murphy | 52 | Executive Vice President and Chief Financial Officer |
| | | Mr. Murphy currently serves as our Executive Vice President and Chief Financial Officer. He joined Adobe in March 2017 and served as our Senior Vice President, Chief Accounting Officer and Corporate Controller until April 2018. Prior to joining Adobe, Mr. Murphy served as Senior Vice President, Chief Accounting Officer and Corporate Controller of Qualcomm Incorporated from September 2014 to March 2017. He previously served as Senior Vice President, Controller and Chief Accounting Officer of DIRECTV Inc. from November 2007 until August 2014, and Vice President and General Auditor of DIRECTV from October 2004 to November 2007. Prior to joining DIRECTV he worked at several global companies, including Experian, Nestle, and Atlantic Richfield (ARCO), in a variety of finance and accounting roles. He served as Director of DirecTV Holdings LLC from November 2007 until August 2014. Mr. Murphy serves on the Corporate Advisory Board of the Marshall School of Business at the University of Southern California. He holds an MBA from the Marshall School of Business at the University of Southern California, a B.S. in Accounting from Fordham University. |

| Name | Age | Positions |
|---|---|---|
| Scott Belsky | 40 | Chief Product Officer and Executive Vice President, Creative Cloud<br><br>Mr. Belsky joined Adobe in December 2017 as Chief Product Officer and Executive Vice President, Creative Cloud. Prior to joining Adobe in December 2017, Belsky was a venture investor at Benchmark in San Francisco from February 2016 to December 2017. Prior to Benchmark, Belsky led Adobe's mobile strategy for Creative Cloud from December 2012 to January 2016, having joined the company through the acquisition of Behance. Belsky co-founded Behance in 2006 and served as its CEO for over 6 years. He was an early advisor and investor to Pinterest, Uber and Warby Parker and other early-stage companies, and co-founded and serves on the board of Globality, a referrals platform that empowers the careers of independent professionals. Mr. Belsky also serves on the advisory board of Cornell University's Entrepreneurship Program and as President of the Smithsonian Cooper-Hewitt National Design Museum board of trustees. |
| Anil Chakravarthy | 53 | Executive Vice President and General Manager, Digital Experience Business and Worldwide Field Operations<br><br>Mr. Chakravarthy joined Adobe in January 2020 as Executive Vice President and General Manager, Digital Experience and was given responsibility over Worldwide Field Operations in July 2020, when he was appointed Executive Vice President and General Manager, Digital Experience Business and Worldwide Field Operations. Prior to joining Adobe, he served as Informatica’s Chief Executive Officer from August 2015 to January 2020 and Executive Vice President and Chief Product Officer from September 2013 to August 2015. Prior to joining Informatica, for over nine years, Mr. Chakravarthy held multiple leadership roles at Symantec Corporation, most recently serving as its Executive Vice President, Information Security from February 2013 to September 2013. Prior to Symantec, he was a Director of Product Management for enterprise security services at VeriSign. Mr. Chakravarthy began his career as an engagement manager at McKinsey & Company. He also serves on the board of the Silicon Valley Leadership Group. Mr. Chakravarthy holds a Bachelor of Technology in Computer Science and Engineering from the Institute of Technology, Varanasi, India and Master of Science and Ph.D. degrees from the Massachusetts Institute of Technology. |
| Gloria Chen | 56 | Chief People Officer and Executive Vice President, Employee Experience<br><br>Ms. Chen joined Adobe in 1997 and currently serves as Chief People Officer and Executive Vice President, Employee Experience. In her more than 20 years at Adobe, she has held senior leadership positions in worldwide sales operations, customer service and support, and strategic planning. In October 2009, Ms. Chen was appointed Vice President and Chief of Staff to the Chief Executive Officer. In March 2018, she was promoted to Senior Vice President, Strategy and Growth, in November 2019, she was elevated to Executive Vice President, Strategy and Growth and in January 2020, she was promoted to Chief People Officer and Executive Vice President, Employee Experience. Prior to joining Adobe, Ms. Chen was an engagement manager at McKinsey & Company. Ms. Chen holds a BS in electrical engineering from the University of Washington, an MS in electrical and computer engineering from Carnegie Mellon University and an MBA from Harvard Business School. |
| Bryan Lamkin | 60 | Executive Vice President and General Manager, Digital Media<br><br>Mr. Lamkin currently serves as Executive Vice President and General Manager, Digital Media. He rejoined Adobe in February 2013 as Senior Vice President, Technology and Corporate Development. From June 2011 to May 2012, Mr. Lamkin served as President and Chief Executive Officer of Clover, a mobile payments platform. Prior to Clover, Mr. Lamkin co-founded and served as the Chief Executive Officer of Bagcheck, a sharing and discovery platform, from June 2010 to May 2011. From April 2009 to June 2010, Mr. Lamkin served as Senior Vice President of Consumer Products and Applications at Yahoo!, a global technology company providing online search, content and communication tools. From May 2008 to April 2009, Mr. Lamkin served as Executive in Residence at Sutter Hill Ventures. Mr. Lamkin previously was with Adobe from 1992 to 2006 and held various senior management positions including Senior Vice President, Creative Solutions Business Unit.<br><br>Mr. Lamkin announced his intent to retire as Executive Vice President and General Manager, Digital Media on October 20, 2020. His retirement will be effective in the first quarter of fiscal year 2021. |

| Name | Age | Positions |
| --- | --- | --- |
| Ann Lewnes | 59 | Chief Marketing Officer and Executive Vice President, Corporate Strategy and Development<br><br>Ms. Lewnes joined Adobe in November 2006 and currently serves as Chief Marketing Officer and Executive Vice President, Corporate Strategy and Development. Ann has held the position of Chief Marketing Officer for over a decade and since December 2020, she also leads Adobe's corporate strategy and strategic M&A efforts globally as Executive Vice President, Corporate Strategy and Development. Prior to joining Adobe, Ms. Lewnes spent 20 years at Intel Corporation, where she was Vice President of Sales and Marketing. Ms. Lewnes is a board member of Mattel and the Adobe Foundation. |
| Abhay Parasnis | 46 | Executive Vice President, Chief Technology Officer and Chief Product Officer, Document Cloud<br><br>Mr. Parasnis currently serves as Executive Vice President, Chief Technology Officer and Chief Product Officer, Document Cloud. He joined Adobe in July 2015 as Senior Vice President of Adobe's Cloud Technology & Services organization and Chief Technology Officer and in February 2020, he was appointed Chief Technology Officer and Executive Vice President, Strategy and Growth. Prior to joining Adobe, he served as President and Chief Operating Officer at Kony, Inc. from March 2013 to March 2015. From January 2012 to November 2013, Mr. Parasnis was a Senior Vice President and later Strategic Advisor for the Oracle Public Cloud at Oracle. Prior to joining Oracle, he was General Manager of Microsoft Azure AppFabric at Microsoft from April 2009 to December 2011. |
| Dana Rao | 51 | Executive Vice President, General Counsel and Corporate Secretary<br><br>Mr. Rao currently serves as our Executive Vice President, General Counsel and Corporate Secretary. He joined Adobe in April 2012 and served as our Vice President, Intellectual Property and Litigation where he spearheaded strategic initiatives including the company's litigation efforts, and its patent, trademark and copyright portfolio strategies until June 2018. Prior to joining Adobe, Mr. Rao was with Microsoft Corporation for 11 years, serving in a variety of roles including Associate General Counsel of Intellectual Property and Licensing, where he oversaw all patent matters for Microsoft's entertainment and devices division as well as the company-wide patent acquisition team. From 1997 until March 2001, he served as a patent attorney at Fenwick & West. He holds a B.S. in Electrical Engineering from Villanova University and a J.D. from George Washington University. |
| Mark Garfield | 50 | Vice President, Chief Accounting Officer and Corporate Controller<br><br>Mr. Garfield currently serves as our Vice President, Chief Accounting Officer and Corporate Controller. Prior to joining Adobe in December 2018, Mr. Garfield served as the Vice President of Finance of Cloudflare, Inc. commencing in November 2017. He served as Senior Vice President and Chief Accounting Officer at Symantec Corporation from March 2014 to October 2017. Prior to joining Symantec, he was at Brightstar Corporation where he served primarily as Senior Vice President and Chief Accounting Officer from January 2013 to February 2014. Mr. Garfield served as Director of Finance at Advanced Micro Devices from August 2010 to December 2012. Prior to Advanced Micro Devices, Mr. Garfield also served in senior level finance roles at LoudCloud and Ernst and Young. Mr. Garfield holds a B.A. in Business Economics from University of California at Santa Barbara. |

## ITEM 1A. RISK FACTORS

As previously discussed, our actual results could differ materially from our forward-looking statements. Below we discuss some of the factors that could cause these differences. These and many other factors described in this report could adversely affect our operations, performance and financial condition.

### Risks Related to Our Ability to Grow Our Business

***The effects of the COVID-19 pandemic have materially affected how we and our customers are operating our businesses, and the duration and extent to which this will impact our future results of operations and overall financial performance remains uncertain.***

The COVID-19 pandemic and related public health measures have materially affected how we and our customers are operating our businesses, and have materially affected our operating results. Due to our subscription-based business model, the effect of the pandemic may not be fully reflected in our results of operations until future periods. If the pandemic has a substantial impact on our employees', partners' or customers' businesses and productivity, our results of operations and overall financial performance may be harmed. The global macroeconomic effects of the pandemic may persist for an indefinite period, even after the pandemic has subsided.

As a result of the pandemic, we have temporarily closed Adobe offices globally and have implemented certain travel restrictions. This global work-from-home operating environment has caused strain for, and may adversely impact the productivity of, certain employees, and these conditions may persist and harm our business, including our future operating results. Additionally, our efforts to re-open our offices safely may not be successful, could expose our employees, customers, and partners to health risks, and us to associated liability, and will involve additional financial burdens. The pandemic may have long-term effects on the nature of the office environment and remote working, and this may present operational challenges that may adversely affect our business.

We have shifted all of our in-person customer events through July 2021 to virtual-only experiences and we may deem it advisable to similarly alter, postpone or cancel entirely additional customer, employee or industry events in the future. Our virtual customer, employee and industry events may not be as successful as in-person events. Moreover, the conditions caused by the pandemic have affected the rate of IT spending and may continue to adversely affect our customers' ability or willingness to purchase our offerings. We have seen and may continue to see these conditions delay prospective customers' purchasing decisions, adversely impact our ability to provide on-site consulting services to our customers, result in extended payment terms, reduce the value or duration of their subscription contracts, or affect attrition rates, all of which could adversely affect our future sales, operating results and overall financial performance.

Our operations have also begun to be negatively affected by a range of external factors related to the pandemic that are not within our control. Authorities throughout the world have implemented measures to contain or mitigate the spread of the virus, including physical distancing, travel bans and restrictions, closure of non-essential businesses, quarantines, work-from-home directives and shelter-in-place orders. These measures have caused, and are continuing to cause, business slowdowns or shutdowns in affected areas, both regionally and worldwide, which have impacted our business and results of operations, and may also delay the provisioning of our offerings.

The extent of the impact from the pandemic depends on future developments that cannot be accurately predicted at this time, such as the duration and spread of the pandemic, the extent and effectiveness of containment actions and the impact of these and other factors on our employees, customers, partners and vendors. If we are not able to respond to and manage the impact of such events effectively, our business will be harmed.

Finally, to the extent that the pandemic harms our business and results of operations, many of the other risks described in this "Risk Factors" section may be heightened.

***Our competitive position and results of operations could be harmed if we do not compete effectively.***

The markets for our products and services are characterized by intense competition, new industry standards, evolving distribution models, limited barriers to entry, disruptive technology developments, short product life cycles, customer price sensitivity, global market conditions and frequent product introductions (including alternatives with limited functionality available at lower costs or free of charge). Any of these factors could create downward pressure on pricing and gross margins and could adversely affect our renewal and upsell and cross-sell rates, as well as our ability to attract new customers. Our future success will depend on our continued ability to enhance and integrate our existing products and services, introduce new products and services in a timely and cost-effective manner, meet changing customer expectations and needs, extend our core technology into new applications, and anticipate emerging standards, business models, software delivery methods and other technological developments. Furthermore, some of our competitors and potential competitors enjoy competitive advantages such as greater financial, technical, sales, marketing and other resources, broader brand awareness and access to larger customer bases. As a result of these advantages, potential and current customers might select the products and services of our competitors, causing a loss of our market share. In addition, consolidation has occurred among some of our competitors. Further consolidations in these markets may subject us to increased competitive pressures and may harm our results of operations.

*For additional information regarding our competition and the risks arising out of the competitive environment in which we operate, see the section entitled "Competition" contained in Part I, Item 1 of this report.*

***If we cannot continue to develop, acquire, market and offer new products and services or enhancements to existing products and services that meet customer requirements, our operating results could suffer.***

The process of developing and acquiring new technology products and services and enhancing existing offerings is complex, costly and uncertain. If we fail to anticipate customers' rapidly changing needs and expectations or adapt to emerging technological trends, our market share and results of operations could suffer. We must make long-term investments, develop, acquire or obtain appropriate intellectual property and commit significant resources before knowing whether our predictions will accurately reflect customer demand for our products and services. If we misjudge customer needs in the future, our new products and services may not succeed and our revenues and earnings may be harmed. Additionally, any delay in the development, acquisition, marketing or launch of a new offering or enhancement to an existing offering could result in customer attrition or impede our ability to attract new customers, causing a decline in our revenue, earnings or stock price and weakening our competitive position.

We offer our products on a variety of hardware platforms. Consumers continue to migrate from personal computers to tablet and mobile devices. If we cannot continue adapting our products to tablet and mobile devices, or if our competitors can adapt their products more quickly than us, our business could be harmed. Releases of new devices or operating systems may make it more difficult for our products to perform or may require significant costs in order for us to adapt our solutions to such devices or operating systems. These potential costs and delays could harm our business.

***Introduction of new technology could harm our business and results of operations.***

The expectations and needs of technology consumers are constantly evolving. Our future success depends on a variety of factors, including our continued ability to innovate, introduce new products and services efficiently, enhance and integrate our products and services in a timely and cost-effective manner, extend our core technology into new applications, and anticipate emerging standards, business models, software delivery methods and other technological developments. Integration of our products and services with one another and other companies' offerings creates an increasingly complex ecosystem that is partly reliant on third parties. If any disruptive technology, or competing products, services or operating systems that are not compatible with our solutions, achieve widespread acceptance, our operating results could suffer and our business could be harmed.

The introduction of, or limitations on, certain technologies may reduce the effectiveness of our products. For example, some of our products rely on third-party cookies or other identifiers where the permissions are managed through web browsers or mobile operating systems. These technologies are used in our products to help our customers more effectively advertise, gauge the performance of their advertisements and detect and prevent fraudulent activity. Consumers can control the use of these technologies through their browsers, device settings or "ad-blocking" software or applications. Increased use of such methods, software or applications that block cookies or other identifiers could harm our business.

***We may not realize the anticipated benefits of past or future investments or acquisitions, and integration of acquisitions may disrupt our business and management.***

We may not realize the anticipated benefits of an investment or acquisition of a company, division, product or technology, each of which involves numerous risks. These risks include:

- inability to achieve the financial and strategic goals for the acquired and combined businesses;

- difficulty in, and the cost of, effectively integrating the operations, technologies, products or services, and personnel of the acquired business;
- entry into markets in which we have minimal prior experience and where competitors in such markets have stronger market positions;
- disruption of our ongoing business and distraction of our management and other employees from other opportunities and challenges;

- inability to retain personnel of the acquired business;
- inability to retain key customers, distributors, vendors and other business partners of the acquired business;
- inability to take advantage of anticipated tax benefits;
- incurring acquisition-related costs or amortization costs for acquired intangible assets that could impact our operating results;
- elevated delinquency or bad debt write-offs related to receivables of the acquired business we assume;
- increased accounts receivables collection times and working capital requirements associated with acquired business models;
- additional costs of bringing acquired companies into compliance with laws and regulations applicable to a multinational corporation;
- difficulty in maintaining controls, procedures and policies during the transition and integration;
- impairment of our relationships with employees, customers, partners, distributors or third-party providers of our technologies, products or services;
- failure of our due diligence processes to identify significant problems, liabilities or other challenges of an acquired company or technology;
- exposure to litigation or other claims in connection with, or inheritance of claims or litigation risk as a result of, an acquisition, such as claims from terminated employees, customers, former stockholders or other third parties;
- incurring significant exit charges if products or services acquired in business combinations are unsuccessful;
- inability to conclude that our internal controls over financial reporting are effective;
- inability to obtain, or obtain in a timely manner, approvals from governmental authorities, which could delay or prevent such acquisitions;
- the failure of strategic investments to perform as expected or to meet financial projections;
- delay in customer and distributor purchasing decisions due to uncertainty about the direction of our product and service offerings; and
- incompatibility of business cultures.

Mergers and acquisitions of technology companies are inherently risky. If we do not complete an announced acquisition transaction or integrate an acquired business successfully and in a timely manner, we may not realize the benefits of the acquisition to the extent anticipated, and in certain circumstances an acquisition could harm our financial position.

Our ability to acquire other businesses or technologies, make strategic investments or integrate acquired businesses effectively may also be impaired by the effects of the COVID-19 pandemic, government actions in light of the pandemic, trade tensions and increased global scrutiny of foreign investments. For example, a number of countries, including the U.S. and countries in Europe and the Asia-Pacific region, are considering or have adopted restrictions on foreign investments. Governments may continue to adopt or tighten restrictions of this nature, and such restrictions could negatively impact our business and financial results.

***The success of some of our product and service offerings depends on our ability to continue to attract and retain customers of and contributors to our online marketplaces for creative content.***

The success of some of our product and service offerings, such as Adobe Stock, depends on our ability to continue to attract new customers and contributors to these online marketplaces for creative content, as well as our ability to continue to retain existing customers and contributors. An increase in paying customers has generally resulted in more content from contributors, which increases the size of our collection and in turn attracts new paying customers. We rely on the functionality and features of our online marketplaces, the size and content of our collection and the effectiveness of our marketing efforts to attract new customers and contributors and retain existing ones. New technologies may render the features of our online marketplaces obsolete, our collection may fail to grow as anticipated or our marketing efforts may be unsuccessful, any of which may adversely affect our results of operations.

***If our products or platforms are used to create or disseminate objectionable content, particularly misleading content intended to manipulate public opinion, our brand reputation may be damaged, and our business and financial results may be harmed.***

We believe that our brands have significantly contributed to the success of our business. Maintaining and enhancing the brands within Adobe increases our ability to enter new categories and launch new and innovative products that better serve the needs of our customers. We also believe that maintaining and enhancing our brands is critical to expanding our base of customers. Our brands may be negatively affected by the use of our products or services to create or disseminate newsworthy content that is deemed to be misleading, deceptive, or intended to manipulate public opinion (e.g. "DeepFakes"), by the use of our products or services for illicit, objectionable, or illegal ends, or by our failure to respond appropriately and expeditiously to such uses of our products and services. Such uses of our products and services may also cause us to face claims related to defamation, rights of publicity and privacy, illegal content, misinformation and personal injury torts. Maintaining and enhancing our brands may require us to make substantial investments and these investments may not be successful. If we fail to appropriately respond to objectionable content created using our products or services or shared on our platforms, our users may lose confidence in our brands and our business and financial results may be adversely affected.

***Social and ethical issues relating to the use of AI in our offerings may result in reputational harm and liability.***

Social and ethical issues relating to the use of new and evolving technologies such as artificial intelligence (AI) in our offerings, may result in reputational harm and liability, and may cause us to incur additional research and development costs to resolve such issues. We are increasingly building AI into many of our offerings. As with many innovations, AI presents risks and challenges that could affect its adoption, and therefore our business. AI presents emerging ethical issues and if we enable or offer solutions that draw controversy due to their perceived or actual impact on society, we may experience brand or reputational harm, competitive harm or legal liability. Potential government regulation in the space of AI ethics may also increase the burden and cost of research and development in this area, subjecting us to brand or reputational harm, competitive harm or legal liability. Failure to address AI ethics issues by us or others in our industry could undermine public confidence in AI and slow adoption of AI in our products and services.

**Risks Related to the Operation of Our Business**

***Security breaches in data centers we manage, or third parties manage on our behalf, may compromise the confidentiality, integrity, or availability of employee and customer data, which could expose us to liability and adversely affect our reputation and business.***

We process and store significant amounts of employee and customer data, a large volume of which is hosted by third-party service providers. A security incident impacting our own data centers or those controlled by our service providers may compromise the confidentiality, integrity or availability of this data. Unauthorized access to or loss or disclosure of data stored by Adobe or our service providers may occur through physical break-ins, breaches of a secure network by an unauthorized party, software vulnerabilities or coding errors, employee theft or misuse or other misconduct. It is also possible that unauthorized access to or disclosure of employee or customer data may be obtained through inadequate use of security controls by customers or employees. Accounts created with weak or recycled passwords could allow cyber-attackers to gain access to employee or customer data. Additionally, failure by Adobe or our customers to remove the accounts of their own employees, or the granting of accounts in an uncontrolled manner, may allow for access by former or unauthorized individuals. If there were an inadvertent disclosure of customer data, or unauthorized access to the data we possess on behalf of our customers, our operations could be disrupted, our reputation could be damaged and we could be subject to claims or other liabilities, regulatory investigations, or fines. In addition, such perceived or actual unauthorized loss or disclosure of the information we collect, process, or store or breach of our security could damage our reputation, result in the loss of customers and harm our business.

***We rely on data centers managed both by Adobe and third parties to host and deliver our services, as well as access, collect, process, use, transmit and store data, and any interruptions or delays in these hosted services, or failures in data collection or transmission could expose us to liability and harm our business and reputation.***

Much of our business relies on hardware and services that are hosted, managed and controlled directly by Adobe or third-party service providers, including our online store at adobe.com, Creative Cloud, Document Cloud and Experience Cloud solutions. We do not have redundancy for all of our systems, many of our critical applications reside in only one of our data centers, and our disaster recovery planning may not account for all eventualities. If our business relationship with a third-party provider of hosting or content delivery services is negatively affected, or if one of our content delivery suppliers were to terminate its agreement with us, without adequate notice, we might not be able to deliver the corresponding hosted offerings to our customers, which could subject us to reputational harm, costly and time-intensive notification requirements, and cause us to lose customers and future business. In addition, the COVID-19 pandemic could potentially disrupt the supply chain of hardware needed to maintain these third-party systems and services or to run our business. Occasionally, we migrate data among data centers and to third-party hosted environments. If a transition among data centers or to third-party service providers encounters unexpected interruptions, unforeseen complexity, or unplanned disruptions despite precautions undertaken during the process, this may impair our delivery of products and services to customers and result in increased costs and liabilities, which may harm our operating results and our business.

It is also possible that hardware or software failures or errors in our systems (or those of our third-party service providers) could result in data loss or corruption, cause the information that we collect or maintain to be incomplete or contain inaccuracies that our customers regard as significant, or cause us to fail to meet committed service levels or comply with regulatory notification requirements. Furthermore, our ability to collect and report data may be delayed or interrupted by a number of factors, including access to the Internet, the failure of our network or software systems, security breaches or significant variability in visitor traffic on customer websites. In addition, computer viruses, worms, or other malware may harm our systems, causing us to lose data, and the transmission of computer viruses or other malware could expose us to litigation or regulatory investigation, and costly and time-intensive notification requirements.

We may also find, on occasion, that we cannot deliver data and reports to our customers in near real time because of a number of factors, including significant spikes in customer activity on their websites or failures of our network or software, or the failure of our third-party service providers' network or software. If we fail to plan infrastructure capacity appropriately and expand it proportionally with the needs of our customer base, and we experience a rapid and significant demand on the capacity of our data centers or those of third parties, service outages could occur, and our customers could suffer impaired performance of our services. Such a strain on our infrastructure capacity could subject us to regulatory and customer notification requirements, violations of service level agreement commitments, financial liabilities, result in customer dissatisfaction, or harm our business. If we supply inaccurate information or experience interruptions in our ability to capture, store and supply information in near real time or at all, our reputation could be harmed and we could lose customers as a result, or we could be found liable for damages or incur other losses.

***Security vulnerabilities in our products and systems, or in our supply chain, could lead to reduced revenue or to liability claims.***

Maintaining the security of our products and services is a critical issue for us and our customers. Security threats to our information systems, end points and networks have the potential to impact our customers as well. Security researchers, criminal hackers and other third parties regularly develop new techniques to penetrate our end points, information systems and network security measures. And, as we have previously disclosed, certain unauthorized parties have in the past managed to gain access to and misuse some of our systems and software in order to access our end users' authentication, payment and personal information. In addition, cyber-attackers also develop and deploy viruses, worms, credential stuffing attack tools and other malicious software programs, some of which may be specifically designed to attack our products, services, information systems or networks. Hardware, software and operating system applications that we develop or procure from third parties may contain defects in design or manufacture, including bugs, vulnerabilities and other problems that could unexpectedly compromise the security of the system or impair a customer's ability to operate or use our products. The costs to prevent, eliminate, mitigate, or alleviate cyber- or other security problems, bugs, viruses, worms, malicious software programs and security vulnerabilities are significant, and our efforts to address these problems, including notifying affected parties, may not be successful or may be delayed and could result in interruptions, delays, cessation of service and loss of existing or potential customers. It is impossible to predict the extent, frequency or impact these problems may have on us.

Outside parties have in the past and may in the future attempt to fraudulently induce our employees or users of our products or services to disclose sensitive, personal, or confidential information via illegal electronic spamming, phishing or other tactics. This existing risk is potentially compounded given the COVID-19 pandemic and the resulting shift to work-from-home arrangements for a large population of employees and contractors. Unauthorized parties may also attempt to gain physical access to our facilities in order to infiltrate our information systems or attempt to gain logical access to our products, services, or information systems for the purpose of exfiltrating content and data. These actual and potential breaches of our security measures and the accidental loss, inadvertent disclosure or unauthorized dissemination of proprietary information or sensitive, personal or confidential data about us, our employees, our customers or their end users, including the potential loss or disclosure of such information or data as a result of hacking, fraud, trickery or other forms of deception, could expose us, our employees, our customers or the individuals affected to a risk of loss or misuse of this information. This may result in litigation and liability or fines, our compliance with costly and time-intensive notice requirements, governmental inquiry or oversight or a loss of customer confidence, any of which could harm our business or damage our brand and reputation, possibly impeding our present and future success in retaining and attracting new customers and thereby requiring time and resources to repair our brand and reputation. These risks will likely increase as we expand our hosted offerings, integrate our products and services and store and process more data, including personal information.

These problems affect our products and services in particular because cyber-attackers tend to focus their efforts on popular offerings with a large user base, and we expect them to continue to do so. Critical vulnerabilities may be identified in some of our applications and services and those of our third-party service providers. These vulnerabilities could cause such applications and services to crash and could allow an attacker to access our or our users' confidential or personal information or take control of the affected system, which could result in liability to us or limit our ability to conduct our business and deliver our products and services to customers. We devote significant resources to address security vulnerabilities through engineering more secure products, enhancing security and reliability features in our products and systems, code hardening, conducting rigorous penetration tests, deploying updates to address security vulnerabilities, reviewing our service providers' security controls, reviewing and auditing our hosted services against independent security control frameworks (such as ISO 27001, SOC 2 and PCI), and improving our incident response time, but these security vulnerabilities cannot be totally eliminated. The cost of these steps could reduce our operating margins, and we may be unable to implement these measures quickly enough to prevent cyber-attackers from gaining unauthorized access into our systems and products. Despite our preventative efforts, actual or perceived security vulnerabilities in our products and systems may harm our reputation or lead to claims against us (and have in the past led to such claims), and could lead some customers to stop using certain products or services, to reduce or delay future purchases of products or services, or to use competing products or services. If we do not make the appropriate level of investment in our technology systems or if our systems become out-of-date or obsolete and we are not able to deliver the quality of data security customers require, our business could be adversely affected. Customers may also adopt security measures designed to protect their existing computer systems from attack, which could delay adoption of new technologies. Further, if we, our supply chain, or our customers are subject to a future attack, or our technology is used in a third-party attack, we could be subject to costly and time-intensive notice requirements, and it may be necessary for us to take additional extraordinary measures and make additional expenditures to take appropriate responsive and preventative steps. Any of these events could adversely affect our revenue or margins. Moreover, delayed sales, lower margins or lost customers resulting from disruptions caused by cyber-attacks or preventative measures could adversely affect our financial results, stock price and reputation.

***Some of our enterprise offerings have extended and complex sales cycles, which can make our sales cycles unpredictable.***

Sales cycles for some of our enterprise offerings, including our Adobe Experience Cloud and Adobe Experience Platform solutions and Enterprise Term License Agreements ("ETLAs") in our Digital Media business, are multi-phased and complex. The complexity in these sales cycles is due to several factors, including:

- the need for our sales representatives to educate customers about the use and benefit of large-scale deployments of our products and services, including technical capabilities, security features, potential cost savings and return on investment;
- the desire of organizations to undertake significant evaluation processes to determine their technology requirements prior to making information technology expenditures;
- the need for our representatives to spend a significant amount of time assisting potential customers in their testing and evaluation of our products and services;
- intensifying competition within the industry;
- the negotiation of large, complex, enterprise-wide contracts;
- the need for our customers to obtain requisition approvals from various decision makers within their organizations due to the complexity of our solutions touching multiple departments within customers' organizations; and
- customer budget constraints, economic conditions and unplanned administrative delays.

We spend substantial time and expense on our sales efforts without assurance that potential customers will ultimately purchase our solutions. Further, restrictions in place for the COVID-19 pandemic have resulted and could continue to result in our inability to negotiate in person. As we target our sales efforts at larger enterprise customers, these trends are expected to continue and could have a greater impact on our results of operations. Additionally, our enterprise sales pattern has historically been uneven, where a higher percentage of a quarter's total sales occur during the final weeks of each quarter, which is common in our industry. Our extended sales cycle for these products and services makes it difficult to predict when a given sales cycle will close.

***If our customers fail to renew subscriptions in accordance with our expectations, our future revenue and operating results could suffer.***

Our Adobe Experience Cloud, Creative Cloud and Document Cloud offerings typically involve subscription-based offerings pursuant to product and service agreements. Revenue from our subscription customers is generally recognized ratably over the term of their agreements, which typically range from 1 to 36 months. Our customers have no obligation to renew their subscriptions for our services after the expiration of their initial subscription period, and customers may not renew their subscriptions at the same or higher level of service, for the same number of seats or for the same duration of time, if at all. Moreover, under certain circumstances, some of our customers have the right to cancel their agreements prior to the expiration of the terms. Our varied customer base combined with the flexibility we offer in the length of our subscription-based agreements complicates our ability to precisely forecast renewal rates. Therefore, we cannot provide assurance that we will be able to accurately predict future customer renewal rates.

Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their level of satisfaction with our services, our ability to continue enhancing features and functionality, the reliability (including uptime) of our subscription offerings, the prices of offerings and those offered by our competitors, the actual or perceived information security of our systems and services, decreases in the size of our customer base, reductions in our customers' spending levels or declines in customer activity as a result of economic downturns or uncertainty in financial markets, including as a result of the COVID-19 pandemic. If our customers do not renew their subscriptions or if they renew on terms less favorable to us, our revenue may decline.

***We face various risks associated with our operating as a multinational corporation.***

As a global business that generates approximately 42% of our total revenue from sales to customers outside of the Americas, we are subject to a number of risks, including:

- foreign currency fluctuations and controls;
- international and regional economic, political and labor conditions, including any instability or security concerns abroad, including uncertainty caused by the United Kingdom's exit from the European Union (Brexit) on January 31, 2020, including the effects of the Trade and Cooperation Agreement between the European Union, the European Atomic Energy Community and the United Kingdom signed on December 30, 2020, as well as uncertainty caused by the evolving relations between the United States and China;
- tax laws (including U.S. taxes on foreign subsidiaries);
- increased financial accounting and reporting burdens and complexities;
- changes in, or impositions of, legislative or regulatory requirements;
- changes in laws governing the free flow of data across international borders;
- failure of laws to protect our intellectual property rights adequately;
- inadequate local infrastructure and difficulties in managing and staffing international operations;
- delays resulting from difficulty in obtaining export licenses for certain technology, tariffs, quotas and other trade barriers;
- the imposition of governmental economic sanctions on countries in which we do business or where we plan to expand our business;
- costs and delays associated with developing products in multiple languages;
- operating in locations with a higher incidence of corruption and fraudulent business practices; and
- other factors beyond our control, such as terrorism, war, natural disasters and pandemics, including fluctuations in the severity and duration of the COVID-19 pandemic and resulting restrictions on business activity which may vary significantly by region.

Some of our third-party business partners have international operations and are also subject to these risks and if our third-party business partners are unable to appropriately manage these risks, our business may be harmed. If sales to any of our customers outside of the Americas are reduced, delayed or canceled because of any of the above factors, our revenue may decline.

***Our business could be harmed if we fail to effectively manage critical strategic third-party business relationships.***

As our offerings expand and our customer base grows, our relationships with strategic partners become increasingly valuable. If our contractual relationships with these third parties were to terminate, or if we were unable to renew on favorable terms, our business could be harmed. This is especially the case when the third party's offerings are integrated with our products and services, or where the third party's offerings are difficult to substitute or replace. Alternative arrangements for such products and services may not be available to us, or on commercially reasonable terms, and we may experience business interruptions upon a transition to an alternative partner. The failure of third parties to provide acceptable products and services or to update their technology, including during the COVID-19 pandemic, may result in a disruption to our business operations and those of our customers, which may reduce our revenues and profits, cause us to lose customers and damage our reputation.

We increasingly utilize the distribution platforms of third parties like Apple's App Store and Google's Play Store for the distribution of certain of our product offerings. Although we benefit from the strong brand recognition and large user base of these distribution platforms to attract new customers, the platform owners have wide discretion to change the pricing structure, terms of service and other policies with respect to us and other developers, and may offer or promote products that compete with our product offerings. Adverse changes by these third parties could adversely affect our financial results.

***Failure of our third-party customer service and technical support providers to adequately address customers' requests could harm our business and adversely affect our financial results.***

Our customers rely on our customer service support organization to resolve issues with our products and services. We outsource a substantial portion of our customer service and technical support activities to third-party service providers. We depend heavily on these third-party customer service and technical support representatives working on our behalf, and we expect to continue to rely heavily on third parties in the future. This strategy presents risks to our business due to the fact that we may not be able to influence the quality of support as directly as we would be able to do if our own employees performed these activities. Our customers may react negatively to providing information to, and receiving support from, third-party organizations, especially if these third-party organizations are based overseas. If we encounter problems with our third-party customer service and technical support providers, our reputation may be harmed, our ability to sell our offerings could be adversely affected, and we could lose customers and associated revenue.

***If we are unable to recruit and retain key personnel, our business may be harmed.***

Much of our future success depends on the continued service, availability and performance of our senior management. These individuals have acquired specialized knowledge and skills with respect to Adobe. The loss of any of these individuals could harm our business, especially if we have not been successful in developing adequate succession plans. Our business is also dependent on our ability to retain, hire and motivate talented, highly skilled personnel across all levels of our organization. Our efforts to attract, develop, integrate and retain highly skilled employees with appropriate qualifications may be compounded by intensified restrictions on travel (including during the COVID-19 pandemic), immigration, or the availability of work visas. Experienced personnel in the information technology industry are in high demand and competition for their talents is intense in many areas where our employees are located. We may experience higher compensation costs to retain senior management and experienced personnel that may not be offset by improved productivity or increased sales. If we are unable to continue to successfully attract and retain key personnel, our business may be harmed.

We continue to hire personnel in countries where exceptional technical knowledge and other expertise are offered at lower costs, which increases the efficiency of our global workforce structure and reduces our personnel related expenditures. Nonetheless, as globalization continues, competition for these employees in these countries has increased, which may impact our ability to retain these employees and increase our expenses resulting from competitive compensation. We may continue to expand our international operations and international sales and marketing activities, which would require significant management attention and resources. We may be unable to scale our infrastructure effectively or as quickly as our competitors in these markets, and our revenue may not increase to offset these expected increases in costs and operating expenses, causing our results to suffer.

We believe that a critical contributor to our success to date has been our corporate culture, which we have built to foster innovation, teamwork and employee satisfaction. As we grow, including from the integration of employees and businesses acquired in connection with previous or future acquisitions, we may find it difficult to maintain important aspects of our corporate culture, which could negatively affect our ability to retain and recruit personnel who are essential to our future success.

***Failure to manage our sales, partner and distribution channels effectively could result in a loss of revenue and harm to our business.***

We contract with a number of software distributors and other strategic partners, none of which are individually responsible for a material amount of our total net revenue for any recent period. Nonetheless, if any single agreement with one of our distributors were terminated, any prolonged delay in securing a replacement distributor could have a negative impact on our results of operations.

Successfully managing our indirect distribution channel efforts to reach various customer segments for our products and services is a complex process across the broad range of geographies where we do business or plan to do business. Our distributors and other channel partners are independent businesses that we do not control. Notwithstanding the independence of our channel partners, we face legal risk and potential reputational harm from the activities of these third parties including, but not limited to, export control violations, workplace conditions, corruption and anti-competitive behavior.

We cannot be certain that our distribution channel will continue to market or sell our products and services effectively. If our partner and distribution channels are not successful, we may lose sales opportunities, customers and revenue. Our distributors also sell our competitors' products and services, and if they favor our competitors' products or services for any reason, they may fail to market our products or services effectively or to devote resources necessary to provide effective sales, which would cause our results to suffer. We also distribute some products and services through our OEM channel, and if our OEMs decide not to bundle our applications on their devices, our results could suffer. In addition, the financial health of our distributors and partners and our continuing relationships with them are important to our success. Some of these distributors and partners may be unable to withstand adverse changes in economic conditions, which could result in insolvency, the inability of such distributors and partners to obtain credit to finance access to or purchases of our products and services, or a delay in paying their obligations to us.

We also sell some of our products and services through our direct sales force. Risks associated with this sales channel include more extended sales and collection cycles associated with direct sales efforts, challenges related to hiring, retaining and motivating our direct sales force, and substantial amounts of ongoing training for sales representatives. Moreover, recent hires may not become as productive as we would like, as in most cases it takes a significant period of time before they achieve full productivity. Our business could be seriously harmed if our expansion efforts do not generate a corresponding significant increase in revenue and we are unable to achieve the efficiencies we anticipate. In addition, the loss of key sales employees could impact our customer relationships and future ability to sell to certain accounts covered by such employees.

***Catastrophic events may disrupt our business.***

We are a highly automated business and rely on our network infrastructure and enterprise applications, internal technology systems and website for our development, marketing, operations, support, hosted services and sales activities. In addition, some of our businesses rely on third-party hosted services, and we do not control the operation of third-party data center facilities serving our customers from around the world, which increases our vulnerability. A disruption, infiltration or failure of these systems or third-party hosted services in the event of a major earthquake, fire, flood, tsunami or other weather event, power loss, telecommunications failure, software or hardware malfunctions, pandemics (including the COVID-19 pandemic), cyber-attack, war, terrorist attack or other catastrophic event that our disaster recovery plans do not adequately address, could cause system interruptions, reputational harm, loss of intellectual property, delays in our product development, lengthy interruptions in our services, breaches of data security and loss of critical data. Any of these events could prevent us from fulfilling our customers' orders or could negatively impact a country or region in which we sell our products, which could in turn decrease that country's or region's demand for our products. Our corporate headquarters, a significant portion of our research and development activities, certain of our data centers and certain other critical business operations are located in the San Francisco Bay Area, and additional facilities where we conduct significant operations are located in the Salt Lake Valley Area, both of which are near major earthquake faults. A catastrophic event that results in the destruction or disruption of any of our data centers or our critical business or information technology systems could severely affect our ability to conduct normal business operations and, as a result, our future operating results could be adversely affected, and the adverse effects of any such catastrophic event would be exacerbated if experienced at the same time as another unexpected and adverse event, such as the COVID-19 pandemic. For example, wildfires have resulted in power shut-offs in California and are likely to occur in the future, and this could adversely affect the work-from-home operations of our employees on the west coast.

***Climate change may have a long-term impact on our business.***

While we seek to partner with organizations that mitigate their business risks associated with climate change, we recognize that there are inherent risks wherever business is conducted. Access to clean water and reliable energy in the communities where we conduct our business, whether for our offices or for our vendors, is a priority. Our major sites in California, Utah and India are vulnerable to climate change effects. For example, in California, increasing intensity of drought throughout the state and annual periods of wildfire danger increase the probability of planned power outages in the communities where we work and live. While this danger has a low-assessed risk of disrupting normal business operations, it has the potential impact on employees' abilities to commute to work or to work from home and stay connected effectively due to COVID-19 in 2020. Climate-related events, including the increasing frequency of extreme weather events and their impact on U.S., India and other major regions' critical infrastructure, have the potential to disrupt our business, our third-party suppliers, and/or the business of our customers, and may cause us to experience higher attrition, losses, and additional costs to maintain or resume operations. To accurately assess and take potential proactive action as appropriate, Adobe is aligned with the guidelines of the Financial Stability Board's Task Force on Climate-related Financial Disclosures recommendations and the Sustainability Accounting Standards Board environmental metrics.

**Risks Related to Laws and Regulations**

***We are subject to risks associated with compliance with laws and regulations globally, which may harm our business.***

We are a global company subject to varied and complex laws, regulations and customs, both domestically and internationally. These laws and regulations relate to a number of aspects of our business, including trade protection, import and export control, data and transaction processing security, payment card industry data security standards, records management, user-generated content hosted on websites we operate, privacy practices, data residency, corporate governance, anti-trust and competition, employee and third-party complaints, anti-corruption, gift policies, conflicts of interest, securities regulations and other regulatory requirements affecting trade and investment. The application of these laws and regulations to our business is often unclear and may at times conflict. For example, in many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by U.S. regulations applicable to us, including the Foreign Corrupt Practices Act. We cannot provide assurance that our employees, contractors, agents and business partners will not take actions in violation of our internal policies or U.S. laws. Compliance with these laws and regulations may involve significant costs or require changes in our business practices that result in reduced revenue and profitability. Non-compliance could also result in fines, damages, criminal sanctions against us, our officers or our employees, prohibitions on the conduct of our business, and damage to our reputation. In response to the COVID-19 pandemic, federal, state, local and foreign governmental authorities have imposed, and may continue to impose, protocols and restrictions intended to contain the spread of the virus, including limitations on the size of gatherings, closures of work facilities, schools, public buildings and businesses, quarantines, lockdowns and travel restrictions. Such restrictions have disrupted and may continue to disrupt our business operations and limit our ability to perform critical functions.

In addition, approximately 48% of our employees are located outside the United States. Accordingly, we are exposed to changes in laws governing our employee relationships in various U.S. and foreign jurisdictions, including laws and regulations regarding wage and hour requirements, fair labor standards, employee data privacy, unemployment tax rates, workers' compensation rates, citizenship requirements and payroll and other taxes, which likely would have a direct impact on our operating costs.

***Increasing regulatory focus on privacy and security issues and expanding laws could impact our business models and expose us to increased liability.***

As a global company, Adobe is subject to global data privacy and security laws, regulations and codes of conduct that apply to our various business units. These laws and regulations may be inconsistent across jurisdictions and are subject to evolving and differing (sometimes conflicting) interpretations. Government officials and regulators, privacy advocates and class action attorneys are increasingly scrutinizing how companies collect, process, use, store, share and transmit personal data. This increased scrutiny may result in new interpretations of existing laws, thereby further impacting Adobe's business. Globally, new and emerging laws, such as the General Data Protection Regulation ("GDPR") and the Network and Information Systems Directive ("NISD") in Europe, state laws in the U.S. on privacy, data and related technologies, such as the California Consumer Privacy Act and the recently passed California Privacy Rights Act, as well as industry self-regulatory codes create new compliance obligations and expand the scope of potential liability, either jointly or severally with our customers and suppliers. While we have invested in readiness to comply with applicable requirements, these new and emerging laws, regulations and codes may affect our ability (and our enterprise customers' ability) to reach current and prospective customers, to respond to both enterprise and individual customer requests under the laws (such as individual rights of access, correction and deletion of their personal information), and to implement our business models effectively.

These new laws may also impact our innovation and business drivers in developing new and emerging technologies (e.g., artificial intelligence and machine learning). These requirements, among others, may impact demand for our offerings and force us to bear the burden of more onerous obligations in our contracts. Any perception of our practices, products or services as a violation of individual privacy rights may subject us to public criticism, class action lawsuits, reputational harm, or investigations or claims by regulators, industry groups or other third parties, all of which could disrupt our business and expose us to increased liability. Additionally, we collect and store information on behalf of our business customers and if our customers fail to comply with contractual obligations or applicable laws, it could result in litigation or reputational harm to us.

Transferring personal information across international borders is complex and subject to legal and regulatory requirements as well as active litigation and enforcement in a number of jurisdictions around the world, each of which could have an adverse impact to our ability to process and transfer personal data as part of our business operations. For example, European data transfers outside the European Economic Area are highly regulated and litigated. The mechanisms that we and many other companies rely upon for European data transfers (e.g., Privacy Shield and Model Clauses) are the subject of recent judicial decisions by the Court of Justice of the European Union resulting in the invalidation of Privacy Shield. We are closely monitoring the impact of the Privacy Shield invalidation and other developments related to the remaining valid transfer mechanisms available for transferring personal data outside the European Union and other countries that have similar trans-border data flow requirements and adjusting our practices accordingly. The invalidation of Privacy Shield and the open questions related to the validity of Model Clauses have resulted in some changes in the obligations required to provide our services in the European Union and could expose us to potential sanctions and fines for non-compliance. Several other countries, including Australia, New Zealand, Brazil, and Japan, have also established specific legal requirements for cross-border transfers of personal information. Other countries, such as India, are considering requirements for data localization (e.g., where personal data must remain in the country). If other countries implement more restrictive regulations for cross-border data transfers (or do not permit data to leave the country of origin), such developments could impact our business, financial condition and results of operations, in those jurisdictions.

***Our intellectual property portfolio is a valuable asset and we may not be able to protect our intellectual property rights, including our source code, from infringement or unauthorized copying, use or disclosure.***

Our intellectual property portfolio is a valuable asset. Infringement or misappropriation of our patents, trademarks, trade secrets, copyrights and other intellectual property rights could result in lost revenues and ultimately reduce their value. Preventing unauthorized use or infringement of our intellectual property rights is inherently difficult. We actively combat software piracy as we enforce our intellectual property rights, but we nonetheless lose significant revenue due to illegal use of our software. If piracy activities continue at historical levels or increase, they may further harm our business. We apply for patents in the U.S. and internationally to protect our newly created technology and if we are unable to obtain patent protection for the technology described in our pending patent, or if the patent is not obtained timely, this could result in revenue loss, adverse effects on operations and harm to our business. We offer our products and services in foreign countries and we may seek intellectual property protection from those foreign legal systems. Some of those foreign countries may not have as robust or comprehensive of intellectual property protection laws and schemes as those offered in the U.S. In some foreign countries, the mechanisms to enforce intellectual property rights may be inadequate to protect our technology, which could harm our business.

If unauthorized disclosure of our source code occurs through security breach, cyber-attack or otherwise, we could lose future trade secret protection for that source code. The loss of future trade secret protection could make it easier for third parties to compete with our products by copying functionality, which could cause us to lose customers and could adversely affect our revenue and operating margins. We also seek to protect our confidential information and trade secrets through the use of non-disclosure agreements with our customers, contractors, vendors and partners. However, there is a risk that our confidential information and trade secrets may be disclosed or published without our authorization, and in these situations, enforcing our rights may be difficult or costly.

***We may incur substantial costs defending against third parties alleging that we infringe their proprietary rights.***

We have been, are currently, and may in the future be, subject to claims, negotiations and complex, protracted litigation relating to disputes regarding the validity or alleged infringement of third-party intellectual property rights, including patent rights. Intellectual property disputes and litigation are typically costly and can be disruptive to our business operations by diverting the attention of management and key personnel. We may not prevail in every lawsuit or dispute. Third-party intellectual property disputes, including those initiated by patent assertion entities, could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from licensing certain of our products or offering certain of our services, subject us to injunctions restricting our sale of products or services, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers, including contractual provisions under various license arrangements and service agreements. In addition, we may incur significant costs in acquiring the necessary third-party intellectual property rights for use in our products, in some cases to fulfill contractual obligations with our customers. Any of these occurrences could significantly harm our business.

***Changes in accounting principles, or interpretations thereof, could have a significant impact on our financial position and results of operations.***

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP"). These principles are subject to interpretation by the SEC and various bodies formed to interpret and create appropriate accounting principles. A change in these principles, how the principles are interpreted, or the adoption of new accounting standards can have a significant effect on our reported results, and could even retroactively affect previously reported transactions, and may require that we make significant changes to our systems, processes and controls.

Changes resulting from these new standards may result in materially different financial results and may require that we change how we process, analyze and report financial information and that we change financial reporting controls. *For additional information regarding these new standards, see the section titled "Recent Accounting Pronouncements Not Yet Effective" within Part II, Item 8, Note 1. Basis of Presentation and Summary of Significant Accounting Policies.*

Such changes in accounting principles may have an adverse effect on our business, financial position and income, or cause an adverse deviation from our revenue and profitability targets, which may negatively impact our financial results.

***Changes in tax rules and regulations, or interpretations thereof, may adversely affect our effective tax rates.***

We are a United States-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. A significant portion of our foreign earnings for the current fiscal year were earned by our Irish subsidiaries. The U.S. Tax Cuts and Jobs Act ("U.S. Tax Act"), enacted into law on December 22, 2017, changed existing U.S. tax law applicable to us and included certain international provisions effective for us starting in fiscal 2019. Among other considerations, the applicability and impact of these new tax provisions, and of other international tax law changes could adversely affect our effective income tax rate and cash flows in years beyond fiscal 2020. *See the section titled "Provision for (Benefit from) Income Taxes" within Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.*

Our income tax expense has differed from the tax computed at the U.S. federal statutory income tax rate due primarily to discrete items including, but not limited to, the effects of tax credits, net tax benefits from trading structure changes, tax benefits from stock-based compensation and settlements of tax examinations, and to net tax on earnings from foreign operations. Unanticipated changes in our tax rates could affect our future results of operations. Our future effective tax rates are likely to be unfavorably affected by changes in the tax rates in jurisdictions where our income is earned, the geographic mix of earnings, our repatriation policy or the valuation of our deferred tax assets and liabilities, by changes in or our interpretation of tax rules and regulations in the jurisdictions in which we do business, or by unexpected negative changes in business and market conditions that could reduce certain tax benefits.

In addition, in countries where we conduct business and in jurisdictions in which we are subject to tax, including those covered by governing bodies that enact tax laws applicable to us, such as the European Commission of the European Union, we are subject to potential changes in relevant tax, accounting and other laws, regulations and interpretations, including changes to tax laws applicable to corporate multinationals such as Adobe. These countries, other governmental bodies and intergovernmental economic organizations such as the Organization for Economic Cooperation and Development, have or could make unprecedented assertions about how taxation is determined in their jurisdictions that are contrary to the way in which we have interpreted and historically applied the rules and regulations described above in such jurisdictions. In the current global tax policy environment, any changes in laws, regulations and interpretations related to these assertions could adversely affect our effective tax rates, cause us to respond by making changes to our business structure, or result in other costs to us which could adversely affect our operations and financial results.

Moreover, we are subject to the continual examination of our income tax returns by the U.S. Internal Revenue Service and other domestic and foreign tax authorities. These tax examinations are expected to focus on our intercompany transfer pricing practices, application of tax rules and other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from these examinations. We cannot provide assurance that the final determination of any of these examinations will not have an adverse effect on our operating results and financial position.

***Contracting with government entities exposes us to additional risks inherent in the government procurement process.***

We provide products and services, directly and indirectly, to a variety of government entities, both domestically and internationally. Risks associated with licensing and selling products and services to government entities include more extended sales and collection cycles, varying governmental budgeting processes and adherence to complex procurement regulations and other government-specific contractual requirements. We may be subject to audits and investigations relating to our government contracts and any violations could result in various civil and criminal penalties and administrative sanctions, including termination of contracts, payment of fines, and suspension or debarment from future government business, as well as harm to our reputation and financial results.

**Risks Related to Financial Performance or General Economic Conditions**

***Uncertainty about current and future economic conditions and other adverse changes in general political conditions in any of the major countries in which we do business could adversely affect our operating results.***

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in economic and political conditions, both domestically and globally, including trends toward protectionism and nationalism, uncertainty caused by the United Kingdom’s exit from the European Union (Brexit), and other events beyond our control, such as the COVID-19 pandemic. Additionally, the business downturn caused by the pandemic may adversely impact the businesses and financial health of many of our customers and hurt their creditworthiness (e.g., international travel bans impacting customers in the travel and hospitality industries). As a result, current or potential customers may be unable to fund software purchases, which could cause them to delay, decrease or cancel purchases of our products and services. Uncertainty about the effects of current and future economic and political conditions on us, our customers, suppliers and partners makes it difficult for us to forecast operating results and to make decisions about future investments. If economic growth in countries where we do business slows, customers may delay or reduce technology purchases, advertising spending or marketing spending, and we have already experienced and may continue to experience the impact of a global decline in advertising spend as the pandemic continues to unfold. This could result in reductions in sales of our products and services, more extended sales cycles, slower adoption of new technologies and increased price competition. Among our customers are government entities, including the U.S. federal government, and our revenue could decline if spending cuts impact the government’s ability to purchase our products and services. Deterioration in economic conditions in any of the countries in which we do business could also cause slower or impaired collections on accounts receivable, which may adversely impact our liquidity and financial condition.

A disruption in financial markets could impair our banking partners, on which we rely for operating cash management and affect our derivative counterparties. Any of these events would likely harm our business, financial condition and results of operations.

Political instability or adverse political developments in or around any of the major countries in which we do business would also likely harm our business, financial condition and results of operations.

***Subscription offerings could create risks related to the timing of revenue recognition.***

We generally recognize revenue from subscription offerings ratably over the terms of their subscription agreements, which typically range from 1 to 36 months. As a result, most of the subscription revenue we report in each quarter is the result of subscription agreements entered into during previous quarters. Any reduction in new or renewed subscriptions in a quarter may not be reflected in our revenue results until a later quarter. Declines in new or renewed subscriptions may decrease our revenue in future quarters. Lower sales, reduced demand for our products and services, and increases in our attrition rate may not be fully reflected in our results of operations until future periods. Our subscription model could also make it difficult for us to rapidly increase our revenue from subscription-based or hosted services through additional sales in any period, as revenue from new customers will be recognized over the applicable subscription term.

Additionally, in connection with our sales efforts to enterprise customers and our use of ETLAs, a number of factors could affect our revenue, including longer-than-expected sales and implementation cycles, potential deferral of revenue and alternative licensing arrangements. If any of our assumptions about revenue from our subscription-based offerings prove incorrect, our actual results may vary materially from those anticipated.

***We may incur losses associated with currency fluctuations and may not be able to effectively hedge our exposure.***

Our operating results are subject to fluctuations in foreign currency exchange rates due to the global scope of our business. Global economic events, including trade disputes, economic sanctions and emerging market volatility, and associated uncertainty may cause currencies to fluctuate, and the impact of the COVID-19 pandemic may introduce further volatility. We attempt to mitigate a portion of these risks through foreign currency hedging based on our judgment of the appropriate trade-offs among risk, opportunity and expense. We regularly review our program to partially hedge our exposure to foreign currency fluctuations and make adjustments as necessary. Our hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movement in foreign currency exchange rates, which could adversely affect our financial condition or results of operations.

***Revenue, margin or earnings shortfalls or the volatility of the market generally may cause the market price of our stock to decline.***

In the past, the market price for our common stock experienced significant fluctuations and it may do so in the future. A number of factors may affect the market price for our common stock, such as:

- shortfalls in, or changes in expectations about, our revenue, margins, earnings, Annualized Recurring Revenue ("ARR"), sales of our Digital Experience offerings, or other key performance metrics;
- changes in estimates or recommendations by securities analysts;
- whether our results meet analysts' expectations;
- compression or expansion of multiples used by investors and analysts to value high technology SaaS companies;
- the announcement of new products or services, product enhancements, service introductions, strategic alliances or significant agreements by us or our competitors;
- the loss of large customers or our inability to increase sales to existing customers, retain customers or attract new customers;
- recruitment or departure of key personnel;
- variations in our or our competitors' results of operations, changes in the competitive landscape generally and developments in our industry;
- general socio-economic, political or market conditions;
- macroeconomic conditions and the economic impact of the COVID-19 pandemic; and
- unusual events such as significant acquisitions by us or our competitors, divestitures, litigation, regulatory actions and other factors, including factors unrelated to our operating performance.

In addition, the market for technology stocks or the stock market in general may experience uneven investor confidence, which may cause the market price for our common stock to decline for reasons unrelated to our operating performance. Volatility in the market price of a company's securities for a period of time may increase the company's susceptibility to securities class action litigation. Oftentimes, this type of litigation is expensive and diverts management's attention and resources which may adversely affect our business.

***If our goodwill or amortizable intangible assets become impaired, then we could be required to record a significant charge to earnings.***

GAAP requires us to test for goodwill impairment at least annually. In addition, we review our goodwill and amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable include declines in stock price, market capitalization or cash flows, and slower growth rates in our industry. Depending on the results of our review, we could be required to record a significant charge to earnings in our consolidated financial statements during the period in which any impairment of our goodwill or amortizable intangible assets were determined, negatively impacting our results of operations.

***We have issued $4.15 billion of notes in debt offerings and may incur other debt in the future, which may adversely affect our financial condition and future financial results.***

We have $4.15 billion in senior unsecured notes and a $1 billion senior unsecured revolving credit agreement, which is currently undrawn. This debt may adversely affect our financial condition and future financial results by, among other things:

- increasing our vulnerability to adverse changes in general economic and industry conditions;

- requiring the dedication of a portion of our expected cash flows from operations to service our debt, thereby reducing the amount of expected cash flows available for other purposes, including capital expenditures and acquisitions; and
- limiting our flexibility in planning for, or reacting to, changes in our business and our industry.

Our senior unsecured notes and senior unsecured credit agreement imposes restrictions on us and require us to maintain compliance with specified covenants. Our ability to comply with these covenants may be affected by events beyond our control. If we breach any of the covenants and do not obtain a waiver from the noteholders or lenders, then, subject to applicable cure periods, any outstanding debt may be declared immediately due and payable.

In addition, changes by any rating agency to our credit rating may negatively impact the value and liquidity of both our debt and equity securities, as well as the potential costs associated with a refinancing of our debt. Under certain circumstances, if our credit ratings are downgraded or other negative action is taken, the interest rate payable by us under our revolving credit facility could increase. Downgrades in our credit ratings could also affect the terms of any such financing and restrict our ability to obtain additional financing in the future.

***Our investment portfolio may become impaired by deterioration of the financial markets.***

Our cash equivalent and short-term investment portfolio as of November 27, 2020 consisted of asset-backed securities, corporate debt securities, foreign government securities, money market mutual funds, municipal securities and time deposits. We follow an established investment policy and set of guidelines to monitor and help mitigate our exposure to interest rate and credit risk. The policy sets forth credit quality standards and limits our exposure to any one issuer, as well as our maximum exposure to various asset classes.

Should financial market conditions worsen in the future, including from impacts of the COVID-19 pandemic, investments in some financial instruments may pose risks arising from market liquidity and credit concerns. In addition, any deterioration of the capital markets could cause our other income and expense to vary from expectations. As of November 27, 2020, we had no material impairment charges associated with our short-term investment portfolio, and although we believe our current investment portfolio has little risk of material impairment, we cannot predict future market conditions, market liquidity or credit availability, and can provide no assurance that our investment portfolio will remain materially unimpaired.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

## ITEM 2. PROPERTIES

Our corporate headquarters is located in San Jose, California where we occupy approximately 1.1 million square feet of office space. We own a substantial portion of our San Jose, California properties which we use for research, product development, sales, marketing, and administrative purposes. We own and lease properties in various locations throughout the United States which we also use for research, product development, sales, marketing, and administrative purposes, and data centers.

Outside of the United States, we own and lease properties throughout EMEA and APAC for research, product development, sales, and administrative purposes. The largest properties we occupy outside of the United States are the Bangalore, India and Noida, India offices which are approximately 0.4 million and 0.6 million square feet, respectively. We own and lease these properties in India.

Additionally, we have ongoing building construction in San Jose, California and Bangalore, India which are currently targeted for completion in fiscal 2023.

Beginning in March 2020, our employees across all geographic regions have shifted to working from home due to the pandemic. Our focus remains on promoting employee health and safety as we carefully evaluate reopening plans and timelines. As of November 27, 2020, we have not terminated any significant lease arrangements. We believe our facilities, with an average overall operating capacity of approximately 89% prior to our shift to working from home, are suitable for the conduct of our business should we decide to reopen our facilities in the next twelve months.

*See Note 18 of Part II, Item 8 titled "Notes to Consolidated Financial Statements" for further information regarding our lease obligations.*

## ITEM 3. LEGAL PROCEEDINGS

In connection with disputes relating to the validity or alleged infringement of third-party intellectual property rights, including patent rights, we have been, are currently and may in the future be subject to claims, negotiations or complex, protracted litigation. Intellectual property disputes and litigation may be very costly and can be disruptive to our business operations by diverting the attention and energies of management and key technical personnel. Although we have successfully defended or resolved past litigation and disputes, we may not prevail in any ongoing or future litigation and disputes. Third-party intellectual property disputes could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from licensing certain of our products or offering certain of our services, subject us to injunctions restricting our sale of products or services, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers including contractual provisions under various license arrangements and service agreements.

In addition to intellectual property disputes, we are subject to legal proceedings, claims and investigations in the ordinary course of business, including claims relating to commercial, employment and other matters. Some of these disputes and legal proceedings may include speculative claims for substantial or indeterminate amounts of damages. We consider all claims on a quarterly basis in accordance with GAAP and, based on known facts, assess whether potential losses are considered reasonably possible or probable and estimable. Based upon this assessment, we then evaluate disclosure requirements and whether to accrue for such claims in our financial statements. This determination is then reviewed and discussed with the Audit Committee of the Board of Directors.

We make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Unless otherwise specifically disclosed in our Consolidated Financial Statements and notes thereto, we have determined that no provision for liability or disclosure is required related to any claim against us because: (a) there is not a reasonable possibility that a loss exceeding amounts already recognized (if any) may be incurred with respect to such claim; (b) a reasonably possible loss or range of loss cannot be estimated; or (c) such estimate is immaterial.

All legal costs associated with litigation are expensed as incurred. Litigation is inherently unpredictable. However, we believe that we have valid defenses with respect to the legal matters pending against us. It is possible, nevertheless, that our consolidated financial position, cash flows or results of operations could be negatively affected by an unfavorable resolution of one or more of such proceedings, claims or investigations.

In connection with our piracy conversion efforts, conducted both internally and through organizations such as the Business Software Alliance, from time to time we undertake litigation against alleged copyright infringers. Such lawsuits may lead to counter-claims alleging improper use of litigation or violation of other laws. We believe we have valid defenses with respect to such counter-claims; however, it is possible that our consolidated financial position, cash flows or results of operations could be negatively affected in any particular period by the resolution of one or more of these counter-claims.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## PART II

## ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

*Market Information for Common Stock*

Our common stock is traded on the NASDAQ Global Select Market under the symbol “ADBE.”

*Stockholders*

According to the records of our transfer agent, there were 974 holders of record of our common stock on January 8, 2021. Because many of such shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

*Dividends*

We do not anticipate paying any cash dividends in the foreseeable future.

### Issuer Purchases of Equity Securities

Below is a summary of stock repurchases for the three months ended November 27, 2020. *See Note 14 of our Notes to Consolidated Financial Statements for information regarding our stock repurchase programs.*

| Period | Total Number of Shares Repurchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans |
|---|---|---|---|
| | (in millions, except average price per s | | |
| Beginning repurchase authority[1] | | | |
| August 29 — September 25, 2020 | | | |
| Shares repurchased | 0.3 | $ 490.89 | 0. |
| September 26 — October 23, 2020 | | | |
| Shares repurchased | 0.7 | $ 484.50 | 0. |
| October 24 — November 27, 2020 | | | |
| Shares repurchased | 0.6 | $ 471.53 | 0. |
| Total | 1.6 | | 1. |

(1) In May 2018, the Board of Directors granted authority to repurchase up to $8 billion in common stock through the end of fiscal 2021.

(2) In September 2020, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of $850 million. As of November 27, 2020, approximately $255 million of the prepayment remained under this agreement.

## ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data is derived from our Consolidated Financial Statements. As our historical operating results are not necessarily indicative of future operating results, this data should be read in conjunction with the Consolidated Financial Statements and notes thereto, and with Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

On November 30, 2019, the beginning of our fiscal year 2020, we adopted the Financial Accounting Standards Board's ("FASB") Accounting Standards Update ("ASU") No. 2016-02, Leases (Topic 842), using the alternative modified retrospective transition method provided in ASU 2018-11, Leases (Topic 842): Targeted Improvements. Similarly, on December 1, 2018, the beginning of our fiscal year 2019, we adopted the FASB's ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), using the modified retrospective method of transition. Financial information prior to the respective periods of adoption has not been restated and continues to be reported under the accounting standards in effect for those periods.

| *(in millions, except per share amounts and employee data)* | Fiscal Years | | | | |
|---|---|---|---|---|---|
| | **2020** | **2019** | **2018** | **2017** | **2016**[2] |
| Operations: | | | | | |
| Revenue | $ 12,868 | $ 11,171 | $ 9,030 | $ 7,302 | $ 5,854 |
| Gross profit | $ 11,146 | $ 9,498 | $ 7,835 | $ 6,291 | $ 5,035 |
| Income before income taxes | $ 4,176 | $ 3,205 | $ 2,794 | $ 2,138 | $ 1,435 |
| Net income | $ 5,260 | $ 2,951 | $ 2,591 | $ 1,694 | $ 1,169 |
| Net income per share: | | | | | |
| Basic | $ 10.94 | $ 6.07 | $ 5.28 | $ 3.43 | $ 2.35 |
| Diluted | $ 10.83 | $ 6.00 | $ 5.20 | $ 3.38 | $ 2.32 |
| Shares used to compute basic net income per share | 481 | 486 | 491 | 494 | 498 |
| Shares used to compute diluted net income per share | 485 | 492 | 498 | 501 | 504 |
| Financial position: | | | | | |
| Cash, cash equivalents and short-term investments | $ 5,992 | $ 4,177 | $ 3,229 | $ 5,820 | $ 4,761 |
| Working capital[1] | $ 2,634 | $ (1,696) | $ 556 | $ 3,720 | $ 3,028 |
| Total assets | $ 24,284 | $ 20,762 | $ 18,769 | $ 14,536 | $ 12,697 |
| Debt, current | $ — | $ 3,149 | $ — | $ — | $ — |
| Debt, non-current | $ 4,117 | $ 989 | $ 4,125 | $ 1,881 | $ 1,892 |
| Stockholders' equity | $ 13,264 | $ 10,530 | $ 9,362 | $ 8,460 | $ 7,425 |
| Additional data: | | | | | |
| Worldwide employees | 22,516 | 22,634 | 21,357 | 17,973 | 15,706 |

(1) As of November 29, 2019, working capital was in a deficit primarily due to the reclassification of our $2.25 billion term loan due April 30, 2020 and $900 million 4.75% senior notes due February 1, 2020 to current liabilities. We subsequently refinanced our Term Loan and 2020 Notes in February 2020, before the respective due dates.

(2) Our fiscal year is a 52- or 53-week year that ends on the Friday closest to November 30. Fiscal 2016 was a 53-week fiscal year compared with the other periods presented which were 52-week fiscal years.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion should be read in conjunction with our Consolidated Financial Statements and Notes thereto. Discussion regarding our financial condition and results of operations for fiscal 2019 as compared to fiscal 2018 is included in Item 7 of our Annual Report on Form 10-K for the fiscal year ended November 29, 2019, filed with the SEC on January 21, 2020.*

### ACQUISITIONS

Subsequent to November 27, 2020, we completed our acquisition of Workfront, a privately held company that provides a work management platform for marketers, for approximately $1.5 billion in cash consideration. Workfront will be integrated into our Digital Experience reportable segment for financial reporting purposes in the first quarter of fiscal 2021.

During fiscal 2019, we acquired the remaining interest in Allegorithmic SAS ("Allegorithmic"), a privately held 3D editing and authoring software company for gaming and entertainment, for approximately $106 million in cash consideration, and integrated it into our Digital Media reportable segment.

During fiscal 2018, we completed our acquisitions of Marketo, a privately held marketing cloud platform company, for approximately $4.73 billion and Magento, a privately held commerce platform company, for approximately $1.64 billion, and integrated them into our Digital Experience reportable segment.

We also completed other immaterial business acquisitions during the fiscal years presented.

*See Note 3 of our Notes to Consolidated Financial Statements for further information regarding these acquisitions, including pro forma financial information related to the Marketo acquisition.* Pro forma information has not been presented for our other acquisitions during the fiscal years presented as the impact to our Consolidated Financial Statements was not material.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

In preparing our Consolidated Financial Statements in accordance with GAAP and pursuant to the rules and regulations of the SEC, we make assumptions, judgments and estimates that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosures of contingent assets and liabilities. We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. We evaluate our assumptions, judgments and estimates on a regular basis. We also discuss our critical accounting policies and estimates with the Audit Committee of the Board of Directors.

We believe that the assumptions, judgments and estimates involved in the accounting for revenue recognition, business combinations and income taxes have the greatest potential impact on our Consolidated Financial Statements. These areas are key components of our results of operations and are based on complex rules requiring us to make judgments and estimates, and consequently, we consider these to be our critical accounting policies. Historically, our assumptions, judgments and estimates relative to our critical accounting policies have not differed materially from actual results.

#### Revenue Recognition

Our contracts with customers may include multiple goods and services. For example, some of our offerings include both on-premise and/or on-device software licenses and cloud services. Determining whether the software licenses and the cloud services are distinct from each other, and therefore performance obligations to be accounted for separately, or not distinct from each other, and therefore part of a single performance obligation, may require significant judgment. We have concluded that the on-premise/on-device software licenses and cloud services provided in our Creative Cloud and Document Cloud subscription offerings are not distinct from each other such that revenue from each offering should be recognized ratably over the subscription period for which the cloud services are provided. In reaching this conclusion, we considered the nature of our promise to Creative Cloud and Document Cloud customers, which is to provide a complete end-to-end creative design or document workflow solution that operates seamlessly across multiple devices and teams. We fulfill this promise by providing access to a solution that integrates cloud-based and on-premise/on-device features that, together through their integration, provide functionalities, utility and workflow efficiencies that could not be obtained from either the on-premise/on-device software or cloud services on their own.

Cloud-based features that are integral to our Creative Cloud and Document Cloud offerings and that work together with the on-premise/on-device software include, but are not limited to: Creative Cloud Libraries, which enable customers to access their work, settings, preferences and other assets seamlessly across desktop and mobile devices and collaborate across teams in real time; shared reviews which enable simultaneous editing and commenting of PDFs across desktop, mobile and web; automatic cloud rendering of a design which enables it to be worked on in multiple mediums; and Sensei, Adobe’s cloud-hosted artificial intelligence and machine learning framework, which enables features such as automated photo-editing, photograph content-awareness, natural language processing, optical character recognition and automated document tagging.

**Business Combinations**

We allocate the purchase price of acquired companies to tangible and intangible assets acquired and liabilities assumed based upon their estimated fair values at the acquisition date. The purchase price allocation process requires management to make significant estimates and assumptions with respect to intangible assets and deferred revenue obligations. Although we believe the assumptions and estimates we have made are reasonable, they are based in part on historical experience, market conditions and information obtained from management of the acquired companies and are inherently uncertain. Examples of critical estimates in valuing certain of the intangible assets we have acquired or may acquire in the future include but are not limited to:

- future expected cash flows from software license sales, subscriptions, support agreements, consulting contracts and acquired developed technologies and patents;
- historical and expected customer attrition rates and anticipated growth in revenue from acquired customers;
- the acquired company’s trade name and trademarks as well as assumptions about the period of time the acquired trade name and trademarks will continue to be used in the combined company’s product portfolio;
- the expected use of the acquired assets; and
- discount rates.

In connection with the purchase price allocations for our acquisitions, we estimate the fair value of the deferred revenue obligations assumed. The estimated fair value of these obligations is determined utilizing a cost build-up approach. The cost build-up approach determines fair value by estimating the costs related to fulfilling the obligations plus a normal profit margin.

Unanticipated events and circumstances may occur which may affect the accuracy or validity of such assumptions, estimates or actual results.

**Accounting for Income Taxes**

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Management must make assumptions, judgments and estimates to determine our current provision for income taxes and also our deferred tax assets and liabilities.

Our assumptions, judgments and estimates relative to the current provision for income taxes take into account current tax laws, our interpretation of current tax laws and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. We have established reserves for income taxes to address potential exposures involving tax positions that could be challenged by tax authorities. In addition, we are subject to the continual examination of our income tax returns by the U.S. Internal Revenue Service and other domestic and foreign tax authorities. These tax examinations are expected to focus on our intercompany transfer pricing practices, application of tax rules, and other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from such examinations. We believe such estimates to be reasonable; however, we cannot provide assurance that the final determination of any of these examinations will not have a significant impact on the amounts provided for income taxes in our Consolidated Financial Statements.

During fiscal 2020, we completed intra-entity transfers of certain intellectual property rights (“IP rights”) which resulted in the establishment of deferred tax assets, net of valuation allowance, and related tax benefits of $224 million and $1.13 billion, based on the fair value of the IP rights transferred in April and November 2020, respectively. The determination of the fair value involves significant judgment on future revenue growth, operating margins and discount rates. Unanticipated events and circumstances may occur that could affect either the accuracy or validity of such assumptions, estimates or actual results. The sustainability of our future tax benefits is dependent upon the acceptance of the valuation estimates and assumptions by the taxing authorities.

### Recent Accounting Pronouncements

*See Note 1 of our Notes to Consolidated Financial Statements for information regarding recent accounting pronouncements that are of significance, or potential significance to us.*

## RESULTS OF OPERATIONS

### Overview of 2020

For our fiscal 2020, we experienced strong demand across our Digital Media offerings consistent with the continued execution of our long-term plans with respect to this segment. In our Digital Experience segment, we continued to experience growth in software-based subscription revenue across our portfolio of offerings.

During the second quarter of fiscal 2020, we began to discontinue our transaction-driven Advertising Cloud offerings, allowing us to focus our investment on strategic growth initiatives. In the fourth quarter of fiscal 2020, we moved our Advertising Cloud offerings from our Digital Experience segment into our new Publishing and Advertising segment, which combined Advertising Cloud with our previous Publishing segment. This realignment is consistent with how we manage our Digital Experience segment to better reflect the strategic shift related to Advertising Cloud and to align with our overall core value proposition of delivering on customer experience management.

*Digital Media*

In our Digital Media segment, we are a market leader with Creative Cloud, our subscription-based offering which provides desktop tools, mobile apps and cloud-based services for designing, creating and publishing rich and immersive content. Creative Cloud delivers value with deep, cross-product integration, frequent product updates and feature enhancements, cloud-enabled services including storage and syncing of files across users' machines, machine learning and artificial intelligence, access to marketplace, social and community-based features with our Adobe Stock and Behance services, app creation capabilities, tools which assist with enterprise deployments and team collaboration, and affordable pricing for cost-sensitive customers.

We offer Creative Cloud for individuals, students, teams and enterprises. We expect Creative Cloud will drive sustained long-term revenue growth through a continued expansion of our customer base by acquiring new users as a result of low cost of entry and delivery of additional features and value to Creative Cloud, as well as keeping existing customers current on our latest release. We have also built out a marketplace for Creative Cloud subscribers to enable the delivery and purchase of stock content in our Adobe Stock service. Overall, our strategy with Creative Cloud is designed to enable us to increase our revenue with users, attract more new customers, and grow our recurring and predictable revenue stream that is recognized ratably.

We continue to implement strategies that will accelerate awareness, consideration and purchase of subscriptions to our Creative Cloud offerings. These strategies include increasing the value Creative Cloud users receive, such as offering new desktop and mobile applications, as well as targeted promotions and offers that attract past customers and potential users to try out and ultimately subscribe to Creative Cloud. Because of the shift towards Creative Cloud subscriptions and Enterprise Term License Agreements ("ETLAs"), revenue from perpetual licensing of our Creative products has been immaterial to our business.

We are also a market leader with our Document Cloud offerings built around our Adobe Acrobat family of products, including Adobe Acrobat Reader DC, and a set of integrated mobile apps and cloud-based document services, including Adobe Scan and Adobe Sign. Acrobat provides reliable creation and exchange of electronic documents, regardless of platform or application source type. Document Cloud, which we believe enhances the way people manage critical documents at home, in the office and across devices, includes Adobe Acrobat DC and Adobe Sign, and a set of integrated services enabling users to create, review, approve, sign and track documents whether on a desktop or mobile device. Adobe Acrobat DC is offered both through subscription and perpetual licenses.

Annualized Recurring Revenue ("ARR") is currently the key performance metric our management uses to assess the health and trajectory of our overall Digital Media segment. ARR should be viewed independently of revenue, deferred revenue, unbilled backlog and remaining performance obligation as ARR is a performance metric and is not intended to be combined with any of these items. We adjust our reported ARR on an annual basis to reflect any material exchange rates changes. Our reported ARR results in the current fiscal year are based on currency rates set at the beginning of the year and held constant throughout the year. We calculate ARR as follows:

| | |
|---|---|
| Creative ARR | Annual Value of Creative Cloud Subscriptions an<br>+<br>Annual Creative ETLA Contract Value |
| Document Cloud ARR | Annual Value of Document Cloud Subscriptions ar<br>+<br>Annual Document Cloud ETLA Contract V |
| Digital Media ARR | Creative ARR<br>+<br>Document Cloud ARR |

Creative ARR exiting fiscal 2020 was $8.72 billion, up from $7.25 billion at the end of fiscal 2019. Document Cloud ARR exiting fiscal 2020 was $1.46 billion, up from $1.08 billion at the end of fiscal 2019. Total Digital Media ARR grew to $10.18 billion at the end of fiscal 2020, up from $8.33 billion at the end of fiscal 2019. Revaluing our ending ARR for fiscal 2020 using currency rates at the beginning of fiscal 2021, our Digital Media ARR at the end of fiscal 2020 would be $10.26 billion or approximately $77 million higher than the ARR reported above.

Our success in driving growth in ARR has positively affected our revenue growth. Creative revenue in fiscal 2020 was $7.74 billion, up from $6.48 billion in fiscal 2019 and representing 19% year-over-year growth. Document Cloud revenue in fiscal 2020 was $1.50 billion, up from $1.22 billion in fiscal 2019 and representing 22% year-over-year revenue growth and reflecting an increase in demand driven by the shift to remote work as well as our continued efforts to transition Document Cloud to a subscription-based model. Total Digital Media segment revenue grew to $9.23 billion in fiscal 2020, up from $7.71 billion in fiscal 2019 and representing 20% year-over-year growth. These increases were driven by strong net new user growth, including those resulting from the current work-from-home environment reflecting expanded digital engagement.

*Digital Experience*

We are a market leader in the fast-growing category addressed by our Digital Experience segment. The Adobe Experience Cloud applications, services and platform are designed to manage customer journeys, enable shoppable experiences and deliver intelligence for businesses of any size in any industry. Our differentiation and competitive advantage is strengthened by our ability to use the Adobe Experience Platform to connect our comprehensive set of solutions.

Adobe Experience Cloud is focused on delivering solutions for our enterprise customers across the following strategic growth pillars:

- *Customer data and insights.* Our solutions deliver real-time customer profiles and intelligence across the customer journey. Our offerings include Adobe Experience Platform, Adobe Analytics, Adobe Audience Manager, Customer Journey Analytics, Real-time Customer Data Platform and Intelligent Services.

- *Content and commerce.* Our solutions to help customers manage, deliver, test, target and optimize content delivery and enable shopping experiences that scale from mid-market to enterprise businesses. Our offerings include Adobe Experience Manager, Adobe Target and Adobe Commerce.

- *Customer journey management.* Our solutions help businesses manage, personalize and orchestrate campaigns and customer journeys across B2E use cases. Our offerings include Adobe Campaign, Marketo Engage and Journey Orchestration.

In addition to chief marketing officers, chief revenue officers and digital marketers, users of our Digital Experience solutions include advertisers, campaign managers, publishers, data analysts, content managers, social marketers, marketing executives and information management and technology executives. These customers often are involved in workflows that utilize other Adobe products, such as our Digital Media offerings. By combining the creativity of our Digital Media business with the science of our Digital Experience business, we help our customers to more efficiently and effectively make, manage, measure and monetize their content across every channel with an end-to-end workflow and feedback loop.

We utilize a direct sales force to market and license our Digital Experience solutions, as well as an extensive ecosystem of partners, including marketing agencies, systems integrators and independent software vendors that help license and deploy our solutions to their customers. We have made significant investments to broaden the scale and size of all of these routes to market, and our recent financial results reflect the success of these investments.

Digital Experience revenue for all fiscal years presented has been updated to reflect the Advertising Cloud segment move. Digital Experience revenue was $3.13 billion in fiscal 2020, up from $2.80 billion in fiscal 2019 which represents 12% year-over-year growth. Driving this increase was the increase in subscription revenue across our offerings which grew to $2.66 billion in fiscal 2020 from $2.28 billion in fiscal 2019, representing 17% year-over-year growth.

**COVID-19 UPDATE**

In March 2020, the World Health Organization declared the outbreak of a disease caused by a novel strain of the coronavirus (COVID-19) to be a pandemic. This pandemic has had widespread, rapidly-evolving and unpredictable impacts on global societies, economies, financial markets and business practices. Federal and state governments have implemented measures in an effort to contain the virus, including physical distancing, travel restrictions, border closures, limitations on public gatherings, work from home, supply chain logistical changes and closure of non-essential businesses. Our focus remains on promoting employee health and safety, serving our customers and ensuring business continuity. As a result, we have taken action to direct our teams to work from home, suspend travel and replace in-person events such as Adobe Summit and MAX, with digital events through July 2021.

During the pandemic, digital has become the primary way for people to connect, work, learn and be entertained, and for businesses to engage with customers. This macro trend towards all things digital has increased the importance and relevance of our solutions and accelerated the tailwinds that benefit our business, which contributed to our continued growth year over year. However, while our revenue and earnings are relatively predictable as a result of our subscription-based business model, the broader implications of the pandemic on our results of operations and overall financial performance remain uncertain. *See Risk Factors for further discussion of the possible impact of the pandemic on our business.*

*Financial Performance Summary for Fiscal 2020*

- Total Digital Media ARR of approximately $10.18 billion as of November 27, 2020 increased by $1.85 billion, or 22%, from $8.33 billion as of November 29, 2019. The increase in our Digital Media ARR was primarily due to new user adoption of our Creative Cloud and Document Cloud offerings.

- Creative revenue of $7.74 billion increased by $1.25 billion, or 19%, during fiscal 2020, from $6.48 billion in fiscal 2019. Document Cloud revenue of $1.50 billion increased by $272 million, or 22%, during fiscal 2020, from $1.22 billion in fiscal 2019. The increases were primarily due to subscription revenue growth associated with our Creative Cloud and Document Cloud offerings.

- Digital Experience revenue of $3.13 billion increased by $330 million, or 12%, during fiscal 2020, from $2.80 billion in fiscal 2019. The increase was primarily due to subscription revenue growth across our offerings.

- Remaining performance obligation of $11.34 billion as of November 27, 2020 increased by $1.52 billion, or 15%, from $9.82 billion as of November 29, 2019, primarily due to new contracts and renewals for our Digital Media and Digital Experience offerings.

- Cost of revenue of $1.72 billion increased by $49 million, or 3%, during fiscal 2020, from $1.67 billion in fiscal 2019 primarily due to increases in hosting services and data center costs, offset in large part by decreases in Advertising Cloud media costs.

- Operating expenses of $6.91 billion increased by $679 million, or 11%, during fiscal 2020, from $6.23 billion in fiscal 2019 primarily due to increases in base and incentive compensation and related benefits costs, as well as increased marketing spend. These increases were offset in part by decreases in travel-related expenses.

- Net income of $5.26 billion increased by $2.31 billion, or 78%, during fiscal 2020 from $2.95 billion in fiscal 2019 primarily due to increases in revenue and the non-recurring benefit from income taxes resulting from intra-entity transfers of certain intellectual property rights.

- Net cash flows from operations of $5.73 billion during fiscal 2020 increased by $1.31 billion, or 30%, from $4.42 billion during fiscal 2019 primarily due to higher net income adjusted for the net effect of non-cash items.

**Presentation Changes**

In the fourth quarter of fiscal 2020, we moved our Advertising Cloud offerings from our Digital Experience segment into our new Publishing and Advertising segment, which combined our Advertising Cloud offerings with our previous Publishing segment. This realignment is consistent with how we manage our Digital Experience segment to better reflect the strategic shift related to Advertising Cloud and to align with our overall core value proposition of delivering on customer experience management.

Further, we reclassified revenue and related cost of revenue of our Advertising Cloud offerings from subscription to services and other on our Consolidated Statements of Income.

Financial information for all fiscal years presented has been updated to reflect these reclassifications. There were no other updates to disclosures included in our prior year report in relation to the reclassifications.

**Revenue**

Our financial results for fiscal 2020 and 2019 are presented in accordance with Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606), which was adopted under the modified retrospective method at the beginning of fiscal 2019. Fiscal 2018 results have not been restated which limits its comparability with other fiscal years presented.

| *(dollars in millions)* | 2020 | 2019 | 2018 | % Change 2020-2019 | % Change 2019-2018 |
|---|---|---|---|---|---|
| Subscription | $ 11,626 | $ 9,634 | $ 7,604 | 21 % | 27 % |
| Percentage of total revenue | 90 % | 86 % | 84 % | | |
| Product | 507 | 648 | 622 | (22)% | 4 % |
| Percentage of total revenue | 4 % | 6 % | 7 % | | |
| Services and other | 735 | 889 | 804 | (17)% | 11 % |
| Percentage of total revenue | 6 % | 8 % | 9 % | | |
| Total revenue | $ 12,868 | $ 11,171 | $ 9,030 | 15 % | 24 % |

*Subscription*

Our subscription revenue is comprised primarily of fees we charge for our subscription and hosted service offerings, and related support, including Creative Cloud and certain of our Adobe Experience Cloud and Document Cloud services. We primarily recognize subscription revenue ratably over the term of agreements with our customers, beginning with commencement of service. Subscription revenue related to certain offerings, where fees are based on a number of transactions and invoicing is aligned to the pattern of performance, customer benefit and consumption, are recognized on a usage basis.

We have the following reportable segments: Digital Media, Digital Experience, and Publishing and Advertising. Subscription revenue by reportable segment for fiscal 2020, 2019 and 2018 is as follows:

| *(dollars in millions)* | 2020 | 2019 | 2018 | % Change 2020-2019 | % Change 2019-2018 |
|---|---|---|---|---|---|
| Digital Media | $ 8,813 | $ 7,208 | $ 5,858 | 22 % | 23 % |
| Digital Experience | 2,660 | 2,280 | 1,600 | 17 % | 43 % |
| Publishing and Advertising | 153 | 146 | 146 | 5 % | * |
| Total subscription revenue | $ 11,626 | $ 9,634 | $ 7,604 | 21 % | 27 % |

(*) Percentage is less than 1%.

*Product*

Our product revenue is comprised primarily of fees related to licenses for on-premise software purchased on a perpetual basis, for a fixed period of time or based on usage for certain of our OEM and royalty agreements. We primarily recognize product revenue at the point in time the software is available to the customer, provided all other revenue recognition criteria are met.

*Services and Other*

Our services and other revenue is comprised primarily of fees related to consulting, training, maintenance and support and our advertising offerings. We typically sell our consulting contracts on a time-and-materials and fixed-fee basis. These revenues are recognized as the services are performed for time and materials contracts and on a relative performance basis for fixed-fee contracts. Training revenues are recognized as the services are performed. Our maintenance and support offerings, which entitle customers, partners and developers to receive desktop product upgrades and enhancements or technical support, depending on the offering, are generally recognized ratably over the term of the arrangement. Transaction-based advertising revenue is recognized on a usage basis as we satisfy the performance obligations to our customers.

*Segments*

In fiscal 2020, we categorized our products into the following reportable segments:

- *Digital Media*—Our Digital Media segment provides tools and solutions that enable individuals, teams and enterprises to create, publish, promote and monetize their digital content anywhere. Our customers include content creators, experience designers, app developers, enthusiasts, students, social media users and creative professionals, as well as marketing departments and agencies, companies and publishers. Our customers also include knowledge workers who create, collaborate on and distribute documents and creative content.

- *Digital Experience*—Our Digital Experience segment provides products, services and solutions for creating, managing, executing, measuring, monetizing and optimizing customer experiences from analytics to commerce. Our customers include marketers, advertisers, agencies, publishers, merchandisers, merchants, web analysts, data scientists, developers, marketing executives, information management and technology executives, product development executives, and sales and support executives.

- *Publishing and Advertising*—Our Publishing and Advertising segment addresses market opportunities ranging from the diverse authoring and publishing needs of technical and business publishing to our legacy type and OEM printing businesses. It also includes our platforms for Advertising Cloud, web conferencing, document and forms, and Primetime.

*Segment Information*

| *(dollars in millions)* | 2020 | 2019 | 2018 | % Change 2020-2019 | % Change 2019-2018 |
|---|---|---|---|---|---|
| Digital Media | $ 9,233 | $ 7,707 | $ 6,325 | 20 % | 22 % |
| Percentage of total revenue | 72 % | 69 % | 70 % | | |
| Digital Experience | 3,125 | 2,795 | 2,073 | 12 % | 35 % |
| Percentage of total revenue | 24 % | 25 % | 23 % | | |
| Publishing and Advertising | 510 | 669 | 632 | (24)% | 6 % |
| Percentage of total revenue | 4 % | 6 % | 7 % | | |
| Total revenue | $ 12,868 | $ 11,171 | $ 9,030 | 15 % | 24 % |

*Digital Media*

Revenue from Digital Media increased $1.53 billion during fiscal 2020 as compared to fiscal 2019, driven by increases in revenue associated with our Creative and Document Cloud offerings due to increased demand and digital engagement amid the work-from-home environment.

Revenue associated with our Creative offerings, which includes our Creative Cloud, perpetually licensed Creative and stock photography offerings, increased during fiscal 2020 primarily due to increases in net new subscriptions across our Creative Cloud offerings.

Document Cloud revenue, which includes our Acrobat product family and Adobe Sign service, increased during fiscal 2020 primarily due to increases in subscription revenue driven by strong adoption of our Document Cloud offerings including Adobe Sign.

*Digital Experience*

Revenue from Digital Experience increased $330 million during fiscal 2020, as compared to fiscal 2019 primarily due to subscription revenue growth across our offerings of which the largest contributors were our AEM and Marketo Engage offerings.

*Geographical Information*

| *(dollars in millions)* | 2020 | 2019 | 2018 | % Change 2020-2019 | % Change 2019-2018 |
|---|---|---|---|---|---|
| Americas | $ 7,454 | $ 6,506 | $ 5,117 | 15 % | 27 % |
| Percentage of total revenue | 58 % | 58 % | 57 % | | |
| EMEA | 3,400 | 2,975 | 2,550 | 14 % | 17 % |
| Percentage of total revenue | 26 % | 27 % | 28 % | | |
| APAC | 2,014 | 1,690 | 1,363 | 19 % | 24 % |
| Percentage of total revenue | 16 % | 15 % | 15 % | | |
| Total revenue | $ 12,868 | $ 11,171 | $ 9,030 | 15 % | 24 % |

Overall revenue during fiscal 2020 increased in all geographic regions as compared to fiscal 2019 primarily due to increases in Digital Media revenue and, to a lesser extent, increases in Digital Experience revenue. Within each geographic region, the fluctuations in revenue by reportable segment were attributable to the factors noted in the segment information above.

Included in the overall change in revenue for fiscal 2020 and fiscal 2019 were impacts associated with foreign currency as shown below. Our cash flow hedging program is used to mitigate a portion of the foreign currency impact to revenue.

| *(in millions)* | 2020 | 2019 |
|---|---|---|
| **Revenue impact:** | Increase/(Decrease) | |
| Euro | $ (24) | $ (73) |
| Australian Dollar | (16) | (27) |
| British Pound | (5) | (27) |
| Japanese Yen | 14 | 2 |
| Brazilian Real | (14) | (2) |
| Other currencies | (8) | (11) |
| Total revenue impact | (53) | (138) |
| **Hedging impact:** | | |
| Euro | 8 | 30 |
| British Pound | (2) | 8 |
| Japanese Yen | (2) | 2 |
| Australian Dollar | (1) | — |
| Total hedging impact | 3 | 40 |
| Total impact | $ (50) | $ (98) |

During fiscal 2020, the U.S. Dollar strengthened largely against EMEA currencies and the Australian Dollar, which decreased revenue in U.S. Dollar equivalents. The foreign currency impact to revenue was partially offset by gains primarily from our Euro cash flow hedging program.

*See Note 2 of our Notes to Consolidated Financial Statements for additional details of revenue by geography.*

**Cost of Revenue**

| *(dollars in millions)* | 2020 | 2019 | 2018 | % Change 2020-2019 | % Change 2019-2018 |
|---|---|---|---|---|---|
| Subscription | $ 1,108 | $ 926 | $ 574 | 20 % | 61 % |
| Percentage of total revenue | 9 % | 8 % | 6 % | | |
| Product | 36 | 40 | 46 | (10)% | (13)% |
| Percentage of total revenue | * | * | 1 % | | |
| Services and other | 578 | 707 | 575 | (18)% | 23 % |
| Percentage of total revenue | 4 % | 6 % | 6 % | | |
| Total cost of revenue | $ 1,722 | $ 1,673 | $ 1,195 | 3 % | 40 % |

(*) Percentage is less than 1%

*Subscription*

Cost of subscription revenue consists of third-party hosting services and data center costs, royalty fees and other expenses related to operating our network infrastructure, including depreciation expense and operating lease payments associated with computer equipment, salaries and related expenses of network operations, implementation, account management and technical support personnel, amortization of certain intangible assets and allocated overhead.

Cost of subscription revenue increased due to the following:

| | Components of % Change 2020-2019 | Components of % Change 2019-2018 |
|---|---|---|
| Hosting services and data center costs | 10 % | 16 % |
| Incentive compensation, cash and stock-based | 5 | 5 |
| Royalty costs | 3 | 5 |
| Base compensation and related benefits associated with headcount | 3 | 5 |
| Software licenses | 2 | 2 |
| Amortization of intangibles | (2) | 24 |
| Various individually insignificant items | (1) | 4 |
| Total change | 20 % | 61 % |

*Product*

Cost of product revenue is primarily comprised of third-party royalties, amortization related to purchased intangibles and acquired rights to use technology, excess and obsolete inventory, localization costs and the costs associated with the manufacturing of our products.

*Services and Other*

Cost of services and other revenue is primarily comprised of employee-related and other associated costs incurred to provide consulting services, training and product support. Cost of services and other also includes media costs related to impressions purchased from third-party ad inventory sources for our transaction-based Adobe Advertising Cloud offerings, which we began to discontinue in the second quarter of fiscal 2020.

Cost of services and other fluctuations were due to the following:

| | Components of % Change 2020-2019 | Components of % Change 2019-2018 |
|---|---|---|
| Media costs | (9)% | 10 % |
| Base compensation and related benefits associated with headcount | (7) | 4 |
| Incentive compensation, cash and stock-based | (1) | 6 |
| Professional and consulting fees | 3 | — |
| Various individually insignificant items | (4) | 3 |
| Total change | (18)% | 23 % |

## Operating Expenses

| *(dollars in millions)* | 2020 | 2019 | 2018 | % Change 2020-2019 |
|---|---|---|---|---|
| Research and development | $ 2,188 | $ 1,930 | $ 1,538 | 13 % |
| Percentage of total revenue | 17 % | 17 % | 17 % | |
| Sales and marketing | 3,591 | 3,244 | 2,621 | 11 % |
| Percentage of total revenue | 28 % | 29 % | 29 % | |
| General and administrative | 968 | 881 | 745 | 10 % |
| Percentage of total revenue | 8 % | 8 % | 8 % | |
| Amortization of intangibles | 162 | 175 | 91 | (7)% |
| Percentage of total revenue | 1 % | 2 % | 1 % | |
| Total operating expenses | $ 6,909 | $ 6,230 | $ 4,995 | 11 % |

*Research and Development*

Research and development expenses consist primarily of salary and benefit expenses for software developers, contracted development efforts, third party fees for hosting services, related facilities costs and expenses associated with computer equipment used in software development.

Research and development expenses increased due to the following:

| | Components of % Change 2020-2019 |
|---|---|
| Incentive compensation, cash and stock-based | 11 % |
| Base compensation and related benefits associated with headcount | 3 |
| Travel | (1) |
| Total change | 13 % |

We believe that investments in research and development, including the recruiting and hiring of software developers, are critical to remain competitive in the marketplace and are directly related to continued timely development of new and enhanced offerings and solutions. We will continue to focus on long-term opportunities available in our end markets and make significant investments in the development of our subscription and service offerings, applications and tools.

*Sales and Marketing*

Sales and marketing expenses consist primarily of salary and benefit expenses, amortization of contract acquisition costs, including sales commissions, travel expenses and related facilities costs for our sales, marketing, order management and global supply chain management personnel. Sales and marketing expenses also include the costs of programs aimed at increasing revenue, such as advertising, trade shows and events, public relations and other market development programs.

Sales and marketing expenses increased due to the following:

| | Components of % Change 2020-2019 |
|---|---|
| Marketing spend related to campaigns, events and overall marketing efforts | 8 % |
| Incentive compensation, cash and stock-based | 4 |
| Transaction fees | 2 |
| Base compensation and related benefits associated with headcount | 1 |
| Professional and consulting fees | (1) |
| Travel | (3) |
| Total change | 11 % |

*General and Administrative*

General and administrative expenses consist primarily of compensation and benefit expenses, travel expenses and related facilities costs for our finance, facilities, human resources, legal, information services and executive personnel. General and administrative expenses also include outside legal and accounting fees, provision for bad debts, expenses associated with computer equipment and software used in the administration of the business, charitable contributions and various forms of insurance.

General and administrative expenses increased due to the following:

| | Components of % Change 2020-2019 |
|---|---|
| Incentive compensation, cash and stock-based | 5 % |
| Charges related to cancellation of corporate events, net of recoveries | 3 |
| Bad debt expense | 2 |
| Charitable contributions | 2 |
| Base compensation and related benefits associated with headcount | 1 |
| Travel | (2) |
| Various individually insignificant items | (1) |
| Total change | 10 % |

During fiscal 2020, we recorded net charges related to the cancellation of our corporate events due to concerns over the pandemic. Certain of these charges were reversed as we successfully negotiated the right to apply certain commitments to other events.

Bad debt expense increased during fiscal 2020 primarily due to specific reserves for certain categories of customers that were more impacted by the changes in the macroeconomic environment as a result of the pandemic.

*Amortization of Intangibles*

Amortization expense decreased during fiscal 2020 as compared to fiscal 2019 primarily due to certain intangible assets from previous acquisitions, including from Marketo and Omniture, becoming fully amortized during the year.

**Non-Operating Income (Expense), Net**

| *(dollars in millions)* | 2020 | 2019 | 2018 | % Change 2020-2019 |
|---|---|---|---|---|
| Interest expense | $ (116) | $ (157) | $ (89) | (26)% |
| Percentage of total revenue | (1)% | (1)% | (1)% | |
| Investment gains (losses), net | 13 | 52 | 3 | (75)% |
| Percentage of total revenue | * | * | * | |
| Other income (expense), net | 42 | 42 | 40 | ** |
| Percentage of total revenue | * | * | * | |
| Total non-operating income (expense), net | $ (61) | $ (63) | $ (46) | (3)% |

(*) Percentage is less than 1%.
(**) Percentage is not meaningful.

*Interest Expense*

Interest expense represents interest associated with our debt instruments. Interest on our Notes is payable semi-annually, in arrears, on February 1 and August 1. Interest on our Term Loan, which was terminated in the first quarter of fiscal 2020, was payable periodically at the end of each interest period. Floating interest payments on the interest rate swaps, which matured in the first quarter of fiscal 2020, were paid monthly and the fixed-rate interest receivable on the swaps was received semi-annually concurrent with the Notes interest payments.

Interest expense decreased during fiscal 2020 as compared to fiscal 2019 primarily due to lower average interest rates on our debt instruments that were refinanced in the first quarter of fiscal 2020.

*Investment Gains (Losses), Net*

Investment gains (losses), net consists principally of unrealized holding gains and losses associated with our deferred compensation plan assets which are classified as trading securities, and gains and losses associated with our direct and indirect investments in privately held companies.

Investment gains (losses), net decreased during fiscal 2020 as compared to fiscal 2019 primarily due to the gain recognized upon our acquisition of the remaining interest in Allegorithmic in January 2019.

*Other Income (Expense), Net*

Other income (expense), net consists primarily of interest earned on cash, cash equivalents and short-term fixed income investments. Other income (expense), net also includes realized gains and losses on fixed income investments and foreign exchange gains and losses.

Other income (expense), remained stable during fiscal 2020 primarily due to decreases in interest income driven by lower average interest rates offset by our change in methodology of accounting for foreign currency cash flow hedges. Effective in the third quarter of fiscal 2019, option premiums, which were previously recorded in other income (expense), net, are recorded in accumulated other comprehensive income (loss).

**Provision for (Benefit from) Income Taxes**

| *(dollars in millions)* | 2020 | 2019 | 2018 | % Change 2020-2019 |
|---|---|---|---|---|
| Provision for (benefit from) income taxes | $ (1,084) | $ 254 | $ 203 | ** |
| Percentage of total revenue | (8)% | 2 % | 2 % | |
| Effective tax rate | (26)% | 8 % | 7 % | |

(**) Percentage is not meaningful.

Our effective tax rate decreased by approximately 34 percentage points during fiscal 2020 as compared to fiscal 2019. The change is primarily due to non-recurring tax benefits resulting from the intra-entity transfers of certain intellectual property rights ("IP rights") completed during fiscal 2020.

Our effective tax rate for fiscal 2020 was lower than the U.S. federal statutory tax rate of 21% primarily due to tax benefits resulting from the intra-entity transfers of certain IP rights, a favorable geographic mix of earnings and tax benefits related to stock-based compensation.

During fiscal 2020, we completed intra-entity transfers of certain IP rights to our Irish subsidiary in order to better align the ownership of these rights with how our business operates. The transfers did not result in taxable gains; however, our Irish subsidiary recognized deferred tax assets for the book and tax basis difference of the transferred IP rights. As a result of these transactions, we recorded deferred tax assets, net of valuation allowance, and related tax benefits of $224 million and $1.13 billion, based on the fair value of the IP rights transferred in April and November 2020, respectively. The tax-deductible amortization related to the transferred IP rights will be recognized over the period of economic benefit. In years beyond fiscal 2020, the change in the geographic mix of international income resulting from these transfers is anticipated to adversely affect our effective income tax rates and cash flows. However, the adverse impact to effective rates for cash paid for income taxes will be partially offset by future deductions on the transferred IP rights.

On December 22, 2017, the U.S. Tax Act was enacted into law, which significantly changed existing U.S. tax law and includes many provisions applicable to us. Certain international provisions of the U.S. Tax Act, such as a tax on global intangible low-tax income, a base erosion and anti-abuse tax and a special tax deduction for foreign-derived intangible income, took effect in fiscal 2019. As the U.S. Treasury releases regulations that impact these provisions, we account for finalized regulations in the period of enactment.

We recognize deferred tax assets to the extent that we believe these assets are more likely than not to be realized. In making such a determination, we considered all available positive and negative evidence, including our past operating results, forecasted earnings, future taxable income and prudent and feasible tax planning strategies. On the basis of this evaluation, we continue to maintain a valuation allowance to reduce our deferred tax assets to the amount realizable. The total valuation allowance was $276 million as of November 27, 2020 and is primarily attributable to certain state and foreign credits and foreign intangible assets.

We are a United States-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. A significant portion of our foreign earnings for the current fiscal year were earned by our Irish subsidiaries. The current U.S. tax law provides an exemption from federal income taxes for distributions from foreign subsidiaries made after December 31, 2017, including certain earnings that were not subject to the one-time transition or global intangible low-tax income tax. As we repatriate the undistributed foreign earnings for use in the U.S., the distributions will generally not be subject to further U.S. federal tax.

In June 2020, California enacted legislation which includes a limitation on the utilization of research and development tax credits for a three-year period beginning in fiscal 2021. The net impact of the legislation is uncertain but is anticipated to increase our California tax and, consequently, adversely impact our effective tax rates for the three-year period beginning in fiscal 2021.

*See Note 10 of our Notes to Consolidated Financial Statements for further information on our provision for (benefit from) income taxes.*

*Accounting for Uncertainty in Income Taxes*

The gross liabilities for unrecognized tax benefits excluding interest and penalties were $201 million, $173 million and $196 million for fiscal 2020, 2019 and 2018, respectively. If the total unrecognized tax benefits at November 27, 2020, November 29, 2019 and November 30, 2018 were recognized, $136 million, $116 million and $136 million would decrease the respective effective tax rates.

The combined amount of accrued interest and penalties related to tax positions taken on our tax returns were approximately $26 million and $25 million for fiscal 2020 and 2019, respectively. These amounts were included in long-term income taxes payable in their respective years.

The timing of the resolution of income tax examinations is highly uncertain as are the amounts and timing of tax payments that are part of any audit settlement process. These events could cause large fluctuations in the balance sheet classification of our tax assets and liabilities. We believe that within the next 12 months, it is reasonably possible that either certain audits will conclude or statutes of limitations on certain income tax examination periods will expire, or both. Given the uncertainties described above, we can only determine a range of estimated potential decreases in underlying unrecognized tax benefits ranging from $0 to approximately $20 million over the next 12 months.

In addition, in countries where we conduct business and in jurisdictions in which we are subject to tax, including those covered by governing bodies that enact tax laws applicable to us, such as the European Commission of the European Union, we are subject to potential changes in relevant tax, accounting and other laws, regulations and interpretations, including changes to tax laws applicable to corporate multinationals such as Adobe. These countries, other governmental bodies and intergovernmental economic organizations such as the Organization for Economic Cooperation and Development, have or could make unprecedented assertions about how taxation is determined in their jurisdictions that are contrary to the way in which we have interpreted and historically applied the rules and regulations described above in such jurisdictions. In the current global tax policy environment, any changes in laws, regulations and interpretations related to these assertions could adversely affect our effective tax rates, cause us to respond by making changes to our business structure, or result in other costs to us which could adversely affect our operations and financial results.

Moreover, we are subject to the continual examination of our income tax returns by the U.S. Internal Revenue Service and other domestic and foreign tax authorities. These tax examinations are expected to focus on our intercompany transfer pricing practices, application of tax rules and other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from these examinations. We cannot provide assurance that the final determination of any of these examinations will not have an adverse effect on our operating results and financial position.

## LIQUIDITY AND CAPITAL RESOURCES

This data should be read in conjunction with our Consolidated Statements of Cash Flows.

| | As of | |
|---|---|---|
| *(in millions)* | November 27, 2020 | November 29, 2019 |
| Cash and cash equivalents | $ 4,478 | $ 2,650 |
| Short-term investments | $ 1,514 | $ 1,527 |
| Working capital | $ 2,634 | $ (1,696) |
| Stockholders' equity | $ 13,264 | $ 10,530 |

*Working Capital*

Working capital as of November 27, 2020 and November 29, 2019 was $2.63 billion of a surplus and $1.70 billion of a deficit, respectively. During the first quarter of fiscal 2020, we refinanced our 2.25 billion term loan due April 30, 2020 ("Term Loan") and $900 million 4.75% senior notes due February 1, 2020 ("2020 Notes"). *See the section titled "Cash Flows from Financing Activities" below.*

A summary of our cash flows for fiscal 2020, 2019 and 2018 is as follows:

| *(in millions)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| Net cash provided by operating activities | $ 5,727 | $ 4,422 | $ 4,029 |
| Net cash used for investing activities | (414) | (456) | (4,685) |
| Net cash used for financing activities | (3,488) | (2,946) | (5) |
| Effect of foreign currency exchange rates on cash and cash equivalents | 3 | (13) | (2) |
| Net increase (decrease) in cash and cash equivalents | $ 1,828 | $ 1,007 | $ (663) |

Our primary source of cash is receipts from revenue and, to a lesser extent, proceeds from participation in the employee stock purchase plan. The primary uses of cash are our stock repurchase program as described below, payroll-related expenses, general operating expenses including marketing, travel and office rent, and cost of revenue. Other uses of cash include business acquisitions, purchases of property and equipment and payments for taxes related to net share settlement of equity awards.

*Cash Flows from Operating Activities*

For fiscal 2020, net cash provided by operating activities of $5.73 billion was primarily comprised of net income adjusted for the net effect of non-cash items. The primary working capital sources of cash were net income together with increases in deferred revenue and decreases in trade receivables, which were offset in part by increases in prepaid expenses and other assets. The increase in deferred revenue was primarily driven by Digital Media offerings with cloud-enabled services, and the decrease in trade receivables was largely attributable to strong collections. The primary working capital use of cash was due to increases in prepaid expenses and other assets driven by sales commissions paid and capitalized and, to a lesser extent, increases due to the timing of billings and payments associated with certain vendors.

*Cash Flows from Investing Activities*

For fiscal 2020, net cash used for investing activities of $414 million was primarily due to ongoing capital expenditures. These cash outflows were offset in part by proceeds from sales and maturities of short-term investments, net of purchases.

*Cash Flows from Financing Activities*

For fiscal 2020, net cash used for financing activities of $3.49 billion was primarily due to payments for our treasury stock repurchases and taxes paid related to the net share settlement of equity awards, which were offset by proceeds from re-issuance of treasury stock for our employee stock purchase plan. *See the section titled "Stock Repurchase Program" discussed below.*

In February 2020, we issued $500 million of 1.70% senior notes due February 1, 2023 (“2023 Notes”), $500 million of 1.90% senior notes due February 1, 2025 (“1.90% 2025 Notes”), $850 million of 2.15% senior notes due February 1, 2027 (“2027 Notes”) and $1.30 billion of 2.30% senior notes due February 1, 2030 (“2030 Notes”). We used the proceeds to repay the Term Loan and 2020 Notes concurrently. *See Note 17 of our Notes to Consolidated Financial Statements for information regarding our debt refinancing.*

### Other Liquidity and Capital Resources Considerations

Our existing cash, cash equivalents and investment balances may fluctuate during fiscal 2021 due to changes in our planned cash outlay.

Cash from operations could also be affected by various risks and uncertainties, including, but not limited to, the effects of the pandemic and other risks detailed in Part I, Item 1A titled "Risk Factors." While the pandemic has not negatively impacted our liquidity and capital resources to date, it has led to increased disruption and volatility in capital markets and credit markets which could adversely affect our liquidity and capital resources in the future. However, based on our current business plan and revenue prospects, we believe that our existing cash, cash equivalents and investment balances, our anticipated cash flows from operations and our available credit facility will be sufficient to meet our working capital, operating resource expenditure and capital expenditure requirements for the next twelve months.

Our cash equivalent and short-term investment portfolio as of November 27, 2020 consisted of asset-backed securities, corporate debt securities, foreign government securities, money market mutual funds, municipal securities and time deposits. We use professional investment management firms to manage a large portion of our invested cash.

We have a $1 billion senior unsecured revolving credit agreement ("Revolving Credit Agreement") with a syndicate of lenders, providing for loans to us and certain of our subsidiaries through October 17, 2023. As of November 27, 2020, there were no outstanding borrowings under this credit agreement and the entire $1 billion credit line remains available for borrowing.

As of November 27, 2020, we have $4.15 billion senior notes outstanding, consisting of the 2023 Notes, 1.90% 2025 Notes, 2027 Notes, 2030 Notes and the $1 billion of 3.25% senior notes due February 1, 2025 (the "3.25% 2025 Notes," and together with the aforementioned notes, the "Notes"). The Notes rank equally with our other unsecured and unsubordinated indebtedness.

We expect to continue our investing activities, including short-term and long-term investments, purchases of computer systems for research and development, sales and marketing, product support and administrative staff, and facilities expansion. As of November 27, 2020, we expect our capital investment to be approximately $550 million to $650 million, primarily to fund our San Jose and Bangalore construction projects through fiscal 2022. Furthermore, cash reserves may be used to repurchase stock under our stock repurchase program and to strategically acquire companies, products or technologies that are complementary to our business.

Subsequent to November 27, 2020, we completed our acquisition of Workfront, a privately held company that provides a work management platform for marketers, for approximately $1.5 billion in cash consideration. *See Note 3 of our Notes to Consolidated Financial Statements for further information regarding this acquisition*.

### Stock Repurchase Program

To facilitate our stock repurchase program, designed to return value to our stockholders and minimize dilution from stock issuances, we may repurchase shares in the open market or enter into structured repurchase agreements with third parties. In May 2018, our Board of Directors granted us an authority to repurchase up to $8 billion in common stock through the end of fiscal 2021.

During fiscal 2020, 2019 and 2018, we entered into several structured stock repurchase agreements with large financial institutions, whereupon we provided them with prepayments totaling $3.05 billion, $2.75 billion, and $2.05 billion, respectively. We enter into these agreements in order to take advantage of repurchasing shares at a guaranteed discount to the Volume Weighted Average Price ("VWAP") of our common stock over a specified period of time. We only enter into such transactions when the discount that we receive is expected to be higher than the foregone return on our cash prepayments to the financial institutions. There were no explicit commissions or fees on these structured repurchases. Under the terms of the agreements, there is no requirement for the financial institutions to return any portion of the prepayment to us.

The financial institutions agree to deliver shares to us at monthly intervals during the contract term. The parameters used to calculate the number of shares deliverable are: the total notional amount of the contract, the number of trading days in the contract, the number of trading days in the interval and the average VWAP of our stock during the interval less the agreed upon discount.

The following is a summary of our structured stock repurchases executed with large financial institutions during fiscal 2020, 2019 and 2018:

| *(in millions, except average price per share)* | 2020 | | 2019 | | 2018 | |
|---|---|---|---|---|---|---|
| **Board approval dates** | **Shares** | **Average per share** | **Shares** | **Average per share** | **Shares** | **Average per share** |
| January 2017 | — | $ — | — | $ — | 8.7 | $ 230.43 |
| May 2018 | 8.0 | $ 376.38 | 9.9 | $ 270.23 | — | $ — |
| Total cost | $3,024 | | $2,671 | | $2,002 | |

For fiscal 2020, 2019 and 2018, the prepayments were classified as treasury stock on our Consolidated Balance Sheets at the payment date, though only shares physically delivered to us by November 27, 2020, November 29, 2019 and November 30, 2018 were excluded from the computation of earnings per share. As of November 27, 2020, $255 million of prepayments remained under the agreement.

Subsequent to November 27, 2020, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of $950 million. This amount will be classified as treasury stock on our Consolidated Balance Sheets. Upon completion of the $950 million stock repurchase agreement, $1.1 billion remains under our May 2018 authority. Further, in December 2020, our Board of Directors granted us additional authority to repurchase up to $15 billion in common stock through the end of fiscal 2024. We have not drawn from our new $15 billion authority as of the issuance of these financial statements.

*See Item 5, Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities for share repurchases during the quarter ended November 27, 2020.*

**Off-Balance Sheet Arrangements and Aggregate Contractual Obligations**

Our principal commitments as of November 27, 2020 consist of our Notes and obligations under operating leases, royalty agreements and various service agreements. *See Notes 16, 17 and 18 of our Notes to Consolidated Financial Statements for additional information regarding our contractual commitments.*

*Contractual Obligations*

The following table summarizes our contractual obligations as of November 27, 2020:

| *(in millions)* | Payment Due by Period | | | | |
|---|---|---|---|---|---|
| | **Total** | **Less than 1 year** | **1-3 years** | **3-5 years** | **More than 5 years** |
| Notes, including interest | $ 4,763 | $ 99 | $ 693 | $ 1,659 | $ 2,312 |
| Operating lease obligations | 657 | 104 | 162 | 119 | 272 |
| Purchase obligations | 1,885 | 872 | 1,012 | 1 | — |
| Total | $ 7,305 | $ 1,075 | $ 1,867 | $ 1,779 | $ 2,584 |

*Senior Notes*

As of November 27, 2020, the carrying value of our Notes was $4.12 billion. Interest is payable semi-annually, in arrears on February 1 and August 1. At November 27, 2020, our maximum commitment for interest payments was $613 million for the remaining duration of our outstanding Notes.

*Covenants*

Our Revolving Credit Agreement contains a financial covenant requiring us not to exceed a maximum leverage ratio. As of November 27, 2020, we were in compliance with this covenant. We believe this covenant will not impact our credit or cash in the coming fiscal year or restrict our ability to execute our business plan. Our Notes do not contain any financial covenants.

Under the terms of our Revolving Credit Agreement, we are not prohibited from paying cash dividends unless payment would trigger an event of default or if one currently exists. We do not anticipate paying any cash dividends in the foreseeable future.

*Transition Taxes Liability*

Our transition tax liability which was accrued as a result of the U.S. Tax Act was approximately $390 million as of November 27, 2020 and is payable in installments through fiscal 2026. The U.S. Tax Act provides an exemption from federal income taxes for distributions from foreign subsidiaries made after December 31, 2017, including certain earnings that were not subject to the one-time transition or global intangible low-tax income tax. As we repatriate the undistributed foreign earnings for use in the U.S., the distributions will generally not be subject to further U.S. federal tax.

*Accounting for Uncertainty in Income Taxes*

See Results of Operations - Provision for (Benefit from) Income Taxes above and Note 10 of our Notes to Consolidated Financial Statements for our discussion on accounting for uncertainty in income taxes.

*Royalties*

We have certain royalty commitments associated with the licensing of certain offerings. Royalty expense is generally based on a dollar amount per unit sold or a percentage of the underlying revenue.

*Indemnifications*

In the normal course of business, we provide indemnifications of varying scope to customers and channel partners against claims of intellectual property infringement made by third parties arising from the use of our products and from time to time, we are subject to claims by our customers under these indemnification provisions. Historically, costs related to these indemnification provisions have not been significant and we are unable to estimate the maximum potential impact of these indemnification provisions on our future results of operations.

To the extent permitted under Delaware law, we have agreements whereby we indemnify our directors and officers for certain events or occurrences while the director or officer is or was serving at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the director's or officer's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that limits our exposure and enables us to recover a portion of any future amounts paid.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

All market risk sensitive instruments were entered into for non-trading purposes.

### Foreign Currency Risk

*Foreign Currency Exposures and Hedging Instruments*

In countries outside the United States, we transact business in U.S. Dollars and various other currencies, which subject us to exposure from movements in exchange rates. We may use foreign exchange option contracts or forward contracts to hedge a portion of our forecasted foreign currency denominated revenue. Additionally, we hedge our net recognized foreign currency monetary assets and liabilities with foreign exchange forward contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates.

Our significant foreign currency revenue exposures for fiscal 2020, 2019 and 2018 were as follows :

| *(in millions)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| Euro | € 1,887 | € 1,603 | € 1,310 |
| Japanese Yen | ¥ 88,640 | ¥ 73,158 | ¥ 60,791 |
| British Pounds | £ 562 | £ 503 | £ 423 |
| Australian Dollars | $ 645 | $ 538 | $ 441 |

As of November 27, 2020, the total notional amounts of all outstanding foreign exchange contracts, including options and forwards, was $2.03 billion, which included the notional equivalent of $923 million in Euros, $385 million in Japanese Yen, $321 million in British Pounds, $212 million in Australian Dollars and $186 million in other foreign currencies. As of November 27, 2020, all contracts were set to expire at various dates through June 2021. The bank counterparties in these contracts could expose us to credit-related losses that would be largely mitigated with master netting arrangements with the same counterparty by permitting net settlement transactions. In addition, we enter into collateral security agreements that provide for collateral to be received or posted when the net fair value of these contracts fluctuates from contractually established thresholds.

A sensitivity analysis was performed on all of our foreign exchange derivatives as of November 27, 2020. This sensitivity analysis measures the hypothetical market value resulting from a 10% shift in the value of exchange rates relative to the U.S. Dollar. For option contracts, the Black-Scholes option pricing model was used. A 10% increase in the value of the U.S. Dollar and a corresponding decrease in the value of the hedged foreign currency asset would lead to an increase in the fair value of our financial hedging instruments by $97 million. Conversely, a 10% decrease in the value of the U.S. Dollar would result in a decrease in the fair value of these financial instruments by $9 million.

As a general rule, we do not use foreign exchange contracts to hedge local currency denominated operating expenses in countries where a natural hedge exists. For example, in many countries, revenue in the local currencies substantially offsets the local currency denominated operating expenses. We also have long-term investment exposures consisting of the capitalization and retained earnings in our non-U.S. Dollar functional currency foreign subsidiaries. As of November 27, 2020 and November 29, 2019, this long-term investment exposure totaled an absolute notional equivalent of $598 million and $385 million, respectively, with the year-over-year increase primarily driven by earnings growth. At this time, we do not hedge these long-term investment exposures.

We do not use foreign exchange contracts for speculative trading purposes, nor do we hedge our foreign currency exposure in a manner that entirely offsets the effects of changes in foreign exchange rates. We regularly review our hedging program and assess the need to utilize financial instruments to hedge currency exposures on an ongoing basis.

*Cash Flow Hedges of Forecasted Foreign Currency Revenue*

We may use foreign exchange purchased options or forward contracts to hedge foreign currency revenue denominated in Euros, British Pounds, Japanese Yen and Australian Dollars. We hedge these cash flow exposures to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates. These foreign exchange contracts, carried at fair value, have maturities of up to twelve months. We enter into these foreign exchange contracts to hedge forecasted revenue in the normal course of business and accordingly, they are not speculative in nature.

We record changes in fair value of these cash flow hedges of foreign currency denominated revenue in accumulated other comprehensive income (loss) in our Consolidated Balance Sheets, until the forecasted transaction occurs. When the forecasted transaction affects earnings, we reclassify the related gain or loss on the cash flow hedge to revenue. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, we reclassify the gain or loss on the related cash flow hedge from accumulated other comprehensive income (loss) to revenue. For the fiscal year ended November 27, 2020, there were no net gains or losses recognized in revenue relating to hedges of forecasted transactions that did not occur.

*Non-Designated Hedges of Foreign Currency Assets and Liabilities*

Our derivatives not designated as hedging instruments consist of foreign currency forward contracts that we primarily use to hedge monetary assets and liabilities denominated in non-functional currencies to reduce the risk that our earnings and cash flows will be adversely affected by changes in foreign currency exchange rates. These foreign exchange contracts are carried at fair value with changes in fair value of these contracts recorded to other income (expense), net in our Consolidated Statements of Income. These contracts reduce the impact of currency exchange rate movements on our assets and liabilities. At November 27, 2020, the outstanding balance sheet hedging derivatives had maturities of 180 days or less.

*See Note 6 of our Notes to Consolidated Financial Statements for information regarding our derivative financial instruments.*

## Interest Rate Risk

*Short-Term Investments and Fixed Income Securities*

At November 27, 2020, we had debt securities classified as short-term investments of $1.51 billion. Changes in interest rates could adversely affect the market value of these investments. A sensitivity analysis was performed on our investment portfolio as of November 27, 2020. The analysis is based on an estimate of the hypothetical changes in market value of the portfolio that would result from an immediate parallel shift in the yield curve of various magnitudes.

The following tables present the hypothetical fair values of our debt securities classified as short-term investments assuming immediate parallel shifts in the yield curve of 50 basis points ("BPS"), 100 BPS and 150 BPS. The analysis is shown as of November 27, 2020 and November 29, 2019:

*(dollars in millions)*

| -150 BPS | -100 BPS | -50 BPS | Fair Value 11/27/20 | +50 BPS | +100 BPS | +150 BPS |
|---|---|---|---|---|---|---|
| $ 1,521 | $ 1,520 | $ 1,519 | $ 1,514 | $ 1,507 | $ 1,500 | $ 1,493 |
| **-150 BPS** | **-100 BPS** | **-50 BPS** | **Fair Value 11/29/19** | **+50 BPS** | **+100 BPS** | **+150 BPS** |
| $ 1,545 | $ 1,539 | $ 1,533 | $ 1,527 | $ 1,521 | $ 1,515 | $ 1,509 |

*Senior Notes*

Following our debt refinancing in February 2020, our outstanding Notes have fixed interest rates. As of November 27, 2020, the total carrying amount of our Notes was $4.12 billion and the related fair value based on observable market prices in less active markets was $4.48 billion.

*See Note 17 of our Notes to Consolidated Financial Statements for information regarding our senior notes.*

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**



All financial statement schedules have been omitted, since the required information is not applicable or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Consolidated Financial Statements and Notes thereto.

**ADOBE INC.**

**CONSOLIDATED BALANCE SHEETS**

**(In millions, except par value)**

| | November 27, 2020 | November 29, 2019 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 4,478 | $ 2,650 |
| Short-term investments | 1,514 | 1,527 |
| Trade receivables, net of allowances for doubtful accounts of $21 and of $10, respectively | 1,398 | 1,535 |
| Prepaid expenses and other current assets | 756 | 783 |
| Total current assets | 8,146 | 6,495 |
| Property and equipment, net | 1,517 | 1,293 |
| Operating lease right-of-use assets, net | 487 | — |
| Goodwill | 10,742 | 10,691 |
| Other intangibles, net | 1,359 | 1,721 |
| Deferred income taxes | 1,370 | — |
| Other assets | 663 | 562 |
| Total assets | $ 24,284 | $ 20,762 |
| | | |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Trade payables | $ 306 | $ 209 |
| Accrued expenses | 1,422 | 1,399 |
| Debt | — | 3,149 |
| Deferred revenue | 3,629 | 3,378 |
| Income taxes payable | 63 | 56 |
| Operating lease liabilities | 92 | — |
| Total current liabilities | 5,512 | 8,191 |
| Long-term liabilities: | | |
| Debt | 4,117 | 989 |
| Deferred revenue | 130 | 123 |
| Income taxes payable | 529 | 616 |
| Deferred income taxes | 10 | 140 |
| Operating lease liabilities | 499 | — |
| Other liabilities | 223 | 173 |
| Total liabilities | 11,020 | 10,232 |
| | | |
| Commitments and contingencies | | |
| | | |
| Stockholders' equity: | | |
| Preferred stock, $0.0001 par value; 2 shares authorized; none issued | — | — |
| Common stock, $0.0001 par value; 900 shares authorized; 601 shares issued; 479 and 483 shares outstanding, respectively | — | — |
| Additional paid-in-capital | 7,357 | 6,504 |
| Retained earnings | 19,611 | 14,829 |
| Accumulated other comprehensive income (loss) | (158) | (188) |
| Treasury stock, at cost (122 and 118 shares, respectively) | (13,546) | (10,615) |
| Total stockholders' equity | 13,264 | 10,530 |
| Total liabilities and stockholders' equity | $ 24,284 | $ 20,762 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE INC.**

**CONSOLIDATED STATEMENTS OF INCOME**

**(In millions, except per share data)**

| | Years Ended | | |
|---|---|---|---|
| | **November 27, 2020** | **November 29, 2019** | **November 30, 2018** |
| Revenue: | | | |
| Subscription | $ 11,626 | $ 9,634 | $ 7,604 |
| Product | 507 | 648 | 622 |
| Services and other | 735 | 889 | 804 |
| Total revenue | 12,868 | 11,171 | 9,030 |
| | | | |
| Cost of revenue: | | | |
| Subscription | 1,108 | 926 | 574 |
| Product | 36 | 40 | 46 |
| Services and other | 578 | 707 | 575 |
| Total cost of revenue | 1,722 | 1,673 | 1,195 |
| | | | |
| Gross profit | 11,146 | 9,498 | 7,835 |
| | | | |
| Operating expenses: | | | |
| Research and development | 2,188 | 1,930 | 1,538 |
| Sales and marketing | 3,591 | 3,244 | 2,621 |
| General and administrative | 968 | 881 | 745 |
| Amortization of intangibles | 162 | 175 | 91 |
| Total operating expenses | 6,909 | 6,230 | 4,995 |
| | | | |
| Operating income | 4,237 | 3,268 | 2,840 |
| | | | |
| Non-operating income (expense): | | | |
| Interest expense | (116) | (157) | (89) |
| Investment gains (losses), net | 13 | 52 | 3 |
| Other income (expense), net | 42 | 42 | 40 |
| Total non-operating income (expense), net | (61) | (63) | (46) |
| Income before income taxes | 4,176 | 3,205 | 2,794 |
| Provision for (benefit from) income taxes | (1,084) | 254 | 203 |
| Net income | $ 5,260 | $ 2,951 | $ 2,591 |
| Basic net income per share | $ 10.94 | $ 6.07 | $ 5.28 |
| Shares used to compute basic net income per share | 481 | 486 | 491 |
| Diluted net income per share | $ 10.83 | $ 6.00 | $ 5.20 |
| Shares used to compute diluted net income per share | 485 | 492 | 498 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(In millions)**

| | Years Ended | | |
|---|---|---|---|
| | November 27, 2020 | November 29, 2019 | November 30, 2018 |
| | Increase/(Decrease) | | |
| Net income | $ 5,260 | $ 2,951 | $ 2,591 |
| Other comprehensive income (loss), net of taxes: | | | |
| Available-for-sale securities: | | | |
| Unrealized gains / losses on available-for-sale securities | 3 | 29 | (24) |
| Reclassification adjustment for recognized gains / losses on available-for-sale securities | (1) | — | 11 |
| Net increase (decrease) from available-for-sale securities | 2 | 29 | (13) |
| Derivatives designated as hedging instruments: | | | |
| Unrealized gains / losses on derivative instruments | (44) | — | 74 |
| Reclassification adjustment for realized gains / losses on derivative instruments | 6 | (44) | (49) |
| Net increase (decrease) from derivatives designated as hedging instruments | (38) | (44) | 25 |
| Foreign currency translation adjustments | 66 | (25) | (48) |
| Other comprehensive income (loss), net of taxes | 30 | (40) | (36) |
| Total comprehensive income, net of taxes | $ 5,290 | $ 2,911 | $ 2,555 |

*See accompanying Notes to Consolidated Financial Statements.*

## ADOBE INC.
## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
## (In millions)

| | Common Stock | | | | | Treasury Stock | | |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Shares | Amount | Total |
| Balances at December 1, 2017 | 601 | $ — | $ 5,082 | $ 9,574 | $ (112) | (109) | $ (6,085) | $ 8,459 |
| Net income | — | — | — | 2,591 | — | — | — | 2,591 |
| Other comprehensive income (loss), net of taxes | — | — | — | — | (36) | — | — | (36) |
| Re-issuance of treasury stock under stock compensation plans | — | — | (1) | (349) | — | 5 | 148 | (202) |
| Purchase of treasury stock | — | — | — | — | — | (9) | (2,050) | (2,050) |
| Equity awards assumed for acquisition | — | — | 3 | — | — | — | — | 3 |
| Stock-based compensation | — | — | 601 | — | — | — | — | 601 |
| Value of shares in deferred compensation plan | — | — | — | — | — | — | (4) | (4) |
| Balances at November 30, 2018 | 601 | $ — | $ 5,685 | $ 11,816 | $ (148) | (113) | $ (7,991) | $ 9,362 |
| Impacts of adoption of the new revenue standard | — | — | — | 442 | — | — | — | 442 |
| Net income | — | — | — | 2,951 | — | — | — | 2,951 |
| Other comprehensive income (loss), net of taxes | — | — | — | — | (40) | — | — | (40) |
| Re-issuance of treasury stock under stock compensation plans | — | — | 48 | (380) | — | 5 | 125 | (207) |
| Purchase of treasury stock | — | — | — | — | — | (10) | (2,750) | (2,750) |
| Stock-based compensation | — | — | 771 | — | — | — | — | 771 |
| Value of shares in deferred compensation plan | — | — | — | — | — | — | 1 | 1 |
| Balances at November 29, 2019 | 601 | $ — | $ 6,504 | $ 14,829 | $ (188) | (118) | $ (10,615) | $ 10,530 |
| Net income | — | — | — | 5,260 | — | — | — | 5,260 |
| Other comprehensive income (loss), net of taxes | — | — | — | — | 30 | — | — | 30 |
| Re-issuance of treasury stock under stock compensation plans | — | — | (56) | (478) | — | 4 | 123 | (411) |
| Purchase of treasury stock | — | — | — | — | — | (8) | (3,050) | (3,050) |
| Stock-based compensation | — | — | 909 | — | — | — | — | 909 |
| Value of shares in deferred compensation plan | — | — | — | — | — | — | (4) | (4) |
| Balances at November 27, 2020 | 601 | $ — | $ 7,357 | $ 19,611 | $ (158) | (122) | $ (13,546) | $ 13,264 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In millions)**

| | Years Ended | | |
|---|---|---|---|
| | November 27, 2020 | November 29, 2019 | November 30, 2018 |
| Cash flows from operating activities: | | | |
| Net income | $ 5,260 | $ 2,951 | $ 2,591 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation, amortization and accretion | 757 | 757 | 346 |
| Stock-based compensation | 909 | 788 | 610 |
| Reduction of operating lease right-of-use assets | 87 | — | — |
| Deferred income taxes | (1,501) | 3 | (469) |
| Unrealized losses (gains) on investments, net | (11) | (48) | 1 |
| Other non-cash items | 40 | 14 | 7 |
| Changes in operating assets and liabilities, net of acquired assets and assumed liabilities: | | | |
| Trade receivables, net | 106 | (188) | (2) |
| Prepaid expenses and other assets | (288) | (551) | (77) |
| Trade payables | 96 | 23 | 55 |
| Accrued expenses and other liabilities | 86 | 172 | 44 |
| Income taxes payable | (72) | 4 | 479 |
| Deferred revenue | 258 | 497 | 444 |
| Net cash provided by operating activities | 5,727 | 4,422 | 4,029 |
| Cash flows from investing activities: | | | |
| Purchases of short-term investments | (1,071) | (700) | (566) |
| Maturities of short-term investments | 915 | 700 | 766 |
| Proceeds from sales of short-term investments | 167 | 86 | 1,709 |
| Acquisitions, net of cash acquired | — | (101) | (6,314) |
| Purchases of property and equipment | (419) | (395) | (267) |
| Purchases of long-term investments, intangibles and other assets | (15) | (49) | (18) |
| Proceeds from sales of long-term investments and other assets | 9 | 3 | 5 |
| Net cash used for investing activities | (414) | (456) | (4,685) |
| Cash flows from financing activities: | | | |
| Purchases of treasury stock | (3,050) | (2,750) | (2,050) |
| Proceeds from re-issuance of treasury stock | 270 | 233 | 191 |
| Taxes paid related to net share settlement of equity awards | (681) | (440) | (393) |
| Proceeds from issuance of debt | 3,144 | — | 2,248 |
| Repayment of debt | (3,150) | — | — |
| Other financing activities, net | (21) | 11 | (1) |
| Net cash used for financing activities | (3,488) | (2,946) | (5) |
| Effect of foreign currency exchange rates on cash and cash equivalents | 3 | (13) | (2) |
| Net increase (decrease) in cash and cash equivalents | 1,828 | 1,007 | (663) |
| Cash and cash equivalents at beginning of year | 2,650 | 1,643 | 2,306 |
| Cash and cash equivalents at end of year | $ 4,478 | $ 2,650 | $ 1,643 |
| Supplemental disclosures: | | | |
| Cash paid for income taxes, net of refunds | $ 469 | $ 352 | $ 210 |
| Cash paid for interest | $ 88 | $ 152 | $ 81 |
| Non-cash investing activities: | | | |
| Issuance of common stock and stock awards assumed in business acquisitions | $ — | $ — | $ 3 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## NOTE 1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

*Operations*

Founded in 1982, Adobe Inc. is one of the largest and most diversified software companies in the world. We offer a line of products and services used by creative professionals, marketers, knowledge workers, students, application developers, enterprises and consumers for creating, managing, delivering, measuring, optimizing, engaging and transacting with compelling content and experiences across personal computers, devices and media. We market our products and services directly to enterprise customers through our sales force and local field offices. We license our products to end users through app stores and our own website at www.adobe.com. We offer many of our products via a Software-as-a-Service ("SaaS") model or a managed services model, both of which are referred to as hosted or cloud-based, as well as through term subscription and pay-per-use models. We also distribute certain products and services through a network of distributors, value-added resellers, systems integrators, independent software vendors, retailers, software developers and original equipment manufacturers ("OEMs"). In addition, we license our technology to hardware manufacturers, software developers and service providers for use in their products and solutions. Our products run on personal and server-based computers, as well as on smartphones, tablets and other devices, depending on the product. We have operations in the Americas; Europe, Middle East and Africa ("EMEA"); and Asia-Pacific ("APAC").

*Basis of Presentation*

The accompanying Consolidated Financial Statements include those of Adobe and its subsidiaries, after elimination of all intercompany accounts and transactions. We have prepared the accompanying Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") and pursuant to the rules and regulations of the United States Securities and Exchange Commission (the "SEC").

*Use of Estimates*

In preparing Consolidated Financial Statements and related disclosures in conformity with GAAP and pursuant to the rules and regulations of the SEC, we must make estimates and judgments that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Estimates are used for, but not limited to, sales allowances and programs, bad debts, stock-based compensation, determining the fair value of acquired assets and assumed liabilities, impairment of goodwill and intangible assets, litigation and income taxes. Actual results may differ materially from these estimates.

In March 2020, the World Health Organization declared the outbreak of a disease caused by a novel strain of the coronavirus (COVID-19) to be a pandemic. This pandemic has created and may continue to create significant uncertainty in the macroeconomic environment which, in addition to other unforeseen effects of this pandemic, may adversely impact our results of operations. As a result, most of our estimates and assumptions may require increased judgment and carry a higher degree of variability and volatility. As events continue to evolve and additional information becomes available, our estimates may change materially in future periods.

*Fiscal Year*

Our fiscal year is a 52- or 53-week year that ends on the Friday closest to November 30. Fiscal years 2020, 2019 and 2018 were 52-week years.

*Reclassifications*

In the fourth quarter of fiscal 2020, we moved our Advertising Cloud offerings from our Digital Experience segment into our new Publishing and Advertising segment, which combined our Advertising Cloud offerings with our previous Publishing segment. This realignment is consistent with how we manage our Digital Experience segment to better reflect the strategic shift related to Advertising Cloud and to align with our overall core value proposition of delivering on customer experience management.

Further, we reclassified revenue and related cost of revenue of our Advertising Cloud offerings from subscription to services and other on our Consolidated Statements of Income.

Financial information for all fiscal years presented has been updated in our Consolidated Financial Statements to reflect these reclassifications. If the change was made at the beginning of fiscal 2020, reported revenue and cost of revenue in our income statements for each quarter of fiscal 2020 would have been as follows:

| | 2020 | | | | |
|---|---|---|---|---|---|
| | Quarter Ended | | | | Year Ended |
| *(in millions)* | February 28 | May 29 | August 28 | November 27 | November 27 |
| Revenue: | | | | | |
| Subscription | $ 2,732 | $ 2,831 | $ 2,948 | $ 3,115 | $ 11,626 |
| Product | 143 | 128 | 109 | 127 | 507 |
| Services and other | 216 | 169 | 168 | 182 | 735 |
| Total revenue | 3,091 | 3,128 | 3,225 | 3,424 | 12,868 |
| Cost of revenue: | | | | | |
| Subscription | 274 | 269 | 282 | 283 | 1,108 |
| Product | 7 | 9 | 10 | 10 | 36 |
| Services and other | 171 | 137 | 135 | 135 | 578 |
| Total cost of revenue | $ 452 | $ 415 | $ 427 | $ 428 | $ 1,722 |

Certain other immaterial prior year amounts have been reclassified to conform to current year presentation in the Consolidated Statements of Cash Flows and Notes to Consolidated Financial Statements.

**Significant Accounting Policies**

*Revenue Recognition*

Our revenue is derived from the sale of cloud-enabled software subscriptions, cloud-hosted offerings, term-based, royalty, and perpetual software licenses, associated software maintenance and support plans, consulting services, training and technical support. Most of our enterprise customer arrangements involve multiple promises to our customers.

Revenue is recognized when a contract exists between us and a customer and upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We enter into contracts that can include various combinations of products and services, which may be capable of being distinct and accounted for as separate performance obligations, or in the case of offerings such as cloud-enabled Creative Cloud and Document Cloud, accounted for as a single performance obligation. Revenue is recognized net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities.

*Subscription, Product and Services Offerings*

We enter into revenue arrangements in which a customer may purchase a combination of cloud-enabled subscriptions, cloud-hosted offerings, term-based, royalty, and perpetual software licenses, associated software maintenance and support plans, consulting services, training and technical support.

Fully hosted subscription services (SaaS) allow customers to access hosted software during the contractual term without taking possession of the software. Cloud-hosted subscription services may be sold on a fee-per-subscription period basis or based on consumption or usage.

We recognize revenue ratably over the contractual service term for hosted services that are priced based on a committed number of transactions where the delivery and consumption of the benefit of the services occur evenly over time, beginning on the date the services associated with the committed transactions are first made available to the customer and continuing through the end of the contractual service term. Over-usage fees and fees based on the actual number of transactions are billed in accordance with contract terms as these fees are incurred and are included in the transaction price of an arrangement as variable consideration. Fees based on a number of transactions, where invoicing is aligned to the pattern of performance, customer benefit and consumption, are typically accounted for utilizing the “as-invoiced” practical expedient. Revenue for subscriptions sold as a fee per period is recognized ratably over the contractual term as the customer simultaneously receives and consumes the benefit of the underlying service.

When cloud-enabled services are highly integrated and interrelated with on-premise software, such as in our cloud-enabled Creative Cloud and Document Cloud offerings, the individual components are not considered distinct and revenue is recognized ratably over the subscription period for which the cloud-enabled services are provided.

The subscription support plans related to those customer arrangements whose revenues we classify as subscription revenues represent stand-ready performance obligations. Revenue from these subscription support plans is recognized ratably over their respective contractual terms and classified as subscription revenue.

Licenses for on-premise software may be purchased on a perpetual basis, as a subscription for a fixed period of time or based on usage for certain of our OEM and royalty agreements. Revenue from distinct on-premise licenses is recognized at the point in time the software is available to the customer, provided all other revenue recognition criteria are met, and classified as product revenue on our Consolidated Statements of Income. Some of our enterprise license arrangements allow customers to commit non-cancellable funds. These non-cancellable committed funds are nonrefundable and provide our customers options to either renew monthly on-premise term-based licenses or use some or all funds to purchase other Adobe products or services. Revenue associated with these monthly term-based licenses and associated maintenance and support is classified as subscription revenue.

Our services and other revenue is comprised primarily of fees related to consulting, training, maintenance and support and our advertising offerings. We typically sell our consulting contracts on a time-and-materials and fixed-fee basis. These revenues are recognized as the services are performed for time and materials contracts and on a relative performance basis for fixed-fee contracts. Training revenues are recognized as the services are performed. Our maintenance and support offerings, which entitle customers, partners and developers to receive desktop product upgrades and enhancements or technical support, depending on the offering, are generally recognized ratably over the term of the arrangement. Our transaction-based advertising offerings, where fees are based on a number of impressions per month and invoicing is aligned to the pattern of performance, customer benefit and consumption, are typically accounted for utilizing the “as-invoiced” practical expedient.

We exclude from the transaction price sales and other taxes collected from customers on behalf of the relevant government authority. Most of our products are delivered electronically, however in instances where shipping and handling costs are incurred, we treat these amounts as costs to fulfill the contract and they are not considered a performance obligation and the associated fees are not included in the transaction price.

*Judgments*

Our contracts with customers may include multiple goods and services. For example, some of our offerings include both on-premise and/or on-device software licenses and cloud services. Determining whether the software licenses and the cloud services are distinct from each other, and therefore performance obligations to be accounted for separately, or not distinct from each other, and therefore part of a single performance obligation, may require significant judgment. We have concluded that the on-premise/on-device software licenses and cloud services provided in our Creative Cloud and Document Cloud subscription offerings are not distinct from each other such that revenue from each offering should be recognized ratably over the subscription period for which the cloud services are provided. In reaching this conclusion, we considered the nature of our promise to Creative Cloud and Document Cloud customers, which is to provide a complete end-to-end creative design or document workflow solution that operates seamlessly across multiple devices and teams. We fulfill this promise by providing access to a solution that integrates cloud-based and on-premise/on-device features that, together through their integration, provide functionalities, utility and workflow efficiencies that could not be obtained from either the on-premise/on-device software or cloud services on their own.

Cloud-based features that are integral to our Creative Cloud and Document Cloud offerings and that work together with the on-premise/on-device software include, but are not limited to: Creative Cloud Libraries, which enable customers to access their work, settings, preferences and other assets seamlessly across desktop and mobile devices and collaborate across teams in real time; shared reviews which enable simultaneous editing and commenting of PDFs across desktop, mobile and web; automatic cloud rendering of a design which enables it to be worked on in multiple mediums; and Sensei, Adobe's cloud-hosted artificial intelligence and machine learning framework, which enables features such as automated photo-editing, photograph content-awareness, natural language processing, optical character recognition and automated document tagging.

Standalone selling price is established by maximizing the amount of observable inputs, primarily actual historical selling prices for performance obligations where available, and includes consideration of factors such as go-to-market model and geography. Individual products may have multiple values for standalone selling price depending on factors such as where they are sold and what channel they are sold through. Where standalone selling price may not be directly observable (e.g., the performance obligation is not sold separately), we maximize the use of observable inputs by using information that may include reviewing pricing practices, performance obligations with similar customers and selling models.

Capitalized costs to obtain a contract are amortized over the expected period of benefit, which we have determined, based on analysis, to be 5 years. We evaluated qualitative and quantitative factors to determine the period of amortization, including contract length, renewals, customer life and the useful lives of our products and acquired products. When the expected period of benefit of an asset which would be capitalized is less than one year, we expense the amount as incurred, utilizing the practical expedient. We regularly evaluate whether there have been changes in the underlying assumptions and data used to determine the amortization period.

When revenue arrangements include components of third-party goods and services, for example in transactions which involve resale, fulfillment or providing advertising impressions to our end customer, we evaluate whether we are the principal, and report revenues on a gross basis, or an agent, and report revenues on a net basis. In this assessment, we consider if we obtain control of the specified goods or services before they are transferred to the customer by evaluating indicators such as which party is primarily responsible for fulfilling the promise to provide the goods or services, which party has discretion in establishing price and the underlying terms and conditions between the parties to the transaction.

We offer limited rights of return, rebates and price protection of our products under various policies and programs with our distributors, resellers and/or end-user customers. We estimate and record reserves for these programs as variable consideration when estimating transaction price. Returns, rebates and other offsets to transaction price are estimated at contract inception on a portfolio basis and assessed for reasonableness each reporting period when additional information becomes available.

*General Contract Provisions*

We maintain revenue reserves for rebates, rights of return and other limited price adjustments.

Distributors are allowed limited rights of return of products purchased during the previous quarter. In addition, distributors are allowed to return products that have reached the end of their lives, as defined by us, and for products that are being replaced by new versions.

We offer rebates to our distributors, resellers and/or end-user customers. Transaction price is reduced for these amounts based on actual performance against objectives set forth by us for a particular reporting period, such as volume and timely reporting.

On a quarterly basis, the amount of revenue that is reserved is calculated based on our historical trends and data specific to each reporting period. The primary method of establishing these reserves is to review historical data from prior periods as a percent of revenue to determine a historical reserve rate. We then apply the historical rate to the current period revenue as a basis for estimating future returns. When necessary, we also provide a specific reserve in excess of portfolio-level estimated requirements. This estimate can be affected by the amount of a particular product in the channel, the rate of sell-through, product plans and other factors.

Although our subscription contracts are generally non-cancellable, a limited number of customers have the right to cancel their contracts by providing prior written notice to us of their intent to cancel the remainder of the contract term and consumers have a period of time to terminate certain agreements without penalty. In the event a customer cancels their contract, they are generally not entitled to a refund for prior services we have provided to them. Contracts that include termination rights without substantive penalty are accounted for as contracts only for the committed period. Periods of time after the right of termination are accounted for as optional purchases when they do not represent material rights. For certain of our usage-based license agreements, typically in our royalty and OEM businesses, reporting may be received after the end of a fiscal period. In such instances, we estimate and accrue license revenue. We base our estimates on multiple factors, including historical sales information, seasonality and other business information which may impact our estimates. We do not estimate variable consideration for our sales and usage-based license royalty agreements, consistent with the associated exception for sales and usage-based royalties for the license of intellectual property under the revenue recognition standard.

*Property and Equipment*

We record property and equipment at cost less accumulated depreciation and amortization. Property and equipment are depreciated using the straight-line method over their estimated useful lives ranging from 1 to 20 years for computers and other equipment, which includes our corporate jet, 1 to 6 years for furniture and fixtures, 5 to 20 years for building improvements and up to 40 years for buildings. Leasehold improvements are amortized using the straight-line method over the lesser of the remaining respective lease term or estimated useful lives ranging from 1 to 15 years.

*Leases*

We determine if an arrangement is or contains a lease at contract inception. In certain of our lease arrangements, primarily those related to our data center arrangements, judgment is required in determining if a contract contains a lease. For these arrangements, there is judgment in evaluating if the arrangement involves an identified asset that is physically distinct or whether we have the right to substantially all of the capacity of an identified asset that is not physically distinct. In arrangements that involve an identified asset, there is also judgment in evaluating if we have the right to direct the use of that asset.

We do not have any finance leases. Operating leases are recorded in our Consolidated Balance Sheets. Right-of-use ("ROU") assets and lease liabilities are measured at the lease commencement date based on the present value of the remaining lease payments over the lease term, determined using the discount rate for the lease at the commencement date. Because the rate implicit in our leases is not readily determinable, we use our incremental borrowing rate as the discount rate, which approximates the interest rate at which we could borrow on a collateralized basis with similar terms and payments and in similar economic environments. As of November 27, 2020, our leases have remaining lease terms of up to 11 years, some of which include options to extend the lease for up to 14 years and options to terminate the lease within 1 year. Optional periods to extend the lease, including by not exercising a termination option, are included in the lease term when it is reasonably certain that the option will be exercised. We also have one land lease that expires in 2091. Operating lease expense is recognized on a straight-line basis over the lease term. We account for lease and non-lease components, principally common area maintenance for our facilities leases, as a single lease component for our facilities and data center leases.

*Goodwill, Intangibles and Other Long-Lived Assets*

Goodwill is assigned to one or more reporting segments on the date of acquisition. We review our goodwill for impairment annually during our second quarter of each fiscal year and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of any one of our reporting units below its respective carrying amount. In performing our goodwill impairment test, we first perform a qualitative assessment, which requires that we consider events or circumstances including macroeconomic conditions, industry and market considerations, cost factors, overall financial performance, changes in management or key personnel, changes in strategy, changes in customers, changes in the composition or carrying amount of a reporting segment's net assets and changes in our stock price. If, after assessing the totality of events or circumstances, we determine that it is more likely than not that the fair values of our reporting segments are greater than the carrying amounts, then the quantitative goodwill impairment test is not performed.

If the qualitative assessment indicates that the quantitative analysis should be performed, we then evaluate goodwill for impairment by comparing the fair value of each of our reporting segments to its carrying value, including the associated goodwill. To determine the fair values, we use the equal weighting of the market approach based on comparable publicly traded companies in similar lines of businesses and the income approach based on estimated discounted future cash flows. Our cash flow assumptions consider historical and forecasted revenue, operating costs and other relevant factors.

We completed our annual goodwill impairment test in the second quarter of fiscal 2020. We determined, after performing a qualitative review of each reporting segment, that it is more likely than not that the fair value of each of our reporting segments substantially exceeds the respective carrying amounts. Accordingly, there was no indication of impairment and the quantitative goodwill impairment test was not performed. We did not identify any events or changes in circumstances since the performance of our annual goodwill impairment test that would require us to perform another goodwill impairment test during the fiscal year.

We amortize intangible assets with finite lives over their estimated useful lives and review them for impairment whenever an impairment indicator exists. We continually monitor events and changes in circumstances that could indicate that the carrying amounts of our long-lived assets, including our intangible assets, may not be recoverable. When such events or changes in circumstances occur, we assess recoverability by determining whether the carrying value of such assets will be recovered through the undiscounted expected future cash flows. If the future undiscounted cash flows are less than the carrying amount of these assets, we recognize an impairment loss based on any excess of the carrying amount over the fair value of the assets. We did not recognize any intangible asset impairment charges in fiscal 2020, 2019 or 2018.

During fiscal 2020, our intangible assets were amortized over their estimated useful lives ranging from 3 to 15 years. Amortization is based on the pattern in which the economic benefits of the intangible asset will be consumed or on a straight-line basis when the consumption pattern is not apparent. The weighted average useful lives of our intangible assets were as follows:

| | **Weighted Average Useful Life (years)** |
|---|---|
| Customer contracts and relationships | 10 |
| Purchased technology | 6 |
| Trademarks | 9 |
| Other | 6 |

*Income Taxes*

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. We record a valuation allowance to reduce deferred tax assets to an amount for which realization is more likely than not.

During fiscal 2020, we completed intra-entity transfers of certain intellectual property rights (“IP rights”) which resulted in the establishment of deferred tax assets, net of valuation allowance, and related tax benefits of $224 million and $1.13 billion based on the fair value of the IP rights transferred in April and November 2020, respectively. The determination of the fair value involves significant judgment on future revenue growth, operating margins and discount rates. The tax-deductible amortization related to the transferred IP rights will be recognized over the period of economic benefit.

*Taxes Collected from Customers*

We net taxes collected from customers against those remitted to government authorities in our financial statements. Accordingly, taxes collected from customers are not reported as revenue.

*Treasury Stock*

We account for treasury stock under the cost method. When treasury stock is re-issued at a price higher than its cost, the difference is recorded as a component of additional paid-in-capital in our Consolidated Balance Sheets. When treasury stock is re-issued at a price lower than its cost, the difference is recorded as a component of additional paid-in-capital to the extent that there are previously recorded gains to offset the losses. If there are no treasury stock gains in additional paid-in-capital, the losses upon re-issuance of treasury stock are recorded as a reduction of retained earnings in our Consolidated Balance Sheets.

*Advertising Expenses*

Advertising costs are expensed as incurred. Advertising expenses for fiscal 2020, 2019 and 2018 were $362 million, $221 million and $174 million, respectively.

*Foreign Currency Translation*

We translate assets and liabilities of foreign subsidiaries, whose functional currency is their local currency, at exchange rates in effect at the balance sheet date. We translate revenue and expenses at the monthly average exchange rates. We include accumulated net translation adjustments in stockholders' equity as a component of accumulated other comprehensive income (loss).

*Derivative Financial Instruments*

In countries outside the United States, we transact business in U.S. Dollars and in various other currencies. We may use foreign exchange option contracts or forward contracts to hedge a portion of our forecasted foreign currency denominated revenue primarily in Euros, British Pounds, Japanese Yen and Australian Dollars. Additionally, we hedge our net recognized foreign currency monetary assets and liabilities with foreign exchange forward contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates.

We recognize all derivative instruments as either assets or liabilities in our Consolidated Balance Sheets and measure them at fair value. Gains and losses resulting from changes in fair value are accounted for depending on the use of the derivative and whether it is designated and qualifies for hedge accounting. Contracts that do not qualify for hedge accounting are adjusted to fair value through earnings.

Gains and losses related to changes in the fair value of interest rate swaps and foreign exchange forward contracts which hedge certain balance sheet positions are recorded each period as a component of other income (expense), net in our Consolidated Statements of Income. Foreign exchange option contracts hedging forecasted foreign currency revenue and Treasury lock agreements are designated as cash flow hedges with gains and losses recorded net of tax as a component of accumulated other comprehensive income (loss) in our Consolidated Balance Sheets until the forecasted transaction occurs. When the forecasted transaction affects earnings, we reclassify the related gain or loss on the foreign currency and Treasury lock cash flow hedges to revenue and interest expense, respectively.

*Concentration of Risk*

Financial instruments that potentially subject us to concentrations of credit risk are short-term fixed-income investments, structured repurchase transactions, foreign currency and interest rate hedge contracts and trade receivables.

Our investment portfolio consists of investment-grade securities diversified among security types, industries and issuers. Our cash and investments are held and primarily managed by recognized financial institutions that follow our investment policy. Our policy limits the amount of credit exposure to any one security issue or issuer and we believe no significant concentration of credit risk exists with respect to these investments.

We enter into master netting arrangements to mitigate credit risk in derivative transactions by permitting net settlement of transactions with the same counterparty. We also enter into collateral security agreements with certain of our counterparties to exchange cash collateral when the net fair value of certain derivative instruments fluctuates from contractually established thresholds.

Credit risk in receivables is limited to OEMs, dealers and distributors of hardware and software products to the retail market, customers to whom we license software directly and our SaaS offerings. A credit review is completed for our new distributors, dealers and OEMs. We also perform ongoing credit evaluations of our customers' financial condition and require letters of credit or other guarantees, whenever deemed necessary. The credit limit given to the customer is based on our risk assessment of their ability to pay, country risk and other factors and is not contingent on the resale of the product or on the collection of payments from their customers. Certain contracts with advertising agencies contain sequential liability provisions, under which the agency is not required to pay until payment is received from the agency's customers. In these circumstances, we evaluate the credit-worthiness of the agency's customers in addition to the agency itself. If we license our software or provide SaaS services to a customer where we have a reason to believe the customer's ability and intention to pay is not probable, the arrangement is not considered to be a revenue contract. Accordingly, we will not recognize any consideration received as revenue until termination or substantive completion of the services.

**Recently Adopted Accounting Guidance**

On February 24, 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-02, Leases (Topic 842), ("ASC 842"), a new standard related to leases to increase transparency and comparability among organizations by requiring the recognition of ROU assets and lease liabilities on the balance sheet for all leases with terms greater than twelve months, including for those leases classified as operating leases under the legacy standard ("ASC 840"). Under ASC 842, added disclosures are required as compared to ASC 840 to meet the objective of enabling users of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases.

On November 30, 2019, the beginning of our fiscal year 2020, we adopted ASC 842 using the alternative modified retrospective transition method provided in ASU 2018-11, Leases (Topic 842): Targeted Improvements. Under this method, we recorded ROU assets and lease liabilities of approximately $519 million and $618 million, respectively, at the adoption date and did not include any retrospective adjustments to comparative periods to reflect the adoption of ASC 842. The lease liabilities reflect the remaining minimum rental payments for our existing leases as of the adoption date, discounted using our incremental borrowing rate for each lease. The standard had no impact on our consolidated net income or cash flows. We elected the package of practical expedients permitted under the transition guidance, which allowed us to carry forward our assessments on whether a contract was or contains a lease, our historical lease classification and our initial direct costs for any leases that existed prior to adoption date. We also elected the practical expedient that allowed us to carry forward our accounting treatment for existing land easements. We did not elect the hindsight practical expedient to determine the lease term for existing leases.

On August 28, 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging, requiring expanded hedge accounting for both non-financial and financial risk components and refining the measurement of hedge results to better reflect an entity's hedging strategies. The updated standard also amends the presentation and disclosure requirements and changes how entities assess hedge effectiveness. On November 30, 2019, the beginning of our fiscal year 2020, we adopted the accounting requirements of the updated standard utilizing the modified retrospective method of transition. The adoption of this standard did not have a material impact on our Consolidated Financial Statements and related disclosures.

**Recent Accounting Pronouncements Not Yet Effective**

On June 16, 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses, requiring the measurement and recognition of expected credit losses for financial assets held at amortized cost, which include our accounts receivable and contract assets. The standard also requires that we recognize credit impairment losses related to our available-for-sale debt securities through an allowance for credit losses instead of a reduction in the cost basis. The effective date of the new standard for public companies is for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. Early adoption is permitted. The new standard must be adopted using a modified retrospective transition with a cumulative effect adjustment recorded to opening retained earnings as of the initial adoption date. The updated standard is effective for us beginning in the first quarter of fiscal 2021, and will not have a material impact on our Consolidated Financial Statements and related disclosures.

With the exception of the new standards discussed above, there have been no other new accounting pronouncements that have significance, or potential significance, to our Consolidated Financial Statements.

## NOTE 2. REVENUE

*Segment Information*

We report segment information based on the “management” approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of our reportable segments.

Our Chief Executive Officer, the chief operating decision maker, reviews revenue and gross margin information for each of our reportable segments, but does not review operating expenses on a segment by segment basis. In addition, with the exception of goodwill, we do not identify or allocate our assets by the reportable segments.

Following the move of our Advertising Cloud offerings from our Digital Experience segment into the Publishing segment, our business is organized into three reportable segments: Digital Media, Digital Experience, and Publishing and Advertising. These segments provide our senior management with a comprehensive financial view of our key businesses. Our segments are aligned around our two strategic growth opportunities as described in the “Business Overview” within Part I, Item 1, placing our Publishing and Advertising business in a third segment that contains some of our legacy products and solutions.

We categorize our products into the following reportable segments:

- *Digital Media*—Our Digital Media segment provides tools and solutions that enable individuals, teams and enterprises to create, publish, promote and monetize their digital content anywhere. Our customers include content creators, experience designers, app developers, enthusiasts, students, social media users and creative professionals, as well as marketing departments and agencies, companies and publishers. Our customers also include knowledge workers who create, collaborate on and distribute documents and creative content.

- *Digital Experience*—Our Digital Experience segment provides products, services and solutions for creating, managing, executing, measuring, monetizing and optimizing customer experiences from analytics to commerce. Our customers include marketers, advertisers, agencies, publishers, merchandisers, merchants, web analysts, data scientists, developers, marketing executives, information management and technology executives, product development executives, and sales and support executives.

- *Publishing and Advertising*—Our Publishing and Advertising segment addresses market opportunities ranging from the diverse authoring and publishing needs of technical and business publishing to our legacy type and OEM printing businesses. It also includes our platforms for Advertising Cloud, web conferencing, document and forms, and Primetime.

Financial results for fiscal 2020 and 2019 are presented below in accordance with ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs - Contracts with Customers (Subtopic 340-40), which was adopted under the modified retrospective method at the beginning of fiscal 2019. Fiscal 2018 revenue has not been restated.

**ADOBE INC.**

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

Our segment revenue and results for fiscal 2020, 2019 and 2018, updated for segment reclassifications discussed above, were as follows:

| *(dollars in millions)* | Digital Media | Digital Experience | Publishing and Advertising | Total |
|---|---|---|---|---|
| **Fiscal 2020** | | | | |
| Revenue | $ 9,233 | $ 3,125 | $ 510 | $ 12,868 |
| Cost of revenue | 352 | 1,126 | 244 | 1,722 |
| Gross profit | $ 8,881 | $ 1,999 | $ 266 | $ 11,146 |
| Gross profit as a percentage of revenue | 96 % | 64 % | 52 % | 87 % |
| **Fiscal 2019** | | | | |
| Revenue | $ 7,707 | $ 2,795 | $ 669 | $ 11,171 |
| Cost of revenue | 290 | 1,056 | 327 | 1,673 |
| Gross profit | $ 7,417 | $ 1,739 | $ 342 | $ 9,498 |
| Gross profit as a percentage of revenue | 96 % | 62 % | 51 % | 85 % |
| **Fiscal 2018** | | | | |
| Revenue | $ 6,325 | $ 2,073 | $ 632 | $ 9,030 |
| Cost of revenue | 249 | 679 | 267 | 1,195 |
| Gross profit | $ 6,076 | $ 1,394 | $ 365 | $ 7,835 |
| Gross profit as a percentage of revenue | 96 % | 67 % | 58 % | 87 % |

Revenue by geographic area for fiscal 2020, 2019 and 2018 were as follows:

| *(in millions)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| Americas: | | | |
| United States | $ 6,746 | $ 5,904 | $ 4,633 |
| Other | 708 | 602 | 484 |
| Total Americas | 7,454 | 6,506 | 5,117 |
| EMEA: | | | |
| United Kingdom | 880 | 794 | 653 |
| Other | 2,520 | 2,181 | 1,897 |
| Total EMEA | 3,400 | 2,975 | 2,550 |
| APAC: | | | |
| Japan | 893 | 751 | 609 |
| Other | 1,121 | 939 | 754 |
| Total APAC | 2,014 | 1,690 | 1,363 |
| Revenue | $ 12,868 | $ 11,171 | $ 9,030 |

Revenue by major offerings in our Digital Media reportable segment for fiscal 2020, 2019 and 2018 were as follows:

| *(in millions)* | 2020 | 2019 | 2018 |
| --- | --- | --- | --- |
| Creative Cloud | $ 7,736 | $ 6,482 | $ 5,343 |
| Document Cloud | 1,497 | 1,225 | 982 |
| Total | $ 9,233 | $ 7,707 | $ 6,325 |

Further, we reclassified revenue of our Advertising Cloud offerings from subscription to services and other on our Consolidated Statements of Income. Subscription revenue by segment for fiscal 2020, 2019 and 2018, updated for the reclassifications discussed above, were as follows:

| *(in millions)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| Digital Media | $ 8,813 | $ 7,208 | $ 5,858 |
| Digital Experience | 2,660 | 2,280 | 1,600 |
| Publishing and Advertising | 153 | 146 | 146 |
| Total | $ 11,626 | $ 9,634 | $ 7,604 |

*Contract Balances*

*Trade Receivables*

A receivable is recorded when an unconditional right to invoice and receive payment exists, such that only the passage of time is required before payment of consideration is due. Timing of revenue recognition may differ from the timing of invoicing to customers. Certain performance obligations may require payment before delivery of the license or service to the customer. Included in trade receivables on the Consolidated Balance Sheets are unbilled receivable balances which have not yet been invoiced, and are typically related to license revenue or services which are delivered prior to invoicing. As of November 27, 2020, the balance of trade receivables, net of allowances for doubtful accounts, was $1.40 billion, inclusive of unbilled receivables of $84 million. As of November 29, 2019, the balance of trade receivables, net of allowance for doubtful accounts, was $1.53 billion, inclusive of unbilled receivables of $149 million.

*Allowance for Doubtful Accounts*

We maintain an allowance for doubtful accounts which reflects our best estimate of potentially uncollectible trade receivables. The allowance is based on both specific and general reserves. We regularly review our trade receivables allowance by considering factors such as historical experience, credit-worthiness, the age of the trade receivable balances and current economic conditions that may affect a customer’s ability to pay and we specifically reserve for those deemed uncollectible.

During fiscal 2020, 2019 and 2018, our allowance for doubtful accounts activities were as follows:

| *(in millions)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| Beginning balance | $ 10 | $ 15 | $ 9 |
| Increase due to acquisition | — | — | 6 |
| Charged to operating expenses | 31 | 5 | 6 |
| Deductions[(1)] | (20) | (10) | (6) |
| Ending balance | $ 21 | $ 10 | $ 15 |

[(1)] Deductions related to the allowance for doubtful accounts represent amounts written off against the allowance, less recoveries.

*Contract Assets*

A contract asset is recognized when a conditional right to consideration exists and transfer of control has occurred. Contract assets are typically related to subscription and hosted service contracts where the transaction price allocated to the satisfied performance obligations exceeds the value of billings to date. Contract assets are included in prepaid expenses and other current assets for the current portion and other assets for the long-term portion on the Consolidated Balance Sheets. We regularly review contract asset balances for impairment, considering factors such as historical experience, credit-worthiness, age of the balance and other economic or business factors. Contract asset impairments were not material in fiscal 2020. Contract assets were $81 million and $64 million as of November 27, 2020 and November 29, 2019, respectively.

*Deferred Revenue and Remaining Performance Obligations*

Deferred revenue primarily consists of billings or payments received in advance of revenue recognition from subscription services, including non-cancellable and non-refundable committed funds and refundable customer deposits. Deferred revenue is recognized as revenue when transfer of control to customers has occurred. Customers are typically invoiced for these agreements in regular installments and revenue is recognized ratably over the contractual subscription period. The deferred revenue balance is influenced by several factors, including seasonality, the compounding effects of renewals, invoice duration, invoice timing, size and new business linearity within the quarter. Deferred revenue does not represent the total contract value of annual or multi-year non-cancellable subscription agreements.

Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 to 60 days. In instances where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts generally do not include a significant financing component. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, such as invoicing at the beginning of a subscription term with revenue recognized ratably over the contract period, and not to receive financing from our customers. Any potential financing fees are considered insignificant in the context of our contracts.

As of November 27, 2020, the balance of deferred revenue was $3.76 billion, which includes $64 million of refundable customer deposits. Refundable customer deposits represent arrangements in which the customer has a unilateral cancellation right for which we are obligated to refund amounts paid related to products or services not yet delivered or provided at the time of cancellation on a prorated basis. Arrangements with some of our enterprise customers with non-cancellable and non-refundable committed funds provide options to either renew monthly on-premise term-based licenses or use some or all funds to purchase other Adobe products or services. Non-cancellable and non-refundable committed funds related to these agreements comprised approximately 6% of the total deferred revenue.

As of November 29, 2019, the balance of deferred revenue was $3.50 billion. Significant movements in the deferred revenue balance during the period consisted of increases due to payments received prior to transfer of control of the underlying performance obligations to the customer, which were offset by decreases due to revenue recognized in the period. During the year ended November 27, 2020, approximately $3.22 billion of revenue was recognized that was included in the balance of deferred revenue as of November 29, 2019.

Transaction price allocated to remaining performance obligations represents contracted revenue that has not yet been recognized, which includes deferred revenue and unbilled amounts that will be recognized as revenue in future periods. Transaction price allocated to the remaining performance obligation is influenced by several factors, including the timing of renewals and average contract term. We applied practical expedients to exclude amounts related to performance obligations that are billed and recognized as they are delivered, optional purchases that do not represent material rights, sales- and usage-based royalties not yet consumed and any estimated amounts of variable consideration that are subject to constraint.

Remaining performance obligations were approximately $11.34 billion as of November 27, 2020. Non-cancellable and non-refundable committed funds related to some of our enterprise customer agreements referred to in the paragraph above comprised approximately 6% of the total remaining performance obligations. Approximately 73% of the remaining performance obligations, excluding the aforementioned enterprise customer agreements, are expected to be recognized over the next 12 months with the remainder recognized thereafter.

*Contract Acquisition Costs*

We recognize an asset for the incremental costs of obtaining a contract with a customer if we expect the benefit of those costs to be longer than one year. We have determined that certain sales incentive programs meet the requirements to be capitalized.

The costs capitalized are primarily sales commissions paid to our sales force personnel. Capitalized costs may also include portions of fringe benefits and payroll taxes associated with compensation for incremental costs to acquire customer contracts and incentive payments to partners.

Capitalized costs to obtain a contract are amortized over the expected period of benefit, which we have determined, based on analysis, to be 5 years. Amortization of capitalized costs are included in sales and marketing expense in our Consolidated Statements of Income. During fiscal 2020 and 2019, we amortized $186 million and $171 million of capitalized contract acquisition costs into sales and marketing expense, respectively. We did not incur any impairment losses in fiscal 2020 and 2019.

Capitalized contract acquisition costs was $530 million and $474 million as of November 27, 2020 and November 29, 2019, of which $352 million and $315 million was long-term and included in other assets in the Consolidated Balance Sheets, respectively. The remaining balance of the capitalized costs to obtain contracts was current and included in prepaid expenses and other current assets.

*Revenue Reserve*

During fiscal 2020, 2019 and 2018, our revenue reserve activities were as follows:

| *(in millions)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| Beginning balance | $ 7 | $ 25 | $ 22 |
| Impacts of adoption of the new revenue standard | — | (15) | — |
| Amount charged to revenue | 24 | 19 | 65 |
| Actual returns | (21) | (22) | (62) |
| Ending balance | $ 10 | $ 7 | $ 25 |

*Refund Liabilities*

As part of our revenue reserves, we record refund liabilities for amounts that may be subject to future refunds, which include sales returns reserves and customer rebates and credits. Refund liabilities are included in accrued expenses on the Consolidated Balance Sheets. Refund liabilities were $127 million and $126 million as of November 27, 2020 and November 29, 2019, respectively.

*Significant Customers*

For fiscal 2020, 2019 and 2018 there were no customers that represented at least 10% of net revenue. As of fiscal year end 2020 and 2019, no single customer was responsible for over 10% of our trade receivables.

## NOTE 3. ACQUISITIONS

*Workfront*

Subsequent to November 27, 2020, we completed our acquisition of Workfront, a privately held company that provides a work management platform for marketers, for approximately $1.50 billion in cash consideration. The initial purchase accounting for this transaction has not yet been completed given the short period of time between the acquisition date and issuance of these financial statements. Workfront will be integrated into our Digital Experience reportable segment for financial reporting purposes in the first quarter of fiscal 2021.

*Allegorithmic*

On January 23, 2019, we completed the acquisition of Allegorithmic, a privately held 3D editing and authoring software company for gaming and entertainment, and integrated it into our Digital Media reportable segment. Prior to the acquisition, we held an equity interest that was accounted for as an equity-method investment. We acquired the remaining equity interest for approximately $106 million in cash consideration. The total purchase price, inclusive of the acquisition-date fair-value of our pre-existing equity interest, was approximately $161 million.

In conjunction with the Allegorithmic acquisition, we separately recognized an investment gain of approximately $42 million, which represents the difference between the $55 million acquisition-date fair value of our pre-existing equity interest and our previous carrying amount.

Under the acquisition method of accounting, the total final purchase price was allocated to Allegorithmic's net tangible and intangible assets based upon their estimated fair values as of the acquisition date. The excess purchase price over the value of the net tangible and identifiable intangible assets was recorded as goodwill. Of the total purchase price, $126 million was allocated to goodwill that was non-deductible for tax purposes, $45 million to identifiable intangible assets and the remainder to net liabilities assumed.

Pro forma financial information has not been presented for the Allegorithmic acquisition as the impact to our Consolidated Financial Statements was not material.

*Marketo*

On October 31, 2018, we completed the acquisition of Marketo, a privately held marketing cloud platform company, for approximately $4.73 billion of cash consideration. Adding Marketo's engagement platform to Adobe Experience Cloud furthers our long-term plan for strategic growth in the Digital Experience segment and enables us to offer a comprehensive set of solutions to enable customers across industries and companies automate and orchestrate their marketing activities. Under the terms of the Share Purchase Agreement ("Purchase Agreement"), we acquired all of the issued and outstanding shares of capital stock of Milestone Topco, Inc., a Delaware corporation ("Topco") and indirect parent company of Marketo, and other equity interests in Marketo. In connection with the acquisition, each Marketo equity award that was issued and outstanding was cancelled and extinguished in exchange for cash consideration. Also pursuant to the Purchase Agreement, upon closing of the transaction, cash was paid for the settlement of Marketo's long-term incentive plan, the settlement of Marketo's indebtedness and the acquisition of all remaining equity interests in Marketo K.K., a Japanese corporation and joint venture.

In connection with the acquisition, we entered into a credit agreement providing for a $2.25 billion senior unsecured term loan ("Term Loan"). The proceeds of the Term Loan were used to fund a portion of the purchase price of the acquisition and pay fees and expenses incurred in connection with the acquisition. The Term Loan funds were received on October 31, 2018 upon closing of the acquisition. *See Note 17 for further details regarding our Term Loan.*

We integrated Marketo into our Digital Experience reportable segment and have included the financial results of Marketo in our Consolidated Financial Statements beginning on the acquisition date. The amounts of net revenue and net loss of Marketo included in our Consolidated Statements of Income from the acquisition date through November 30, 2018 were not material. The direct transaction costs associated with the acquisition were also not material.

*Purchase Price Allocation*

Under the purchase accounting method, the total final purchase price was allocated to Marketo's net tangible and intangible assets based upon their estimated fair values as of the acquisition date. The excess purchase price over the value of the net tangible and identifiable intangible assets was recorded as goodwill.

The table below represents the final purchase price allocation to the acquired net tangible and intangible assets of Marketo based on their estimated fair values as of October 31, 2018 and the associated estimated useful lives at that date. During fiscal 2019, we recorded immaterial purchase accounting adjustments based on changes to management's estimates and assumptions in regards to total purchase price, intangible assets, deferred revenue, tax liabilities assumed and their related impact to goodwill.

| *(in millions)* | Amount | Weighted Average Useful Life (years) |
|---|---|---|
| Customer contracts and relationships | $ 578 | 11 |
| Purchased technology | 444 | 7 |
| Backlog | 105 | 2 |
| Non-competition agreements | 12 | 2 |
| Trademarks | 329 | 9 |
| Total identifiable intangible assets | 1,468 | |
| Net liabilities assumed | (194) | N/A |
| Goodwill [1] | 3,459 | N/A |
| Total purchase price | $ 4,733 | |

[1] Non-deductible for tax-purposes.

*Identifiable intangible assets* — Customer relationships consist of Marketo's contractual relationships and customer loyalty related to their enterprise and commercial customers as well as technology partner relationships. The estimated fair value of the customer contracts and relationships was determined based on projected cash flows attributable to the asset. Purchased technology acquired primarily consists of Marketo's cloud-based engagement marketing software platform. The estimated fair value of the purchased technology was determined based on the expected future cost savings resulting from ownership of the asset. Backlog relates to subscription contracts and professional services. Non-compete agreements include agreements with key Marketo employees that preclude them from competing against Marketo for a period of two years from the acquisition date. Trademarks include the Marketo trade name, which is well known in the marketing ecosystem. We amortize the fair value of these intangible assets on a straight-line basis over their respective estimated useful lives.

*Goodwill* — Approximately $3.46 billion of goodwill has been allocated entirely to our Digital Experience reportable segment. Goodwill represents the excess of the purchase price over the fair value of the underlying acquired net tangible and intangible assets. The factors that contributed to the recognition of goodwill included securing buyer-specific synergies that increase revenue and profits and are not otherwise available to a marketplace participant, acquiring a talented workforce and cost savings opportunities.

*Net liabilities assumed* — Marketo's tangible assets and liabilities as of October 31, 2018 were reviewed and adjusted to their fair value as necessary. The net liabilities assumed included, among other items, $103 million in accrued expenses, $75 million in deferred revenue and $183 million in deferred tax liabilities, which were partially offset by $55 million in cash and cash equivalents and $72 million in trade receivables acquired.

*Deferred revenue* — Included in net liabilities assumed is Marketo's deferred revenue which represents advance payments from customers related to subscription contracts and professional services. We estimated our obligation related to the deferred revenue using the cost build-up approach. The cost build-up approach determines fair value by estimating the direct and indirect costs related to supporting the obligation plus an assumed operating margin. The sum of the costs and assumed operating profit approximates, in theory, the amount that Marketo would be required to pay a third party to assume the obligation. The estimated costs to fulfill the obligation were based on the near-term projected cost structure for subscription and professional services. As a result, we recorded an adjustment to reduce Marketo's carrying value of deferred revenue to $75 million, which represents our estimate of the fair value of the contractual obligations assumed.

*Taxes* — As part of our accounting for the Marketo acquisition, a portion of the overall purchase price was allocated to goodwill and acquired intangible assets. Amortization expense associated with acquired intangible assets is not deductible for tax purposes. Thus, approximately $349 million, included in the net liabilities assumed, was established as a deferred tax liability for the future amortization of the intangible assets, and was partially offset by other tax assets of $166 million, which primarily consist of net operating loss carryforwards.

Any impairment charges made in the future associated with goodwill will not be tax deductible and will result in an increased effective income tax rate in the quarter the impairment is recorded.

*Unaudited Pro Forma Results*

The financial information in the table below summarizes the combined results of operations of Adobe and Marketo, on a pro forma basis, as though the companies had been combined as of the beginning of the periods presented. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place on the earliest period presented or of results that may occur in the future.

The following unaudited pro forma financial information for fiscal 2018 combines the historical results for Adobe for the year ended November 30, 2018 and the historical results of Marketo for the period January 1, 2018 through October 31, 2018:

| *(in millions)* | 2018 |
|---|---|
| Net revenues | $ 9,339 |
| Net income | $ 2,362 |

*Magento*

On June 18, 2018, we completed our acquisition of Magento Commerce ("Magento"), a privately held commerce platform company, and integrated it into our Digital Experience reportable segment.

The table below represents the final purchase price allocation to the acquired net assets of Magento based on their estimated fair values as of June 18, 2018 and the associated estimated useful lives at that date. During fiscal 2019, we recorded immaterial purchase accounting adjustments based on changes to management's estimates and assumptions in regards to net liabilities assumed and their related impact to goodwill.

| *(in millions)* | Amount | Weighted Average Useful Life (years) |
|---|---|---|
| Customer contracts and relationships | $ 208 | 8 |
| Purchased technology | 84 | 5 |
| In-process research and development [(1)] | 39 | N/A |
| Trademarks | 21 | 3 |
| Other intangibles | 44 | 3 |
| Total identifiable intangible assets | 396 | |
| Net liabilities assumed | (68) | N/A |
| Goodwill [(2)] | 1,317 | N/A |
| Total purchase price | $ 1,645 | |

(1) Capitalized as purchased technology and are considered indefinite lived until the completion or abandonment of the associated research and development efforts. Subsequent to the acquisition, the associated in-process research and development efforts for certain projects were completed and the rest were abandoned. The respective related amortization and write-off were each immaterial.

(2) Substantially non-deductible for tax purposes.

Pro forma financial information has not been presented for the Magento acquisition as the impact to our Consolidated Financial Statements was not material.

*Other*

We also completed other immaterial business acquisitions during the fiscal years presented. Pro forma information has not been presented for these acquisitions as the impact to our Consolidated Financial Statements was not material.

## NOTE 4. CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

Cash equivalents consist of all highly liquid debt investments with remaining maturities of three months or less at the date of purchase. We classify our investments in marketable debt securities as “available-for-sale.” We carry these investments at fair value, based on quoted market prices or other readily available market information. Unrealized gains and losses, net of taxes, are included in accumulated other comprehensive income (loss), which is reflected as a separate component of stockholders’ equity in our Consolidated Balance Sheets. Gains and losses are determined using the specific identification method and recognized when realized in our Consolidated Statements of Income. When we have determined that an other-than-temporary decline in fair value has occurred, the amount of the decline that is related to a credit loss is recognized in income.

Cash, cash equivalents and short-term investments consisted of the following as of November 27, 2020:

| *(in millions)* | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Current assets: | | | | |
| Cash | $ 849 | $ — | $ — | $ 849 |
| Cash equivalents: | | | | |
| Corporate debt securities | 28 | — | — | 28 |
| Money market mutual funds | 3,483 | — | — | 3,483 |
| Time deposits | 118 | — | — | 118 |
| Total cash equivalents | 3,629 | — | — | 3,629 |
| Total cash and cash equivalents | 4,478 | — | — | 4,478 |
| Short-term fixed income securities: | | | | |
| Asset-backed securities | 105 | 1 | — | 106 |
| Corporate debt securities | 1,378 | 8 | — | 1,386 |
| Foreign government securities | 3 | — | — | 3 |
| Municipal securities | 19 | — | — | 19 |
| Total short-term investments | 1,505 | 9 | — | 1,514 |
| Total cash, cash equivalents and short-term investments | $ 5,983 | $ 9 | $ — | $ 5,992 |

Cash, cash equivalents and short-term investments consisted of the following as of November 29, 2019:

| *(in millions)* | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Current assets: | | | | |
| Cash | $ 467 | $ — | $ — | $ 467 |
| Cash equivalents: | | | | |
| Corporate debt securities | 46 | — | — | 46 |
| Money market mutual funds | 2,049 | — | — | 2,049 |
| Time deposits | 88 | — | — | 88 |
| Total cash equivalents | 2,183 | — | — | 2,183 |
| Total cash and cash equivalents | 2,650 | — | — | 2,650 |
| Short-term fixed income securities: | | | | |
| Asset-backed securities | 89 | — | — | 89 |
| Corporate debt securities | 1,408 | 4 | — | 1,412 |
| Municipal securities | 18 | — | — | 18 |
| U.S. Treasury securities | 8 | — | — | 8 |
| Total short-term investments | 1,523 | 4 | — | 1,527 |
| Total cash, cash equivalents and short-term investments | $ 4,173 | $ 4 | $ — | $ 4,177 |

*See Note 5 for further information regarding the fair value of our financial instruments.*

We had immaterial gross unrealized losses related to our available-for-sale securities as of November 27, 2020 and November 29, 2019. The following table summarizes the fair value of our available-for-sale securities that have been in a continuous unrealized loss position as of November 27, 2020 and November 29, 2019:

| *(in millions)* | 2020 | | 2019 | |
|---|---|---|---|---|
| | Less Than Twelve Months | More Than Twelve Months | Less Than Twelve Months | More Than Twelve Months |
| Corporate debt securities | $ 207 | $ — | $ 235 | $ 44 |
| Asset-backed securities | 22 | — | 7 | 7 |
| Municipal securities | — | — | 3 | — |
| Foreign government securities | 3 | — | — | — |
| Total | $ 232 | $ — | $ 245 | $ 51 |

There were 99 securities and 115 securities in an unrealized loss position for less than twelve months at November 27, 2020 and November 29, 2019, respectively. There were no securities and 38 securities in an unrealized loss position for more than twelve months at November 27, 2020 and November 29, 2019, respectively.

The following table summarizes the cost and estimated fair value of the fixed income securities classified as short-term investments based on stated effective maturities as of November 27, 2020:

| *(in millions)* | Amortized Cost | Estimated Fair Value |
|---|---|---|
| Due within one year | $ 841 | $ 843 |
| Due between one and two years | 428 | 433 |
| Due between two and three years | 185 | 186 |
| Due after three years | 51 | 52 |
| Total | $ 1,505 | $ 1,514 |

We review our debt securities classified as short-term investments on a regular basis to evaluate whether or not any security has experienced an other-than-temporary decline in fair value. We consider factors such as the length of time and extent to which the market value has been less than the cost, the financial condition and near-term prospects of the issuer and our intent to sell, or whether it is more likely than not we will be required to sell the investment before recovery of the investment's amortized cost basis. If we believe that an other-than-temporary decline exists in one of these securities, we write down these investments to fair value. The portion of the write-down related to credit loss would be recorded to other income (expense), net in our Consolidated Statements of Income. Any portion not related to credit loss would be recorded to accumulated other comprehensive income (loss), which is reflected as a separate component of stockholders' equity in our Consolidated Balance Sheets. During fiscal 2020, 2019 and 2018, we did not consider any of our investments to be other-than-temporarily impaired.

## NOTE 5. FAIR VALUE MEASUREMENTS

*Assets and Liabilities Measured and Recorded at Fair Value on a Recurring Basis*

We measure certain financial assets and liabilities at fair value on a recurring basis. There have been no transfers between fair value measurement levels during the year ended November 27, 2020.

The fair value of our financial assets and liabilities at November 27, 2020 was determined using the following inputs:

| *(in millions)* | Fair Value Measurements at Reporting Date Using | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Corporate debt securities | $ 28 | $ — | $ 28 | $ — |
| Money market mutual funds | 3,483 | 3,483 | — | — |
| Time deposits | 118 | 118 | — | — |
| Short-term investments: | | | | |
| Asset-backed securities | 106 | — | 106 | — |
| Corporate debt securities | 1,386 | — | 1,386 | — |
| Foreign government securities | 3 | — | 3 | — |
| Municipal securities | 19 | — | 19 | — |
| Prepaid expenses and other current assets: | | | | |
| Foreign currency derivatives | 15 | — | 15 | — |
| Other assets: | | | | |
| Deferred compensation plan assets | 116 | 7 | 109 | — |
| Total assets | $ 5,274 | $ 3,608 | $ 1,666 | $ — |
| | | | | |
| Liabilities: | | | | |
| Accrued expenses: | | | | |
| Foreign currency derivatives | $ 4 | $ — | $ 4 | $ — |

**ADOBE INC.**

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

The fair value of our financial assets and liabilities at November 29, 2019 was determined using the following inputs:

| *(in millions)* | Fair Value Measurements at Reporting Date Using | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Corporate debt securities | $ 46 | $ — | $ 46 | $ — |
| Money market mutual funds | 2,049 | 2,049 | — | — |
| Time deposits | 88 | 88 | — | — |
| Short-term investments: | | | | |
| Asset-backed securities | 89 | — | 89 | — |
| Corporate debt securities | 1,412 | — | 1,412 | — |
| Municipal securities | 18 | — | 18 | — |
| U.S. Treasury securities | 8 | — | 8 | — |
| Prepaid expenses and other current assets: | | | | |
| Foreign currency derivatives | 29 | — | 29 | — |
| Other assets: | | | | |
| Deferred compensation plan assets | 94 | 5 | 89 | — |
| Total assets | $ 3,833 | $ 2,142 | $ 1,691 | $ — |
| | | | | |
| Liabilities: | | | | |
| Accrued expenses: | | | | |
| Treasury lock derivatives | $ 30 | $ — | $ 30 | $ — |
| Foreign currency derivatives | 3 | — | 3 | — |
| Total liabilities | $ 33 | $ — | $ 33 | $ — |

*See Note 4 for further information regarding the fair value of our financial instruments.*

Our fixed income available-for-sale debt securities consist of high quality, investment grade securities from diverse issuers with a weighted average credit rating of A+. We value these securities based on pricing from independent pricing vendors who use matrix pricing valuation techniques including market approach methodologies that model information generated by market transactions involving identical or comparable assets, as well as discounted cash flow methodologies. Inputs include quoted prices in active markets for identical assets or inputs other than quoted prices that are observable either directly or indirectly in determining fair value, including benchmark yields, issuer spreads off benchmark yields, interest rates and U.S. Treasury or swap curves. We therefore classify all of our fixed income available-for-sale securities as Level 2. We perform routine procedures such as comparing prices obtained from multiple independent sources to ensure that appropriate fair values are recorded.

The fair values of our money market mutual funds and time deposits are based on the closing price of these assets as of the reporting date. We classify our money market mutual funds and time deposits as Level 1.

Our Level 2 over-the-counter foreign currency derivatives are valued using pricing models and discounted cash flow methodologies based on observable foreign exchange and interest rate data at the measurement date.

The invested amounts under our deferred compensation plan consist of money market mutual funds and other mutual funds, which are recorded as other assets on our Consolidated Balance Sheets with a corresponding offset to long-term liabilities.

Our other current financial assets and current financial liabilities have fair values that approximate their carrying values.

*Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis*

The fair value of our senior notes was $4.48 billion as of November 27, 2020, based on observable market prices in less active markets and categorized as Level 2. *See Note 17 for further details regarding our debt.*

## NOTE 6. DERIVATIVE FINANCIAL INSTRUMENTS

We may use derivatives to partially offset our business exposure to foreign currency and interest rate risk on expected future cash flows, and certain existing assets and liabilities. We do not use any of our derivative instruments for trading purposes.

We enter into master netting arrangements to mitigate credit risk in derivative transactions by permitting net settlement of transactions with the same counterparty. We do not offset fair value amounts recognized for derivative instruments under master netting arrangements. We also enter into collateral security agreements with certain of our counterparties to exchange cash collateral when the net fair value of certain derivative instruments fluctuates from contractually established thresholds. Collateral posted is included in prepaid expenses and other current assets and collateral received is included in accrued expenses on our Consolidated Balance Sheets.

*Cash Flow Hedges*

In countries outside the United States, we transact business in U.S. Dollars and in various other currencies. We may use foreign exchange option contracts or forward contracts to hedge a portion of our forecasted foreign currency denominated revenue. These foreign exchange contracts, carried at fair value, have maturities of up to twelve months. As of November 27, 2020, total notional amounts of outstanding cash flow hedges were $1.53 billion, hedging exposures denominated in Euros, British Pounds, Japanese Yen and Australian Dollars. As of November 29, 2019, total notional amounts of outstanding cash flow hedges were $1.20 billion, hedging exposures denominated in Euros, British Pounds and Japanese Yen.

In June 2019, in anticipation of refinancing our $2.25 billion term loan due April 30, 2020 (“Term Loan”) and $900 million 4.75% fixed interest rate senior notes due February 1, 2020 (“2020 Notes”), we entered into Treasury lock agreements with large financial institutions which fixed benchmark U.S. Treasury rates for an aggregate notional amount of $1 billion of our future debt issuance. These derivative instruments hedged the impact of changes in the benchmark interest rate to future interest payments and were settled upon debt issuance in the first quarter of fiscal 2020. We incurred a loss related to the settlement of the instruments which is amortized to interest expense over the term of our debt due February 1, 2030. *See Note 17 for further details regarding our debt.*

As of November 27, 2020, we had net derivative losses on our foreign exchange option contracts expected to be recognized within the next 18 months, of which $28 million of losses are expected to be recognized into revenue within the next 12 months. In addition, we had net derivative losses on our Treasury lock agreements, of which $4 million is expected to be recognized into interest expense within the next 12 months.

To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge, and the hedges must be highly effective in offsetting changes to future cash flows on hedged transactions. We record changes in fair value of these cash flow hedges in accumulated other comprehensive income (loss) in our Consolidated Balance Sheets, until the forecasted transaction occurs. When the forecasted transaction affects earnings, we reclassify the related gain or loss on the foreign currency and Treasury lock cash flow hedges to revenue and interest expense, respectively. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, we reclassify the gain or loss on the related cash flow hedge from accumulated other comprehensive income (loss) to the same income statement line item as the hedged item. We evaluate hedge effectiveness at the inception of the hedge prospectively, and on an ongoing basis both retrospectively and prospectively. If we do not elect hedge accounting, or the contract does not qualify for hedge accounting treatment, the changes in fair value from period to period are recorded in the same income statement line item as the hedged item.

Effective in the third quarter of fiscal 2019, all changes in fair value of our foreign currency cash flow hedges are recorded in accumulated other comprehensive income (loss). Prior to this, we recorded the time value of purchased contracts in other income (expense), net in our Consolidated Statements of Income. The impact of the de-designation of our hedges due to the change in methodology in the third quarter of fiscal 2019 was immaterial.

For fiscal 2020, 2019 and 2018, there were no net gains or losses recognized in income relating to hedges of forecasted transactions that did not occur.

*Fair Value Hedges*

During the third quarter of fiscal 2014, we entered into interest rate swaps designated as a fair value hedge related to our 2020 Notes. The interest rate swaps converted the fixed interest rate on our 2020 Notes to a floating interest rate based on the London Interbank Offered Rate ("LIBOR"). *See Note 17 for further details regarding our debt.*

The interest rate swaps were accounted for as fair value hedges and substantially offset the changes in fair value of the hedged portion of the underlying debt that were attributable to the changes in interest rate. Therefore, the gains and losses related to changes in the fair value of the interest rate swaps were included in other income (expense), net in our Consolidated Statements of Income.

During the first quarter of fiscal 2020, our 2020 Notes became due and were paid in conjunction with our debt refinancing. As of November 27, 2020, the interest rate swap agreements had matured and were no longer recognized in our Consolidated Financial Statements.

*Non-Designated Hedges*

Our derivatives not designated as hedging instruments consist of foreign currency forward contracts that we primarily use to hedge monetary assets and liabilities denominated in non-functional currencies. The changes in fair value of these contracts is recorded to other income (expense), net in our Consolidated Statements of Income. Changes in the fair value of the underlying assets and liabilities associated with the hedged risk are generally offset by the changes in the fair value of the related contracts.

As of November 27, 2020, total notional amounts of outstanding foreign currency forward contracts were $492 million, primarily hedging exposures denominated in Euros, British Pounds, Japanese Yen, Indian Rupees and Australian Dollars. As of November 29, 2019, total notional amounts of outstanding contracts were $702 million, primarily hedging exposures denominated in Euros, British Pounds, Japanese Yen and Indian Rupees. At November 27, 2020 and November 29, 2019, the outstanding balance sheet hedging derivatives had maturities of 180 days or less.

The fair value of derivative instruments on our Consolidated Balance Sheets as of November 27, 2020 and November 29, 2019 were as follows:

| *(in millions)* | 2020 | | 2019 | |
|---|---|---|---|---|
| | **Fair Value Asset Derivatives** | **Fair Value Liability Derivatives** | **Fair Value Asset Derivatives** | **Fair Value Liability Derivatives** |
| Derivatives designated as hedging instruments: | | | | |
| Foreign exchange option contracts [1] | $ 12 | $ — | $ 26 | $ — |
| Treasury lock [1] | — | — | — | 30 |
| Derivatives not designated as hedging instruments: | | | | |
| Foreign exchange forward contracts [1] | 3 | 4 | 3 | 3 |
| Total derivatives | $ 15 | $ 4 | $ 29 | $ 33 |

(1) Fair value asset derivatives are included in prepaid expenses and other current assets and fair value liability derivatives are included in accrued expenses on our Consolidated Balance Sheets.

Gains (losses) on derivative instruments, net of tax, recognized in our Consolidated Statements of Comprehensive Income for fiscal 2020, 2019 and 2018 were as follows:

| *(in millions)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| Derivatives in cash flow hedging relationships: | | | |
| Foreign exchange option contracts | $ (43) | $ 23 | $ 74 |
| Treasury lock | $ (1) | $ (23) | $ — |

The effects of derivative instruments on our Consolidated Statements of Income for fiscal 2020, 2019 and 2018 were as follows:

| *(in millions)* | 2020 | | | 2019 | | | 2018 | |
|---|---|---|---|---|---|---|---|---|
| | Revenue | Interest Expense | Other Income (Expense), Net | Revenue | Interest Expense | Other Income (Expense), Net | Revenue | Other Income (Expense), Net |
| Derivatives in cash flow hedging relationships: | | | | | | | | |
| Foreign exchange option contracts [(1)] | | | | | | | | |
| Net gain (loss) reclassified from accumulated OCI into income, net of tax | $ 3 | $ — | $ — | $ 39 | $ — | $ — | $ 49 | $ — |
| Amount excluded from effectiveness testing and ineffective portion | $ — | $ — | $ — | $ — | $ — | $ (24) | $ — | $ (41) |
| Treasury lock | | | | | | | | |
| Net gain (loss) reclassified from accumulated OCI into income, net of tax | $ — | $ (3) | $ — | $ — | $ (1) | $ — | $ — | $ — |
| Derivatives not designated as hedging relationships: | | | | | | | | |
| Foreign exchange option contracts | $ — | $ — | $ — | $ 1 | $ — | $ — | $ — | $ — |
| Foreign exchange forward contracts | $ — | $ — | $ 5 | $ — | $ — | $ 4 | $ — | $ 2 |

(1) Starting the third quarter of fiscal 2019, all changes in fair value of our foreign currency cash flow hedges are recorded in accumulated other comprehensive income (loss) (“OCI”).

Net gains (losses) recognized in other income (expense), net relating to foreign currency derivatives not designated as hedging instruments for fiscal 2020, 2019 and 2018 were as follows:

| *(in millions)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| Gain (loss) on foreign currency assets and liabilities: | | | |
| Net realized gain (loss) recognized in other income | $ (2) | $ (14) | $ 1 |
| Net unrealized gain (loss) recognized in other income | (5) | 8 | (4) |
| Gain (loss) on foreign currency assets and liabilities | (7) | (6) | (3) |
| Gain (loss) on hedges of foreign currency assets and liabilities: | | | |
| Net realized gain (loss) recognized in other income | 6 | 7 | (2) |
| Net unrealized gain (loss) recognized in other income | (1) | (3) | 4 |
| Gain (loss) on hedges of foreign currency assets and liabilities | 5 | 4 | 2 |
| Net gain (loss) recognized in other income (expense), net | $ (2) | $ (2) | $ (1) |

ADOBE INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

### NOTE 7. PROPERTY AND EQUIPMENT

Property and equipment, net consisted of the following as of November 27, 2020 and November 29, 2019:

| *(in millions)* | 2020 | 2019 |
|---|---|---|
| Computers and other equipment | $ 1,287 | $ 1,424 |
| Buildings | 561 | 483 |
| Building improvements | 340 | 308 |
| Leasehold improvements | 284 | 246 |
| Land | 145 | 145 |
| Furniture and fixtures | 159 | 144 |
| Capital projects in-progress | 199 | 112 |
| Total | 2,975 | 2,862 |
| Less: Accumulated depreciation and amortization | (1,458) | (1,569) |
| Property and equipment, net | $ 1,517 | $ 1,293 |

Depreciation and amortization expense of property and equipment for fiscal 2020, 2019 and 2018 was $192 million, $173 million and $157 million, respectively.

Property and equipment, net, by geographic area as of November 27, 2020 and November 29, 2019 was as follows:

| *(in millions)* | 2020 | 2019 |
|---|---|---|
| Americas: | | |
| United States | $ 1,328 | $ 1,126 |
| Other | 2 | 3 |
| Total Americas | 1,330 | 1,129 |
| EMEA | 64 | 54 |
| APAC | 123 | 110 |
| Property and equipment, net | $ 1,517 | $ 1,293 |

### NOTE 8. GOODWILL AND OTHER INTANGIBLES

Goodwill by reportable segment and activity for fiscal 2020 and 2019 was as follows:

| *(in millions)* | 2018 | Acquisitions | Other[1] | 2019 | Reclassification[2] | Other[1] | 2020 |
|---|---|---|---|---|---|---|---|
| Digital Media | $ 2,740 | $ 126 | $ (1) | $ 2,865 | $ — | $ 3 | $ 2,868 |
| Digital Experience | 7,463 | — | (15) | 7,448 | (20) | 48 | 7,476 |
| Publishing and Advertising | 378 | — | — | 378 | 20 | — | 398 |
| Goodwill | $ 10,581 | $ 126 | $ (16) | $ 10,691 | $ — | $ 51 | $ 10,742 |

(1) Amounts consist of foreign currency translation adjustments.

(2) In the fourth quarter of fiscal 2020, we moved our Advertising Cloud offerings from our Digital Experience segment into our new Publishing and Advertising segment, which combined Advertising Cloud with our previous Publishing segment.

Certain goodwill balances were misclassified between our reportable segments, which have been updated in the above tables. The impact to our prior year disclosures was immaterial and there was no impact to the Consolidated Financial Statements resulting from the change in classification.

**ADOBE INC.**

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

Other intangibles, net, as of November 27, 2020 and November 29, 2019 were as follows:

| *(in millions)* | 2020 | | | 2019 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net | Gross Carrying Amount | Accumulated Amortization | Net |
| Customer contracts and relationships | $ 958 | $ (289) | $ 669 | $ 1,219 | $ (436) | $ 783 |
| Purchased technology | 756 | (347) | 409 | 759 | (223) | 536 |
| Trademarks | 384 | (122) | 262 | 384 | (73) | 311 |
| Other | 84 | (65) | 19 | 227 | (136) | 91 |
| Other intangibles, net | $ 2,182 | $ (823) | $ 1,359 | $ 2,589 | $ (868) | $ 1,721 |

In fiscal 2020, and 2019, certain intangibles associated with our acquisitions in prior years became fully amortized and were removed from the Consolidated Balance Sheets.

Amortization expense related to other intangibles was $367 million, $402 million and $183 million for fiscal 2020, 2019 and 2018 respectively. Of these amounts, $205 million, $227 million and $91 million were included in cost of sales for fiscal 2020, 2019 and 2018 respectively.

Other intangibles are amortized over their estimated useful lives of 3 to 15 years. As of November 27, 2020, we expect the estimated aggregate amortization expense for each of the five succeeding fiscal years to be as follows:

| *(in millions)* | Other Intangibles |
|---|---|
| 2021 | $ 254 |
| 2022 | 224 |
| 2023 | 215 |
| 2024 | 202 |
| 2025 | 183 |
| Thereafter | 281 |
| Total expected amortization expense | $ 1,359 |

## NOTE 9. ACCRUED EXPENSES

Accrued expenses as of November 27, 2020 and November 29, 2019 consisted of the following:

| *(in millions)* | 2020 | 2019 |
|---|---|---|
| Accrued compensation and benefits | $ 375 | $ 318 |
| Accrued bonuses | 330 | 222 |
| Refund liabilities | 127 | 126 |
| Accrued corporate marketing | 134 | 80 |
| Accrued media costs | 55 | 118 |
| Taxes payable | 95 | 83 |
| Accrued hosting fees | 66 | 36 |
| Royalties payable | 34 | 62 |
| Accrued interest expense | 32 | 29 |
| Fair value of derivatives | 4 | 33 |
| Accrued building rent | — | 99 |
| Other | 170 | 193 |
| Accrued expenses | $ 1,422 | $ 1,399 |

Accrued media costs primarily relate to our transaction-driven Advertising Cloud offerings which we began to discontinue during the second quarter of fiscal 2020. Other primarily includes general corporate accruals for local and regional expenses, including accruals for fees associated with the cancellation of corporate events. Beginning the first quarter of fiscal 2020, as a result of ASC 842 adoption, accrued building rent is recorded as a reduction to our operating lease right-of-use assets on our Consolidated Balance Sheets. *See Note 1 for further information regarding our adoption of ASC 842.*

## NOTE 10. INCOME TAXES

Income before income taxes for fiscal 2020, 2019 and 2018 consisted of the following:

| *(in millions)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| Domestic | $ 1,090 | $ 438 | $ 543 |
| Foreign | 3,086 | 2,767 | 2,251 |
| Income before income taxes | $ 4,176 | $ 3,205 | $ 2,794 |

The provision for (benefit from) income taxes for fiscal 2020, 2019 and 2018 consisted of the following:

| *(in millions)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| Current: | | | |
| United States federal | $ 119 | $ 7 | $ 501 |
| Foreign | 222 | 211 | 140 |
| State and local | 79 | 31 | 29 |
| Total current | 420 | 249 | 670 |
| Deferred: | | | |
| United States federal | (123) | 23 | (466) |
| Foreign | (1,313) | (12) | (10) |
| State and local | (68) | (6) | 9 |
| Total deferred | (1,504) | 5 | (467) |
| Provision for (benefit from) income taxes | $ (1,084) | $ 254 | $ 203 |

*Intra-Entity Transfers of Certain Intellectual Property Rights ("IP rights")*

During fiscal 2020, we completed intra-entity transfers of certain IP rights to our Irish subsidiary in order to better align the ownership of these rights with how our business operates. The transfers did not result in taxable gains; however, our Irish subsidiary recognized deferred tax assets for the book and tax basis difference of the transferred IP rights. As a result of these transactions, we recorded deferred tax assets, net of valuation allowance, and related tax benefits of $224 million and $1.13 billion, based on the fair value of the IP rights transferred in April and November 2020, respectively. The determination of the fair value involves significant judgment on future revenue growth, operating margins and discount rates. The tax-deductible amortization related to the transferred IP rights will be recognized over the period of economic benefit.

*U.S. Tax Reform*

On December 22, 2017, the U.S. Tax Cuts and Jobs Act ("U.S. Tax Act") was enacted into law, which significantly changed existing U.S. tax law and included many provisions applicable to us, such as reducing the U.S. federal statutory tax rate to 21% and imposing a one-time transition tax on deferred foreign income not previously subject to U.S. income tax and certain international provisions. During fiscal 2018, we recorded tax charges for the impact of the U.S. Tax Act using the available information and technical guidance as of November 30, 2018.

Certain international provisions introduced in the U.S. Tax Act, such as a tax on global intangible low-tax income, a base erosion and anti-abuse tax and a special tax deduction for foreign-derived intangible income, took effect in fiscal 2019. As the U.S. Treasury releases regulations that impact these provisions, we account for finalized regulations in the period of enactment.

*Reconciliation of Provision for (Benefit from) Income Taxes*

Total income tax expense differs from the expected tax expense, computed by multiplying the U.S. federal statutory rate of 21% in both fiscal 2020 and 2019 and 22.2% in fiscal 2018 by income before income taxes, as a result of the following:

| *(in millions)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| Computed "expected" tax expense | $ 877 | $ 673 | $ 620 |
| State tax expense, net of federal benefit | 10 | 24 | 25 |
| Impacts of intra-entity IP transfers | (1,360) | — | — |
| Tax credits | (101) | (100) | (111) |
| Effects of non-U.S. operations | (337) | (224) | (384) |
| Stock-based compensation, net of tax deduction | (154) | (86) | (95) |
| Resolution of income tax examinations | (23) | (39) | (42) |
| Impacts of the U.S. Tax Act | — | 3 | 186 |
| Other | 4 | 3 | 4 |
| Provision for (benefit from) income taxes | $ (1,084) | $ 254 | $ 203 |

**ADOBE INC.**

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

*Deferred Tax Assets and Liabilities*

The tax effects of the temporary differences that gave rise to significant portions of the deferred tax assets and liabilities as of November 27, 2020 and November 29, 2019 are presented below:

| *(in millions)* | 2020 | 2019 |
|---|---|---|
| Deferred tax assets: | | |
| Intangible assets | $ 1,368 | $ 5 |
| Reserves and accruals | 71 | 54 |
| Stock-based compensation | 92 | 107 |
| Net operating loss carryforwards of acquired companies | 54 | 137 |
| Credit carryforwards | 218 | 252 |
| Capitalized expenses | 292 | 45 |
| Benefits relating to tax positions | 44 | 47 |
| Operating lease liabilities | 131 | — |
| Other | 37 | 45 |
| Total gross deferred tax assets | 2,307 | 692 |
| Valuation allowance | (276) | (245) |
| Total deferred tax assets | 2,031 | 447 |
| Deferred tax liabilities: | | |
| Depreciation and amortization | 52 | 36 |
| Undistributed earnings of foreign subsidiaries | 51 | 52 |
| Prepaid expenses | 107 | 86 |
| Acquired intangible assets | 330 | 413 |
| Operating lease right-of-use assets | 131 | — |
| Total deferred tax liabilities | 671 | 587 |
| Net deferred tax assets (liabilities) | $ 1,360 | $ (140) |

Deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. In assessing the realizability of deferred tax assets, management determined that it is not more likely than not that we will have sufficient taxable income in certain states and foreign jurisdictions to fully utilize available tax credits and other attributes. The deferred tax assets are offset by a valuation allowance to the extent it is more likely than not that they are not expected to be realized.

We provide U.S. income taxes on the earnings of foreign subsidiaries unless the subsidiaries' earnings are considered permanently reinvested outside the United States or are exempted from further taxation. To the extent that the foreign earnings previously treated as permanently reinvested are repatriated, the related U.S. tax liability may be reduced by any foreign income taxes paid on these earnings. As of November 27, 2020, the cumulative amount of foreign earnings upon which U.S. income taxes have not been provided, and the corresponding unrecognized deferred tax liability, is not material.

As of November 27, 2020, we have net operating loss carryforwards of approximately $39 million for federal, $367 million for state and $75 million for foreign. We also have federal, state and foreign tax credit carryforwards of approximately $16 million, $236 million and $16 million, respectively. The net operating loss carryforward assets and tax credits will expire in various years from fiscal 2021 through 2038. The majority of the state tax credit carryforwards can be carried forward indefinitely. Certain net operating loss carryforward assets and tax credits are reduced by a valuation allowance and/or are subject to an annual limitation under Internal Revenue Code Section 382. The carrying amount of such assets and credits is expected to be fully realized.

As of November 27, 2020, a valuation allowance of $276 million has been established for certain deferred tax assets related to certain state and foreign assets. For fiscal 2020, the total change in the valuation allowance was $31 million.

*Accounting for Uncertainty in Income Taxes*

During fiscal 2020 and 2019, our aggregate changes in our total gross amount of unrecognized tax benefits are summarized as follows:

| *(in millions)* | 2020 | 2019 |
|---|---|---|
| Beginning balance | $ 173 | $ 196 |
| Gross increases in unrecognized tax benefits – prior year tax positions | 14 | 15 |
| Gross decreases in unrecognized tax benefits – prior year tax positions | — | (2) |
| Gross increases in unrecognized tax benefits – current year tax positions | 44 | 18 |
| Gross decreases in unrecognized tax benefits – current year tax positions | — | (3) |
| Settlements with taxing authorities | (11) | — |
| Lapse of statute of limitations | (23) | (50) |
| Foreign exchange gains and losses | 4 | (1) |
| Ending balance | $ 201 | $ 173 |

The combined amount of accrued interest and penalties related to tax positions taken on our tax returns were approximately $26 million and $25 million for fiscal 2020 and 2019, respectively. These amounts were included in long-term income taxes payable in their respective years.

While we file federal, state and local income tax returns globally, our major tax jurisdictions are Ireland, California and the United States. We are subject to the continual examination of our income tax returns by the U.S. Internal Revenue Service and other domestic and foreign tax authorities. These tax examinations are expected to focus on our intercompany transfer pricing practices, application of tax rules and other matters. For Ireland, California and the United States, the earliest fiscal years open for examination are 2008, 2016 and 2017, respectively. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from these examinations. We believe such estimates to be reasonable; however, we cannot provide assurance that the final determination of any of these examinations will not have an adverse effect on our operating results and financial position.

The timing of the resolution of income tax examinations is highly uncertain as are the amounts and timing of tax payments that are part of any audit settlement process. These events could cause large fluctuations in the balance sheet classification of our tax assets and liabilities. We believe that within the next 12 months, it is reasonably possible that either certain audits will conclude or statutes of limitations on certain income tax examination periods will expire, or both. Given the uncertainties described above, we can only determine a range of estimated potential decreases in underlying unrecognized tax benefits ranging from $0 to approximately $20 million over the next 12 months.

## NOTE 11. BENEFIT PLANS

*Retirement Savings Plan*

In 1987, we adopted an Employee Investment Plan, qualified under Section 401(k) of the Internal Revenue Code, which is a retirement savings plan covering substantially all of our U.S. employees, now referred to as the Adobe Inc. 401(k) Retirement Savings Plan. Under the plan, eligible employees may contribute up to 65% of their pretax or after-tax salary, subject to the IRS annual contribution limits. In fiscal 2020, we matched 50% of the first 6% of the employee's eligible compensation. We contributed $59 million, $52 million and $41 million in fiscal 2020, 2019 and 2018, respectively. We are under no obligation to continue matching future employee contributions and, at our discretion, may change our practices at any time.

*Deferred Compensation Plan*

On September 21, 2006, the Board of Directors approved the Adobe Inc. Deferred Compensation Plan, effective December 2, 2006 (the “Deferred Compensation Plan”). The Deferred Compensation Plan is an unfunded, non-qualified, deferred compensation arrangement under which certain executives are able to defer a portion of their annual compensation. Participants may elect to contribute up to 75% of their base salary and 100% of other specified compensation, including commissions, bonuses and directors’ fees. Participants are able to elect the payment of benefits to begin on a specified date at least three years after the end of the plan year in which election is made or vests. Members of the Board of Directors are also eligible to participate in the Plan and are able to defer cash compensation and elect cash benefit distributions in the same manner as executives. Beginning January 1, 2020, only members of the Board are permitted to defer vested equity awards. For cash benefit elections, distributions are made in cash and in the form of a lump sum, or five, ten, or fifteen-year annual installments. For equity award elections, distributions are settled in stock and in the form of a lump sum payment only.

As of November 27, 2020 and November 29, 2019, the invested amounts under the Deferred Compensation Plan total $117 million and $94 million, respectively and were recorded as other assets on our Consolidated Balance Sheets. As of November 27, 2020 and November 29, 2019, $137 million and $109 million, respectively, were recorded as long-term liabilities to recognize undistributed deferred compensation due to employees.

## NOTE 12. STOCK-BASED COMPENSATION

Our stock-based compensation programs are long-term retention programs that are intended to attract, retain and provide incentives for employees, officers and directors, and to align stockholder and employee interests. We have the following stock-based compensation plans and programs:

*Restricted Stock Units and Performance Share Programs*

We grant restricted stock units and performance awards to eligible employees under our 2019 Equity Incentive Plan (“2019 Plan”). Restricted stock units generally vest over four years. Certain grants have other vesting periods approved by the Executive Compensation Committee of our Board of Directors.

As of November 27, 2020, we had reserved 46.0 million shares of common stock for issuance under our 2019 Plan and had 38.1 million shares available for grant.

Our Performance Share Programs aim to help focus key employees on building stockholder value, provide significant award potential for achieving outstanding Company performance and enhance the ability of the Company to attract and retain highly talented and competent individuals. The Executive Compensation Committee of our Board of Directors approves the terms of each of our Performance Share Programs, including the award calculation methodology. Shares may be earned based on the achievement of an objective relative total stockholder return measured over a three-year performance period. Performance share awards will be awarded and cliff-vest upon the later of the Executive Compensation Committee's certification of the level of achievement or the three-year anniversary of each grant. Participants can earn between 0% and 200% of the target number of performance shares.

On January 24, 2020, the Executive Compensation Committee approved the 2020 Performance Share Program, the terms of which are similar to prior year performance share programs as discussed above.

As of November 27, 2020, the shares awarded under our 2020, 2019 and 2018 Performance Share Programs remain outstanding and are yet to be achieved.

*Employee Stock Purchase Plan*

Our Employee Stock Purchase Plan (“ESPP”) allows eligible employee participants to purchase shares of our common stock at a discount through payroll deductions. The ESPP consists of twenty-four-month offering periods with four six-month purchase periods in each offering period. Employees purchase shares in each purchase period at

85% of the market value of our common stock at either the beginning of the offering period or the end of the purchase period, whichever price is lower. The ESPP will continue until the earlier of termination by the Board of Directors or the date on which all of the shares available for issuance under the plan have been issued.

**ADOBE INC.**

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

In April 2020, our stockholders approved the 2020 Employee Stock Purchase Plan ("2020 ESPP") which amended and restated the 1997 ESPP to increase the maximum number of shares of our common stock that may be issued under the plan.

As of November 27, 2020, we had reserved 103.0 million shares of our common stock for issuance under the 2020 ESPP and approximately 12.6 million shares remain available for future issuance.

*Issuance of Shares*

Upon vesting of restricted stock units and performance shares or purchase of shares under the ESPP, we will issue treasury stock. If treasury stock is not available, common stock will be issued. In order to minimize the impact of on-going dilution from issuance of shares, we instituted a stock repurchase program. *See Note 14 for information regarding our stock repurchase programs.*

*Valuation of Stock-Based Compensation*

Stock-based compensation cost is measured at the grant date based on the fair value of the award.

Our performance share awards are valued using a Monte Carlo Simulation model. The fair value of the awards are fixed at grant date and amortized over the longer of the remaining performance or service period.

We use the Black-Scholes option pricing model to determine the fair value of ESPP shares. The determination of the fair value of stock-based payment awards on the date of grant using an option pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the expected term of the awards, actual and projected employee stock option exercise behaviors, a risk-free interest rate and any expected dividends.

*Summary of Restricted Stock Units*

Restricted stock unit activity for fiscal 2020 was as follows:

| | Number of Shares (in millions) | Weighted Average Grant Date Fair Value | Aggregate Fair Value[1] (in millions) | Weighted Average Remaining Contractual Life (years) |
|---|---|---|---|---|
| Beginning outstanding balance | 8.6 | $ 211.95 | | |
| Awarded | 3.1 | $ 358.68 | | |
| Released | (4.2) | $ 193.08 | | |
| Forfeited | (0.5) | $ 255.16 | | |
| Ending outstanding balance | 7.0 | $ 285.69 | $ 3,322 | 1.15 |
| Expected to vest | 6.4 | $ 283.77 | $ 3,066 | 1.09 |

[1] The aggregate fair value is calculated using the closing stock price as of November 27, 2020 of $477.03.

The weighted average grant date fair values of restricted stock units granted during fiscal 2020, 2019 and 2018 were $358.68, $253.91 and $208.73, respectively. The total fair value of restricted stock units vested during fiscal 2020, 2019 and 2018 was $1.61 billion, $970 million and $837 million, respectively.

*Summary of Performance Shares*

Performance share activity for fiscal 2020 was as follows:

| | Number of Shares (in millions) | Weighted Average Grant Date Fair Value | Aggregate Fair Value[1] (in millions) | Weighted Average Remaining Contractual Life (years) |
|---|---|---|---|---|
| Beginning outstanding balance | 1.0 | $ 199.78 | | |
| Awarded | 0.6 | $ 271.62 | | |
| Achieved | (0.8) | $ 118.84 | | |
| Forfeited | (0.1) | $ 303.13 | | |
| Ending outstanding balance | 0.7 | $ 333.85 | $ 342 | 1.16 |
| Expected to vest | 0.7 | $ 327.36 | $ 315 | 1.12 |

[1] The aggregate fair value is calculated using the closing stock price as of November 27, 2020 of $477.03.

Shares awarded during fiscal 2020 include 0.4 million additional shares awarded for the final achievement of the 2017 Performance Share Program which was certified in the first quarter of fiscal 2020. The remaining awarded shares were for the 2020 Performance Share Program. Shares achieved during fiscal 2020 resulted from 200% achievement of target for the 2017 Performance Share Program.

The weighted average grant date fair values of performance awards granted during fiscal 2020, 2019 and 2018 were $271.62, $177.33 and $123.78, respectively. The total fair value of performance awards achieved during fiscal 2020, 2019 and 2018 was $273 million, $204 million and $208 million, respectively.

*Summary of Employee Stock Purchase Plan Shares*

Employees purchased 1.2 million shares at an average price of $218.37, 1.5 million shares at an average price of $150.55, and 1.8 million shares at an average price of $104.94 for fiscal 2020, 2019 and 2018, respectively. The intrinsic value of shares purchased during fiscal 2020, 2019 and 2018 was $216 million, $179 million and $199 million, respectively. The intrinsic value is calculated as the difference between the market value on the date of purchase and the purchase price of the shares.

*Compensation Costs*

We recognize the estimated compensation cost of restricted stock units, net of estimated forfeitures, on a straight-line basis over the requisite service period of the entire award, which is generally the vesting period. The estimated compensation cost is based on the fair value of our common stock on the date of grant.

We also recognize the estimated compensation cost of performance shares, net of estimated forfeitures, on a straight-line basis over the requisite performance period or service period of the entire award, whichever is longer. Our performance share awards are earned upon achievement of an objective total stockholder return measure at the end of the three-year performance period, as described above.

We estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate forfeitures and record stock-based compensation expense only for those awards that are expected to vest.

As of November 27, 2020, there was $1.57 billion of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock-based awards and purchase rights which will be recognized over a weighted average period of 2.04 years. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

ADOBE INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Total stock-based compensation costs that have been included in our Consolidated Statements of Income for fiscal 2020, 2019 and 2018 were as follows:

| *(in millions)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| Cost of revenue | $ 61 | $ 55 | $ 42 |
| Research and development | 467 | 375 | 277 |
| Sales and marketing | 261 | 249 | 206 |
| General and administrative | 120 | 109 | 85 |
| Total [1] | $ 909 | $ 788 | $ 610 |

[1] During fiscal 2020, 2019 and 2018, we recorded tax benefits related to stock-based compensation costs of $352 million, $248 million and $222 million, respectively.

## NOTE 13. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The components of accumulated other comprehensive income (loss) and activity, net of related taxes, for fiscal 2020 were as follows:

| *(in millions)* | November 29, 2019 | Increase / Decrease | Reclassification Adjustments | November 27, 2020 |
|---|---|---|---|---|
| Unrealized gains on available-for-sale securities | $ 4 | $ 3 | $ (1) [1] | $ 6 |
| Net unrealized gains / losses on derivative instruments designated as hedging instruments | (22) | (44) | 6 [2] | (60) |
| Cumulative foreign currency translation adjustments | (170) | 66 | — | (104) |
| Total accumulated other comprehensive income (loss), net of taxes | $ (188) | $ 25 | $ 5 | $ (158) |

[1] Reclassification adjustments for gains / losses on available-for-sale securities are classified in other income (expense), net.

[2] Reclassification adjustments for gains / losses on foreign currency hedges are classified in revenue and reclassification adjustments for gains / losses on Treasury lock hedges are classified in interest expense.

Taxes related to each component of other comprehensive income (loss) were immaterial for the fiscal years presented.

## NOTE 14. STOCK REPURCHASE PROGRAM

To facilitate our stock repurchase program, designed to return value to our stockholders and minimize dilution from stock issuances, we may repurchase shares in the open market or enter into structured repurchase agreements with third parties. In May 2018, our Board of Directors granted us an authority to repurchase up to $8 billion in common stock through the end of fiscal 2021.

During fiscal 2020, 2019 and 2018, we entered into several structured stock repurchase agreements with large financial institutions, whereupon we provided them with prepayments totaling $3.05 billion, $2.75 billion, and $2.05 billion, respectively. We enter into these agreements in order to take advantage of repurchasing shares at a guaranteed discount to the Volume Weighted Average Price (“VWAP”) of our common stock over a specified period of time. We only enter into such transactions when the discount that we receive is expected to be higher than the foregone return on our cash prepayments to the financial institutions. There were no explicit commissions or fees on these structured repurchases. Under the terms of the agreements, there is no requirement for the financial institutions to return any portion of the prepayment to us.

The financial institutions agree to deliver shares to us at monthly intervals during the contract term. The parameters used to calculate the number of shares deliverable are: the total notional amount of the contract, the number of trading days in the contract, the number of trading days in the interval and the average VWAP of our stock during the interval less the agreed upon discount. We repurchased approximately 8.0 million shares at an average price of $376.38 per share in fiscal 2020, 9.9 million shares at an average price of $270.23 per share in fiscal 2019, and 8.7 million shares at an average price of $230.43 per share in fiscal 2018.

For fiscal 2020, 2019 and 2018, the prepayments were classified as treasury stock on our Consolidated Balance Sheets at the payment date, though only shares physically delivered to us by November 27, 2020, November 29, 2019 and November 30, 2018 were excluded from the computation of earnings per share. As of November 27, 2020, $255 million of prepayments remained under the agreement.

Subsequent to November 27, 2020, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of $950 million. This amount will be classified as treasury stock on our Consolidated Balance Sheets. Upon completion of the $950 million stock repurchase agreement, $1.1 billion remains under our May 2018 authority. Further, in December 2020, our Board of Directors granted us additional authority to repurchase up to $15 billion in common stock through the end of fiscal 2024. We have not drawn from our new $15 billion authority as of the issuance of these financial statements.

## NOTE 15. NET INCOME PER SHARE

Basic net income per share is computed using the weighted average number of common shares outstanding for the period, excluding unvested restricted stock units and performance awards. Diluted net income per share is based upon the weighted average common shares outstanding for the period plus dilutive potential common shares, including unvested restricted stock units, stock purchase rights, performance share awards and stock options using the treasury stock method.

The following table sets forth the computation of basic and diluted net income per share for fiscal 2020, 2019 and 2018:

| *(in millions, except per share data)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| Net income | $ 5,260 | $ 2,951 | $ 2,591 |
| Shares used to compute basic net income per share | 480.9 | 486.3 | 490.6 |
| Dilutive potential common shares | 4.6 | 5.3 | 7.2 |
| Shares used to compute diluted net income per share | 485.5 | 491.6 | 497.8 |
| Basic net income per share | $ 10.94 | $ 6.07 | $ 5.28 |
| Diluted net income per share | $ 10.83 | $ 6.00 | $ 5.20 |
| Anti-dilutive potential common shares [1] | 0.5 | 0.2 | 0.2 |

(1) Potential common stock equivalents not included in the calculation of diluted net income per share as the effect would have been anti-dilutive.

## NOTE 16. COMMITMENTS AND CONTINGENCIES

*Unconditional Purchase Obligations*

Our purchase obligations consist of agreements to purchase goods and services entered into in the ordinary course of business. The following table summarizes our non-cancellable unconditional purchase obligations for each of the next five years and thereafter as of November 27, 2020:

*(in millions)*

| Fiscal Year | Purchase Obligations |
|---|---|
| 2021 | $ 872 |
| 2022 | 484 |
| 2023 | 528 |
| 2024 | 1 |
| 2025 | — |
| Thereafter | — |
| Total | $ 1,885 |

*Royalties*

We have royalty commitments associated with the licensing of certain offerings and products. Royalty expense is generally based on a dollar amount per unit or a percentage of the underlying revenue. Royalty expense, which was recorded under our cost of revenue on our Consolidated Statements of Income, was approximately $176 million, $154 million and $119 million in fiscal 2020, 2019 and 2018, respectively.

*Indemnifications*

In the ordinary course of business, we provide indemnifications of varying scope to customers and channel partners against claims of intellectual property infringement made by third parties arising from the use of our products and from time to time, we are subject to claims by our customers under these indemnification provisions. Historically, costs related to these indemnification provisions have not been significant and we are unable to estimate the maximum potential impact of these indemnification provisions on our future results of operations.

To the extent permitted under Delaware law, we have agreements whereby we indemnify our officers and directors for certain events or occurrences while the officer or director is or was serving at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the officer's or director's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that reduces our exposure and enables us to recover a portion of any future amounts paid. We believe the estimated fair value of these indemnification agreements in excess of applicable insurance coverage is minimal.

*Legal Proceedings*

In connection with disputes relating to the validity or alleged infringement of third-party intellectual property rights, including patent rights, we have been, are currently and may in the future be subject to claims, negotiations or complex, protracted litigation. Intellectual property disputes and litigation may be very costly and can be disruptive to our business operations by diverting the attention and energies of management and key technical personnel. Although we have successfully defended or resolved past litigation and disputes, we may not prevail in any ongoing or future litigation and disputes. Third-party intellectual property disputes could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from licensing certain of our products or offering certain of our services, subject us to injunctions restricting our sale of products or services, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers including contractual provisions under various license arrangements and service agreements.

In addition to intellectual property disputes, we are subject to legal proceedings, claims and investigations in the ordinary course of business, including claims relating to commercial, employment and other matters. Some of these disputes and legal proceedings may include speculative claims for substantial or indeterminate amounts of damages. We consider all claims on a quarterly basis in accordance with GAAP and based on known facts assess whether potential losses are considered reasonably possible or probable and estimable. Based upon this assessment, we then evaluate disclosure requirements and whether to accrue for such claims in our financial statements. This determination is then reviewed and discussed with the Audit Committee of the Board of Directors.

We make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Unless otherwise specifically disclosed in this note, we have determined that no provision for liability nor disclosure is required related to any claim against us because: (a) there is not a reasonable possibility that a loss exceeding amounts already recognized (if any) may be incurred with respect to such claim; (b) a reasonably possible loss or range of loss cannot be estimated; or (c) such estimate is immaterial.

All legal costs associated with litigation are expensed as incurred. Litigation is inherently unpredictable. However, we believe that we have valid defenses with respect to the legal matters pending against us. It is possible, nevertheless, that our consolidated financial position, cash flows or results of operations could be negatively affected by an unfavorable resolution of one or more of such proceedings, claims or investigations.

In connection with our anti-piracy efforts, conducted both internally and through organizations such as the Business Software Alliance, from time to time we undertake litigation against alleged copyright infringers. Such lawsuits may lead to counter-claims alleging improper use of litigation or violation of other laws. We believe we have valid defenses with respect to such counter-claims; however, it is possible that our consolidated financial position, cash flows or results of operations could be negatively affected in any particular period by the resolution of one or more of these counter-claims.

**NOTE 17. DEBT**

The carrying value of our borrowings as of November 27, 2020 and November 29, 2019 were as follows:

| *(dollar in millions)* | Issuance Date | Due Date | Effective Interest Rate | 2020 | 2019 |
|---|---|---|---|---|---|
| 4.75% 2020 Notes | February 2010 | February 2020 | 4.92% | $ — | $ 900 |
| 1.70% 2023 Notes | February 2020 | February 2023 | 1.92% | 500 | — |
| 1.90% 2025 Notes | February 2020 | February 2025 | 2.07% | 500 | — |
| 3.25% 2025 Notes | January 2015 | February 2025 | 3.67% | 1,000 | 1,000 |
| 2.15% 2027 Notes | February 2020 | February 2027 | 2.26% | 850 | — |
| 2.30% 2030 Notes | February 2020 | February 2030 | 2.69% | 1,300 | — |
| Term Loan | October 2018 | April 2020 | 2.47% | — | 2,250 |
| Total debt outstanding, at par | | | | $ 4,150 | $ 4,150 |
| Less: Current portion of debt | | | | — | (3,150) |
| Unamortized discount and debt issuance costs | | | | (33) | (11) |
| Carrying value of long-term debt | | | | $ 4,117 | $ 989 |
| | | | | | |
| Current portion of debt, at par | | | | $ — | $ 3,150 |
| Unamortized discount and debt issuance costs | | | | — | (1) |
| Carrying value of current debt | | | | $ — | $ 3,149 |

*Term Loan*

In October 2018, we entered into a credit agreement providing a $2.25 billion senior unsecured term loan (“Term Loan") with a maturity date of April 30, 2020. The Term Loan ranked equally with our other unsecured and unsubordinated indebtedness. There were no scheduled principal amortization payments prior to maturity and the Term Loan could be prepaid and terminated at our election at any time without penalty or premium. At our election, the Term Loan bore interest at either (i) LIBOR plus a margin, based on our debt ratings, ranging from 0.500% to 1.000% or (ii) a base rate plus a margin, based on our debt ratings, ranging from 0.040% to 0.110%. The related issuance costs were amortized to interest expense over the Term Loan period using the effective interest method. Interest was payable periodically, in arrears, at the end of each interest period we elect. The Term Loan was paid and terminated in conjunction with our debt refinancing during the first quarter of fiscal 2020.

*2020 Notes*

In February 2010, we issued $900 million of 4.75% senior notes due February 1, 2020 (“2020 Notes"). The related discount and issuance costs were amortized to interest expense over the term of the 2020 Notes using the effective interest method. The 2020 Notes became due and were paid in conjunction with our debt refinancing during the first quarter of fiscal 2020.

We entered into interest rate swaps with a total notional amount of $900 million designated as a fair value hedge related to our 2020 Notes in fiscal 2014. The interest rate swaps effectively converted the fixed interest rate on our 2020 Notes to a floating interest rate based on LIBOR. The interest rate swap agreements also matured during the first quarter of fiscal 2020. *See Note 6 for further details regarding our interest rate swap derivatives.*

*Debt Refinancing*

In February 2020, we issued $500 million of 1.70% senior notes due February 1, 2023 (“2023 Notes”), $500 million of 1.90% senior notes due February 1, 2025 (“1.90% 2025 Notes”), $850 million of 2.15% senior notes due February 1, 2027 (“2027 Notes”) and $1.30 billion of 2.30% senior notes due February 1, 2030 (“2030 Notes”). Interest is payable semi-annually, in arrears on February 1 and August 1 commencing on August 1, 2020. Our total proceeds were approximately $3.14 billion, used for general corporate purposes including repayment of the 2020 Notes and Term Loan, and were net of an issuance discount of $6 million. In addition, we incurred total issuance costs of approximately $21 million. Both the discount and issuance costs are being amortized to interest expense over the respective terms of the senior notes using the effective interest method.

In June 2019, in anticipation of our debt refinancing, we entered into Treasury lock agreements with large financial institutions which fixed benchmark U.S. Treasury rates for an aggregate notional amount of $1 billion of our future debt issuance. These derivative instruments hedged the impact of changes in the benchmark interest rate to future interest payments. Upon debt issuance, the Treasury lock agreements were settled and we incurred a loss which is amortized to interest expense over the term of our 2030 Notes using the effective interest method. *See Note 6 for further details regarding our Treasury lock agreement.*

*3.25% 2025 Notes*

In January 2015, we issued $1 billion of 3.25% senior notes due February 1, 2025 (the “3.25% 2025 Notes”) which remain outstanding as of November 27, 2020. The related discount and issuance costs are being amortized to interest expense over the term of the 3.25% 2025 Notes using the effective interest method. Interest is payable semi-annually, in arrears on February 1 and August 1.

As of November 27, 2020, our outstanding notes payable consists of the 2023 Notes, 1.90% 2025 Notes, 3.25% 2025 Notes, 2027 Notes and 2030 Notes (collectively, the “Notes”). Based on quoted prices in inactive markets, the total fair value of our outstanding Notes was $4.48 billion as of November 27, 2020.

Our Notes rank equally with our other unsecured and unsubordinated indebtedness. We may redeem the Notes at any time, subject to a make-whole premium. In addition, upon the occurrence of certain change of control triggering events, we may be required to repurchase the Notes, at a price equal to 101% of their principal amount, plus accrued and unpaid interest to the date of repurchase. The Notes also include covenants that limit our ability to grant liens on assets and to enter into sale and leaseback transactions, subject to significant allowances. As of November 27, 2020, we were in compliance with all of the covenants.

*Revolving Credit Agreement*

In October 2018, we entered into a credit agreement ("Revolving Credit Agreement"), providing for a five-year $1 billion senior unsecured revolving credit facility, which replaced our previous five-year $1 billion senior unsecured revolving credit agreement dated as of March 2, 2012 (as amended, the "Prior Revolving Credit Agreement"). In addition, we incurred issuance costs of $1 million which is amortized to interest expense over the term using the straight-line method. The Revolving Credit Agreement provides for loans to Adobe and certain of its subsidiaries that may be designated from time to time as additional borrowers. Pursuant to the terms of the Revolving Credit Agreement, we may, subject to the agreement of lenders to provide additional commitments, obtain up to an additional $500 million in commitments, for a maximum aggregate commitment of $1.5 billion. At our election, loans under the Revolving Credit Agreement will bear interest at either (i) LIBOR plus a margin, based on our debt ratings, ranging from 0.585% to 1.015% or (ii) a base rate, which is defined as the highest of (a) the agent's prime rate, (b) the federal funds effective rate plus 0.500% or (c) LIBOR plus 1.00% plus a margin, based on our debt ratings, ranging from 0.000% to 0.015%. In addition, facility fees determined according to our debt ratings are payable on the aggregate commitments, regardless of usage, quarterly in an amount ranging from 0.04% to 0.11% per annum. We are permitted to permanently reduce the aggregate commitment under the Revolving Credit Agreement at any time. Subject to certain conditions stated in the Revolving Credit Agreement, Adobe and any of its subsidiaries designated as additional borrowers may borrow, prepay and re-borrow amounts at any time during the term of the Revolving Credit Agreement.

The Revolving Credit Agreement contains customary representations, warranties, affirmative and negative covenants, including a financial covenant, events of default and indemnification provisions in favor of the lenders. The negative covenants include restrictions regarding the incurrence of liens and indebtedness, certain merger and acquisition transactions, dispositions and other matters, all subject to certain exceptions. The financial covenant, based on a quarterly financial test, requires us not to exceed a maximum leverage ratio.

The facility will terminate and all amounts owing thereunder will be due and payable on the maturity date unless (a) the commitments are terminated earlier upon the occurrence of certain events, including an event of default, or (b) the maturity date is further extended upon our request, subject to the agreement of the lenders.

As of November 27, 2020, there were no outstanding borrowings under this Credit Agreement and we were in compliance with all covenants.

**NOTE 18. LEASES**

We lease certain facilities and data centers under non-cancellable operating lease arrangements that expire at various dates through 2031. We also have one land lease that expires in 2091. We account for lease and non-lease components as a single lease component for our facilities and data center leases. We apply the accounting requirements of ASC 842 to short-term leases. Therefore, leases with an initial term of 12 months or less are recorded on the balance sheet, with lease expense for these leases recognized on a straight-line basis over the lease term. Our lease agreements do not contain any material residual value guarantees, material variable payment provisions or material restrictive covenants.

After our adoption of ASC 842, operating lease expense was $119 million for fiscal 2020. Operating lease expense was $170 million and $137 million for fiscal 2019 and 2018, respectively. We recognized operating lease expense in cost of revenue and operating expenses in our Consolidated Statements of Income. Our operating lease expense is net of sublease income and includes variable lease costs, both of which are not material.

Supplemental cash flow information for fiscal 2020 related to operating leases was as follows:

*(in millions)*

| | | |
|---|---|---|
| Cash paid for amounts included in the measurement of operating lease liabilities | $ | 99 |
| Right-of-use assets obtained in exchange for operating lease liabilities | $ | 52 |

The weighted-average remaining lease term and weighted-average discount rate for our operating lease liabilities as of November 27, 2020 were 9 years and 2.32%, respectively.

As of November 27, 2020, the maturities of lease liabilities under operating leases are as follows:

| *(in millions)* |
| --- |
| **Fiscal Year** |
| 2021 |
| 2022 |
| 2023 |
| 2024 |
| 2025 |
| Thereafter |
| Total lease liabilities |
| Less: Imputed interest |
| Present value of lease liabilities |

(1) Operating lease payments exclude $17 million of legally binding minimum lease payments for leases signed but not yet commenced.

Future minimum rental payments and future minimum sublease income for our operating leases as of November 29, 2019, prior to our adoption of the new leases standard, were as follows:

| *(in millions)* | Operating Leases | |
| --- | --- | --- |
| **Fiscal Year** | **Future Minimum Rental Payments** | **Future Minimum Sublease Income** |
| 2020 | $ 98 | $ 10 |
| 2021 | 92 | 9 |
| 2022 | 81 | 6 |
| 2023 | 69 | 2 |
| 2024 | 61 | — |
| Thereafter | 338 | — |
| Total | $ 739 | $ 27 |

**ADOBE INC.**

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

## NOTE 19. NON-OPERATING INCOME (EXPENSE)

Non-operating income (expense) for fiscal 2020, 2019 and 2018 included the following:

| *(in millions)* | 2020 | 2019 | 2018 |
|---|---|---|---|
| Interest expense | $ (116) | $ (157) | $ (89) |
| Investment gains (losses), net: | | | |
| Realized investment gains | $ 5 | $ 46 | $ 6 |
| Realized investment losses | (1) | — | — |
| Unrealized investment gains (losses), net | 9 | 6 | (3) |
| Investment gains (losses), net | $ 13 | $ 52 | $ 3 |
| Other income (expense), net: | | | |
| Interest income | $ 43 | $ 68 | $ 93 |
| Foreign exchange gains (losses) | (2) | (26) | (42) |
| Realized gains on fixed income investments | 1 | — | — |
| Realized losses on fixed income investments | — | — | (11) |
| Other income (expense), net | $ 42 | $ 42 | $ 40 |
| Non-operating income (expense), net | $ (61) | $ (63) | $ (46) |

## NOTE 20. SELECTED QUARTERLY FINANCIAL DATA (unaudited)

| *(in millions, except per share data)* | 2020 | | | |
|---|---|---|---|---|
| | Quarter Ended | | | |
| | February 28 | May 29 | August 28 | November 27 |
| Revenue | $ 3,091 | $ 3,128 | $ 3,225 | $ 3,424 |
| Gross profit | $ 2,639 | $ 2,713 | $ 2,798 | $ 2,996 |
| Income before income taxes | $ 919 | $ 1,000 | $ 1,060 | $ 1,197 |
| Net income | $ 955 | $ 1,100 | $ 955 | $ 2,250 |
| Basic net income per share | $ 1.98 | $ 2.28 | $ 1.99 | $ 4.69 |
| Diluted net income per share | $ 1.96 | $ 2.27 | $ 1.97 | $ 4.64 |

| *(in millions, except per share data)* | 2019 | | | |
|---|---|---|---|---|
| | Quarter Ended | | | |
| | March 1 | May 31 | August 30 | November 29 |
| Revenue | $ 2,601 | $ 2,744 | $ 2,834 | $ 2,992 |
| Gross profit | $ 2,204 | $ 2,337 | $ 2,418 | $ 2,540 |
| Income before income taxes | $ 702 | $ 711 | $ 835 | $ 957 |
| Net income | $ 674 | $ 633 | $ 793 | $ 852 |
| Basic net income per share | $ 1.38 | $ 1.30 | $ 1.63 | $ 1.76 |
| Diluted net income per share | $ 1.36 | $ 1.29 | $ 1.61 | $ 1.74 |

Our fiscal year is a 52- or 53-week year that ends on the Friday closest to November 30. Each of the fiscal quarters presented were comprised of 13 weeks.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors
Adobe Inc.:

*Opinions on the Consolidated Financial Statements and Internal Control Over Financial Reporting*

We have audited the accompanying consolidated balance sheets of Adobe Inc. and subsidiaries (the Company) as of November 27, 2020 and November 29, 2019, the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the fiscal years in the three fiscal year period ended November 27, 2020, and the related notes (collectively, the consolidated financial statements). We also have audited the Company's internal control over financial reporting as of November 27, 2020, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of November 27, 2020 and November 29, 2019, and the results of its operations and its cash flows for each of the fiscal years in the three fiscal year period ended November 27, 2020, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of November 27, 2020 based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

*Change in Accounting Principle*

As discussed in Note 1 and Note 2 to the consolidated financial statements, the Company has changed its method of accounting for leases as of November 30, 2019 due to the adoption of Financial Accounting Standards Board's (FASB) Accounting Standards Update (ASU) 2016-02, "*Leases* (Topic 842)," and changed its method of accounting for revenue from contracts with customers and sales commissions as of December 1, 2018 due to the adoption of FASB's Accounting Standards Codification (ASC) Topic 606, "*Revenue from Contracts with Customers* (ASC 606)," and Subtopic 340-40, "*Other Assets and Deferred Costs - Contracts with Customers* (ASC 340-40)."

*Basis for Opinions*

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Controls over Financial Reporting. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

*Definition and Limitations of Internal Control Over Financial Reporting*

A company’s internal control over financial reporting is a process designed 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. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

*Critical Audit Matters*

The critical audit matters communicated below are matters arising from the current period audit of the consolidated financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

*Performance obligations in cloud-enabled software subscriptions*

As discussed in Note 1 to the consolidated financial statements, cloud-enabled services are highly integrated and interrelated with on-premise or on-device software licenses in the Company's Creative Cloud and Document Cloud subscription offerings. Because of this, the cloud-based services and the on-premise/on-device software licenses are not considered distinct from each other and the applicable subscription is accounted for as a single performance obligation.

We identified the assessment of performance obligations in these cloud-enabled software subscription offerings as a critical audit matter. A high degree of subjective auditor judgment was required to assess the nature of the Company's Creative Cloud and Document Cloud offerings, their intended benefit to customers as an integrated offering, and the level of integration that exists between the cloud-enabled services and the on-premise/on-device licenses.

The following are the primary procedures we performed to address this critical audit matter. We evaluated the design and tested the operating effectiveness of an internal control related to the assessment of distinct performance obligations. We read the Creative Cloud and Document Cloud subscription offering agreements to understand the contractual terms and conditions. We participated in product demonstrations, examined marketing materials, and performed interviews with the Company's product and engineering department to both understand and observe specific functionalities of the integrated offering and evaluate the nature of the promise made to the Company's Creative Cloud and Document Cloud customers. We evaluated the features and functionalities of the Creative Cloud and Document Cloud subscription that can be accessed only when using the on-premise/on-device software while connected to the Adobe Cloud to assess that customers receive the intended benefit from each solution only as an integrated offering.

*Fair value of the intra-entity transfer of certain intellectual property rights*

As discussed in Note 10 to the consolidated financial statements, the Company completed an intra-entity transfer of certain intangible property rights ("IP rights") to one of its foreign subsidiaries during the fourth quarter of fiscal 2020. As a result of this transaction, the Company recorded a deferred tax asset, net of valuation allowance, and related tax benefit of $1.13 billion as of and for the period ended November 27, 2020 based on the fair value of the IP rights transferred. The tax-deductible amortization related to the transferred IP rights will be recognized over the period of economic benefit.

We identified the fair value of transferred IP rights as a critical audit matter. We performed sensitivity analyses to determine the significant assumptions used to value the transferred IP rights. Subjective auditor judgment was required to evaluate management's estimates and assumptions used to determine the fair value of the transferred IP rights, including the near-term revenue growth rate, operating margin, terminal growth rate, and discount rate assumptions.

The following are the primary procedures we performed to address this critical audit matter. We evaluated the design and tested the operating effectiveness of certain internal controls related to the Company's income tax process. This included controls related to the development of the near-term revenue growth rate, operating margin, terminal growth rate, and discount rate assumptions. We assessed the near-term revenue growth rate by comparing it to historical results and comparing it to third-party analyst expectations for the industry. We assessed the operating margin assumption by comparing it to historical results. We assessed the terminal growth rate by comparing it to third-party analyst expectations for the industry. We involved valuation professionals with specialized skills and knowledge who assisted in assessing the discount rate assumption by comparing it to a discount rate range that was independently developed using publicly available market data for comparable entities.

(signed) KPMG LLP

We have served as the Company's auditor since 1983.

Santa Clara, California
January 15, 2021

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

## ITEM 9A. CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of November 27, 2020. Based on their evaluation as of November 27, 2020, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective at the reasonable assurance level to ensure that the information required to be disclosed by us in this Annual Report on Form 10-K was (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Adobe have been detected.

### Management's Annual Report on Internal Controls over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal controls over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Our management assessed the effectiveness of our internal controls over financial reporting as of November 27, 2020. In making this assessment, our management used the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Our management has concluded that, as of November 27, 2020, our internal controls over financial reporting is effective based on these criteria.

KPMG LLP, the independent registered public accounting firm that audited our financial statements included in this Annual Report on Form 10-K, has issued an attestation report on our internal controls over financial reporting, which is included herein.

### Changes in Internal Controls over Financial Reporting

On November 30, 2019, we implemented new and modified existing internal controls based on the adoption of the new leases standard. This resulted in changes to our processes related to lease accounting and underlying control activities, including our information systems.

Beginning in March 2020, our employees across all geographic regions have shifted to working from home due to the pandemic. We have performed an evaluation of our control environment, operating procedures, data and internal controls and determined that the design of our processes and controls have continued to operate effectively throughout this shift to a work-from-home environment.

There were no changes in our internal controls over financial reporting during the quarter ended November 27, 2020 that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

## ITEM 9B. OTHER INFORMATION

None.

## PART III

### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item 10 of Form 10-K that is found in our 2021 Proxy Statement to be filed with the SEC in connection with the solicitation of proxies for the Company's 2021 Annual Meeting of Stockholders ("2021 Proxy Statement") is incorporated herein by reference to our 2021 Proxy Statement. The 2021 Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year to which this report relates. For information with respect to our executive officers, see "Executive Officers" at the end of Part I, Item 1 of this report.

### ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item 11 of Form 10-K is incorporated herein by reference to our 2021 Proxy Statement.

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item 12 of Form 10-K is incorporated herein by reference to our 2021 Proxy Statement.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item 13 of Form 10-K is incorporated herein by reference to our 2021 Proxy Statement.

### ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item 14 of Form 10-K is incorporated herein by reference to our 2021 Proxy Statement.

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

1. Financial Statements. See Index to Consolidated Financial Statements in Part II, Item 8 of this Form 10-K.

| Exhibit Number | Exhibit Description | Incorporated by Reference Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
|---|---|---|---|---|---|---|
| 2.1 | Share Purchase Agreement by and among: Adobe, a Delaware corporation; Milestone Topco, Inc., a Delaware corporation; Vista Equity Partners Fund V, L.P., a Delaware limited partnership; Vista Equity Partners Fund V-A, L.P., a Cayman Island exempted limited partnership; Vista Equity Partners Fund V-B, L.P., a Cayman Island exempted limited partnership; VEPF V FAF, L.P., a Delaware limited partnership; Vista Equity Partners Fund V Executive, L.P., a Delaware limited partnership; Vista Equity Associates V, LLC, a Delaware limited liability company; Vista Equity Partners Fund VI, L.P., a Cayman Island exempted limited partnership; Vista Equity Partners Fund VI-A, L.P., a Cayman Island exempted limited partnership; VEPF VI FAF, L.P., a Cayman Island exempted limited partnership; and Vista Equity Partners Management, LLC, a Delaware limited liability company, as the Sellers' Representative | 8-K | 9/21/18 | 2.1 | 000-15175 | |
| 3.1 | Restated Certificate of Incorporation of Adobe | 8-K | 4/26/11 | 3.3 | 000-15175 | |
| 3.2 | Certificate of Amendment to Restated Certificate of Adobe | 8-K | 10/9/18 | 3.1 | 000-15175 | |
| 3.3 | Amended and Restated Bylaws | 8-K | 10/9/18 | 3.2 | 000-15175 | |

Table of Contents

| Exhibit Number | Exhibit Description | Incorporated by Reference: Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
|---|---|---|---|---|---|---|
| 4.1 | Specimen Common Stock Certificate | 10-K | 1/25/19 | 4.1 | 000-15175 | |
| 4.2 | Form of Indenture dated as of January 25, 2010 by and between Adobe and Wells Fargo Bank, National Association, as trustee | S-3 | 2/26/16 | 4.1 | 333-209764 | |
| 4.3 | Forms of Global Note for Adobe Inc.'s 1.700% Notes due 2023, 1.900% Notes due 2025, 2.150% Notes due 2027, and 2.300% Notes due 2030, together with an Officer's Certificate setting forth the terms of the Notes | 8-K | 2/3/20 | 4.1 | 000-15175 | |
| 4.4 | Form of Global Note for Adobe's 3.250% Notes due 2025, together with Form of Officer's Certificate setting forth the terms of the Note | 8-K | 1/26/15 | 4.1 | 000-15175 | |
| 4.5 | Description of Adobe's Common Stock | 10-K | 1/21/20 | 4.5 | 000-15175 | |
| 10.1 | 2020 Employee Stock Purchase Plan, as amended* | | | | | X |
| 10.2A | 2003 Equity Incentive Plan, as amended* | 8-K | 4/13/18 | 10.2 | 000-15175 | |
| 10.2B | Form of Stock Option Agreement used in connection with the 2003 Equity Incentive Plan* | 8-K | 12/20/10 | 99.4 | 000-15175 | |
| 10.2C | Form of RSU Grant Notice and Award Agreement pursuant to 2003 Equity Incentive Plan* | 8-K | 1/26/18 | 10.6 | 000-15175 | |
| 10.2D | Form of Restricted Stock Unit Grant Notice and Award Agreement pursuant to 2003 Equity Incentive Plan* | 8-K | 1/28/19 | 10.5 | 000-15175 | |
| 10.2E | Form of Restricted Stock Agreement used in connection with the 2003 Equity Incentive Plan* | 10-Q | 10/7/04 | 10.11 | 000-15175 | |
| 10.2F | 2018 Performance Share Program pursuant to the 2003 Equity Incentive Plan* | 8-K | 1/26/18 | 10.2 | 000-15175 | |
| 10.2G | Form of 2018 Performance Share Award Grant Notice and Award Agreement pursuant to 2018 Performance Share Program and 2003 Equity Incentive Plan* | 8-K | 1/26/18 | 10.3 | 000-15175 | |
| 10.2H | 2019 Performance Share Program pursuant to the 2003 Equity Incentive Plan* | 8-K | 1/28/19 | 10.2 | 000-15175 | |
| 10.2I | Form of 2019 Performance Share Award Grant Notice and Award Agreement pursuant to 2019 Performance Share Program and 2003 Equity Incentive Plan* | 8-K | 1/28/19 | 10.3 | 000-15175 | |
| 10.3A | 2019 Equity Incentive Plan* | 8-K | 4/12/19 | 10.1 | 000-15175 | |
| 10.3B | 2020 Performance Share Program pursuant to the 2019 Equity Incentive Plan* | 8-K | 1/30/20 | 10.2 | 000-15175 | |

Table of Contents

| Exhibit Number | Exhibit Description | Incorporated by Reference Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
|---|---|---|---|---|---|---|
| 10.3C | Form of 2020 Performance Share Award Grant Notice and Award Agreement pursuant to 2020 Performance Share Program and 2019 Equity Incentive Plan* | 8-K | 1/30/20 | 10.3 | 000-15175 | |
| 10.3D | Form of Restricted Stock Unit Grant Notice and Award Agreement pursuant to 2019 Equity Incentive Plan (for awards granted prior to January 15, 2021)* | 10-Q | 6/26/19 | 10.35B | 000-15175 | |
| 10.3E | Form of Restricted Stock Unit Grant Notice and Award Agreement pursuant to 2019 Equity Incentive Plan (for awards granted on or after January 15, 2021)* | | | | | X |
| 10.3F | Form of Director Grant Restricted Stock Unit Grant Notice and Award Agreement pursuant to 2019 Equity Incentive Plan* | 10-Q | 6/26/19 | 10.35C | 000-15175 | |
| 10.4 | Retention Agreement between Adobe and Shantanu Narayen, effective December 5, 2014* | 8-K | 12/11/14 | 10.2 | 000-15175 | |
| 10.5 | Form of Indemnity Agreement* | 10-Q | 6/26/09 | 10.12 | 000-15175 | |
| 10.6A | Adobe Deferred Compensation Plan, as Amended and Restated* | 10-K | 1/20/15 | 10.19 | 000-15175 | |
| 10.6B | Amendment No. One to Adobe Deferred Compensation Plan* | 10-K | 1/21/20 | 10.6B | 000-15175 | |
| 10.7 | Credit Agreement, dated as of October 17, 2018, among Adobe Inc. and certain subsidiaries as Borrowers, JPMorgan Chase Bank, N.A., Wells Fargo Bank National Association, U.S Bank National Association, Société Générale S.A. as Co-Syndication Agents, Bank of America, N.A. as Administrative Agent and Swing Line Lender, and the Other Lenders Party Thereto | 8-K | 10/19/18 | 10.1 | 000-15175 | |
| 10.8 | Adobe Inc. 2020 Executive Severance Plan in the Event of a Change of Control* | 8-K | 12/10/20 | 10.1 | 000-15175 | |
| 10.10 | 2020 Executive Annual Incentive Plan, as amended and restated* | 8-K | 6/11/20 | 10.1 | 000-15175 | |
| 10.11 | Description of 2019 and 2020 Director Compensation* | 8-K | 1/24/19 | 10.1 | 000-15175 | |
| 10.12 | Description of 2021 and 2022 Director Compensation* | | | | | X |
| 21 | Subsidiaries of the Registrant | | | | | X |
| 23.1 | Consent of Independent Registered Public Accounting Firm, KPMG LLP | | | | | X |
| 24.1 | Power of Attorney (set forth on the signature page to this Annual Report on Form 10-K) | | | | | X |

| Exhibit Number | Exhibit Description | Incorporated by Reference | | | | Filed Herewith |
|---|---|---|---|---|---|---|
| | | Form | Filing Date | Exhibit Number | SEC File No. | |
| 31.1 | Certification of Chief Executive Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934 | | | | | X |
| 31.2 | Certification of Chief Financial Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934 | | | | | X |
| 32.1 | Certification of Chief Executive Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934† | | | | | X |
| 32.2 | Certification of Chief Financial Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934† | | | | | X |
| 101.INS | Inline XBRL Instance - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document. | | | | | X |
| 101.SCH | Inline XBRL Taxonomy Extension Schema | | | | | X |
| 101.CAL | Inline XBRL Taxonomy Extension Calculation | | | | | X |
| 101.LAB | Inline XBRL Taxonomy Extension Labels | | | | | X |
| 101.PRE | Inline XBRL Taxonomy Extension Presentation | | | | | X |
| 101.DEF | Inline XBRL Taxonomy Extension Definition | | | | | X |
| 104 | Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101) | | | | | |

* Compensatory plan or arrangement.

† The certifications attached as Exhibits 32.1 and 32.2 that accompany this Annual Report on Form 10-K, are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Adobe Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Form 10-K, irrespective of any general incorporation language contained in such filing.

## ITEM 16. FORM 10-K SUMMARY

None.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ADOBE INC.

By: /s/ JOHN MURPHY

John Murphy
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: January 15, 2021

## POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Shantanu Narayen and John Murphy, and each or any one of them, his or her lawful attorneys-in-fact and agents, for such person in any and all capacities, to sign any and all amendments to this report and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that either of said attorneys-in-fact and agent, or substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
| --- | --- | --- |
| /s/ SHANTANU NARAYEN<br>Shantanu Narayen | Chairman of the Board of Directors, President and Chief Executive Officer (Principal Executive Officer) | January 15, 2021 |
| /s/ JOHN MURPHY<br>John Murphy | Executive Vice President, Chief Financial Officer (Principal Financial Officer) | January 15, 2021 |
| /s/ MARK GARFIELD<br>Mark Garfield | Vice President, Corporate Controller and Chief Accounting Officer (Principal Accounting Officer) | January 15, 2021 |
| /s/ FRANK CALDERONI<br>Frank Calderoni | Director | January 15, 2021 |
| /s/ AMY BANSE<br>Amy Banse | Director | January 15, 2021 |
| /s/ MELANIE BOULDEN<br>Melanie Boulden | Director | January 15, 2021 |

| Signature | Title | Date |
|---|---|---|
| /s/ JAMES DALEY<br>James Daley | Director | January 15, 2021 |
| /s/ LAURA DESMOND<br>Laura Desmond | Director | January 15, 2021 |
| /s/ KATHLEEN OBERG<br>Kathleen Oberg | Director | January 15, 2021 |
| /s/ DHEERAJ PANDEY<br>Dheeraj Pandey | Director | January 15, 2021 |
| /s/ DAVID RICKS<br>David Ricks | Director | January 15, 2021 |
| /s/ DAN ROSENSWEIG<br>Dan Rosensweig | Director | January 15, 2021 |
| /s/ JOHN WARNOCK<br>John Warnock | Director | January 15, 2021 |

Table of Contents

## SUMMARY OF TRADEMARKS

The following trademarks of Adobe Inc. or its subsidiaries, which may be registered in the United States and/ or other countries, are referenced in this Form 10-K:

Acrobat
Acrobat Reader
Adobe
Adobe Aero
Adobe Audition
Adobe Dimension
Adobe Experience Cloud
Adobe Fresco
Adobe Marketing Cloud
Adobe Premiere
Adobe Premiere Rush
Adobe Sensei
After Effects
Behance
Creative Cloud
Document Cloud
Illustrator
InCopy
InDesign
Lightroom
Magento
Marketo
Photoshop
PostScript
Premiere Rush
Reader
Sensei
Substance Alchemist
Substance Designer
Substance Painter
Substance Source
Workfront

All other trademarks are the property of their respective owners.



# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**Washington, D.C. 20549**

# FORM 10-K

**(Mark One)**

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

**For the fiscal year ended November 29, 2019**

or

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

**For the transition period from__________to__________**

**Commission File Number: 0-15175**

# ADOBE INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **77-0019522** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

**345 Park Avenue, San Jose, California 95110-2704**
(Address of principal executive offices)

**(408) 536-6000**
(Registrant's telephone number, including area code)

**Securities registered pursuant to Section 12(b) of the Act:**

| Title of Each Class | Trading Symbol | Name of Each Exchange on Which Registered |
|---|---|---|
| Common Stock, $0.0001 par value per share | ADBE | NASDAQ |

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

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

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Large accelerated filer | ☒ | Accelerated filer | ☐ | Non-accelerated filer | ☐ | Smaller reporting company | ☐ | Emerging growth company | ☐ |

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

The aggregate market value of the registrant's common stock, $0.0001 par value per share, held by non-affiliates of the registrant on May 31, 2019, the last business day of the registrant's most recently completed second fiscal quarter, was $102.25 billion (based on the closing sales price of the registrant's common stock on that date). Shares of the registrant's common stock held by each officer and director and each person who owns 5% or more of the outstanding common stock of the registrant have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes. As of January 10, 2020, 482,130,975 shares of the registrant's common stock, $0.0001 par value per share, were issued and outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the registrant's 2020 Annual Meeting of Stockholders (the "Proxy Statement"), to be filed within 120 days of the end of the fiscal year ended November 29, 2019, are incorporated by reference in Part III hereof. Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part hereof.

**ADOBE INC.**
**FORM 10-K**

**TABLE OF CONTENTS**

**Forward-Looking Statements**

*In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements, including statements regarding product plans, future growth, market opportunities, strategic initiatives, industry positioning, customer acquisition and retention, the amount of annualized recurring revenue and revenue growth. In addition, when used in this report, the words "will," "expects," "could," "would," "may," "anticipates," "intends," "plans," "believes," "seeks," "targets," "estimates," "looks for," "looks to," "continues" and similar expressions, as well as statements regarding our focus for the future, are generally intended to identify forward-looking statements. Each of the forward-looking statements we make in this report involves risks and uncertainties that could cause actual results to differ materially from these forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Risk Factors" in Part I, Item 1A of this report. You should carefully review the risks described herein and in other documents we file from time to time with the U.S. Securities and Exchange Commission (the "SEC"), including our Quarterly Reports on Form 10-Q to be filed in 2020. You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document, except as required by law.*

**PART I**

**ITEM 1. BUSINESS**

Founded in 1982, Adobe Inc. is one of the largest and most diversified software companies in the world. We offer a line of products and services used by creative professionals, marketers, knowledge workers, students, application developers, enterprises and consumers for creating, managing, delivering, measuring, optimizing, engaging and transacting with compelling content and experiences across personal computers, devices and media. We market our products and services directly to enterprise customers through our sales force and local field offices. We license our products to end users through app stores and our own website at www.adobe.com. We offer many of our products via a Software-as-a-Service ("SaaS") model or a managed services model (both of which are referred to as hosted or cloud-based) as well as through term subscription and pay-per-use models. We also distribute certain products and services through a network of distributors, value-added resellers ("VARs"), systems integrators ("SIs"), independent software vendors ("ISVs"), retailers, software developers and original equipment manufacturers ("OEMs"). In addition, we license our technology to hardware manufacturers, software developers and service providers for use in their products and solutions. Our products run on personal and server-based computers, as well as on smartphones, tablets and other devices, depending on the product. We have operations in the Americas, Europe, Middle East and Africa ("EMEA"), and Asia-Pacific ("APAC").

Adobe was originally incorporated in California in October 1983 and was reincorporated in Delaware in May 1997. Our executive offices and principal facilities are located at 345 Park Avenue, San Jose, California 95110-2704. Our telephone number is 408-536-6000 and our website is www.adobe.com. Investors can obtain copies of our SEC filings from this site free of charge, as well as from the SEC website at www.sec.gov. The information posted to our website is not incorporated into this Annual Report on Form 10-K.

**BUSINESS OVERVIEW**

For over 35 years, Adobe's innovations have transformed how individuals, teams, businesses and governments engage and interact with their constituents in print and online. We help our customers create and deliver the most compelling experiences in a streamlined workflow and optimize those experiences for greater return on investment. Our solutions turn ordinary interactions into valuable digital experiences, across media and devices, anytime, anywhere.

While we continue to offer a broad portfolio of products, services and solutions, we focus our investments in two strategic growth areas:

Digital Media – providing products, services and solutions that enable individuals, teams and enterprises to create, publish and promote their content anywhere. Our customers include creative professionals like photographers, video editors, graphic and experience designers, and application and game developers; communicators like content creators, students, marketers and knowledge workers who create, collaborate on and distribute documents and creative content; and consumers. This is the core of what we have delivered for decades, and we have evolved our business model to provide our customers with a range of flexible solutions that allow them to reach their full creative potential anytime, anywhere, on any device on projects of all types.

Digital Experience – providing a comprehensive and integrated platform and set of applications and services through Adobe Experience Cloud that enables businesses and brands to create, manage, execute, measure, monetize and optimize customer experiences that span from advertising to commerce. Our customers include marketers, advertisers, agencies, publishers, merchandisers, merchants, web analysts, data scientists, developers, marketing executives, information management and technology executives, product development executives and sales and support executives. Underpinning Adobe Experience Cloud is our Adobe Experience Platform, which provides businesses and brands with an open and extensible platform for customer experience management with real-time customer profiles that enable deep customer insights and the delivery of personalized digital experiences in milliseconds. By combining the creativity of our Digital Media business with the science of our Digital Experience offerings, we help our customers more efficiently and effectively make, manage, measure and monetize their content across channels and devices with an end-to-end workflow and feedback loop.

We believe we are uniquely positioned to be a leader in both the Digital Media and Digital Experience markets, where our mission is to change the world through digital experiences. By integrating products from each of these areas, our customers are able to utilize a comprehensive suite of solutions and services that no other company currently offers. In addition, our ability to deliver innovation and productivity improvements across customer workflows involving the creation, management, delivery, measurement and optimization of engaging content favorably positions Adobe as our customers continue to invest in delivering digital experiences.

## SEGMENTS

Our business is organized into three reportable segments: Digital Media, Digital Experience and Publishing. These segments provide Adobe's senior management with a comprehensive financial view of our key businesses. Our segments are aligned around our two strategic growth opportunities described above, placing our Publishing business in a third segment that contains some of our mature products and solutions.

## MARKET OVERVIEW

This overview provides an explanation of our markets and a discussion of strategic opportunities in fiscal 2020 and beyond for each of our segments. *See "Results of Operations" within Part II, Item 7 titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 2 of Part II, Item 8 titled "Notes to Consolidated Financial Statements" for further segment information.*

### Digital Media

*Digital Media Opportunity*

Recent technology trends in digital communications continue to provide a significant market opportunity for Adobe in digital media. Everyone has a story to tell — from creative professionals, to students and knowledge workers, to immersive content and experience designers — and they need to tell those stories on an ever-increasing number of canvasses. In today's world where the velocity of creation and consumption of digital content is constantly growing, design and creativity have never been more relevant and customers are looking for a way to meet demand with engaging online experiences. Adobe is in a strong position to capitalize on this opportunity with innovation that will accelerate the creative process across all platforms and devices, deepen engagement with communities and accelerate long-term revenue growth by focusing on cloud-based offerings, which are licensed on a subscription basis.

The flagship of our Digital Media business is Adobe Creative Cloud — a subscription service that allows members to use Adobe's creative products integrated with cloud-delivered services across desktop, web and mobile devices. Creative Cloud members can download and access the latest versions of our creative products such as Photoshop, Illustrator, Premiere Pro, Lightroom, InDesign, Adobe XD and many more creative applications. To expand our reach and improve the way we serve the needs of our customers, we create different combinations of these services, including our applications with free and paid tiers such as Adobe Lightroom Mobile that have brought new customers into our franchise and increased our footprint on mobile devices. In addition, members can access built-in templates and presets created by the Adobe user community to jumpstart designs and step-by-step interactive tutorials to sharpen their skills and get up to speed quickly. Through Creative Cloud, members can access online services to sync, store and share files across users' devices, access marketplace, social and community-based features within our Adobe Stock and Behance services, and create apps and websites, all at affordable subscription pricing.

Adobe continues to redefine the creative process with Adobe Creative Cloud so that our customers can obtain everything they need to create, collaborate and be inspired. One part of our strategy is Adobe Sensei, a proprietary framework and set of intelligent services for dramatically improving the design and delivery of digital experiences. Adobe Sensei leverages Adobe's massive content and data assets, as well as its deep domain expertise in the creative, marketing and document segments, within a unified artificial intelligence (“AI”) and machine learning framework to help customers discover hidden opportunities, reduce tedious processes and offer relevant experiences to every customer.

Adobe Creative Cloud addresses the needs of creative professionals such as artists, designers, developers, students and administrators, as well as knowledge workers, marketers, educators, hobbyists and consumers, who also use our products to create and deliver content. Our customers rely on our products for content creation, design, video and animation production, mobile app and gaming development and document creation and collaboration. End users of our creative products work in businesses of all sizes ranging from large publishers, media companies and global enterprises, to smaller design agencies and individual freelancers. Moreover, our creative products are used to create much of the printed and online information people see, read and interact with every day, including video, animation, mobile and advertising content. We have introduced new products, features and services to address emerging categories of content creation across devices and platforms, such as voice-based prototyping, refined content creation tools, 3D, augmented reality, virtual reality and user experience design. New projects announced and solutions offered include: Substance, a suite of applications for creating, mixing and applying textures and materials for 3D creations; Adobe Fresco, a mobile drawing and painting application, featuring live brushes that mimic natural media like oil paint and watercolors in amazingly lifelike ways; Adobe Aero, a free iOS application for viewing, building and sharing immersive and interactive augmented reality experiences; Photoshop Camera, an AI-driven mobile camera application launching in 2020 powered by Adobe Sensei featuring unique Photoshop lenses and camera effects right inside the camera; and both Illustrator on iPad, which will be available in 2020, and Photoshop on iPad to enable a seamless content creation experience across devices and attract a new, mobile-centric audience.

Adobe's Digital Media segment includes our Adobe Document Cloud business, built around our Acrobat family of products, including Adobe Acrobat and Adobe Acrobat Reader, and a set of integrated, cloud-based document services, including Adobe Sign and Adobe Scan. Tens of millions of knowledge workers worldwide interact with documents daily. Across industries and across the world, business processes from contracting to invoicing to employee onboarding are making the change from paper to electronic documents. Cloud services and mobile devices are reshaping how we work in ways that are more ad hoc, collaborative, unstructured and on the go. For over 25 years, Acrobat has provided for the reliable creation and exchange of electronic documents, regardless of platform or application source type. Users can collaborate on documents with electronic comments and tailor the security of a file in order to distribute reliable Adobe PDF documents that can be viewed, printed or filled out utilizing our free Acrobat Reader on any device. Acrobat provides essential electronic document capabilities and services across desktop, mobile devices and the web to help knowledge workers accomplish a wide variety of tasks ranging from simple publications and forms to mission-critical engineering documentation and architectural plans. With our Acrobat product and its innovative cloud services, we have extended the capabilities of our document solutions, from view and create, to edit, secure, scan, review, embed, share and sign. Users can create a PDF with just the camera on their phone with Adobe Scan, edit PDFs on the go with Acrobat on iOS and Android, and turn slow, manual signing processes into automated experiences and collect signatures with Adobe Sign.

*Digital Media Strategy*

Our goal is to be the leading platform for creativity where we offer a range of products and services that allow individuals, teams and enterprises, and both professionals and enthusiasts, to design and deliver amazing digital content.

We believe there is significant opportunity for growth across all customer segments and expect Adobe Creative Cloud will drive sustained long-term revenue growth through a continued expansion of our customer base by using our products to enable everyone to create and tell their stories, expanding into new categories and technologies like immersive 3D and augmented reality, making the creative process more productive with cloud-enabled collaboration and workflows, delivering intelligent, time-saving features with Adobe Sensei's artificial intelligence and machine learning capabilities, and acquiring new users by engaging with the creative community.

We will continue to deepen our relationship with existing users through meeting their needs holistically and delivering additional features and increased value, including through data-driven customer engagement, AI and machine learning through Adobe Sensei, and offering a true "multi-surface platform" that provides our customers with the ability to use our tools for creation wherever inspiration strikes, by enabling them to seamlessly access their assets in the cloud and work across mobile, tablet and desktop with new applications like Adobe Fresco and Photoshop for iPad. We are embracing new frontiers in technology and creativity such as immersive 3D and augmented reality ("AR") experiences with Adobe Aero and our Substance suite of products. We are pursuing new ways to help our customers develop creative skills such as allowing creators to live-stream their creative process on Behance and allowing users to learn with step-by-step, in-app, interactive tutorials from experienced creators.

As appropriate, we plan to optimize our pricing strategy and move our customers to higher priced and better value offerings and continue to employ targeted promotions that attract past customers and potential users to try out and ultimately subscribe to Adobe Creative Cloud. To target new customers and better address the needs of our existing customers, we will continue to invest in driving innovation to maintain the leadership position that we have established. We offer a marketplace for Creative Cloud subscribers to enable the delivery and purchase of stock content in our Adobe Stock service. Overall, our strategy with Creative Cloud is designed to enable us to increase our revenue with users, attract more new customers and grow a recurring and predictable revenue stream that is recognized ratably.

As part of our Adobe Creative Cloud strategy, we utilize a data-driven operating model and our Adobe Experience Cloud solutions to drive and optimize customer awareness, engagement and licensing of our creative products and services at every stop of the customer journey through our website and across other channels. Adobe.com is increasingly becoming the destination site where we engage individual and small business customers to sign up for and renew Creative Cloud subscriptions. We offer free apps and trials to attract new customers and through a data-driven model, we optimize conversion of these trialists to paid subscribers. We utilize channel partners to target mid-size creative customers with our Creative Cloud for teams offering. Our direct sales force is focused on building relationships with our largest customers and driving adoption of our Creative Cloud for enterprise offering.

We offer many of the products included in Adobe Creative Cloud on a standalone basis, including subscriptions to the Creative Cloud version of certain point products. We also offer a range of other creative tools and services, including our hobbyist products such as Photoshop Elements and Premiere Elements, Adobe Fonts and mobile apps such as Photoshop Express, Photoshop Sketch, Adobe Capture, Premiere Rush and Adobe Spark. Further descriptions of our Digital Media products are included below under “Principal Products and Services.”

In our Adobe Document Cloud business, Adobe Acrobat has achieved strong market adoption and a leadership position in document-intensive industries such as government, financial services, pharmaceutical, legal, aerospace, insurance and technical publishing. Trillions of PDF documents are created every year and we believe there remain hundreds of millions of users in industries that engage with PDF files on a daily basis like legal, financial services or publishing, as well as a broader array of communicators, knowledge workers and Acrobat Reader users, who need the capabilities provided by our Acrobat applications and the document services platform found in Document Cloud. We expect to drive sustained long-term revenue growth in Adobe Document Cloud through a continued expansion of our customer base by delivering the best PDF experience on every platform and across platforms, expanding the number of actions and features in Acrobat, using Adobe Sensei to make both new and legacy documents more intelligent and responsive, and investing in embedded document services such as integrating Adobe Sign in third-party applications. As with our Adobe Creative Cloud strategy, we utilize a data-driven operating model to market our Document Cloud solutions to and optimize our subscription-based pricing for individuals as well as small and medium-sized businesses, large enterprises and government institutions around the world. We aim to increase our seat penetration in our key markets through the utilization of our corporate and volume licensing programs. We also intend to increase our focus on marketing and licensing Acrobat in targeted vertical markets such as education, financial services, telecommunications and government, as well as on expanding into emerging markets. We will continue to engage in strategic partnerships to help drive the enterprise business, including our partnership with Microsoft.

Our Document Cloud customers increasingly expect business processes to be seamless across desktop, web and mobile devices. Acrobat on mobile devices can be used to create, edit, export, combine, collaborate on and share PDFs on the go and the Adobe Scan app for mobile devices can be used to capture paper documents as images and transform them into full-featured PDFs via Document Cloud services that can be shared immediately, essentially putting scanning capabilities in the pocket of every person. We are delivering PDF document services on the web, such as allowing users to create, convert and compress PDFs on Adobe.com. Our Adobe Sign service also provides a green alternative to costly paper-based solutions, and is a more modern and convenient way for customers to digitally manage their documents, processes and contract workflows. We believe that by growing the awareness of electronic signatures in the broader contract delivery and signing market, utilizing Adobe Sensei to enhance customer experiences through machine learning and AI, and continuing to add new capabilities to our Adobe Scan and Adobe Sign offerings, we can help our customers migrate away from paper-based express mailing and adopt our solution to modernize and digitize document experiences, growing our revenue with this business in the process.

**Digital Experience**

*Digital Experience Opportunity*

Digital transformation is a macro trend that affects every business, government and educational institution today - making every business a digital business. Consumers today buy experiences, not just products, and they demand compelling experiences in their digital interactions that are seamless across channels and devices. Enterprises and brands recognize that customers have more choices and lower switching costs than ever before. In this new hyper-connected digital environment, it is the customer experience that differentiates brands and ultimately determines customer loyalty. As a result, businesses must determine how to best attract, engage, acquire and retain customers in a digital world where the reach and quality of experiences directly impact success. Business customers are consumers too, and they increasingly have the same expectations, which are driving business-to-business

(“B2B”) companies to deliver business-to-consumer (“B2C”) experiences with a “business-to-everyone” (“B2E”) strategy. Delivering the best experience to a consumer at a given moment requires the right combination of data, insights and content across multiple channels in real time. To deliver these multi-channel experiences that are personalized to every customer, executives are increasingly demanding solutions that optimize their consumers’ experiences in real time and deliver the greatest return on marketing and IT spend so they can demonstrate the business impact of their programs using objective metrics.

For the past decade, Adobe Experience Cloud has helped businesses provide exceptional experiences to their customers via a comprehensive suite of solutions. We believe there is now a significant opportunity to address these challenges of customer experience management and help our customers transform their businesses into "Experience Businesses." The world's leading brands are increasingly steering their marketing, advertising and development budgets toward digital experiences. As enterprises make this move to digital, our opportunity is accelerating as brands seek vendors to help them navigate this transition. Enterprises have a mandate to deliver meaningful experiences to their consumers across digital channels and in areas such as sales, support and product interactions where consumers expect experiences to be consistent and personalized.

Our Adobe Experience Cloud business targets this large and growing opportunity to help companies deliver the most engaging customer experiences by providing an integrated, comprehensive set of solutions for customer experience management. Together, our applications, services and platforms provide real-time data and insights, deliver content and personalization, enable customer journey management and provide platforms for commerce and advertising management. Our solutions address analytics, targeting, advertising optimization, digital experience management, marketing automation and engagement, cross-channel campaign management, content management, creative asset management, audience management, digital commerce enablement, order management, predictive intelligence and monetization. Collectively, these comprehensive solutions enable marketers to measure, personalize and optimize digital experiences across all channels and touch points to drive stronger business performance throughout the customer journey.

We believe the market for Adobe Experience Cloud is large and rapidly growing as more businesses and enterprises invest in solutions that aid their goals to transform how they engage with their customers and constituents digitally.

*Digital Experience Strategy*

Our goal is to be the leading provider of cloud-based solutions for delivering digital experiences and enabling digital transformation. The Adobe Experience Cloud applications, services and platform are designed to manage customer journeys, enable shoppable experiences and deliver intelligence for businesses of any size in any industry. Our differentiation and competitive advantage is strengthened by our ability to use the Adobe Experience Platform to connect our comprehensive set of solutions.

Adobe Experience Cloud delivers the following sets of solutions for our customers:

- *Data and insights*. Our solutions deliver real-time customer profiles and intelligence across the customer journey. Adobe Analytics provides an experience system of intelligence for real-time cross-channel data, insights and activations across every channel. Adobe Audience Manager, our data management platform, helps digital publishers build unique audience profiles to identify the most valuable segments and use them across any digital channel. Adobe Experience Platform ingests, processes and stitches data across sources, channels and customer interactions in real time to create unified customer profiles. Adobe's Real-time Customer Data Platform service, built on Adobe Experience Platform, enables brands to bring together known and unknown customer data, to activate customer profiles across channels and leverage intelligent decision-making throughout the customer journey. Our Customer Journey Analytics service brings a powerful set of analytics tools to omnichannel data in Adobe Experience Platform, providing brands viewing data across channels an easy, interactive way to dig deeper and uncover new insights, while making analytics more accessible across their organization.

- *Content and commerce*. We offer solutions to help customers manage, deliver, test, target and optimize content delivery and enable shopping experiences that scale from mid-market to enterprise businesses. Our leading digital experience management solution, Adobe Experience Manager, helps customers organize, create, manage and deliver creative assets and other content across digital marketing channels, including web, mobile, email, communities and video, enabling customers to improve their market and brand perception and provide a personalized experience to their consumers. Adobe Target is a personalization engine that lets our customers test, target and optimize content using machine learning across multiple apps and the web. Magento Commerce, which integrates with Adobe Experience Manager, enables our customers to create content and promotions for storefronts on every platform and provides a highly customizable and scalable end-to-end platform to manage, personalize and optimize the commerce experience across every touchpoint by bringing together digital commerce, order management and predictive intelligence to enable engaging shopping experiences.

- *Customer journey management*. Our solutions help businesses manage, personalize and orchestrate campaigns and customer journeys across B2E use cases. Adobe Campaign enables marketers to manage the B2C customer journey and use rich customer data to create, coordinate and deliver dynamic, personalized experiences that are synchronized across multiple channels and determined by each consumer's behaviors and preferences. Marketo Engage is a complete customer experience management solution optimized for B2B, cross-channel campaigns requiring lead management, account-based marketing and revenue attribution technology by bringing together planning, engagement and measurement capabilities into an integrated marketing platform. Our Journey Orchestration service, built on Adobe

Experience Platform, enables businesses to design, orchestrate and measure event-driven, customer-led journeys across the entire customer lifecycle at the individual level to intelligently anticipate every individual's needs across their personal journey.

- *Advertising.* Adobe Advertising Cloud delivers an end-to-end platform for managing advertising across traditional TV and digital formats, and simplifies the delivery of video, display and search advertising across channels and screens. Adobe Sensei enables machine learning and predictive intelligence and helps automate digital media buying to traditional TV advertising as well as ad creation. Adobe Advertising Cloud integrates with Adobe Creative Cloud products and combines capabilities from the Adobe Advertising Cloud Demand-Side Platform, Adobe Advertising Cloud Search, Adobe Advertising Cloud TV and Adobe Advertising Cloud Creative offerings.

We believe the AI and machine learning framework enabled by our strategy with Adobe Sensei enhances the delivery of digital experiences. Adobe Experience Cloud offers domain-specific AI services powered by Adobe Sensei that work with Adobe Experience Platform to augment existing Experience Cloud product offerings. These AI services help provide domain-specific intelligence in areas such as attribution and automated insights, customer journey management, lead management, sentiment analysis, one-click personalization, enhanced anomaly detection and more. By building on existing features and these AI-powered services, we believe Adobe Sensei will increase the value we provide our customers and create a competitive differentiation in the market.

Adobe Experience Cloud also offers an open platform and ecosystem through its multi-cloud foundation, the Adobe Experience Platform, AI services powered by Adobe Sensei, and developer services through Adobe I/O. Adobe Experience Platform standardizes data into an easily sharable format consumable by Adobe Sensei and provides an open and extensible cloud infrastructure for Adobe Experience Cloud that allows data to flow freely within the Adobe Experience Platform and between Adobe Experience Cloud solutions and third-party software. This open architecture offers scalability with a wide variety of supporting products and services, empowers users to quickly develop innovative applications to interact with consumers, and enables a broad industry ecosystem through our Open Data Initiative, an open alliance among Adobe, Microsoft, SAP and others.

To drive growth of Adobe Experience Cloud, we are focused on delivering the best customer experience management solutions for B2E, enterprise and mid-market through our applications, services and platform. We also intend to focus on customer engagement, growing within existing customer accounts, and product differentiation. We are expanding our customers to include Chief Information Officers and continuing to invest in Adobe Experience Platform integrations with Adobe Analytics and Adobe Audience Manager, as well as new services such as Customer Journey Analytics and our Real-time Customer Data Platform, to create a truly comprehensive customer data and insights offering. To give our customers increased flexibility and expand our reach, we are also delivering new functionality through additional services delivered on the Adobe Experience Platform such as Journey Orchestration. We utilize a direct sales force to market and license our Experience Cloud solutions, as well as an extensive ecosystem of partners, including marketing agencies, SIs and ISVs that help license and deploy our solutions to their customers. Strategic partnerships, such as the one we have formed with Microsoft, continue to increase our market reach. We have made significant investments to broaden the scale and size of all of these routes to market and believe these investments will result in continued growth in revenue in our Digital Experience segment in fiscal 2020 and beyond.

**Publishing**

Our Publishing segment contains legacy products and services that address diverse market opportunities including eLearning solutions, technical document publishing, web conferencing, document and forms platform, web application development and high-end printing. Graphics professionals and professional publishers continue to require quality, reliability and efficiency in production printing, and our Adobe PostScript and Adobe PDF printing technologies provide advanced functionality to meet the sophisticated requirements of this marketplace. As high-end printing systems evolve and transition to fully digital, composite workflows, we believe we are well positioned to be a supplier of software and technology based on the Adobe PostScript and Adobe PDF standards for use by this industry.

We generate revenue by licensing our technology to OEMs that manufacture workflow software, printers and other output devices. In fiscal 2019, we maintained a relatively consistent annual revenue run-rate with the mature products we market and license in our Publishing business.

## COMPETITION

The markets for our products and services are characterized by intense competition, new industry standards, evolving distribution models, disruptive technology developments, frequent product introductions, short product life cycles, price cutting with resulting downward pressure on gross margins and price sensitivity on the part of consumers. Our future success will depend on our ability to enhance and better integrate our existing products, introduce new products on a timely and cost-effective basis, meet changing customer needs, provide best-in-class information security to build customer confidence and combat cyber-attacks, extend our core technology into new applications and anticipate emerging standards, business models, software delivery methods and other technological changes.

### Digital Media

No single company has offerings that match the capabilities of our Adobe Creative Cloud products and services, but we face collective competition from a variety of point offerings, free products and downloadable apps. Our competition includes offerings from companies such as Apple, Autodesk, Avid, Corel, Microsoft, Affinity and others, as well as from many lower-end offerings. We believe our greatest advantage in this space is the performance and scope of our integrated solutions, which work together as part of Creative Cloud. With Creative Cloud, we compete favorably on the basis of features and functionality, ease of use, product reliability, value and performance characteristics.

Professional digital imaging, drawing and illustration products are characterized by feature-rich competition, brand awareness and price sensitivity. Competition in this space is also emerging with drawing and illustration applications on tablet and smartphone platforms. The demand for professional web page layout and professional web content creation tools is constantly evolving and highly volatile. In this area, we face direct and indirect competition from desktop software companies and various proprietary and open source web-authoring tools.

We face competition from device, hardware and camera manufacturers as they try to differentiate their offerings by bundling, for free, their own digital imaging software or those of our competitors. Similarly, we face potential competition from operating system manufacturers as they integrate or offer hobbyist-level digital imaging and image management features with their operating systems. We also face competition from smartphone and tablet manufacturers that integrate imaging and video software into their devices to work with cameras that come as part of their smartphone and tablet offerings. In addition, social networking platforms such as Facebook (including Instagram), Snapchat, Twitter, TikTok and Pinterest, as well as portal sites such as Google and Bing are becoming a direct means to post, edit and share digital media, bypassing the step of using image editing and sharing software. Online storage and synchronization are becoming free and ubiquitous. Consumers will be encouraged to use the image and video editing software offered by those storage products, thus competing with our software.

In addition, the needs of digital imaging and video editing software users are constantly evolving due to rapid technology and hardware advancements in digital cameras, digital video cameras, printers, personal computers, tablets, smartphones and other new devices. Our imaging and video offerings, including Photoshop, Lightroom, After Effects, Premiere Pro and Premiere Rush, face competition from established and emerging companies offering similar products.

New image editing applications for mobile devices and tablets with features that compete with our professional tools are also emerging as adoption of these devices grows. Our consumer digital imaging and video editing offerings are subject to intense competition, including customer price sensitivity and competitor brand awareness. We face direct and indirect competition in the consumer digital imaging space from a number of companies whose market software competes with our offerings.

Applications and tools for experience and interface design and prototyping are still emerging and evolving as adoption of these tools by designers, design teams and larger organizations grows. Competitors to Adobe XD include Figma, Invision and Sketch. Partnerships and integrations between these companies and third parties create an increasingly competitive landscape in this space.

The universe of applications for 3D texturing and material authoring as well as other applications and tools in the areas of 3D, augmented reality and immersive design are still developing and advancing as adoption grows and new use cases emerge. Adobe's Substance suite of applications and Adobe Aero face competition from both hardware and software players in these nascent fields and competitors include Autodesk, Foundry, Quixel and Unity.

The stock content marketplace has significant competition, especially in the microstock segment, where Adobe primarily operates today with our Adobe Stock offering. Key competitors in this segment include Shutterstock, Getty Images and a number of smaller companies. Deep product integration with Adobe Creative Cloud and superior reach and relationships with creative professionals around the world differentiate our Adobe Stock offerings.

The nature of traditional digital document creation, storage, collaboration and signing has been rapidly evolving as knowledge workers and consumers shift their behavior increasingly to non-desktop workflows. Competitors like Microsoft, Google, Box, Dropbox and DocuSign all offer competitive alternatives to our Adobe Document Cloud business for creating and managing PDFs and e-signatures. In addition, other PDF creation solutions can be found at a low cost or for free on the web or via mobile applications. To address these competitive threats, we are working to ensure our Document Cloud applications stay at the forefront of innovation in emerging opportunities such as PDF document generation, document collaboration and document security, document workflow management, easeful software integrations, enablement of paper to digital transformations, and accessibility and usability on multiple devices, including mobile and desktop.

**Digital Experience**

The markets in which our Digital Experience business unit competes are growing rapidly and characterized by intense competition. Our Adobe Experience Cloud solutions face competition from large companies such as Google, Oracle, salesforce.com, SAP, SAS, Shopify, Sitecore and others, in addition to point product solutions and focused competitors. Additionally, new competitors are constantly entering these markets. Some of these competitors provide SaaS solutions to customers, generally through a web browser, while others provide software that is installed by customers directly on their servers. In addition, we compete at times with our customers' or potential customers' internally developed applications. Of the competitors listed above, no single company has products identical in breadth and depth to our Adobe Experience Cloud offerings. Adobe Experience Cloud competes in a variety of areas, including: reporting and analytics; cross-channel marketing and optimization; online marketing; audience management; advertising and real-time bidding technology; marketing automation; customer data platforms; digital commerce enablement; order management; web experience management; customer experience management and others.

Large software, internet and database management companies have expanded their offerings in the digital experience area, either by developing competing services or by acquiring existing competitors or strategic partners of ours. We believe competitive factors in our markets include the proven performance, security, scalability, flexibility and reliability of services; the strategic relationships and integration with third-party applications; the intuitiveness and visual appeal of user interfaces; demonstrable cost-effective benefits to customers; pricing; the flexibility of services to match changing business demands; enterprise-level customer service and training; perceived market leadership; the usability of services; real-time data and reporting; independence from portals and search engines; the ability to deploy the services globally; and success in educating customers in how to utilize services effectively. We believe we compete favorably with both the enterprise and low-cost alternatives based on many of these competitive factors including our strong feature set, the breadth of our offerings, our focus on global, multi-brand companies, our superior user experience, tools for building multi-screen, cross-channel applications, standards-based architecture, scalability and performance and leadership in industry standards efforts.

Creative and digital agencies, as well as SIs, are increasingly investing in acquiring their own digital experience technology to complement their creative services offerings. Adobe may face competition from these agencies and SIs as they come to market with best-of-breed offerings in one or more digital experience capabilities, or if agencies attempt to create a more complete technology platform offering. We believe our creative tools heritage differentiates us from our competitors. We have worked closely with marketing and creative customers for over 30 years. We also believe we have leadership in this space, with current customers representing leading global brands. Our comprehensive solutions extend more broadly than any other company in serving the needs of marketers and addressing this market opportunity; we integrate content and data, analytics, personalization, digital experience management, marketing automation, cross-channel campaign management, digital commerce, audience management and customer intelligence in our Adobe Experience Cloud. Most importantly, we provide a vision for our Digital Experience customers as we engage with them across the important aspects of their business, extending from their use of Adobe Creative Cloud and Adobe Document Cloud to how they manage, deliver, measure and monetize their content, participate in digital commerce, and create highly personalized and engaging shoppable experiences with our Experience Cloud.

**Publishing**

Our Publishing product offerings face competition from large-scale publishing systems, XML-based publishing companies, as well as lower-end desktop publishing products. Similarly, our web conferencing product faces competition from a number of established products from other companies, including Cisco, Citrix and Microsoft. Competition involves a number of factors, including: product features, ease-of-use, printer service support, the level of customization and integration with other publishing system components, the number of hardware platforms supported, service and price. We believe we can successfully compete based upon the quality and features of our products, our strong brand among users, the widespread adoption of our products among printer service bureaus, and our extensive application programming interfaces.

In printing technologies, we believe the principal competitive factors for OEMs in selecting a page description language or a printing technology are product capabilities, market leadership, reliability, price, support and engineering development assistance. We believe that our competitive advantages include our technology competency, OEM customer relationships and our intellectual property portfolio.

## PRINCIPAL PRODUCTS AND SERVICES

### Digital Media Offerings

#### *Creative Cloud*

Adobe Creative Cloud is a cloud-based subscription offering that enables creative professionals and enthusiasts alike to express themselves with apps and services for video, design, photography and the web that connect across devices, platforms and geographies. Members have access to a vibrant creative community, publishing services to deliver apps and websites, cloud storage to easily access their work, the ability to sync their files to virtually any device, collaboration capabilities with team members, and new products and exclusive updates as they are developed. Creative Cloud members can build a Creative Profile which persists wherever they are. A user's Creative Profile moves with them via Creative Cloud services from app to app and device to device, giving them immediate access to their personal files, photos, brushes, graphics, colors, fonts, text styles, desktop setting customizations and other important assets. All of the applications listed below and many more are available through subscriptions to Creative Cloud.

*Adobe Photoshop and Adobe Lightroom*

Adobe Photoshop is the world's most advanced digital imaging and design app. It is used by photographers, designers, animators, web professionals and video professionals, and is available to Adobe Creative Cloud subscribers on both desktop and iPad. Lightroom, our cloud-based photo service for editing, organizing, storing and sharing photos, is also available to Creative Cloud subscribers on desktop, tablet and mobile devices. Customers can also subscribe to Photoshop or Lightroom as individual cloud-enabled subscription products, or through our Photography Plan, which is a cloud-enabled offering targeted at photographers and photo hobbyists and includes Photoshop, Lightroom, integrated cloud services, and Lightroom Classic, a desktop-only version of the photo service app.

We also offer Photoshop Elements, which is targeted at consumers who desire the brand and power of Photoshop through an easy-to-use interface. For tablet and smartphone users, we offer several mobile apps including Photoshop Sketch, Photoshop Mix, Photoshop Express and Photoshop Fix – all of which enable sophisticated photo editing and content creation using a touch-based interface on tablet and mobile devices.

*Adobe Illustrator*

Adobe Illustrator is our industry-standard vector graphics app used worldwide by designers of all types who want to create digital graphics and illustrations from web icons and product packaging to book illustrations and billboards, and for all kinds of media: print, web, interactive, video and mobile. Illustrator is available to Adobe Creative Cloud subscribers, and customers can also subscribe to use it as an individual subscription product. Users can also utilize mobile apps such as Illustrator Draw to gain access to Illustrator capabilities on their tablets and mobile devices, and seamlessly sync their work across apps and devices through Adobe CreativeSync technology, including for use with Illustrator on their desktop. Illustrator will also be available on iPad starting in 2020.

*Adobe Fresco*

Adobe Fresco (formerly Project Gemini) is an illustration app designed for the latest stylus and touch devices that brings together the world's largest collection of vector and raster brushes, plus revolutionary new Live Brushes, to deliver a completely natural painting and drawing experience for artists, illustrators, animators, sketchers and anyone who wants to discover - or rediscover - the joy of drawing and painting. Live Brushes, powered by Adobe Sensei, look, feel and act just like real watercolors that bloom and bleed in real time or oil that can be swirled and smudged on canvas. Tight integration with Adobe Creative Cloud enables customers to start their projects on tablet devices and move seamlessly to desktop, with all files, brushes, fonts and assets synced across devices through Adobe Creative Cloud. A free version of Adobe Fresco is available and a premium version is offered as part of Adobe Creative Cloud, as part of an Adobe Photoshop subscription plan, or as a standalone subscription for individuals, teams, education or enterprises. Adobe Fresco is available for iPad, Microsoft Surface computers and Wacom Mobile Studio devices.

*Adobe InDesign*

Adobe InDesign is the industry-leading design and layout app for print and digital media. Our customers use it to create, preflight and publish a broad range of content including newspapers and magazines for print, online and tablet app delivery. From stationery, fliers and posters to brochures, annual reports, magazines and books with professional layout and typesetting tools, customers can create multicolumn pages that feature stylish typography and rich graphics, images and tables. Tight integration with other Adobe offerings such as Photoshop, Illustrator and Acrobat enables customers to work productively in print and digital workflows. InDesign integrates seamlessly with Adobe InCopy, so customers can work on layouts simultaneously with writers and editors. Customers can also access Adobe digital publishing capabilities from within InDesign to create and publish engaging apps for a broad range of devices, including iOS, Android and Amazon-based devices. InDesign is available to Adobe Creative Cloud subscribers, and customers can also subscribe to use InDesign as an individual cloud-enabled subscription product.

*Adobe Stock*

Adobe Stock provides designers and businesses with access to millions of high-quality, curated, royalty-free photos, vectors, illustrations, videos, templates and 3D assets, for all their creative projects. Adobe Stock is built into Adobe Creative Cloud apps, including Photoshop , Illustrator and InDesign, enabling users to search, browse, and add images to their Creative Cloud Libraries, and obtain instant access to assets across desktop and mobile devices. Adobe Stock assets may be licensed directly within the Creative Cloud desktop apps, through stock.adobe.com or as a multi-asset subscription.

*Adobe XD*

Adobe XD is our all-in-one experience design (XD) solution used to build user experiences (UX) and user interfaces (UI) when designing websites, mobile apps and more; Adobe XD enables users to go from concept to prototype faster. Adobe XD brings design and prototyping together with fast, intuitive tools that deliver precision and performance using timesaving features like Responsive Resize, Repeat Grid, Auto-Animate and flexible artboards to create everything from low-fidelity wireframes to fully interactive prototypes for any size screen in minutes. Adobe XD also makes it easy to, with a single click, share and collaborate on designs and prototypes with teammates and allow multiple colleagues on multiple devices to simultaneously make changes to the same document in real time, with support for version control. Adobe XD offers prototyping capabilities that no other design tools offer by allowing designers to design, prototype and share digital experiences that extend beyond the screen, including keyboard and gamepad triggers for desktop and console-based experiences, and voice prototyping to create audio interactions for voice-based smart assistants and other similar platforms. Adobe XD also enables users to share and reuse assets with design systems that can scale as teams and organizations grow. Adobe XD is available to Adobe Creative Cloud subscribers, and individuals and teams can also subscribe to use it as an individual cloud-enabled subscription product. A free version is also available.

*Adobe Premiere Pro and Adobe Premiere Rush*

Adobe Premiere Pro is a leading nonlinear video editing tool used by filmmakers, TV editors, YouTubers and videographers. Customers can import and combine various types of media, from video shot on a smartphone to 8K to virtual reality, and then edit in its native format without transcoding. Premiere Pro supports a vast majority of formats, and customers can use multiple graphics cards to accelerate, render and export times. Premiere Pro is the only nonlinear editor that lets users have multiple projects open while simultaneously collaborating on a single project with their team. Automated tools powered by Adobe Sensei like Auto-Reframe save time and workflows for color, graphics, audio and immersive 360/VR in Premiere Pro take customers from first edit to final credits faster than ever. Adobe Premiere Rush (formerly Project Rush) is an all-in-one, easy-to-use video editing app that simplifies video creation and sharing on platforms including YouTube, Instagram and TikTok, while delivering professional quality video results. Premiere Rush is uniquely positioned toward social media marketers, video bloggers and video enthusiasts who are looking for an all-in-one app to create and directly share online videos. Premiere Pro and Premiere Rush tightly integrate with other Adobe creative applications and are available to Adobe Creative Cloud subscribers, and customers can also subscribe to use Premiere Pro and Premiere Rush as individual cloud-enabled subscription products, or they can download the free Premiere Rush starter plan.

*Adobe After Effects*

Adobe After Effects is our industry-standard motion graphics and visual effects app used by a wide variety of animators, designers and compositors to create cinematic movie titles, remove objects from videos, apply countless effects and create animations. It offers superior control, a wealth of creative options and integration with other post-production applications. After Effects works together seamlessly with other Adobe apps such as Premiere Pro, Photoshop, Illustrator, Adobe XD and Adobe Audition. After Effects is available to Adobe Creative Cloud subscribers, and customers can also subscribe to use it as an individual cloud-enabled subscription product.

*Adobe Dimension*

Adobe Dimension is designed to make it easy for graphic designers to compose, adjust and render high-quality, photorealistic 3D images. Users can composite 2D and 3D assets to create product shots, craft photorealistic scenes and visualize branding, packaging and logo designs in 3D with photorealistic renderings. Dimension integrates well with other Adobe apps. Users can drag and drop background images from Photoshop, geometry from Substance Painter and 3D models from Adobe Stock - without leaving Dimension. Dimension is available to Adobe Creative Cloud subscribers, and customers can also subscribe to use it as an individual cloud-enabled subscription product.

*Adobe Aero*

Adobe Aero (formerly Project Aero) is our free iOS application for viewing, building and sharing immersive and interactive augmented reality experiences. Users can directly import 2D and 3D assets created in Adobe applications like Adobe Photoshop, Adobe Illustrator, Adobe Dimension and Substance by Adobe, as well as third-party applications like Cinema4D, and bring them to life with animations and interactive triggers. Adobe Aero automatically optimizes these assets for augmented reality and uses machine learning technology to mimic real-world lighting on objects without the need for complex models or time-consuming manual rendering. Adobe Aero is available for free on the iOS App Store.

*Substance by Adobe*

On January 23, 2019, Adobe acquired Allegorithmic, a privately held 3D editing and authoring software company for gaming and entertainment, and began integrating it into Adobe Creative Cloud as Substance by Adobe. Substance by Adobe is a suite of tools, comprised of Substance Painter, Substance Source, Substance Alchemist and Substance Designer, for 3D texturing and materials authoring that enables users to get all the details just right in their 3D creations. Substance Painter allows users to nondestructively paint 3D textures on models in real time with smart materials that adjust to any object to show realistic wear and tear. Substance Source is a 3D materials library from which users can import professional quality 3D textures into their projects and generate infinite texture variations. Substance Alchemist allows users to create collections of 3D textures and materials, mix and tweak existing materials and even create new materials from the real world using photographs and high-resolution scans. Substance Designer is the industry standard texture authoring tool for precisely creating custom materials with complete nondestructive authoring control. Substance integrates well with other Adobe apps like Dimension, as well as game engines like Epic Games' Unreal Engine 4, Unity, Autodesk's Maya and 3ds Max and more. Customers can also subscribe to use Substance as an individual subscription product.

*Adobe Fonts*

Adobe Fonts brings thousands of fonts from foundry partners into one library for quick browsing, easy use on the web or on the user's desktop and endless typographic inspiration. Our full library of commercially-licensed fonts is offered through Adobe Creative Cloud. In addition, customers may subscribe to the standalone Adobe Fonts portfolio plan, or license individual fonts from the Adobe Fonts Marketplace.

*Behance*

Behance is the leading social community to showcase and discover creative work online. Adobe Portfolio allows users to quickly and simply build a fully customizable and hosted website that seamlessly syncs with Behance.

*Adobe Spark*

Adobe Spark is our integrated web and mobile software for creating and sharing impactful visual stories. Designed for everyday communication, Adobe Spark empowers users to transform text, photos and videos into dynamic web stories, video stories or professional-looking graphics for social media that engage audiences across multiple channels and on any device. The Adobe Spark web app seamlessly syncs with the Spark Post, Spark Page and Spark Video iOS mobile apps (with Spark Post also available as an Android app), allowing users to create, edit and share their story from any location regardless of their design experience. Adobe Spark with premium features allows users to apply custom branding to anything they create; the premium product is offered as part of any Adobe Creative Cloud plan or as a standalone subscription for individuals, teams, education or enterprises. A free version is also available.

***Acrobat and Adobe Document Cloud***

Adobe Document Cloud is a cloud-based subscription offering that enables complete, reliable and automated digital document and signature workflows across desktop, mobile, web and third-party enterprise applications to drive business productivity for individuals, teams, small businesses and enterprises. With Document Cloud, users can create, review, approve, sign and track documents, and store them in Document Cloud for easy access and sharing, whether on a desktop or mobile device. Document Cloud includes Adobe Acrobat DC, Adobe Sign, Adobe Scan and other Document Cloud apps and services that work standalone or integrate with users' existing productivity apps, processes and systems.

At the heart of Adobe Document Cloud is Adobe Acrobat DC, the industry standard for PDF creation and conversion. Acrobat enables users to create secure, reliable and compact Adobe PDF documents from authoring applications such as Microsoft

Office software, graphics applications and more. Acrobat enables automated collaborative workflows with a rich set of commenting tools and review tracking features and includes everything needed to create and distribute rich, secure electronic documents that can be viewed easily within leading web browsers or on computer desktops via the free Adobe Acrobat Reader.

Adobe Acrobat is available to both Adobe Creative Cloud and Adobe Document Cloud subscribers. Customers can also license Acrobat Pro DC or Acrobat Standard DC (which has a subset of Acrobat Pro DC features) as individual point products available through a cloud-enabled subscription. Adobe Acrobat Reader, our free software for reliable viewing, annotating and printing of Adobe PDF documents on a variety of desktop and mobile platforms, offers additional features for subscribers to Adobe Document Cloud or Adobe Acrobat DC that enables subscribers to create, edit, export, combine, share and collaborate on PDF documents on mobile devices. Users of both Acrobat and Acrobat Reader can also access, edit and save changes to their PDF files stored in the Adobe Document Cloud, or other third-party cloud storage services, including Box, Dropbox, Google Drive and Microsoft OneDrive.

Adobe Scan can be used for free on mobile devices to provide scanning capabilities in the pocket of every person. It captures paper documents as images and transforms them into full-featured and versatile PDFs via Adobe Document Cloud services for instant sharing with others.

Our Adobe Sign cloud-based e-signature service allows users to securely electronically send and sign any document from any device. As well as being available on the web, Adobe Sign has a mobile app that allows users to e-sign documents and forms, send them for signature, track responses in real time and obtain instant signatures with in-person signing. Adobe Sign also integrates with users' enterprise systems through a comprehensive set of applicable programming interfaces, and Adobe Experience Manager Forms and Advanced Workflows for Adobe Sign, to create forms and provide seamless experiences to customers across web and mobile sites. Adobe Sign is Microsoft's preferred e-sign solution and is integrated into Microsoft Office 365, Microsoft Dynamics 365 and Microsoft SharePoint.

**Digital Experience Offerings**

Adobe Experience Cloud is a comprehensive collection of best-in-class solutions for advertising, analytics, marketing and commerce, all integrated on a cloud platform, along with service, support and an open ecosystem. Experience Cloud is comprised of the following sets of solutions for our customers: Data and Insights, Content and Commerce, Customer Journey Management and Advertising, which are each described below.

***Data and Insights***

Our Data and Insights solutions deliver real-time customer profiles and intelligence across the customer journey with a unified, purpose-built platform for customer experience management, a data management platform and cross-channel analytics. The following is a brief description of our solutions for Data and Insights.

*Adobe Experience Platform*

Adobe Experience Platform is the industry's first purpose-built platform for customer experience management that helps users ingest, process and stitch together known and unknown customer data from every customer interaction across multiple channels in real time into unified customer profiles. Adobe Experience Platform standardizes data into an easily sharable format consumable by Adobe Sensei and provides an open and extensible cloud infrastructure which allows that data to flow freely within the Adobe Experience Platform and between Adobe applications and services and third-party software. This open architecture offers scalability with a wide variety of supporting products and services, empowers users to quickly develop innovative applications to interact with consumers and enables a broad industry ecosystem through our Open Data Initiative, an open alliance among Adobe, Microsoft and SAP. Adobe Experience Platform also offers Query Service and Data Science Workspace, which enable users to gain deeper insights from stored datasets, and customer journey intelligence, which leverages predefined data-driven operational best practices, AI and business intelligence to enable and optimize real-time decisions, actions and business processes. Users are able to leverage Adobe Experience Platform to activate insights across all Adobe Experience Cloud applications.

*Adobe Analytics*

Adobe Analytics is our industry leading solution that helps our customers create a holistic view of their business by turning consumer interactions into actionable insights. Adobe Analytics enables web, social, video, mobile, attribution and predictive analytics to continuously improve the performance of marketing activities and better direct our customers' marketing spend. From attribution and predictive modeling to contribution analysis and propensity scoring, Adobe Analytics is immersed in machine learning and AI. With intuitive and interactive dashboards and reports, our customers can sift, sort and share real-time information to provide insights that can be used to identify problems and opportunities and to drive conversion and relevant consumer experiences. Our Analysis Workspace provides a robust, flexible canvas for creating and curating reusable analysis projects that are customized to their needs. Adobe Analytics lets users capture, analyze and integrate data from virtually any source, both online and offline, from web, email and CRM to voice, IoT and connected car data.

*Adobe Audience Manager*

Adobe Audience Manager is a data management platform that helps digital publishers build unique audience profiles to identify the most valuable segments and use them across any digital channel. Adobe Audience Manager consolidates audience information from all available sources. It then identifies, quantifies and optimizes high-value target audiences, which can then be offered to advertisers via an integrated, secure, privacy-friendly management system that works across all advertising distribution platforms. Adobe Audience Manager provides access to multiple data sources, offering digital publishers the ability to use a wide variety of third-party data as well as Audience Manager's private data co-op.

*Customer Journey Analytics*

Our Customer Journey Analytics service, built on Adobe Experience Platform, brings a powerful set of analytics tools that stitch and analyze cross-channel data to deliver comprehensive customer journey insights that allow our customers to more easily deliver consistent experiences regardless of channel. This service provides brands viewing data across channels with an easy, interactive way to dig deeper and uncover new insights with omnichannel data analysis, while making analytics more accessible across their organization. The Customer Journey Analytics interface democratizes data analysis by allowing users to creatively and intelligently visualize their customer data and gather collections of insights for different audiences in real time by manipulating layers of data.

*Real-Time Customer Data Platform*

Our Real-time Customer Data Platform, built on Adobe Experience Platform, uses customer data to instantly personalize experiences. It does so by activating Adobe Experience Platform's unified customer profiles across channels to leverage intelligent decision making throughout the customer journey and deliver hyper-personalized experiences across all known channels and devices. The Real-time Customer Data Platform utilizes an open and extensible architecture that allows integration with a variety of data sources and activation touchpoints and provides continuous data refreshes to keep customer profiles updated in real time.

***Content and Commerce***

Our Content and Commerce solutions help customers manage, deliver, test, target and optimize content delivery and enable shopping experiences that scale from mid-market to enterprise businesses. The following is a brief description of our solutions for Content and Commerce.

*Adobe Experience Manager*

Adobe Experience Manager is a leading digital experience management solution that uses AI tools to help customers organize, create and manage the delivery of creative assets and other content across digital marketing channels, including web, mobile, email, communities and video. It enables customers to manage content on premise or host it in the cloud, delivering agile and rapid deployment. With this ultimate control of content and campaigns, our customers can deliver real-time and personalized experiences to their consumers that help build customers' brands, drive demand and extend reach. Adobe Experience Manager includes digital asset management, web content management, digital publishing and enterprise-level forms management. These tools enable customers to improve their market and brand perception and provide a personalized experience to their consumers.

*Adobe Target*

Adobe Target is a personalization engine that lets our customers test, target and optimize content using machine learning across multiple apps and the web. With Adobe Target, our customers have the tools they need to quickly discover what gets noticed and what increases conversion and engagement. It paves a path from simple testing to targeting to true segmentation and optimization through A/B and multivariate testing, AI-powered automation at scale, content targeting and automated decision making. Adobe Target capabilities also enable our customers to test and target adaptive or responsive mobile web experiences.

*Magento Commerce*

Magento Commerce offers digital commerce enablement and order orchestration for both physical and digital goods across a range of industries, including consumer packaged goods, retail, wholesale, manufacturing and the public sector. Magento Commerce brings together digital commerce, order management and predictive intelligence to enable shopping experiences that scale from mid-market to enterprise businesses. Based on an open-source ecosystem, Magento Commerce extends beyond the web shopping cart to every shoppable experience, including email, mobile, in-store and marketplaces. Magento Commerce also integrates with Adobe Experience Manager to enable the user-friendly creation and deployment of content and promotions for shopping experiences that integrate seamlessly across mobile, social or in-store.

***Customer Journey Management***

Our Customer Journey Management solutions enable our customers to manage and orchestrate individual cross-channel campaigns that encourage meaningful customer experiences; personalize content and deliver optimized experiences at scale that are meaningful to each of their customers; and plan, orchestrate and measure engagement with their prospects and customers at every stage of the customer journey, across B2E use cases. The following is a brief description of our solutions for Customer Journey Management.

*Adobe Campaign*

Adobe Campaign is optimized for B2C experiences involving high volume email and cross-channel campaign management. Adobe Campaign enables marketers to manage the customer journey and use rich customer data to create, coordinate and deliver dynamic, personalized experiences that are synchronized across multiple channels and determined by each consumer's behaviors and preferences. As part of its feature set, Adobe Campaign provides visual campaign orchestration, allowing for intuitive design and automated consumer experiences across channels, from one-off campaigns to triggered messages, with a graphically rich interface. Marketers can also integrate consumer data from across marketing channels to develop and deliver more relevant marketing experiences to their consumers through email, mobile, offline channels and more. Features also include targeted segmentation, multilingual email execution, real-time interaction, in-app messaging and operational reporting to easily see how well campaigns are performing.

*Marketo Engage*

Marketo Engage is a complete customer experience management solution optimized for B2B, cross-channel campaigns requiring lead management, account-based marketing and revenue attribution technology by bringing together planning, engagement and measurement capabilities into an integrated marketing platform. Marketo Engage simplifies how companies plan, orchestrate and measure engagement with prospects and customers at every stage of their experience and allows companies to better align marketing and sales at every touchpoint to engage high priority accounts. It offers a feature-rich and cloud-native platform with a set of solutions for delivering transformative customer experiences across industries and companies of all sizes.

*Journey Orchestration*

Our Journey Orchestration service, built on Adobe Experience Platform, enables businesses to design, orchestrate and measure event-driven, customer-led journeys across the entire customer lifecycle at the individual level to intelligently anticipate every individual's needs across their personal journey. It allows businesses to trigger individual journeys, apply conditions in real time to qualify events and personalize journeys, as well as visually map individual journeys across all systems in an intuitive workflow-based interface. Journey Orchestration also allows businesses to track detailed performance of executed journeys and how individuals are progressing in real time, with data automatically sent to Adobe Experience Platform to allow full-funnel analysis.

***Advertising***

Adobe Advertising Cloud is an end-to-end, independent platform for managing advertising that unifies and automates all media, screens, data and creativity at scale. With Adobe Advertising Cloud and its use of Adobe Sensei AI and data integrations, customers can identify and amplify their high-value audiences for more personal and accurate targeting; seamlessly unite creative, data and media buying across all screens and formats; protect their brand by preventing their campaigns from mixing with content and properties that do not align with their image; scale bidding and optimization strategies; implement programmatic creative management using automated advertisement creation for both prospecting and retargeting customers; generate advertisements at scale using Adobe Creative Cloud apps; and use data insights that reveal customers' interests and past behaviors to create relevant, targeted ads. Adobe Advertising Cloud includes Adobe Advertising Cloud Demand Side Platform, Adobe Advertising Cloud Search, Adobe Advertising Cloud TV and Adobe Advertising Cloud Creative offerings.

Adobe Advertising Cloud DSP is the first independent, omnichannel demand-side platform that brings cross-screen and cross-channel integrations for planning, buying, measurement and optimization and supports all forms of TV (linear, addressable and connected), video, display, native, audio, social and search campaigns. It builds identities, finds optimal mixes to reach audiences and manages tactics that span multiple sites simultaneously, effortlessly and nearly instantly. Adobe Advertising Cloud Search brings customers the most comprehensive search management through the automation of search, shopping and retargeting campaigns by offering model transparency and accuracy reports that give insight into actual performance rather than just forecasts for clicks, cost and revenue. With intuitive navigation and time-saving workflows, it delivers powerful, real-time integration with

Adobe Analytics, Adobe Audience Manager and Adobe Campaign and connects users’ data, audience segments and other marketing channels to get a bird’s-eye view of their performance. Adobe Advertising Cloud TV uses data and automation to help customers make smarter TV buying decisions, deliver precision against their audiences and increase the impact of their TV advertising with access to over 30,000 audience data attributes. As part of the Adobe Advertising Cloud DSP, Adobe Advertising Cloud Creative uniquely brings together designers and marketing professionals in a self-serve, intuitive interface with direct integration with Adobe Creative Cloud apps that enhances collaboration between customers’ ad production and media teams and enables users to automatically create thousands of ads at scale.

**Other Products and Services**

We also offer a broad range of other enterprise and digital media products and services. Information about other products not referenced here can be found on our corporate website, www.adobe.com.

## OPERATIONS

**Marketing and Sales**

We market and license our products directly using our sales force and certain local offices and through our own website at www.adobe.com. We also market and distribute our products through sales channels, which include distributors, retailers, software developers, SIs, ISVs and VARs, as well as through OEM and hardware bundle customers.

Our local field offices include locations in Australia, Belgium, Brazil, Canada, China, Denmark, France, Germany, Hong Kong, India, Ireland, Israel, Italy, Japan, Mexico, Moldova, the Netherlands, Poland, Romania, Singapore, South Africa, South Korea, Spain, Sweden, Switzerland, Taiwan, the United Kingdom and the United States.

We sell the majority of our products through a software subscription model where our customers purchase access to a product for a specific period of time during which they always have rights to use the most recent version of that product. We also license perpetual versions of our software with maintenance and support, which includes rights to upgrades, when and if available, support, updates and enhancements.

For fiscal 2019, 2018 and 2017, there were no customers that represented at least 10% of net revenue. As of fiscal year end 2019 and 2018, no single customer was responsible for over 10% of our trade receivables.

**Services and Support**

We provide expert consulting, customer success management, technical support and learning services across all our customer segments, including enterprises, small and medium businesses, creative professionals and consumers. With a focus on ensuring sustained customer success and realized value, this comprehensive portfolio of services is designed to help customers and partners maximize the return on their investments in our cloud solutions and licensed products. Our service and support revenue consists primarily of consulting fees, software maintenance, technical support fees and training fees.

*Consulting Services*

We have a global professional services team dedicated to designing and implementing solutions for our largest customers. Our professional services team uses a comprehensive, customer-focused methodology that has been refined over years of capturing and analyzing best practices from numerous customer engagements across a diverse mix of solutions, industries and customer segments. Increasingly, our customers seek to integrate across Adobe’s products and cloud solutions, and engage our professional services teams to share their expertise in leading customers’ digital strategies, multi-solution integrations and in running customer platforms. Using our methodology, our professional services teams are able to accelerate customers’ time to value, and maximize the return customers earn on their investment in Adobe solutions.

A key component of Adobe’s strategy is developing a large partner ecosystem to expand the reach and breadth of Adobe solutions in the global marketplace. In order to assist partners in building their respective digital practices, Adobe Global Services provides a comprehensive set of deliverables through Adobe’s Solution Partner Program. The breadth of services described in the program provides system integrators, agencies and regional partners the tools required to develop core capabilities for positioning and building with Adobe technology, as well as implementing and running customer platforms. We believe that through these programmatic services and support, our joint customers benefit greatly from the combination of Adobe technology and the deep customer context that our global partners represent.

*Customer Success Account Management*

Adobe Customer Solutions provides Customer Success Managers, who work with enterprise and commercial customers on an ongoing basis to understand their current and future business needs, promote faster solution adoption, and align product capabilities to customers' business objectives to maximize the return on their investment in Adobe's offerings. We engage customers to share innovative best practices, relevant industry and vertical knowledge, and proven success strategies based on our extensive engagements with leading marketers and brands. The performance of these teams is directly associated with customer-focused outcomes.

*Technical Support*

Adobe provides enterprise maintenance and support services to customers of subscription products as part of the subscription entitlement, and to perpetual license customers via annual fee-based maintenance and support programs. These offerings provide:

- technical support on the products they have purchased from Adobe;
- "how to" help in using our products; and
- product upgrades and enhancements during the term of the maintenance and support or subscription period, which is typically one to three years.

We provide product support through a global support organization that includes several regional and global support centers, supplemented with outsourced vendors for specific services. Customers can seek help through multiple channels including phone, chat, web, social media and email, allowing quick and easy access to the information they need. These teams are responsible for providing timely, high-quality technical expertise on all our products.

Certain consumers are eligible to receive Getting Started support, to assist with easy adoption of their products. Support for some products and in some countries may vary. For enterprise customers with greater support needs, we offer personalized service options through Premium Services options, delivered by global support centers and technical account managers who can also provide proactive risk mitigation services and on-site support services for those with business-critical deployments.

Lastly, we also offer delivery assurance, technical support and enablement services to partners and developer organizations. Through the Adobe Partner Connection Reseller Program, we provide developers with high-quality tools, software development kits, information and services.

*Digital Learning Services*

Adobe Customer Solutions offers a comprehensive portfolio of learning and enablement services to assist our customer and partner teams in the use of our products, including those within Digital Experience, Digital Media and other legacy products and solutions. Our training portfolio includes a large number of free online self-service learning options on www.training.adobe.com. Adobe Digital Learning Services also has an extensive portfolio of fee-based learning programs including a wide range of traditional classroom, virtual and on-demand training and certifications delivered by our team of training professionals and partners across the globe.

These core offerings are complemented by our custom learning services, which support our largest enterprise customers and their unique requirements. Solution-specific skills assessments help our enterprise customers objectively assess the knowledge and competencies within their marketing teams and tailor their learning priorities accordingly. Finally, aligned with our cloud strategy, we have introduced a new learning subscription service that enables customers to access both business and technical Digital Experience training over a 12-month period, which is a scalable approach to supporting long-term learning.

**Investments**

From time to time we make direct investments in privately held companies. We enter into these investments with the intent of securing financial returns as well as for strategic purposes, as they often increase our knowledge of emerging markets and technologies and expand our opportunities to provide Adobe products and services.

## PRODUCT DEVELOPMENT

A continuous high level of investment is required for the enhancement of existing solutions and the development of new solutions due to the speed of technological change that characterizes the software industry. We develop our software internally, as well as acquire products or technology developed by others by purchasing the stock or assets of the business entity that owns the technology. In other instances, we have licensed or purchased the intellectual property ownership rights of programs developed by others with license or technology transfer agreements that may obligate us to pay a flat license fee or royalties, typically based on a dollar amount per unit or a percentage of the revenue generated by those programs.

## PROTECTING AND LICENSING OUR PRODUCTS

We protect our intellectual property through a combination of patents, copyrights, trademarks and trade secrets, foreign intellectual property laws, confidentiality procedures and contractual provisions. We have United States and foreign patents and pending applications that relate to various aspects of our products and technology. Although our patents have value, no single patent is essential to any of our principal businesses. We have also registered, and applied for the registration of, U.S. and international trademarks, service marks, domain names and copyrights.

Our enterprise customers license our hosted offerings as SaaS or Managed Services, and consumers primarily use our desktop software and mobile apps. We license our desktop software to users under ‘click through’ or signed license agreements containing restrictions on duplication, disclosure and transfer. Similarly, cloud products and services are provided to users under ‘click through’ or signed agreements containing restrictions on access and use.

Despite our efforts to protect our proprietary technology and our intellectual property rights, unauthorized parties may attempt to copy or obtain and use our technology to develop applications with the same functionality as our application. Policing unauthorized use of our technology and intellectual property rights is difficult. We believe that our transition from perpetual-use software licenses to a subscription-based business model combined with the increased focus on cloud-based computing has and may continue to improve our efforts to combat the pirating of our products.

## EMPLOYEES

As of November 29, 2019, we employed 22,634 people. We have not experienced work stoppages and believe our employee relations are good.

## AVAILABLE INFORMATION

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed or furnished pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge on our Investor Relations website at www.adobe.com/adbe as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information posted on our website is not incorporated into this report.

## EXECUTIVE OFFICERS

Adobe’s executive officers as of January 21, 2020 are as follows:

| Name | Age | Positions |
| --- | --- | --- |
| Shantanu Narayen | 56 | Chairman, President and Chief Executive Officer<br><br>Mr. Narayen currently serves as our Chairman of the Board, President and Chief Executive Officer. He joined Adobe in January 1998 as Vice President and General Manager of our engineering technology group. In January 1999, he was promoted to Senior Vice President, Worldwide Products, and in March 2001 he was promoted to Executive Vice President, Worldwide Product Marketing and Development. In January 2005, Mr. Narayen was promoted to President and Chief Operating Officer, and effective December 2007, he was appointed our Chief Executive Officer and joined our Board of Directors. In January 2017, he was named our Chairman of the Board. Mr. Narayen serves as lead independent director on the board of directors of Pfizer, a multinational pharmaceutical corporation. Mr. Narayen holds a B.S. in Electronics Engineering from Osmania University in India, a M.S. in Computer Science from |

Bowling Green State University and an M.B.A. from the Haas School of Business, University of California, Berkeley.

| Name | Age | Positions |
|---|---|---|
| John Murphy | 51 | Executive Vice President and Chief Financial Officer<br><br>Mr. Murphy currently serves as our Executive Vice President and Chief Financial Officer. He joined Adobe in March 2017 and served as our Senior Vice President, Chief Accounting Officer and Corporate Controller until April 2018. Prior to joining Adobe, Mr. Murphy served as Senior Vice President, Chief Accounting Officer and Corporate Controller of Qualcomm Incorporated from September 2014 to March 2017. He previously served as Senior Vice President, Controller and Chief Accounting Officer of DIRECTV Inc. from November 2007 until August 2014, and Vice President and General Auditor of DIRECTV from October 2004 to November 2007. Prior to joining DIRECTV he worked at several global companies, including Experian, Nestle, and Atlantic Richfield (ARCO), in a variety of finance and accounting roles. He served as Director of DirecTV Holdings LLC from November 2007 until August 2014. Mr. Murphy serves on the Corporate Advisory Board of the Marshall School of Business at the University of Southern California. He holds an MBA from the Marshall School of Business at the University of Southern California, a B.S. in Accounting from Fordham University. |
| Scott Belsky | 39 | Chief Product Officer and Executive Vice President, Creative Cloud<br><br>Mr. Belsky joined Adobe in December 2017 as Chief Product Officer and Executive Vice President, Creative Cloud. Prior to joining Adobe in December 2017, Belsky was a venture investor at Benchmark in San Francisco from February 2016 to December 2017. Prior to Benchmark, Belsky led Adobe's mobile strategy for Creative Cloud from December 2012 to January 2016, having joined the company through the acquisition of Behance. Belsky co-founded Behance in 2006 and served as its CEO for over 6 years. He is an early advisor and investor to Pinterest, Uber and Warby Parker among other early-stage companies, and co-founded and serves on the board of Prefer, a referrals platform that empowers the careers of independent professionals. Mr. Belsky also serves on the advisory board of Cornell University's Entrepreneurship Program and as President of the Smithsonian Cooper-Hewitt National Design Museum board of trustees. |
| Anil Chakravarthy | 52 | Executive Vice President and General Manager, Digital Experience<br><br>Mr. Chakravarthy joined Adobe in January 2020 as Executive Vice President and General Manager, Digital Experience. Prior to joining Adobe, he served as Informatica’s Chief Executive Officer from August 2015 to January 2020 and Executive Vice President and Chief Product Officer from September 2013 to August 2015. Prior to joining Informatica, for over nine years, Mr. Chakravarthy held multiple leadership roles at Symantec Corporation, most recently serving as its Executive Vice President, Information Security from February 2013 to September 2013. Prior to Symantec, he was a Director of Product Management for enterprise security services at VeriSign. Mr. Chakravarthy began his career as an engagement manager at McKinsey & Company. Mr. Chakravarthy holds a Bachelor of Technology in Computer Science and Engineering from the Institute of Technology, Varanasi, India and Master of Science and Ph.D. degrees from the Massachusetts Institute of Technology. |
| Gloria Chen | 55 | Executive Vice President, Strategy and Growth<br><br>Ms. Chen joined Adobe in 1997 and currently serves as Executive Vice President, Strategy and Growth. In her more than 20 years at Adobe, she has held senior leadership positions in worldwide sales operations, customer service and support, and strategic planning. In October 2009, Ms. Chen was appointed Vice President and Chief of Staff to the Chief Executive Officer. In March 2018, she was promoted to Senior Vice President, Strategy and Growth and in November 2019, she was elevated to Executive Vice President, Strategy and Growth. Prior to joining Adobe, Ms. Chen was an engagement manager at McKinsey & Company. Ms. Chen holds a BS in electrical engineering from the University of Washington, an MS in electrical and computer engineering from Carnegie Mellon University and an MBA from Harvard Business School. |
| Bryan Lamkin | 59 | Executive Vice President and General Manager, Digital Media |

Mr. Lamkin currently serves as Executive Vice President and General Manager, Digital Media. He rejoined Adobe in February 2013 as Senior Vice President, Technology and Corporate Development. From June 2011 to May 2012, Mr. Lamkin served as President and Chief Executive Officer of Clover, a mobile payments platform. Prior to Clover, Mr. Lamkin co-founded and served as the Chief Executive Officer of Bagcheck, a sharing and discovery platform, from June 2010 to May 2011. From April 2009 to June 2010, Mr. Lamkin served as Senior Vice President of Consumer Products and Applications at Yahoo!, a global technology company providing online search, content and communication tools. From May 2008 to April 2009, Mr. Lamkin served as Executive in Residence at Sutter Hill Ventures. Mr. Lamkin previously was with Adobe from 1992 to 2006 and held various senior management positions including Senior Vice President, Creative Solutions Business Unit.

| Name | Age | Positions |
| --- | --- | --- |
| Ann Lewnes | 58 | Executive Vice President and Chief Marketing Officer<br><br>Ms. Lewnes joined Adobe in November 2006 and currently serves as Executive Vice President and Chief Marketing Officer. Prior to joining Adobe, Ms. Lewnes spent 20 years at Intel Corporation, where she was Vice President of Sales and Marketing. Ms. Lewnes is a board member of Mattel and the Adobe Foundation. |
| Donna Morris | 52 | Chief Human Resources Officer and Executive Vice President, Employee Experience<br><br>Ms. Morris currently serves as Chief Human Resources Officer and Executive Vice President of Adobe's Global Customer and Employee Experience organization. Ms. Morris joined Adobe as Senior Director of Global Talent Management in April 2002 through the acquisition of Accelio Corporation, a Canadian software company, where she served as Vice President of Human Resources and Learning. In December 2005, Ms. Morris was promoted to Vice President Global Human Resources Operations and subsequently to Senior Vice President Human Resources in March 2007. Ms. Morris is a director of Marvell Technology Group Limited and the Adobe Foundation. |
| Abhay Parasnis | 45 | Executive Vice President and Chief Technology Officer<br><br>Mr. Parasnis joined Adobe in July 2015 as Senior Vice President of Adobe's Cloud Technology & Services organization and Chief Technology Officer. Prior to joining Adobe, he served as President and Chief Operating Officer at Kony, Inc. from March 2013 to March 2015. From January 2012 to November 2013, Mr. Parasnis was a Senior Vice President and later Strategic Advisor for the Oracle Public Cloud at Oracle. Prior to joining Oracle, he was General Manager of Microsoft Azure AppFabric at Microsoft from April 2009 to December 2011. |
| Dana Rao | 50 | Executive Vice President, General Counsel and Corporate Secretary<br><br>Mr. Rao currently serves as our Executive Vice President, General Counsel and Corporate Secretary. He joined Adobe in April 2012 and served as our Vice President, Intellectual Property and Litigation where he spearheaded strategic initiatives including the company’s litigation efforts, and its patent, trademark and copyright portfolio strategies until June 2018. Prior to joining Adobe, Mr. Rao was with Microsoft Corporation for 11 years, serving in a variety of roles including Associate General Counsel of Intellectual Property and Licensing, where he oversaw all patent matters for Microsoft’s entertainment and devices division as well as the company-wide patent acquisition team. From 1997 until March 2001, he served as a patent attorney at Fenwick & West. He holds a B.S. in Electrical Engineering from Villanova University and a J.D. from George Washington University. |
| Matthew Thompson | 61 | Executive Vice President, Worldwide Field Operations<br><br>Mr. Thompson currently serves as Executive Vice President, Worldwide Field Operations. Mr. Thompson joined Adobe in January 2007 as Senior Vice President, Worldwide Field Operations. In January 2013, he was promoted to Executive Vice President, Worldwide Field Operations. Prior to joining Adobe, Mr. Thompson served as Senior Vice President of Worldwide Sales at Borland Software Corporation, a software delivery optimization solutions provider, from October 2003 to December 2006. Prior to joining Borland, Mr. Thompson was Vice President of Worldwide Sales and Field Operations for Marimba, Inc., a provider of products and services for software change and configuration management, from February 2001 to January 2003. From July 2000 to January 2001, Mr. Thompson was Vice President of Worldwide Sales for Calico Commerce, Inc., a provider of eBusiness applications. Prior to joining Calico, Mr. Thompson spent six years at Cadence Design Systems, Inc., a provider of electronic design technologies. While at Cadence, from January 1998 to June 2000, Mr. Thompson served as Senior Vice President, Worldwide Sales and Field Operations and from April 1994 to January 1998 as Vice President, Worldwide Professional Services. Mr. Thompson is a board member of NCR Corporation. |
| Mark Garfield | 49 | Vice President, Chief Accounting Officer and Corporate Controller |

Mr. Garfield currently serves as our Vice President, Chief Accounting Officer and Corporate Controller. Prior to joining Adobe in December 2018, Mr. Garfield served as the Vice President of Finance of Cloudflare, Inc. commencing in November 2017. He served as Senior Vice President and Chief Accounting Officer at Symantec Corporation from March 2014 to October 2017. Prior to joining Symantec, he was at Brightstar Corporation where he served primarily as Senior Vice President and Chief Accounting Officer from January 2013 to February 2014. Mr. Garfield served as Director of Finance at Advanced Micro Devices from August 2010 to December 2012. Prior to Advanced Micro Devices, Mr. Garfield also served in senior level finance roles at LoudCloud and Ernst and Young. Mr. Garfield holds a B.A. in Business Economics from University of California at Santa Barbara.

## ITEM 1A. RISK FACTORS

As previously discussed, our actual results could differ materially from our forward-looking statements. Below we discuss some of the factors that could cause these differences. These and many other factors described in this report could adversely affect our operations, performance and financial condition.

***Our competitive position and results of operations could be harmed if we do not compete effectively.***

The markets for our products and services are characterized by intense competition, new industry standards, evolving distribution models, limited barriers to entry, disruptive technology developments, short product life cycles, customer price sensitivity and frequent product introductions (including alternatives with limited functionality available at lower costs or free of charge). Any of these factors could create downward pressure on pricing and gross margins and could adversely affect our renewal and upsell and cross-sell rates, as well as our ability to attract new customers. Our future success will depend on our continued ability to enhance and integrate our existing products and services, introduce new products and services in a timely and cost-effective manner, meet changing customer expectations and needs, extend our core technology into new applications, and anticipate emerging standards, business models, software delivery methods and other technological developments. Furthermore, some of our competitors and potential competitors enjoy competitive advantages such as greater financial, technical, sales, marketing and other resources, broader brand awareness and access to larger customer bases. As a result of these advantages, potential and current customers might select the products and services of our competitors, causing a loss of our market share. In addition, consolidation has occurred among some of our competitors. Further consolidations in these markets may subject us to increased competitive pressures and may harm our results of operations.

*For additional information regarding our competition and the risks arising out of the competitive environment in which we operate, see the section entitled "Competition" contained in Part I. Item 1 of this report.*

***If we cannot continue to develop, acquire, market and offer new products and services or enhancements to existing products and services that meet customer requirements, our operating results could suffer.***

The process of developing and acquiring new technology products and services and enhancing existing offerings is complex, costly and uncertain. If we fail to anticipate customers' rapidly changing needs and expectations or adapt to emerging technological trends, our market share and results of operations could suffer. We must make long-term investments, develop, acquire or obtain appropriate intellectual property and commit significant resources before knowing whether our predictions will accurately reflect customer demand for our products and services. If we misjudge customer needs in the future, our new products and services may not succeed and our revenues and earnings may be harmed. Additionally, any delay in the development, acquisition, marketing or launch of a new offering or enhancement to an existing offering could result in customer attrition or impede our ability to attract new customers, causing a decline in our revenue, earnings or stock price and weakening our competitive position.

We offer our products on a variety of hardware platforms. Consumers continue to migrate from personal computers to tablet and mobile devices. If we cannot continue adapting our products to tablet and mobile devices, or if our competitors can adapt their products more quickly than us, our business could be harmed. Releases of new devices or operating systems may make it more difficult for our products to perform or may require significant costs in order for us to adapt our solutions to such devices or operating systems. These potential costs and delays could harm our business.

***Introduction of new technology could harm our business and results of operations.***

The expectations and needs of technology consumers are constantly evolving. Our future success depends on a variety of factors, including our continued ability to innovate, introduce new products and services efficiently, enhance and integrate our products and services in a timely and cost-effective manner, extend our core technology into new applications, and anticipate emerging standards, business models, software delivery methods and other technological developments. Integration of our products and services with one another and other companies' offerings creates an increasingly complex ecosystem that is partly reliant on third parties. If any disruptive technology, or competing products, services or operating systems that are not compatible with our solutions, achieve widespread acceptance, our operating results could suffer and our business could be harmed.

The introduction of certain technologies may reduce the effectiveness of our products. For example, some of our products rely on third-party cookies, which are placed on individual browsers when consumers visit websites that contain advertisements. We use these cookies to help our customers more effectively advertise, gauge the

performance of their advertisements and detect and prevent fraudulent activity. Consumers can block or delete cookies through their browsers or “ad-blocking” software or applications. The most common Internet browsers allow consumers to modify their browser settings to prevent cookies from being accepted by their browsers, or are set to block third-party cookies by default. Increased use of methods, software or applications that block cookies could harm our business.

***Security breaches in data centers we manage, or third parties manage on our behalf, may compromise the confidentiality, integrity, or availability of employee and customer data, which could expose us to liability and adversely affect our reputation and business.***

We process and store significant amounts of employee and customer data, a large volume of which is hosted by third-party service providers. A security incident impacting our own data centers or those controlled by our service providers may compromise the confidentiality, integrity or availability of this data. Unauthorized access to or loss or disclosure of data stored by Adobe or our service providers may occur through physical break-ins, breaches of a secure network by an unauthorized party, software vulnerabilities or coding errors, employee theft or misuse or other misconduct. It is also possible that unauthorized access to or disclosure of employee or customer data may be obtained through inadequate use of security controls by customers or employees. Accounts created with weak or recycled passwords could allow cyber-attackers to gain access to employee or customer data. Additionally, failure by Adobe or our customers to remove the accounts of their own employees, or the granting of accounts in an uncontrolled manner, may allow for access by former or unauthorized individuals. If there were an inadvertent disclosure of customer data, or unauthorized access to the data we possess on behalf of our customers, our operations could be disrupted, our reputation could be damaged and we could be subject to claims or other liabilities, regulatory investigations, or fines. In addition, such perceived or actual unauthorized loss or disclosure of the information we collect, process, or store or breach of our security could damage our reputation, result in the loss of customers and harm our business.

***We rely on data centers managed both by Adobe and third parties to host and deliver our services, as well as access, collect, process, use, transmit and store data, and any interruptions or delays in these hosted services, or failures in data collection or transmission could expose us to liability and harm our business and reputation.***

Much of our business relies on hardware and services that are hosted, managed and controlled directly by Adobe or third-party service providers, including our online store at adobe.com, Creative Cloud, Document Cloud and Experience Cloud solutions. We do not have redundancy for all of our systems, many of our critical applications reside in only one of our data centers, and our disaster recovery planning may not account for all eventualities. If our business relationship with a third-party provider of hosting or content delivery services is negatively affected, or if one of our content delivery suppliers were to terminate its agreement with us, without adequate notice, we might not be able to deliver the corresponding hosted offerings to our customers, which could subject us to reputational harm, costly and time-intensive notification requirements, and cause us to lose customers and future business. Occasionally, we migrate data among data centers and to third-party hosted environments. If a transition among data centers or to third-party service providers encounters unexpected interruptions, unforeseen complexity, or unplanned disruptions despite precautions undertaken during the process, this may impair our delivery of products and services to customers and result in increased costs and liabilities, which may harm our operating results and our business.

It is also possible that hardware or software failures or errors in our systems (or those of our third-party service providers) could result in data loss or corruption, cause the information that we collect or maintain to be incomplete or contain inaccuracies that our customers regard as significant, or cause us to fail to meet committed service levels or comply with regulatory notification requirements. Furthermore, our ability to collect and report data may be delayed or interrupted by a number of factors, including access to the Internet, the failure of our network or software systems, security breaches or significant variability in visitor traffic on customer websites. In addition, computer viruses, worms, or other malware may harm our systems, causing us to lose data, and the transmission of computer viruses or other malware could expose us to litigation or regulatory investigation, and costly and time-intensive notification requirements.

We may also find, on occasion, that we cannot deliver data and reports to our customers in near real time because of a number of factors, including significant spikes in customer activity on their websites or failures of our network or software, or the failure of our third-party service providers' network or software. If we fail to plan infrastructure capacity appropriately and expand it proportionally with the needs of our customer base, and we experience a rapid and significant demand on the capacity of our data centers or those of third parties, service outages could occur, and our customers could suffer impaired performance of our services. Such a strain on our infrastructure capacity could subject us to regulatory and customer notification requirements, violations of service level agreement commitments, financial liabilities, result in customer dissatisfaction, or harm our business. If we supply inaccurate information or experience interruptions in our ability to capture, store and supply information in near real time or at all, our reputation could be harmed and we could lose customers as a result, or we could be found liable for damages or incur other losses.

***Increasing regulatory focus on privacy and security issues and expanding laws could impact our business models and expose us to increased liability.***

As a global company, Adobe is subject to global data privacy and security laws, regulations and codes of conduct that apply to our various business units. These laws and regulations may be inconsistent across jurisdictions and are subject to evolving and differing (sometimes conflicting) interpretations. Government officials and regulators, privacy advocates and class action attorneys are increasingly scrutinizing how companies collect, process, use, store, share and transmit personal data. This increased scrutiny may result in new interpretations of existing laws, thereby further impacting Adobe's business. Globally, new and emerging laws, such as the General Data Protection Regulation ("GDPR") and the Network and Information Systems Directive ("NISD") in Europe, state laws in the U.S. on privacy, data and related technologies, such as the California Consumer Privacy Act, as well as industry self-regulatory codes create new compliance obligations and expand the scope of potential liability, either jointly or severally with our customers and suppliers. While we have invested in readiness to comply with applicable requirements, these new and emerging laws, regulations and codes may affect our ability (and our enterprise customers' ability) to reach current and prospective customers, to respond to both enterprise and individual customer requests under the laws (such as individual rights of access, correction and deletion of their personal information), and to implement our business models effectively. These new laws may also impact our innovation and business drivers in developing new and emerging technologies (e.g., artificial intelligence and machine learning). These requirements, among others, may impact demand for our offerings and force us to bear the burden of more onerous obligations in our contracts. Any perception of our practices, products or services as a violation of individual privacy rights may subject us to public criticism, class action lawsuits, reputational harm, or investigations or claims by regulators, industry groups or other third parties, all of which could disrupt our business and expose us to increased liability. Additionally, we collect and store information on behalf of our business customers and if our customers fail to comply with contractual obligations or applicable laws, it could result in litigation or reputational harm to us.

Transferring personal information across international borders is becoming increasingly complex. For example, European data transfers outside the European Economic Area are highly regulated. The mechanisms that we and many other companies rely upon for European data transfers (e.g., Privacy Shield and Model Clauses) are being contested in the European court system. We are closely monitoring developments related to requirements for transferring personal data outside the European Union and other countries that have similar trans-border data flow requirements. These requirements may result in an increase in the obligations required to provide our services in the European Union or in sanctions and fines for non-compliance. Several other countries, including Australia and Japan, have also established specific legal requirements for cross-border transfers of personal information. Other countries, such as India, are considering requirements for data localization (e.g., where personal data must remain in the country). If the mechanisms for transferring personal information from certain countries or areas, including Europe to the United States, should be found invalid or if other countries implement more restrictive regulations for cross-border data transfers (or not permit data to leave the country of origin), such developments could harm our business, financial condition and results of operations.

***Security vulnerabilities in our products and systems, or in our supply chain, could lead to reduced revenue or to liability claims.***

Maintaining the security of our products and services is a critical issue for us and our customers. Security threats to our information systems, end points and networks have the potential to impact our customers as well. Security researchers, criminal hackers and other third parties regularly develop new techniques to penetrate our end points, information systems and network security measures. And, as we have previously disclosed, certain unauthorized parties have in the past managed to gain access to and misuse some of our systems and software in order to access our end users' authentication, payment and personal information. In addition, cyber-attackers also develop and deploy viruses, worms, credential stuffing attack tools and other malicious software programs, some of which may be specifically designed to attack our products, services, information systems or networks. Hardware, software and operating system applications that we develop or procure from third parties may contain defects in design or manufacture, including bugs, vulnerabilities and other problems that could unexpectedly compromise the security of the system or impair a customer's ability to operate or use our products. The costs to prevent, eliminate, mitigate, or alleviate cyber- or other security problems, bugs, viruses, worms, malicious software programs and security vulnerabilities are significant, and our efforts to address these problems, including notifying affected parties, may not be successful or may be delayed and could result in interruptions, delays, cessation of service and loss of existing or potential customers. It is impossible to predict the extent, frequency or impact these problems may have on us.

Outside parties have in the past and may in the future attempt to fraudulently induce our employees or users of our products or services to disclose sensitive, personal, or confidential information via illegal electronic spamming, phishing or other tactics. Unauthorized parties may also attempt to gain physical access to our facilities in order to infiltrate our information systems or attempt to gain logical access to our products, services, or information systems for the purpose of exfiltrating content and data. These actual and potential breaches of our security measures and the accidental loss, inadvertent disclosure or unauthorized dissemination of proprietary information or sensitive, personal or confidential data about us, our employees, our customers or their end users, including the potential loss or disclosure of such information or data as a result of hacking, fraud, trickery or other forms of deception, could expose us, our employees, our customers or the individuals affected to a risk of loss or misuse of this information. This may result in litigation and liability or fines, our compliance with costly and time-intensive notice requirements, governmental inquiry or oversight or a loss of customer confidence, any of which could harm our business or damage our brand and reputation, possibly impeding our present and future success in retaining and attracting new customers and thereby requiring time and resources to repair our brand and reputation. These risks will likely increase as we expand our hosted offerings, integrate our products and services and store and process more data, including personal information.

These problems affect our products and services in particular because cyber-attackers tend to focus their efforts on popular offerings with a large user base, and we expect them to continue to do so. Critical vulnerabilities may be identified in some of our applications and services and those of our third-party service providers. These vulnerabilities could cause such applications and services to crash and could allow an attacker to access our or our users' confidential or personal information or take control of the affected system, which could result in liability to us or limit our ability to conduct our business and deliver our products and services to customers. We devote significant resources to address security vulnerabilities through engineering more secure products, enhancing security and reliability features in our products and systems, code hardening, conducting rigorous penetration tests, deploying updates to address security vulnerabilities, reviewing our service providers' security controls, reviewing and auditing our hosted services against independent security control frameworks (such as ISO 27001, SOC 2 and PCI), and improving our incident response time, but these security vulnerabilities cannot be totally eliminated. The cost of these steps could reduce our operating margins, and we may be unable to implement these measures quickly enough to prevent cyber-attackers from gaining unauthorized access into our systems and products. Despite our preventative efforts, actual or perceived security vulnerabilities in our products and systems may harm our reputation or lead to claims against us (and have in the past led to such claims), and could lead some customers to stop using certain products or services, to reduce or delay future purchases of products or services, or to use competing products or services. If we do not make the appropriate level of investment in our technology systems or if our systems become out-of-date or obsolete and we are not able to deliver the quality of data security customers require, our business could be adversely affected. Customers may also adopt security measures designed to protect their existing computer systems from attack, which could delay adoption of new technologies. Further, if we, our supply chain, or our customers are subject to a future attack, or our technology is used in a third-party attack, we could be subject to costly and time-intensive notice requirements, and it may be necessary for us to take additional extraordinary measures and make additional expenditures to take appropriate responsive and preventative steps. Any of these events could adversely affect our revenue or margins. Moreover, delayed sales, lower margins or lost customers resulting from disruptions caused by cyber-attacks or preventative measures could adversely affect our financial results, stock price and reputation.

***Some of our enterprise offerings have extended and complex sales cycles, which can make our sales cycles unpredictable.***

Sales cycles for some of our enterprise offerings, including our Adobe Experience Cloud and Adobe Experience Platform solutions and Enterprise Term License Agreements ("ETLAs") in our Digital Media business, are multi-phased and complex. The complexity in these sales cycles is due to several factors, including:

- the need for our sales representatives to educate customers about the use and benefit of large-scale deployments of our products and services, including technical capabilities, security features, potential cost savings and return on investment;
- the desire of organizations to undertake significant evaluation processes to determine their technology requirements prior to making information technology expenditures;
- the need for our representatives to spend a significant amount of time assisting potential customers in their testing and evaluation of our products and services;
- intensifying competition within the industry;
- the negotiation of large, complex, enterprise-wide contracts;
- the need for our customers to obtain requisition approvals from various decision makers within their organizations due to the complexity of our solutions touching multiple departments within customers' organizations; and
- customer budget constraints, economic conditions and unplanned administrative delays.

We spend substantial time and expense on our sales efforts without assurance that potential customers will ultimately purchase our solutions. As we target our sales efforts at larger enterprise customers, these trends are expected to continue and could have a greater impact on our results of operations. Additionally, our enterprise sales pattern has historically been uneven, where a higher percentage of a quarter's total sales occur during the final weeks of each quarter, which is common in our industry. Our extended sales cycle for these products and services makes it difficult to predict when a given sales cycle will close.

***If our customers fail to renew subscriptions in accordance with our expectations, our future revenue and operating results could suffer.***

Our Adobe Experience Cloud, Creative Cloud and Document Cloud offerings typically involve subscription-based offerings pursuant to product and service agreements. Revenue from our subscription customers is generally recognized ratably over the term of their agreements, which typically range from 1 to 36 months. Our customers have no obligation to renew their subscriptions for our services after the expiration of their initial subscription period, and customers may not renew their subscriptions at the same or higher level of service, for the same number of seats or for the same duration of time, if at all. Moreover, under certain circumstances, some of our customers have the right to cancel their agreements prior to the expiration of the terms. Our varied customer base combined with the flexibility we offer in the length of our subscription-based agreements complicates our ability to precisely forecast renewal rates. Therefore, we cannot provide assurance that we will be able to accurately predict future customer renewal rates.

Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their level of satisfaction with our services, our ability to continue enhancing features and functionality, the reliability (including uptime) of our subscription offerings, the prices of offerings and those offered by our competitors, the actual or perceived information security of our systems and services, decreases in the size of our customer base, reductions in our customers' spending levels or declines in customer activity as a result of economic downturns or uncertainty in financial markets. If our customers do not renew their subscriptions or if they renew on terms less favorable to us, our revenue may decline.

***We face various risks associated with our operating as a multinational corporation.***

As a global business that generates approximately 42% of our total revenue from sales to customers outside of the Americas, we are subject to a number of risks, including:

- foreign currency fluctuations and controls;
- international and regional economic, political and labor conditions, including any instability or security concerns abroad and the United Kingdom's vote to exit the European Union (Brexit);
- tax laws (including U.S. taxes on foreign subsidiaries);
- increased financial accounting and reporting burdens and complexities;
- changes in, or impositions of, legislative or regulatory requirements;
- changes in laws governing the free flow of data across international borders;
- failure of laws to protect our intellectual property rights adequately;
- inadequate local infrastructure and difficulties in managing and staffing international operations;
- delays resulting from difficulty in obtaining export licenses for certain technology, tariffs, quotas and other trade barriers;
- the imposition of governmental economic sanctions on countries in which we do business or where we plan to expand our business;
- costs and delays associated with developing products in multiple languages;
- operating in locations with a higher incidence of corruption and fraudulent business practices; and
- other factors beyond our control, such as terrorism, war, natural disasters and pandemics.

Some of our third-party business partners have international operations and are also subject to these risks and if our third-party business partners are unable to appropriately manage these risks, our business may be harmed. If sales to any of our customers outside of the Americas are reduced, delayed or canceled because of any of the above factors, our revenue may decline.

***Our business could be harmed if we fail to effectively manage critical strategic third-party business relationships.***

As our offerings expand and our customer base grows, our relationships with strategic partners become increasingly valuable. If our contractual relationships with these third parties were to terminate, or if we were unable to renew on favorable terms, our business could be harmed. This is especially the case when the third party's offerings are integrated with our products and services, or where the third party's offerings are difficult to substitute or replace. Alternative arrangements for such products and services may not be available to us, or on commercially reasonable terms, and we may experience business interruptions upon a transition to an alternative partner. The failure of third parties to provide acceptable products and services or to update their technology may result in a disruption to our business operations and those of our customers, which may reduce our revenues and profits, cause us to lose customers and damage our reputation.

***We may not realize the anticipated benefits of past or future investments or acquisitions, and integration of acquisitions may disrupt our business and management.***

We may not realize the anticipated benefits of an investment or acquisition of a company, division, product or technology, each of which involves numerous risks. These risks include:

- inability to achieve the financial and strategic goals for the acquired and combined businesses;
- difficulty in, and the cost of, effectively integrating the operations, technologies, products or services, and personnel of the acquired business;
- entry into markets in which we have minimal prior experience and where competitors in such markets have stronger market positions;
- disruption of our ongoing business and distraction of our management and other employees from other opportunities and challenges;
- inability to retain personnel of the acquired business;
- inability to retain key customers, distributors, vendors and other business partners of the acquired business;
- inability to take advantage of anticipated tax benefits;
- incurring acquisition-related costs or amortization costs for acquired intangible assets that could impact our operating results;
- elevated delinquency or bad debt write-offs related to receivables of the acquired business we assume;
- increased accounts receivables collection times and working capital requirements associated with acquired business models;
- additional costs of bringing acquired companies into compliance with laws and regulations applicable to a multinational corporation;
- difficulty in maintaining controls, procedures and policies during the transition and integration;
- impairment of our relationships with employees, customers, partners, distributors or third-party providers of our technologies, products or services;
- failure of our due diligence processes to identify significant problems, liabilities or other challenges of an acquired company or technology;
- exposure to litigation or other claims in connection with, or inheritance of claims or litigation risk as a result of, an acquisition, such as claims from terminated employees, customers, former stockholders or other third parties;
- incurring significant exit charges if products or services acquired in business combinations are unsuccessful;
- inability to conclude that our internal controls over financial reporting are effective;

- inability to obtain, or obtain in a timely manner, approvals from governmental authorities, which could delay or prevent such acquisitions;

- the failure of strategic investments to perform as expected or to meet financial projections;

- delay in customer and distributor purchasing decisions due to uncertainty about the direction of our product and service offerings; and

- incompatibility of business cultures.

Mergers and acquisitions of technology companies are inherently risky. If we do not complete an announced acquisition transaction or integrate an acquired business successfully and in a timely manner, we may not realize the benefits of the acquisition to the extent anticipated, and in certain circumstances an acquisition could harm our financial position.

***We are subject to risks associated with compliance with laws and regulations globally, which may harm our business.***

We are a global company subject to varied and complex laws, regulations and customs, both domestically and internationally. These laws and regulations relate to a number of aspects of our business, including trade protection, import and export control, data and transaction processing security, payment card industry data security standards, records management, user-generated content hosted on websites we operate, privacy practices, data residency, corporate governance, anti-trust and competition, employee and third-party complaints, anti-corruption, gift policies, conflicts of interest, securities regulations and other regulatory requirements affecting trade and investment. The application of these laws and regulations to our business is often unclear and may at times conflict. For example, in many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by U.S. regulations applicable to us, including the Foreign Corrupt Practices Act. We cannot provide assurance that our employees, contractors, agents and business partners will not take actions in violation of our internal policies or U.S. laws. Compliance with these laws and regulations may involve significant costs or require changes in our business practices that result in reduced revenue and profitability. Non-compliance could also result in fines, damages, criminal sanctions against us, our officers or our employees, prohibitions on the conduct of our business, and damage to our reputation.

In addition, approximately 48% of our employees are located outside the United States. Accordingly, we are exposed to changes in laws governing our employee relationships in various U.S. and foreign jurisdictions, including laws and regulations regarding wage and hour requirements, fair labor standards, employee data privacy, unemployment tax rates, workers' compensation rates, citizenship requirements and payroll and other taxes, which likely would have a direct impact on our operating costs.

***Uncertainty about current and future economic conditions and other adverse changes in general political conditions in any of the major countries in which we do business could adversely affect our operating results.***

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in economic and political conditions, both domestically and globally, including trends toward protectionism and nationalism. Uncertainty about the effects of current and future economic and political conditions on us, our customers, suppliers and partners makes it difficult for us to forecast operating results and to make decisions about future investments. If economic growth in countries where we do business slows, customers may delay or reduce technology purchases, advertising spending or marketing spending. This could result in reductions in sales of our products and services, more extended sales cycles, slower adoption of new technologies and increased price competition. Among our customers are government entities, including the U.S. federal government, and our revenue could decline if spending cuts impact the government's ability to purchase our products and services. Deterioration in economic conditions in any of the countries in which we do business could also cause slower or impaired collections on accounts receivable, which may adversely impact our liquidity and financial condition.

A disruption in financial markets could impair our banking partners, on which we rely for operating cash management and affect our derivative counterparties. Any of these events would likely harm our business, financial condition and results of operations.

Political instability or adverse political developments in or around any of the major countries in which we do business would also likely harm our business, financial condition and results of operations.

***Subscription offerings could create risks related to the timing of revenue recognition.***

We generally recognize revenue from subscription offerings ratably over the terms of their subscription agreements, which typically range from 1 to 36 months. As a result, most of the subscription revenue we report in each quarter is the result of subscription agreements entered into during previous quarters. Any reduction in new or renewed subscriptions in a quarter may not be reflected in our revenue results until a later quarter. Declines in new or renewed subscriptions may decrease our revenue in future quarters. Lower sales, reduced demand for our products and services, and increases in our attrition rate may not be fully reflected in our results of operations until future periods. Our subscription model could also make it difficult for us to rapidly increase our revenue from subscription-based or hosted services through additional sales in any period, as revenue from new customers will be recognized over the applicable subscription term.

Additionally, in connection with our sales efforts to enterprise customers and our use of ETLAs, a number of factors could affect our revenue, including longer-than-expected sales and implementation cycles, potential deferral of revenue and alternative licensing arrangements. If any of our assumptions about revenue from our subscription-based offerings prove incorrect, our actual results may vary materially from those anticipated.

***Changes in accounting principles, or interpretations thereof, could have a significant impact on our financial position and results of operations.***

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP"). These principles are subject to interpretation by the SEC and various bodies formed to interpret and create appropriate accounting principles. A change in these principles, how the principles are interpreted, or the adoption of new accounting standards can have a significant effect on our reported results, and could even retroactively affect previously reported transactions, and may require that we make significant changes to our systems, processes and controls.

Changes resulting from these new standards may result in materially different financial results and may require that we change how we process, analyze and report financial information and that we change financial reporting controls. For additional information regarding these new standards, see the section titled "Recent Accounting Pronouncements Not Yet Effective" within Part II. Item 8, Note 1. Basis of Presentation and Summary of Significant Accounting Policies.

Such changes in accounting principles may have an adverse effect on our business, financial position and income, or cause an adverse deviation from our revenue and profitability targets, which may negatively impact our financial results.

***Changes in tax rules and regulations, or interpretations thereof, may adversely affect our effective tax rates.***

We are a United States-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. A significant portion of our foreign earnings for the current fiscal year were earned by our Irish subsidiaries. The Tax Cuts and Jobs Act, enacted into law on December 22, 2017, changed existing U.S. tax law applicable to us and included certain international provisions effective for us starting in fiscal 2019. The applicability and impact of these new tax provisions, and of other international tax law changes effective for fiscal 2020 and beyond, will likely require us to respond by making change(s) to our international trading structure. The net impact of such change(s) is uncertain but is anticipated to adversely affect our effective income tax rate and cash flows in years beyond fiscal 2020.

Our income tax expense has differed from the tax computed at the U.S. federal statutory income tax rate due primarily to discrete items including, but not limited to, the effects of tax credits, stock-based compensation and settlements of tax examinations, and to tax on earnings from foreign operations. Unanticipated changes in our tax rates could affect our future results of operations. Our future effective tax rates are likely to be unfavorably affected by changes in the tax rates in jurisdictions where our income is earned, by changes in our repatriation policy, by changes in or our interpretation of tax rules and regulations in the jurisdictions in which we do business, by unanticipated decreases in the amount of earnings in countries with low statutory tax rates, by unexpected negative changes in business and market conditions that could reduce certain tax benefits, or by changes in the valuation of our deferred tax assets and liabilities.

In addition, in countries where we conduct business and in jurisdictions in which we are subject to tax, including those covered by governing bodies that enact tax laws applicable to us, such as the European Commission of the European Union, we are subject to potential changes in relevant tax, accounting and other laws, regulations and interpretations, including changes to tax laws applicable to corporate multinationals such as Adobe. These countries, other governmental bodies and intergovernmental economic organizations such as the Organization for Economic Cooperation and Development, have or could make unprecedented assertions about how taxation is determined in their jurisdictions that are contrary to the way in which we have interpreted and historically applied the rules and regulations described above in our income tax returns filed in such jurisdictions. In the current global tax policy environment, any changes in laws, regulations and interpretations related to these assertions could adversely affect our effective tax rates or result in other costs to us which could adversely affect our operations and financial results.

Moreover, we are subject to the continual examination of our income tax returns by the U.S. Internal Revenue Service and other domestic and foreign tax authorities. These tax examinations are expected to focus on our intercompany transfer pricing practices as well as other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for adjustments that may result from these examinations. We cannot provide assurance that the final determination of any of these examinations will not have an adverse effect on our operating results and financial position.

***If our products or platforms are used to create or disseminate objectionable content, particularly misleading content intended to manipulate public opinion, our brand reputation may be damaged, and our business and financial results may be harmed.***

We believe that our brands have significantly contributed to the success of our business. Maintaining and enhancing the brands within Adobe increases our ability to enter new categories and launch new and innovative products that better serve the needs of our customers. We also believe that maintaining and enhancing our brands is critical to expanding our base of customers. Our brands may be negatively affected by the use of our products or services to create or disseminate newsworthy content that is deemed to be misleading, deceptive, or intended to manipulate public opinion (e.g. “DeepFakes”), by the use of our products or services for illicit, objectionable, or illegal ends, or by our failure to respond appropriately and expeditiously to such uses of our products and services. Such uses of our products and services may also cause us to face claims related to defamation, rights of publicity and privacy, illegal content, misinformation and personal injury torts. Maintaining and enhancing our brands may require us to make substantial investments and these investments may not be successful. If we fail to appropriately respond to objectionable content created using our products or services or shared on our platforms, our users may lose confidence in our brands and our business and financial results may be adversely affected.

***The success of some of our product and service offerings depends on our ability to continue to attract and retain customers of and contributors to our online marketplaces for creative content.***

The success of some of our product and service offerings, such as Adobe Stock, depends on our ability to continue to attract new customers and contributors to these online marketplaces for creative content, as well as our ability to continue to retain existing customers and contributors. An increase in paying customers has generally resulted in more content from contributors, which increases the size of our collection and in turn attracts new paying customers. We rely on the functionality and features of our online marketplaces, the size and content of our collection and the effectiveness of our marketing efforts to attract new customers and contributors and retain existing ones. New technologies may render the features of our online marketplaces obsolete, our collection may fail to grow as anticipated or our marketing efforts may be unsuccessful, any of which may adversely affect our results of operations.

***Our intellectual property portfolio is a valuable asset and we may not be able to protect our intellectual property rights, including our source code, from infringement or unauthorized copying, use or disclosure.***

Our intellectual property portfolio is a valuable asset. Infringement or misappropriation of our patents, trademarks, trade secrets, copyrights and other intellectual property rights could result in lost revenues and ultimately reduce their value. Preventing unauthorized use or infringement of our intellectual property rights is inherently difficult. We actively combat software piracy as we enforce our intellectual property rights, but we nonetheless lose significant revenue due to illegal use of our software. If piracy activities continue at historical levels or increase, they may further harm our business. We apply for patents in the U.S. and internationally to protect our newly created technology and if we are unable to obtain patent protection for the technology described in our pending patent, or if the patent is not obtained timely, this could result in revenue loss, adverse effects on operations and harm to our business. We offer our products and services in foreign countries and we may seek intellectual property protection from those foreign legal systems. Some of those foreign countries may not have as robust or comprehensive of intellectual property protection laws and schemes as those offered in the U.S. In some foreign countries, the mechanisms to enforce intellectual property rights may be inadequate to protect our technology, which could harm our business.

If unauthorized disclosure of our source code occurs through security breach, cyber-attack or otherwise, we could lose future trade secret protection for that source code. The loss of future trade secret protection could make it easier for third parties to compete with our products by copying functionality, which could cause us to lose customers and could adversely affect our revenue and operating margins. We also seek to protect our confidential information and trade secrets through the use of non-disclosure agreements with our customers, contractors, vendors and partners. However, there is a risk that our confidential information and trade secrets may be disclosed or published without our authorization, and in these situations, enforcing our rights may be difficult or costly.

***We may incur substantial costs defending against third parties alleging that we infringe their proprietary rights.***

We have been, are currently, and may in the future be, subject to claims, negotiations and complex, protracted litigation relating to disputes regarding the validity or alleged infringement of third-party intellectual property rights, including patent rights. Intellectual property disputes and litigation are typically costly and can be disruptive to our business operations by diverting the attention of management and key personnel. We may not prevail in every lawsuit or dispute. Third-party intellectual property disputes, including those initiated by patent assertion entities, could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from licensing certain of our products or offering certain of our services, subject us to injunctions restricting our sale of products or services, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers, including contractual provisions under various license arrangements and service agreements. In addition, we may incur significant costs in acquiring the necessary third-party intellectual property rights for use in our products, in some cases to fulfill contractual obligations with our customers. Any of these occurrences could significantly harm our business.

***We may incur losses associated with currency fluctuations and may not be able to effectively hedge our exposure.***

Our operating results are subject to fluctuations in foreign currency exchange rates due to the global scope of our business. Global economic events, including trade disputes, economic sanctions and emerging market volatility, and associated uncertainty may cause currencies to fluctuate. We attempt to mitigate a portion of these risks through foreign currency hedging based on our judgment of the appropriate trade-offs among risk, opportunity and expense. We regularly review our program to partially hedge our exposure to foreign currency fluctuations and make adjustments as necessary. Our hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movement in foreign currency exchange rates, which could adversely affect our financial condition or results of operations.

***Failure of our third-party customer service and technical support providers to adequately address customers' requests could harm our business and adversely affect our financial results.***

Our customers rely on our customer service support organization to resolve issues with our products and services. We outsource a substantial portion of our customer service and technical support activities to third-party service providers. We depend heavily on these third-party customer service and technical support representatives working on our behalf, and we expect to continue to rely heavily on third parties in the future. This strategy presents risks to our business due to the fact that we may not be able to influence the quality of support as directly as we would be able to do if our own employees performed these activities. Our customers may react negatively to providing information to, and receiving support from, third-party organizations, especially if these third-party organizations are based overseas. If we encounter problems with our third-party customer service and technical support providers, our reputation may be harmed, our ability to sell our offerings could be adversely affected, and we could lose customers and associated revenue.

***Revenue, margin or earnings shortfalls or the volatility of the market generally may cause the market price of our stock to decline.***

In the past, the market price for our common stock experienced significant fluctuations and it may do so in the future. A number of factors may affect the market price for our common stock, such as:

- shortfalls in, or changes in expectations about, our revenue, margins, earnings, Annualized Recurring Revenue ("ARR"), sales of our Digital Experience offerings, or other key performance metrics;
- changes in estimates or recommendations by securities analysts;
- whether our results meet analysts' expectations;
- compression or expansion of multiples used by investors and analysts to value high technology SaaS companies;
- the announcement of new products or services, product enhancements, service introductions, strategic alliances or significant agreements by us or our competitors;
- the loss of large customers or our inability to increase sales to existing customers, retain customers or attract new customers;
- recruitment or departure of key personnel;
- variations in our or our competitors' results of operations, changes in the competitive landscape generally and developments in our industry;
- general socio-economic, political or market conditions; and
- unusual events such as significant acquisitions by us or our competitors, divestitures, litigation, regulatory actions and other factors, including factors unrelated to our operating performance.

In addition, the market for technology stocks or the stock market in general may experience uneven investor confidence, which may cause the market price for our common stock to decline for reasons unrelated to our operating performance. Volatility in the market price of a company's securities for a period of time may increase the company's susceptibility to securities class action litigation. Oftentimes, this type of litigation is expensive and diverts management's attention and resources which may adversely affect our business.

***Contracting with government entities exposes us to additional risks inherent in the government procurement process.***

We provide products and services, directly and indirectly, to a variety of government entities, both domestically and internationally. Risks associated with licensing and selling products and services to government entities include more extended sales and collection cycles, varying governmental budgeting processes and adherence to complex procurement regulations and other government-specific contractual requirements. We may be subject to audits and investigations relating to our government contracts and any violations could result in various civil and criminal penalties and administrative sanctions, including termination of contracts, payment of fines, and suspension or debarment from future government business, as well as harm to our reputation and financial results.

***If we are unable to recruit and retain key personnel, our business may be harmed.***

Much of our future success depends on the continued service, availability and performance of our senior management. These individuals have acquired specialized knowledge and skills with respect to Adobe. The loss of any of these individuals could harm our business, especially if we have not been successful in developing adequate succession plans. Our business is also dependent on our ability to retain, hire and motivate talented, highly skilled personnel across all levels of our organization. Our efforts to attract, develop, integrate and retain highly skilled employees with appropriate qualifications may be compounded by intensified restrictions on travel, immigration, or the availability of work visas. Experienced personnel in the information technology industry are in high demand and competition for their talents is intense in many areas where our employees are located. We may experience higher compensation costs to retain senior management and experienced personnel that may not be offset by improved productivity or increased sales. If we are unable to continue to successfully attract and retain key personnel, our business may be harmed.

We continue to hire personnel in countries where exceptional technical knowledge and other expertise are offered at lower costs, which increases the efficiency of our global workforce structure and reduces our personnel related expenditures. Nonetheless, as globalization continues, competition for these employees in these countries has increased, which may impact our ability to retain these employees and increase our expenses resulting from competitive compensation. We may continue to expand our international operations and international sales and marketing activities, which would require significant management attention and resources. We may be unable to scale our infrastructure effectively or as quickly as our competitors in these markets, and our revenue may not increase to offset these expected increases in costs and operating expenses, causing our results to suffer.

We believe that a critical contributor to our success to date has been our corporate culture, which we have built to foster innovation, teamwork and employee satisfaction. As we grow, including from the integration of employees and businesses acquired in connection with previous or future acquisitions, we may find it difficult to maintain important aspects of our corporate culture, which could negatively affect our ability to retain and recruit personnel who are essential to our future success.

***Failure to manage our sales and distribution channels effectively could result in a loss of revenue and harm to our business.***

We contract with a number of software distributors and other strategic partners, none of which are individually responsible for a material amount of our total net revenue for any recent period. Nonetheless, if any single agreement with one of our distributors were terminated, any prolonged delay in securing a replacement distributor could have a negative impact on our results of operations.

Successfully managing our indirect distribution channel efforts to reach various customer segments for our products and services is a complex process across the broad range of geographies where we do business or plan to do business. Our distributors and other channel partners are independent businesses that we do not control. Notwithstanding the independence of our channel partners, we face legal risk and potential reputational harm from the activities of these third parties including, but not limited to, export control violations, workplace conditions, corruption and anti-competitive behavior.

We cannot be certain that our distribution channel will continue to market or sell our products and services effectively. If our distribution channel is not successful, we may lose sales opportunities, customers and revenue. Our distributors also sell our competitors' products and services, and if they favor our competitors' products or services for any reason, they may fail to market our products or services effectively or to devote resources necessary to provide effective sales, which would cause our results to suffer. We also distribute some products and services through our OEM channel, and if our OEMs decide not to bundle our applications on their devices, our results could suffer. In addition, the financial health of our distributors and our continuing relationships with them are important to our success. Some of these distributors may be unable to withstand adverse changes in economic conditions, which could result in insolvency, the inability of such distributors to obtain credit to finance purchases of our products and services, or a delay in paying their obligations to us.

We also sell some of our products and services through our direct sales force. Risks associated with this sales channel include more extended sales and collection cycles associated with direct sales efforts, challenges related to hiring, retaining and motivating our direct sales force, and substantial amounts of ongoing training for sales representatives. Moreover, recent hires may not become as productive as we would like, as in most cases it takes a significant period of time before they achieve full productivity. Our business could be seriously harmed if our expansion efforts do not generate a corresponding significant increase in revenue and we are unable to achieve the efficiencies we anticipate. In addition, the loss of key sales employees could impact our customer relationships and future ability to sell to certain accounts covered by such employees.

***If our goodwill or amortizable intangible assets become impaired, then we could be required to record a significant charge to earnings.***

GAAP requires us to test for goodwill impairment at least annually. In addition, we review our goodwill and amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable include declines in stock price, market capitalization or cash flows, and slower growth rates in our industry. Depending on the results of our review, we could be required to record a significant charge to earnings in our consolidated financial statements during the period in which any impairment of our goodwill or amortizable intangible assets were determined, negatively impacting our results of operations.

***We have issued $1.9 billion of notes in debt offerings and have a $2.25 billion term loan, and may incur other debt in the future, which may adversely affect our financial condition and future financial results.***

We have $1.9 billion in senior unsecured notes and a $2.25 billion senior unsecured term loan outstanding. We also have a $1 billion senior unsecured revolving credit agreement, which is currently undrawn. This debt may adversely affect our financial condition and future financial results by, among other things:

- increasing our vulnerability to adverse changes in general economic and industry conditions;
- requiring the dedication of a portion of our expected cash flow from operations to service our indebtedness, thereby reducing the amount of expected cash flow available for other purposes, including capital expenditures and acquisitions; and
- limiting our flexibility in planning for, or reacting to, changes in our business and our industry.

Our senior unsecured notes and senior unsecured credit agreements impose restrictions on us and require us to maintain compliance with specified covenants. Our ability to comply with these covenants may be affected by events beyond our control. If we breach any of the covenants and do not obtain a waiver from the noteholders or lenders, then, subject to applicable cure periods, any outstanding indebtedness may be declared immediately due and payable.

In addition, changes by any rating agency to our credit rating may negatively impact the value and liquidity of both our debt and equity securities, as well as the potential costs associated with a refinancing of our debt. Under certain circumstances, if our credit ratings are downgraded or other negative action is taken, the interest rate payable by us under our revolving credit facility and Term Loan could increase. Downgrades in our credit ratings could also affect the terms of any such financing and restrict our ability to obtain additional financing in the future.

***Catastrophic events may disrupt our business.***

We are a highly automated business and rely on our network infrastructure and enterprise applications, internal technology systems and website for our development, marketing, operations, support, hosted services and sales activities. In addition, some of our businesses rely on third-party hosted services, and we do not control the operation of third-party data center facilities serving our customers from around the world, which increases our vulnerability. A disruption, infiltration or failure of these systems or third-party hosted services in the event of a major earthquake, fire, flood, tsunami or other weather event, power loss, telecommunications failure, software or hardware malfunctions, pandemics, cyber-attack, war, terrorist attack or other catastrophic event that our disaster recovery plans do not adequately address, could cause system interruptions, reputational harm, loss of intellectual property, delays in our product development, lengthy interruptions in our services, breaches of data security and loss of critical data. Any of these events could prevent us from fulfilling our customers' orders or could negatively impact a country or region in which we sell our products, which could in turn decrease that country's or region's demand for our products. Our corporate headquarters, a significant portion of our research and development activities, certain of our data centers and certain other critical business operations are located in the San Francisco Bay Area, and additional facilities where we conduct significant operations are located in the Salt Lake Valley Area, both of which are near major earthquake faults. A catastrophic event that results in the destruction or disruption of any of our data centers or our critical business or information technology systems could severely affect our ability to conduct normal business operations and, as a result, our future operating results could be adversely affected.

***Climate change may have a long-term impact on our business.***

While we seek to partner with organizations that mitigate their business risks associated with climate change, we recognize that there are inherent risks wherever business is conducted. Access to clean water and reliable energy in the communities where we conduct our business, whether for our offices or for our vendors, is a priority. Our major sites in California, Utah and India are vulnerable to climate change effects. For example, in California, increasing intensity of drought throughout the state and annual periods of wildfire danger increase the probability of planned power outages in the communities where we work and live. While this danger has a low-assessed risk of disrupting normal business operations, it has the potential impact on employees' abilities to commute to work and to stay connected. Climate-related events, including the increasing frequency of extreme weather events and their impact on U.S., India and other major regions' critical infrastructure, have the potential to disrupt our business, our third-party suppliers, and/or the business of our customers, and may cause us to experience higher attrition, losses, and additional costs to maintain or resume operations. To accurately assess and take potential proactive action as appropriate, Adobe is aligned with the guidelines of the Financial Stability Board's Task Force on Climate-related Financial Disclosures recommendations and the Sustainability Accounting Standards Board environmental metrics.

***Our investment portfolio may become impaired by deterioration of the financial markets.***

Our cash equivalent and short-term investment portfolio as of November 29, 2019 consisted of asset-backed securities, corporate debt securities, money market mutual funds, municipal securities, time deposits and U.S. Treasury securities. We follow an established investment policy and set of guidelines to monitor and help mitigate our exposure to interest rate and credit risk. The policy sets forth credit quality standards and limits our exposure to any one issuer, as well as our maximum exposure to various asset classes.

Should financial market conditions worsen in the future, investments in some financial instruments may pose risks arising from market liquidity and credit concerns. In addition, any deterioration of the capital markets could cause our other income and expense to vary from expectations. As of November 29, 2019, we had no material impairment charges associated with our short-term investment portfolio, and although we believe our current investment portfolio has little risk of material impairment, we cannot predict future market conditions, market liquidity or credit availability, and can provide no assurance that our investment portfolio will remain materially unimpaired.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

## ITEM 2. PROPERTIES

The following table sets forth the location, approximate square footage and use of our material properties during fiscal 2019:

| **Location** | **Owned / Leased** | **Approximate Square Footage** | | **Use** |
|---|---|---|---|---|
| *Americas:* | | | | |
| San Jose, California | Owned & leased | 1,081,000 | (1) | Research, product development, sales, marketing and administration |
| San Francisco, California | Owned & leased | 657,000 | (2) | Research, product development, sales, marketing and administration |
| *APAC:* | | | | |
| Bangalore, India | Owned & leased | 422,000 | (3) | Research, product development, sales and administration |
| Noida, India | Owned & leased | 554,000 | (4) | Research, product development, sales and administration |
| *EMEA:* | | | | |
| Greater London Area, United Kingdom | Leased | 92,000 | | Product development, sales, marketing and administration |

(1) We own approximately 989,000 square feet of our San Jose properties where our headquarters is located.

(2) We own approximately 346,000 square feet of our San Francisco properties

(3) We own approximately 250,000 square feet of our Bangalore properties.

(4)

We own our Noida properties except for a land lease for one of our buildings. The term for the land lease is until 2091.

We lease or sublease the properties we occupy under operating leases. Such leases expire at various times through 2031, with the exception of our ground lease in Noida.

In general, all facilities are in good condition, suitable for the conduct of our business and are operating at an average capacity of approximately 95%.

## ITEM 3. LEGAL PROCEEDINGS

In connection with disputes relating to the validity or alleged infringement of third-party intellectual property rights, including patent rights, we have been, are currently and may in the future be subject to claims, negotiations or complex, protracted litigation. Intellectual property disputes and litigation may be very costly and can be disruptive to our business operations by diverting the attention and energies of management and key technical personnel. Although we have successfully defended or resolved past litigation and disputes, we may not prevail in any ongoing or future litigation and disputes. Third-party intellectual property disputes could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from licensing certain of our products or offering certain of our services, subject us to injunctions restricting our sale of products or services, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers including contractual provisions under various license arrangements and service agreements.

In addition to intellectual property disputes, we are subject to legal proceedings, claims and investigations in the ordinary course of business, including claims relating to commercial, employment and other matters. Some of these disputes and legal proceedings may include speculative claims for substantial or indeterminate amounts of damages. We consider all claims on a quarterly basis in accordance with GAAP and, based on known facts, assess whether potential losses are considered reasonably possible, probable and estimable. Based upon this assessment, we then evaluate disclosure requirements and whether to accrue for such claims in our financial statements. This determination is then reviewed and discussed with the Audit Committee of the Board of Directors and our independent registered public accounting firm.

We make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Unless otherwise specifically disclosed in our Consolidated Financial Statements and notes thereto, we have determined that no provision for liability or disclosure is required related to any claim against us because: (a) there is not a reasonable possibility that a loss exceeding amounts already recognized (if any) may be incurred with respect to such claim; (b) a reasonably possible loss or range of loss cannot be estimated; or (c) such estimate is immaterial.

All legal costs associated with litigation are expensed as incurred. Litigation is inherently unpredictable. However, we believe that we have valid defenses with respect to the legal matters pending against us. It is possible, nevertheless, that our consolidated financial position, cash flows or results of operations could be negatively affected by an unfavorable resolution of one or more of such proceedings, claims or investigations.

In connection with our piracy conversion efforts, conducted both internally and through organizations such as the Business Software Alliance, from time to time we undertake litigation against alleged copyright infringers. Such lawsuits may lead to counter-claims alleging improper use of litigation or violation of other laws. We believe we have valid defenses with respect to such counter-claims; however, it is possible that our consolidated financial position, cash flows or results of operations could be negatively affected in any particular period by the resolution of one or more of these counter-claims.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

**PART II**

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

*Market Information for Common Stock*

Our common stock is traded on the NASDAQ Global Select Market under the symbol "ADBE."

*Stockholders*

According to the records of our transfer agent, there were 993 holders of record of our common stock on January 10, 2020. Because many of such shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

*Dividends*

We do not anticipate paying any cash dividends in the foreseeable future.

### Issuer Purchases of Equity Securities

Below is a summary of stock repurchases for the three months ended November 29, 2019. *See Note 14 of our Notes to Consolidated Financial Statements for information regarding our stock repurchase programs.*

| Period | Total Number of Shares Repurchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans | Approximate Dollar Value that May Yet be Purchased Under the Plan[1] |
|---|---|---|---|---|
| | (in thousands, except average price per share) | | | |
| Beginning repurchase authority | | | | $ 6,100,054 |
| August 31 — September 27, 2019 | | | | |
| Shares repurchased | 885 | $ 282.43 | 885 | $ (250,054) |
| September 28 — October 25, 2019 | | | | |
| Shares repurchased | 927 | $ 274.12 | 927 | $ (254,032) [2] |
| October 26 — November 29, 2019 | | | | |
| Shares repurchased | 954 | $ 279.52 | 954 | $ (266,779) [2] |
| Total | 2,766 | | 2,766 | $ 5,329,189 |

(1) In May 2018, the Board of Directors granted authority to repurchase up to $8 billion in common stock through the end of fiscal 2021.

(2) In September 2019, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of $750 million. As of November 29, 2019, approximately $229.2 million of the prepayment remained under this agreement.

## ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data is derived from our Consolidated Financial Statements. As our historical operating results are not necessarily indicative of future operating results, this data should be read in conjunction with the Consolidated Financial Statements and notes thereto, and with Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

| *(in thousands, except per share amounts and employee data)* | Fiscal Years | | | | |
|---|---|---|---|---|---|
| | 2019[1] | 2018 | 2017 | 2016[3] | 2015 |
| Operations: | | | | | |
| Revenue: | $ 11,171,297 | $ 9,030,008 | $ 7,301,505 | $ 5,854,430 | $ 4,795,511 |
| Gross profit | $ 9,498,577 | $ 7,835,009 | $ 6,291,014 | $ 5,034,522 | $ 4,051,194 |
| Income before income taxes | $ 3,204,741 | $ 2,793,876 | $ 2,137,641 | $ 1,435,138 | $ 873,781 |
| Net income | $ 2,951,458 | $ 2,590,774 | $ 1,693,954 | $ 1,168,782 | $ 629,551 |
| Net income per share: | | | | | |
| Basic | $ 6.07 | $ 5.28 | $ 3.43 | $ 2.35 | $ 1.26 |
| Diluted | $ 6.00 | $ 5.20 | $ 3.38 | $ 2.32 | $ 1.24 |
| Shares used to compute basic net income per share | 486,291 | 490,564 | 493,632 | 498,345 | 498,764 |
| Shares used to compute diluted net income per share | 491,572 | 497,843 | 501,123 | 504,299 | 507,164 |
| Financial position: | | | | | |
| Cash, cash equivalents and short-term investments | $ 4,176,976 | $ 3,228,962 | $ 5,819,774 | $ 4,761,300 | $ 3,988,084 |
| Working capital[2] | $ (1,696,013) | $ 555,913 | $ 3,720,356 | $ 3,028,139 | $ 2,608,336 |
| Total assets | $ 20,762,400 | $ 18,768,682 | $ 14,535,556 | $ 12,697,246 | $ 11,714,500 |
| Debt, current | $ 3,149,343 | $ — | $ — | $ — | $ — |
| Debt, non-current | $ 988,924 | $ 4,124,800 | $ 1,881,421 | $ 1,892,200 | $ 1,895,259 |
| Stockholders' equity | $ 10,530,155 | $ 9,362,114 | $ 8,459,869 | $ 7,424,835 | $ 7,001,580 |
| Additional data: | | | | | |
| Worldwide employees | 22,634 | 21,357 | 17,973 | 15,706 | 13,893 |

(1) On December 1, 2018, the beginning of our fiscal year 2019, we adopted the requirements of the Financial Accounting Standards Board's Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers, Topic 606, utilizing the modified retrospective method of transition. Prior period information has not been restated and continues to be reported under the accounting standard in effect for those periods.

(2) As of November 29, 2019, working capital was in a deficit primarily due to the reclassification of our $2.25 billion term loan due April 30, 2020 and $900 million 4.75% senior notes due February 1, 2020 to current liabilities. We intend to refinance our Term Loan and 2020 Notes on or before the due dates.

(3) Our fiscal year is a 52- or 53-week year that ends on the Friday closest to November 30. Fiscal 2016 was a 53-week fiscal year compared with the other periods presented which were 52-week fiscal years.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion should be read in conjunction with our Consolidated Financial Statements and Notes thereto. Discussion regarding our financial condition and results of operations for fiscal 2018 as compared to fiscal 2017 is included in Item 7 of our Annual Report on Form 10-K for the fiscal year ended November 30, 2018, filed with the SEC on January 25,2019.*

### ACQUISITIONS

During fiscal 2019, we acquired the remaining interest in Allegorithmic SAS ("Allegorithmic"), a privately held 3D editing and authoring software company for gaming and entertainment, for approximately $106.2 million in cash consideration, and integrated it into our Digital Media reportable segment.

During fiscal 2018, we completed our acquisitions of Marketo, a privately held marketing cloud platform company, for $4.73 billion and Magento, a privately held commerce platform company, for $1.64 billion, and integrated them into our Digital Experience reportable segment.

During fiscal 2017, we completed our acquisition of TubeMogul, a publicly held video advertising platform company, for $560.8 million, and integrated it into our Digital Experience reportable segment.

We also completed other immaterial business acquisitions during the fiscal years presented.

See Note 3 of our Notes to Consolidated Financial Statements for further information regarding these acquisitions, including pro forma financial information related to the Marketo acquisition. Pro forma information has not been presented for our other acquisitions during the fiscal years presented as the impact to our Consolidated Financial Statements was not material.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

In preparing our Consolidated Financial Statements in accordance with GAAP and pursuant to the rules and regulations of the SEC, we make assumptions, judgments and estimates that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosures of contingent assets and liabilities. We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. On a regular basis, we evaluate our assumptions, judgments and estimates. We also discuss our critical accounting policies and estimates with the Audit Committee of the Board of Directors.

We believe that the assumptions, judgments and estimates involved in the accounting for revenue recognition, business combinations and income taxes have the greatest potential impact on our Consolidated Financial Statements. These areas are key components of our results of operations and are based on complex rules requiring us to make judgments and estimates, and consequently, we consider these to be our critical accounting policies. Historically, our assumptions, judgments and estimates relative to our critical accounting policies have not differed materially from actual results.

#### Revenue Recognition

Our contracts with customers may include multiple goods and services. For example, some of our offerings include both on-premise and/or on-device software licenses and cloud services. Determining whether the software licenses and the cloud services are distinct from each other, and therefore performance obligations to be accounted for separately, or not distinct from each other, and therefore part of a single performance obligation, may require significant judgment. We have concluded that the on-premise/on-device software licenses and cloud services provided in our Creative Cloud and Document Cloud subscription offerings are not distinct from each other such that revenue from each offering should be recognized ratably over the subscription period for which the cloud services are provided. In reaching this conclusion, we considered the nature of our promise to Creative Cloud and Document Cloud customers, which is to provide a complete end-to-end creative design or document workflow solution that operates seamlessly across multiple devices and teams. We fulfill this promise by providing access to a solution that integrates cloud-based and on-premise/on-device features that, together through their integration, provide functionalities, utility and workflow efficiencies that could not be obtained from either the on-premise/on-device software or cloud services on their own.

Cloud-based features that are integral to our Creative Cloud and Document Cloud offerings and that work together with the on-premise/on-device software include, but are not limited to: Creative Cloud Libraries, which enable customers to access their work, settings, preferences, and other assets seamlessly across desktop and mobile devices and collaborate across teams in real time; shared reviews which enable simultaneous editing and commenting of PDFs across desktop, mobile, and web; automatic cloud rendering of a design which enables it to be worked on in multiple mediums; and Sensei, Adobe's cloud-hosted artificial intelligence and machine learning framework, which enables features such as automated photo-editing, photograph content-awareness, natural language processing, optical character recognition, and automated document tagging.

**Business Combinations**

We allocate the purchase price of acquired companies to tangible and intangible assets acquired and liabilities assumed based upon their estimated fair values at the acquisition date. The purchase price allocation process requires management to make significant estimates and assumptions with respect to intangible assets and deferred revenue obligations. Although we believe the assumptions and estimates we have made are reasonable, they are based in part on historical experience, market conditions and information obtained from management of the acquired companies and are inherently uncertain. Examples of critical estimates in valuing certain of the intangible assets we have acquired or may acquire in the future include but are not limited to:

- future expected cash flows from software license sales, subscriptions, support agreements, consulting contracts and acquired developed technologies and patents;

- historical and expected customer attrition rates and anticipated growth in revenue from acquired customers;

- the acquired company’s trade name and trademarks as well as assumptions about the period of time the acquired trade name and trademarks will continue to be used in the combined company’s product portfolio;

- the expected use of the acquired assets; and

- discount rates.

In connection with the purchase price allocations for our acquisitions, we estimate the fair value of the deferred revenue obligations assumed. The estimated fair value of these obligations is determined utilizing a cost build-up approach. The cost build-up approach determines fair value by estimating the costs related to fulfilling the obligations plus a normal profit margin.

Unanticipated events and circumstances may occur which may affect the accuracy or validity of such assumptions, estimates or actual results.

**Accounting for Income Taxes**

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Management must make assumptions, judgments and estimates to determine our current provision for income taxes and also our deferred tax assets and liabilities.

Our assumptions, judgments and estimates relative to the current provision for income taxes take into account current tax laws, our interpretation of current tax laws and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. We have established reserves for income taxes to address potential exposures involving tax positions that could be challenged by tax authorities. In addition, we are subject to the continual examination of our income tax returns by the U.S. Internal Revenue Service (“IRS”) and other domestic and foreign tax authorities. We expect future examinations to focus on our intercompany transfer pricing practices as well as other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from such examinations. We believe such estimates to be reasonable; however, the final determination of any of these examinations could significantly impact the amounts provided for income taxes in our Consolidated Financial Statements.

**Recent Accounting Pronouncements**

*See Note 1 of our Notes to Consolidated Financial Statements for information regarding recent accounting pronouncements that are of significance, or potential significance to us.*

## RESULTS OF OPERATIONS

### Overview of 2019

For fiscal 2019, we reported strong financial results consistent with the continued execution of our long-term plans for our two strategic growth areas, Digital Media and Digital Experience, while continuing to market and license a broad portfolio of products and solutions.

On December 1, 2018, the beginning of our fiscal year 2019, we adopted the requirements of the new revenue standard utilizing the modified retrospective method of transition, and began to report our financial results under the new revenue standard. The impact of the adoption was not significant to our results of operations.

In our Digital Media segment, we are a market leader with Creative Cloud, our subscription-based offering which provides desktop tools, mobile apps and cloud-based services for designing, creating and publishing rich and immersive content. Creative Cloud delivers value with deep, cross-product integration, frequent product updates and feature enhancements, cloud-enabled services including storage and syncing of files across users' machines, machine learning and artificial intelligence, access to marketplace, social and community-based features with our Adobe Stock and Behance services, app creation capabilities, tools which assist with enterprise deployments and team collaboration, and affordable pricing for cost-sensitive customers.

We offer Creative Cloud for individuals, students, teams and enterprises. We expect Creative Cloud will drive sustained long-term revenue growth through a continued expansion of our customer base by acquiring new users as a result of low cost of entry and delivery of additional features and value to Creative Cloud, as well as keeping existing customers current on our latest release. We have also built out a marketplace for Creative Cloud subscribers to enable the delivery and purchase of stock content in our Adobe Stock service. Overall, our strategy with Creative Cloud is designed to enable us to increase our revenue with users, attract more new customers, and grow our recurring and predictable revenue stream that is recognized ratably.

We continue to implement strategies that will accelerate awareness, consideration and purchase of subscriptions to our Creative Cloud offerings. These strategies include increasing the value Creative Cloud users receive, such as offering new desktop and mobile applications, as well as targeted promotions and offers that attract past customers and potential users to try out and ultimately subscribe to Creative Cloud. Because of the shift towards Creative Cloud subscriptions and Enterprise Term License Agreements ("ETLAs"), revenue from perpetual licensing of our Creative products has been immaterial to our business.

We are also a market leader with our Adobe Document Cloud offerings built around our Adobe Acrobat family of products, including Adobe Acrobat Reader DC, and a set of integrated cloud-based document services, including Adobe Sign. Acrobat provides reliable creation and exchange of electronic documents, regardless of platform or application source type. Document Cloud, which we believe enhances the way people manage critical documents at home, in the office and across devices, includes Adobe Acrobat DC and Adobe Sign, and a set of integrated services enabling users to create, review, approve, sign and track documents whether on a desktop or mobile device. Adobe Acrobat DC, with a touch-enabled user interface, is offered both through subscription and perpetual licenses.

Annualized Recurring Revenue ("ARR") is currently the key performance metric our management uses to assess the health and trajectory of our overall Digital Media segment. ARR should be viewed independently of revenue, deferred revenue, unbilled backlog and remaining performance obligation as ARR is a performance metric and is not intended to be combined with any of these items. We adjust our reported ARR on an annual basis to reflect any material exchange rates changes. Our reported ARR results in the current fiscal year are based on currency rates set at the beginning of the year and held constant throughout the year. We calculate ARR as follows:

| | |
|---|---|
| Creative ARR | Annual Value of Creative Cloud Subscriptions and Services<br>+<br>Annual Creative ETLA Contract Value |
| Document Cloud ARR | Annual Value of Document Cloud Subscriptions and Services<br>+<br>Annual Document Cloud ETLA Contract Value |
| Digital Media ARR | Creative ARR<br>+<br>Document Cloud ARR |

Creative ARR exiting fiscal 2019 was $7.31 billion, up from $5.92 billion at the end of fiscal 2018. Document Cloud ARR exiting fiscal 2019 was $1.09 billion, up from $791 million at the end of fiscal 2018. Total Digital Media ARR grew to $8.40 billion at the end of fiscal 2019, up from $6.71 billion at the end of fiscal 2018. Revaluing our ending ARR for fiscal 2019 using currency rates at the beginning of fiscal 2019, our Digital Media ARR at the end of fiscal 2019 would be $8.33 billion or approximately $66 million lower than the ARR reported above.

Our success in driving growth in ARR has positively affected our revenue growth. Creative revenue in fiscal 2019 was $6.48 billion, up from $5.34 billion in fiscal 2018 and representing 21% year-over-year growth. Document Cloud revenue in fiscal 2019 was $1.22 billion, up from $981.8 million in fiscal 2018 and representing 25% year-over-year revenue growth. Total Digital Media segment revenue grew to $7.71 billion in fiscal 2019, up from $6.33 billion in fiscal 2018 and representing 22% year-over-year growth.

We are a market leader in the fast-growing category addressed by our Digital Experience segment. Our Digital Experience business provides comprehensive solutions that include analytics, targeting, media optimization, digital experience management, cross-channel campaign management, marketing automation, audience management, commerce, premium video delivery and monetization. These comprehensive solutions enable marketers to measure, personalize and optimize marketing campaigns and digital experiences across channels for optimal marketing performance.

During fiscal 2019, our hierarchy of solutions in the Digital Experience segment consisted of the following cloud offerings:

- Adobe Advertising Cloud—delivers an end-to-end platform for managing advertising across traditional TV and digital formats, and simplifies the delivery of video, display and search advertising across channels and screens.

- Adobe Analytics Cloud—enables businesses to move from insights to actions in real time by uniquely integrating audiences as the core system of intelligence for the enterprise; makes data available across all Adobe clouds through the capture, aggregation, rationalization and understanding of vast amounts of disparate data and then translating that data into singular customer profiles; includes Adobe Analytics and Adobe Audience Manager.

- Adobe Marketing Cloud—provides an integrated set of solutions to help marketers differentiate their brands and engage their customers, helping businesses manage, personalize, and orchestrate campaigns and customer journeys; includes Adobe Experience Manager ("AEM"), Adobe Campaign, Adobe Target, Marketo Engage and Adobe Primetime.

- Adobe Commerce Cloud—provides digital commerce, order management and predictive intelligence based on a unified commerce platform enabling shopping experiences across a wide array of industries; includes Magento Commerce.

In addition to chief marketing officers, chief revenue officers and digital marketers, users of our Digital Experience solutions include advertisers, campaign managers, publishers, data analysts, content managers, social marketers, marketing executives and information management and technology executives. These customers often are involved in workflows that utilize other Adobe products, such as our Digital Media offerings. By combining the creativity of our Digital Media business with the science of our Digital Experience business, we help our customers to more efficiently and effectively make, manage, measure and monetize their content across every channel with an end-to-end workflow and feedback loop.

We utilize a direct sales force to market and license our Digital Experience solutions, as well as an extensive ecosystem of partners, including marketing agencies, systems integrators and independent software vendors that help license and deploy our solutions to their customers. We have made significant investments to broaden the scale and size of all of these routes to market, and our recent financial results reflect the success of these investments.

We achieved record Digital Experience revenue of $3.21 billion in fiscal 2019, up from $2.44 billion in fiscal 2018 which represents 31% year-over-year growth. Driving this increase was the increase in subscription revenue across our offerings which grew to $2.67 billion in fiscal 2019 from $1.95 billion in fiscal 2018, representing 37% year-over-year growth. Largely contributing to the increase in Digital Experience subscription revenue was revenue associated with Marketo Engage. To a lesser extent, subscription revenue associated with Magento Commerce and Adobe Experience Manager also contributed to the overall increase. We expect that continued demand across our portfolio of Adobe Experience Cloud solutions, including new offerings and enhancements to existing solutions, will drive revenue growth in future years.

Our financial results for fiscal 2019 are presented in accordance with the new revenue standard that was adopted under the modified retrospective method at the beginning of fiscal 2019. Prior period results have not been restated which limits the comparability of our results of operations for fiscal 2019 when compared to the year-ago period. *See Note 2 of our Notes to Consolidated Financial Statements for information regarding adoption of the new revenue standard.*

*Financial Performance Summary for Fiscal 2019*

- Total Digital Media ARR of approximately $8.40 billion as of November 29, 2019 increased by $1.69 billion, or 25%, from $6.71 billion as of November 30, 2018. The change in our Digital Media ARR was primarily due to stronger new user adoption of our Creative Cloud and Adobe Document Cloud offerings.

- Creative revenue of $6.48 billion increased by $1.14 billion, or 21%, during fiscal 2019, from $5.34 billion in fiscal 2018. The increase was primarily due to the increase in subscription revenue associated with our Creative Cloud offerings.

- Digital Experience revenue of $3.21 billion increased by $762.4 million, or 31%, during fiscal 2019, from $2.44 billion in fiscal 2018. The increase was primarily due to the increase in subscription revenue driven by the addition of Marketo and Magento, which we acquired in the later part of fiscal 2018.

- Our total deferred revenue of $3.50 billion as of November 29, 2019 increased by $447.1 million, or 15%, from $3.05 billion as of November 30, 2018. The increase was primarily due to increases in new contracts and the timing of renewals for offerings with cloud-enabled services and hosted services.

- Cost of revenue of $1.67 billion increased by $477.7 million, or 40%, during fiscal 2019, from $1.19 billion in fiscal 2018. The increase was primarily due to increases in amortization of intangibles from our acquisition of Magento and Marketo in the later part of fiscal 2018. To a lesser extent, increases in hosting services and data center costs also contributed to the overall increase in cost of revenue.

- Operating expenses of $6.23 billion increased by $1.24 billion, or 25%, during fiscal 2019, from $4.99 billion in fiscal 2018. The increase was primarily due to increases in base compensation and related benefits costs and stock-based compensation expense associated with headcount growth, including additions from the acquisitions of Magento and Marketo in the later part of fiscal 2018. To a lesser extent, increases in marketing spend also contributed to the overall increase in operating expenses.

- Net income of $2.95 billion increased by $360.7 million, or 14%, during fiscal 2019 from $2.59 billion in fiscal 2018 primarily due to increases in revenue and offset in part by the increases in operating expenses and cost of revenue.

- Net cash flow from operations of $4.42 billion during fiscal 2019 increased by $392.5 million, or 10%, from $4.03 billion during fiscal 2018 primarily due to higher net income adjusted for the net effect of non-cash items. This increase was offset in part by comparatively lower increases in income taxes payable and higher increases in prepaid expenses and other assets.

**Revenue**

| *(dollars in millions)* | 2019 | 2018 | 2017 | % Change 2019-2018 |
|---|---|---|---|---|
| Subscription | $ 9,994.5 | $ 7,922.2 | $ 6,133.9 | 26 % |
| Percentage of total revenue | 89 % | 88 % | 84 % | |
| Product | 647.8 | 622.1 | 706.7 | 4 % |
| Percentage of total revenue | 6 % | 7 % | 10 % | |
| Services and support | 529.0 | 485.7 | 460.9 | 9 % |
| Percentage of total revenue | 5 % | 5 % | 6 % | |

| | | | | |
|---|---|---|---|---|
| Total revenue | $ 11,171.3 | $ 9,030.0 | $ 7,301.5 | 24% |

*Subscription Revenue by Segment*

Our subscription revenue is comprised primarily of fees we charge for our subscription and hosted service offerings including Creative Cloud and certain of our Digital Experience and Document Cloud services. We recognize subscription revenue ratably over the term of agreements with our customers, beginning with commencement of service.

We have the following reportable segments: Digital Media, Digital Experience and Publishing. Subscription revenue by reportable segment for fiscal 2019, 2018 and 2017 is as follows:

| *(dollars in millions)* | 2019 | 2018 | 2017 | % Change 2019-2018 |
|---|---|---|---|---|
| Digital Media | $ 7,208.3 | $ 5,857.7 | $ 4,480.8 | 23 % |
| Digital Experience | 2,670.7 | 1,949.3 | 1,552.5 | 37 % |
| Publishing | 115.5 | 115.2 | 100.6 | * |
| Total subscription revenue | $ 9,994.5 | $ 7,922.2 | $ 6,133.9 | 26 % |

(*) Percentage is less than 1%.

Our product revenue is primarily comprised of revenue from distinct on-premise software licenses recognized at a point in time and certain of our OEM and royalty agreements. Our services and support revenue is comprised of consulting, training and maintenance and support, primarily related to the licensing of our enterprise offerings and the sale of our hosted Digital Experience services. Our support revenue also includes technical support and developer support to partners and developer organizations related to our desktop products. Our maintenance and support offerings, which entitle customers to receive desktop product upgrades and enhancements or technical support, depending on the offering, are generally recognized ratably over the term of the arrangement.

*Segments*

In fiscal 2019, we categorized our products into the following reportable segments:

- *Digital Media*—Our Digital Media segment provides tools and solutions that enable individuals, teams and enterprises to create, publish, promote and monetize their digital content anywhere. Our customers include content creators, experience designers, app developers, enthusiasts, students, social media users and creative professionals, as well as marketing departments and agencies, companies and publishers. Our customers also include knowledge workers who create, collaborate on and distribute documents and creative content.

- *Digital Experience*—Our Digital Experience segment provides products, services and solutions for creating, managing, executing, measuring, monetizing and optimizing customer experiences from advertising to commerce. Our customers include marketers, advertisers, agencies, publishers, merchandisers, merchants, web analysts, data scientists, developers, marketing executives, information management and technology executives, product development executives, and sales and support executives.

- *Publishing*—Our Publishing segment addresses market opportunities ranging from the diverse authoring and publishing needs of technical and business publishing to our legacy type and OEM printing businesses. It also includes our web conferencing and document and forms platforms.

*Segment Information*

| *(dollars in millions)* | 2019 | 2018 | 2017 | % Change 2019-2018 |
|---|---|---|---|---|
| Digital Media | $ 7,707.0 | $ 6,325.3 | $ 5,010.6 | 22 % |
| Percentage of total revenue | 69 % | 70 % | 69 % | |
| Digital Experience | 3,206.2 | 2,443.7 | 2,030.3 | 31 % |
| Percentage of total revenue | 29 % | 27 % | 28 % | |
| Publishing | 258.1 | 261.0 | 260.6 | (1 )% |
| Percentage of total revenue | 2 % | 3 % | 3 % | |
| Total revenue | $ 11,171.3 | $ 9,030.0 | $ 7,301.5 | 24 % |

*Digital Media*

Revenue from Digital Media increased $1.38 billion during fiscal 2019 as compared to fiscal 2018, driven by increases in revenue associated with our Creative and Document Cloud offerings. Revenue associated with our Creative offerings, which includes our Creative Cloud, perpetually licensed Creative and stock photography offerings, increased during fiscal 2019. The increase was primarily due to an increase in subscription revenue across all of our Creative Cloud offerings driven by increases in net new subscriptions. Adobe Document Cloud revenue, which includes our Acrobat product family and Adobe Sign service, increased during fiscal 2019 as compared to fiscal 2018 primarily due to increases in subscription revenue driven by strong adoption of our Document Cloud.

*Digital Experience*

Revenue from Digital Experience increased $762.5 million during fiscal 2019, as compared to fiscal 2018 primarily due to subscription revenue growth across our Experience Cloud offerings. Largely contributing to the subscription revenue increases were revenue associated with Marketo Engage, which we acquired in the fourth quarter of fiscal 2018, and revenue associated with our Magento Commerce offerings. Also contributing to the subscription revenue growth were increases in our AEM and Campaign offerings.

*Geographical Information*

| *(dollars in millions)* | 2019 | 2018 | 2017 | % Change 2019-2018 |
|---|---|---|---|---|
| Americas | $ 6,505.9 | $ 5,116.8 | $ 4,216.5 | 27 % |
| Percentage of total revenue | 58 % | 57 % | 58 % | |
| EMEA | 2,975.2 | 2,550.0 | 1,985.1 | 17 % |
| Percentage of total revenue | 27 % | 28 % | 27 % | |
| APAC | 1,690.2 | 1,363.2 | 1,099.9 | 24 % |
| Percentage of total revenue | 15 % | 15 % | 15 % | |
| Total revenue | $ 11,171.3 | $ 9,030.0 | $ 7,301.5 | 24 % |

Overall revenue during fiscal 2019 increased in all geographic regions as compared to fiscal 2018 primarily due to increases in Digital Media and Digital Experience revenue. Within each geographic region, the fluctuations in revenue by reportable segment were attributable to the factors noted in the segment information above.

Included in the overall change in revenue for fiscal 2019 and fiscal 2018 were impacts associated with foreign currency as shown below. Our cash flow hedging program is used to mitigate a portion of the foreign currency impact to revenue.

| *(in millions)* | 2019 | 2018 |
|---|---|---|
| **Revenue impact:** | Increase/(Decrease) | |
| Euro | $ (73.2 ) | $ 96.3 |
| Australian Dollar | (27.2 ) | (0.7 ) |
| British Pound | (27.0 ) | 21.6 |
| Japanese Yen | 2.3 | 2.8 |
| Other currencies | (12.9 ) | 2.6 |
| Total revenue impact | (138.0 ) | 122.6 |
| **Hedging impact:** | | |
| Euro | 30.3 | 29.1 |
| British Pound | 8.2 | 11.3 |
| Japanese Yen | 1.4 | 8.2 |
| Total hedging impact | 39.9 | 48.6 |
| Total impact | $ (98.1 ) | $ 171.2 |

During fiscal 2019, the U.S. Dollar strengthened against EMEA and other currencies, which decreased revenue in U.S. Dollar equivalents. The foreign currency impact to revenue was offset in part by hedging gains primarily from our EMEA currencies cash flow hedging programs during fiscal 2019.

*See Note 2 of our Notes to Consolidated Financial Statements for additional details of revenue by geography.*

*Backlog*

Adoption of the new revenue standard resulted in changes to our measurement of unbilled backlog starting in fiscal 2019 such that orders with a right of termination and unbilled amounts recognized as revenue under the new revenue standard are not included in our unbilled backlog, consistent with our measurement of remaining performance obligations. Our unbilled backlog represents expected future billings not yet recognized in revenue that are contractually committed under our existing subscription agreements. As of November 29, 2019, we had unbilled backlog of $6.38 billion, which excludes amounts cancellable without substantive penalty. Approximately $2.61 billion of our unbilled backlog is not reasonably expected to be recognized during fiscal

2020. As of November 30, 2018, we had unbilled backlog of approximately $5.05 billion, which was measured under the accounting standard in effect for that period.

We expect that the amount of unbilled backlog will change from period to period due to certain factors, including the timing and duration of large customer subscription agreements, varying billing cycles of these agreements, timing of customer renewals, timing of revenue recognition, changes in customer financial circumstances and foreign currency fluctuations. Our presentation of unbilled backlog may differ from that of other companies in the industry.

**Cost of Revenue**

| *(dollars in millions)* | 2019 | 2018 | 2017 | % Change 2019-2018 |
|---|---|---|---|---|
| Subscription | $ 1,222.5 | $ 807.2 | $ 623.0 | 51 % |
| Percentage of total revenue | 11 % | 9 % | 9 % | |
| Product | 39.6 | 46.0 | 57.1 | (14 )% |
| Percentage of total revenue | * | 1 % | 1 % | |
| Services and support | 410.6 | 341.8 | 330.4 | 20 % |
| Percentage of total revenue | 4 % | 4 % | 5 % | |
| Total cost of revenue | $ 1,672.7 | $ 1,195.0 | $ 1,010.5 | 40 % |

(*) Percentage is less than 1%

*Subscription*

Cost of subscription revenue consists of third-party royalties and expenses related to operating our network infrastructure, including depreciation expense and operating lease payments associated with computer equipment, data center costs, salaries and related expenses of network operations, implementation, account management and technical support personnel, amortization of certain intangible assets and allocated overhead. We enter into contracts with third parties for hosting services and use of data center facilities. Our data center costs largely consist of the amounts we pay to these third parties for rack space, power and similar items. Cost of subscription revenue also includes media costs related to impressions purchased from third-party ad inventory sources for our Adobe Advertising Cloud offerings.

Cost of subscription revenue increased due to the following:

| | Components of % Change 2019-2018 |
|---|---|
| Amortization of intangibles | 17 % |
| Hosting services and data center costs | 12 |
| Media rebill costs | 7 |
| Royalty costs | 4 |
| Incentive compensation, cash and stock-based | 4 |
| Base compensation and related benefits associated with headcount | 3 |
| Various individually insignificant items | 4 |
| Total change | 51 % |

Amortization of intangibles increased during fiscal 2019 as compared to fiscal 2018 primarily due to amortization of intangible assets purchased through our acquisitions of Magento and Marketo in fiscal 2018.

*Product*

Cost of product revenue includes product packaging, third-party royalties, excess and obsolete inventory, amortization of intangibles and the costs associated with the manufacturing of our products.

Cost of product revenue decreased during fiscal 2019 as compared to fiscal 2018 primarily due to decreases in localization costs.

*Services and Support*

Cost of services and support revenue is primarily comprised of employee-related costs and associated costs incurred to provide consulting services, training and product support.

Cost of services and support revenue increased due to the following:

| | Components of % Change 2019-2018 |
|---|---|
| Incentive compensation, cash and stock-based | 10 % |
| Base compensation and related benefits associated with headcount | 7 |
| Various individually insignificant items | 3 |
| Total change | 20 % |

**Operating Expenses**

| *(dollars in millions)* | 2019 | 2018 | 2017 | % Change 2019-2018 |
|---|---|---|---|---|
| Research and development | $ 1,930.2 | $ 1,537.8 | $ 1,224.1 | 26 % |
| Percentage of total revenue | 17 % | 17 % | 17 % | |
| Sales and marketing | 3,244.4 | 2,620.8 | 2,197.6 | 24 % |
| Percentage of total revenue | 29 % | 29 % | 30 % | |
| General and administrative | 880.6 | 744.9 | 624.7 | 18 % |
| Percentage of total revenue | 8 % | 8 % | 9 % | |
| Amortization of intangibles | 175.3 | 91.1 | 76.5 | 92 % |
| Percentage of total revenue | 2 % | 1 % | 1 % | |
| Total operating expenses | $ 6,230.5 | $ 4,994.6 | $ 4,122.9 | 25 % |

*Research and Development*

Research and development expenses consist primarily of salary and benefit expenses for software developers, contracted development efforts, related facilities costs and expenses associated with computer equipment used in software development.

Research and development expenses increased due to the following:

| | Components of % Change 2019-2018 |
|---|---|
| Incentive compensation, cash and stock-based | 11 % |
| Base compensation and related benefits associated with headcount | 8 |
| Professional and consulting fees | 4 |
| Various individually insignificant items | 3 |
| Total change | 26 % |

We believe that investments in research and development, including the recruiting and hiring of software developers, are critical to remain competitive in the marketplace and are directly related to continued timely development of new and enhanced offerings and solutions. We will continue to focus on long-term opportunities available in our end markets and make significant investments in the development of our subscription and service offerings, applications and tools.

*Sales and Marketing*

Sales and marketing expenses consist primarily of salary and benefit expenses, amortization of contract acquisitions costs including sales commissions, travel expenses and related facilities costs for our sales, marketing, order management and global supply chain management personnel. Sales and marketing expenses also include the costs of programs aimed at increasing revenue, such as advertising, trade shows, public relations and other market development programs.

Sales and marketing expenses increased due to the following:

| | Components of % Change 2019-2018 |
|---|---|
| Marketing spending related to campaigns, events and overall marketing efforts | 8 % |
| Base compensation and related benefits associated with headcount | 7 |
| Incentive compensation, cash and stock-based | 3 |
| Professional and consulting fees | 2 |
| Amortization of contract acquisition costs, including sales commissions | 2 |
| Various individually insignificant items | 2 |
| Total change | 24 % |

*General and Administrative*

General and administrative expenses consist primarily of compensation and benefit expenses, travel expenses and related facilities costs for our finance, facilities, human resources, legal, information services and executive personnel. General and administrative expenses also include outside legal and accounting fees, provision for bad debts, expenses associated with computer equipment and software used in the administration of the business, charitable contributions and various forms of insurance.

General and administrative expenses increased due to the following:

| | Components of % Change 2019-2018 |
|---|---|
| Professional and consulting fees | 4 % |
| Facilities and telecom | 4 |
| Incentive compensation, cash and stock-based | 4 |
| Base compensation and related benefits associated with headcount | 3 |
| Software licenses | 2 |
| Various individually insignificant items | 1 |
| Total change | 18 % |

*Amortization of Intangibles*

During the last several years, we have completed a number of business combinations and asset acquisitions. As a result of these acquisitions, we purchased intangible assets that are being amortized over their estimated useful lives ranging from one to fifteen years.

Amortization expense increased during fiscal 2019 as compared to fiscal 2018 primarily due to amortization of intangible assets purchased through our acquisitions of Magento and Marketo in the later part of fiscal 2018 and partially offset by certain fully amortized acquired intangible assets from previous acquisitions.

**Non-Operating Income (Expense), Net**

| *(dollars in millions)* | 2019 | 2018 | 2017 | % Change 2019-2018 |
|---|---|---|---|---|
| Interest and other income (expense), net | $ 42.2 | $ 39.5 | $ 36.4 | ** |
| Percentage of total revenue | * | * | * | |
| Interest expense | (157.2 ) | (89.2 ) | (74.4 ) | 76 % |
| Percentage of total revenue | (1 %) | (1 %) | (1 %) | |
| Investment gains (losses), net | 51.6 | 3.2 | 7.5 | ** |
| Percentage of total revenue | * | * | * | |
| Total non-operating income (expense), net | $ (63.4 ) | $ (46.5 ) | $ (30.5 ) | 36 % |

(*) Percentage is less than 1%.
(**) Percentage is not meaningful.

*Interest and Other Income (Expense), Net*

Interest and other income (expense), net consists primarily of interest earned on cash, cash equivalents and short-term fixed income investments. Interest and other income (expense), net also includes gains and losses on fixed income investments and foreign exchange gains and losses.

*Interest Expense*

Interest expense primarily represents interest associated with our Term Loan, senior notes and interest rate swaps. In October 2018, we entered into a credit agreement providing for a $2.25 billion senior unsecured term loan for the purpose of partially funding the purchase price for our acquisition of Marketo. Interest on our Term Loan is payable periodically at the end of each interest period, whereas interest on our senior notes is payable semi-annually, in arrears, on February 1 and August 1. Floating interest payments on the interest rate swaps are paid monthly. The fixed-rate interest receivable on the swaps is received semi-annually concurrent with the senior notes interest payments. *See Notes 6 and 17 of our Notes to Consolidated Financial Statements for further details regarding our interest rate swaps and debt, respectively.*

Interest expense increased during fiscal 2019 as compared to fiscal 2018 primarily due to interest on our Term Loan which was entered into in the fourth quarter of fiscal 2018.

*Investment Gains (Losses), Net*

Investment gains (losses), net consists principally of unrealized holding gains and losses associated with our deferred compensation plan assets which are classified as trading securities, and gains and losses associated with our direct and indirect investments in privately held companies.

Investment gains increased during fiscal 2019 as compared to fiscal 2018 primarily due to the gain recognized upon our acquisition of the remaining interest in Allegorithmic in January 2019, which was accounted for as an equity-method investment immediately before the acquisition. *See Note 3 of our Notes to Consolidated Financial Statements for further details regarding our acquisition of Allegorithmic.*

**Provision for Income Taxes**

| *(dollars in millions)* | 2019 | 2018 | 2017 | % Change 2019-2018 | % Change 2018-2017 |
|---|---|---|---|---|---|
| Provision | $ 253.3 | $ 203.1 | $ 443.7 | 25 % | (54 %) |
| Percentage of total revenue | 2 % | 2 % | 6 % | | |
| Effective tax rate | 8 % | 7 % | 21 % | | |

Our effective tax rate increased by approximately one percentage point during fiscal 2019 as compared to fiscal 2018. The effective tax rate for fiscal 2019 included U.S. federal and state taxes associated with our current year international earnings resulting from the international provisions of the Tax Cuts and Jobs Act ("Tax Act") effective this year and for additional foreign taxation on our foreign operations. This increase was offset in part by the provisional accounting expense recorded in the prior year for the effects of the Tax Act adoption.

Our effective tax rate decreased by approximately 14 percentage points during fiscal 2018 as compared to fiscal 2017. The lower effective tax rate was primarily due to the effects of the Tax Act enacted on December 22, 2017, which included the reduction in the statutory federal corporate income tax rate from 35% to 21% effective on January 1, 2018, and a related change to our corporate tax structure from which we serve our foreign customers that provided us the ability to deduct more expenses against our earnings in the U.S.

Beginning in our fiscal 2019, the annual statutory federal corporate tax rate is 21% and certain international provisions of the Tax Act, such as a tax on global intangible low-tax income, a base erosion and anti-abuse tax and a special tax deduction for foreign-derived intangible income, took effect. The U.S. Treasury Department has issued proposed regulations that could impact the calculation of taxes related to these provisions and which are anticipated to be applicable on a retroactive basis. While the Company continues to evaluate the impact, such regulations have not been finalized and are subject to change. We will account for new regulations in the period of enactment.

We recognize deferred tax assets to the extent that we believe these assets are more likely than not to be realized. In making such a determination, we considered all available positive and negative evidence, including our past operating results, forecasted earnings, future taxable income and prudent and feasible tax planning strategies. On the basis of this evaluation, we continue to maintain a valuation allowance related primarily to the realizability of state and foreign credits. Total valuation allowance was $244.4 million as of November 29, 2019.

We are a United States-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. A significant portion of our foreign earnings for the current fiscal year were earned by our Irish subsidiaries. The Tax Act provides an exemption from federal income taxes for distributions from foreign subsidiaries made after December 31, 2017, including certain earnings that were not subject to the one-time transition or global intangible low-tax income tax. As we repatriate the undistributed foreign earnings for use in the U.S., the distributions will generally not be subject to further U.S. federal tax.

Subsequent to November 29, 2019, final and proposed tax regulations were issued that are applicable to Adobe. We are currently evaluating the impact of these enacted and issued regulations, but we do not anticipate they will have a material impact to our fiscal 2020 operating results.

The Tax Act included certain international provisions effective for us starting in fiscal 2019. As discussed in Part 1. Item 1A. Risk Factors, the applicability and impact of these new tax provisions, and of other international tax law changes effective for fiscal 2020 and beyond, will likely require us to respond by making change(s) to our international trading structure. The net impact of such change(s) is uncertain but is anticipated to adversely affect our effective income tax rate and cash flows in years beyond fiscal 2020.

*See Note 10 of our Notes to Consolidated Financial Statements for further information on our provision for income taxes.*

*Accounting for Uncertainty in Income Taxes*

The gross liabilities for unrecognized tax benefits excluding interest and penalties were $173.3 million, $196.2 million and $172.9 million for fiscal 2019, 2018 and 2017, respectively. If the total unrecognized tax benefits at November 29, 2019, November 30, 2018 and December 1, 2017 were recognized, $127.0 million, $145.2 million and $135.0 million would decrease the respective effective tax rates.

The combined amount of accrued interest and penalties related to tax positions taken on our tax returns were approximately $25.1 million and $24.6 million for fiscal 2019 and 2018, respectively. These amounts were included in long-term income taxes payable in their respective years.

The timing of the resolution of income tax examinations is highly uncertain as are the amounts and timing of tax payments that are part of any audit settlement process. These events could cause large fluctuations in the balance sheet classification of our tax assets and liabilities. We believe that within the next 12 months, it is reasonably possible that either certain audits will conclude or statutes of limitations on certain income tax examination periods will expire, or both. Given the uncertainties described above, we can only determine a range of estimated potential decreases in underlying unrecognized tax benefits ranging from $0 to approximately $20 million.

In addition, in countries where we conduct business and in jurisdictions in which we are subject to tax, including those covered by governing bodies that enact tax laws applicable to us, such as the European Commission of the European Union, we are subject to potential changes in relevant tax, accounting and other laws, regulations and interpretations, including changes to tax laws applicable to corporate multinationals such as Adobe. These countries, other governmental bodies and intergovernmental economic organizations such as the Organization for Economic Cooperation and Development, have or could make unprecedented assertions about how taxation is determined in their jurisdictions that are contrary to the way in which we have interpreted and historically applied the rules and regulations described above in our income tax returns filed in such jurisdictions. In the current global tax policy environment, any changes in laws, regulations and interpretations related to these assertions could adversely affect our effective tax rates or result in other costs to us which could adversely affect our operations and financial results.

Moreover, we are subject to the continual examination of our income tax returns by the IRS and other domestic and foreign tax authorities. These tax examinations are expected to focus on our intercompany transfer pricing practices as well as other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for adjustments that may result from these examinations. We cannot provide assurance that the final determination of any of these examinations will not have an adverse effect on our operating results and financial position.

## LIQUIDITY AND CAPITAL RESOURCES

This data should be read in conjunction with our Consolidated Statements of Cash Flows.

| *(in millions)* | As of November 29, 2019 | As of November 30, 2018 |
|---|---|---|
| Cash and cash equivalents | $ 2,650.2 | $ 1,642.8 |
| Short-term investments | $ 1,526.8 | $ 1,586.2 |
| Working capital | $ (1,696.0) | $ 555.9 |
| Stockholders' equity | $ 10,530.2 | $ 9,362.1 |

*Working Capital*

Working capital as of November 29, 2019 and November 30, 2018 was $1.70 billion of a deficit and $555.9 million of a surplus, respectively. The decrease was primarily due to the reclassification of $3.15 billion total carrying value of our $2.25 billion term loan due April 30, 2020 ("Term Loan") and $900 million 4.75% senior notes due February 1, 2020 ("2020 Notes") to current liabilities. We intend to refinance our Term Loan and 2020 Notes on or before the due dates.

A summary of our cash flows is as follows:

| *(in millions)* | 2019 | 2018 | 2017 |
|---|---|---|---|
| Net cash provided by operating activities | $ 4,421.8 | $ 4,029.3 | $ 2,912.9 |
| Net cash used for investing activities | (455.6) | (4,685.3) | (442.9) |
| Net cash used for financing activities | (2,946.1) | (5.6) | (1,183.7) |
| Effect of foreign currency exchange rates on cash and cash equivalents | (12.7) | (1.7) | 8.5 |
| Net increase (decrease) in cash and cash equivalents | $ 1,007.4 | $ (663.3) | $ 1,294.8 |

Our primary source of cash is receipts from revenue and, to a lesser extent, proceeds from participation in the employee stock purchase plan. The primary uses of cash are our stock repurchase program as described below, payroll-related expenses, general operating expenses including marketing, travel and office rent, and cost of revenue. Other uses of cash include business acquisitions, purchases of property and equipment and payments for taxes related to net share settlement of equity awards.

*Cash Flows from Operating Activities*

For fiscal 2019, net cash provided by operating activities of $4.42 billion was primarily comprised of net income adjusted for the net effect of non-cash items. The primary working capital sources of cash were net income coupled with an increase in deferred revenue, which was offset in large part by cash outflows due to an increase in prepaid expenses and other assets. The increase in deferred revenue was primarily driven by increases related to Digital Media offerings with cloud-enabled services and Digital Experience hosted services. The primary working capital use of cash was due to increases in prepaid expenses with certain vendors, sales commissions paid and capitalized, advanced payments related to income taxes and increase in long-term contract assets.

*Cash Flows from Investing Activities*

For fiscal 2019, net cash used for investing activities of $455.6 million was primarily due to purchases of property and equipment and our acquisition of the remaining equity interest in Allegorithmic. These cash outflows were offset primarily by proceeds from sales and maturities of short-term investments, net of purchases. *See Note 3 of our Notes to Consolidated Financial Statements for more detailed information regarding our acquisitions.*

*Cash Flows from Financing Activities*

For fiscal 2019, net cash used for financing activities was $2.95 billion primarily due to payments for our treasury stock repurchases and taxes related to net share settlement of equity awards, which were offset by proceeds from re-issuance of treasury stock for our employee stock purchase plan. *See the section titled "Stock Repurchase Program" discussed below.*

We expect to continue our investing activities, including short-term and long-term investments, facilities expansion and purchases of computer systems for research and development, sales and marketing, product support and administrative staff. Furthermore, cash reserves may be used to repurchase stock under our stock repurchase program and to strategically acquire companies, products or technologies that are complementary to our business.

**Other Liquidity and Capital Resources Considerations**

Our existing cash, cash equivalents and investment balances may fluctuate during fiscal 2020 due to changes in our planned cash outlay, including changes in incremental costs such as direct costs and integration costs related to our acquisitions.

Cash from operations could also be affected by various risks and uncertainties, including, but not limited to, the risks detailed in Part I, Item 1A titled “Risk Factors.” However, based on our current business plan and revenue prospects, we believe that our existing cash, cash equivalents and investment balances, our anticipated cash flows from operations and our available credit facility will be sufficient to meet our working capital and operating resource expenditure requirements for the next twelve months.

We have a $1 billion senior unsecured revolving credit agreement (“Revolving Credit Agreement”) with a syndicate of lenders, providing for loans to us and certain of our subsidiaries through October 17, 2023. As of November 29, 2019, there were no outstanding borrowings under this credit agreement and the entire $1 billion credit line remains available for borrowing.

As of November 29, 2019, we have a $2.25 billion Term Loan outstanding and $1.9 billion senior notes outstanding, consisting of our 2020 Notes and $1 billion of 3.25% senior notes due February 1, 2025 (the “2025 Notes,” and together with the 2020 Notes, the “Notes”). The Notes and Term Loan rank equally with our other unsecured and unsubordinated indebtedness.

During the first quarter of fiscal 2019, we reclassified the 2020 Notes as current debt in our Consolidated Balance Sheets. During the second quarter of fiscal 2019, we reclassified the Term Loan as current debt in our Consolidated Balance Sheets. As of November 29, 2019, the carrying value of the 2020 Notes was $899.6 million which includes the fair value of the related interest rate swap and is net of debt issuance costs, and the carrying value of the Term Loan was $2.25 billion, net of unamortized original issuance discount. We intend to refinance the Term Loan and 2020 Notes on or before the due dates.

During the third quarter of fiscal 2019, in anticipation of refinancing our Term Loan and 2020 Notes, we entered into Treasury lock agreements with large financial institutions which fixed benchmark U.S. Treasury rates for an aggregate notional amount of $1 billion of our future debt issuance. These derivative instruments hedge the impact of changes in the benchmark interest rate to future interest payments and will be terminated upon debt issuance.

Our short-term investment portfolio is primarily invested in corporate debt securities, asset-backed securities, municipal securities and U.S. Treasury securities. We use professional investment management firms to manage a large portion of our investment portfolio.

**Stock Repurchase Program**

To facilitate our stock repurchase program, designed to return value to our stockholders and minimize dilution from stock issuances, we may repurchase shares in the open market or enter into structured repurchase agreements with third parties. In May 2018, our Board of Directors granted us an authority to repurchase up to $8 billion in common stock through the end of fiscal 2021.

During fiscal 2019, 2018 and 2017, we entered into several structured stock repurchase agreements with large financial institutions, whereupon we provided them with prepayments totaling $2.75 billion, $2.05 billion, and $1.10 billion, respectively. We enter into these agreements in order to take advantage of repurchasing shares at a guaranteed discount to the Volume Weighted Average Price (“VWAP”) of our common stock over a specified period of time. We only enter into such transactions when the discount that we receive is higher than the expected foregone return on our cash prepayments to the financial institutions. There were no explicit commissions or fees on these structured repurchases. Under the terms of the agreements, there is no requirement for the financial institutions to return any portion of the prepayment to us.

The financial institutions agree to deliver shares to us at monthly intervals during the contract term. The parameters used to calculate the number of shares deliverable are: the total notional amount of the contract, the number of trading days in the contract, the number of trading days in the interval and the average VWAP of our stock during the interval less the agreed upon discount.

The following is a summary of our structured stock repurchases executed with large financial institutions during fiscal 2019, 2018, and 2017:

| *(shares in thousands and total cost in millions)* | 2019 | | 2018 | | 2017 | |
|---|---|---|---|---|---|---|
| **Board approval dates** | **Shares** | **Average per share** | **Shares** | **Average per share** | **Shares** | **Average per share** |
| January 2015 | — | $ — | — | $ — | 4,263 | $ 118.00 |
| January 2017 | — | $ — | 8,686 | $ 230.43 | 3,923 | $ 151.80 |
| May 2018 | 9,883 | $ 270.23 | — | $ — | — | $ — |
| Total shares | 9,883 | $ 270.23 | 8,686 | $ 230.43 | 8,186 | $ 134.20 |
| Total cost | $2,671 | | $2,002 | | $1,099 | |

For fiscal 2019, 2018 and 2017, the prepayments were classified as treasury stock on our Consolidated Balance Sheets at the payment date, though only shares physically delivered to us by November 29, 2019, November 30, 2018 and December 1, 2017 were excluded from the computation of earnings per share. As of November 29, 2019, $229.2 million of prepayments remained under the agreement.

Subsequent to November 29, 2019, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of $850 million. This amount will be classified as treasury stock on our Consolidated Balance Sheets. Upon completion of the $850 million stock repurchase agreement, $4.25 billion remains under our May 2018 authority.

*See Item 5, Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities for share repurchases during the quarter ended November 29, 2019.*

**Off-Balance Sheet Arrangements and Aggregate Contractual Obligations**

Our principal commitments as of November 29, 2019 consist of obligations under operating leases, royalty agreements and various service agreements. *See Note 16 of our Notes to Consolidated Financial Statements for additional information regarding our contractual commitments.*

*Contractual Obligations*

The following table summarizes our contractual obligations as of November 29, 2019:

| *(in millions)* | Payment Due by Period | | | | |
|---|---|---|---|---|---|
| | **Total** | **Less than 1 year** | **1-3 years** | **3-5 years** | **More than 5 years** |
| Term Loan and Notes, including interest | $ 4,373.3 | $ 3,227.0 | $ 65.0 | $ 65.0 | $ 1,016.3 |
| Operating lease obligations, net | 711.5 | 88.7 | 158.0 | 126.9 | 337.9 |
| Purchase obligations | 2,036.5 | 545.0 | 935.8 | 555.7 | — |
| Total | $ 7,121.3 | $ 3,860.7 | $ 1,158.8 | $ 747.6 | $ 1,354.2 |

As of November 29, 2019, our Term Loan's carrying value was $2.25 billion. At our election, the Term Loan will bear interest at either (i) the London Interbank Offered Rate ("LIBOR") plus a margin, based on our debt ratings, ranging from 0.500% to 1.000% or (ii) a base rate plus a margin, based on our debt ratings, ranging from 0.040% to 0.110%. Interest is payable periodically, in arrears, at the end of each interest period we elect. Based on the LIBOR rate at November 29, 2019, our estimated maximum commitment for interest payments was $23.2 million for the remaining duration of the Term Loan.

As of November 29, 2019, the carrying value of our Notes payable was $1.89 billion. Interest on our Notes is payable semi-annually, in arrears on February 1 and August 1. At November 29, 2019, our maximum commitment for interest payments was $200.1 million for the remaining duration of our Notes.

Our Term Loan and Revolving Credit Agreement contain similar financial covenants requiring us not to exceed a maximum leverage ratio. As of November 29, 2019, we were in compliance with this covenant. We believe this covenant will not impact our credit or cash in the coming fiscal year or restrict our ability to execute our business plan. Our senior notes do not contain any financial covenants.

Under the terms of our Term Loan and Revolving Credit Agreement, we are not prohibited from paying cash dividends unless payment would trigger an event of default or if one currently exists. We do not anticipate paying any cash dividends in the foreseeable future.

*Transition Taxes Liability*

As a result of the Tax Act enacted on December 22, 2017, an accrued transition tax liability of approximately $427.1 million as of November 29, 2019 is payable in installments through fiscal 2026. The Tax Act provides an exemption from federal income taxes for distributions from foreign subsidiaries made after December 31, 2017, including certain earnings that were not subject to the one-time transition or global intangible low-tax income tax. As we repatriate the undistributed foreign earnings for use in the U.S., the distributions will generally not be subject to further U.S. federal tax.

*Accounting for Uncertainty in Income Taxes*

See Results of Operations - Provision for Income Taxes above and Note10 of our Notes to Consolidated Financial Statements for our discussion on accounting for uncertainty in income taxes.

*Royalties*

We have certain royalty commitments associated with the licensing of certain offerings. Royalty expense is generally based on a dollar amount per unit sold or a percentage of the underlying revenue.

*Indemnifications*

In the normal course of business, we provide indemnifications of varying scope to customers and channel partners against claims of intellectual property infringement made by third parties arising from the use of our products and from time to time, we are subject to claims by our customers under these indemnification provisions. Historically, costs related to these indemnification provisions have not been significant and we are unable to estimate the maximum potential impact of these indemnification provisions on our future results of operations.

To the extent permitted under Delaware law, we have agreements whereby we indemnify our directors and officers for certain events or occurrences while the director or officer is or was serving at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the director's or officer's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that limits our exposure and enables us to recover a portion of any future amounts paid.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

All market risk sensitive instruments were entered into for non-trading purposes.

### Foreign Currency Risk

*Foreign Currency Exposures and Hedging Instruments*

In countries outside the United States, we transact business in U.S. Dollars and various other currencies, which subject us to exposure from movements in exchange rates. We may use foreign exchange purchased options or forward contracts to hedge our foreign currency revenue. Additionally, we hedge our net recognized foreign currency monetary assets and liabilities with foreign exchange forward contracts. We hedge these exposures to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates.

Our significant foreign currency revenue exposures for fiscal 2019, 2018 and 2017 were as follows :

| *(in millions, except Japanese Yen)* | | 2019 | | 2018 | | 2017 |
|---|---|---|---|---|---|---|
| Euro | € | 1,603.2 | € | 1,309.9 | € | 1,044.7 |
| Japanese Yen (in billions) | ¥ | 73.2 | ¥ | 60.8 | ¥ | 51.0 |
| British Pounds | £ | 503.3 | £ | 423.1 | £ | 338.4 |

As of November 29, 2019, the total absolute value of all outstanding foreign exchange contracts, including options and forwards, was $1.90 billion, which included the notional equivalent of $927.0 million in Euros, $431.0 million in British Pounds, $341.3 million in Japanese Yen and $201.8 million in other foreign currencies. As of

November 29, 2019, all contracts were set to expire at various dates through June 2020. The bank counterparties in these contracts could expose us to credit-related losses that would be largely mitigated with master netting arrangements with the same counterparty by permitting net settlement transactions. In addition, we enter into collateral security agreements that provide for collateral to be received or posted when the net fair value of these contracts fluctuates from contractually established thresholds.

A sensitivity analysis was performed on all of our foreign exchange derivatives as of November 29, 2019. This sensitivity analysis measures the hypothetical market value resulting from a 10% shift in the value of exchange rates relative to the U.S. Dollar. For option contracts, the Black-Scholes option pricing model was used. A 10% increase in the value of the U.S. Dollar and a corresponding decrease in the value of the hedged foreign currency asset would lead to an increase in the fair value of our financial hedging instruments by $113.6 million. Conversely, a 10% decrease in the value of the U.S. Dollar would result in a decrease in the fair value of these financial instruments by $33.4 million.

As a general rule, we do not use foreign exchange contracts to hedge local currency denominated operating expenses in countries where a natural hedge exists. For example, in many countries, revenue in the local currencies substantially offsets the local currency denominated operating expenses. We also have long-term investment exposures consisting of the capitalization and retained earnings in our non-U.S. Dollar functional currency foreign subsidiaries. As of November 29, 2019 and November 30, 2018, this long-term investment exposure totaled an absolute notional equivalent of $385.2 million and $292.3 million, respectively, with the year-over-year increase primarily driven by earnings growth. At this time, we do not hedge these long-term investment exposures.

We do not use foreign exchange contracts for speculative trading purposes, nor do we hedge our foreign currency exposure in a manner that entirely offsets the effects of changes in foreign exchange rates. We regularly review our hedging program and assess the need to utilize financial instruments to hedge currency exposures on an ongoing basis.

*Cash Flow Hedges of Forecasted Foreign Currency Revenue*

We may use foreign exchange purchased options or forward contracts to hedge foreign currency revenue denominated in Euros, British Pounds and Japanese Yen. We hedge these cash flow exposures to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates. These foreign exchange contracts, carried at fair value, may have maturities between one and twelve months. We enter into these foreign exchange contracts to hedge forecasted revenue in the normal course of business and accordingly, they are not speculative in nature.

We record changes in fair value of these cash flow hedges of foreign currency denominated revenue in accumulated other comprehensive income (loss) until the forecasted transaction occurs. When the forecasted transaction affects earnings, we reclassify the related gain or loss on the cash flow hedge to revenue. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, we reclassify the gain or loss on the related cash flow hedge from accumulated other comprehensive income (loss) to revenue. For the fiscal year ended November 29, 2019, there were no net gains or losses recognized in revenue relating to hedges of forecasted transactions that did not occur.

*Non-Designated Hedges of Foreign Currency Assets and Liabilities*

Our derivatives not designated as hedging instruments consist of foreign currency forward contracts that we primarily use to hedge monetary assets and liabilities denominated in non-functional currencies to reduce the risk that our earnings and cash flows will be adversely affected by changes in foreign currency exchange rates. These foreign exchange contracts are carried at fair value with changes in fair value of these contracts recorded to interest and other income (expense), net in our Consolidated Statements of Income. These contracts reduce the impact of currency exchange rate movements on our assets and liabilities. At November 29, 2019, the outstanding balance sheet hedging derivatives had maturities of 180 days or less.

*See Note 6 of our Notes to Consolidated Financial Statements for information regarding our derivative financial instruments.*

**Interest Rate Risk**

*Short-Term Investments and Fixed Income Securities*

At November 29, 2019, we had debt securities classified as short-term investments of $1.53 billion. Changes in interest rates could adversely affect the market value of these investments. A sensitivity analysis was performed on our investment portfolio as of November 29, 2019. The analysis is based on an estimate of the hypothetical changes in market value of the portfolio that would result from an immediate parallel shift in the yield curve of various magnitudes.

The following tables present the hypothetical fair values of our debt securities classified as short-term investments assuming immediate parallel shifts in the yield curve of 50 basis points ("BPS"), 100 BPS and 150 BPS. The analysis is shown as of November 29, 2019 and November 30, 2018:

*(dollars in millions)*

| -150 BPS | -100 BPS | -50 BPS | Fair Value 11/29/19 | +50 BPS | +100 BPS | +150 BPS |
|---|---|---|---|---|---|---|
| $ 1,544.8 | $ 1,538.8 | $ 1,532.8 | $ 1,526.8 | $ 1,520.7 | $ 1,514.7 | $ 1,508.7 |
| **-150 BPS** | **-100 BPS** | **-50 BPS** | **Fair Value 11/30/18** | **+50 BPS** | **+100 BPS** | **+150 BPS** |
| $ 1,617.5 | $ 1,607.1 | $ 1,596.6 | $ 1,586.2 | $ 1,575.7 | $ 1,565.3 | $ 1,554.8 |

*Term Loan*

As of November 29, 2019, our Term Loan's carrying value was $2.25 billion. At our election, the Term Loan will bear interest at either (i) LIBOR plus a margin, based on our debt ratings, ranging from 0.500% to 1.000% or (ii) a base rate plus a margin, based on our debt ratings, ranging from 0.040% to 0.110%. Interest is payable periodically, in arrears, at the end of each interest period we elect. An immediate hypothetical 50 basis points increase or decrease in market interest rates would not have a significant impact on our results of operations.

*Senior Notes*

As of November 29, 2019, the amount outstanding under our Notes was $1.9 billion. In June 2014, we entered into interest rate swaps that effectively converted the fixed interest rate on our 2020 Notes to a floating interest rate based on LIBOR plus a fixed number of basis points through February 1, 2020. Accordingly, our exposure to fluctuations in market interest rates is on the hedged fixed-rate debt of $900 million. An immediate hypothetical 50 basis points increase or decrease in market interest rates would not have a significant impact on our results of operations.

As of November 29, 2019, the total carrying amount of the Notes was $1.89 billion and the related fair value based on observable market prices in less active markets was $1.96 billion.

*Cash Flow Hedges of Interest Rate Risk*

In June 2019, in anticipation of refinancing our $2.25 billion Term Loan due April 30, 2020 and $900 million notes payable due February 1, 2020, we entered into Treasury lock agreements with large financial institutions which fixed benchmark U.S. Treasury rates for an aggregate notional amount of $1 billion of our future debt issuance. These derivative instruments hedge the impact of changes in the benchmark interest rate to future interest payments and will be terminated upon closing of our anticipated refinancing. We record changes in the fair value of these cash flow hedges of interest rate risk in accumulated other comprehensive income (loss) until the anticipated refinancing. Upon refinancing and termination of the derivative instruments, their fair value will be amortized over the term of our new debt to interest expense.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

### INDEX TO CONSOLIDATED FINANCIAL STATEMENTS



All financial statement schedules have been omitted, since the required information is not applicable or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Consolidated Financial Statements and Notes thereto.

# ADOBE INC.

## CONSOLIDATED BALANCE SHEETS

## (In thousands, except par value)

| | November 29, 2019 | November 30, 2018 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 2,650,221 | $ 1,642,775 |
| Short-term investments | 1,526,755 | 1,586,187 |
| Trade receivables, net of allowances for doubtful accounts of $9,650 and of $14,981, respectively | 1,534,809 | 1,315,578 |
| Prepaid expenses and other current assets | 783,140 | 312,499 |
| Total current assets | 6,494,925 | 4,857,039 |
| Property and equipment, net | 1,293,015 | 1,075,072 |
| Goodwill | 10,691,199 | 10,581,048 |
| Other intangibles, net | 1,720,565 | 2,069,001 |
| Other assets | 562,696 | 186,522 |
| Total assets | $ 20,762,400 | $ 18,768,682 |
| | | |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Trade payables | $ 209,499 | $ 186,258 |
| Accrued expenses | 1,398,548 | 1,163,185 |
| Debt | 3,149,343 | — |
| Deferred revenue | 3,377,986 | 2,915,974 |
| Income taxes payable | 55,562 | 35,709 |
| Total current liabilities | 8,190,938 | 4,301,126 |
| Long-term liabilities: | | |
| Debt | 988,924 | 4,124,800 |
| Deferred revenue | 122,727 | 137,630 |
| Income taxes payable | 616,102 | 644,101 |
| Deferred income taxes | 140,498 | 46,702 |
| Other liabilities | 173,056 | 152,209 |
| Total liabilities | 10,232,245 | 9,406,568 |
| | | |
| Commitments and contingencies | | |
| | | |
| Stockholders' equity: | | |
| Preferred stock, $0.0001 par value; 2,000 shares authorized; none issued | — | — |
| Common stock, $0.0001 par value; 900,000 shares authorized; 600,834 shares issued; 482,339 and 487,663 shares outstanding, respectively | 61 | 61 |
| Additional paid-in-capital | 6,504,800 | 5,685,337 |
| Retained earnings | 14,828,562 | 11,815,597 |
| Accumulated other comprehensive income (loss) | (188,034 ) | (148,130 ) |
| Treasury stock, at cost (118,495 and 113,171 shares, respectively), net of re-issuances | (10,615,234 ) | (7,990,751 ) |
| Total stockholders' equity | 10,530,155 | 9,362,114 |
| Total liabilities and stockholders' equity | $ 20,762,400 | $ 18,768,682 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE INC.**

**CONSOLIDATED STATEMENTS OF INCOME**

**(In thousands, except per share data)**

| | Years Ended | | |
|---|---|---|---|
| | November 29, 2019 | November 30, 2018 | December 1, 2017 |
| Revenue: | | | |
| Subscription | $ 9,994,463 | $ 7,922,152 | $ 6,133,869 |
| Product | 647,788 | 622,153 | 706,767 |
| Services and support | 529,046 | 485,703 | 460,869 |
| Total revenue | 11,171,297 | 9,030,008 | 7,301,505 |
| | | | |
| Cost of revenue: | | | |
| Subscription | 1,222,520 | 807,221 | 623,048 |
| Product | 39,625 | 46,009 | 57,082 |
| Services and support | 410,575 | 341,769 | 330,361 |
| Total cost of revenue | 1,672,720 | 1,194,999 | 1,010,491 |
| | | | |
| Gross profit | 9,498,577 | 7,835,009 | 6,291,014 |
| | | | |
| Operating expenses: | | | |
| Research and development | 1,930,228 | 1,537,812 | 1,224,059 |
| Sales and marketing | 3,244,347 | 2,620,829 | 2,197,592 |
| General and administrative | 880,637 | 744,898 | 624,706 |
| Amortization of intangibles | 175,244 | 91,101 | 76,562 |
| Total operating expenses | 6,230,456 | 4,994,640 | 4,122,919 |
| | | | |
| Operating income | 3,268,121 | 2,840,369 | 2,168,095 |
| | | | |
| Non-operating income (expense): | | | |
| Interest and other income (expense), net | 42,255 | 39,536 | 36,395 |
| Interest expense | (157,214) | (89,242) | (74,402) |
| Investment gains (losses), net | 51,579 | 3,213 | 7,553 |
| Total non-operating income (expense), net | (63,380) | (46,493) | (30,454) |
| Income before income taxes | 3,204,741 | 2,793,876 | 2,137,641 |
| Provision for income taxes | 253,283 | 203,102 | 443,687 |
| Net income | $ 2,951,458 | $ 2,590,774 | $ 1,693,954 |
| Basic net income per share | $ 6.07 | $ 5.28 | $ 3.43 |
| Shares used to compute basic net income per share | 486,291 | 490,564 | 493,632 |
| Diluted net income per share | $ 6.00 | $ 5.20 | $ 3.38 |
| Shares used to compute diluted net income per share | 491,572 | 497,843 | 501,123 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(In thousands)**

| | Years Ended | | |
|---|---|---|---|
| | November 29, 2019 | November 30, 2018 | December 1, 2017 |
| | Increase/(Decrease) | | |
| Net income | $ 2,951,458 | $ 2,590,774 | $ 1,693,954 |
| Other comprehensive income (loss), net of taxes: | | | |
| Available-for-sale securities: | | | |
| Unrealized gains / losses on available-for-sale securities | 29,409 | (24,464) | (2,503) |
| Reclassification adjustment for recognized gains / losses on available-for-sale securities | 124 | 10,650 | (947) |
| Net increase (decrease) from available-for-sale securities | 29,533 | (13,814) | (3,450) |
| Derivatives designated as hedging instruments: | | | |
| Unrealized gains / losses on derivative instruments | 294 | 74,080 | 6,917 |
| Reclassification adjustment for realized gains / losses on derivative instruments | (44,334) | (48,981) | (31,973) |
| Net increase (decrease) from derivatives designated as hedging instruments | (44,040) | 25,099 | (25,056) |
| Foreign currency translation adjustments | (25,397) | (47,594) | 90,287 |
| Other comprehensive income (loss), net of taxes | (39,904) | (36,309) | 61,781 |
| Total comprehensive income, net of taxes | $ 2,911,554 | $ 2,554,465 | $ 1,755,735 |

*See accompanying Notes to Consolidated Financial Statements.*

## ADOBE INC.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

## (In thousands)

| | Common Stock | | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | | Total |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | | | | Shares | Amount | |
| Balances at December 2, 2016 | 600,834 | $ 61 | $ 4,616,331 | $ 8,114,517 | $ (173,602) | (106,580) | $ (5,132,472) | $ 7,424,835 |
| Net income | — | — | — | 1,693,954 | — | — | — | 1,693,954 |
| Other comprehensive income (losses), net of taxes | — | — | — | — | 61,781 | — | — | 61,781 |
| Re-issuance of treasury stock under stock compensation plans | — | — | 1,768 | (234,601) | — | 5,194 | 151,058 | (81,775) |
| Purchase of treasury stock | — | — | — | — | — | (8,186) | (1,100,000) | (1,100,000) |
| Equity awards assumed for acquisition | — | — | 10,348 | — | — | — | — | 10,348 |
| Stock-based compensation | — | — | 453,748 | — | — | — | — | 453,748 |
| Value of shares in deferred compensation plan | — | — | — | — | — | — | (3,022) | (3,022) |
| Balances at December 1, 2017 | 600,834 | $ 61 | $ 5,082,195 | $ 9,573,870 | $ (111,821) | (109,572) | $ (6,084,436) | $ 8,459,869 |
| Net income | — | — | — | 2,590,774 | — | — | — | 2,590,774 |
| Other comprehensive income (losses), net of taxes | — | — | — | — | (36,309) | — | — | (36,309) |
| Re-issuance of treasury stock under stock compensation plans | — | — | (1,125) | (348,729) | — | 5,087 | 147,651 | (202,203) |
| Purchase of treasury stock | — | — | — | — | — | (8,686) | (2,050,000) | (2,050,000) |
| Equity awards assumed for acquisition | — | — | 2,784 | — | — | — | — | 2,784 |
| Stock-based compensation | — | — | 601,483 | — | — | — | — | 601,483 |
| Value of shares in deferred compensation plan | — | — | — | — | — | — | (3,966) | (3,966) |
| Impacts of the U.S. Tax Act | — | — | — | (318) | — | — | — | (318) |
| Balances at November 30, 2018 | 600,834 | $ 61 | $ 5,685,337 | $ 11,815,597 | $ (148,130) | (113,171) | $ (7,990,751) | $ 9,362,114 |
| Impacts of adoption of the new revenue standard | — | — | — | 442,319 | — | — | — | 442,319 |
| Net income | — | — | — | 2,951,458 | — | — | — | 2,951,458 |
| Other comprehensive income (losses), net of taxes | — | — | — | — | (39,904) | — | — | (39,904) |
| Re-issuance of treasury stock under stock compensation plans | — | — | 48,686 | (380,812) | — | 4,559 | 125,074 | (207,052) |
| | — | — | — | — | — | (9,883) | (2,750,000) | (2,750,000) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Purchase of treasury stock | | | | | | | | |
| Stock-based compensation | — | — | 770,777 | — | — | — | — | 770,777 |
| Value of shares in deferred compensation plan | — | — | — | — | — | — | 443 | 443 |
| Balances at November 29, 2019 | 600,834 | $ 61 | $ 6,504,800 | $ 14,828,562 | $ (188,034) | (118,495) | $ (10,615,234) | $ 10,530,155 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands)**

| | Years Ended | | |
|---|---|---|---|
| | **November 29, 2019** | **November 30, 2018** | **December 1, 2017** |
| Cash flows from operating activities: | | | |
| Net income | $ 2,951,458 | $ 2,590,774 | $ 1,693,954 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation, amortization and accretion | 736,669 | 346,492 | 325,997 |
| Stock-based compensation | 787,705 | 609,562 | 454,472 |
| Deferred income taxes | 2,707 | (468,936) | 51,605 |
| Unrealized losses (gains) on investments, net | (47,626) | 793 | (5,494) |
| Other non-cash items | 13,835 | 7,193 | 4,625 |
| Changes in operating assets and liabilities, net of acquired assets and assumed liabilities: | | | |
| Trade receivables, net | (187,826) | (1,983) | (187,173) |
| Prepaid expenses and other assets | (531,054) | (77,225) | 28,040 |
| Trade payables | 23,129 | 54,920 | (45,186) |
| Accrued expenses | 171,705 | 43,837 | 151,104 |
| Income taxes payable | 4,152 | 479,184 | (34,493) |
| Deferred revenue | 496,959 | 444,693 | 475,402 |
| Net cash provided by operating activities | 4,421,813 | 4,029,304 | 2,912,853 |
| Cash flows from investing activities: | | | |
| Purchases of short-term investments | (699,893) | (566,084) | (1,931,011) |
| Maturities of short-term investments | 699,540 | 765,860 | 759,737 |
| Proceeds from sales of short-term investments | 86,137 | 1,709,480 | 1,393,929 |
| Acquisitions, net of cash acquired | (100,704) | (6,314,382) | (459,626) |
| Purchases of property and equipment | (394,479) | (266,579) | (178,122) |
| Purchases of long-term investments, intangibles and other assets | (48,735) | (18,513) | (29,918) |
| Proceeds from sale of long-term investments and other assets | 2,550 | 4,923 | 2,134 |
| Net cash used for investing activities | (455,584) | (4,685,295) | (442,877) |
| Cash flows from financing activities: | | | |
| Purchases of treasury stock | (2,750,000) | (2,050,000) | (1,100,000) |
| Proceeds from re-issuance of treasury stock | 232,932 | 190,990 | 158,351 |
| Taxes paid related to net share settlement of equity awards | (439,984) | (393,193) | (240,126) |
| Proceeds from debt issuance, net of costs | — | 2,248,342 | — |
| Other financing activities, net | 11,008 | (1,707) | (1,960) |
| Net cash used for financing activities | (2,946,044) | (5,568) | (1,183,735) |
| Effect of foreign currency exchange rates on cash and cash equivalents | (12,739) | (1,738) | 8,516 |
| Net increase (decrease) in cash and cash equivalents | 1,007,446 | (663,297) | 1,294,757 |
| Cash and cash equivalents at beginning of year | 1,642,775 | 2,306,072 | 1,011,315 |
| Cash and cash equivalents at end of year | $ 2,650,221 | $ 1,642,775 | $ 2,306,072 |
| Supplemental disclosures: | | | |
| Cash paid for income taxes, net of refunds | $ 352,478 | $ 210,369 | $ 396,668 |
| Cash paid for interest | $ 152,075 | $ 81,258 | $ 69,430 |
| Non-cash investing activities: | | | |
| Investment in lease receivable applied to building purchase | $ — | $ — | $ 80,439 |

| | | | |
|---|---|---|---|
| Issuance of common stock and stock awards assumed in business acquisitions | $ — | $ 2,784 | $ 10,348 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## NOTE 1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

*Operations*

Founded in 1982, Adobe Inc. is one of the largest and most diversified software companies in the world. We offer a line of products and services used by creative professionals, marketers, knowledge workers, students, application developers, enterprises and consumers for creating, managing, delivering, measuring, optimizing, engaging and transacting with compelling content and experiences across personal computers, devices and media. We market our products and services directly to enterprise customers through our sales force and local field offices. We license our products to end users through app stores and our own website at www.adobe.com. We offer many of our products via a Software-as-a-Service ("SaaS") model or a managed services model (both of which are referred to as hosted or cloud-based) as well as through term subscription and pay-per-use models. We also distribute certain products and services through a network of distributors, value-added resellers, systems integrators, independent software vendors, retailers, software developers and original equipment manufacturers ("OEMs"). In addition, we license our technology to hardware manufacturers, software developers and service providers for use in their products and solutions. Our products run on personal and server-based computers, as well as on smartphones, tablets and other devices, depending on the product. We have operations in the Americas, Europe, Middle East and Africa ("EMEA"), and Asia-Pacific ("APAC").

*Basis of Presentation*

The accompanying Consolidated Financial Statements include those of Adobe and its subsidiaries, after elimination of all intercompany accounts and transactions. We have prepared the accompanying Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") and pursuant to the rules and regulations of the United States Securities and Exchange Commission (the "SEC").

*Use of Estimates*

In preparing Consolidated Financial Statements and related disclosures in conformity with GAAP and pursuant to the rules and regulations of the SEC, we must make estimates and judgments that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Estimates are used for, but not limited to, sales allowances and programs, bad debts, stock-based compensation, determining the fair value of acquired assets and assumed liabilities, impairment of goodwill and intangible assets, litigation and income taxes. Actual results may differ materially from these estimates.

*Fiscal Year*

Our fiscal year is a 52- or 53-week year that ends on the Friday closest to November 30. Fiscal years 2019, 2018 and 2017 were 52-week years.

*Reclassifications*

Certain immaterial prior year amounts have been reclassified to conform to current year presentation in the Notes to Consolidated Financial Statements.

ADOBE INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**Recently Adopted Accounting Guidance**

On May 28, 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers, Topic 606, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. Topic 606 also includes Subtopic 340-40, Other Assets and Deferred Costs - Contracts with Customers, which requires the capitalization of incremental costs to obtain a contract with a customer. The new revenue standard replaces most existing revenue recognition guidance in GAAP and permits the use of either the full retrospective or modified retrospective transition method.

On December 1, 2018, the beginning of our fiscal year 2019, we adopted the requirements of the new revenue standard utilizing the modified retrospective method of transition. Prior period information has not been restated and continues to be reported under the accounting standard in effect for those periods. We applied the new revenue standard to contracts that were not completed as of the adoption date, consistent with the transition guidance. Further, adoption of the new revenue standard resulted in changes to our accounting policies for revenue recognition and sales commissions as detailed below.

We recognized the following cumulative effects of initially applying the new revenue standard as of December 1, 2018:

| *(in thousands)* | As of November 30, 2018 | Topic 606 Adoption Adjustments | As of December 1, 2018 |
|---|---|---|---|
| Assets | | | |
| Trade receivables, net of allowances for doubtful accounts | $ 1,315,578 | $ 43,028 | $ 1,358,606 |
| Prepaid expenses and other current assets | 312,499 | 186,220 | 498,719 |
| Other assets | 186,522 | 273,421 | 459,943 |
| Liabilities and Stockholders' Equity | | | |
| Accrued expenses | 1,163,185 | 30,358 | 1,193,543 |
| Deferred revenue, current | 2,915,974 | (52,842 ) | 2,863,132 |
| Deferred income taxes | 46,702 | 82,834 | 129,536 |
| Retained earnings | $ 11,815,597 | $ 442,319 | $ 12,257,916 |

Below is a summary of the adoption impacts of the new revenue standard:

- We capitalized $413.2 million of contract acquisition costs comprised of sales and partner commission costs at adoption date (included in prepaid expenses and other current assets for the current portion and other assets for the long-term portion), with a corresponding adjustment to retained earnings. We are amortizing these costs over their respective expected period of benefit.

- Revenue for certain contracts that were previously deferred would have been recognized in periods prior to adoption under the new standard. Upon adoption, we recorded the following adjustments to our beginning balances to reflect the amount of revenue that will no longer be recognized in future periods for such contracts: an increase in unbilled receivables (included in trade receivables, net) of $24.8 million, an increase in contract assets (included in prepaid expenses and other current assets for the current portion and other assets for the long-term portion) of $46.4 million and a decrease in deferred revenue of $52.8 million, with corresponding adjustments to retained earnings.

- We recorded an increase to our opening deferred income tax liability of $82.8 million, with a corresponding adjustment to retained earnings, to record the tax effect of the above adjustments.

- Further, we had other impacts to various accounts which resulted to an immaterial net reduction to our retained earnings.

**ADOBE INC.**

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

Adoption of the new revenue standard impacted our Consolidated Statements of Income for the year ended November 29, 2019 as follows:

| *(in thousands, except per share amounts)* | As reported | Adjustments | Balances without Topic 606 adoption impact |
|---|---|---|---|
| Revenue | | | |
| Subscription | $ 9,994,463 | $ 1,440 | $ 9,995,903 |
| Product | 647,788 | (101,981) | 545,807 |
| Services and support | 529,046 | (7,431) | 521,615 |
| Total revenue | 11,171,297 | (107,972) | 11,063,325 |
| Operating expenses | | | |
| Sales and marketing | 3,244,347 | 11,987 | 3,256,334 |
| General and administrative | 880,637 | (7,646) | 872,991 |
| Provision for income taxes | 253,283 | (6,517) | 246,766 |
| Net income | $ 2,951,458 | $ (105,953) | $ 2,845,505 |
| Basic net income per share | $ 6.07 | $ (0.22) | $ 5.85 |
| Diluted net income per share | $ 6.00 | $ (0.21) | $ 5.79 |

Adoption of the new revenue standard impacted our Consolidated Balance Sheets as of November 29, 2019 as follows:

| *(in thousands)* | As reported | Adjustments | Balances without Topic 606 adoption impact |
|---|---|---|---|
| Assets | | | |
| Trade receivables, net of allowances for doubtful accounts | $ 1,534,809 | $ (58,140) | $ 1,476,669 |
| Prepaid expenses and other current assets | 783,140 | (198,692) | 584,448 |
| Other assets | 562,696 | (340,458) | 222,238 |
| Liabilities and Stockholders' Equity | | | |
| Accrued expenses | 1,398,548 | (51,918) | 1,346,630 |
| Deferred revenue, current | 3,377,986 | 113,432 | 3,491,418 |
| Deferred revenue, long-term | 122,727 | (14,723) | 108,004 |
| Income taxes payable, long-term | 616,102 | (7,112) | 608,990 |
| Deferred income taxes | 140,498 | (88,697) | 51,801 |
| Retained earnings | $ 14,828,562 | $ (548,272) | $ 14,280,290 |

There was no net impact to our Consolidated Statements of Comprehensive Income and Consolidated Statements of Cash Flows resulting from the adoption of the new revenue standard other than the impact to reported net income as presented above. The impact to our Consolidated Statements of Stockholders' Equity was only to retained earnings, as presented above.

The most significant impact of the new revenue standard relates to our capitalization of certain incremental costs to acquire contracts and the requirement to amortize these amounts over the expected period of benefit. Under the previous standard, we expensed costs related to the acquisition of revenue-generating contracts as incurred. Additionally, there was impact from arrangements with our customers that include on-premise term-based software licenses bundled with maintenance and support. Under the previous standard, revenue attributable to these software licenses was recognized ratably over the term of the arrangement because vendor-specific objective evidence

(“VSOE”) did not exist for the undelivered maintenance and support element as it is not sold separately. The requirement to have VSOE for undelivered elements to enable the separation of revenue recognition for delivered software licenses is eliminated under the new revenue standard. Accordingly, under the new revenue standard we recognize as revenue a portion of the arrangement fee upon delivery of the software licenses and classify that recognized revenue as product revenue instead of subscription revenue in our Consolidated Statements of Income.

**ADOBE INC.**

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

Other impacts to our policies and disclosures include earlier recognition of revenue for certain contracts due to the elimination of contingent revenue limitations, the requirement to estimate variable consideration for certain arrangements, increased allocation of revenue to and from professional services and other offerings and changes to our financial statement disclosures such as new disclosures related to our remaining performance obligations. However, the timing and pattern of revenue recognition related to our professional services and cloud-enabled offerings, including Creative Cloud and Document Cloud for enterprises, individuals and teams, remain substantially unchanged. When Creative Cloud and Document Cloud are sold with cloud-enabled services, the on-premise/on-device software licenses and cloud-enabled services are so highly interrelated and interdependent that they are not each separately identifiable within the context of the contract and therefore not distinct from each other. Revenue for these offerings continues to be recognized ratably over the subscription period for which the cloud-enabled services are provided.

There have been no other new accounting pronouncements made effective during fiscal 2019 that have significance, or potential significance, to our Consolidated Financial Statements.

**Significant Accounting Policies**

*Revenue Recognition*

Our revenue is derived from the sale of cloud-enabled software subscriptions, cloud-hosted offerings, term-based, royalty, and perpetual software licenses, associated software maintenance and support plans, consulting services, training and technical support. Most of our enterprise customer arrangements involve multiple promises to our customers.

Revenue is recognized when a contract exists between us and a customer and upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We enter into contracts that can include various combinations of products and services, which may be capable of being distinct and accounted for as separate performance obligations, or in the case of offerings such as cloud-enabled Creative Cloud and Document Cloud, accounted for as a single performance obligation. Revenue is recognized net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities.

*Product, Subscription and Services Offerings*

We enter into revenue arrangements in which a customer may purchase a combination of cloud-enabled subscriptions, cloud-hosted offerings, term-based, royalty, and perpetual software licenses, associated software maintenance and support plans, consulting services, training and technical support.

Fully hosted subscription services (SaaS) allow customers to access hosted software during the contractual term without taking possession of the software. Cloud-hosted subscription services may be sold on a fee-per-subscription period basis or based on consumption or usage.

We recognize revenue ratably over the contractual service term for hosted services that are priced based on a committed number of transactions where the delivery and consumption of the benefit of the services occur evenly over time, beginning on the date the services associated with the committed transactions are first made available to the customer and continuing through the end of the contractual service term. Over-usage fees and fees based on the actual number of transactions are billed in accordance with contract terms as these fees are incurred and are included in the transaction price of an arrangement as variable consideration. Fees based on a number of transactions or impressions per month, where invoicing is aligned to the pattern of performance, customer benefit and consumption, are typically accounted for utilizing the “as-invoiced” practical expedient. Revenue for subscriptions sold as a fee per period is recognized ratably over the contractual term as the customer simultaneously receives and consumes the benefit of the underlying service.

When cloud-enabled services are highly integrated and interrelated with on-premise software, such as in our cloud-enabled Creative Cloud and Document Cloud offerings, the individual components are not considered distinct and revenue is recognized ratably over the subscription period for which the cloud-enabled services are provided.

Licenses for on-premise software may be purchased on a perpetual basis, as a subscription for a fixed period of time or based on usage for certain of our OEM and royalty agreements. Revenue from distinct on-premise licenses is recognized at the point in time the software is available to the customer, provided all other revenue recognition criteria are met, and classified as product revenue on our Consolidated Statements of Income. Some of our enterprise license arrangements allow customers to commit non-cancellable funds. These non-cancellable committed funds are nonrefundable and provide our customers options to either renew monthly on-premise term-based licenses or use some or all funds to purchase other Adobe products or services. Revenue associated with these monthly term-based licenses is classified as subscription revenue.

Our services and support revenue is composed of consulting, training, and maintenance and support, primarily related to our enterprise offerings. Our support revenue also includes technical support and developer support to partners and developer organizations related to our desktop products. We typically sell our consulting contracts on a time-and-materials basis and recognize the related revenue as services are rendered. We typically sell our maintenance and support contracts on a flat fee or percentage of associated license fees basis and recognize the related revenue ratably over the support term as the underlying service is a stand-ready performance obligation.

We exclude from the transaction price sales and other taxes collected from customers on behalf of the relevant government authority. Most of our products are delivered electronically, however in instances where shipping and handling costs are incurred, we treat these amounts as costs to fulfill the contract and they are not considered a performance obligation and the associated fees are not included in the transaction price.

*Judgments*

Our contracts with customers may include multiple goods and services. For example, some of our offerings include both on-premise and/or on-device software licenses and cloud services. Determining whether the software licenses and the cloud services are distinct from each other, and therefore performance obligations to be accounted for separately, or not distinct from each other, and therefore part of a single performance obligation, may require significant judgment. We have concluded that the on-premise/on-device software licenses and cloud services provided in our Creative Cloud and Document Cloud subscription offerings are not distinct from each other such that revenue from each offering should be recognized ratably over the subscription period for which the cloud services are provided. In reaching this conclusion, we considered the nature of our promise to Creative Cloud and Document Cloud customers, which is to provide a complete end-to-end creative design or document workflow solution that operates seamlessly across multiple devices and teams. We fulfill this promise by providing access to a solution that integrates cloud-based and on-premise/on-device features that, together through their integration, provide functionalities, utility and workflow efficiencies that could not be obtained from either the on-premise/on-device software or cloud services on their own.

Cloud-based features that are integral to our Creative Cloud and Document Cloud offerings and that work together with the on-premise/on-device software include, but are not limited to: Creative Cloud Libraries, which enable customers to access their work, settings, preferences, and other assets seamlessly across desktop and mobile devices and collaborate across teams in real time; shared reviews which enable simultaneous editing and commenting of PDFs across desktop, mobile and web; automatic cloud rendering of a design which enables it to be worked on in multiple mediums; and Sensei, Adobe's cloud-hosted artificial intelligence and machine learning framework, which enables features such as automated photo-editing, photograph content-awareness, natural language processing, optical character recognition and automated document tagging.

Standalone selling price is established by maximizing the amount of observable inputs, primarily actual historical selling prices for performance obligations where available, and includes consideration of factors such as go-to-market model and geography. Individual products may have multiple values for standalone selling price depending on factors such as where they are sold and what channel they are sold through. Where standalone selling price may not be directly observable (e.g., the performance obligation is not sold separately), we maximize the use of observable inputs by using information that may include reviewing pricing practices, performance obligations with similar customers and selling models.

Capitalized costs to obtain a contract are amortized over the expected period of benefit, which we have determined, based on analysis, to be 5 years. We evaluated qualitative and quantitative factors to determine the period of amortization, including contract length, renewals, customer life and the useful lives of our products and acquired products. When the expected period of benefit of an asset which would be capitalized is less than one year, we expense the amount as incurred, utilizing the practical expedient. We regularly evaluate whether there have been changes in the underlying assumptions and data used to determine the amortization period.

When revenue arrangements include components of third-party goods and services, for example in transactions which involve resale, fulfillment or providing advertising impressions to our end customer, we evaluate whether we are the principal, and report revenues on a gross basis, or an agent, and report revenues on a net basis. In this assessment, we consider if we obtain control of the specified goods or services before they are transferred to the customer by evaluating indicators such as which party is primarily responsible for fulfilling the promise to provide the goods or services, which party has discretion in establishing price and the underlying terms and conditions between the parties to the transaction.

We offer limited rights of return, rebates and price protection of our products under various policies and programs with our distributors, resellers and/or end-user customers. We estimate and record reserves for these programs as variable consideration when estimating transaction price. Returns, rebates and other offsets to transaction price are estimated at contract inception on a portfolio basis and assessed for reasonableness each reporting period when additional information becomes available.

*General Contract Provisions*

We maintain revenue reserves for rebates, rights of return and other limited price adjustments.

Distributors are allowed limited rights of return of products purchased during the previous quarter. In addition, distributors are allowed to return products that have reached the end of their lives, as defined by us, and for products that are being replaced by new versions.

We offer rebates to our distributors, resellers and/or end-user customers. Transaction price is reduced for these amounts based on actual performance against objectives set forth by us for a particular reporting period, such as volume and timely reporting.

On a quarterly basis, the amount of revenue that is reserved is calculated based on our historical trends and data specific to each reporting period. The primary method of establishing these reserves is to review historical data from prior periods as a percent of revenue to determine a historical reserve rate. We then apply the historical rate to the current period revenue as a basis for estimating future returns. When necessary, we also provide a specific reserve in excess of portfolio-level estimated requirements. This estimate can be affected by the amount of a particular product in the channel, the rate of sell-through, product plans and other factors.

Although our subscription contracts are generally non-cancellable, a limited number of customers have the right to cancel their contracts by providing prior written notice to us of their intent to cancel the remainder of the contract term and consumers have a period of time to terminate certain agreements without penalty. In the event a customer cancels their contract, they are generally not entitled to a refund for prior services we have provided to them. Contracts that include termination rights without substantive penalty are accounted for as contracts only for the committed period. Periods of time after the right of termination are accounted for as optional purchases when they do not represent material rights. For certain of our usage-based license agreements, typically in our royalty and OEM businesses, reporting may be received after the end of a fiscal period. In such instances, we estimate and accrue license revenue. We base our estimates on multiple factors, including historical sales information, seasonality and other business information which may impact our estimates. We do not estimate variable consideration for our sales and usage-based license royalty agreements, consistent with the associated exception for sales and usage-based royalties for the license of intellectual property under the new revenue standard.

*Property and Equipment*

We record property and equipment at cost less accumulated depreciation and amortization. Property and equipment are depreciated using the straight-line method over their estimated useful lives ranging from 1 to 20 years for computers and other equipment, which includes our corporate jet, 1 to 6 years for furniture and fixtures, 5 to 20 years for building improvements and up to 40 years for buildings. Leasehold improvements are amortized using the straight-line method over the lesser of the remaining respective lease term or estimated useful lives ranging from 1 to 15 years.

*Goodwill, Intangibles and Other Long-Lived Assets*

Goodwill is assigned to one or more reporting segments on the date of acquisition. We review our goodwill for impairment annually during our second quarter of each fiscal year and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of any one of our reporting units below its respective carrying amount. In performing our goodwill impairment test, we first perform a qualitative assessment, which requires that we consider events or circumstances including macroeconomic conditions, industry and market considerations, cost factors, overall financial performance, changes in management or key personnel, changes in strategy, changes in customers, changes in the composition or carrying amount of a reporting segment's net assets and changes in our stock price. If, after assessing the totality of events or circumstances, we determine that it is more likely than not that the fair values of our reporting segments are greater than the carrying amounts, then the quantitative goodwill impairment test is not performed.

If the qualitative assessment indicates that the quantitative analysis should be performed, we then evaluate goodwill for impairment by comparing the fair value of each of our reporting segments to its carrying value, including the associated goodwill. To determine the fair values, we use the equal weighting of the market approach based on comparable publicly traded companies in similar lines of businesses and the income approach based on estimated discounted future cash flows. Our cash flow assumptions consider historical and forecasted revenue, operating costs and other relevant factors.

We completed our annual goodwill impairment test in the second quarter of fiscal 2019. We determined, after performing a qualitative review of each reporting segment, that it is more likely than not that the fair value of each of our reporting segments substantially exceeds the respective carrying amounts. Accordingly, there was no indication of impairment and the quantitative goodwill impairment test was not performed. We did not identify any events or changes in circumstances since the performance of our annual goodwill impairment test that would require us to perform another goodwill impairment test during the fiscal year.

We amortize intangible assets with finite lives over their estimated useful lives and review them for impairment whenever an impairment indicator exists. We continually monitor events and changes in circumstances that could indicate carrying amounts of our long-lived assets, including our intangible assets, may not be recoverable. When such events or changes in circumstances occur, we assess recoverability by determining whether the carrying value of such assets will be recovered through the undiscounted expected future cash flows. If the future undiscounted cash flows are less than the carrying amount of these assets, we recognize an impairment loss based on any excess of the carrying amount over the fair value of the assets. We did not recognize any intangible asset impairment charges in fiscal 2019, 2018 or 2017.

During fiscal 2019, our intangible assets were amortized over their estimated useful lives ranging from 1 to 15 years. Amortization is based on the pattern in which the economic benefits of the intangible asset will be consumed or on a straight-line basis when the consumption pattern is not apparent. The weighted average useful lives of our intangible assets were as follows:

| | Weighted Average Useful Life (years) |
|---|---|
| Customer contracts and relationships | 10 |
| Purchased technology | 6 |
| Trademarks | 9 |
| Backlog | 2 |
| Acquired rights to use technology | 10 |
| Other | 4 |

*Income Taxes*

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. We record a valuation allowance to reduce deferred tax assets to an amount for which realization is more likely than not.

*Taxes Collected from Customers*

We net taxes collected from customers against those remitted to government authorities in our financial statements. Accordingly, taxes collected from customers are not reported as revenue.

*Treasury Stock*

We account for treasury stock under the cost method. When treasury stock is re-issued at a price higher than its cost, the difference is recorded as a component of additional paid-in-capital in our Consolidated Balance Sheets. When treasury stock is re-issued at a price lower than its cost, the difference is recorded as a component of additional paid-in-capital to the extent that there are previously recorded gains to offset the losses. If there are no treasury stock gains in additional paid-in-capital, the losses upon re-issuance of treasury stock are recorded as a reduction of retained earnings in our Consolidated Balance Sheets.

*Advertising Expenses*

Advertising costs are expensed as incurred. Advertising expenses for fiscal 2019, 2018 and 2017 were $221.1 million, $173.6 million and $141.7 million, respectively.

*Foreign Currency Translation*

We translate assets and liabilities of foreign subsidiaries, whose functional currency is their local currency, at exchange rates in effect at the balance sheet date. We translate revenue and expenses at the monthly average exchange rates. We include accumulated net translation adjustments in stockholders' equity as a component of accumulated other comprehensive income (loss).

*Derivative Financial Instruments*

In countries outside the United States, we transact business in U.S. Dollars and in various other currencies. We may use foreign exchange option and forward contracts to hedge a portion of our forecasted foreign currency denominated revenue primarily in Euros, British Pounds and Japanese Yen. We hedge our net recognized foreign currency assets and liabilities with foreign exchange forward contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates.

We recognize all derivative instruments as either assets or liabilities in our Consolidated Balance Sheets and measure them at fair value. Gains and losses resulting from changes in fair value are accounted for depending on the use of the derivative and whether it is designated and qualifies for hedge accounting. Contracts that do not qualify for hedge accounting are adjusted to fair value through earnings.

Gains and losses related to changes in the fair value of interest rate swaps and foreign exchange forward contracts which hedge certain balance sheet positions are recorded each period as a component of interest and other income (expense), net in our Consolidated Statements of Income. Foreign exchange option contracts hedging forecasted foreign currency revenue and Treasury lock agreements are designated as cash flow hedges with gains and losses recorded net of tax as a component of accumulated other comprehensive income (loss) in our Consolidated Balance Sheets, until the forecasted transaction occurs. When the forecasted transaction affects earnings, we reclassify the related gain or loss on the foreign currency and Treasury lock cash flow hedges to revenue and interest expense, respectively.

*Concentration of Risk*

Financial instruments that potentially subject us to concentrations of credit risk are short-term fixed-income investments, structured repurchase transactions, foreign currency and interest rate hedge contracts and trade receivables.

Our investment portfolio consists of investment-grade securities diversified among security types, industries and issuers. Our cash and investments are held and primarily managed by recognized financial institutions that follow our investment policy. Our policy limits the amount of credit exposure to any one security issue or issuer and we believe no significant concentration of credit risk exists with respect to these investments.

We enter into master netting arrangements to mitigate credit risk in derivative transactions by permitting net settlement of transactions with the same counterparty. We also enter into collateral security agreements with certain of our counterparties to exchange cash collateral when the net fair value of certain derivative instruments fluctuates from contractually established thresholds.

Credit risk in receivables is limited to OEMs, dealers and distributors of hardware and software products to the retail market, customers to whom we license software directly and our SaaS offerings. A credit review is completed for our new distributors, dealers and OEMs. We also perform ongoing credit evaluations of our customers' financial condition and require letters of credit or other guarantees, whenever deemed necessary. The credit limit given to the customer is based on our risk assessment of their ability to pay, country risk and other factors and is not contingent on the resale of the product or on the collection of payments from their customers. Certain contracts with advertising agencies contain sequential liability provisions, under which the agency is not required to pay until payment is received from the agency's customers. In these circumstances, we evaluate the credit-worthiness of the agency's customers in addition to the agency itself. If we license our software or provide SaaS services to a customer where we have a reason to believe the customer's ability and intention to pay is not probable, the arrangement is not considered to be a revenue contract. Accordingly, we will not recognize any consideration received as revenue until termination or substantive completion of the services.

**Recent Accounting Pronouncements Not Yet Effective**

On February 24, 2016, the FASB issued ASU No. 2016-02, Leases, requiring lessees to recognize a right-of-use asset and a lease liability on the balance sheet for all leases with the exception of short-term leases with a lease term of twelve months or less. For lessees, leases will continue to be classified as either operating or finance leases in the income statement. Lessor accounting is similar to the current model but updated to align with certain changes to the lessee model. Lessors will continue to classify leases as operating, direct financing or sales-type leases. The effective date of the new leases standard for public companies is for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted. The new leases standard is effective for us beginning in the first quarter of fiscal 2020, and we did not early adopt.

The new leases standard must be adopted using a modified retrospective transition method and allows for the application of the new guidance at the beginning of the earliest comparative period presented or at the adoption date. In July 2018, the FASB issued ASU No. 2018-11, Leases - Targeted Improvements, providing an optional transition method that allows entities to initially apply the new leases standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. We will adopt the new leases standard using this optional transition method.

We have completed our assessment of the impacts of the standard, and note that the most significant impact will be the recognition of right-of-use assets and lease liabilities on our Consolidated Balance Sheets. The standard will not have a material impact to our Consolidated Statements of Income and Cash Flows. We are in the final stages of implementing a new lease accounting system and updating our processes for the adoption of the new leases standard.

On August 28, 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging, requiring expanded hedge accounting for both non-financial and financial risk components and refining the measurement of hedge results to better reflect an entity's hedging strategies. For example, adoption would result in reclassification of hedge costs from foreign currency hedges from interest and other income (expense), net to revenue in our Consolidated Statements of Income. The updated standard also amends the presentation and disclosure requirements and changes how entities assess hedge effectiveness. The effective date of the new standard for public companies is for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted. The new standard must be adopted using a modified retrospective transition with a cumulative-effect adjustment recorded to opening retained earnings as of the initial adoption date. The updated standard is effective for us beginning in the first quarter of fiscal 2020, and will not have a material impact on our Consolidated Financial Statements and related disclosures.

With the exception of the new standards discussed above, there have been no other new accounting pronouncements that have significance, or potential significance, to our Consolidated Financial Statements.

## NOTE 2. REVENUE

*Segment Information*

We report segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of our reportable segments.

Our Chief Executive Officer, the chief operating decision maker, reviews revenue and gross margin information for each of our reportable segments, but does not review operating expenses on a segment by segment basis. In addition, with the exception of goodwill and intangible assets, we do not identify or allocate our assets by the reportable segments.

Our business is organized into three reportable segments: Digital Media, Digital Experience and Publishing. These segments provide our senior management with a comprehensive financial view of our key businesses. Our segments are aligned around our two strategic growth opportunities as described in the "Business Overview" within Part I, Item 1, placing our Publishing business in a third segment that contains some of our mature products and solutions.

In fiscal 2019, we categorized our products into the following reportable segments:

- *Digital Media*—Our Digital Media segment provides tools and solutions that enable individuals, teams and enterprises to create, publish, promote and monetize their digital content anywhere. Our customers include content creators, experience designers, app developers, enthusiasts, students, social media users and creative professionals, as well as marketing departments and agencies, companies and publishers. Our customers also include knowledge workers who create, collaborate on and distribute documents and creative content.

- *Digital Experience*—Our Digital Experience segment provides products, services and solutions for creating, managing, executing, measuring, monetizing and optimizing customer experiences from advertising to commerce. Our customers include marketers, advertisers, agencies, publishers, merchandisers, merchants, web analysts, data scientists, developers, marketing executives, information management and technology executives, product development executives, and sales and support executives.

- *Publishing*—Our Publishing segment addresses market opportunities ranging from the diverse authoring and publishing needs of technical and business publishing to our legacy type and OEM printing businesses. It also includes our web conferencing and document and forms platforms.

Revenue for fiscal 2019 presented below is in accordance with the new revenue standard that was adopted under the modified retrospective method. Prior period revenue has not been restated.

Our segment revenue and results for fiscal 2019, 2018 and 2017 were as follows:

| *(dollars in thousands)* | Digital Media | Digital Experience | Publishing | Total |
|---|---|---|---|---|
| **Fiscal 2019** | | | | |
| Revenue | $ 7,706,983 | $ 3,206,169 | $ 258,145 | $ 11,171,297 |
| Cost of revenue | 289,639 | 1,362,886 | 20,195 | 1,672,720 |
| Gross profit | $ 7,417,344 | $ 1,843,283 | $ 237,950 | $ 9,498,577 |
| Gross profit as a percentage of revenue | 96 % | 57 % | 92 % | 85 % |
| **Fiscal 2018** | | | | |
| Revenue | $ 6,325,315 | $ 2,443,745 | $ 260,948 | $ 9,030,008 |
| Cost of revenue | 249,386 | 922,414 | 23,199 | 1,194,999 |
| Gross profit | $ 6,075,929 | $ 1,521,331 | $ 237,749 | $ 7,835,009 |
| Gross profit as a percentage of revenue | 96 % | 62 % | 91 % | 87 % |
| **Fiscal 2017** | | | | |
| Revenue | $ 5,010,579 | $ 2,030,324 | $ 260,602 | $ 7,301,505 |
| Cost of revenue | 239,994 | 747,005 | 23,492 | 1,010,491 |
| Gross profit | $ 4,770,585 | $ 1,283,319 | $ 237,110 | $ 6,291,014 |
| Gross profit as a percentage of revenue | 95 % | 63 % | 91 % | 86 % |

Revenue by geographic area for fiscal 2019, 2018 and 2017 were as follows:

| *(in thousands)* | 2019 | 2018 | 2017 |
|---|---|---|---|
| Americas: | | | |
| United States | $ 5,904,185 | $ 4,632,469 | $ 3,830,845 |
| Other | 601,721 | 484,296 | 385,686 |
| Total Americas | 6,505,906 | 5,116,765 | 4,216,531 |
| EMEA | 2,975,243 | 2,550,062 | 1,985,105 |
| APAC: | | | |
| Japan | 751,542 | 609,361 | 524,254 |
| Other | 938,606 | 753,820 | 575,615 |
| Total APAC | 1,690,148 | 1,363,181 | 1,099,869 |
| Revenue | $ 11,171,297 | $ 9,030,008 | $ 7,301,505 |

Revenue by major offerings in our Digital Media reportable segment for fiscal 2019, 2018 and 2017 were as follows:

| *(in thousands)* | 2019 | 2018 | 2017 |
|---|---|---|---|
| Creative Cloud | $ 6,482,345 | $ 5,343,498 | $ 4,173,964 |
| Document Cloud | 1,224,638 | 981,817 | 836,615 |
| Total | $ 7,706,983 | $ 6,325,315 | $ 5,010,579 |

Subscription revenue by segment for fiscal 2019, 2018 and 2017 were as follows:

| *(in thousands)* | 2019 | 2018 | 2017 |
|---|---|---|---|
| Digital Media | $ 7,208,238 | $ 5,857,700 | $ 4,480,745 |
| Digital Experience | 2,670,748 | 1,949,185 | 1,552,536 |
| Publishing | 115,477 | 115,267 | 100,588 |
| Total | $ 9,994,463 | $ 7,922,152 | $ 6,133,869 |

*Contract Balances*

*Trade Receivables*

A receivable is recorded when an unconditional right to invoice and receive payment exists, such that only the passage of time is required before payment of consideration is due. Timing of revenue recognition may differ from the timing of invoicing to customers. Certain performance obligations may require payment before delivery of the license or service to the customer. Included in trade receivables on the Consolidated Balance Sheets are unbilled receivable balances which have not yet been invoiced, and are typically related to license revenue or services which are delivered prior to invoicing occurring.

The opening balance of trade receivables, net of allowances for doubtful accounts, as of December 1, 2018 was $1.36 billion, inclusive of unbilled receivables of $105.8 million. As of November 29, 2019, the balance of trade receivables, net of allowances for doubtful accounts, was $1.53 billion, inclusive of unbilled receivables of $149.3 million.

**ADOBE INC.**

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

*Allowance for Doubtful Accounts*

We maintain an allowance for doubtful accounts which reflects our best estimate of potentially uncollectible trade receivables. The allowance is based on both specific and general reserves. We regularly review our trade receivables allowance by considering factors such as historical experience, credit-worthiness, the age of the trade receivable balances and current economic conditions that may affect a customer's ability to pay and we specifically reserve for those deemed uncollectible.

During fiscal 2019, 2018 and 2017, our allowance for doubtful accounts activities were as follows:

| *(in thousands)* | 2019 | 2018 | 2017 |
|---|---|---|---|
| Beginning balance | $ 14,981 | $ 9,151 | $ 6,214 |
| Increase due to acquisition | 10 | 5,602 | 2,391 |
| Charged to operating expenses | 5,324 | 5,962 | 4,411 |
| Deductions[(1)] | (10,665) | (5,734) | (3,865) |
| Ending balance | $ 9,650 | $ 14,981 | $ 9,151 |

(1) Deductions related to the allowance for doubtful accounts represent amounts written off against the allowance, less recoveries.

*Contract Assets*

A contract asset is recognized when a conditional right to consideration exists and transfer of control has occurred. Contract assets are typically related to subscription and hosted service contracts where the transaction price allocated to the satisfied performance obligations exceeds the value of billings to date. Contract assets are included in prepaid expenses and other current assets for the current portion and other assets for the long-term portion on the Consolidated Balance Sheets. We regularly review contract asset balances for impairment, considering factors such as historical experience, credit-worthiness, age of the balance and other economic or business factors. Contract asset impairments were not significant in fiscal 2019.

The opening balance of contract assets as of December 1, 2018 was $46.4 million. As of November 29, 2019, the balance of contract assets was $63.9 million.

*Deferred Revenue and Remaining Performance Obligations*

Deferred revenue primarily consists of billings or payments received in advance of revenue recognition from subscription services, including non-cancellable and non-refundable committed funds and deposits. Deferred revenue is recognized as revenue when transfer of control to customers has occurred. Customers are typically invoiced for these agreements in regular installments and revenue is recognized ratably over the contractual subscription period. The deferred revenue balance is influenced by several factors, including seasonality, the compounding effects of renewals, invoice duration, invoice timing, size and new business linearity within the quarter. Deferred revenue does not represent the total contract value of annual or multi-year non-cancellable subscription agreements.

Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 to 60 days. In instances where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts generally do not include a significant financing component. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, such as invoicing at the beginning of a subscription term with revenue recognized ratably over the contract period, and not to receive financing from our customers. Any potential financing fees are considered insignificant in the context of our contracts.

The adjusted opening balance of deferred revenue as of December 1, 2018 was $3.00 billion. As of November 29, 2019, the balance of deferred revenue was $3.50 billion, inclusive of $265.4 million of non-cancellable and non-refundable committed funds and $56.9 million of refundable customer deposits. Arrangements with non-cancellable and non-refundable committed funds provide our customers options to either renew monthly on-premise term-based licenses or use some or all funds to purchase other Adobe products or services. Refundable customer deposits represent arrangements in which the customer has a unilateral cancellation right for which we are obligated to refund amounts paid related to products or services not yet delivered or provided at the time of cancellation on a prorated basis.

Significant movements in the deferred revenue balance during the period consisted of increases due to payments received prior to transfer of control of the underlying performance obligations to the customer and deferred revenue assumed through business combinations, which were offset by decreases due to revenue recognized in the period. During the year ended November 29, 2019, approximately $2.8 billion of revenue was recognized that was included in the adjusted opening balance of deferred revenue as of December 1, 2018.

Transaction price allocated to remaining performance obligations represents contracted revenue that has not yet been recognized, which includes deferred revenue and unbilled amounts that will be recognized as revenue in future periods. Transaction price allocated to the remaining performance obligation is influenced by several factors, including the timing of renewals and average contract terms. We applied practical expedients to exclude amounts related to performance obligations that are billed and recognized as they are delivered, optional purchases that do not represent material rights, sales- and usage-based royalties not yet consumed and any estimated amounts of variable consideration that are subject to constraint in accordance with the new revenue standard.

Remaining performance obligations were approximately $9.82 billion as of November 29, 2019, which includes $776.4 million of non-cancellable and non-refundable committed funds related to some of our enterprise customer agreements. Approximately 74% of the remaining performance obligations, excluding the aforementioned enterprise customer agreements, are expected to be recognized over the next 12 months with the remainder recognized thereafter.

*Contract Acquisition Costs*

We recognize an asset for the incremental costs of obtaining a contract with a customer if we expect the benefit of those costs to be longer than one year. We have determined that certain sales incentive programs meet the requirements to be capitalized.

The costs capitalized under the new revenue standard are primarily sales commissions paid to our sales force personnel. Capitalized costs may also include portions of fringe benefits and payroll taxes associated with compensation for incremental costs to acquire customer contracts and incentive payments to partners.

Capitalized costs to obtain a contract are amortized over the expected period of benefit, which we have determined, based on analysis, to be 5 years. Amortization of capitalized costs are included in sales and marketing expense in our Consolidated Statements of Income. During fiscal 2019, we amortized $170.9 million of capitalized contract acquisition costs into sales and marketing expense. We did not incur any impairment losses.

The opening balance of capitalized contract acquisition costs as of December 1, 2018 was $413.2 million. As of November 29, 2019, the balance of capitalized contract acquisition costs was $473.7 million, of which $314.7 million was long-term and included in other assets in the Consolidated Balance Sheets. The remaining balance of the capitalized costs to obtain contracts was current and included in prepaid expenses and other current assets.

*Revenue Reserve*

During fiscal 2019, 2018 and 2017, our revenue reserve activities were as follows:

| *(in thousands)* | 2019 | 2018 | 2017 |
|---|---|---|---|
| Beginning balance | $ 25,425 | $ 22,006 | $ 23,096 |
| Impacts of adoption of the new revenue standard | (14,733) | — | — |
| Amount charged to revenue | 18,276 | 65,241 | 61,031 |
| Actual returns | (22,236) | (61,822) | (62,121) |
| Ending balance | $ 6,732 | $ 25,425 | $ 22,006 |

*Refund Liabilities*

As part of our revenue reserves, we record refund liabilities for amounts that may be subject to future refunds, which include sales returns reserves and customer rebates and credits. Refund liabilities are included in accrued expenses on the Consolidated Balance Sheets.

The opening balance of refund liabilities as of December 1, 2018 was $75.3 million. As of November 29, 2019, the balance of refund liabilities was $126.1 million.

*Significant Customers*

For fiscal 2019, 2018 and 2017 there were no customers that represented at least 10% of net revenue. As of fiscal year end 2019 and 2018, no single customer was responsible for over 10% of our trade receivables.

## NOTE 3. ACQUISITIONS

*Allegorithmic*

On January 23, 2019, we completed the acquisition of Allegorithmic, a privately held 3D editing and authoring software company for gaming and entertainment, and integrated it into our Digital Media reportable segment. Prior to the acquisition, we held an equity interest that was accounted for as an equity-method investment. We acquired the remaining equity interest for approximately $106.2 million in cash consideration. The total purchase price, inclusive of the acquisition-date fair-value of our pre-existing equity interest, was approximately $161.1 million.

In conjunction with the Allegorithmic acquisition, we separately recognized an investment gain of approximately $42.0 million, which represents the difference between the $54.8 million acquisition-date fair value of our pre-existing equity interest and our previous carrying amount.

Under the acquisition method of accounting, the total final purchase price was allocated to Allegorithmic's net tangible and intangible assets based upon their estimated fair values as of the acquisition date. The excess purchase price over the value of the net tangible and identifiable intangible assets was recorded as goodwill. Of the total purchase price, $125.9 million was allocated to goodwill that was non-deductible for tax purposes, $44.8 million to identifiable intangible assets and the remainder to net liabilities assumed.

Pro forma financial information has not been presented for the Allegorithmic acquisition as the impact to our Consolidated Financial Statements was not material.

*Marketo*

On October 31, 2018, we completed the acquisition of Marketo, a privately held marketing cloud platform company, for approximately $4.73 billion of cash consideration. Adding Marketo's engagement platform to Adobe Experience Cloud furthers our long-term plan for strategic growth in the Digital Experience segment and enables us to offer a comprehensive set of solutions to enable customers across industries and companies automate and orchestrate their marketing activities. Under the terms of the Share Purchase Agreement ("Purchase Agreement"), we acquired all of the issued and outstanding shares of capital stock of Milestone Topco, Inc., a Delaware corporation ("Topco") and indirect parent company of Marketo, and other equity interests in Marketo. In connection with the acquisition, each Marketo equity award that was issued and outstanding was cancelled and extinguished in exchange for cash consideration. Also pursuant to the Purchase Agreement, upon closing of the transaction, cash was paid for the settlement of Marketo's long-term incentive plan, the settlement of Marketo's indebtedness and the acquisition of all remaining equity interests in Marketo K.K., a Japanese corporation and joint venture.

In connection with the acquisition, we entered into a credit agreement providing for a $2.25 billion senior unsecured term loan ("Term Loan"). The proceeds of the Term Loan were used to fund a portion of the purchase price of the acquisition and pay fees and expenses incurred in connection with the acquisition. The Term Loan funds were received on October 31, 2018 upon closing of the acquisition. *See Note 17 for further details regarding our Term Loan.*

**ADOBE INC.**

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

We integrated Marketo into our Digital Experience reportable segment and have included the financial results of Marketo in our Consolidated Financial Statements beginning on the acquisition date. The amounts of net revenue and net loss of Marketo included in our Consolidated Statements of Income from the acquisition date through November 30, 2018 were not material. The direct transaction costs associated with the acquisition were also not material.

*Purchase Price Allocation*

Under the purchase accounting method, the total final purchase price was allocated to Marketo's net tangible and intangible assets based upon their estimated fair values as of the acquisition date. The excess purchase price over the value of the net tangible and identifiable intangible assets was recorded as goodwill.

The table below represents the final purchase price allocation to the acquired net tangible and intangible assets of Marketo based on their estimated fair values as of October 31, 2018 and the associated estimated useful lives at that date. During fiscal 2019, we recorded immaterial purchase accounting adjustments based on changes to management's estimates and assumptions in regards to total purchase price, intangible assets, deferred revenue, tax liabilities assumed and their related impact to goodwill.

| *(in thousands)* | Amount | Weighted Average Useful Life (years) |
|---|---|---|
| Customer contracts and relationships | $ 577,500 | 11 |
| Purchased technology | 444,500 | 7 |
| Backlog | 105,500 | 2 |
| Non-competition agreements | 12,100 | 2 |
| Trademarks | 328,500 | 9 |
| Total identifiable intangible assets | 1,468,100 | |
| Net liabilities assumed | (194,588) | N/A |
| Goodwill [1] | 3,459,256 | N/A |
| Total purchase price | $ 4,732,768 | |

(1) Non-deductible for tax-purposes.

*Identifiable intangible assets* — Customer relationships consist of Marketo's contractual relationships and customer loyalty related to their enterprise and commercial customers as well as technology partner relationships. The estimated fair value of the customer contracts and relationships was determined based on projected cash flows attributable to the asset. Purchased technology acquired primarily consists of Marketo's cloud-based engagement marketing software platform. The estimated fair value of the purchased technology was determined based on the expected future cost savings resulting from ownership of the asset. Backlog relates to subscription contracts and professional services. Non-compete agreements include agreements with key Marketo employees that preclude them from competing against Marketo for a period of two years from the acquisition date. Trademarks include the Marketo trade name, which is well known in the marketing ecosystem. We amortize the fair value of these intangible assets on a straight-line basis over their respective estimated useful lives.

*Goodwill* — Approximately $3.46 billion of goodwill has been allocated entirely to our Digital Experience reportable segment. Goodwill represents the excess of the purchase price over the fair value of the underlying acquired net tangible and intangible assets. The factors that contributed to the recognition of goodwill included securing buyer-specific synergies that increase revenue and profits and are not otherwise available to a marketplace participant, acquiring a talented workforce and cost savings opportunities.

*Net liabilities assumed* — Marketo's tangible assets and liabilities as of October 31, 2018 were reviewed and adjusted to their fair value as necessary. The net liabilities assumed included, among other items, $102.6 million in accrued expenses, $74.8 million in deferred revenue and $182.6 million in deferred tax liabilities, which were partially offset by $54.9 million in cash and cash equivalents and $71.6 million in trade receivables acquired.

*Deferred revenue* — Included in net liabilities assumed is Marketo’s deferred revenue which represents advance payments from customers related to subscription contracts and professional services. We estimated our obligation related to the deferred revenue using the cost build-up approach. The cost build-up approach determines fair value by estimating the direct and indirect costs related to supporting the obligation plus an assumed operating margin. The sum of the costs and assumed operating profit approximates, in theory, the amount that Marketo would be required to pay a third party to assume the obligation. The estimated costs to fulfill the obligation were based on the near-term projected cost structure for subscription and professional services. As a result, we recorded an adjustment to reduce Marketo's carrying value of deferred revenue to $74.8 million, which represents our estimate of the fair value of the contractual obligations assumed.

*Taxes* — As part of our accounting for the Marketo acquisition, a portion of the overall purchase price was allocated to goodwill and acquired intangible assets. Amortization expense associated with acquired intangible assets is not deductible for tax purposes. Thus, approximately $348.8 million, included in the net liabilities assumed, was established as a deferred tax liability for the future amortization of the intangible assets, and was partially offset by other tax assets of $166.2 million, which primarily consist of net operating loss carryforwards.

Any impairment charges made in the future associated with goodwill will not be tax deductible and will result in an increased effective income tax rate in the quarter the impairment is recorded.

*Unaudited Pro Forma Results*

The financial information in the table below summarizes the combined results of operations of Adobe and Marketo, on a pro forma basis, as though the companies had been combined as of the beginning of the periods presented. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place on December 3, 2016 or of results that may occur in the future.

The following unaudited pro forma financial information for fiscal 2018 and 2017 combines the historical results for Adobe for the years ended November 30, 2018 and December 1, 2017 and the historical results of Marketo for the period January 1, 2018 through October 31, 2018 and the year ended December 31, 2017, respectively:

| *(in thousands)* | 2018 | 2017 |
|---|---|---|
| Net revenues | $ 9,338,790 | $ 7,568,713 |
| Net income | $ 2,362,238 | $ 1,404,864 |

*Magento*

On June 18, 2018, we completed our acquisition of Magento Commerce ("Magento"), a privately held commerce platform company, and integrated it into our Digital Experience reportable segment.

The table below represents the final purchase price allocation to the acquired net assets of Magento based on their estimated fair values as of June 18, 2018 and the associated estimated useful lives at that date. During fiscal 2019, we recorded immaterial purchase accounting adjustments based on changes to management's estimates and assumptions in regards to net liabilities assumed and their related impact to goodwill.

| *(in thousands)* | Amount | Weighted Average Useful Life (years) |
|---|---|---|
| Customer contracts and relationships | $ 208,000 | 8 |
| Purchased technology | 84,200 | 5 |
| In-process research and development [(1)] | 39,100 | N/A |
| Trademarks | 21,100 | 3 |
| Other intangibles | 43,400 | 3 |
| Total identifiable intangible assets | 395,800 | |

| | | |
|---|---|---|
| Net liabilities assumed | (68,182 ) | N/A |
| Goodwill (2) | 1,316,983 | N/A |
| Total purchase price | $ 1,644,601 | |

_________________________________

(1) Capitalized as purchased technology and are considered indefinite lived until the completion or abandonment of the associated research and development efforts. Subsequent to the acquisition, the associated in-process research and development efforts for certain projects were completed and the rest were abandoned. The respective related amortization and write-off were each immaterial.

(2) Non-deductible for tax purposes.

Pro forma financial information has not been presented for the Magento acquisition as the impact to our Consolidated Financial Statements was not material.

*TubeMogul*

On December 19, 2016, we completed our acquisition of TubeMogul, a publicly held video advertising platform company, and integrated it into our Digital Experience reportable segment.

Under the acquisition method of accounting, the total final purchase price was allocated to TubeMogul's net tangible and intangible assets based upon their estimated fair values as of December 19, 2016. During fiscal 2017, we recorded immaterial purchase accounting adjustments based on changes to management's estimates and assumptions in regards to tangible assets, liabilities assumed, and their related impact to goodwill. The total final purchase price for TubeMogul was $560.8 million of which $348.4 million was allocated to goodwill that was non-deductible for tax purposes, $113.1 million to identifiable intangible assets and $99.3 million to net assets acquired.

Pro forma financial information has not been presented for the TubeMogul acquisition as the impact to our Consolidated Financial Statements was not material.

*Other*

We also completed other immaterial business acquisitions during the fiscal years presented. Pro forma information has not been presented for these acquisitions as the impact to our Consolidated Financial Statements was not material.

## NOTE 4. CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

Cash equivalents consist of all highly liquid debt investments with remaining maturities of three months or less at the date of purchase. We classify our investments in marketable debt securities as "available-for-sale." We carry these investments at fair value, based on quoted market prices or other readily available market information. Unrealized gains and losses, net of taxes, are included in accumulated other comprehensive income, which is reflected as a separate component of stockholders' equity in our Consolidated Balance Sheets. Gains and losses are determined using the specific identification method and recognized when realized in our Consolidated Statements of Income. When we have determined that an other-than-temporary decline in fair value has occurred, the amount of the decline that is related to a credit loss is recognized in income.

**ADOBE INC.**

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

Cash, cash equivalents and short-term investments consisted of the following as of November 29, 2019:

| *(in thousands)* | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Current assets: | | | | |
| Cash | $ 466,941 | $ — | $ — | $ 466,941 |
| Cash equivalents: | | | | |
| Corporate debt securities | 45,703 | 2 | (1) | 45,704 |
| Money market mutual funds | 2,049,057 | — | — | 2,049,057 |
| Time deposits | 88,519 | — | — | 88,519 |
| Total cash equivalents | 2,183,279 | 2 | (1) | 2,183,280 |
| Total cash and cash equivalents | 2,650,220 | 2 | (1) | 2,650,221 |
| Short-term fixed income securities: | | | | |
| Asset-backed securities | 88,584 | 146 | (9) | 88,721 |
| Corporate debt securities | 1,408,332 | 4,251 | (252) | 1,412,331 |
| Municipal securities | 17,642 | 67 | — | 17,709 |
| U.S. Treasury securities | 7,992 | 2 | — | 7,994 |
| Total short-term investments | 1,522,550 | 4,466 | (261) | 1,526,755 |
| Total cash, cash equivalents and short-term investments | $ 4,172,770 | $ 4,468 | $ (262) | $ 4,176,976 |

Cash, cash equivalents and short-term investments consisted of the following as of November 30, 2018:

| *(in thousands)* | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Current assets: | | | | |
| Cash | $ 368,564 | $ — | $ — | $ 368,564 |
| Cash equivalents: | | | | |
| Money market mutual funds | 1,234,188 | — | — | 1,234,188 |
| Time deposits | 40,023 | — | — | 40,023 |
| Total cash equivalents | 1,274,211 | — | — | 1,274,211 |
| Total cash and cash equivalents | 1,642,775 | — | — | 1,642,775 |
| Short-term fixed income securities: | | | | |
| Asset-backed securities | 41,875 | — | (367) | 41,508 |
| Corporate debt securities | 1,546,860 | 44 | (24,696) | 1,522,208 |
| Foreign government securities | 4,179 | — | (24) | 4,155 |
| Municipal securities | 18,601 | 1 | (286) | 18,316 |
| Total short-term investments | 1,611,515 | 45 | (25,373) | 1,586,187 |
| Total cash, cash equivalents and short-term investments | $ 3,254,290 | $ 45 | $ (25,373) | $ 3,228,962 |

*See Note 5 for further information regarding the fair value of our financial instruments.*

**ADOBE INC.**

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

The following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category, that have been in an unrealized loss position for less than twelve months, as of November 29, 2019 and November 30, 2018:

| *(in thousands)* | 2019 | | 2018 | |
|---|---|---|---|---|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Corporate debt securities | $ 235,155 | $ (183) | $ 538,109 | $ (7,966) |
| Asset-backed securities | 6,651 | (5) | 6,696 | (54) |
| Municipal securities | 3,305 | — | 6,599 | (81) |
| Total | $ 245,111 | $ (188) | $ 551,404 | $ (8,101) |

There were 115 securities and 369 securities in an unrealized loss position for less than twelve months at November 29, 2019 and at November 30, 2018, respectively.

The following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category, that were in a continuous unrealized loss position for more than twelve months, as of November 29, 2019 and November 30, 2018:

| *(in thousands)* | 2019 | | 2018 | |
|---|---|---|---|---|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Corporate debt securities | $ 44,300 | $ (70) | $ 969,701 | $ (16,730) |
| Asset-backed securities | 6,754 | (4) | 34,812 | (313) |
| Municipal securities | — | — | 11,532 | (205) |
| Foreign government securities | — | — | 4,154 | (24) |
| Total | $ 51,054 | $ (74) | $ 1,020,199 | $ (17,272) |

There were 38 securities and 577 securities in an unrealized loss position for more than twelve months at November 29, 2019 and at November 30, 2018, respectively.

The following table summarizes the cost and estimated fair value of the fixed income securities classified as short-term investments based on stated effective maturities as of November 29, 2019:

| *(in thousands)* | Amortized Cost | Estimated Fair Value |
|---|---|---|
| Due within one year | $ 928,472 | $ 929,616 |
| Due between one and two years | 394,436 | 395,917 |
| Due between two and three years | 179,468 | 180,867 |
| Due after three years | 20,174 | 20,355 |
| Total | $ 1,522,550 | $ 1,526,755 |

We review our debt securities classified as short-term investments on a regular basis to evaluate whether or not any security has experienced an other-than-temporary decline in fair value. We consider factors such as the length of time and extent to which the market value has been less than the cost, the financial condition and near-term prospects of the issuer and our intent to sell, or whether it is more likely than not we will be required to sell the investment before recovery of the investment's amortized cost basis. If we believe that an other-than-temporary decline exists in one of these securities, we write down these investments to fair value. The portion of the write-down related to credit loss would be recorded to interest and other income (expense), net in our Consolidated Statements of Income. Any portion not related to credit loss would be recorded to accumulated other comprehensive income, which is reflected as a separate component of stockholders' equity in our Consolidated Balance Sheets. During fiscal 2019, 2018 and 2017, we did not consider any of our investments to be other-than-temporarily impaired.

ADOBE INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 5. FAIR VALUE MEASUREMENTS

*Assets and Liabilities Measured and Recorded at Fair Value on a Recurring Basis*

We measure certain financial assets and liabilities at fair value on a recurring basis. There have been no transfers between fair value measurement levels during the year ended November 29, 2019.

The fair value of our financial assets and liabilities at November 29, 2019 was determined using the following inputs:

| *(in thousands)* | Fair Value Measurements at Reporting Date Using | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Corporate debt securities | $ 45,704 | $ — | $ 45,704 | $ — |
| Money market mutual funds | 2,049,057 | 2,049,057 | — | — |
| Time deposits | 88,519 | 88,519 | — | — |
| Short-term investments: | | | | |
| Asset-backed securities | 88,721 | — | 88,721 | — |
| Corporate debt securities | 1,412,331 | — | 1,412,331 | — |
| Municipal securities | 17,709 | — | 17,709 | — |
| U.S. Treasury securities | 7,994 | — | 7,994 | — |
| Prepaid expenses and other current assets: | | | | |
| Foreign currency derivatives | 28,829 | — | 28,829 | — |
| Other assets: | | | | |
| Deferred compensation plan assets | 93,776 | 4,348 | 89,428 | — |
| Total assets | $ 3,832,640 | $ 2,141,924 | $ 1,690,716 | $ — |
| | | | | |
| Liabilities: | | | | |
| Accrued expenses: | | | | |
| Treasury lock derivatives | $ 29,652 | $ — | $ 29,652 | $ — |
| Foreign currency derivatives | 2,671 | — | 2,671 | — |
| Interest rate swap derivatives | 208 | — | 208 | — |
| Total liabilities | $ 32,531 | $ — | $ 32,531 | $ — |

**ADOBE INC.**

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

The fair value of our financial assets and liabilities at November 30, 2018 was determined using the following inputs:

| *(in thousands)* | Fair Value Measurements at Reporting Date Using | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Money market mutual funds | $ 1,234,188 | $ 1,234,188 | $ — | $ — |
| Time deposits | 40,023 | 40,023 | — | — |
| Short-term investments: | | | | |
| Asset-backed securities | 41,508 | — | 41,508 | — |
| Corporate debt securities | 1,522,208 | — | 1,522,208 | — |
| Foreign government securities | 4,155 | — | 4,155 | — |
| Municipal securities | 18,316 | — | 18,316 | — |
| Prepaid expenses and other current assets: | | | | |
| Foreign currency derivatives | 44,259 | — | 44,259 | — |
| Other assets: | | | | |
| Deferred compensation plan assets | 68,988 | 3,895 | 65,093 | — |
| Total assets | $ 2,973,645 | $ 1,278,106 | $ 1,695,539 | $ — |
| | | | | |
| Liabilities: | | | | |
| Accrued expenses: | | | | |
| Foreign currency derivatives | $ 816 | $ — | $ 816 | $ — |
| Other liabilities: | | | | |
| Interest rate swap derivatives | 9,744 | — | 9,744 | — |
| Total liabilities | $ 10,560 | $ — | $ 10,560 | $ — |

*See Note 4 for further information regarding the fair value of our financial instruments.*

Our fixed income available-for-sale debt securities consist of high quality, investment grade securities from diverse issuers with a weighted average credit rating of A+. We value these securities based on pricing from independent pricing vendors who use matrix pricing valuation techniques including market approach methodologies that model information generated by market transactions involving identical or comparable assets, as well as discounted cash flow methodologies. Inputs include quoted prices in active markets for identical assets or inputs other than quoted prices that are observable either directly or indirectly in determining fair value, including benchmark yields, issuer spreads off benchmark yields, interest rates and U.S. Treasury or swap curves. We therefore classify all of our fixed income available-for-sale securities as Level 2. We perform routine procedures such as comparing prices obtained from multiple independent sources to ensure that appropriate fair values are recorded.

The fair values of our money market mutual funds and time deposits are based on the closing price of these assets as of the reporting date. We classify our money market mutual funds and time deposits as Level 1.

Our Level 2 over-the-counter foreign currency, Treasury lock and interest rate swap derivatives are valued using pricing models and discounted cash flow methodologies based on observable foreign exchange and interest rate data at the measurement date.

Our deferred compensation plan assets consist of money market mutual funds and other mutual funds.

**ADOBE INC.**

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

*Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis*

The fair value of our senior notes was $1.96 billion as of November 29, 2019, based on observable market prices in less active markets and categorized as Level 2. *See Note 17 for further details regarding our debt.*

## NOTE 6. DERIVATIVE FINANCIAL INSTRUMENTS

We may use derivatives to partially offset our business exposure to foreign currency and interest rate risk on expected future cash flows, and certain existing assets and liabilities. We do not use any of our derivative instruments for trading purposes.

We enter into master netting arrangements to mitigate credit risk in derivative transactions by permitting net settlement of transactions with the same counterparty. We do not offset fair value amounts recognized for derivative instruments under master netting arrangements. We also enter into collateral security agreements with certain of our counterparties to exchange cash collateral when the net fair value of certain derivative instruments fluctuates from contractually established thresholds. Collateral posted is included in prepaid expenses and other current assets and collateral received is included in accrued expenses on our Consolidated Balance Sheets.

*Cash Flow Hedges*

In countries outside the United States, we transact business in U.S. Dollars and in various other currencies. We may use foreign exchange option contracts or forward contracts to hedge a portion of our forecasted foreign currency denominated revenue. These foreign exchange contracts, carried at fair value, have maturities of up to twelve months. As of November 29, 2019, total notional amounts of outstanding cash flow hedges were $1.20 billion, hedging exposures denominated in Euros, British Pounds and Japanese Yen.

In June 2019, in anticipation of refinancing our $2.25 billion Term Loan due April 30, 2020 and $900 million notes payable due February 1, 2020, we entered into Treasury lock agreements with large financial institutions which fixed benchmark U.S. Treasury rates for an aggregate notional amount of $1 billion of our future debt issuance. These derivative instruments hedge the impact of changes in the benchmark interest rate to future interest payments and will be terminated upon closing of our anticipated refinancing. Upon refinancing and termination of the derivative instruments, their fair value will be amortized over the term of our new debt to interest expense.

To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge, and the hedges must be highly effective in offsetting changes to future cash flows on hedged transactions. We record changes in fair value of these cash flow hedges in accumulated other comprehensive income (loss) in our Consolidated Balance Sheets, until the forecasted transaction occurs. When the forecasted transaction affects earnings, we reclassify the related gain or loss on the foreign currency and Treasury lock cash flow hedges to revenue and interest expense, respectively. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, we reclassify the gain or loss on the related cash flow hedge from accumulated other comprehensive income (loss) to the same income statement line item as the hedged item. If we do not elect hedge accounting, or the contract does not qualify for hedge accounting treatment, the changes in fair value from period to period are recorded in the same income statement line item as the hedged item.

We evaluate hedge effectiveness at the inception of the hedge prospectively, and on an ongoing basis both retrospectively and prospectively. We record any ineffective portion of the hedging instruments in interest and other income (expense), net on our Consolidated Statements of Income. The net gain or loss recognized in interest and other income (expense), net due to hedge ineffectiveness was insignificant for all fiscal years presented.

Effective in the third quarter of fiscal 2019, all changes in fair value of our foreign currency cash flow hedges are recorded in accumulated other comprehensive income (loss). Prior to this, we recorded the time value of purchased contracts in interest and other income (expense), net in our Consolidated Statements of Income. The impact of the de-designation of our hedges due to the change in methodology in the third quarter of fiscal 2019 was immaterial.

For fiscal 2019, 2018, and 2017, there were no net gains or losses recognized in income relating to hedges of forecasted transactions that did not occur.

**ADOBE INC.**

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

*Fair Value Hedges*

During the third quarter of fiscal 2014, we entered into interest rate swaps designated as a fair value hedge related to our $900 million of 4.75% fixed interest rate senior notes due February 1, 2020 (the “2020 Notes”). In effect, the interest rate swaps convert the fixed interest rate on our 2020 Notes to a floating interest rate based on the London Interbank Offered Rate (“LIBOR”). Under the terms of the swaps, we pay monthly interest at the one-month LIBOR rate plus a fixed number of basis points on the $900 million notional amount through February 1, 2020. In exchange, we receive 4.75% fixed rate interest from the swap counterparties. *See Note 17 for further details regarding our debt.*

The interest rate swaps are accounted for as fair value hedges and substantially offset the changes in fair value of the hedged portion of the underlying debt that are attributable to the changes in interest rate. Therefore, the gains and losses related to changes in the fair value of the interest rate swaps are included in interest and other income (expense), net in our Consolidated Statements of Income. As of November 29, 2019, the fair value of the interest rate swaps is recognized in accrued expenses on our Consolidated Balance Sheets with a corresponding offset to current debt.

*Non-Designated Hedges*

Our derivatives not designated as hedging instruments consist of foreign currency forward contracts that we primarily use to hedge monetary assets and liabilities denominated in non-functional currencies. The changes in fair value of these contracts is recorded to interest and other income (expense), net in our Consolidated Statements of Income. Changes in the fair value of the underlying assets and liabilities associated with the hedged risk are generally offset by the changes in the fair value of the related contracts.

As of November 29, 2019, total notional amounts of outstanding foreign currency forward contracts were $702.4 million, primarily hedging exposures denominated in Euros, British Pounds, Japanese Yen and Indian Rupees. As of November 30, 2018, total notional amounts of outstanding contracts were $427.9 million, primarily hedging exposures denominated in Euros, British Pounds, Japanese Yen and Indian Rupees. At November 29, 2019 and November 30, 2018, the outstanding balance sheet hedging derivatives had maturities of 180 days or less.

The fair value of derivative instruments on our Consolidated Balance Sheets as of November 29, 2019 and November 30, 2018 were as follows:

| *(in thousands)* | 2019 | | 2018 | |
|---|---|---|---|---|
| | **Fair Value Asset Derivatives** | **Fair Value Liability Derivatives** | **Fair Value Asset Derivatives** | **Fair Value Liability Derivatives** |
| Derivatives designated as hedging instruments: | | | | |
| Foreign exchange option contracts (1) (2) | $ 25,605 | $ — | $ 40,191 | $ — |
| Treasury lock (1) | — | 29,652 | — | — |
| Interest rate swap (3) | — | 208 | — | 9,744 |
| Derivatives not designated as hedging instruments: | | | | |
| Foreign exchange forward contracts (1) | 3,224 | 2,671 | 4,068 | 816 |
| Total derivatives | $ 28,829 | $ 32,531 | $ 44,259 | $ 10,560 |

(1) Fair value asset derivatives included in prepaid expenses and other current assets and fair value liability derivatives included in accrued expenses on our Consolidated Balance Sheets.

(2) Hedging effectiveness expected to be recognized to income within the next 18 months, of which $13.2 million is expected within the next 12 months.

(3) Included in accrued expenses and other liabilities on our Consolidated Balance Sheets as of November 29, 2019 and November 30, 2018, respectively.

**ADOBE INC.**

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

The effects of foreign currency derivative instruments designated as cash flow hedges and foreign currency derivative instruments not designated as hedges in our Consolidated Statements of Income for fiscal 2019, 2018 and 2017 were as follows:

| *(in thousands)* | 2019 | | | 2018 | | 2017 | |
|---|---|---|---|---|---|---|---|
| | Foreign Exchange Option Contracts | Foreign Exchange Forward Contracts | Treasury Lock | Foreign Exchange Option Contracts | Foreign Exchange Forward Contracts | Foreign Exchange Option Contracts | Foreign Exchange Forward Contracts |
| Derivatives in cash flow hedging relationships: | | | | | | | |
| Net gain (loss) recognized in OCI, net of tax [(1)] | $ 16,526 | $ — | $ (22,684) | $ 74,080 | $ — | $ 6,917 | $ — |
| Net gain (loss) reclassified from accumulated OCI into income, net of tax [(2) (4)] | 39,111 | — | (1,228) | 48,647 | — | 32,852 | — |
| Net gain (loss) recognized in income [(3) (4)] | (24,269) | — | — | (41,179) | — | (30,243) | — |
| Derivatives not designated as hedging relationships: | | | | | | | |
| Net gain (loss) recognized in revenue | 761 | — | — | — | — | — | — |
| Net gain (loss) recognized in interest and other income (expense), net | $ — | $ 4,229 | $ — | $ — | $ 1,529 | $ — | $ 6,586 |

(1) Net change in the fair value of the effective portion classified in other comprehensive income ("OCI").

(2) Effective portion of the foreign currency and Treasury lock cash flow hedges classified as revenue and interest expense, respectively.

(3) Amount excluded from effectiveness testing and ineffective portion classified in interest and other income (expense), net.

(4) Starting the third quarter of fiscal 2019, all changes in fair value of our foreign currency cash flow hedges are recorded in accumulated other comprehensive income.

Net gains (losses) recognized in interest and other income (expense), net relating to foreign currency derivatives not designated as hedging instruments for fiscal 2019, 2018 and 2017 were as follows:

| *(in thousands)* | 2019 | 2018 | 2017 |
|---|---|---|---|
| Gain (loss) on foreign currency assets and liabilities: | | | |
| Net realized gain (loss) recognized in other income | $ (14,420) | $ 882 | $ (6,142) |
| Net unrealized gain (loss) recognized in other income | 8,050 | (3,843) | (907) |
| | (6,370) | (2,961) | (7,049) |
| Gain (loss) on hedges of foreign currency assets and liabilities: | | | |
| Net realized gain (loss) recognized in other income | 6,928 | (2,042) | 5,415 |
| Net unrealized gain (loss) recognized in other income | (2,699) | 3,571 | 1,171 |
| | 4,229 | 1,529 | 6,586 |
| Net gain (loss) recognized in interest and other income (expense), net | $ (2,141) | $ (1,432) | $ (463) |

**ADOBE INC.**

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

## NOTE 7. PROPERTY AND EQUIPMENT

Property and equipment, net consisted of the following as of November 29, 2019 and November 30, 2018:

| *(in thousands)* | 2019 | 2018 |
|---|---|---|
| Computers and other equipment | $ 1,424,368 | $ 1,239,033 |
| Buildings | 482,797 | 485,024 |
| Building improvements | 307,396 | 285,564 |
| Leasehold improvements | 246,244 | 181,990 |
| Land | 144,871 | 145,065 |
| Furniture and fixtures | 143,739 | 121,206 |
| Capital projects in-progress | 112,232 | 23,026 |
| Total | 2,861,647 | 2,480,908 |
| Less accumulated depreciation and amortization | (1,568,632) | (1,405,836) |
| Property and equipment, net | $ 1,293,015 | $ 1,075,072 |

Depreciation and amortization expense of property and equipment for fiscal 2019, 2018 and 2017 was $173.1 million, $157.1 million and $156.9 million, respectively.

Property and equipment, net, by geographic area as of November 29, 2019 and November 30, 2018 was as follows:

| *(in thousands)* | 2019 | 2018 |
|---|---|---|
| Americas: | | |
| United States | $ 1,126,406 | $ 882,145 |
| Other | 2,735 | 30,475 |
| Total Americas | 1,129,141 | 912,620 |
| EMEA | 54,394 | 51,033 |
| APAC | 109,480 | 111,419 |
| Property and equipment, net | $ 1,293,015 | $ 1,075,072 |

## NOTE 8. GOODWILL AND OTHER INTANGIBLES

Goodwill by reportable segment and activity for the years ended November 29, 2019 and November 30, 2018 was as follows:

| *(in thousands)* | 2017 | Acquisitions | Other[(1)] | 2018 | Acquisitions | Other[(1)] | 2019 |
|---|---|---|---|---|---|---|---|
| Digital Media | $ 2,724,747 | $ 15,247 | $ (2,481) | $ 2,737,513 | $ 125,899 | $ (914) | $ 2,862,498 |
| Digital Experience | 2,838,390 | 4,775,969 | (29,246) | 7,585,113 | 270 | (15,103) | 7,570,280 |
| Publishing | 258,424 | — | (2) | 258,422 | — | (1) | 258,421 |
| Goodwill | $ 5,821,561 | $ 4,791,216 | $ (31,729) | $ 10,581,048 | $ 126,169 | $ (16,018) | $ 10,691,199 |

(1) Amounts primarily consist of foreign currency translation adjustments.

Other intangibles, net, by reportable segment as of November 29, 2019 and November 30, 2018 were as follows:

| *(in thousands)* | **2019** | **2018** |
|---|---|---|
| Digital Media | $ 79,483 | $ 68,280 |
| Digital Experience | 1,640,925 | 2,000,718 |
| Publishing | 157 | 3 |
| Other intangibles, net | $ 1,720,565 | $ 2,069,001 |

**ADOBE INC.**

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

Certain goodwill and other intangibles were misclassified between Digital Media and Digital Experience in the prior year, which have been recast in the above tables. The impact to our prior year disclosures was immaterial and there was no impact to the Consolidated Financial Statements resulting from the change in classification.

Other intangibles, net, as of November 29, 2019 and November 30, 2018 were as follows:

| *(in thousands)* | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated Amortization | Net | Cost | Accumulated Amortization | Net |
| Customer contracts and relationships | $ 1,219,029 | $ (436,545) | $ 782,484 | $ 1,329,432 | $ (416,176) | $ 913,256 |
| Purchased technology | 759,111 | (223,115) | 535,996 | 750,286 | (118,812) | 631,474 |
| Trademarks | 384,300 | (73,546) | 310,754 | 384,855 | (25,968) | 358,887 |
| Backlog | 143,400 | (75,570) | 67,830 | 147,300 | (13,299) | 134,001 |
| Acquired rights to use technology | 59,524 | (46,823) | 12,701 | 58,966 | (48,770) | 10,196 |
| Other | 23,745 | (12,945) | 10,800 | 51,096 | (29,909) | 21,187 |
| Other intangibles, net | $ 2,589,109 | $ (868,544) | $ 1,720,565 | $ 2,721,935 | $ (652,934) | $ 2,069,001 |

In fiscal 2019, and 2018, certain intangibles associated with our acquisitions in prior years became fully amortized and were removed from the Consolidated Balance Sheets.

Amortization expense related to other intangibles was $402.3 million, $182.6 million and $153.6 million for fiscal 2019, 2018 and 2017 respectively. Of these amounts, $227.0 million, $91.3 million and $76.1 million were included in cost of sales for fiscal 2019, 2018 and 2017 respectively.

Other intangibles are amortized over their estimated useful lives of 1 to 15 years. As of November 29, 2019, we expect the estimated aggregate amortization expense for each of the five succeeding fiscal years to be as follows:

| *(in thousands)* | Other Intangibles |
|---|---|
| 2020 | $ 364,683 |
| 2021 | 254,921 |
| 2022 | 222,810 |
| 2023 | 214,188 |
| 2024 | 201,953 |
| Thereafter | 462,010 |
| Total expected amortization expense | $ 1,720,565 |

**ADOBE INC.**

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

## NOTE 9. ACCRUED EXPENSES

Accrued expenses as of November 29, 2019 and November 30, 2018 consisted of the following:

| *(in thousands)* | 2019 | 2018 |
|---|---|---|
| Accrued compensation and benefits | $ 317,897 | $ 313,874 |
| Accrued bonuses | 222,333 | 216,007 |
| Accrued media costs | 117,591 | 124,849 |
| Accrued building rent | 98,570 | 61,544 |
| Taxes payable | 82,988 | 57,525 |
| Accrued corporate marketing | 79,937 | 66,186 |
| Sales and marketing allowances | 74,163 | 44,968 |
| Royalties payable | 61,938 | 51,529 |
| Fair value of derivatives | 32,531 | 816 |
| Accrued interest expense | 28,878 | 29,481 |
| Other | 281,722 | 196,406 |
| Accrued expenses | $ 1,398,548 | $ 1,163,185 |

Accrued media costs primarily relate to our advertising platform offerings. We accrue for media costs related to impressions purchased from third-party ad inventory sources. Other primarily includes general corporate accruals for local and regional expenses and sales returns reserves.

## NOTE 10. INCOME TAXES

Income before income taxes for fiscal 2019, 2018 and 2017 consisted of the following:

| *(in thousands)* | 2019 | 2018 | 2017 |
|---|---|---|---|
| Domestic | $ 437,603 | $ 542,948 | $ 1,056,156 |
| Foreign | 2,767,138 | 2,250,928 | 1,081,485 |
| Income before income taxes | $ 3,204,741 | $ 2,793,876 | $ 2,137,641 |

The provision for income taxes for fiscal 2019, 2018 and 2017 consisted of the following:

| *(in thousands)* | 2019 | 2018 | 2017 |
|---|---|---|---|
| Current: | | | |
| United States federal | $ 6,563 | $ 501,272 | $ 298,802 |
| Foreign | 211,174 | 140,308 | 60,962 |
| State and local | 30,893 | 28,612 | 33,578 |
| Total current | 248,630 | 670,192 | 393,342 |
| Deferred: | | | |
| United States federal | 22,528 | (466,113) | 48,905 |
| Foreign | (11,675) | (9,734) | (4,242) |
| State and local | (6,200) | 8,757 | 5,682 |
| Total deferred | 4,653 | (467,090) | 50,345 |
| Provision for income taxes | $ 253,283 | $ 203,102 | $ 443,687 |

**ADOBE INC.**

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

*U.S. Tax Reform*

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted into law, which significantly changed existing U.S. tax law and includes many provisions applicable to us, such as reducing the U.S. federal statutory tax rate, imposing a one-time transition tax on deemed repatriation of deferred foreign income and adopting a territorial tax system. The Tax Act reduced the U.S. federal statutory tax rate from 35% to 21% effective January 1, 2018. For fiscal 2018, our blended U.S. federal statutory tax rate was 22.2%. This was the result of using the tax rate of 35% for the first month of fiscal 2018 and the reduced tax rate of 21% for the remaining eleven months of fiscal 2018. The Tax Act also required us to incur a one-time transition tax on deferred foreign income not previously subject to U.S. income tax at a rate of 15.5% for foreign cash and certain other net current assets, and 8% on the remaining income, in each case reduced by certain foreign tax credits. The Tax Act also included a provision to tax global intangible low-taxed income of foreign subsidiaries, a special tax deduction for foreign-derived intangible income and a base erosion anti-abuse tax measure that may tax certain payments between a U.S. corporation and its subsidiaries. These additional provisions of the Tax Act were effective for us beginning December 1, 2018.

During fiscal 2018, we recorded tax charges for the impact of the Tax Act using the current available information and technical guidance on the interpretations of the Tax Act. The accounting analysis was finalized based on the guidance, interpretations and data available as of November 30, 2018.

Certain international provisions introduced in the Tax Act are effective for us starting in fiscal 2019. As part of these provisions, an accounting policy election is available to either account for the tax effects of certain taxes in the period that is subject to such taxes or to provide deferred taxes for book and tax basis differences that upon reversal may be subject to such taxes. We elected to account for the tax effects of these provisions in the period that it is subject to such tax.

*Reconciliation of Provision for Income Taxes*

Total income tax expense differs from the expected tax expense (computed by multiplying the U.S. federal statutory rate of 21% in 2019, 22.2% in 2018 and 35% in 2017 by income before income taxes) as a result of the following:

| *(in thousands)* | 2019 | 2018 | 2017 |
|---|---|---|---|
| Computed "expected" tax expense | $ 672,996 | $ 620,240 | $ 748,174 |
| State tax expense, net of federal benefit | 23,510 | 25,214 | 25,131 |
| Tax credits | (99,772) | (110,849) | (38,000) |
| Effects of non-U.S. operations | (224,214) | (384,393) | (215,490) |
| Stock-based compensation, net of tax deduction | (85,944) | (95,372) | (42,512) |
| Resolution of income tax examinations | (39,291) | (42,432) | (31,358) |
| Domestic manufacturing deduction benefit | — | (13,098) | (32,200) |
| Impacts of the U.S. Tax Act | 2,955 | 185,997 | — |
| Tax charge for licensing acquired company technology to foreign subsidiaries | — | — | 24,771 |
| Other | 3,043 | 17,795 | 5,171 |
| Provision for income taxes | $ 253,283 | $ 203,102 | $ 443,687 |

**ADOBE INC.**

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

*Deferred Tax Assets and Liabilities*

The tax effects of the temporary differences that gave rise to significant portions of the deferred tax assets and liabilities as of November 29, 2019 and November 30, 2018 are presented below:

| *(in thousands)* | 2019 | 2018 |
|---|---|---|
| Deferred tax assets: | | |
| Acquired technology | $ 4,568 | $ 9,561 |
| Reserves and accruals | 53,796 | 59,100 |
| Deferred revenue | 12,036 | 37,690 |
| Stock-based compensation | 106,911 | 89,240 |
| Net operating loss carryforwards of acquired companies | 137,151 | 209,445 |
| Credit carryforwards | 252,074 | 173,748 |
| Capitalized expenses | 44,912 | 19,074 |
| Benefits relating to tax positions | 47,458 | 51,965 |
| Other | 32,794 | 37,160 |
| Total gross deferred tax assets | 691,700 | 686,983 |
| Deferred tax asset valuation allowance | (244,432) | (174,496) |
| Total deferred tax assets | 447,268 | 512,487 |
| Deferred tax liabilities: | | |
| Depreciation and amortization | 36,458 | 40,425 |
| Undistributed earnings of foreign subsidiaries | 51,883 | 17,556 |
| Prepaid expenses | 86,279 | — |
| Acquired intangible assets | 413,146 | 501,208 |
| Total deferred tax liabilities | 587,766 | 559,189 |
| Net deferred tax liabilities | $ 140,498 | $ 46,702 |

Deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Included in the deferred tax assets and liabilities for fiscal 2019 and 2018 are amounts related to various acquisitions. In assessing the realizability of deferred tax assets, management determined that it is not more likely than not that we will have sufficient taxable income in certain states and foreign jurisdictions to fully utilize available tax credits and other attributes. The deferred tax assets are offset by a valuation allowance to the extent it is more likely than not that they are not expected to be realized.

We provide U.S. income taxes on the earnings of foreign subsidiaries unless the subsidiaries' earnings are considered permanently reinvested outside the United States or are exempted from taxation as a result of the new territorial tax system. To the extent that the foreign earnings previously treated as permanently reinvested are repatriated, the related U.S. tax liability may be reduced by any foreign income taxes paid on these earnings. As of November 29, 2019, the cumulative amount of foreign earnings upon which U.S. income taxes have not been provided, and the corresponding unrecognized deferred tax liability, is not material.

As of November 29, 2019, we have net operating loss carryforwards of approximately $421.6 million for federal, $374.5 million for state and $82.6 million for foreign. We also have federal, state and foreign tax credit carryforwards of approximately $44.4 million, $243.8 million and $15.1 million, respectively. The net operating loss carryforward assets and tax credits will expire in various years from fiscal 2020 through 2038. The majority of the state tax credit carryforwards and a portion of the federal net operating loss carryforwards can be carried forward indefinitely. The net operating loss carryforward assets and certain credits are reduced by the valuation allowance and are subject to an annual limitation under Internal Revenue Code Section 382. The carrying amount of such assets and credits is expected to be fully realized.

As of November 29, 2019, a valuation allowance of $244.4 million has been established for certain deferred tax assets related to certain federal, state and foreign assets. For fiscal 2019, the total change in the valuation allowance was $69.9 million.

*Accounting for Uncertainty in Income Taxes*

During fiscal 2019 and 2018, our aggregate changes in our total gross amount of unrecognized tax benefits are summarized as follows:

| *(in thousands)* | 2019 | 2018 |
|---|---|---|
| Beginning balance | $ 196,152 | $ 172,945 |
| Gross increases in unrecognized tax benefits – prior year tax positions | 14,850 | 16,191 |
| Gross decreases in unrecognized tax benefits – prior year tax positions | (2,282) | (4,000) |
| Gross increases in unrecognized tax benefits – current year tax positions | 18,526 | 60,721 |
| Gross decreases in unrecognized tax benefits – current year tax positions | (2,879) | — |
| Settlements with taxing authorities | (230) | — |
| Lapse of statute of limitations | (49,813) | (45,922) |
| Foreign exchange gains and losses | (987) | (3,783) |
| Ending balance | $ 173,337 | $ 196,152 |

The combined amount of accrued interest and penalties related to tax positions taken on our tax returns were approximately $25.1 million and $24.6 million for fiscal 2019 and 2018, respectively. These amounts were included in long-term income taxes payable in their respective years.

We file income tax returns in the United States on a federal basis and in many U.S. state and foreign jurisdictions. We are subject to the continual examination of our income tax returns by the U.S. Internal Revenue Service ("IRS") and other domestic and foreign tax authorities. Our major tax jurisdictions are Ireland, California and the United States. For Ireland, California and the United States, the earliest fiscal years open for examination are 2008, 2015 and 2016, respectively. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from these examinations. We believe such estimates to be reasonable; however, there can be no assurance that the final determination of any of these examinations will not have an adverse effect on our operating results and financial position.

The timing of the resolution of income tax examinations is highly uncertain as are the amounts and timing of tax payments that are part of any audit settlement process. These events could cause large fluctuations in the balance sheet classification of our tax assets and liabilities. We believe that within the next 12 months, it is reasonably possible that either certain audits will conclude or statutes of limitations on certain income tax examination periods will expire, or both. Given the uncertainties described above, we can only determine a range of estimated potential decreases in underlying unrecognized tax benefits ranging from $0 to approximately $20 million.

## NOTE 11. BENEFIT PLANS

*Retirement Savings Plan*

In 1987, we adopted an Employee Investment Plan, qualified under Section 401(k) of the Internal Revenue Code, which is a retirement savings plan covering substantially all of our U.S. employees, now referred to as the Adobe Inc. 401(k) Retirement Savings Plan. Under the plan, eligible employees may contribute up to 65% of their pretax or after-tax salary, subject to the IRS annual contribution limits. In fiscal 2019, we matched 50% of the first 6% of the employee's eligible compensation. We contributed $51.7 million, $41.0 million and $34.3 million in fiscal 2019, 2018 and 2017, respectively. We are under no obligation to continue matching future employee contributions and, at our discretion, may change our practices at any time.

*Deferred Compensation Plan*

On September 21, 2006, the Board of Directors approved the Adobe Inc. Deferred Compensation Plan, effective December 2, 2006 (the “Deferred Compensation Plan”). The Deferred Compensation Plan is an unfunded, non-qualified, deferred compensation arrangement under which certain executives and members of the Board of Directors are able to defer a portion of their annual compensation. Participants may elect to contribute up to 75% of their base salary and 100% of other specified compensation, including commissions, bonuses, performance awards, time-based restricted stock units and directors’ fees. Participants are able to elect the payment of benefits to begin on a specified date at least three years after the end of the plan year in which election is made or vests. For cash benefit elections, distributions are made in cash and in the form of a lump sum, or five, ten, or fifteen-year annual installments. For stock benefit elections, distributions are settled in stock and in the form of a lump sum payment only. Beginning January 1, 2020, our updated Deferred Compensation Plan will no longer allow participants, except our Board of Directors, to make stock benefit elections.

As of November 29, 2019 and November 30, 2018, the invested amounts under the Deferred Compensation Plan total $93.8 million and $69.0 million, respectively and were recorded as other assets on our Consolidated Balance Sheets. As of November 29, 2019 and November 30, 2018, $108.8 million and $84.0 million, respectively, were recorded as long-term liabilities to recognize undistributed deferred compensation due to employees.

## NOTE 12. STOCK-BASED COMPENSATION

Our stock-based compensation programs are long-term retention programs that are intended to attract, retain and provide incentives for employees, officers and directors, and to align stockholder and employee interests. We have the following stock-based compensation plans and programs:

*Restricted Stock Units*

Prior to April 2019, we granted restricted stock units and performance awards to eligible employees under our 2003 Equity Incentive Plan, as amended (“2003 Plan”). In April 2019, our stockholders approved the 2019 Equity Incentive Plan (“2019 Plan”) which replaced the 2003 Plan.

Beginning January 2019, restricted stock units granted as part of our annual review process or for promotions vest over four years. Restricted stock units granted as part of our annual review process or for promotions with grant dates prior to January 2019 continue to vest over three years. Restricted stock units granted to new hires generally vest over four years. Certain grants have other vesting periods approved by our Board of Directors or an authorized committee. We grant performance awards to officers and key employees which cliff-vest after three years.

As of November 29, 2019, we had reserved 46.0 million shares of common stock for issuance under our 2019 Plan and had 44.1 million shares available for grant.

*Employee Stock Purchase Plan*

Our 1997 Employee Stock Purchase Plan (“ESPP”) allows eligible employee participants to purchase shares of our common stock at a discount through payroll deductions. The ESPP consists of a twenty-four-month offering period with four six-month purchase periods in each offering period. Employees purchase shares in each purchase period at 85% of the market value of our common stock at either the beginning of the offering period or the end of the purchase period, whichever price is lower. The ESPP will continue until the earlier of termination by the Board of Directors or the date on which all of the shares available for issuance under the plan have been issued.

As of November 29, 2019, we had reserved 93.0 million shares of our common stock for issuance under the ESPP and approximately 3.8 million shares remain available for future issuance.

*Performance Share Programs*

Our 2019, 2018 and 2017 Performance Share Programs aim to help focus key employees on building stockholder value, provide significant award potential for achieving outstanding Company performance and enhance the ability of the Company to attract and retain highly talented and competent individuals. The Executive Compensation Committee of our Board of Directors approves the terms of each of our Performance Share Programs, including the award calculation methodology, under the terms of our 2003 Plan. Shares may be earned based on the achievement of an objective relative total stockholder return measured over a three-year performance period. Performance share awards will be awarded and fully vest upon the later of the Executive Compensation Committee's certification of the level of achievement or the three-year anniversary of each grant. Program participants generally have the ability to receive up to 200% of the target number of shares originally granted.

On January 24, 2018, the Executive Compensation Committee approved the 2019 Performance Share Program, the terms of which are similar to prior year performance share programs as discussed above.

**ADOBE INC.**

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

As of November 29, 2019, the shares awarded under our 2019, 2018 and 2017 Performance Share Programs remain outstanding and are yet to be achieved.

*Issuance of Shares*

Upon vesting of restricted stock units and performance shares, purchases of shares under the ESPP and exercise of stock options, we will issue treasury stock. If treasury stock is not available, common stock will be issued. In order to minimize the impact of on-going dilution from exercises of stock options and vesting of restricted stock units and performance shares, we instituted a stock repurchase program. *See Note 14 for information regarding our stock repurchase programs.*

*Valuation of Stock-Based Compensation*

Stock-based compensation cost is measured at the grant date based on the fair value of the award.

Our performance share awards are valued using a Monte Carlo Simulation model. The fair value of the awards are fixed at grant date and amortized over the longer of the remaining performance or service period.

We use the Black-Scholes option pricing model to determine the fair value of ESPP shares. The determination of the fair value of stock-based payment awards on the date of grant using an option pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the expected term of the awards, actual and projected employee stock option exercise behaviors, a risk-free interest rate and any expected dividends.

The expected term of ESPP shares is the average of the remaining purchase periods under each offering period. The assumptions used to value employee stock purchase rights were as follows:

| | 2019 | 2018 | 2017 |
|---|---|---|---|
| Expected life (in years) | 0.5 - 2.0 | 0.5 - 2.0 | 0.5 - 2.0 |
| Volatility | 30% - 35% | 26% - 29% | 22% - 27% |
| Risk free interest rate | 1.78% - 2.47% | 1.54% - 2.52% | 0.62% - 1.41% |

*Summary of Restricted Stock Units*

Restricted stock unit activity for fiscal 2019, 2018 and 2017 was as follows:

| *(in thousands)* | 2019 | 2018 | 2017 |
|---|---|---|---|
| Beginning outstanding balance | 8,668 | 9,304 | 8,316 |
| Awarded | 4,598 | 4,012 | 5,018 |
| Released | (3,847) | (3,988) | (3,859) |
| Forfeited | (785) | (660) | (766) |
| Increase due to acquisition | — | — | 595 |
| Ending outstanding balance | 8,634 | 8,668 | 9,304 |

The weighted average grant date fair values of restricted stock units granted during fiscal 2019, 2018 and 2017 were $253.91, $208.73 and $120.33, respectively. The total fair value of restricted stock units vested during fiscal 2019, 2018 and 2017 was $969.6 million, $837.3 million and $472.0 million, respectively.

**ADOBE INC.**

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

Information regarding restricted stock units outstanding at November 29, 2019, November 30, 2018 and December 1, 2017 is summarized below:

| | Number of Shares (thousands) | Weighted Average Remaining Contractual Life (years) | Aggregate Intrinsic Value(*) (millions) |
|---|---|---|---|
| **2019** | | | |
| Restricted stock units outstanding | 8,634 | 1.12 | $ 2,672.6 |
| Restricted stock units expected to vest | 7,987 | 1.05 | $ 2,472.2 |
| **2018** | | | |
| Restricted stock units outstanding | 8,668 | 1.06 | $ 2,174.7 |
| Restricted stock units expected to vest | 8,049 | 1.01 | $ 2,019.5 |
| **2017** | | | |
| Restricted stock units outstanding | 9,304 | 1.11 | $ 1,670.2 |
| Restricted stock units expected to vest | 8,608 | 1.05 | $ 1,545.3 |

(*) The intrinsic value is calculated as the market value as of the end of the fiscal period. As reported by the NASDAQ Global Select Market, the market values as of November 29, 2019, November 30, 2018 and December 1, 2017 were $309.53, $250.89 and $179.52, respectively.

*Summary of Performance Shares*

Performance share activity for fiscal 2019, 2018 and 2017 was as follows:

| *(in thousands)* | 2019 | | 2018 | | 2017 | |
|---|---|---|---|---|---|---|
| | Shares Granted (1) | Maximum Shares Eligible to Receive | Shares Granted (2) | Maximum Shares Eligible to Receive | Shares Granted (3) | Maximum Shares Eligible to Receive |
| Beginning outstanding balance | 1,148 | 2,296 | 1,534 | 3,068 | 1,630 | 3,261 |
| Awarded | 722 | 614 | 837 | 628 | 1,082 | 1,040 |
| Achieved | (830) | (830) | (1,050) | (1,053) | (1,135) | (1,147) |
| Forfeited | (82) | (164) | (173) | (347) | (43) | (86) |
| Ending outstanding balance | 958 | 1,916 | 1,148 | 2,296 | 1,534 | 3,068 |

(1) Shares awarded during fiscal 2019 include 0.4 million additional shares awarded for the final achievement of the 2016 Performance Share Program which was certified in the first quarter of fiscal 2019. The remaining awarded shares were for the 2019 Performance Share Program. Shares achieved during fiscal 2019 resulted from 200% achievement of target for the 2016 Performance Share Program.

(2) Shares awarded during fiscal 2018 include 0.5 million additional shares awarded for the final achievement of the 2015 Performance Share Program which was certified in the first quarter of fiscal 2018. The remaining awarded shares were for the 2018 Performance Share Program. Shares achieved during fiscal 2018 resulted from 200% achievement of target for the 2015 Performance Share Program.

(3) Shares awarded during fiscal 2017 include 0.6 million additional shares awarded for the final achievement of the 2014 Performance Share Program which was certified in the first quarter of fiscal 2017. The remaining

awarded shares were for the 2017 Performance Share Program. Shares achieved during fiscal 2017 resulted from 198% achievement of target for the 2014 Performance Share Program.

The total fair value of performance awards vested during fiscal 2019, 2018 and 2017 was $203.8 million, $208.2 million and $127.4 million, respectively.

*Summary of Employee Stock Purchase Plan Shares*

The weighted average subscription date fair value of shares under the ESPP during fiscal 2019, 2018 and 2017 were $72.98, $53.12 and $29.86, respectively. Employees purchased 1.5 million shares at an average price of $150.55, 1.8 million shares at an average price of $104.94, and 1.9 million shares at an average price of $77.63 for fiscal 2019, 2018 and 2017, respectively. The intrinsic value of shares purchased during fiscal 2019, 2018 and 2017 was $178.8 million, $198.9 million and $97.7 million, respectively. The intrinsic value is calculated as the difference between the market value on the date of purchase and the purchase price of the shares.

*Grants to Executive Officers*

All equity awards granted to executive officers are made after a review by and with the approval of the Executive Compensation Committee of the Board of Directors.

*Grants to Non-Employee Directors*

Although the 2003 and 2019 Plans provide for the granting of non-qualified stock options and restricted stock units to non-employee directors, restricted stock units are the primary form of our grants to non-employee directors. The initial equity grant to new non-employee directors and annual equity grants to existing non-employee directors are restricted stock unit awards, each grant having an aggregate value of $0.3 million based on the average stock price over the 30 calendar days ending on the day before the date of grant and vest 100% on the day preceding the next annual meeting. The actual target grant value of initial equity grants will be prorated based on the number of days remaining before the next annual meeting or the date of the first anniversary of our last annual meeting if the next annual meeting is not yet scheduled.

Restricted stock units granted to directors for fiscal 2019, 2018 and 2017 were as follows:

| *(in thousands)* | **2019** | **2018** | **2017** |
|---|---|---|---|
| Annual equity grants to existing directors | 10 | 11 | 18 |
| Initial equity grants to new directors | 1 | 1 | — |

*Compensation Costs*

We recognize the estimated compensation cost of restricted stock units, net of estimated forfeitures, on a straight-line basis over the requisite service period of the entire award, which is generally the vesting period. The estimated compensation cost is based on the fair value of our common stock on the date of grant.

We also recognize the estimated compensation cost of performance shares, net of estimated forfeitures, on a straight-line basis over the requisite performance period or service period of the entire award, whichever is longer. Our performance share awards are earned upon achievement of an objective total stockholder return measure at the end of the three-year performance period, as described above.

We estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate forfeitures and record stock-based compensation expense only for those awards that are expected to vest.

As of November 29, 2019, there was $1.36 billion of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock-based awards and purchase rights which will be recognized over a weighted average period of 1.9 years. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

**ADOBE INC.**

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

Total stock-based compensation costs that have been included in our Consolidated Statements of Income for fiscal 2019, 2018 and 2017 were as follows:

| *(in thousands)* | Income Statement Classifications | | | | | |
|---|---|---|---|---|---|---|
| | Cost of Revenue–Subscription | Cost of Revenue–Services and Support | Research and Development | Sales and Marketing | General and Administrative | Total (1) |
| **Restricted Stock Units and Performance Share Awards** | | | | | | |
| 2019 | $ 22,822 | $ 18,535 | $ 338,483 | $ 206,371 | $ 98,886 | $ 685,097 |
| 2018 | $ 17,515 | $ 12,111 | $ 253,078 | $ 178,548 | $ 77,462 | $ 538,714 |
| 2017 | $ 16,792 | $ 9,602 | $ 161,366 | $ 139,047 | $ 77,133 | $ 403,940 |
| **Stock Purchase Rights and Options** | | | | | | |
| 2019 | $ 5,823 | $ 7,271 | $ 36,663 | $ 42,405 | $ 10,446 | $ 102,608 |
| 2018 | $ 4,102 | $ 8,286 | $ 23,918 | $ 27,252 | $ 7,290 | $ 70,848 |
| 2017 | $ 180 | $ 6,661 | $ 20,126 | $ 18,592 | $ 4,973 | $ 50,532 |

(1) During fiscal 2019, 2018 and 2017, we recorded tax benefits related to stock-based compensation costs of $248.4 million, $222.4 million and $153.2 million, respectively.

## NOTE 13. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The components of accumulated other comprehensive income (loss) and activity, net of related taxes, for fiscal 2019 were as follows:

| *(in thousands)* | November 30, 2018 | Increase / Decrease | Reclassification Adjustments | | November 29, 2019 |
|---|---|---|---|---|---|
| Net unrealized gains / losses on available-for-sale securities: | | | | | |
| Unrealized gains on available-for-sale securities | $ 44 | $ 4,594 | $ (171) | | $ 4,467 |
| Unrealized losses on available-for-sale securities | (25,374) | 24,815 | 295 | | (264) |
| Total net unrealized gains / losses on available-for-sale securities | (25,330) | 29,409 | 124 | (1) | 4,203 |
| Net unrealized gains / losses on derivative instruments designated as hedging instruments | 21,732 | 294 | (44,334) | (2) | (22,308) |
| Cumulative foreign currency translation adjustments | (144,532) | (25,397) | — | | (169,929) |
| Total accumulated other comprehensive income (loss), net of taxes | $ (148,130) | $ 4,306 | $ (44,210) | | $ (188,034) |

(1) Reclassification adjustments for gains / losses on available-for-sale securities are classified in interest and other income (expense), net.

(2) Reclassification adjustments for gains / losses on foreign currency hedges are classified in revenue and reclassification adjustments for gains / losses on Treasury lock hedges are classified in interest expense.

The following table sets forth the taxes related to each component of other comprehensive income for fiscal 2019, 2018 and 2017:

| *(in thousands)* | 2019 | 2018 | 2017 |
|---|---|---|---|
| Available-for-sale securities: | | | |
| Unrealized gains / losses | $ — | $ — | $ 663 |
| Reclassification adjustments | — | — | (491) |
| Subtotal available-for-sale securities | — | — | 172 |
| Derivatives designated as hedging instruments: | | | |
| Unrealized gains / losses | 6,968 | — | — |
| Reclassification adjustments | (383) | (1,946) | (732) |
| Subtotal derivatives designated as hedging instruments | 6,585 | (1,946) | (732) |
| Foreign currency translation adjustments | — | (1,742) | 3,005 |
| Total taxes, other comprehensive income (loss) | $ 6,585 | $ (3,688) | $ 2,445 |

## NOTE 14. STOCK REPURCHASE PROGRAM

To facilitate our stock repurchase program, designed to return value to our stockholders and minimize dilution from stock issuances, we may repurchase shares in the open market or enter into structured repurchase agreements with third parties. In May 2018, our Board of Directors granted us an authority to repurchase up to $8 billion in common stock through the end of fiscal 2021.

During fiscal 2019, 2018 and 2017, we entered into several structured stock repurchase agreements with large financial institutions, whereupon we provided them with prepayments totaling $2.75 billion, $2.05 billion, and $1.10 billion, respectively. We enter into these agreements in order to take advantage of repurchasing shares at a guaranteed discount to the Volume Weighted Average Price ("VWAP") of our common stock over a specified period of time. We only enter into such transactions when the discount that we receive is higher than the foregone return on our cash prepayments to the financial institutions. There were no explicit commissions or fees on these structured repurchases. Under the terms of the agreements, there is no requirement for the financial institutions to return any portion of the prepayment to us.

The financial institutions agree to deliver shares to us at monthly intervals during the contract term. The parameters used to calculate the number of shares deliverable are: the total notional amount of the contract, the number of trading days in the contract, the number of trading days in the interval and the average VWAP of our stock during the interval less the agreed upon discount. We repurchased approximately 9.9 million shares at an average price of $270.23 per share in fiscal 2019, 8.7 million shares at an average price of $230.43 per share in fiscal 2018, and 8.2 million shares at an average price of $134.20 per share in fiscal 2017.

For fiscal 2019, 2018 and 2017, the prepayments were classified as treasury stock on our Consolidated Balance Sheets at the payment date, though only shares physically delivered to us by November 29, 2019, November 30, 2018 and December 1, 2017 were excluded from the computation of earnings per share. As of November 29, 2019, $229.2 million of prepayments remained under the agreement.

Subsequent to November 29, 2019, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of $850 million. This amount will be classified as treasury stock on our Consolidated Balance Sheets. Upon completion of the $850 million stock repurchase agreement, $4.25 billion remains under our May 2018 authority.

**ADOBE INC.**

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

## NOTE 15. NET INCOME PER SHARE

Basic net income per share is computed using the weighted average number of common shares outstanding for the period, excluding unvested restricted stock units and performance awards. Diluted net income per share is based upon the weighted average common shares outstanding for the period plus dilutive potential common shares, including unvested restricted stock units, purchase rights, performance awards and stock options using the treasury stock method.

The following table sets forth the computation of basic and diluted net income per share for fiscal 2019, 2018 and 2017:

| *(in thousands, except per share data)* | 2019 | 2018 | 2017 |
|---|---|---|---|
| Net income | $ 2,951,458 | $ 2,590,774 | $ 1,693,954 |
| Shares used to compute basic net income per share | 486,291 | 490,564 | 493,632 |
| Dilutive potential common shares: | | | |
| Restricted stock units and performance share awards | 4,875 | 7,142 | 7,161 |
| Stock purchase rights and options | 406 | 137 | 330 |
| Shares used to compute diluted net income per share | 491,572 | 497,843 | 501,123 |
| Basic net income per share | $ 6.07 | $ 5.28 | $ 3.43 |
| Diluted net income per share | $ 6.00 | $ 5.20 | $ 3.38 |
| | | | |
| Anti-dilutive potential common shares [(1)] | 175 | 209 | 141 |

_________________

(1) Potential common stock equivalents not included in the calculation of diluted net income per share as the effect would have been anti-dilutive.

## NOTE 16. COMMITMENTS AND CONTINGENCIES

*Lease Commitments*

We lease certain of our facilities and some of our equipment under non-cancellable operating lease arrangements that expire at various dates through 2031. We also have one land lease that expires in 2091. Rent expense includes base contractual rent and variable costs such as building expenses, utilities, taxes, insurance and equipment rental. Rent expense for these leases was approximately $170.5 million, $137.2 million and $115.4 million in fiscal 2019, 2018 and 2017, respectively. Our sublease income was immaterial for all periods presented.

*Unconditional Purchase Obligations*

Our purchase obligations consist of agreements to purchase goods and services entered into in the ordinary course of business. The following table summarizes our non-cancellable unconditional purchase obligations and operating leases for each of the next five years and thereafter as of November 29, 2019:

| *(in thousands)* | | Operating Leases | |
|---|---|---|---|
| **Fiscal Year** | **Purchase Obligations** | **Future Minimum Lease Payments** | **Future Minimum Sublease Income** |
| 2020 | $ 545,042 | $ 98,200 | $ 9,523 |
| 2021 | 407,528 | 91,866 | 9,000 |
| 2022 | 528,266 | 81,493 | 6,362 |

| | | | |
|---|---|---|---|
| 2023 | 555,658 | 68,539 | 2,327 |
| 2024 | — | 60,691 | — |
| Thereafter | — | 337,903 | — |
| Total | $ 2,036,494 | $ 738,692 | $ 27,212 |

*Royalties*

We have royalty commitments associated with the licensing of certain offerings and products. Royalty expense is generally based on a dollar amount per unit or a percentage of the underlying revenue. Royalty expense, which was recorded under our cost of revenue on our Consolidated Statements of Income, was approximately $153.7 million, $119.1 million and $100.9 million in fiscal 2019, 2018 and 2017, respectively.

*Indemnifications*

In the ordinary course of business, we provide indemnifications of varying scope to customers and channel partners against claims of intellectual property infringement made by third parties arising from the use of our products and from time to time, we are subject to claims by our customers under these indemnification provisions. Historically, costs related to these indemnification provisions have not been significant and we are unable to estimate the maximum potential impact of these indemnification provisions on our future results of operations.

To the extent permitted under Delaware law, we have agreements whereby we indemnify our officers and directors for certain events or occurrences while the officer or director is or was serving at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the officer's or director's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that reduces our exposure and enables us to recover a portion of any future amounts paid. We believe the estimated fair value of these indemnification agreements in excess of applicable insurance coverage is minimal.

*Legal Proceedings*

In connection with disputes relating to the validity or alleged infringement of third-party intellectual property rights, including patent rights, we have been, are currently and may in the future be subject to claims, negotiations or complex, protracted litigation. Intellectual property disputes and litigation may be very costly and can be disruptive to our business operations by diverting the attention and energies of management and key technical personnel. Although we have successfully defended or resolved past litigation and disputes, we may not prevail in any ongoing or future litigation and disputes. Third-party intellectual property disputes could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from licensing certain of our products or offering certain of our services, subject us to injunctions restricting our sale of products or services, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers including contractual provisions under various license arrangements and service agreements.

In addition to intellectual property disputes, we are subject to legal proceedings, claims and investigations in the ordinary course of business, including claims relating to commercial, employment and other matters. Some of these disputes and legal proceedings may include speculative claims for substantial or indeterminate amounts of damages. We consider all claims on a quarterly basis in accordance with GAAP and based on known facts assess whether potential losses are considered reasonably possible, probable and estimable. Based upon this assessment, we then evaluate disclosure requirements and whether to accrue for such claims in our financial statements. This determination is then reviewed and discussed with our Audit Committee and our independent registered public accounting firm.

We make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Unless otherwise specifically disclosed in this note, we have determined that no provision for liability nor disclosure is required related to any claim against us because: (a) there is not a reasonable possibility that a loss exceeding amounts already recognized (if any) may be incurred with respect to such claim; (b) a reasonably possible loss or range of loss cannot be estimated; or (c) such estimate is immaterial.

All legal costs associated with litigation are expensed as incurred. Litigation is inherently unpredictable. However, we believe that we have valid defenses with respect to the legal matters pending against us. It is possible, nevertheless, that our consolidated financial position, cash flows or results of operations could be negatively affected by an unfavorable resolution of one or more of such proceedings, claims or investigations.

In connection with our anti-piracy efforts, conducted both internally and through organizations such as the Business Software Alliance, from time to time we undertake litigation against alleged copyright infringers. Such lawsuits may lead to counter-claims alleging improper use of litigation or violation of other laws. We believe we have valid defenses with respect to such counter-claims; however, it is possible that our consolidated financial position, cash flows or results of operations could be negatively affected in any particular period by the resolution of one or more of these counter-claims.

## NOTE 17. DEBT

Our debt as of November 29, 2019 and November 30, 2018 consisted of the following:

| *(in thousands)* | 2019 | 2018 |
|---|---|---|
| Current debt: | | |
| Term loan | $ 2,249,784 | $ — |
| Notes | 899,767 | — |
| Fair value of interest rate swap | (208) | — |
| Current debt | 3,149,343 | — |
| Long-term debt: | | |
| Term loan | — | 2,248,427 |
| Notes | 988,924 | 1,886,117 |
| Fair value of interest rate swap | — | (9,744) |
| Long-term debt | 988,924 | 4,124,800 |
| Total carrying value of debt | $ 4,138,267 | $ 4,124,800 |

*Term Loan Credit Agreement*

In October 2018, we entered into a credit agreement providing for an up to $2.25 billion senior unsecured term loan for the purpose of partially funding the purchase price for our acquisition of Marketo and the related fees and expenses incurred in connection with the acquisition. The Term Loan funds were received on October 31, 2018 upon closing of the acquisition and will mature 18 months following the initial funding date. In addition, we incurred issuance costs of $0.7 million which are amortized to interest expense over the term using the straight-line method. The Term Loan ranks equally with our other unsecured and unsubordinated indebtedness. There are no scheduled principal amortization payments prior to maturity and the Term Loan may be prepaid and terminated at our election at any time without penalty or premium. At our election, the Term Loan will bear interest at either (i) LIBOR plus a margin, based on our debt ratings, ranging from 0.500% to 1.000% or (ii) a base rate plus a margin, based on our debt ratings, ranging from 0.040% to 0.110%. Interest is payable periodically, in arrears, at the end of each interest period we elect. During fiscal 2019, we made interest payments on our Term Loan totaling $69.9 million. The Term Loan credit agreement contains customary representations, warranties, affirmative and negative covenants, events of default and indemnification provisions in favor of the lenders similar to those contained in the Revolving Credit Agreement, including the financial covenant. As of November 29, 2019, we were in compliance with all covenants. During the second quarter of fiscal 2019, we reclassified the Term Loan as current debt in our Consolidated Balance Sheets. As of November 29, 2019, the carrying value of the Term Loan was $2.25 billion which is net of debt issuance costs. We intend to refinance the Term Loan on or before the due date.

*Senior Notes*

In February 2010, we issued $900 million of 4.75% senior notes due February 1, 2020. Our proceeds were approximately $894.5 million which is net of an issuance discount of $5.5 million. In addition, we incurred issuance costs of $6.4 million. Both the discount and issuance costs are being amortized to interest expense over the term of the 2020 Notes using the effective interest method. The effective interest rate including the discount and issuance costs was 4.92%. Interest is payable semi-annually, in arrears, on February 1 and August 1, and commenced on August 1, 2010.

In June 2014, we entered into interest rate swaps with a total notional amount of $900 million designated as a fair value hedge related to our 2020 Notes. The interest rate swaps effectively convert the fixed interest rate on our 2020 Notes to a floating interest rate based on LIBOR. Under the terms of the swap, we will pay monthly interest at the one-month LIBOR interest rate plus a fixed number of basis points on the $900 million notional amount. In exchange, we will receive 4.75% fixed rate interest from the swap counterparties. The fair value of the interest rate swaps is included in the carrying value of our debt in the Consolidated Balance Sheets. *See Note 6 for further details regarding our interest rate swap derivatives.*

In January 2015, we issued $1 billion of 3.25% senior notes due February 1, 2025 (the “2025 Notes”). Our proceeds were approximately $989.3 million which is net of an issuance discount of $10.7 million. In addition, we incurred issuance costs of $7.9 million. Both the discount and issuance costs are being amortized to interest expense over the term of the 2025 Notes using the effective interest method. The effective interest rate including the discount, issuance costs and interest rate agreement is 3.67%. Interest is payable semi-annually, in arrears on February 1 and August 1, and commenced on August 1, 2015.

During the first quarter of fiscal 2019, we reclassified the 2020 Notes as current debt in our Consolidated Balance Sheets. As of November 29, 2019, the carrying value of the 2020 Notes was $899.6 million which includes the fair value of the interest rate swap and is net of debt issuance costs. We intend to refinance the 2020 Notes on or before the due date.

As of November 29, 2019, our outstanding notes payable consist of the 2020 Notes and 2025 Notes (the “Notes”) with a total carrying value of $1.89 billion, which includes the fair value of the interest rate swaps and is net of debt issuance costs. Based on quoted prices in inactive markets, the fair value of the Notes was $1.96 billion as of November 29, 2019.

The Notes rank equally with our other unsecured and unsubordinated indebtedness. We may redeem the Notes at any time, subject to a make-whole premium. In addition, upon the occurrence of certain change of control triggering events, we may be required to repurchase the Notes, at a price equal to 101% of their principal amount, plus accrued and unpaid interest to the date of repurchase. The Notes also include covenants that limit our ability to grant liens on assets and to enter into sale and leaseback transactions, subject to significant allowances. As of November 29, 2019, we were in compliance with all of the covenants.

During fiscal 2019, we made semi-annual interest payments on our 2020 and 2025 Notes totaling $75.3 million.

In June 2019, in anticipation of refinancing our Term Loan and 2020 Notes, we entered into Treasury lock agreements with large financial institutions which fixed benchmark U.S. Treasury rates for an aggregate notional amount of $1 billion of our future debt issuance. These derivative instruments hedge the impact of changes in the benchmark interest rate to future interest payments and will be terminated upon debt issuance. These derivative instruments were designated as cash flow hedges. *See Note 6 for further details regarding our Treasury lock agreements.*

*Revolving Credit Agreement*

In October 2018, we entered into a credit agreement (“Revolving Credit Agreement”), providing for a five-year $1 billion senior unsecured revolving credit facility and incurred issuance costs of $0.8 million which are amortized to interest expense over the term using the straight-line method. The Revolving Credit Agreement provides for loans to Adobe and certain of its subsidiaries that may be designated from time to time as additional borrowers. Pursuant to the terms of the Revolving Credit Agreement, we may, subject to the agreement of lenders to provide additional commitments, obtain up to an additional $500 million in commitments, for a maximum aggregate commitment of $1.5 billion. At our election, loans under the Revolving Credit Agreement will bear interest at either (i) LIBOR plus a margin, based on our debt ratings, ranging from 0.585% to 1.015% or (ii) a base rate, which is defined as the highest of (a) the agent’s prime rate, (b) the federal funds effective rate plus 0.500% or (c) LIBOR plus 1.00% plus a margin, based on our debt ratings, ranging from 0.000% to 0.015%. In addition, facility fees determined according to our debt ratings are payable on the aggregate commitments, regardless of usage, quarterly in an amount ranging from 0.040% to 0.110% per annum. We are permitted to permanently reduce the aggregate commitment under the Revolving Credit Agreement at any time. Subject to certain conditions stated in the Revolving Credit Agreement, Adobe and any of its subsidiaries designated as additional borrowers may borrow, prepay and re-borrow amounts at any time during the term of the Revolving Credit Agreement.

The Revolving Credit Agreement contains customary representations, warranties, affirmative and negative covenants, including a financial covenant, events of default and indemnification provisions in favor of the lenders. The negative covenants include restrictions regarding the incurrence of liens and indebtedness, certain merger and acquisition transactions, dispositions and other matters, all subject to certain exceptions. The financial covenant, based on a quarterly financial test, requires us not to exceed a maximum leverage ratio.

The facility will terminate and all amounts owing thereunder will be due and payable on the maturity date unless (a) the commitments are terminated earlier upon the occurrence of certain events, including an event of default, or (b) the maturity date is further extended upon our request, subject to the agreement of the lenders.

As of November 29, 2019, there were no outstanding borrowings under this Credit Agreement and we were in compliance with all covenants.

## NOTE 18. NON-OPERATING INCOME (EXPENSE)

Non-operating income (expense) for fiscal 2019, 2018 and 2017 included the following:

| *(in thousands)* | 2019 | 2018 | 2017 |
|---|---|---|---|
| Interest and other income (expense), net: | | | |
| Interest income | $ 68,321 | $ 92,540 | $ 66,069 |
| Foreign exchange gains (losses) | (26,252) | (42,612) | (30,705) |
| Realized gains on fixed income investments | 171 | 655 | 1,673 |
| Realized losses on fixed income investments | (295) | (11,305) | (725) |
| Other | 310 | 258 | 83 |
| Interest and other income (expense), net | $ 42,255 | $ 39,536 | $ 36,395 |
| Interest expense | $ (157,214) | $ (89,242) | $ (74,402) |
| Investment gains (losses), net: | | | |
| Realized investment gains | $ 46,141 | $ 6,128 | $ 3,279 |
| Unrealized investment gains | 5,572 | — | 4,274 |
| Realized investment losses | (134) | — | — |
| Unrealized investment losses | — | (2,915) | — |
| Investment gains (losses), net | $ 51,579 | $ 3,213 | $ 7,553 |
| Non-operating income (expense), net | $ (63,380) | $ (46,493) | $ (30,454) |

**ADOBE INC.**

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

## NOTE 19. SELECTED QUARTERLY FINANCIAL DATA (unaudited)

| *(in thousands, except per share data)* | 2019 | | | |
|---|---|---|---|---|
| | Quarter Ended | | | |
| | March 1 | May 31 | August 30 | November 29 |
| Revenue | $ 2,600,946 | $ 2,744,280 | $ 2,834,126 | $ 2,991,945 |
| Gross profit | $ 2,203,660 | $ 2,336,792 | $ 2,418,163 | $ 2,539,962 |
| Income before income taxes | $ 702,334 | $ 710,772 | $ 834,488 | $ 957,147 |
| Net income | $ 674,241 | $ 632,593 | $ 792,763 | $ 851,861 |
| Basic net income per share | $ 1.38 | $ 1.30 | $ 1.63 | $ 1.76 |
| Diluted net income per share | $ 1.36 | $ 1.29 | $ 1.61 | $ 1.74 |

| *(in thousands, except per share data)* | 2018 | | | |
|---|---|---|---|---|
| | Quarter Ended | | | |
| | March 2 | June 1 | August 31 | November 30 |
| Revenue | $ 2,078,947 | $ 2,195,360 | $ 2,291,076 | $ 2,464,625 |
| Gross profit | $ 1,820,045 | $ 1,914,016 | $ 1,995,584 | $ 2,105,364 |
| Income before income taxes | $ 702,502 | $ 690,799 | $ 701,358 | $ 699,217 |
| Net income | $ 583,076 | $ 663,167 | $ 666,291 | $ 678,240 |
| Basic net income per share | $ 1.18 | $ 1.35 | $ 1.36 | $ 1.39 |
| Diluted net income per share | $ 1.17 | $ 1.33 | $ 1.34 | $ 1.37 |

Our fiscal year is a 52- or 53-week year that ends on the Friday closest to November 30. Each of the fiscal quarters presented were comprised of 13 weeks.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors
Adobe Inc.:

*Opinions on the Consolidated Financial Statements and Internal Control Over Financial Reporting*

We have audited the accompanying consolidated balance sheets of Adobe Inc. and subsidiaries (the Company) as of November 29, 2019 and November 30, 2018, the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended November 29, 2019, and the related notes (collectively, the consolidated financial statements). We also have audited the Company's internal control over financial reporting as of November 29, 2019, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of November 29, 2019 and November 30, 2018, and the results of its operations and its cash flows for each of the years in the three-year period ended November 29, 2019, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of November 29, 2019 based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

*Change in Accounting Principle*

As discussed in Note 1 to the consolidated financial statements, the Company has changed its method of accounting for revenue from contracts with customers and sales commissions as of December 1, 2018, due to the adoption of Financial Accounting Standards Board's Accounting Standards Codification (ASC) Topic 606,*Revenue from Contracts with Customers,* and Subtopic 340-40, *Other Assets and Deferred Costs - Contracts with Customers*.

*Basis for Opinions*

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Controls over Financial Reporting under item 9A. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

*Definition and Limitations of Internal Control Over Financial Reporting*

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

*Critical Audit Matter*

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgment. The communication of a critical audit matter does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

*Assessment of performance obligations in cloud-enabled software subscriptions*

As discussed in Note 1 to the consolidated financial statements, cloud-enabled services are highly integrated and interrelated with on-premise or on-device software licenses in the Company's Creative Cloud and Document Cloud subscription offerings. Because of this, the cloud-based services and the on-premise/on-device software licenses are not considered distinct from each other and the applicable subscription is accounted for as a single performance obligation.

We identified the assessment of performance obligations in these cloud-enabled software subscription offerings as a critical audit matter. A high degree of subjective auditor judgment was required to assess the nature of the Company's Creative Cloud and Document Cloud offerings, their intended benefit to customers as an integrated offering, and the level of integration that exists between the cloud-enabled services and the on-premise/on-device licenses.

The primary procedures we performed to address this critical audit matter included the following. We tested certain internal controls over the Company's revenue recognition process, including controls related to the assessment of distinct performance obligations. We read the Creative Cloud and Document Cloud subscription offering agreements to understand the contractual terms and conditions. We participated in product demonstrations, examined marketing materials, and performed interviews with the Company's product and engineering department to both understand and observe specific functionalities of the integrated offering and evaluate the nature of the promise made to the Company's Creative Cloud and Document Cloud customers. We evaluated the features and functionalities of the Creative Cloud and Document Cloud subscription that can be accessed only when using the on-premise/on-device software while connected to the Adobe cloud to assess that customers receive the intended benefit from each solution only as an integrated offering.

(signed) KPMG LLP

We have served as the Company's auditor since 1983.

Santa Clara, California
January 21, 2020

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

## ITEM 9A. CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of November 29, 2019. Based on their evaluation as of November 29, 2019, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective at the reasonable assurance level to ensure that the information required to be disclosed by us in this Annual Report on Form 10-K was (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Adobe have been detected.

### Management's Annual Report on Internal Controls over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal controls over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Our management assessed the effectiveness of our internal controls over financial reporting as of November 29, 2019. In making this assessment, our management used the criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Our management has concluded that, as of November 29, 2019, our internal controls over financial reporting is effective based on these criteria.

KPMG LLP, the independent registered public accounting firm that audited our financial statements included in this Annual Report on Form 10-K, has issued an attestation report on our internal controls over financial reporting, which is included herein.

### Changes in Internal Controls over Financial Reporting

On December 1, 2018, we implemented new and modified existing internal controls based on the adoption of the new revenue standard. This resulted in changes to our processes related to revenue recognition and underlying control activities, including our information systems. There were no changes in our internal controls over financial reporting during the quarter ended November 29, 2019 that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

## ITEM 9B. OTHER INFORMATION

None.

# PART III

## ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item 10 of Form 10-K that is found in our 2020 Proxy Statement to be filed with the SEC in connection with the solicitation of proxies for the Company's 2020 Annual Meeting of Stockholders ("2020 Proxy Statement") is incorporated herein by reference to our 2020 Proxy Statement. The 2020 Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year to which this report relates. For information with respect to our executive officers, see "Executive Officers" at the end of Part I, Item 1 of this report.

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by this Item 11 of Form 10-K is incorporated herein by reference to our 2020 Proxy Statement.

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item 12 of Form 10-K is incorporated herein by reference to our 2020 Proxy Statement.

## ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item 13 of Form 10-K is incorporated herein by reference to our 2020 Proxy Statement.

## ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item 14 of Form 10-K is incorporated herein by reference to our 2020 Proxy Statement.

# PART IV

## ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

1. Financial Statements. See Index to Consolidated Financial Statements in Part II, Item 8 of this Form 10-K.

| | | Incorporated by Reference | | | | |
|---|---|---|---|---|---|---|
| **Exhibit Number** | **Exhibit Description** | **Form** | **Filing Date** | **Exhibit Number** | **SEC File No.** | **Filed Herewith** |
| 2.1 | Share Purchase Agreement by and among: Adobe, a Delaware corporation; Milestone Topco, Inc., a Delaware corporation; Vista Equity Partners Fund V, L.P., a Delaware limited partnership; Vista Equity Partners Fund V-A, L.P., a Cayman Island exempted limited partnership; Vista Equity Partners Fund V-B, L.P., a Cayman Island exempted limited partnership; VEPF V FAF, L.P., a Delaware limited partnership; Vista Equity Partners Fund V Executive, L.P., a Delaware limited partnership; Vista Equity Associates V, LLC, a Delaware limited liability company; Vista Equity Partners Fund VI, L.P., a Cayman Island exempted limited partnership; Vista Equity Partners Fund VI-A, L.P., a Cayman Island exempted limited partnership; VEPF VI FAF, L.P., a Cayman Island exempted limited partnership; and Vista Equity Partners Management, LLC, a Delaware limited liability company, as the Sellers' Representative | 8-K | 9/21/18 | 2.1 | 000-15175 | |
| 3.1 | Restated Certificate of Incorporation of Adobe | 8-K | 4/26/11 | 3.3 | 000-15175 | |
| 3.2 | Certificate of Amendment to Restated Certificate of Adobe | 8-K | 10/9/18 | 3.1 | 000-15175 | |
| 3.3 | Amended and Restated Bylaws | 8-K | 10/9/18 | 3.2 | 000-15175 | |
| 4.1 | Specimen Common Stock Certificate | 10-K | 1/25/19 | 4.1 | 000-15175 | |

| | | | | | |
|---|---|---|---|---|---|
| 4.2 | Form of Indenture dated as of January 25, 2010 by and between Adobe and Wells Fargo Bank, National Association, as trustee | S-3 | 2/26/16 | 4.1 | 333-209764 |
| 4.3 | Form of Global Note for Adobe Systems Incorporated’s 4.750% Notes due 2020, together with Form of Officer’s Certificate setting forth the terms of the Note | 8-K | 1/26/10 | 4.1 | 000-15175 |

| Exhibit Number | Exhibit Description | Incorporated by Reference Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
|---|---|---|---|---|---|---|
| 4.4 | Form of Global Note for Adobe's 3.250% Notes due 2025, together with Form of Officer's Certificate setting forth the terms of the Note | 8-K | 1/26/15 | 4.1 | 000-15175 | |
| 4.5 | Description of Adobe's Common Stock | | | | | X |
| 10.1 | 1997 Employee Stock Purchase Plan, as amended* | 10-Q | 6/29/16 | 10.3 | 000-15175 | |
| 10.2A | 2003 Equity Incentive Plan, as amended* | 8-K | 4/13/18 | 10.2 | 000-15175 | |
| 10.2B | Form of Stock Option Agreement used in connection with the 2003 Equity Incentive Plan* | 8-K | 12/20/10 | 99.4 | 000-15175 | |
| 10.2C | Form of RSU Grant Notice and Award Agreement pursuant to 2003 Equity Incentive Plan* | 8-K | 1/26/18 | 10.6 | 000-15175 | |
| 10.2D | Form of Restricted Stock Unit Grant Notice and Award Agreement pursuant to 2003 Equity Incentive Plan* | 8-K | 1/28/19 | 10.5 | 000-15175 | |
| 10.2E | Form of Restricted Stock Agreement used in connection with the 2003 Equity Incentive Plan* | 10-Q | 10/7/04 | 10.11 | 000-15175 | |
| 10.2F | 2017 Performance Share Program pursuant to the 2003 Equity Incentive Plan* | 8-K | 1/27/17 | 10.2 | 000-15175 | |
| 10.2G | Form of 2017 Performance Share Award Grant Notice and Award Agreement pursuant to 2017 Performance Share Program and 2003 Equity Incentive Plan* | 8-K | 1/27/17 | 10.3 | 000-15175 | |
| 10.2H | 2018 Performance Share Program pursuant to the 2003 Equity Incentive Plan* | 8-K | 1/26/18 | 10.2 | 000-15175 | |
| 10.2I | Form of 2018 Performance Share Award Grant Notice and Award Agreement pursuant to 2018 Performance Share Program and 2003 Equity Incentive Plan* | 8-K | 1/26/18 | 10.3 | 000-15175 | |
| 10.2J | 2019 Performance Share Program pursuant to the 2003 Equity Incentive Plan* | 8-K | 1/28/19 | 10.2 | 000-15175 | |
| 10.2K | Form of 2019 Performance Share Award Grant Notice and Award Agreement pursuant to 2019 Performance Share Program and 2003 Equity Incentive Plan* | 8-K | 1/28/19 | 10.3 | 000-15175 | |

| | | | | | |
|---|---|---|---|---|---|
| 10.3A | 2019 Equity Incentive Plan* | 8-K | 4/12/19 | 10.1 | 000-15175 |
| 10.3B | Form of Restricted Stock Unit Grant Notice and Award Agreement pursuant to 2019 Equity Incentive Plan* | 10-Q | 6/26/19 | 10.35B | 000-15175 |

| Exhibit Number | Exhibit Description | Incorporated by Reference Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
|---|---|---|---|---|---|---|
| 10.3C | Form of Director Grant Restricted Stock Unit Grant Notice and Award Agreement pursuant to 2019 Equity Incentive Plan* | 10-Q | 6/26/19 | 10.35C | 000-15175 | |
| 10.3D | Anil Chakravarthy Restricted Stock Unit Grant Notice and Award Agreement pursuant to 2019 Equity Incentive Plan* | | | | | X |
| 10.4 | Retention Agreement between Adobe and Shantanu Narayen, effective December 5, 2014* | 8-K | 12/11/14 | 10.2 | 000-15175 | |
| 10.5 | Form of Indemnity Agreement* | 10-Q | 6/26/09 | 10.12 | 000-15175 | |
| 10.6A | Adobe Deferred Compensation Plan, as Amended and Restated* | 10-K | 1/20/15 | 10.19 | 000-15175 | |
| 10.6B | Amendment No. One to Adobe Deferred Compensation Plan* | | | | | X |
| 10.7 | Credit Agreement, dated as of October 17, 2018, among Adobe Inc. and certain subsidiaries as Borrowers, JPMorgan Chase Bank, N.A., Wells Fargo Bank National Association, U.S Bank National Association, Societe Generale S.A. as Co-Syndication Agents, Bank of America, N.A. as Administrative Agent and Swing Line Lender, and the Other Lenders Party Thereto | 8-K | 10/19/18 | 10.1 | 000-15175 | |
| 10.8 | Credit Agreement, dated as of October 17, 2018, among Adobe Inc. as Borrower, JPMorgan Chase Bank, N.A. as Syndication Agent, Wells Fargo Bank National Association as Documentation Agent, Bank of America, N.A. as Administrative Agent, and the Other Lenders Party Thereto | 8-K | 10/19/18 | 10.2 | 000-15175 | |
| 10.9 | Adobe Systems Incorporated 2017 Executive Severance Plan in the Event of a Change of Control* | 8-K | 12/14/17 | 10.1 | 000-15175 | |
| 10.10 | 2019 Executive Annual Incentive Plan* | 8-K | 1/28/19 | 10.4 | 000-15175 | |
| 10.11 | Description of 2019 and 2020 Director Compensation* | 8-K | 1/24/19 | 10.1 | 000-15175 | |
| 21 | Subsidiaries of the Registrant | | | | | X |
| 23.1 | Consent of Independent Registered Public Accounting Firm, KPMG LLP | | | | | X |

| | | |
|---|---|---|
| 24.1 | Power of Attorney (set forth on the signature page to this Annual Report on Form 10-K) | X |
| 31.1 | Certification of Chief Executive Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934 | X |

| Exhibit Number | Exhibit Description | Incorporated by Reference | | | | Filed Herewith |
|---|---|---|---|---|---|---|
| | | Form | Filing Date | Exhibit Number | SEC File No. | |
| 31.2 | Certification of Chief Financial Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934 | | | | | X |
| 32.1 | Certification of Chief Executive Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934† | | | | | X |
| 32.2 | Certification of Chief Financial Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934† | | | | | X |
| 101.INS | Inline XBRL Instance | | | | | X |
| 101.SCH | Inline XBRL Taxonomy Extension Schema | | | | | X |
| 101.CAL | Inline XBRL Taxonomy Extension Calculation | | | | | X |
| 101.LAB | Inline XBRL Taxonomy Extension Labels | | | | | X |
| 101.PRE | Inline XBRL Taxonomy Extension Presentation | | | | | X |
| 101.DEF | Inline XBRL Taxonomy Extension Definition | | | | | X |
| 104 | Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101) | | | | | |

* Compensatory plan or arrangement.

† The certifications attached as Exhibits 32.1 and 32.2 that accompany this Annual Report on Form 10-K, are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Adobe Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Form 10-K, irrespective of any general incorporation language contained in such filing.

**ITEM 16. FORM 10-K SUMMARY**

None.

Table of Contents

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ADOBE INC.

By: /s/ JOHN MURPHY
John Murphy
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: January 21, 2020

## POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Shantanu Narayen and John Murphy, and each or any one of them, his or her lawful attorneys-in-fact and agents, for such person in any and all capacities, to sign any and all amendments to this report and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that either of said attorneys-in-fact and agent, or substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ SHANTANU NARAYEN<br>Shantanu Narayen | Chairman of the Board of Directors, President and Chief Executive Officer (Principal Executive Officer) | January 21, 2020 |
| /s/ JOHN MURPHY<br>John Murphy | Executive Vice President, Chief Financial Officer (Principal Financial Officer) | January 21, 2020 |
| /s/ MARK GARFIELD<br>Mark Garfield | Vice President, Corporate Controller and Chief Accounting Officer (Principal Accounting Officer) | January 21, 2020 |
| /s/ JAMES DALEY<br>James Daley | Director | January 21, 2020 |
| /s/ AMY BANSE<br>Amy Banse | Director | January 21, 2020 |

| Signature | Title | Date |
| --- | --- | --- |
| /s/ FRANK CALDERONI<br>Frank Calderoni | Director | January 21, 2020 |
| /s/ LAURA DESMOND<br>Laura Desmond | Director | January 21, 2020 |
| /s/ CHARLES GESCHKE<br>Charles Geschke | Director | January 21, 2020 |
| /s/ KATHLEEN OBERG<br>Kathleen Oberg | Director | January 21, 2020 |
| /s/ DHEERAJ PANDEY<br>Dheeraj Pandey | Director | January 21, 2020 |
| /s/ DAVID RICKS<br>David Ricks | Director | January 21, 2020 |
| /s/ DAN ROSENSWEIG<br>Dan Rosensweig | Director | January 21, 2020 |
| /s/ JOHN WARNOCK<br>John Warnock | Director | January 21, 2020 |

Table of Contents

**SUMMARY OF TRADEMARKS**

The following trademarks of Adobe Inc. or its subsidiaries, which may be registered in the United States and/or other countries, are referenced in this Form 10-K:

Acrobat
Acrobat Reader
Adobe
Adobe Aero
Adobe Audition
Adobe CreativeSync
Adobe Dimension
Adobe Experience Cloud
Adobe Fresco
Adobe Marketing Cloud
Adobe Premiere
Adobe Premiere Rush
Adobe Sensei
After Effects
Behance
Creative Cloud
Document Cloud
Illustrator
InCopy
InDesign
Lightroom
Magento
Marketo
Photoshop
PostScript
Premiere Rush
Reader
Sensei
TubeMogul

All other trademarks are the property of their respective owners.



10-K 1 adbe10kfy18.htm 10-K

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**Washington, D.C. 20549**

# FORM 10-K

**(Mark One)**

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

**For the fiscal year ended November 30, 2018**

**or**

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

**For the transition period from_________to_________**

**Commission File Number: 0-15175**

# Adobe Inc.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware**<br>(State or other jurisdiction of incorporation or organization) | **77-0019522**<br>(I.R.S. Employer Identification No.) |

**345 Park Avenue, San Jose, California 95110-2704**
(Address of principal executive offices)

**(408) 536-6000**
(Registrant's telephone number, including area code)

**Securities registered pursuant to Section 12(b) of the Act:**

| Title of Each Class | Name of Each Exchange on Which Registered |
|---|---|
| Common Stock, $0.0001 par value per share | The NASDAQ Stock Market LLC<br>(NASDAQ Global Select Market) |

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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

| | | | | |
|---|---|---|---|---|
| Large accelerated filer ☒ | Accelerated filer ☐ | Non-accelerated filer ☐ | Smaller reporting company ☐ | Emerging growth company ☐ |

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

The aggregate market value of the registrant's common stock, $0.0001 par value per share, held by non-affiliates of the registrant on June 1, 2018, the last business day of the registrant's most recently completed second fiscal quarter, was $96,776,869,889 (based on the closing sales price of the registrant's common stock on that date). Shares of the registrant's common stock held by each officer and director and each person who owns 5% or more of the outstanding common stock of the registrant have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes. As of January 18, 2019, 487,725,915 shares of the registrant's common stock, $0.0001 par value per share, were issued and outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the registrant's 2019 Annual Meeting of Stockholders (the "Proxy Statement"), to be filed within 120 days of the end of the fiscal year ended November 30, 2018, are incorporated by reference in Part III hereof. Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part hereof.

**ADOBE INC.**
**FORM 10-K**

**TABLE OF CONTENTS**

**Forward-Looking Statements**

*In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements, including statements regarding product plans, future growth, market opportunities, strategic initiatives, industry positioning, customer acquisition and retention, the amount of recurring revenue and revenue growth. In addition, when used in this report, the words "will," "expects," "could," "would," "may," "anticipates," "intends," "plans," "believes," "seeks," "targets," "estimates," "looks for," "looks to," "continues" and similar expressions, as well as statements regarding our focus for the future, are generally intended to identify forward-looking statements. Each of the forward-looking statements we make in this report involves risks and uncertainties that could cause actual results to differ materially from these forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Risk Factors" in Part I, Item 1A of this report. You should carefully review the risks described herein and in other documents we file from time to time with the U.S. Securities and Exchange Commission (the "SEC"), including our Quarterly Reports on Form 10-Q to be filed in 2019. You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document, except as required by law.*

## PART I

## ITEM 1. BUSINESS

Founded in 1982, Adobe Inc. (formerly Adobe Systems Incorporated) is one of the largest and most diversified software companies in the world. We offer a line of products and services used by creative professionals, marketers, knowledge workers, students, application developers, enterprises and consumers for creating, managing, delivering, measuring, optimizing, engaging and transacting with compelling content and experiences across personal computers, devices and media. We market our products and services directly to enterprise customers through our sales force and local field offices. We license our products to end users through app stores and our own website at www.adobe.com. We offer many of our products via a Software-as-a-Service ("SaaS") model or a managed services model (both of which are referred to as hosted or cloud-based) as well as through term subscription and pay-per-use models. We also distribute certain products and services through a network of distributors, value-added resellers ("VARs"), systems integrators ("SIs"), independent software vendors ("ISVs"), retailers, software developers and original equipment manufacturers ("OEMs"). In addition, we license our technology to hardware manufacturers, software developers and service providers for use in their products and solutions. Our products run on personal and server-based computers, as well as on smartphones, tablets and other devices, depending on the product. We have operations in the Americas, Europe, Middle East and Africa ("EMEA"), and Asia-Pacific ("APAC").

Adobe was originally incorporated in California in October 1983 and was reincorporated in Delaware in May 1997. Our executive offices and principal facilities are located at 345 Park Avenue, San Jose, California 95110-2704. Our telephone number is 408-536-6000 and our website is www.adobe.com. Investors can obtain copies of our SEC filings from this site free of charge, as well as from the SEC website at www.sec.gov. The information posted to our website is not incorporated into this Annual Report on Form 10-K.

### BUSINESS OVERVIEW

For over 35 years, Adobe's innovations have transformed how individuals, teams, businesses and governments interact. We help our customers create and deliver the most compelling experiences in a streamlined workflow and optimize those experiences for greater return on investment. Our solutions turn ordinary interactions into valuable digital experiences, across media and devices, anytime, anywhere.

While we continue to offer a broad portfolio of products, services, and solutions, we focus our investments in two strategic growth areas:

Digital Media—providing products, services and solutions that enable individuals, teams and enterprises to create, publish and promote their content anywhere. Our customers include content creators, web designers, app developers, enthusiasts, and digital media professionals, as well as management in marketing departments and agencies, companies and publishers. Our customers also include knowledge workers who create, collaborate on and distribute documents. This is the core of what we have delivered for over 25 years, and we have evolved our business model to provide our customers with a range of flexible solutions that allow them to reach their full creative potential anytime, anywhere, on any device on projects of all types.

Digital Experience—providing enterprises and brands a comprehensive and integrated suite of products, services and solutions for creating, managing, executing, measuring and optimizing customer experiences that span from advertising to commerce. Our customers include marketers, advertisers, agencies, publishers, merchandisers, merchants, web analysts, data scientists, developers, marketing executives, information management executives, product development executives, and sales and support executives. Our robust Adobe Experience Platform provides enterprises and brands a profile that enables deep customer insights and personalized digital experiences delivered with our Adobe Experience Cloud solutions. By combining the creativity of our Digital Media business with the science of our Digital Experience offerings, we help our customers more efficiently and effectively make, manage, measure and monetize their content across channels and devices with an end-to-end workflow and feedback loop.

We believe we are uniquely positioned to be a leader in both the Digital Media and Digital Experience markets, where our mission is to change the world through digital experiences. By integrating products from each of these areas, our customers are able to utilize a comprehensive suite of solutions and services that no other company currently offers. In addition, our ability to deliver innovation and productivity improvements across customer workflows involving the creation, management, delivery, measurement and optimization of engaging content favorably positions Adobe as our customers continue investing in engaging their constituents digitally.

## SEGMENTS

Our business is organized into three reportable segments: Digital Media, Digital Experience, and Publishing. These segments provide Adobe's senior management with a comprehensive financial view of our key businesses. Our segments are aligned around our two strategic growth opportunities described above, placing our Publishing business in a third segment that contains some of our mature products and solutions.

## MARKET OVERVIEW

This overview provides an explanation of our markets and a discussion of strategic opportunities in fiscal 2019 and beyond for each of our segments. *See "Results of Operations" within Part II, Item 7 titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" for further segment information.*

### Digital Media

*Digital Media Opportunity*

Recent technology trends in digital communications continue to provide a significant market opportunity for Adobe in digital media. In today's world where the velocity of creation and consumption of digital content is ever increasing, customers are looking for a way to meet demand with engaging online experiences. Adobe is in a strong position to capitalize on this opportunity by driving modernization and innovation that will accelerate the creative process across all platforms and devices, deepen engagement with communities, and accelerate long-term revenue growth by focusing on cloud-based offerings, which are licensed on a subscription basis.

The flagship of our Digital Media business is Adobe Creative Cloud—a subscription service that allows members to use Adobe's creative products integrated with cloud-delivered services across desktop, web and mobile devices. Creative Cloud members can download and access the latest versions of our creative products such as Photoshop, Illustrator, Premiere Pro, Lightroom CC, InDesign, Adobe XD and many more creative applications. To expand our reach and improve the way we serve the needs of our customers, we create different combinations of these services, including our launch of a mobile photography offering that has brought new customers into our franchise and grown the amount of our photography subscriptions. In addition, members can access built-in templates to jumpstart designs and step-by-step tutorials to sharpen skills and get up to speed quickly. Through Creative Cloud, members can access online services to sync, store, and share files across users' machines, access marketplace, social and community-based features within our Adobe Stock and Behance services, and create apps and websites, all at affordable subscription pricing for cost-sensitive customers.

Adobe continues to redefine the creative process with Adobe Creative Cloud so that our customers can obtain everything they need to create, collaborate and be inspired. A core part of our strategy is Adobe Sensei, a proprietary framework and set of intelligent services for dramatically improving the design and delivery of digital experiences. Adobe Sensei leverages Adobe's massive content and data assets, as well as its deep domain expertise in the creative, marketing and document segments, within a unified artificial intelligence ("AI") and machine learning framework to help customers discover hidden opportunities, reduce tedious processes, and offer relevant experiences to every customer.

Adobe Creative Cloud addresses the needs of creative professionals such as artists, designers, developers, students and administrators. They rely on our products for publishing, web design and development, video and animation production, mobile app and gaming development, and document creation and collaboration. End users of our creative products work in businesses ranging from large publishers, media companies and global enterprises, to smaller design agencies, and individual freelancers. Moreover, our creative products are used to create much of the printed and online information people see, read and interact with every day, including video, animation, mobile and advertising content. Knowledge workers, educators, hobbyists and consumers also use our products to create and deliver content. We have introduced new products, features and services to address emerging categories of content creation, such as voice-based prototyping, refined content creation tools, 3D, augmented reality, virtual reality and user experience design. New projects announced and solutions offered include Project Gemini, a mobile drawing and painting application, featuring live brushes that mimic natural media like oil paint and watercolors in amazingly lifelike ways; Adobe Premiere Rush, an easy-to-use video editing app that simplifies video creation and sharing on platforms including YouTube and Instagram, while delivering professional quality video results for social media marketers, video bloggers and video enthusiasts; and Photoshop on iPad to enable a seamless experience across devices, and attract a new, mobile-centric audience.

Adobe's Digital Media segment includes our Adobe Document Cloud business, built around our Acrobat family of products, including Adobe Acrobat and Adobe Acrobat Reader, and a set of integrated, cloud-based document services, including Adobe Sign and Adobe Scan. Tens of millions of knowledge workers worldwide interact with documents daily. For over 25 years, Acrobat has provided for the reliable creation and exchange of electronic documents, regardless of platform or application source type. Users can collaborate on documents with electronic comments and tailor the security of a file in order to distribute reliable Adobe PDF documents that can be viewed, printed or filled out utilizing our free Acrobat Reader on any device. Acrobat provides essential electronic document capabilities and services to help knowledge workers accomplish a wide variety of tasks ranging from simple publications and forms to mission-critical engineering documentation and architectural plans. With our Acrobat product and its innovative cloud services, we have extended the capabilities of our solutions. Users can turn slow, manual signing processes into automated experiences and collect signatures with Adobe Scan and Adobe Sign. In addition, we have mobile apps such as Adobe Scan that allows any user to create a PDF with the camera on their phone.

*Digital Media Strategy*

Our goal is to be the leading platform for creativity where we offer a range of products and services that allow individuals, teams and enterprises, both professionals and enthusiasts, to design and deliver amazing digital content.

We believe there is significant opportunity for growth across all customer segments and expect Adobe Creative Cloud will drive sustained long-term revenue growth through a continued expansion of our customer base by acquiring new users in North America and international markets, especially in emerging markets where there is an opportunity to target new creative professionals and enthusiasts entering the market, and drive conversion of non-genuine Adobe users. Enabling students to create and tell their stories is another opportunity where Adobe Spark uniquely positions us to deliver on the needs of educators and students in and outside of classrooms.

We will continue to deepen our relationship with existing users through meeting their needs holistically and delivering additional features and value, including data-driven customer engagement, AI and machine learning through Adobe Sensei, and new design categories. As appropriate, we plan to optimize our pricing strategy and move our customers to higher priced and better value offerings and continue to employ targeted promotions that attract past customers and potential users to try out and ultimately subscribe to Adobe Creative Cloud. To target new customers and better address the needs of our existing customers, we will continue to invest in driving innovation to maintain the leadership position that we have established. We offer a marketplace for Creative Cloud subscribers to enable the delivery and purchase of stock content in our Adobe Stock service. Overall, our strategy with Creative Cloud is designed to enable us to increase our revenue with users, attract more new customers, and grow a recurring and predictable revenue stream that is recognized ratably.

As part of our Adobe Creative Cloud strategy, we utilize a data-driven operating model and our Adobe Experience Cloud solutions to drive customer awareness and licensing of our creative products and services through our website and across other channels. Adobe.com is increasingly becoming the destination site where we engage individual and small business customers to sign up for and renew Creative Cloud subscriptions. We offer free apps and trials to attract new customers and through a data-driven model, we optimize conversion of these trialists to paid subscribers. We utilize channel partners to target mid-size creative customers with our Creative Cloud for teams offering. Our direct sales force is focused on building relationships with our largest customers and driving adoption of our Creative Cloud for enterprise offering.

We offer many of the products included in Adobe Creative Cloud on a standalone basis, including subscriptions to the Creative Cloud version of certain point products. We also offer a range of other creative tools and services, including our hobbyist products such as Photoshop Elements and Premiere Elements, Adobe Fonts (formerly Typekit) and mobile apps such as Photoshop Mix, Photoshop Sketch, Photoshop Fix, Adobe Capture, and Adobe Spark. Further descriptions of our Digital Media products are included below under “Principal Products and Services.”

In our Adobe Document Cloud business, Adobe Acrobat has achieved strong market adoption and a leadership position in document-intensive industries such as government, financial services, pharmaceutical, legal, aerospace, insurance and technical publishing. We believe there remain tens of millions of users - both individuals and enterprises - who need the capabilities provided by Acrobat and the service capabilities found in Document Cloud. We plan to build out a data driven operating model to market the benefits of our Document Cloud solutions, combined with the low entry point of subscription-based pricing, to individuals as well as small and medium-sized businesses, large enterprises and government institutions around the world. We intend to continue promoting the capabilities of our cloud-based document solutions and Adobe Sensei features to millions of Acrobat users and hundreds of millions of Acrobat Reader users. We aim to increase our seat penetration in our key markets through the utilization of our corporate and volume licensing programs. We also intend to increase our focus on marketing and licensing Acrobat in targeted vertical markets such as education, financial services, telecommunications and government, as well as on expanding into emerging markets. We will continue to engage in strategic partnerships to help drive the enterprise business, including our partnership with Microsoft. Our Adobe Sign service provides a green alternative to costly paper-based solutions, and is a more modern and convenient way for customers to digitally manage their documents, processes, and contract workflows. The Adobe Scan app for mobile devices can be used to capture paper documents as images and transform them into full-featured PDFs via Document Cloud services that can be shared immediately, essentially putting scanning capabilities in the pocket of every person. We believe that by growing the awareness of electronic signatures in the broader contract delivery and signing market, utilizing Adobe Sensei to enhance customer experiences through machine learning and AI, and continuing to add new capabilities to our Adobe Scan and Adobe Sign offerings, we can help our customers migrate away from paper-based express mailing and adopt our solution to modernize and digitize document experiences, growing our revenue with this business in the process.

**Digital Experience**

*Digital Experience Opportunity*

Consumers today increasingly demand compelling experiences in their digital interactions, that are seamless across channels and devices. Enterprises and brands recognize that customers have more choices and lower switching costs than ever before. In this new hyper-connected digital environment, it is the customer experience that differentiates brands and ultimately determines customer loyalty. As a result, businesses must determine how to best attract, engage, acquire and retain customers in a digital world where the reach and quality of experiences directly impact success. Delivering the best experience to a consumer at a given moment requires the right combination of data, insights and content. Executives are increasingly demanding solutions that optimize their consumers' experiences and deliver the greatest return on marketing and IT spend so they can demonstrate the business impact of their programs using objective metrics.

We believe there is a significant opportunity to address these challenges and help customers transform their businesses. The world's leading brands are increasingly steering their marketing, advertising, and development budgets toward digital experiences. As enterprises make this move to digital, our opportunity is accelerating as brands seek vendors to help them navigate this transition. Enterprises have a mandate to deliver meaningful experiences to their consumers across digital channels and in areas such as sales, support, and product interactions where consumers expect experiences to be consistent and personalized.

Our Adobe Experience Cloud business targets this large and growing opportunity by providing comprehensive solutions that include analytics, targeting, advertising optimization, digital experience management, marketing automation and engagement, cross-channel campaign management, content management, asset management, audience management, premium video delivery, digital commerce enablement, order management, predictive intelligence and monetization. These comprehensive solutions enable marketers to measure, personalize and optimize digital experiences across channels for optimal performance.

We believe the market for Adobe Experience Cloud is large and rapidly growing as more businesses and enterprises invest in solutions that aid their goals to transform how they engage with their customers and constituents digitally.

*Digital Experience Strategy*

Our goal is to be the leading provider of solutions that enable our customers to provide exceptional digital experiences and enable digital transformation. Our integrated cloud-based solutions enable enterprises to build personalized campaigns, offer shoppable experiences, manage advertising, and gain deep intelligence about their customers. Our content and data platform provides differentiation and competitive advantage.

Adobe Experience Cloud consists of the following cloud offerings:

- Adobe Advertising Cloud—delivers an end-to-end platform for managing advertising across traditional TV and digital formats, and simplifies the delivery of video, display and search advertising across channels and screens; uses Adobe Sensei to enable machine learning and predictive intelligence, automates digital media buying to traditional TV advertising; automates ad creation and integrates with Adobe Creative Cloud products; and combines capabilities from the Adobe Advertising Cloud Demand-Side Platform, Adobe Advertising Cloud Search, Adobe Advertising Cloud TV, and Adobe Advertising Cloud Creative offerings.

- Adobe Analytics Cloud—enables businesses to move from insights to actions in real time by uniquely integrating audiences as the core system of intelligence for the enterprise; makes data available across all Adobe clouds through the capture, aggregation, rationalization and understanding of vast amounts of disparate data and then translating that data into singular customer profiles; includes Adobe Analytics and Adobe Audience Manager.

- Adobe Marketing Cloud—provides an integrated set of solutions to help marketers differentiate their brands and engage their customers, helping businesses manage, personalize, and orchestrate campaigns and customer journeys across business-to-business ("B2B") and business-to-consumer ("B2C") use cases; includes Adobe Experience Manager ("AEM"), Adobe Campaign, Adobe Target, Marketo Engagement Platform, and Adobe Primetime.

- Magento Commerce Cloud—offers digital commerce enablement and order orchestration for both physical and digital goods across a range of industries, including consumer packaged goods, retail, wholesale, manufacturing and the public sector, and brings together digital commerce, order management and predictive intelligence to enable shopping experiences that scale from mid-market to enterprise businesses.

Adobe acquired Magento on June 18, 2018 and integrated it into the Adobe Experience Cloud as the Magento Commerce Cloud. Adobe acquired Marketo on October 31, 2018 and began integrating it into the Adobe Marketing Cloud as the Marketo Engagement Platform. Marketo Engagement Platform is a cloud platform for global business-to-business marketers driving new business growth by personalizing complex buyer journeys and empowering go-to-market teams to optimize the enterprise buyer experience. As part of the Adobe Marketing Cloud, the Marketo Engagement Platform simplifies how companies plan, orchestrate and measure engagement with prospects and customers at every stage of their experience through both lead and account-based marketing strategies, while uniquely aligning marketing and sales teams across every channel through a single, enterprise-grade platform.

We believe the AI and machine learning framework enabled by our strategy with Adobe Sensei enhances the delivery of digital experiences. By building on existing features such as Enhanced Anomaly Detection, Auto-Target, and other capabilities, we believe Adobe Sensei will increase the value we provide our customers and create a competitive differentiation in the market.

To drive growth of Adobe Experience Cloud, we also intend to focus on customer engagement, growing within existing customer accounts, and product differentiation. We are also investing in the Adobe Experience Platform, which is powered by Adobe Sensei to help users weave all their data together so they can better understand customer behavior and deliver the best experiences in real time. Our Open Data Initiative is an open alliance among Adobe, Microsoft and SAP, that enables a seamless flow of customer data within the Adobe Experience Platform. We utilize a direct sales force to market and license our Experience Cloud solutions, as well as an extensive ecosystem of partners, including marketing agencies, SIs and ISVs that help license and deploy our solutions to their customers. Strategic partnerships, such as the one we have formed with Microsoft , continue to increase our market reach. We have made significant investments to broaden the scale and size of all of these routes to market, and believe these investments will result in continued growth in revenue in our Digital Experience segment in fiscal 2019 and beyond.

**Publishing**

Our Publishing segment contains legacy products and services that address diverse market opportunities including eLearning solutions, technical document publishing, web conferencing, document and forms platform, web application development and high-end printing. Graphics professionals and professional publishers continue to require quality, reliability and efficiency in production printing, and our Adobe PostScript and Adobe PDF printing technologies provide advanced functionality to meet the sophisticated requirements of this marketplace. As high-end printing systems evolve and transition to fully digital, composite workflows, we believe we are well positioned to be a supplier of software and technology based on the Adobe PostScript and Adobe PDF standards for use by this industry.

We generate revenue by licensing our technology to OEMs that manufacture workflow software, printers and other output devices. In fiscal 2018, we maintained a relatively consistent quarterly revenue run-rate with the mature products we market and license in our Publishing business.

## COMPETITION

The markets for our products and services are characterized by intense competition, new industry standards, evolving distribution models, disruptive technology developments, frequent product introductions, short product life cycles, price cutting with resulting downward pressure on gross margins and price sensitivity on the part of consumers. Our future success will depend on our ability to enhance and better integrate our existing products, introduce new products on a timely and cost-effective basis, meet changing customer needs, provide best-in-class information security to build customer confidence and combat cyber-attacks, extend our core technology into new applications and anticipate emerging standards, business models, software delivery methods and other technological changes.

### Digital Media

No single company has offerings that match the capabilities of our Adobe Creative Cloud products and services, but we face collective competition from a variety of point offerings, free products and downloadable apps. Our competition includes offerings from companies such as Apple, Autodesk, Avid, Corel, Microsoft, Affinity, Quark and others, as well as from many lower-end offerings. We believe our greatest advantage in this space is the performance and scope of our integrated solutions, which work together as part of Creative Cloud. With Creative Cloud, we compete favorably on the basis of features and functionality, ease of use, product reliability, value and performance characteristics.

Professional digital imaging, drawing and illustration products are characterized by feature-rich competition, brand awareness and price sensitivity. Competition in this space is also emerging with drawing and illustration applications on tablet and smartphone platforms. The demand for professional web page layout and professional web content creation tools is constantly evolving and highly volatile. In this area, we face direct and indirect competition from desktop software companies and various proprietary and open source web-authoring tools.

We face competition from device, hardware and camera manufacturers as they try to differentiate their offerings by bundling, for free, their own digital imaging software or those of our competitors. Similarly, we face potential competition from operating system manufacturers as they integrate or offer hobbyist-level digital imaging and image management features with their operating systems. We also face competition from smartphone and tablet manufacturers that integrate imaging and video software into their devices to work with cameras that come as part of their smartphone and tablet offerings. In addition, social networking platforms such as Facebook (including Instagram), Snapchat, Twitter and Pinterest, as well as portal sites such as Google, Bing and Yahoo! are becoming a direct means to post, edit and share images, bypassing the step of using image editing and sharing software. Online storage and synchronization are becoming free and ubiquitous. Consumers will be encouraged to use the image and video editing software offered by those storage products, thus competing with our software.

In addition, the needs of digital imaging and video editing software users are constantly evolving due to rapid technology and hardware advancements in digital cameras, digital video cameras, printers, personal computers, tablets, smartphones and other new devices. Our imaging and video offerings, including Photoshop, Lightroom, After Effects, Premiere Pro, and Premiere Rush, face competition from established and emerging companies offering similar products.

New image editing applications for mobile devices and tablets with features that compete with our professional tools are also emerging as adoption of these devices grows. Our consumer digital imaging and video editing offerings are subject to intense competition, including customer price sensitivity and competitor brand awareness. We face direct and indirect competition in the consumer digital imaging space from a number of companies whose market software competes with our offerings.

The stock content marketplace has significant competition, especially in the microstock segment, where Adobe primarily operates today with our Adobe Stock offering. Key competitors in this segment include Shutterstock, Getty Images and a number of smaller companies. Deep product integration with Adobe Creative Cloud and superior reach and relationships with creative professionals around the world differentiate our Adobe Stock offerings.

The nature of traditional digital document creation, storage, and collaboration has been rapidly evolving as knowledge workers and consumers shift their behavior increasingly to non-desktop workflows. Competitors like Microsoft, Google, Box and Dropbox all offer competitive alternatives to our Adobe Document Cloud business for creating and managing PDFs. In addition, other PDF creation solutions can be found at a low cost or for free on the web or via mobile applications. To address these competitive threats, we are working to ensure our Document Cloud applications stay at the forefront of innovation in emerging opportunities such as PDF document generation, document collaboration and document security, document workflow management, easeful software integrations, enablement of paper to digital transformations, and accessibility and usability on multiple devices, including mobile and desktop.

E-signatures have quickly become a core element of digital documents and are inherently part of a company's digital document transformation efforts. Partnerships and integrations between these companies and third-parties create an increasingly competitive landscape in this space. Competitors to Adobe Sign include DocuSign.

**Digital Experience**

The markets in which our Digital Experience business unit competes are growing rapidly and characterized by intense competition. Our Adobe Experience Cloud solutions face competition from large companies such as Google, IBM, Oracle, salesforce.com, SAP, SAS, Teradata, Shopify and others, in addition to point product solutions and focused competitors. Additionally, new competitors are constantly entering these markets. Some of these competitors provide SaaS solutions to customers, generally through a web browser, while others provide software that is installed by customers directly on their servers. In addition, we compete at times with our customers' or potential customers' internally developed applications. Of the competitors listed above, no single company has products identical to our Adobe Experience Cloud offerings. Adobe Experience Cloud competes in a variety of areas, including: reporting and analytics; cross-channel marketing and optimization; online marketing; audience management; advertising and real-time bidding technology; video delivery and monetization; marketing automation; digital commerce enablement; order management; web experience management and others.

Large software, internet and database management companies have expanded their offerings in the digital experience area, either by developing competing services or by acquiring existing competitors or strategic partners of ours. We believe competitive factors in our markets include the proven performance, security, scalability, flexibility and reliability of services; the strategic relationships and integration with third-party applications; the intuitiveness and visual appeal of user interfaces; demonstrable cost-effective benefits to customers; pricing; the flexibility of services to match changing business demands; enterprise-level customer service and training; perceived market leadership; the usability of services; real-time data and reporting; independence from portals and search engines; the ability to deploy the services globally; and success in educating customers in how to utilize services effectively. We believe we compete favorably with both the enterprise and low-cost alternatives based on many of these competitive factors including our strong feature set, the breadth of our offerings, our focus on global, multi-brand companies, our superior user experience, tools for building multi-screen, cross-channel applications, standards-based architecture, scalability and performance and leadership in industry standards efforts.

Creative and digital agencies, as well as SIs, are increasingly investing in acquiring their own digital experience technology to complement their creative services offerings. Adobe may face competition from these agencies and SIs as they come to market with best-of-breed offerings in one or more digital experience capabilities, or if agencies attempt to create a more complete technology platform offering. We believe our creative tools heritage differentiates us from our competitors. We have worked closely with marketing and creative customers for over 30 years. We also believe we have leadership in this space, with current customers representing leading global brands. Our comprehensive solutions extend more broadly than any other company in serving the needs of marketers and addressing this market opportunity; we integrate content and data, analytics, personalization, digital experience management, marketing automation, cross-channel campaign management, digital commerce, audience management, video delivery and monetization and social capabilities in our Adobe Experience Cloud. Most importantly, we provide a vision for our digital experience customers as we engage with them across the important aspects of their business, extending from their use of Adobe Creative Cloud and Adobe Document Cloud to how they manage, deliver, measure and monetize their content, participate in digital commerce, and create highly personalized and engaging shoppable experiences with our Experience Cloud.

**Publishing**

Our Publishing product offerings face competition from large-scale publishing systems, XML-based publishing companies, as well as lower-end desktop publishing products. Similarly, our web conferencing product faces competition from a number of established products from other companies, including Cisco, Citrix and Microsoft. Competition involves a number of factors, including: product features, ease-of-use, printer service support, the level of customization and integration with other publishing system components, the number of hardware platforms supported, service and price. We believe we can successfully compete based upon the quality and features of our products, our strong brand among users, the widespread adoption of our products among printer service bureaus, and our extensive application programming interfaces.

In printing technologies, we believe the principal competitive factors for OEMs in selecting a page description language or a printing technology are product capabilities, market leadership, reliability, price, support and engineering development assistance. We believe that our competitive advantages include our technology competency, OEM customer relationships and our intellectual property portfolio.

## PRINCIPAL PRODUCTS AND SERVICES

### Digital Media Offerings

***Creative Cloud***

Adobe Creative Cloud is a cloud-based subscription offering that enables creative professionals and enthusiasts alike to express themselves with apps and services that connect across devices, platforms and geographies. Members have access to a vibrant creative community, publishing services to deliver apps and websites, cloud storage to easily access their work, the ability to sync their files to virtually any device, collaboration capabilities with team members, and new products and exclusive updates as they are developed. Creative Cloud members can build a Creative Profile which persists wherever they are. A user's Creative Profile moves with them via Creative Cloud services from app to app and device to device, giving them immediate access to their personal files, photos, brushes, graphics, colors, fonts, text styles, desktop setting customizations and other important assets. Creative Cloud subscriptions include all of the applications listed below and many more.

*Photoshop and Lightroom*

Adobe Photoshop is the world's most advanced digital imaging and design app. It is used by photographers, designers, animators, web professionals, and video professionals, and is available to Adobe Creative Cloud subscribers. Lightroom CC, our cloud-based photo service for editing, organizing, storing and sharing photos, is also available to Creative Cloud subscribers. Customers can also subscribe to Photoshop or Lightroom CC as individual cloud-enabled subscription products, or through our Photography Plan, which is a cloud-enabled offering targeted at photographers and photo hobbyists and includes Lightroom CC, integrated cloud services, and Lightroom Classic, a desktop-only version of the photo service app.

We also offer Photoshop Elements, which is targeted at consumers who desire the brand and power of Photoshop through an easy-to-use interface. For tablet and smartphone users, we offer several mobile apps including Photoshop Sketch, Photoshop Mix, Photoshop Express, Lightroom for mobile and Photoshop Fix—all of which enable sophisticated photo editing and content creation using a touch-based interface on tablet and mobile devices.

*Illustrator*

Adobe Illustrator is our industry-standard vector graphics app used worldwide by designers of all types who want to create digital graphics and illustrations from web icons and product packaging to book illustrations and billboards, and for all kinds of media: print, web, interactive, video, and mobile. Illustrator is available to Adobe Creative Cloud subscribers, and customers can also subscribe to use it as an individual subscription product. Users can also utilize mobile apps such as Illustrator Draw to gain access to Illustrator capabilities on their tablets and mobile devices, and sync their work through Adobe CreativeSync for use with Illustrator on their desktop.

*InDesign*

Adobe InDesign is the industry-leading design and layout app for print and digital media. Our customers use it to design, preflight, and publish a broad range of content including newspapers and magazines for print, online, and tablet app delivery. From stationery, fliers and posters to brochures, annual reports, magazines and books with professional layout and typesetting tools, customers can create multicolumn pages that feature stylish typography and rich graphics, images, and tables. Tight integration with other Adobe offerings such as Photoshop, Illustrator and Acrobat enables customers to work productively in print and digital workflows. InDesign integrates seamlessly with Adobe InCopy, so customers can work on layouts simultaneously with writers and editors. Customers can also access Adobe digital publishing capabilities from within InDesign to create and publish engaging apps for a broad range of devices, including iOS, Android and Amazon-based devices. InDesign is available to Adobe Creative Cloud subscribers, and customers can also subscribe to use InDesign as an individual cloud-enabled subscription product.

*Adobe Stock*

Adobe Stock provides designers and businesses with access to millions of high-quality, curated, royalty-free photos, vectors, illustrations, videos, templates, and 3D assets, for all their creative projects. Adobe Stock is built into Adobe Creative Cloud apps, including Photoshop , Illustrator , and InDesign, enabling users to search, browse, and add images to their Creative Cloud Libraries, and obtain instant access to assets across desktop and mobile devices. Adobe Stock assets may be licensed directly within the Creative Cloud desktop apps, through stock.adobe.com, or as a multi-asset subscription.

*Adobe XD*

Adobe XD is our all-in-one experience design (XD) solution used to build user experiences (UX) and user interfaces (UI) when designing websites, mobile apps and more; Adobe XD enables users to go from concept to prototype faster. It contains intuitive tools that deliver precision and performance using timesaving features like Repeat Grid and flexible artboards to create everything from low-fidelity wireframes to fully interactive prototypes for any screen in minutes. Adobe XD also makes it easy to share prototypes with teammates via the web and show colleagues how multiscreen experiences look, feel and work with a single click. Adobe XD allows designers to design, prototype, and share digital experiences that extend beyond the screen, including triggers and speech playback to create audio interactions for voice-based smart assistants and other similar platforms. Adobe XD is available to Adobe Creative Cloud subscribers, and customers can also subscribe to use it as an individual cloud-enabled subscription product.

*Adobe Premiere Pro and Adobe Premiere Rush*

Adobe Premiere Pro is a leading nonlinear video editing tool used by filmmakers, videographers, and designers. Customers can import and combine various types of media, from video shot on a smartphone to 8K to virtual reality, and then edit in its native format without transcoding. Premiere Pro supports a vast majority of formats, and customers can use multiple graphics cards to accelerate render and export times. Premiere Pro is the only nonlinear editor that lets users have multiple projects open while simultaneously collaborating on a single project with their team. Workflows for color, graphics, audio, and immersive 360/VR in Premiere Pro take customers from first edit to final credits faster than ever. Adobe Premiere Rush (formerly Project Rush) is an all-in-one, easy-to-use video editing app that simplifies video creation and sharing on platforms including YouTube and Instagram, while delivering professional quality video results. Premiere Rush is uniquely positioned toward social media marketers, video bloggers, and video enthusiasts who are looking for an all-in-one app to create and share online videos. As part of Adobe Creative Cloud, Premiere Pro and Premiere Rush tightly integrates with other Adobe creative applications. Customers can also subscribe to use Premiere Pro and Premiere Rush as an individual cloud-enabled subscription product, or they can download the free Premiere Rush starter plan.

*After Effects*

Adobe After Effects is our industry-leading animation and creative compositing app used by a wide variety of motion graphics, visual effects artists, animators, designers and compositors. It offers superior control, a wealth of creative options, and integration with other post-production applications. After Effects works together seamlessly with other Adobe apps such as Premiere Pro, Photoshop, Illustrator, and Audition. After Effects is available to Adobe Creative Cloud subscribers, and customers can also subscribe to use it as an individual cloud-enabled subscription product.

*Adobe Dimension*

Adobe Dimension is designed to make it easy for graphic designers to create high-quality, photorealistic 3D images. Users can composite 2D and 3D assets to build product shots, scene visualizations, and abstract art. Dimension integrates well with other Adobe apps. Users can drag and drop background images from Photoshop and 3D models from Adobe Stock - without leaving Dimension. Dimension is available to Adobe Creative Cloud subscribers, and customers can also subscribe to use it as an individual cloud-enabled subscription product.

*Adobe Fonts*

Adobe Fonts brings thousands of fonts from foundry partners into one library for quick browsing, easy use on the web or on the user’s desktop, and endless typographic inspiration. Our full library of commercially-licensed fonts is offered through Adobe Creative Cloud. In addition, customers may subscribe to the standalone Adobe Fonts portfolio plan, or license individual fonts in the Adobe Fonts Marketplace.

*Behance*

Behance is the leading social community to showcase and discover creative work online. Adobe Portfolio allows users to quickly and simply build a fully customizable and hosted website that seamlessly syncs with Behance.

*Adobe Spark*

Adobe Spark is our integrated web and mobile software for creating and sharing impactful visual stories. Designed for everyday communication, Adobe Spark empowers users to transform words, images, and videos into dynamic web stories that engage audiences across multiple channels and on any device. The Adobe Spark web app seamlessly syncs with Spark Post, Spark Page and Spark Video iOS mobile apps, allowing users to create, edit and share their story from any location regardless of their design experience. Adobe Spark with premium features allows users to apply custom branding to anything they create; the premium product is offered as part of any Adobe Creative Cloud plan or as a standalone subscription. A free version is also still available to attract new users.

***Acrobat and Adobe Document Cloud***

Adobe Document Cloud modernizes document experiences by offering a complete portfolio of secure digital document solutions that speed business transactions through streamlined digital workflows. With Document Cloud, users can create, review, approve, sign and track documents, whether on a desktop or mobile device.

At the heart of Adobe Document Cloud is Adobe Acrobat DC, the industry standard for PDF creation and conversion. Acrobat enables users to create secure, reliable and compact Adobe PDF documents from desktop authoring applications such as Microsoft Office software, graphics applications and more. Acrobat enables automated collaborative workflows with a rich set of commenting tools and review tracking features and includes everything needed to create and distribute rich, secure electronic documents that can be viewed easily within leading web browsers or on computer desktops via the free Adobe Acrobat Reader.

Adobe Acrobat is available to both Adobe Creative Cloud and Adobe Document Cloud subscribers. Customers can also license Acrobat Pro or Acrobat Standard (which has a subset of Acrobat Pro features) as individual point products, either as a cloud-enabled subscription or in the form of desktop software. Adobe Acrobat Reader is also available as a free mobile app that allows users to view, annotate, and scan documents. Acrobat Reader is our free software for reliable viewing, searching, reviewing and printing of Adobe PDF documents on a variety of hardware and operating system platforms. Users of both Acrobat and Acrobat Reader can also access, edit and save changes to their PDF files stored on the Dropbox website or mobile app.

Our Adobe Scan app can be used for free on mobile devices to provide scanning capabilities in the pocket of every person. It captures paper documents as images and transforms them into full-featured and versatile PDFs via Adobe Document Cloud services for instant sharing with others.

Our Adobe Sign e-signature service allows users to securely electronically send and sign any document from any device. Adobe Sign has a mobile app companion allowing users to e-sign documents and forms, send them for signature, track responses in real-time, and obtain instant signatures with in-person signing. It integrates with users' enterprise systems through a comprehensive set of applicable programming interfaces, and Adobe Experience Manager Forms and Advanced Workflows for Adobe Sign, to create forms and provide seamless experiences to customers across web and mobile sites. Adobe Sign is Microsoft's preferred e-sign solution and is integrated into Microsoft Office 365, Microsoft Dynamics 365, and Microsoft SharePoint.

**Adobe Experience Cloud Products and Services**

Adobe Experience Cloud includes our Advertising Cloud, Analytics Cloud, Marketing Cloud, and Magento Commerce Cloud offerings, which are each described below.

***Adobe Advertising Cloud***

Adobe Advertising Cloud is an independent ad platform that unifies and automates all media, screens, data, and creativity at scale. With Adobe Advertising Cloud and its use of Adobe Sensei AI and data integrations, customers can identify and amplify their high-value audiences for more personal and accurate targeting; seamlessly unite creative, data, and media buying across all screens and formats; protect their brand by preventing their campaigns from mixing with content and properties that do not align with their image; scale bidding and optimization strategies; implement programmatic creative management using automated advertisement creation for both prospecting and retargeting customers; generate advertisements at scale using Adobe Creative Cloud apps; and use data insights that reveal customers' interests and past behaviors to create relevant, targeted ads. Adobe Advertising Cloud includes Adobe Advertising Cloud Demand Side Platform, Adobe Advertising Cloud Search, Adobe Advertising Cloud TV, and Adobe Advertising Cloud Creative offerings described below.

*Adobe Advertising Cloud Demand-Side Platform (DSP)*

Adobe Advertising Cloud DSP uses data to build identities and find optimal mixes to reach audiences. Adobe Advertising Cloud DSP manages tactics that span multiple sites simultaneously, effortlessly, and nearly instantly. It is the first independent demand-side platform that brings cross-screen and cross-channel integrations for planning, buying, measurement, and optimization. It is the only omnichannel demand-side platform that supports all forms of TV (linear, addressable, and connected), video, display, native, audio, social, and search campaigns. With real-time, in-dash reporting, custom reports, raw activity logs, and reporting APIs, customers get the ultimate flexibility to analyze campaign performance and make faster, more informed optimization choices. When combined with our proprietary ad creative management platform, integrated brand surveys, and other Adobe Experience Cloud products, customers have the ability to deliver engaging, personalized experiences.

*Adobe Advertising Cloud Search*

Adobe Advertising Cloud Search powered by Adobe Sensei AI brings customers the most comprehensive search management through the automation of search, shopping, and retargeting campaigns. Adobe Advertising Cloud Search offers model transparency and accuracy reports that give insight into actual performance rather than just forecasts for clicks, cost and revenue. It helps Adobe Sensei to make the right decisions to most efficiently meet customers' performance goals. With an intuitive navigation and time-saving workflows, it delivers powerful, real-time integration with Adobe Analytics, Adobe Audience Manager and Adobe Campaign and connects users' data, audience segments, and other marketing channels.

*Adobe Advertising Cloud TV*

Adobe Advertising Cloud TV advances TV advertising through software. By using data and automation, Adobe Advertising Cloud TV helps customers make smarter TV buying decisions, deliver precision against their audiences, and increase the impact of their TV advertising with access to over 30,000 audience data attributes. With access to the most broadcast and linear cable inventory of any platform, Adobe Advertising Cloud TV opens the door to the entire TV experience – linear, addressable, and connected TV to reach 100+ million households across national, local, video-on-demand, and more.

*Adobe Advertising Cloud Creative*

Adobe Advertising Cloud Creative uniquely brings together designers and marketing professionals in a self-serve, intuitive interface. The direct integration with Adobe Creative Cloud apps enhances collaboration between customers' ad production and media teams, enabling users to automatically create thousands of ads at scale. Using Adobe Advertising Cloud Creative, users can target, sequence, iterate, and optimize personalized ad experiences for their audiences. Adobe Advertising Cloud Creative is part of the Adobe Advertising Cloud DSP and can be enabled to work with other media buying properties.

***Adobe Analytics Cloud***

Adobe Analytics Cloud uses advanced machine learning and automation to provide a core intelligence engine for enterprises that allow customers to put real-time insights into action. With Adobe Analytics Cloud, enterprise-level marketing analytics is made understandable and accessible to everyone in the organization; targeting is improved, as our customers can connect their analytics with real-time activation so the transition from insight to action is fast; users are provided with an objective view of their customers' journeys across every device and channel that helps them achieve better understanding of their ROI; and segmentation is more precise as our customers can discover and create high-value audiences and understand the best way to reach them. The following is a brief description of the solutions that comprise the Adobe Analytics Cloud.

*Adobe Analytics*

Adobe Analytics is our industry leading solution that helps our customers create a holistic view of their business by turning consumer interactions into actionable insights. From attribution and predictive modeling to contribution analysis and propensity scoring, Adobe Analytics is immersed in machine learning and AI. With intuitive and interactive dashboards and reports, our customers can sift, sort, and share real-time information to provide insights that can be used to identify problems and opportunities and to drive conversion and relevant consumer experiences. Our Analysis Workspace provides analysts our most powerful tools available at a click so they can create and curate reusable projects that are customized to their needs. Adobe Analytics enables web, social, video, mobile, attribution, and predictive analytics across online and offline channels to continuously improve the performance of marketing activities. Adobe Analytics lets users integrate everything from web, email, and CRM to voice and connected car data smoothly. It also provides the ability to perform advanced ad-hoc segmentation and to integrate data from offline and third-party sources.

*Adobe Audience Manager*

Adobe Audience Manager is a data management platform that helps digital publishers build unique audience profiles to identify the most valuable segments and use them across any digital channel. Adobe Audience Manager consolidates audience information from all available sources. It then identifies, quantifies and optimizes high-value target audiences, which can then be offered to advertisers via an integrated, secure, privacy-friendly management system that works across all advertising distribution platforms. Adobe Audience Manager provides access to multiple data sources, offering digital publishers the ability to use a wide variety of third-party data as well as Audience Manager's private data co-op.

***Adobe Marketing Cloud***

Adobe Marketing Cloud provides a complete set of integrated digital marketing solutions. It contains everything necessary to deliver first-class digital experiences. Adobe Marketing Cloud enables our customers to manage their content and assets; grow audiences and increase engagement to optimize customer experiences;

personalize content and deliver optimized experiences at scale that are meaningful to each of their customers; orchestrate individual cross-channel campaigns that encourage meaningful customer experiences; and plan, orchestrate and measure engagement with their prospects and customers at every stage of the experience journey on a single platform. Adobe Marketing Cloud also provides a solution that allows our customers to monetize video experiences. The following is a brief description of the solutions that comprise the Adobe Marketing Cloud.

*Adobe Experience Manager*

Adobe Experience Manager is a leading digital experience management solution that uses AI tools to help customers organize, create, and manage the delivery of creative assets and other content across digital marketing channels, including web, mobile, email, communities and video. It enables customers to manage content on premise or host it in the cloud, delivering agile and rapid deployment. With this ultimate control of content and campaigns, our customers can deliver real-time and personalized experiences to their consumers that help build customers' brand, drive demand and extend reach. Adobe Experience Manager includes digital asset management, web content management, digital publishing, integrated mobile app development, enterprise-level forms management, and social capabilities, providing customers with tools enabling users to improve their market and brand perception and provide a personalized experience to their consumers.

*Adobe Campaign*

Adobe Campaign is optimized for B2C experiences involving high volume email and cross-channel campaign management. Adobe Campaign enables marketers to manage the customer journey and orchestrate personalized experiences determined by each consumer's behaviors and preferences. As part of its feature set, Adobe Campaign provides visual campaign orchestration, allowing for intuitive design and automated consumer experiences across channels, from one-off campaigns to triggered messages, with a graphically rich interface. Marketers can also integrate consumer data from across marketing channels to develop and deliver more relevant marketing experiences to their consumers through email, mobile, offline channels, and more. Features also include targeted segmentation, multilingual email execution, real-time interaction, in-app messaging, and operational reporting to easily see how well campaigns are performing.

*Adobe Target*

Adobe Target lets our customers test, target and personalize content across multiple devices. With Adobe Target, our customers have the tools they need to quickly discover what gets noticed and what increases conversion and engagement. It paves a path from simple testing to targeting to true segmentation and optimization through A/B and multivariate testing, AI-powered automation at scale, content targeting and automated decision-making. Adobe Target capabilities also enable our customers to test and target adaptive or responsive mobile web experiences.

*Marketo Engagement Platform*

Marketo Engagement Platform is optimized for B2B, cross-channel campaigns requiring lead management, account-based marketing and revenue attribution technology by bringing together planning, engagement and measurement capabilities into an integrated marketing platform. Marketo Engagement Platform simplifies how companies plan, orchestrate and measure engagement with prospects and customers at every stage of their experience. It offers a feature-rich and cloud-native platform with a set of solutions for delivering transformative customer experiences across industries and companies of all sizes.

*Adobe Primetime*

Adobe Primetime is a multiscreen TV platform that helps broadcasters, cable networks, and pay-TV providers create and monetize engaging, personalized viewing experiences. When integrated with Adobe Experience Cloud solutions, media sellers can optimize campaign and advertisement delivery in real time. Adobe Primetime combined with Adobe Analytics captures detailed authentication and viewing behavior across devices and delivers effective insights.

***Magento Commerce Cloud***

Magento Commerce Cloud offers digital commerce enablement and order orchestration for both physical and digital goods across a range of industries, including consumer packaged goods, retail, wholesale, manufacturing and the public sector. Magento Commerce Cloud brings together digital commerce, order management and predictive intelligence to enable shopping experiences that scale from mid-market to enterprise businesses. Based on an open-source ecosystem, Magento Commerce Cloud extends beyond the web shopping cart to every shoppable experience, including email, mobile, in-store, and marketplaces. Magento Commerce Cloud combined with the Adobe Experience Cloud offers a single, end-to-end platform for content creation, marketing, advertising, analytics and commerce for business-to-business and business-to-consumer customers globally.

**Other Products and Services**

We also offer a broad range of other enterprise and digital media products and services. Information about other products not referenced here can be found on our corporate website, www.adobe.com.

## OPERATIONS

### Marketing and Sales

We market and license our products directly using our sales force and certain local offices and through our own website at www.adobe.com. We also market and distribute our products through sales channels, which include distributors, retailers, software developers, SIs, ISVs and VARs, as well as through OEM and hardware bundle customers.

Our local field offices include locations in Australia, Austria, Belgium, Brazil, Canada, Chile, China, Columbia, Czech Republic, Denmark, Finland, France, Germany, Hong Kong, India, Ireland, Israel, Italy, Japan, Mexico, Moldova, the Netherlands, New Zealand, Norway, Poland, Romania, Singapore, South Africa, South Korea, Spain, Sweden, Switzerland, Taiwan, United Arab Emirates, the United Kingdom and the United States.

We sell the majority of our products through a software subscription model where our customers purchase access to a product for a specific period of time during which they always have rights to use the most recent version of that product. We also license perpetual versions of our software with maintenance and support, which includes rights to upgrades, when and if available, support, updates and enhancements.

For fiscal 2018, 2017 and 2016, there were no customers that represented at least 10% of net revenue. As of fiscal year end 2018 and 2017, no single customer was responsible for over 10% of our trade receivables.

### Services and Support

We provide expert consulting, customer success management, technical support, and learning services across all our customer segments, including enterprises, small and medium businesses, creative professionals, and consumers. With a focus on ensuring sustained customer success and realized value, this comprehensive portfolio of services is designed to help customers and partners maximize the return on their investments in our cloud solutions and licensed products. Our service and support revenue consists primarily of consulting fees, software maintenance, technical support fees and training fees.

*Consulting Services*

We have a global professional services team dedicated to designing and implementing solutions for our largest customers. Our professional services team uses a comprehensive, customer-focused methodology that has been refined over years of capturing and analyzing best practices from numerous customer engagements across a diverse mix of solutions, industries, and customer segments. Increasingly, our customers seek to integrate across Adobe's products and cloud solutions, and engage our professional services teams to share their expertise in leading customers' digital strategies and multi-solution integrations. Using our methodology, our professional services teams are able to accelerate customers' time to value, and maximize the return customers earn on their investment in Adobe solutions.

A key component of Adobe's strategy is developing a large partner ecosystem to expand the reach and breadth of Adobe solutions in the global marketplace. In order to assist partners in building their respective digital practices, Adobe Global Services provides a comprehensive set of deliverables through Adobe's Solution Partner Program. The breadth of services described in the program provides system integrators, agencies, and regional partners the tools required to develop core capabilities for positioning and building with Adobe technology, as well as implementing and running customer platforms. We believe that through these programmatic services and support, our joint customers benefit greatly by the combination of Adobe technology and the deep customer context that our global partners represent.

*Customer Success Account Management*

Adobe Customer Solutions provides post-sales Customer Success Managers, who work with specific enterprise customers on an ongoing basis to understand their current and future business needs, promote faster solution adoption, and align product capabilities to customers' business objectives to maximize the return on their investment in Adobe's offerings. We engage customers to share innovative best practices, relevant industry and vertical knowledge, and proven success strategies based on our extensive engagements with leading marketers and brands. The performance of these teams is directly associated with customer-focused outcomes, notably ongoing customer retention.

*Technical Support*

Adobe provides enterprise maintenance and support services to customers of subscription products as part of the subscription entitlement, and to perpetual license customers via annual fee-based maintenance and support programs. These offerings provide:

- technical support on the products they have purchased from Adobe;
- "how to" help in using our products; and
- product upgrades and enhancements during the term of the maintenance and support or subscription period, which is typically one to three years.

We provide product support through a global support organization that includes several regional and global support centers, supplemented with outsourced vendors for specific services. Customers can seek help through multiple channels including phone, chat, web, social media, and email, allowing quick and easy access to the information they need. These teams are responsible for providing timely, high-quality technical expertise on all our products.

Certain consumers are eligible to receive Getting Started support, to assist with easy adoption of their products. Support for some products and in some countries may vary. For enterprise customers with greater support needs, we offer personalized service options through Premium Services options, delivered by technical account managers who can also provide proactive risk mitigation services and on-site support services for those with business critical deployments.

Lastly, we also offer delivery assurance, technical support, and enablement services to partners and developer organizations. Through the Adobe Partner Connection Reseller Program, we provide developers with high-quality tools, software development kits, information and services.

*Digital Learning Services*

Adobe Global Services offers a comprehensive portfolio of learning and enablement services to assist our customer and partner teams in the use of our products, including those within Digital Experience, Digital Media and other legacy products and solutions. Our training portfolio includes a large number of free online self-service learning options on www.training.adobe.com. Adobe Digital Learning Services also has an extensive portfolio of fee-based learning programs including a wide range of traditional classroom, virtual, and on-demand training and certifications delivered by our team of training professionals and partners across the globe.

These core offerings are complemented by our custom learning services, which support our largest enterprise customers and their unique requirements. Solution-specific skills assessments help our enterprise customers objectively assess the knowledge and competencies within their marketing teams and tailor their learning priorities accordingly. Finally, aligned with our cloud strategy, we have introduced a new learning subscription service that enables customers to access both business and technical Digital Experience training over a 12-month period, which is a scalable approach to supporting long-term learning.

**Investments**

From time to time we make direct investments in privately held companies. We enter into these investments with the intent of securing financial returns as well as for strategic purposes, as they often increase our knowledge of emerging markets and technologies and expand our opportunities to provide Adobe products and services.

## PRODUCT DEVELOPMENT

A continuous high level of investment is required for the enhancement of existing solutions and the development of new solutions due to the speed of technological change that characterizes the software industry. We develop our software internally, as well as acquire products or technology developed by others by purchasing the stock or assets of the business entity that owns the technology. In other instances, we have licensed or purchased the intellectual property ownership rights of programs developed by others with license or technology transfer agreements that may obligate us to pay a flat license fee or royalties, typically based on a dollar amount per unit or a percentage of the revenue generated by those programs.

## PROTECTING AND LICENSING OUR PRODUCTS

We protect our intellectual property through a combination of patents, copyrights, trademarks and trade secrets, foreign intellectual property laws, confidentiality procedures and contractual provisions. We have United States and foreign patents and pending applications that relate to various aspects of our products and technology. Although our patents have value, no single patent is essential to any of our principal businesses. We have also registered, and applied for the registration of, U.S. and international trademarks, service marks, domain names and copyrights.

Our enterprise customers license our hosted offerings as On-demand Services or Managed Services, and consumers primarily use our desktop software and mobile apps. We license our desktop software to users under ‘click through’ or signed license agreements containing restrictions on duplication, disclosure, and transfer. Similarly, cloud products and services are provided to users under ‘click through’ or signed agreements containing restrictions on access and use.

Despite our efforts to protect our proprietary technology and our intellectual property rights, unauthorized parties may attempt to copy or obtain and use our technology to develop applications with the same functionality as our application. Policing unauthorized use of our technology and intellectual property rights is difficult. We believe that our transition from perpetual-use software licenses to a subscription-based business model combined with the increased focus on cloud-based computing has and may continue to improve our efforts to combat the pirating of our products.

## EMPLOYEES

As of November 30, 2018, we employed 21,357 people. We have not experienced work stoppages and believe our employee relations are good.

## AVAILABLE INFORMATION

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed or furnished pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge on our Investor Relations website at www.adobe.com/adbe as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information posted on our website is not incorporated into this report.

## EXECUTIVE OFFICERS

Adobe’s executive officers as of January 18, 2019 are as follows:

| Name | Age | Positions |
|---|---|---|
| Shantanu Narayen | 55 | Chairman, President and Chief Executive Officer |
| | | Mr. Narayen currently serves as our Chairman of the Board, President and Chief Executive Officer. He joined Adobe in January 1998 as Vice President and General Manager of our engineering technology group. In January 1999, he was promoted to Senior Vice President, Worldwide Products, and in March 2001 he was promoted to Executive Vice President, Worldwide Product Marketing and Development. In January 2005, Mr. Narayen was promoted to President and Chief Operating Officer, and effective December 2007, he was appointed our Chief Executive Officer and joined our Board of Directors. In January 2017, he was named our Chairman of the Board. Mr. Narayen serves as lead independent director on the board of directors of Pfizer, a multinational pharmaceutical corporation. He previously served as a director of Dell from September 2009 to October 2013. Mr. Narayen holds a B.S. in Electronics Engineering from Osmania University in India, a M.S. in Computer Science from Bowling Green State University and an M.B.A. from the Haas School of Business, University of California, Berkeley. |
| John Murphy | 50 | Executive Vice President and Chief Financial Officer |
| | | Mr. Murphy currently serves as our Executive Vice President and Chief Financial Officer. He joined Adobe in March 2017 and served as our Senior Vice President, Chief Accounting Officer and Corporate Controller until April 2018. Prior to joining Adobe, |

Mr. Murphy served as Senior Vice President, Chief Accounting Officer and Corporate Controller of Qualcomm Incorporated from September 2014 to March 2017. He previously served as Senior Vice President, Controller and Chief Accounting Officer of DIRECTV Inc. from November 2007 until August 2014, and Vice President and General Auditor of DIRECTV from October 2004 to November 2007. Prior to joining DIRECTV he worked at several global companies, including Experian, Nestle, and Atlantic Richfield (ARCO), in a variety of finance and accounting roles. He served as Director of DirecTV Holdings LLC from November 2007 until August 2014. Mr. Murphy serves on the Corporate Advisory Board of the Marshall School of Business at the University of Southern California. He holds an MBA from the Marshall School of Business at the University of Southern California, a B.S. in Accounting from Fordham University and is a Certified Public Accountant.

| Name | Age | Positions |
|---|---|---|
| Scott Belsky | 38 | Chief Product Officer and Executive Vice President, Creative Cloud |
| | | Mr. Belsky joined Adobe in December 2017 as Chief Product Officer and Executive Vice President, Creative Cloud. Prior to joining Adobe in December 2017, Belsky was a venture investor at Benchmark in San Francisco from February 2016 to December 2017. Prior to Benchmark, Belsky led Adobe's mobile strategy for Creative Cloud from December 2012 to January 2016, having joined the company through the acquisition of Behance. Belsky co-founded Behance in 2006 and served as its CEO for over 6 years. He is an early advisor and investor to Pinterest, Uber, and Warby Parker among other early-stage companies, and co-founded and serves on the board of Prefer, a referrals platform that empowers the careers of independent professionals. Mr. Belsky also serves on the advisory board of Cornell University's Entrepreneurship Program and as President of the Smithsonian Cooper-Hewitt National Design Museum board of trustees. |
| Bryan Lamkin | 58 | Executive Vice President and General Manager, Digital Media |
| | | Mr. Lamkin currently serves as Executive Vice President and General Manager, Digital Media. He rejoined Adobe in February 2013 as Senior Vice President, Technology and Corporate Development. From June 2011 to May 2012, Mr. Lamkin served as President and Chief Executive Officer of Clover, a mobile payments platform. Prior to Clover, Mr. Lamkin co-founded and served as the Chief Executive Officer of Bagcheck, a sharing and discovery platform, from June 2010 to May 2011. From April 2009 to June 2010, Mr. Lamkin served as Senior Vice President of Consumer Products and Applications at Yahoo!, a global technology company providing online search, content and communication tools. From May 2008 to April 2009, Mr. Lamkin served as Executive in Residence at Sutter Hill Ventures. Mr. Lamkin previously was with Adobe from 1992 to 2006 and held various senior management positions including Senior Vice President, Creative Solutions Business Unit. |
| Ann Lewnes | 57 | Executive Vice President and Chief Marketing Officer |
| | | Ms. Lewnes joined Adobe in November 2006 and currently serves as Executive Vice President and Chief Marketing Officer. Prior to joining Adobe, Ms. Lewnes spent 20 years at Intel Corporation, where she was Vice President of Sales and Marketing. Ms. Lewnes is a board member of Mattel, The Ad Council, and the Adobe Foundation. |
| Donna Morris | 51 | Chief Human Resources Officer and Executive Vice President, Employee Experience |
| | | Ms. Morris currently serves as Chief Human Resources Officer and Executive Vice President of Adobe's Global Customer and Employee Experience organization. Ms. Morris joined Adobe as Senior Director of Global Talent Management in April 2002 through the acquisition of Accelio Corporation, a Canadian software company, where she served as Vice President of Human Resources and Learning. In December 2005, Ms. Morris was promoted to Vice President Global Human Resources Operations and subsequently to Senior Vice President Human Resources in March 2007. Ms. Morris is a director of Marvell Technology Group Limited and the Adobe Foundation. |
| Abhay Parasnis | 44 | Executive Vice President and Chief Technology Officer |
| | | Mr. Parasnis joined Adobe in July 2015 as Senior Vice President of Adobe's Cloud Technology & Services organization and Chief Technology Officer. Prior to joining Adobe, he served as President and Chief Operating Officer at Kony, Inc. from March 2013 to March 2015. From January 2012 to November 2013, Mr. Parasnis was a Senior Vice President and later Strategic Advisor for the Oracle Public Cloud at Oracle. Prior to joining Oracle, he was General Manager of Microsoft Azure AppFabric at Microsoft from April 2009 to December 2011. |
| Dana Rao | 49 | Executive Vice President, General Counsel and Corporate Secretary |

Mr. Rao currently serves as our Executive Vice President, General Counsel and Corporate Secretary. He joined Adobe in April 2012 and served as our Vice President, Intellectual Property and Litigation where he spearheaded strategic initiatives including the company's litigation efforts, and its patent, trademark and copyright portfolio strategies until June 2018. Prior to joining Adobe, Mr. Rao was with Microsoft Corporation for 11 years, serving in a variety of roles including Associate General Counsel of Intellectual Property and Licensing, where he oversaw all patent matters for Microsoft's entertainment and devices division as well as the company-wide patent acquisition team. From 1997 until March 2001, he served as a patent attorney at Fenwick & West. He holds a B.S. in Electrical Engineering from Villanova University and a J.D. from George Washington University.

| Name | Age | Positions |
|---|---|---|
| Bradley Rencher | 45 | Executive Vice President and General Manager, Digital Experience<br><br>Mr. Rencher serves as Executive Vice President and General Manager of Adobe's Digital Experience business unit. Mr. Rencher joined Omniture, Inc. in January 2008 as Vice President of Corporate Development and was promoted to Senior Vice President of Business Operations prior to Adobe's acquisition of Omniture in 2009. Following the acquisition, he joined Adobe as Vice President of Business Operations. Mr. Rencher was promoted to Vice President and General Manager, Omniture business unit in 2010 and subsequently to Senior Vice President in 2011. Prior to joining Omniture, Mr. Rencher was a member of the technology investment banking team at Morgan Stanley from 2005 to 2008 and a member of the investment banking team at RBC Capital Markets from 1998 to 2004. Mr. Rencher is a director of Pluralsight and the Utah Symphony. |
| Matthew Thompson | 60 | Executive Vice President, Worldwide Field Operations<br><br>Mr. Thompson currently serves as Executive Vice President, Worldwide Field Operations. Mr. Thompson joined Adobe in January 2007 as Senior Vice President, Worldwide Field Operations. In January 2013, he was promoted to Executive Vice President, Worldwide Field Operations. Prior to joining Adobe, Mr. Thompson served as Senior Vice President of Worldwide Sales at Borland Software Corporation, a software delivery optimization solutions provider, from October 2003 to December 2006. Prior to joining Borland, Mr. Thompson was Vice President of Worldwide Sales and Field Operations for Marimba, Inc., a provider of products and services for software change and configuration management, from February 2001 to January 2003. From July 2000 to January 2001, Mr. Thompson was Vice President of Worldwide Sales for Calico Commerce, Inc., a provider of eBusiness applications. Prior to joining Calico, Mr. Thompson spent six years at Cadence Design Systems, Inc., a provider of electronic design technologies. While at Cadence, from January 1998 to June 2000, Mr. Thompson served as Senior Vice President, Worldwide Sales and Field Operations and from April 1994 to January 1998 as Vice President, Worldwide Professional Services. Mr. Thompson is a board member of NCR Corporation. |
| Mark Garfield | 48 | Vice President, Chief Accounting Officer and Corporate Controller<br><br>Mr. Garfield currently serves as our Vice President, Chief Accounting Officer and Corporate Controller. Prior to joining Adobe in December 2018, Mr. Garfield served as the Vice President of Finance of Cloudflare, Inc. commencing in November 2017. He served as Senior Vice President and Chief Accounting Officer at Symantec Corporation from March 2014 to October 2017. Prior to joining Symantec, he was at Brightstar Corporation where he served primarily as Senior Vice President and Chief Accounting Officer from January 2013 to February 2014. Mr. Garfield served as Director of Finance at Advanced Micro Devices from August 2010 to December 2012. Prior to Advanced Micro Devices, Mr. Garfield also served in senior level finance roles at LoudCloud and Ernst and Young. Mr. Garfield holds a B.A. in Business Economics from University of California at Santa Barbara. |

## ITEM 1A. RISK FACTORS

As previously discussed, our actual results could differ materially from our forward-looking statements. Below we discuss some of the factors that could cause these differences. These and many other factors described in this report could adversely affect our operations, performance and financial condition.

***Our competitive position and results of operations could be harmed if we do not compete effectively.***

The markets for our products and services are characterized by intense competition, new industry standards, evolving distribution models, limited barriers to entry, disruptive technology developments, short product life cycles, customer price sensitivity and frequent product introductions (including alternatives with limited functionality available at lower costs or free of charge). Any of these factors could create downward pressure on pricing and gross margins and could adversely affect our renewal and upsell and cross-sell rates, as well as our ability to attract new customers. Our future success will depend on our continued ability to enhance and integrate our existing products and services, introduce new products and services in a timely and cost-effective manner, meet changing customer expectations and needs, extend our core technology into new applications, and anticipate emerging standards, business models, software delivery methods and other technological developments. Furthermore, some of our competitors and potential competitors enjoy competitive advantages such as greater financial, technical, sales, marketing and other resources, broader brand awareness, and access to larger customer bases. As a result of these advantages, potential and current customers might select the products and services of our competitors, causing a loss of our market share. In addition, consolidation has occurred among some of our competitors. Further consolidations in these markets may subject us to increased competitive pressures and may harm our results of operations.

*For additional information regarding our competition and the risks arising out of the competitive environment in which we operate, see the section entitled "Competition" contained in Part I. Item 1 of this report.*

***If we cannot continue to develop, acquire, market and offer new products and services or enhancements to existing products and services that meet customer requirements, our operating results could suffer.***

The process of developing and acquiring new technology products and services and enhancing existing offerings is complex, costly and uncertain. If we fail to anticipate customers' rapidly changing needs and expectations or adapt to emerging technological trends, our market share and results of operations could suffer. We must make long-term investments, develop, acquire or obtain appropriate intellectual property and commit significant resources before knowing whether our predictions will accurately reflect customer demand for our products and services. If we misjudge customer needs in the future, our new products and services may not succeed and our revenues and earnings may be harmed. Additionally, any delay in the development, acquisition, marketing or launch of a new offering or enhancement to an existing offering could result in customer attrition or impede our ability to attract new customers, causing a decline in our revenue, earnings or stock price and weakening our competitive position.

We offer our products on a variety of hardware platforms. Consumers continue to migrate from personal computers to tablet and mobile devices. If we cannot continue adapting our products to tablet and mobile devices, or if our competitors can adapt their products more quickly than us, our business could be harmed. Releases of new devices or operating systems may make it more difficult for our products to perform or may require significant costs in order for us to adapt our solutions to such devices or operating systems. These potential costs and delays could harm our business.

***Introduction of new technology could harm our business and results of operations.***

The expectations and needs of technology consumers are constantly evolving. Our future success depends on a variety of factors, including our continued ability to innovate, introduce new products and services efficiently, enhance and integrate our products and services in a timely and cost-effective manner, extend our core technology into new applications, and anticipate emerging standards, business models, software delivery methods and other technological developments. Integration of our products and services with one another and other companies' offerings creates an increasingly complex ecosystem that is partly reliant on third parties. If any disruptive technology, or competing products, services or operating systems that are not compatible with our solutions, achieve widespread acceptance, our operating results could suffer and our business could be harmed.

The introduction of certain technologies may reduce the effectiveness of our products. For example, some of our products rely on third-party cookies, which are placed on individual browsers when consumers visit websites that contain advertisements. We use these cookies to help our customers more effectively advertise, gauge the

performance of their advertisements, and detect and prevent fraudulent activity. Consumers can block or delete cookies through their browsers or “ad-blocking” software or applications. The most common Internet browsers allow consumers to modify their browser settings to prevent cookies from being accepted by their browsers, or are set to block third-party cookies by default. Increased use of methods, software or applications that block cookies could harm our business.

***Security breaches in data centers we manage, or third parties manage on our behalf, may compromise the confidentiality, integrity, or availability of employee and customer data, which could expose us to liability and adversely affect our reputation and business.***

We process and store significant amounts of employee and customer data, most of which is hosted by third-party service providers. A security incident impacting our own data centers or those controlled by our service providers may compromise the confidentiality, integrity or availability of this data. Unauthorized access to or loss or disclosure of data stored by Adobe or our service providers may occur through break-ins, breaches of a secure network by an unauthorized party, software vulnerabilities or coding errors, employee theft or misuse or other misconduct. It is also possible that unauthorized access to or disclosure of customer data may be obtained through inadequate use of security controls by customers or employees. Accounts created with weak or recycled passwords could allow cyber-attackers to gain access to customer data. Additionally, failure by customers to remove accounts of their own employees, or the granting of accounts by the customer in an uncontrolled manner, may allow for access by former or unauthorized customer representatives. If there were an inadvertent disclosure of customer data, or if a third party were to gain unauthorized access to the data we possess on behalf of our customers, our operations could be disrupted, our reputation could be damaged and we could be subject to claims or other liabilities, regulatory investigations, or fines. In addition, such perceived or actual unauthorized loss or disclosure of the information we collect or breach of our security could damage our reputation, result in the loss of customers and harm our business.

***We rely on data centers managed both by Adobe and third parties to host and deliver our services, as well as access, collect, use, transmit, and store data, and any interruptions or delays in these hosted services, or failures in data collection or transmission could expose us to liability and harm our business and reputation.***

Much of our business relies on hardware and services that are hosted, managed, and controlled directly by Adobe or third-party service providers, including our online store at adobe.com, Creative Cloud, Document Cloud, and Experience Cloud solutions. We do not have redundancy for all of our systems, many of our critical applications reside in only one of our data centers, and our disaster recovery planning may not account for all eventualities. If our business relationship with a third-party provider of hosting or content delivery services is negatively affected, or if one of our content delivery suppliers were to terminate its agreement with us, without adequate notice, we might not be able to deliver the corresponding hosted offerings to our customers, which could subject us to reputational harm, costly and time intensive notification requirements, and cause us to lose customers and future business. Occasionally, we migrate data among data centers and to third-party hosted environments. If a transition among data centers or to third-party service providers encounters unexpected interruptions, unforeseen complexity, or unplanned disruptions despite precautions undertaken during the process, this may impair our delivery of products and services to customers and result in increased costs and liabilities, which may harm our operating results and our business.

It is also possible that hardware or software failures or errors in our systems (or those of our third-party service providers) could result in data loss or corruption, cause the information that we collect or maintain to be incomplete or contain inaccuracies that our customers regard as significant, or cause us to fail to meet committed service levels or comply with regulatory notification requirements. Furthermore, our ability to collect and report data may be delayed or interrupted by a number of factors, including access to the Internet, the failure of our network or software systems, security breaches or significant variability in visitor traffic on customer websites. In addition, computer viruses, worms, or other malware may harm our systems, causing us to lose data, and the transmission of computer viruses or other malware could expose us to litigation or regulatory investigation, and costly and time intensive notification requirements.

We may also find, on occasion, that we cannot deliver data and reports to our customers in near real time because of a number of factors, including significant spikes in customer activity on their websites or failures of our network or software, or the failure of our third-party service providers' network or software. If we fail to plan infrastructure capacity appropriately and expand it proportionally with the needs of our customer base, and we experience a rapid and significant demand on the capacity of our data centers or those of third parties, service outages could occur, and our customers could suffer impaired performance of our services. Such a strain on our infrastructure capacity could subject us to regulatory notification requirements, violations of service level agreement commitments, financial liabilities, result in customer dissatisfaction, or harm our business. If we supply inaccurate information or experience interruptions in our ability to capture, store and supply information in near real time or at all, our reputation could be harmed and we could lose customers as a result, or we could be found liable for damages or incur other losses.

***Increasing regulatory focus on privacy issues and expanding laws could impact our business models and expose us to increased liability.***

As a global company, Adobe is subject to global privacy and data security laws, regulations, and codes of conduct that apply to our various business units. These laws and regulations may be inconsistent across jurisdictions and are subject to evolving and differing (sometimes conflicting) interpretations. Government regulators, privacy advocates and class action attorneys are increasingly scrutinizing how companies collect, process, use, store, share and transmit personal data. This increased scrutiny may result in new interpretations of existing laws, thereby further impacting Adobe's business. Globally, new and emerging laws, such as the General Data Protection Regulation ("GDPR") in Europe, state laws in the U.S. on privacy, data and related technologies, such as the California Consumer Privacy Act, as well as industry self-regulatory codes create new compliance obligations and expand the scope of potential liability, either jointly or severally with our customers and suppliers. While we have invested in readiness to comply with applicable requirements, these new and emerging laws, regulations and codes may affect our ability (and our enterprise customers' ability) to reach current and prospective customers, to respond to both enterprise and individual customer requests under the laws (such as individual rights of access, correction, and deletion of their personal information), and to implement our business models effectively. These new laws may also impact our innovation and business drivers in developing new and emerging technologies (e.g., artificial intelligence and machine learning). These requirements, among others, may impact demand for our offerings and force us to bear the burden of more onerous obligations in our contracts. Any perception of our practices, products or services as a violation of individual privacy rights may subject us to public criticism, class action lawsuits, reputational harm, or investigations or claims by regulators, industry groups or other third parties, all of which could disrupt our business and expose us to increased liability. Additionally, we collect and store information on behalf of our business customers and if our customers fail to comply with contractual obligations or applicable laws, it could result in litigation or reputational harm to us.

Transferring personal information across international borders is becoming increasingly complex. For example, European data transfers outside the European Economic Area are highly regulated. The mechanisms that we and many other companies rely upon for European data transfers (e.g. Privacy Shield and Model Clauses) are being contested in the European court system. We are closely monitoring developments related to requirements for transferring personal data outside the EU and other countries that have similar trans-border data flow requirements. These requirements may result in an increase in the obligations required to provide our services in the EU or in sanctions and fines for non-compliance. Several other countries, including Australia and Japan, have also established specific legal requirements for cross-border transfers of personal information. Other countries, such as India, are considering requirements for data localization (e.g. where personal data must remain in the country). If the mechanisms for transferring personal information from certain countries or areas, including Europe to the United States should be found invalid or if other countries implement more restrictive regulations for cross-border data transfers (or not permit data to leave the country of origin), such developments could harm our business, financial condition and results of operations.

***Security vulnerabilities in our products and systems could lead to reduced revenue or to liability claims.***

Maintaining the security of our products, computers and networks is a critical issue for us and our customers. Security researchers, criminal hackers and other third parties regularly develop new techniques to penetrate computer and network security measures and, as we have previously disclosed, certain parties have in the past managed to breach and misuse some of our systems and software in order to access our end users' authentication and payment information. In addition, cyber-attackers also develop and deploy viruses, worms, credential stuffing attack tools, and other malicious software programs, some of which may be specifically designed to attack our products, systems, computers or networks. Sophisticated hardware and operating system applications that we develop or procure from third parties may contain defects in design or manufacture, including bugs, vulnerabilities and other problems that could unexpectedly compromise the security of the system or impair a customer's ability to operate or use our products. The costs to prevent, eliminate, notify affected parties of, or alleviate cyber- or other security problems, bugs, viruses, worms, malicious software programs and security vulnerabilities are significant, and our efforts to address these problems may not be successful or may be delayed and could result in interruptions, delays, cessation of service and loss of existing or potential customers. It is impossible to predict the extent, frequency or impact these problems may have on us.

Outside parties have in the past and may in the future attempt to fraudulently induce our employees or users of our products or services to disclose sensitive information via illegal electronic spamming, phishing or other tactics. Unauthorized parties may also attempt to gain physical access to our facilities in order to infiltrate our information systems or attempt to gain logical access to our products, services, or information systems for the purpose of exfiltrating content and data. These actual and potential breaches of our security measures and the accidental loss, inadvertent disclosure or unauthorized dissemination of proprietary information or sensitive, personal or confidential data about us, our employees, our customers or their end users, including the potential loss or disclosure of such information or data as a result of hacking, fraud, trickery or other forms of deception, could expose us, our employees, our customers or the individuals affected to a risk of loss or misuse of this information. This may result in litigation and liability or fines, our compliance with costly and time intensive notice requirements, governmental inquiry or oversight or a loss of customer confidence, any of which could harm our business or damage our brand and reputation, possibly impeding our present and future success in retaining and attracting new customers and thereby requiring time and resources to repair our brand and reputation. These risks will likely increase as we expand our hosted offerings, integrate our products and services, and store and process more data, including personal information.

These problems affect our products and services in particular because cyber-attackers tend to focus their efforts on popular offerings with a large user base, and we expect them to continue to do so. Critical vulnerabilities may be identified in some of our applications and services and those of our third-party service providers. These vulnerabilities could cause such applications and services to crash and could allow an attacker to take control of the affected system, which could result in liability to us or limit our ability to conduct our business and deliver our products and services to customers. We devote significant resources to address security vulnerabilities through engineering more secure products, enhancing security and reliability features in our products and systems, code hardening, conducting rigorous penetration tests, deploying updates to address security vulnerabilities, reviewing our service providers' security controls, and improving our incident response time, but these security vulnerabilities cannot be totally eliminated. The cost of these steps could reduce our operating margins, and we may be unable to implement these measures quickly enough to prevent cyber-attackers from gaining unauthorized access into our systems and products. Despite our preventative efforts, actual or perceived security vulnerabilities in our products and systems may harm our reputation or lead to claims against us (and have in the past led to such claims), and could lead some customers to stop using certain products or services, to reduce or delay future purchases of products or services, or to use competing products or services. If we do not make the appropriate level of investment in our technology systems or if our systems become out-of-date or obsolete and we are not able to deliver the quality of data security customers require, our business could be adversely affected. Customers may also adopt security measures designed to protect their existing computer systems from attack, which could delay adoption of new technologies. Further, if we or our customers are subject to a future attack, or our technology is used in a third-party attack, we could be subject to costly and time intensive notice requirements, and it may be necessary for us to take additional extraordinary measures and make additional expenditures to take appropriate responsive and preventative steps. Any of these events could adversely affect our revenue or margins. Moreover, delayed sales, lower margins or lost customers resulting from disruptions caused by cyber-attacks or preventative measures could adversely affect our financial results, stock price and reputation.

***Some of our enterprise offerings have extended and complex sales cycles, which can make our sales cycles unpredictable.***

Sales cycles for some of our enterprise offerings, including our Adobe Experience Cloud solutions and ETLAs in our Digital Media business, are multi-phased and complex. The complexity in these sales cycles is due to several factors, including:

- the need for our sales representatives to educate customers about the use and benefit of large-scale deployments of our products and services, including technical capabilities, security features, potential cost savings and return on investment;
- the desire of organizations to undertake significant evaluation processes to determine their technology requirements prior to making information technology expenditures;
- the need for our representatives to spend a significant amount of time assisting potential customers in their testing and evaluation of our products and services;
- intensifying competition within the industry;
- the negotiation of large, complex, enterprise-wide contracts;
- the need for our customers to obtain requisition approvals from various decision makers within their organizations due to the complexity of our solutions touching multiple departments within customers' organizations; and
- customer budget constraints, economic conditions and unplanned administrative delays.

We spend substantial time and expense on our sales efforts without assurance that potential customers will ultimately purchase our solutions. As we target our sales efforts at larger enterprise customers, these trends are expected to continue and could have a greater impact on our results of operations. Additionally, our enterprise sales pattern has historically been uneven, where a higher percentage of a quarter's total sales occur during the final weeks of each quarter, which is common in our industry. Our extended sales cycle for these products and services makes it difficult to predict when a given sales cycle will close.

***Subscription offerings could create risks related to the timing of revenue recognition.***

We generally recognize revenue from subscription offerings ratably over the terms of their subscription agreements, which range from 1 to 36 months. As a result, most of the subscription revenue we report in each quarter is the result of subscription agreements entered into during previous quarters. Any reduction in new or renewed subscriptions in a quarter may not be reflected in our revenue results until a later quarter. Declines in new or renewed subscriptions may decrease our revenue in future quarters. Lower sales, reduced demand for our products and services, and increases in our attrition rate may not be fully reflected in our results of operations until future periods. Our subscription model could also make it difficult for us to rapidly increase our revenue from subscription-based or hosted services through additional sales in any period, as revenue from new customers will be recognized over the applicable subscription term.

Additionally, in connection with our sales efforts to enterprise customers and our use of ETLAs, a number of factors could affect our revenue, including longer-than-expected sales and implementation cycles, potential deferral of revenue due to multiple-element revenue arrangements and alternative licensing arrangements. If any of our assumptions about revenue from our subscription-based offerings prove incorrect, our actual results may vary materially from those anticipated.

***If our customers fail to renew subscriptions in accordance with our expectations, our future revenue and operating results could suffer.***

Our Adobe Experience Cloud, Creative Cloud, and Document Cloud offerings typically involve subscription-based offerings pursuant to product and service agreements. Revenue from our subscription customers is generally recognized ratably over the term of their agreements, which typically range from 1 to 36 months. Our customers have no obligation to renew their subscriptions for our services after the expiration of their initial subscription period, and customers may not renew their subscriptions at the same or higher level of service, for the same number of seats or for the same duration of time, if at all. Moreover, under certain circumstances, some of our customers have the right to cancel their agreements prior to the expiration of the terms. Our varied customer base combined with the flexibility we offer in the length of our subscription-based agreements complicates our ability to precisely forecast renewal rates. Therefore, we cannot provide assurance that we will be able to accurately predict future customer renewal rates.

Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their level of satisfaction with our services, our ability to continue enhancing features and functionality, the reliability (including uptime) of our subscription offerings, the prices of offerings and those offered by our competitors, the actual or perceived information security of our systems and services, decreases in the size of our customer base, reductions in our customers' spending levels or declines in customer activity as a result of economic downturns or uncertainty in financial markets. If our customers do not renew their subscriptions or if they renew on terms less favorable to us, our revenue may decline.

***We may not realize the anticipated benefits of past or future investments or acquisitions, and integration of acquisitions may disrupt our business and management.***

We may not realize the anticipated benefits of an investment or acquisition of a company, division, product or technology, each of which involves numerous risks. These risks include:

- inability to achieve the financial and strategic goals for the acquired and combined businesses;
- difficulty in, and the cost of, effectively integrating the operations, technologies, products or services, and personnel of the acquired business;
- entry into markets in which we have minimal prior experience and where competitors in such markets have stronger market positions;
- disruption of our ongoing business and distraction of our management and other employees from other opportunities and challenges;
- inability to retain personnel of the acquired business;
- inability to retain key customers, distributors, vendors and other business partners of the acquired business;
- inability to take advantage of anticipated tax benefits;
- incurring acquisition-related costs or amortization costs for acquired intangible assets that could impact our operating results;

- elevated delinquency or bad debt write-offs related to receivables of the acquired business we assume;
- increased accounts receivables collection times and working capital requirements associated with acquired business models;
- additional costs of bringing acquired companies into compliance with laws and regulations applicable to a multinational corporation;
- difficulty in maintaining controls, procedures and policies during the transition and integration;

- impairment of our relationships with employees, customers, partners, distributors or third-party providers of our technologies, products or services;

- failure of our due diligence processes to identify significant problems, liabilities or other challenges of an acquired company or technology;

- exposure to litigation or other claims in connection with, or inheritance of claims or litigation risk as a result of, an acquisition, such as claims from terminated employees, customers, former stockholders or other third parties;

- incurring significant exit charges if products or services acquired in business combinations are unsuccessful;

- inability to conclude that our internal controls over financial reporting are effective;

- inability to obtain, or obtain in a timely manner, approvals from governmental authorities, which could delay or prevent such acquisitions;

- the failure of strategic investments to perform as expected or to meet financial projections;

- delay in customer and distributor purchasing decisions due to uncertainty about the direction of our product and service offerings; and

- incompatibility of business cultures.

Mergers and acquisitions of technology companies are inherently risky. If we do not complete an announced acquisition transaction or integrate an acquired business successfully and in a timely manner, we may not realize the benefits of the acquisition to the extent anticipated, and in certain circumstances an acquisition could harm our financial position.

***Our business could be harmed if we fail to effectively manage critical strategic third-party business relationships.***

As our offerings expand and our customer base grows, our relationships with strategic partners become increasingly valuable. If our contractual relationships with these third parties were to terminate, or if we were unable to renew on favorable terms, our business could be harmed. This is especially the case when the third party's offerings are integrated with our products and services, or where the third party's offerings are difficult to substitute or replace. Alternative arrangements for such products and services may not be available to us, or on commercially reasonable terms, and we may experience business interruptions upon a transition to an alternative partner. The failure of third parties to provide acceptable products and services or to update their technology may result in a disruption to our business operations and those of our customers, which may reduce our revenues and profits, cause us to lose customers and damage our reputation.

***We face various risks associated with our operating as a multinational corporation.***

As a global business that generates approximately 43% of our total revenue from sales to customers outside of the Americas, we are subject to a number of risks, including:

- foreign currency fluctuations and controls;

- international and regional economic, political and labor conditions, including any instability or security concerns abroad;

- tax laws (including U.S. taxes on foreign subsidiaries);
- increased financial accounting and reporting burdens and complexities;
- changes in, or impositions of, legislative or regulatory requirements;
- changes in laws governing the free flow of data across international borders;
- failure of laws to protect our intellectual property rights adequately;
- inadequate local infrastructure and difficulties in managing and staffing international operations;

- delays resulting from difficulty in obtaining export licenses for certain technology, tariffs, quotas and other trade barriers;
- the imposition of governmental economic sanctions on countries in which we do business or where we plan to expand our business;
- costs and delays associated with developing products in multiple languages;
- operating in locations with a higher incidence of corruption and fraudulent business practices; and
- other factors beyond our control, such as terrorism, war, natural disasters and pandemics.

Some of our third-party business partners have international operations and are also subject to these risks and if our third-party business partners are unable to appropriately manage these risks, our business may be harmed. If sales to any of our customers outside of the Americas are reduced, delayed or canceled because of any of the above factors, our revenue may decline.

***We are subject to risks associated with compliance with laws and regulations globally, which may harm our business.***

We are a global company subject to varied and complex laws, regulations and customs, both domestically and internationally. These laws and regulations relate to a number of aspects of our business, including trade protection, import and export control, data and transaction processing security, payment card industry data security standards, records management, user-generated content hosted on websites we operate, privacy practices, data residency, corporate governance, anti-trust and competition, employee and third-party complaints, anti-corruption, gift policies, conflicts of interest, securities regulations and other regulatory requirements affecting trade and investment. The application of these laws and regulations to our business is often unclear and may at times conflict. For example, in many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by U.S. regulations applicable to us, including the Foreign Corrupt Practices Act. We cannot provide assurance that our employees, contractors, agents, and business partners will not take actions in violation of our internal policies or U.S. laws. Compliance with these laws and regulations may involve significant costs or require changes in our business practices that result in reduced revenue and profitability. Non-compliance could also result in fines, damages, criminal sanctions against us, our officers or our employees, prohibitions on the conduct of our business, and damage to our reputation.

In addition, approximately 49% of our employees are located outside the United States. Accordingly, we are exposed to changes in laws governing our employee relationships in various U.S. and foreign jurisdictions, including laws and regulations regarding wage and hour requirements, fair labor standards, employee data privacy, unemployment tax rates, workers' compensation rates, citizenship requirements and payroll and other taxes, which likely would have a direct impact on our operating costs.

***Changes in accounting principles, or interpretations thereof, could have a significant impact on our financial position and results of operations.***

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP"). These principles are subject to interpretation by the SEC and various bodies formed to interpret and create appropriate accounting principles. A change in these principles, how the principles are interpreted, or the adoption of new accounting standards can have a significant effect on our reported results, and could even retroactively affect previously reported transactions, and may require that we make significant changes to our systems, processes and controls.

Changes resulting from these new standards may result in materially different financial results and may require that we change how we process, analyze and report financial information and that we change financial reporting controls. For additional information regarding these new standards, see the section titled "Recent

Accounting Pronouncements Not Yet Effective” within Part II. Item 8, Note 1. Basis of Presentation and Summary of Significant Accounting Policies.

Such changes in accounting principles may have an adverse effect on our business, financial position, and income, or cause an adverse deviation from our revenue and profitability targets, which may negatively impact our financial results.

***Changes in tax rules and regulations, or interpretations thereof, may adversely affect our effective tax rates.***

We are a United States-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. The Tax Act, enacted into law on December 22, 2017, changes existing U.S. tax law applicable to us and includes adoption of a territorial tax system requiring us to incur a transition tax on previously untaxed earnings and profits of our foreign subsidiaries. A significant portion of our foreign earnings for the current fiscal year were earned by our Irish subsidiaries. As part of the adoption of a territorial tax system, the Tax Act also provides an exemption from federal income taxes for distributions from foreign subsidiaries made after December 31, 2017 that were not subject to the one-time transition tax. In addition, certain international provisions introduced in the Tax Act will be effective for us in fiscal 2019. These provisions and changes that we may make to our corporate tax structure could adversely affect our tax rate and cash flow in future years.

Our income tax expense has differed from the tax computed at the U.S. federal statutory income tax rate due primarily to discrete items and to tax on earnings from foreign operations. Unanticipated changes in our tax rates could affect our future results of operations. Our future effective tax rates could be unfavorably affected by changes in the tax rates in jurisdictions where our income is earned, by changes in or our interpretation of tax rules and regulations in the jurisdictions in which we do business, by unanticipated decreases in the amount of earnings in countries with low statutory tax rates, by unexpected negative changes in business and market conditions that could reduce certain tax benefits, or by changes in the valuation of our deferred tax assets and liabilities.

In addition, in the United States, the European Commission, countries in the European Union and other countries where we do business, we are subject to potential changes in relevant tax, accounting and other laws, regulations and interpretations, including changes to tax laws applicable to corporate multinationals such as Adobe. These countries and other governmental bodies have or could make unprecedented assertions about how taxation is determined in their jurisdictions that are contrary to the way in which we have interpreted and historically applied the rules and regulations described above in our income tax returns filed in such jurisdictions. In the current global tax policy environment, any changes in laws, regulations and interpretations related to these assertions could adversely affect our effective tax rates or result in other costs to us which could adversely affect our operations and financial results.

Moreover, we are subject to the continual examination of our income tax returns by the U.S. Internal Revenue Service (“IRS”) and other domestic and foreign tax authorities. These tax examinations are expected to focus on our intercompany transfer pricing practices as well as other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for adjustments that may result from these examinations. We cannot provide assurance that the final determination of any of these examinations will not have an adverse effect on our operating results and financial position.

***Uncertainty about current and future economic conditions and other adverse changes in general political conditions in any of the major countries in which we do business could adversely affect our operating results.***

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in economic and political conditions, both domestically and globally. Uncertainty about the effects of current and future economic and political conditions on us, our customers, suppliers and partners makes it difficult for us to forecast operating results and to make decisions about future investments. If economic growth in countries where we do business slows, customers may delay or reduce technology purchases, advertising spending or marketing spending. This could result in reductions in sales of our products and services, more extended sales cycles, slower adoption of new technologies and increased price competition. Among our customers are government entities, including the U.S. federal government, and our revenue could decline if spending cuts impact the government’s ability to purchase our products and services. Deterioration in economic conditions in any of the countries in which we do business could also cause slower or impaired collections on accounts receivable, which may adversely impact our liquidity and financial condition.

A disruption in financial markets could impair our banking partners, on which we rely for operating cash management and affect our derivative counterparties. Any of these events would likely harm our business, financial condition, and results of operations.

Political instability or adverse political developments in or around any of the major countries in which we do business would also likely harm our business, results of operations and financial condition.

***The success of some of our product and service offerings depends on our ability to continue to attract and retain customers of and contributors to our online marketplaces for creative content.***

The success of some of our product and service offerings, such as Adobe Stock, depends on our ability to continue to attract new customers and contributors to these online marketplaces for creative content, as well as our ability to continue to retain existing customers and contributors. An increase in paying customers has generally resulted in more content from contributors, which increases the size of our collection and in turn attracts new paying customers. We rely on the functionality and features of our online marketplaces, the size and content of our collection and the effectiveness of our marketing efforts to attract new customers and contributors and retain existing ones. New technologies may render the features of our online marketplaces obsolete, our collection may fail to grow as anticipated or our marketing efforts may be unsuccessful, any of which may adversely affect our results of operations.

***Our intellectual property portfolio is a valuable asset and we may not be able to protect our intellectual property rights, including our source code, from infringement or unauthorized copying, use or disclosure.***

Our intellectual property portfolio is a valuable asset. Infringement or misappropriation of our patents, trademarks, trade secrets, copyrights and other intellectual property rights could result in lost revenues and ultimately reduce their value. Preventing unauthorized use or infringement of our intellectual property rights is inherently difficult. We actively combat software piracy as we enforce our intellectual property rights, but we nonetheless lose significant revenue due to illegal use of our software. If piracy activities continue at historical levels or increase, they may further harm our business. We apply for patents in the U.S. and internationally to protect our newly created technology and if we are unable to obtain patent protection for the technology described in our pending patent, or if the patent is not obtained timely, this could result in revenue loss, adverse effects on operations, and harm to our business. We offer our products and services in foreign countries and we may seek intellectual property protection from those foreign legal systems. Some of those foreign countries may not have as robust or comprehensive of intellectual property protection laws and schemes as those offered in the U.S. In some foreign countries, the mechanisms to enforce intellectual property rights may be inadequate to protect our technology, which could harm our business.

If unauthorized disclosure of our source code occurs through security breach, cyber-attack or otherwise, we could lose future trade secret protection for that source code. The loss of future trade secret protection could make it easier for third parties to compete with our products by copying functionality, which could cause us to lose customers and could adversely affect our revenue and operating margins. We also seek to protect our confidential information and trade secrets through the use of non-disclosure agreements with our customers, contractors, vendors and partners. However, there is a risk that our confidential information and trade secrets may be disclosed or published without our authorization, and in these situations, enforcing our rights may be difficult or costly.

***We may incur substantial costs defending against third parties alleging that we infringe their proprietary rights.***

We have been, are currently, and may in the future be, subject to claims, negotiations and complex, protracted litigation relating to disputes regarding the validity or alleged infringement of third-party intellectual property rights, including patent rights. Intellectual property disputes and litigation are typically costly and can be disruptive to our business operations by diverting the attention of management and key personnel. We may not prevail in every lawsuit or dispute. Third-party intellectual property disputes, including those initiated by patent assertion entities, could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from licensing certain of our products or offering certain of our services, subject us to injunctions restricting our sale of products or services, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers, including contractual provisions under various license arrangements and service agreements. In addition, we may incur significant costs in acquiring the necessary third-party intellectual property rights for use in our products, in some cases to fulfill contractual obligations with our customers. Any of these occurrences could significantly harm our business.

***We may incur losses associated with currency fluctuations and may not be able to effectively hedge our exposure.***

Our operating results are subject to fluctuations in foreign currency exchange rates due to the global scope of our business. Global economic events, including trade disputes, economic sanctions and emerging market volatility, and associated uncertainty may cause currencies to fluctuate. We attempt to mitigate a portion of these risks through foreign currency hedging based on our judgment of the appropriate trade-offs among risk, opportunity and expense. We regularly review our program to partially hedge our exposure to foreign currency fluctuations and make adjustments as necessary. Our hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movement in foreign currency exchange rates, which could adversely affect our financial condition or results of operations.

***Failure of our third-party customer service and technical support providers to adequately address customers' requests could harm our business and adversely affect our financial results.***

Our customers rely on our customer service support organization to resolve issues with our products and services. We outsource a substantial portion of our customer service and technical support activities to third-party service providers. We depend heavily on these third-party customer service and technical support representatives working on our behalf, and we expect to continue to rely heavily on third parties in the future. This strategy presents risks to our business due to the fact that we may not be able to influence the quality of support as directly as we would be able to do if our own employees performed these activities. Our customers may react negatively to providing information to, and receiving support from, third-party organizations, especially if these third-party organizations are based overseas. If we encounter problems with our third-party customer service and technical support providers, our reputation may be harmed, our ability to sell our offerings could be adversely affected, and we could lose customers and associated revenue.

***Revenue, margin or earnings shortfalls or the volatility of the market generally may cause the market price of our stock to decline.***

In the past, the market price for our common stock experienced significant fluctuations and it may do so in the future. A number of factors may affect the market price for our common stock, such as:

- shortfalls in, or changes in expectations about our revenue, margins, earnings, Annualized Recurring Revenue ("ARR"), sales of our Adobe Experience Cloud offerings, or other key performance metrics;
- changes in estimates or recommendations by securities analysts;
- whether our results meet analysts' expectations;
- compression or expansion of multiples used by investors and analysts to value high technology SaaS companies;
- the announcement of new products or services, product enhancements, service introductions, strategic alliances or significant agreements by us or our competitors;
- the loss of large customers or our inability to increase sales to existing customers, retain customers or attract new customers;
- recruitment or departure of key personnel;
- variations in our or our competitors' results of operations, changes in the competitive landscape generally and developments in our industry;
- general socio-economic, political or market conditions; and
- unusual events such as significant acquisitions by us or our competitors, divestitures, litigation, regulatory actions and other factors, including factors unrelated to our operating performance.

In addition, the market for technology stocks or the stock market in general may experience uneven investor confidence, which may cause the market price for our common stock to decline for reasons unrelated to our operating performance. Volatility in the market price of a company's securities for a period of time may increase the company's susceptibility to securities class action litigation. Oftentimes, this type of litigation is expensive and diverts management's attention and resources which may adversely affect our business.

***Contracting with government entities exposes us to additional risks inherent in the government procurement process.***

We provide products and services, directly and indirectly, to a variety of government entities, both domestically and internationally. Risks associated with licensing and selling products and services to government entities include more extended sales and collection cycles, varying governmental budgeting processes and adherence to complex procurement regulations and other government-specific contractual requirements. We may be subject to audits and investigations relating to our government contracts and any violations could result in various civil and criminal penalties and administrative sanctions, including termination of contracts, payment of fines, and suspension or debarment from future government business, as well as harm to our reputation and financial results.

***If we are unable to recruit and retain key personnel, our business may be harmed.***

Much of our future success depends on the continued service, availability and performance of our senior management. These individuals have acquired specialized knowledge and skills with respect to Adobe. The loss of any of these individuals could harm our business, especially if we have not been successful in developing adequate succession plans. Our business is also dependent on our ability to retain, hire and motivate talented, highly skilled personnel across all levels of our organization. Experienced personnel in the information technology industry are in high demand and competition for their talents is intense in many areas where our employees are located. We may experience higher compensation costs to retain senior management and experienced personnel that may not be offset by improved productivity or increased sales. If we are unable to continue to successfully attract and retain key personnel, our business may be harmed.

We continue to hire personnel in countries where exceptional technical knowledge and other expertise are offered at lower costs, which increases the efficiency of our global workforce structure and reduces our personnel related expenditures. Nonetheless, as globalization continues, competition for these employees in these countries has increased, which may impact our ability to retain these employees and increase our expenses resulting from competitive compensation. We may continue to expand our international operations and international sales and marketing activities, which would require significant management attention and resources. We may be unable to scale our infrastructure effectively or as quickly as our competitors in these markets, and our revenue may not increase to offset these expected increases in costs and operating expenses, causing our results to suffer.

We believe that a critical contributor to our success to date has been our corporate culture, which we have built to foster innovation, teamwork and employee satisfaction. As we grow, including from the integration of employees and businesses acquired in connection with previous or future acquisitions, we may find it difficult to maintain important aspects of our corporate culture, which could negatively affect our ability to retain and recruit personnel who are essential to our future success.

***Failure to manage our sales and distribution channels effectively could result in a loss of revenue and harm to our business.***

We contract with a number of software distributors and other strategic partners, none of which is individually responsible for a material amount of our total net revenue for any recent period. Nonetheless, if any single agreement with one of our distributors were terminated, any prolonged delay in securing a replacement distributor could have a negative impact on our results of operations.

Successfully managing our indirect distribution channel efforts to reach various customer segments for our products and services is a complex process across the broad range of geographies where we do business or plan to do business. Our distributors and other channel partners are independent businesses that we do not control. Notwithstanding the independence of our channel partners, we face legal risk and potential reputational harm from the activities of these third parties including, but not limited to, export control violations, workplace conditions, corruption and anti-competitive behavior.

We cannot be certain that our distribution channel will continue to market or sell our products and services effectively. If our distribution channel is not successful, we may lose sales opportunities, customers and revenue. Our distributors also sell our competitors' products and services, and if they favor our competitors' products or services for any reason, they may fail to market our products or services effectively or to devote resources necessary to provide effective sales, which would cause our results to suffer. We also distribute some products and services through our OEM channel, and if our OEMs decide not to bundle our applications on their devices, our results could suffer. In addition, the financial health of our distributors and our continuing relationships with them are important to our success. Some of these distributors may be unable to withstand adverse changes in economic conditions, which could result in insolvency, the inability of such distributors to obtain credit to finance purchases of our products and services, or a delay in paying their obligations to us.

We also sell some of our products and services through our direct sales force. Risks associated with this sales channel include more extended sales and collection cycles associated with direct sales efforts, challenges related to hiring, retaining and motivating our direct sales force, and substantial amounts of ongoing training for sales representatives. Moreover, recent hires may not become as productive as we would like, as in most cases it takes a significant period of time before they achieve full productivity. Our business could be seriously harmed if our expansion efforts do not generate a corresponding significant increase in revenue and we are unable to achieve the efficiencies we anticipate. In addition, the loss of key sales employees could impact our customer relationships and future ability to sell to certain accounts covered by such employees.

***If our goodwill or amortizable intangible assets become impaired, then we could be required to record a significant charge to earnings.***

GAAP requires us to test for goodwill impairment at least annually. In addition, we review our goodwill and amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable include declines in stock price, market capitalization or cash flows, and slower growth rates in our industry. Depending on the results of our review, we could be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets were determined, negatively impacting our results of operations.

***We have issued $1.9 billion of notes in debt offerings and have a $2.25 billion term loan, and may incur other debt in the future, which may adversely affect our financial condition and future financial results.***

We have $1.9 billion in senior unsecured notes and a $2.25 billion senior unsecured term loan outstanding. We also have a $1 billion senior unsecured revolving credit agreement, which is currently undrawn. This debt may adversely affect our financial condition and future financial results by, among other things:

- increasing our vulnerability to adverse changes in general economic and industry conditions;
- requiring the dedication of a portion of our expected cash flow from operations to service our indebtedness, thereby reducing the amount of expected cash flow available for other purposes, including capital expenditures and acquisitions; and
- limiting our flexibility in planning for, or reacting to, changes in our business and our industry.

Our senior unsecured notes and senior unsecured credit agreements impose restrictions on us and require us to maintain compliance with specified covenants. Our ability to comply with these covenants may be affected by events beyond our control. If we breach any of the covenants and do not obtain a waiver from the lenders or noteholders, then, subject to applicable cure periods, any outstanding indebtedness may be declared immediately due and payable.

In addition, changes by any rating agency to our credit rating may negatively impact the value and liquidity of both our debt and equity securities, as well as the potential costs associated with a refinancing of our debt. Under certain circumstances, if our credit ratings are downgraded or other negative action is taken, the interest rate payable by us under our revolving credit facility and term loan could increase. Downgrades in our credit ratings could also affect the terms of any such financing and restrict our ability to obtain additional financing in the future.

***Catastrophic events may disrupt our business.***

We are a highly automated business and rely on our network infrastructure and enterprise applications, internal technology systems and website for our development, marketing, operations, support, hosted services and sales activities. In addition, some of our businesses rely on third-party hosted services, and we do not control the operation of third-party data center facilities serving our customers from around the world, which increases our vulnerability. A disruption, infiltration or failure of these systems or third-party hosted services in the event of a major earthquake, fire, flood, tsunami or other weather event, power loss, telecommunications failure, software or hardware malfunctions, pandemics, cyber-attack, war, terrorist attack or other catastrophic event that our disaster recovery plans do not adequately address, could cause system interruptions, reputational harm, loss of intellectual property, delays in our product development, lengthy interruptions in our services, breaches of data security and loss of critical data. Any of these events could prevent us from fulfilling our customers' orders or could negatively impact a country or region in which we sell our products, which could in turn decrease that country's or region's demand for our products. Our corporate headquarters, a significant portion of our research and development activities, certain of our data centers and certain other critical business operations are located in the San Francisco Bay Area, and additional facilities where we conduct significant operations are located in the Salt Lake Valley Area, both of which are near major earthquake faults. A catastrophic event that results in the destruction or disruption of any of our data centers or our critical business or information technology systems could severely affect our ability to conduct normal business operations and, as a result, our future operating results could be adversely affected.

***Climate change may have a long-term impact on our business.***

While we seek to partner with organizations that mitigate their business risks associated with climate change, we recognize that there are inherent risks wherever business is conducted. Access to clean water and reliable energy in the communities where we conduct our business, whether for our offices or for our vendors, is a priority. Our major sites in California, Utah and India are vulnerable to prolonged droughts due to climate change. In the event of a natural disaster that disrupts business due to limited access to these resources, we have the potential to experience losses to our business, and added costs to resume operations. To accurately assess and take potential proactive action as appropriate, Adobe is aligned with the guidelines of the Financial Stability Board's ("FSB") Task Force on Climate-related Financial Disclosures ("TCFD") recommendations.

***Our investment portfolio may become impaired by deterioration of the financial markets.***

Our cash equivalent and short-term investment portfolio as of November 30, 2018 consisted of corporate debt securities, foreign government securities and U.S. Treasury securities, money market mutual funds, municipal securities, time deposits and asset-backed securities. We follow an established investment policy and set of guidelines to monitor and help mitigate our exposure to interest rate and credit risk. The policy sets forth credit quality standards and limits our exposure to any one issuer, as well as our maximum exposure to various asset classes.

Should financial market conditions worsen in the future, investments in some financial instruments may pose risks arising from market liquidity and credit concerns. In addition, any deterioration of the capital markets could cause our other income and expense to vary from expectations. As of November 30, 2018, we had no material impairment charges associated with our short-term investment portfolio, and although we believe our current investment portfolio has little risk of material impairment, we cannot predict future market conditions, market liquidity or credit availability, and can provide no assurance that our investment portfolio will remain materially unimpaired.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

The following table sets forth the location, approximate square footage and use of our principal properties during fiscal 2018:

| Location | Owned / Leased | Approximate Square Footage | | Use |
|---|---|---|---|---|
| *Americas:* | | | | |
| San Jose, California | Owned & leased | 1,081,000 | (1) | Research, product development, sales, marketing and administration |
| San Francisco, California | Owned & leased | 549,000 | (2) | Research, product development, sales, marketing and administration |
| Lehi, Utah | Owned & leased | 282,000 | (3) | Research, product development, sales, marketing and administration |
| Hillsboro, Oregon | Owned | 85,000 | | Data center |
| *APAC:* | | | | |
| Bangalore, India | Owned & leased | 422,000 | (4) | Research, product development, sales and administration |
| Noida, India | Owned & leased | 554,000 | (5) | Research, product development, sales and administration |
| Japan | Leased | 64,000 | | Research, product development, sales and administration |
| *EMEA:* | | | | |
| Bucharest, Romania | Leased | 97,000 | | Research and product development |
| Dublin, Ireland | Leased | 42,000 | | Administration |
| Maidenhead, United Kingdom | Leased | 49,000 | | Product development, sales, marketing and administration |

(1) We own approximately 989,000 square feet of our San Jose properties where our headquarters is located.

(2) We own approximately 346,000 square feet of our San Francisco properties.

(3) We own approximately 257,000 square feet of our Lehi properties.

(4) We own approximately 250,000 square feet of our Bangalore properties.

(5) We own our Noida properties except for a land lease for one of our buildings. The term for the land lease is until 2091.

We lease or sublease the properties we occupy under operating leases. Such leases expire at various times through 2031, with the exception of our ground lease in Noida.

In general, all facilities are in good condition, suitable for the conduct of our business and are operating at an average capacity of approximately 91%.

## ITEM 3. LEGAL PROCEEDINGS

In connection with disputes relating to the validity or alleged infringement of third-party intellectual property rights, including patent rights, we have been, are currently and may in the future be subject to claims, negotiations or complex, protracted litigation. Intellectual property disputes and litigation may be very costly and can be disruptive to our business operations by diverting the attention and energies of management and key technical personnel. Although we have successfully defended or resolved past litigation and disputes, we may not prevail in any ongoing or future litigation and disputes. Third-party intellectual property disputes could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from licensing certain of our products or offering certain of our services, subject us to injunctions restricting our sale of products or services, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers including contractual provisions under various license arrangements and service agreements.

In addition to intellectual property disputes, we are subject to legal proceedings, claims and investigations in the ordinary course of business, including claims relating to commercial, employment and other matters. Some of these disputes and legal proceedings may include speculative claims for substantial or indeterminate amounts of damages. We consider all claims on a quarterly basis in accordance with GAAP and, based on known facts, assess whether potential losses are considered reasonably possible, probable and estimable. Based upon this assessment, we then evaluate disclosure requirements and whether to accrue for such claims in our financial statements. This determination is then reviewed and discussed with the Audit Committee of the Board of Directors and our independent registered public accounting firm.

We make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Unless otherwise specifically disclosed in our Consolidated Financial Statements and notes thereto, we have determined that no provision for liability or disclosure is required related to any claim against us because: (a) there is not a reasonable possibility that a loss exceeding amounts already recognized (if any) may be incurred with respect to such claim; (b) a reasonably possible loss or range of loss cannot be estimated; or (c) such estimate is immaterial.

All legal costs associated with litigation are expensed as incurred. Litigation is inherently unpredictable. However, we believe that we have valid defenses with respect to the legal matters pending against us. It is possible, nevertheless, that our consolidated financial position, cash flows or results of operations could be negatively affected by an unfavorable resolution of one or more of such proceedings, claims or investigations.

In connection with our piracy conversion efforts, conducted both internally and through organizations such as the Business Software Alliance, from time to time we undertake litigation against alleged copyright infringers. Such lawsuits may lead to counter-claims alleging improper use of litigation or violation of other laws. We believe we have valid defenses with respect to such counter-claims; however, it is possible that our consolidated financial position, cash flows or results of operations could be negatively affected in any particular period by the resolution of one or more of these counter-claims.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

**PART II**

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

*Market Information for Common Stock*

Our common stock is traded on the NASDAQ Global Select Market under the symbol "ADBE."

*Stockholders*

According to the records of our transfer agent, there were 1,030 holders of record of our common stock on January 18, 2019. Because many of such shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

*Dividends*

We do not anticipate paying any cash dividends in the foreseeable future.

**Issuer Purchases of Equity Securities**

Below is a summary of stock repurchases for the three months ended November 30, 2018. *See Note 12 of our Notes to Consolidated Financial Statements for information regarding our stock repurchase programs.*

| Period | Total Number of Shares Repurchased | Average Price Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans | Approximate Dollar Value that May Yet be Purchased Under the Plan |
|---|---|---|---|---|
| | (in thousands, except average price per share) | | | |
| Beginning repurchase authority [1] | | | | $ 8,397,282 |
| September 1 — September 28, 2018 | | | | |
| Shares repurchased | 945 | $ 261.72 | 945 | $ (247,282) |
| October 27 — November 30, 2018 | | | | |
| Shares repurchased | 616 | $ 243.52 | 616 | $ (150,000) [2] |
| Total | 1,561 | | 1,561 | $ 8,000,000 |

(1) In January 2017, the Board of Directors granted authority to repurchase up to $2.5 billion in common stock through the end of fiscal 2019. In May 2018, the Board of Directors approved another authority to repurchase up to $8.0 billion in common stock through the end of fiscal 2021. As of November 30, 2018, there is no remaining balance under our January 2017 authority.

(2) In October 2018, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of $300 million. As of November 30, 2018, approximately $150.0 million of the prepayment remained under this agreement.

## ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data (presented in thousands, except per share amounts and employee data) is derived from our Consolidated Financial Statements. As our historical operating results are not necessarily indicative of future operating results, this data should be read in conjunction with the Consolidated Financial Statements and notes thereto, and with Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

| | Fiscal Years | | | | |
|---|---|---|---|---|---|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| Operations: | | | | | |
| Revenue | $ 9,030,008 | $ 7,301,505 | $ 5,854,430 | $ 4,795,511 | $ 4,147,065 |
| Gross profit | $ 7,835,009 | $ 6,291,014 | $ 5,034,522 | $ 4,051,194 | $ 3,524,985 |
| Income before income taxes | $ 2,793,876 | $ 2,137,641 | $ 1,435,138 | $ 873,781 | $ 361,376 |
| Net income | $ 2,590,774 | $ 1,693,954 | $ 1,168,782 | $ 629,551 | $ 268,395 |
| Net income per share: | | | | | |
| Basic | $ 5.28 | $ 3.43 | $ 2.35 | $ 1.26 | $ 0.54 |
| Diluted | $ 5.20 | $ 3.38 | $ 2.32 | $ 1.24 | $ 0.53 |
| Shares used to compute basic net income per share | 490,564 | 493,632 | 498,345 | 498,764 | 497,867 |
| Shares used to compute diluted net income per share | 497,843 | 501,123 | 504,299 | 507,164 | 508,480 |
| Financial position:(1) | | | | | |
| Cash, cash equivalents and short-term investments | $ 3,228,962 | $ 5,819,774 | $ 4,761,300 | $ 3,988,084 | $ 3,739,491 |
| Working capital(2) | $ 555,913 | $ 3,720,356 | $ 3,028,139 | $ 2,608,336 | $ 2,107,893 |
| Total assets | $ 18,768,682 | $ 14,535,556 | $ 12,697,246 | $ 11,714,500 | $ 10,781,991 |
| Debt, non-current | $ 4,124,800 | $ 1,881,421 | $ 1,892,200 | $ 1,895,259 | $ 907,248 |
| Stockholders' equity | $ 9,362,114 | $ 8,459,869 | $ 7,424,835 | $ 7,001,580 | $ 6,775,905 |
| Additional data: | | | | | |
| Worldwide employees | 21,357 | 17,973 | 15,706 | 13,893 | 12,499 |

(1) Information associated with our financial position is as of the Friday closest to November 30 for the five fiscal periods through 2018.

(2) For fiscal 2014, our working capital did not include the effects of the adoption of ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes, which required all deferred tax assets and liabilities and any related valuation allowance to be classified as non-current on our Consolidated Balance Sheets. The new standard was adopted prospectively starting fiscal 2015.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion should be read in conjunction with our Consolidated Financial Statements and Notes thereto.*

### ACQUISITIONS

During fiscal 2018, we completed our acquisitions of Marketo, a privately held marketing cloud platform company, for $4.74 billion and Magento, a privately held commerce platform company, for $1.64 billion. As of the end of fiscal 2018, we are continuing to integrate Marketo and Magento into our Digital Experience reportable segment.

During fiscal 2017, we completed our acquisition of TubeMogul, a publicly held video advertising platform company, for $560.8 million. As of the end of fiscal 2018, we have integrated TubeMogul into our Digital Experience reportable segment.

We also completed other immaterial business acquisitions during the fiscal years presented.

See Note 2 of our Notes to Consolidated Financial Statements for pro forma financial information related to the Marketo acquisition. Pro forma information has not been presented for our other acquisitions during the fiscal years presented as the impact to our Consolidated Financial Statements was not material.

Subsequent to November 30, 2018, we acquired the remaining interest in Allegorithmic SAS ("Allegorithmic"), a privately held 3D editing and authoring software company for gaming and entertainment, for approximately $105.0 million in cash consideration. Allegorithmic will be integrated into our Digital Media reportable segment for financial reporting purposes in the first quarter of fiscal 2019.

*See Note 2 of our Notes to Consolidated Financial Statements for further information regarding these acquisitions.*

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

In preparing our Consolidated Financial Statements in accordance with GAAP and pursuant to the rules and regulations of the SEC, we make assumptions, judgments and estimates that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosures of contingent assets and liabilities. We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. On a regular basis, we evaluate our assumptions, judgments and estimates. We also discuss our critical accounting policies and estimates with the Audit Committee of the Board of Directors.

We believe that the assumptions, judgments and estimates involved in the accounting for business combinations and income taxes have the greatest potential impact on our Consolidated Financial Statements. These areas are key components of our results of operations and are based on complex rules requiring us to make judgments and estimates, so we consider these to be our critical accounting policies. Historically, our assumptions, judgments and estimates relative to our critical accounting policies have not differed materially from actual results.

**Business Combinations**

We allocate the purchase price of acquired companies to the tangible and intangible assets acquired and liabilities assumed based upon their estimated fair values at the acquisition date. The purchase price allocation process requires management to make significant estimates and assumptions with respect to intangible assets and deferred revenue obligations. Although we believe the assumptions and estimates we have made are reasonable, they are based in part on historical experience, market conditions and information obtained from management of the acquired companies and are inherently uncertain. Examples of critical estimates in valuing certain of the intangible assets we have acquired or may acquire in the future include but are not limited to:

- future expected cash flows from software license sales, subscriptions, support agreements, consulting contracts and acquired developed technologies and patents;
-

historical and expected customer attrition rates and anticipated growth in revenue from acquired customers;

- the acquired company's trade name and trademarks as well as assumptions about the period of time the acquired trade name and trademarks will continue to be used in the combined company's product portfolio;

- the expected use of the acquired assets; and

- discount rates.

In connection with the purchase price allocations for our acquisitions, we estimate the fair value of the deferred revenue obligations assumed. The estimated fair value of these obligations is determined utilizing a cost build-up approach. The cost build-up approach determines fair value by estimating the costs related to fulfilling the obligations plus a normal profit margin.

Unanticipated events and circumstances may occur which may affect the accuracy or validity of such assumptions, estimates or actual results.

**Accounting for Income Taxes**

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Management must make assumptions, judgments and estimates to determine our current provision for income taxes and also our deferred tax assets and liabilities.

Our assumptions, judgments and estimates relative to the current provision for income taxes take into account current tax laws, our interpretation of current tax laws and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. We have established reserves for income taxes to address potential exposures involving tax positions that could be challenged by tax authorities. In addition, we are subject to the continual examination of our income tax returns by the U.S. Internal Revenue Service ("IRS") and other domestic and foreign tax authorities. We expect future examinations to focus on our intercompany transfer pricing practices as well as other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from such examinations. We believe such estimates to be reasonable; however, the final determination of any of these examinations could significantly impact the amounts provided for income taxes in our Consolidated Financial Statements.

**Recent Accounting Pronouncements**

*See Note 1 of our Notes to Consolidated Financial Statements for information regarding recent accounting pronouncements that are of significance, or potential significance to us.*

## RESULTS OF OPERATIONS

**Overview of 2018**

For fiscal 2018, we reported strong financial results consistent with the continued execution of our long-term plans for our two strategic growth areas, Digital Media and Digital Experience (formerly Digital Marketing), while continuing to market and license a broad portfolio of products and solutions.

In our Digital Media segment, we are a market leader with Creative Cloud, our subscription-based offering which provides desktop tools, mobile apps and cloud-based services for designing, creating and publishing rich and immersive content. Creative Cloud delivers value with deep, cross-product integration, frequent product updates and feature enhancements, cloud-based services including storage and syncing of files across users' machines, access to marketplace, social and community-based features with our Adobe Stock and Behance services, app creation capabilities, tools which assist with enterprise deployments and team collaboration, and affordable pricing for cost-sensitive customers.

We offer Creative Cloud for individuals, students, teams and enterprises. We expect Creative Cloud will drive sustained long-term revenue growth through a continued expansion of our customer base by acquiring new users on account of low cost of entry and delivery of additional features and value to Creative Cloud, as well as keeping existing customers current on our latest release. We have also built out a marketplace for Creative Cloud subscribers to enable the delivery and purchase of stock content in our Adobe Stock service. Overall, our strategy with Creative Cloud is designed to enable us to increase our revenue with users, attract more new customers, and grow our recurring and predictable revenue stream that is recognized ratably.

We continue to implement strategies that will accelerate awareness, consideration and purchase of subscriptions to our Creative Cloud offerings. These strategies include increasing the value Creative Cloud users receive, such as offering new desktop and mobile applications, as well as targeted promotions and offers that attract past customers and potential users to try out and ultimately subscribe to Creative Cloud. Because of the shift towards Creative Cloud subscriptions and Enterprise Term License Agreements ("ETLAs"), revenue from perpetual licensing of our Creative products has been immaterial to our business.

We are also a market leader with our Adobe Document Cloud offerings built around our Adobe Acrobat family of products, including Adobe Acrobat Reader DC, and a set of integrated cloud-based document services, including Adobe Sign. Acrobat provides reliable creation and exchange of electronic documents, regardless of platform or application source type. Document

Cloud, which we believe enhances the way people manage critical documents at home, in the office and across devices, includes Adobe Acrobat DC and Adobe Sign, and a set of integrated services enabling users to create, review, approve, sign and track documents whether on a desktop or mobile device. Adobe Acrobat DC, with a touch-enabled user interface, is offered both through subscription and perpetual licenses.

Annualized Recurring Revenue ("ARR") is currently the key performance metric our management uses to assess the health and trajectory of our overall Digital Media segment. ARR should be viewed independently of revenue, deferred revenue and unbilled deferred revenue as ARR is a performance metric and is not intended to be combined with any of these items. We adjust our reported ARR on an annual basis to reflect any material exchange rates changes. Our reported ARR results in fiscal 2018 are based on currency rates set at the start of fiscal 2018 and held constant throughout the year. We calculate ARR as follows:

| | |
|---|---|
| Creative ARR | Annual Value of Creative Cloud Subscriptions and Services<br>+<br>Annual Digital Publishing Suite Contract Value<br>+<br>Annual Creative ETLA Contract Value |
| Document Cloud ARR | Annual Value of Document Cloud Subscriptions and Services<br>+<br>Annual Document Cloud ETLA Contract Value |
| Digital Media ARR | Creative ARR<br>+<br>Document Cloud ARR |

Creative ARR exiting fiscal 2018 was $6.03 billion, up from $4.77 billion at the end of fiscal 2017. Document Cloud ARR exiting fiscal 2018 was $801 million, up from $614 million at the end of fiscal 2017. Total Digital Media ARR grew to $6.83 billion at the end of fiscal 2018, up from $5.39 billion at the end of fiscal 2017. Revaluing our ending ARR for fiscal 2018 using currency rates at the beginning of fiscal 2019, our Digital Media ARR at the end of fiscal 2018 would be $6.71 billion or approximately $123 million lower than the ARR reported above.

Our success in driving growth in ARR has positively affected our revenue growth. Creative revenue in fiscal 2018 was $5.34 billion, up from $4.17 billion in fiscal 2017 and representing 28% year-over-year growth. Document Cloud revenue in fiscal 2018 was $981.8 million, up from $836.7 million in fiscal 2017 and representing 17% year-over-year revenue growth as we continue to transition Document Cloud to a subscription-based model. Total Digital Media segment revenue grew to $6.33 billion in fiscal 2018, up from $5.01 billion in fiscal 2017 and representing 26% year-over-year growth.

We are a market leader in the fast-growing category addressed by our Digital Experience segment. Our Digital Experience business provides comprehensive solutions that include analytics, social marketing, targeting, media optimization, digital experience management, cross-channel campaign management, marketing automation, audience management, commerce, premium video delivery and monetization. These comprehensive solutions enable marketers to measure, personalize and optimize marketing campaigns and digital experiences across channels for optimal marketing performance.

Our hierarchy of solutions in the Digital Experience segment, available in our Adobe Experience Cloud, consists of the following cloud offerings:

- Adobe Advertising Cloud—delivers an end-to-end platform for managing advertising across traditional TV and digital formats, and simplifies the delivery of video, display and search advertising across channels and screens.

-

Adobe Analytics Cloud—enables businesses to move from insights to actions in real time by uniquely integrating audiences as the core system of intelligence for the enterprise; makes data available across all Adobe clouds through the capture, aggregation, rationalization and understanding of vast amounts of disparate data and then translating that data into singular customer profiles; includes Adobe Analytics and Adobe Audience Manager.

- Adobe Marketing Cloud—provides an integrated set of solutions to help marketers differentiate their brands and engage their customers, helping businesses manage, personalize, and orchestrate campaigns and customer journeys; includes Adobe Experience Manager ("AEM"), Adobe Campaign, Adobe Target, Marketo Engagement Platform and Adobe Primetime.

- Magento Commerce Cloud—provides digital commerce, order management and predictive intelligence based on a unified commerce platform enabling shopping experiences across a wide array of industries. This cloud offering was integrated into the Adobe Experience Cloud after our acquisition of privately held Magento in June 2018.

In addition to chief marketing officers, chief revenue officers and digital marketers, users of our Adobe Experience Cloud solutions include advertisers, campaign managers, digital marketers, publishers, data analysts, content managers, social marketers and marketing executives. These customers often are involved in workflows that utilize other Adobe products, such as our Digital Media offerings. By combining the creativity of our Digital Media business with the science of our Digital Experience business, we help our customers to more efficiently and effectively make, manage, measure and monetize their content across every channel with an end-to-end workflow and feedback loop.

In October 2018, we acquired privately held marketing cloud platform company Marketo. We began integrating Magento, as discussed above, and Marketo into our Digital Experience business in the second half of fiscal 2018.

We utilize a direct sales force to market and license our Adobe Experience Cloud solutions, as well as an extensive ecosystem of partners, including marketing agencies, systems integrators and independent software vendors that help license and deploy our solutions to their customers. We have made significant investments to broaden the scale and size of all of these routes to market, and our recent financial results reflect the success of these investments.

We achieved record Adobe Experience Cloud revenue of $2.44 billion in fiscal 2018, up from $2.03 billion in fiscal 2017 which represents 20% year-over-year growth. Driving the increase in Adobe Experience Cloud revenue was the increase in subscription revenue across our offerings which grew to $1.95 billion in fiscal 2018 from $1.55 billion in fiscal 2017, representing 26% year-over-year growth. Also contributing to the increase in Digital Experience subscription revenue, to a lesser extent, was revenue associated with Magento's commerce platform offerings and Marketo's marketing cloud platform offerings. We expect that the addition of Marketo and Magento, and continued demand across our portfolio of Adobe Experience Cloud solutions, will drive revenue growth in future years.

*Financial Performance Summary for Fiscal 2018*

- Total Digital Media ARR of approximately $6.83 billion as of November 30, 2018 increased by $1.44 billion, or 27%, from $5.39 billion as of December 1, 2017. The change in our Digital Media ARR was primarily due to strong adoption of our Creative Cloud and Adobe Document Cloud offerings.

- Creative revenue of $5.34 billion increased by $1.17 billion, or 28%, during fiscal 2018, from $4.17 billion in fiscal 2017. The increase was primarily due to the increase in subscription revenue associated with our Creative Cloud offerings.

- Adobe Experience Cloud revenue of $2.44 billion increased by $413.4 million, or 20%, during fiscal 2018, from $2.03 billion in fiscal 2017. The increase was primarily due to the increase in subscription revenue across our offerings.

- Our total deferred revenue of $3.05 billion as of November 30, 2018 increased by $559.1 million, or 22%, from $2.49 billion as of December 1, 2017. The increase was primarily due to increases in new contracts and the timing of renewals related to our Digital Media offerings and, to a lesser extent, deferred revenue assumed from Magento and Marketo.

- Cost of revenue of $1.19 billion increased by $184.5 million, or 18%, during fiscal 2018, from $1.01 billion in fiscal 2017. The increase was primarily due to increases in media rebill costs associated with our Advertising Cloud offerings and hosting services and data center costs.

- Operating expenses of $4.99 billion increased by $871.7 million, or 21%, during fiscal 2018, from $4.12 billion in fiscal 2017. The increase was primarily due to increases in base compensation and related benefits costs and stock-based compensation expense associated with headcount growth.

- Net income of $2.59 billion increased by $896.8 million, or 53%, during fiscal 2018 from $1.69 billion in fiscal 2017 primarily due to increases in subscription revenue and, to a lesser extent, the decrease in the provision for income taxes.

- Net cash flow from operations of $4.03 billion during fiscal 2018 increased by $1.12 billion, or 38%, from $2.91 billion during fiscal 2017 primarily due to higher net income.

**Revenue (dollars in millions)**

Revenue for fiscal 2016 benefited from an extra week in the first quarter of fiscal 2016 due to our 52/53-week financial calendar whereby fiscal 2016 was a 53-week year compared with fiscal 2018 and 2017, which were 52-week years.

| | Fiscal 2018 | Fiscal 2017 | Fiscal 2016 | % Change 2018-2017 | % Change 2017-2016 |
|---|---|---|---|---|---|
| Subscription | $ 7,922.2 | $ 6,133.9 | $ 4,584.8 | 29 % | 34 % |
| Percentage of total revenue | 88 % | 84 % | 78 % | | |
| Product | 622.1 | 706.7 | 800.5 | (12 %) | (12 %) |
| Percentage of total revenue | 7 % | 10 % | 14 % | | |
| Services and support | 485.7 | 460.9 | 469.1 | 5 % | (2 %) |
| Percentage of total revenue | 5 % | 6 % | 8 % | | |
| Total revenue | $ 9,030.0 | $ 7,301.5 | $ 5,854.4 | 24 % | 25 % |

Our subscription revenue is comprised primarily of fees we charge for our subscription and hosted service offerings including Creative Cloud and certain of our Adobe Experience Cloud and Document Cloud services. We recognize subscription revenue ratably over the term of agreements with our customers, beginning with commencement of service.

We have the following reportable segments—Digital Media, Digital Experience and Publishing. Subscription revenue by reportable segment for fiscal 2018, 2017 and 2016 is as follows (dollars in millions):

| | Fiscal 2018 | Fiscal 2017 | Fiscal 2016 | % Change 2018-2017 | % Change 2017-2016 |
|---|---|---|---|---|---|
| Digital Media | $ 5,857.7 | $ 4,480.8 | $ 3,370.8 | 31 % | 33 % |
| Digital Experience | 1,949.3 | 1,552.5 | 1,123.2 | 26 % | 38 % |
| Publishing | 115.2 | 100.6 | 90.8 | 15 % | 11 % |
| Total subscription revenue | $ 7,922.2 | $ 6,133.9 | $ 4,584.8 | 29 % | 34 % |

In fiscal 2018, we moved our legacy enterprise offerings from our Digital Experience segment into Publishing. Prior year information in the table above has been reclassified to reflect this change. *See below for additional details.*

Our services and support revenue is comprised of consulting, training and maintenance and support, primarily related to the licensing of our enterprise offerings and the sale of our hosted Adobe Experience Cloud services. Our support revenue also includes technical support and developer support to partners and developer organizations related to our desktop products. Our maintenance and support offerings, which entitle customers to receive desktop product upgrades and enhancements or technical support, depending on the offering, are generally recognized ratably over the term of the arrangement.

*Segments*

In fiscal 2018, we categorized our products into the following reportable segments:

- *Digital Media*—Our Digital Media segment provides tools and solutions that enable individuals, small and medium businesses and enterprises to create, publish, promote and monetize their digital content anywhere. Our customers include traditional content creators, web application developers and digital media professionals, as well as their management in marketing departments and agencies, companies and publishers. Our customers also include knowledge workers who create, collaborate on and distribute documents.

- *Digital Experience*—Our Digital Experience segment provides solutions and services for how digital advertising and marketing are created, managed, executed, measured and optimized. Our customers include digital marketers, advertisers, publishers, merchandisers, web analysts, chief marketing officers, chief information officers and chief revenue officers. This segment also includes our Marketo marketing cloud platform offerings and Magento commerce platform offerings, both acquired in fiscal 2018.

- *Publishing*—Our Publishing segment addresses market opportunities ranging from the diverse authoring and publishing needs of technical and business publishing to our legacy type and OEM printing businesses. It also includes our web conferencing and document and forms platforms.

In fiscal 2018, we moved our legacy enterprise offerings—Adobe Connect web conferencing platform and Adobe LiveCycle, an enterprise document and forms platform—from our Digital Experience segment into Publishing, in order to more closely align our Digital Experience business with the strategic growth opportunity. Prior year information in the tables below have been reclassified to reflect this change.

*Segment Information (dollars in millions)*

| | Fiscal 2018 | Fiscal 2017 | Fiscal 2016 | % Change 2018-2017 | % Change 2017-2016 |
|---|---|---|---|---|---|
| Digital Media | $ 6,325.3 | $ 5,010.6 | $ 3,941.0 | 26% | 27 % |
| Percentage of total revenue | 70% | 69% | 67% | | |
| Digital Experience | 2,443.7 | 2,030.3 | 1,631.4 | 20% | 24 % |
| Percentage of total revenue | 27% | 28% | 28% | | |
| Publishing | 261.0 | 260.6 | 282.0 | —% | (8%) |
| Percentage of total revenue | 3% | 3% | 5% | | |
| Total revenue | $ 9,030.0 | $ 7,301.5 | $ 5,854.4 | 24% | 25 % |

*Fiscal 2018 Revenue Compared to Fiscal 2017 Revenue*

*Digital Media*

Revenue from Digital Media increased $1.31 billion during fiscal 2018 as compared to fiscal 2017, primarily driven by increases in revenue associated with our Creative offerings.

Revenue associated with our Creative offerings, which includes our Creative Cloud, perpetually licensed Creative and stock photography offerings, increased during fiscal 2018. The increase was primarily due to an increase in subscription revenue across all of our Creative Cloud offerings driven by the increase in net new subscriptions.

Adobe Document Cloud revenue, which includes our Acrobat product family and Adobe Sign service, increased during fiscal 2018 as compared to fiscal 2017 primarily due to increases in subscriptions revenue driven by strong adoption of our Document Cloud.

*Digital Experience*

Revenue from Digital Experience increased $413.4 million during fiscal 2018, as compared to fiscal 2017 primarily due to subscription revenue growth associated with our Adobe Experience Cloud offerings. The increase in subscription revenue was primarily driven by continued adoption of our AEM offerings which is part of our Marketing Cloud and growth in revenue associated with our Analytics Cloud. Also contributing to the increase in subscription revenue, but to a lesser extent, was revenue associated with our Magento Commerce Cloud and Advertising Cloud.

*Fiscal 2017 Revenue Compared to Fiscal 2016 Revenue*

*Digital Media*

Revenue from Digital Media increased $1.07 billion during fiscal 2017 as compared to fiscal 2016, primarily driven by increases in revenue associated with our creative offerings.

Revenue associated with our Creative offerings, which includes our Creative Cloud, perpetually licensed Creative and stock photography offerings, increased during fiscal 2017 as compared to fiscal 2016. The increase was primarily due to an increase in subscription revenue associated with our Creative Cloud offerings driven by increases in individual, team and enterprise subscriptions. Also contributing to the increase in revenue was revenue growth associated with our Creative Cloud Photography Plan subscription offering.

Document Cloud revenue, which includes our Acrobat product family and Adobe Sign service, increased during fiscal 2017 as compared to fiscal 2016 primarily due to increases in Document Cloud subscription revenue, offset in part by expected declines in revenue associated with our perpetually licensed Acrobat offering. Also contributing to the increase in Document Cloud revenue was an increase in Adobe Sign revenue.

*Digital Experience*

Revenue from Digital Experience increased $398.9 million during fiscal 2017, as compared to fiscal 2016 primarily due to subscription revenue growth associated with our Adobe Experience Cloud. The increase in subscription revenue was driven by strong performance with our Marketing Cloud offerings, which include AEM and Adobe Campaign, and our Analytics Cloud offerings, which includes Audience Manager. Also contributing to the increase in Adobe Experience Cloud revenue were increases in revenue associated with our Advertising Cloud offerings, including TubeMogul which we acquired in fiscal 2017.

*Geographical Information (dollars in millions)*

| | Fiscal 2018 | Fiscal 2017 | Fiscal 2016 | % Change 2018-2017 | % Change 2017-2016 |
|---|---|---|---|---|---|
| Americas | $ 5,116.8 | $ 4,216.5 | $ 3,400.1 | 21 % | 24 % |
| Percentage of total revenue | 57 % | 58 % | 58 % | | |
| EMEA | 2,550.0 | 1,985.1 | 1,619.2 | 28 % | 23 % |
| Percentage of total revenue | 28 % | 27 % | 28 % | | |
| APAC | 1,363.2 | 1,099.9 | 835.1 | 24 % | 32 % |
| Percentage of total revenue | 15 % | 15 % | 14 % | | |
| Total revenue | $ 9,030.0 | $ 7,301.5 | $ 5,854.4 | 24 % | 25 % |

*Fiscal 2018 Revenue by Geography Compared to Fiscal 2017 Revenue by Geography*

Overall revenue during fiscal 2018 increased in all geographic regions as compared to fiscal 2017 primarily due to increases in Digital Media and Digital Experience revenue. Within each geographic region, the fluctuations in revenue by reportable segment were attributable to the factors noted in the segment information above. Further, the overall increase in EMEA revenue during fiscal 2018 was positively impacted by the relative weakening of the U.S. Dollar against EMEA currencies as discussed below.

*Fiscal 2017 Revenue by Geography Compared to Fiscal 2016 Revenue by Geography*

Overall revenue during fiscal 2017 increased in all geographic regions as compared to fiscal 2016 primarily due to increases in Digital Media and Digital Experience revenue. Within each geographic region, the fluctuations in revenue by reportable segment were attributable to the factors noted in the segment information above. The overall increase in EMEA revenue was slightly offset by declines due to the relative strength of the U.S. Dollar against EMEA currencies as discussed below.

Included in the overall change in revenue for fiscal 2018 and fiscal 2017 were impacts associated with foreign currency as shown below. Our currency hedging program is used to mitigate a portion of the foreign currency impact to revenue.

| (in millions) | Fiscal 2018 | Fiscal 2017 |
|---|---|---|
| **Revenue impact:** | Increase/(Decrease) | |
| Euro | $ 96.3 | $ (2.3) |
| British Pound | 21.6 | (46.1) |
| Japanese Yen | 2.8 | 4.0 |
| Other currencies | 1.9 | 6.1 |
| Total revenue impact | 122.6 | (38.3) |
| **Hedging impact:** | | |
| Euro | 29.1 | 13.7 |
| British Pound | 11.3 | 7.1 |
| Japanese Yen | 8.2 | 12.1 |
| Total hedging impact | 48.6 | 32.9 |
| Total impact | $ 171.2 | $ (5.4) |

During fiscal 2018, the U.S. Dollar weakened against EMEA currencies, which positively impacted revenue in U.S. Dollar equivalents. In addition, we had $48.6 million in hedging gains from our EMEA currency hedging programs during fiscal 2018.

During fiscal 2017, the U.S. Dollar strengthened against the British Pound, which negatively impacted revenue in EMEA measured in U.S. Dollar equivalents. The net foreign currency impact to revenue was offset in part by hedging gains from our EMEA and Japanese Yen currencies hedging programs during fiscal 2017.

*See Note 17 of our Notes to the Consolidated Financial Statements for further geographic information.*

*Backlog*

Deferred revenue on our consolidated balance sheet consists of billings and payments received in advance of revenue recognition for our products and solutions and does not represent the total contract value of existing annual or multi-year, non-cancellable commercial subscription, SaaS and managed services agreements or government contracts with fiscal funding clauses. Unbilled deferred revenue represents expected future billings that are contractually committed under our existing subscription, SaaS and managed services agreements that have not been invoiced and are not recorded in deferred revenue within our financial statements. Our presentation of unbilled deferred revenue backlog may differ from that of other companies in the industry. As of November 30, 2018, we had unbilled deferred revenue backlog, including that of our fiscal 2018 acquisitions, of approximately $5.05 billion of which approximately 40% to 50% is not reasonably expected to be billed during fiscal 2019. Comparatively, we had unbilled deferred revenue backlog of approximately $3.94 billion as of December 1, 2017, of which approximately 40% to 50% was not reasonably expected to be billed during fiscal 2018.

We expect that the amount of unbilled deferred revenue backlog will change from period to period due to certain factors, including the timing and duration of large customer subscriptions, SaaS and managed service agreements, varying billing cycles of these agreements, the timing of customer renewals, the timing of when unbilled deferred revenue backlog is to be billed, changes in customer financial circumstances and foreign currency fluctuations. Additionally, the unbilled deferred revenue backlog for multi-year subscription agreements that are billed annually is typically higher at the beginning of the contract period, lower prior to renewal and typically increases when the agreement is renewed. Accordingly, fluctuations in unbilled deferred revenue backlog may not be a reliable indicator of future business prospects and the related revenue associated with these contractual commitments.

**Cost of Revenue (dollars in millions)**

| | Fiscal 2018 | Fiscal 2017 | Fiscal 2016 | % Change 2018-2017 | % Change 2017-2016 |
|---|---|---|---|---|---|
| Subscription | $ 807.2 | $ 623.0 | $ 461.9 | 30 % | 35 % |
| Percentage of total revenue | 9 % | 9 % | 8 % | | |
| Product | 46.0 | 57.1 | 68.9 | (19 )% | (17 )% |
| Percentage of total revenue | 1 % | 1 % | 1 % | | |
| Services and support | 341.8 | 330.4 | 289.1 | 3 % | 14 % |
| Percentage of total revenue | 4 % | 5 % | 5 % | | |
| Total cost of revenue | $ 1,195.0 | $ 1,010.5 | $ 819.9 | 18 % | 23 % |

*Subscription*

Cost of subscription revenue consists of third-party royalties and expenses related to operating our network infrastructure, including depreciation expense and operating lease payments associated with computer equipment, data center costs, salaries and related expenses of network operations, implementation, account management and technical support personnel, amortization of certain intangible assets and allocated overhead. We enter into contracts with third parties for hosting services and use of data center facilities. Our data center costs largely consist of the amounts we pay to these third parties for rack space, power and similar items. Cost of subscription revenue also includes media costs related to impressions purchased from third-party ad inventory sources for our Adobe Advertising Cloud offerings.

Cost of subscription revenue increased due to the following:

| | % Change 2018-2017 | % Change 2017-2016 |
|---|---|---|
| Media rebill costs | 8 % | 9 % |
| Hosting services and data center costs | 8 | 7 |
| Royalty costs | 4 | 6 |
| Base compensation and related benefits associated with headcount | 1 | 6 |
| Incentive compensation, cash and stock-based | 3 | 5 |
| Amortization of purchased intangibles | 2 | 2 |
| Depreciation expense | — | (1 ) |
| Software licenses | 2 | — |
| Various individually insignificant items | 2 | 1 |
| Total change | 30 % | 35 % |

*Product*

Cost of product revenue includes product packaging, third-party royalties, excess and obsolete inventory, amortization related to localization costs, purchased intangibles and acquired rights to use technology and the costs associated with the manufacturing of our products.

Cost of product revenue decreased during fiscal 2018 and fiscal 2017 as compared to the corresponding year-ago periods primarily due to decreased royalty costs as a result of declines in obligations to certain key vendors for technology use.

*Services and Support*

Cost of services and support revenue is primarily comprised of employee-related costs and associated costs incurred to provide consulting services, training and product support.

Cost of services and support revenue increased due to the following:

| | % Change 2018-2017 | % Change 2017-2016 |
|---|---|---|
| Base compensation and related benefits associated with headcount | 1 % | 13 % |
| Incentive compensation, cash and stock-based | 1 | 1 |
| Professional and consulting fees | — | (3 ) |
| Various individually insignificant items | 1 | 3 |
| Total change | 3 % | 14 % |

Compensation costs increased during fiscal 2017 as compared to fiscal 2016 primarily due to increases in headcount resulting from decreased usage of outside consultants that were providing consulting and training services to customers.

**Operating Expenses (dollars in millions)**

| | Fiscal 2018 | Fiscal 2017 | Fiscal 2016 | % Change 2018-2017 | % Change 2017-2016 |
|---|---|---|---|---|---|
| Research and development | $ 1,537.8 | $ 1,224.1 | $ 976.0 | 26 % | 25 % |
| Percentage of total revenue | 17 % | 17 % | 17 % | | |
| Sales and marketing | 2,620.8 | 2,197.6 | 1,910.2 | 19 % | 15 % |
| Percentage of total revenue | 29 % | 30 % | 33 % | | |
| General and administrative | 744.9 | 624.7 | 576.2 | 19 % | 8 % |
| Percentage of total revenue | 8 % | 9 % | 10 % | | |
| Amortization of purchased intangibles | 91.1 | 76.5 | 78.5 | 19 % | (3 )% |
| Percentage of total revenue | 1 % | 1 % | 1 % | | |
| Total operating expenses | $ 4,994.6 | $ 4,122.9 | $ 3,540.9 | 21 % | 16 % |

*Research and Development, Sales and Marketing and General and Administrative Expenses*

Research and development, sales and marketing and general and administrative expenses increased during fiscal 2018 as compared to fiscal 2017 due to increases in base compensation and related benefits costs and stock-based compensation expenses associated with headcount growth.

Research and development, sales and marketing and general and administrative expenses increased during fiscal 2017 as compared to fiscal 2016 primarily due to increases in base compensation and related benefits costs driven by headcount increases and stock-based compensation expense.

*Research and Development*

Research and development expenses consist primarily of salary and benefit expenses for software developers, contracted development efforts, related facilities costs and expenses associated with computer equipment used in software development.

Research and development expenses increased due to the following:

| | % Change 2018-2017 | % Change 2017-2016 |
|---|---|---|
| Base compensation and related benefits associated with headcount | 14 % | 11 % |
| Incentive compensation, cash and stock-based | 8 | 9 |
| Professional and consulting fees | 3 | 4 |
| Various individually insignificant items | 1 | 1 |
| Total change | 26 % | 25 % |

We believe that investments in research and development, including the recruiting and hiring of software developers, are critical to remain competitive in the marketplace and are directly related to continued timely development of new and enhanced offerings and solutions. We will continue to focus on long-term opportunities available in our end markets and make significant investments in the development of our subscription and service offerings, applications and tools.

*Sales and Marketing*

Sales and marketing expenses consist primarily of salary and benefit expenses, sales commissions, travel expenses and related facilities costs for our sales, marketing, order management and global supply chain management personnel. Sales and marketing expenses also include the costs of programs aimed at increasing revenue, such as advertising, trade shows, public relations and other market development programs.

Sales and marketing expenses as a percentage of revenue during fiscal 2018 decreased slightly compared to fiscal 2017 primarily due to our revenue growing at a faster pace compared with the increases in sales and marketing expenses.

Sales and marketing expenses increased due to the following:

| | **% Change 2018-2017** | **% Change 2017-2016** |
|---|---|---|
| Base compensation and related benefits associated with headcount | 7% | 5% |
| Incentive compensation, cash and stock-based | 6 | 2 |
| Professional and consulting fees | — | 2 |
| Marketing spending related to product launches and overall marketing efforts | 2 | 4 |
| Various individually insignificant items | 4 | 2 |
| Total change | 19% | 15% |

*General and Administrative*

General and administrative expenses consist primarily of compensation and benefit expenses, travel expenses and related facilities costs for our finance, facilities, human resources, legal, information services and executive personnel. General and administrative expenses also include outside legal and accounting fees, provision for bad debts, expenses associated with computer equipment and software used in the administration of the business, charitable contributions and various forms of insurance.

General and administrative expenses increased due to the following:

| | **% Change 2018-2017** | **% Change 2017-2016** |
|---|---|---|
| Professional and consulting fees | 10% | 1% |
| Base compensation and related benefits associated with headcount | 2 | 2 |
| Incentive compensation, cash and stock-based | 5 | 3 |
| Facilities and telecom | 2 | 2 |
| Total change | 19% | 8% |

Professional and consulting fees increased from fiscal 2018 as compared to fiscal 2017 primarily due to incurred transaction costs associated with our acquisitions of Magento and Marketo both of which closed in fiscal 2018.

*Amortization of Purchased Intangibles*

During the last several years, we have completed a number of business combinations and asset acquisitions. As a result of these acquisitions, we purchased intangible assets that are being amortized over their estimated useful lives ranging from one to fourteen years.

Amortization expense increased during fiscal 2018 as compared to fiscal 2017. The increase was primarily due to amortization of intangible assets purchased through our acquisitions of Magento and Marketo in the third and fourth quarter of fiscal 2018, respectively, and partially offset by certain fully amortized acquired intangible assets from previous acquisitions. We expect that intangible assets purchased through our acquisitions of Magento and Marketo will continue to increase our amortization expense in future periods.

Amortization expense remained relatively consistent during fiscal 2017 as compared to fiscal 2016. The decreases associated with certain fully amortized acquired intangible assets from previous acquisitions were offset by increases associated with intangible assets purchased through our acquisition of TubeMogul in the first quarter of fiscal 2017.

**Non-Operating Income (Expense), Net (dollars in millions)**

| | Fiscal 2018 | Fiscal 2017 | Fiscal 2016 | % Change 2018-2017 | % Change 2017-2016 |
|---|---|---|---|---|---|
| Interest and other income (expense), net | $ 39.5 | $ 36.4 | $ 13.5 | 9 % | 170 % |
| Percentage of total revenue | ** | ** | ** | | |
| Interest expense | (89.2) | (74.4) | (70.4) | 20 % | 6 % |
| Percentage of total revenue | (1 %) | (1 %) | (1 %) | | |
| Investment gains (losses), net | 3.2 | 7.5 | (1.6) | * | * |
| Percentage of total revenue | ** | ** | ** | | |
| Total non-operating income (expense), net | $ (46.5) | $ (30.5) | $ (58.5) | 52 % | (48 %) |

(*) Percentage is not meaningful.
(**) Percentage is less than 1%.

*Interest and Other Income (Expense), Net*

Interest and other income (expense), net consists primarily of interest earned on cash, cash equivalents and short-term fixed income investments. Interest and other income (expense), net also includes gains and losses on fixed income investments and foreign exchange gains and losses other than any gains recorded to revenue from our hedging programs.

Interest and other income (expense), net increased in fiscal 2017 as compared to fiscal 2016 due to higher average invested balances and interest rates and a decline in foreign exchange hedging costs.

*Interest Expense*

Interest expense primarily represents interest associated with our term loan, senior notes and interest rate swaps. In October 2018, we entered into a credit agreement providing for a $2.25 billion senior unsecured term loan for the purpose of partially funding the purchase price for our acquisition of Marketo. Interest on our Term Loan is payable periodically at the end of each interest period, whereas interest on our senior notes is payable semi-annually, in arrears, on February 1 and August 1. Floating interest payments on the interest rate swaps are paid monthly. The fixed-rate interest receivable on the swaps is received semi-annually concurrent with the senior notes interest payments. *See Notes 5 and 15 of our Notes to Consolidated Financial Statements for further details regarding our interest rate swaps and debt, respectively.*

Interest expense increased during fiscal 2018 as compared to fiscal 2017 primarily due to higher short-term floating interest rates on interest rate swaps and higher average debt balances.

*Investment Gains (Losses), Net*

Investment gains (losses), net consists principally of unrealized holding gains and losses associated with our deferred compensation plan assets which are classified as trading securities, and gains and losses associated with our direct and indirect investments in privately held companies.

**Provision for Income Taxes (dollars in millions)**

| | Fiscal 2018 | Fiscal 2017 | Fiscal 2016 | % Change 2018-2017 | % Change 2017-2016 |
|---|---|---|---|---|---|
| Provision | $ 203.1 | $ 443.7 | $ 266.4 | (54 %) | 67 % |
| Percentage of total revenue | 2 % | 6 % | 5 % | | |
| Effective tax rate | 7 % | 21 % | 19 % | | |

Our effective tax rate decreased by approximately 14 percentage points during fiscal 2018 as compared to fiscal 2017. The lower effective tax rate was primarily due to the effects of the Tax Act enacted on December 22, 2017 and a change to our corporate tax structure from which we serve our foreign customers that provided us the ability to deduct more expenses against our earnings in the U.S.

Our effective tax rate increased by approximately two percentage points during fiscal 2017 as compared to fiscal 2016. The increase was partially related to a one-time tax cost associated with licensing acquired company assets to our trading subsidiaries, offset in part by the recognition of excess tax benefits due to our adoption of new accounting guidance related to stock-based compensation and the completion of certain income tax examinations. In addition to the above noted items, the effective tax rate for fiscal 2016 included tax benefits recognized as a result of the completion of certain income tax examinations, and to a lesser extent, a one-time tax benefit related to the retroactive reinstatement of the fiscal 2015 U.S. Research and Development credit.

The above noted Tax Act transitions the U.S. tax system to a new territorial system and lowers the statutory corporate tax rate from 35% to 21%. Reduction of the statutory federal corporate tax rate to 21% became effective on January 1, 2018. In fiscal 2018, our statutory federal corporate tax rate is a blended rate of 22.2%, which will be reduced to 21% in fiscal 2019 and thereafter.

During fiscal 2018, we recorded tax charges for the impact of the Tax Act effects using the current available information and technical guidance on the interpretations of the Tax Act. As permitted by SEC Staff Accounting Bulletin 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act, we recorded provisional estimates and have subsequently finalized our accounting analysis based on the guidance, interpretations, and data available as of November 30, 2018. Adjustments made in the fourth quarter of fiscal 2018 upon finalization of our accounting analysis were not material to our Consolidated Financial Statements.

As a result of the reduction in the federal corporate tax rate, we remeasured our deferred taxes and recorded a tax charge of $10 million based on the tax rate that is expected to apply when such deferred taxes are settled or realized in future periods. To calculate the remeasurement of deferred taxes, we estimated when the existing deferred taxes will be settled or realized.

As part of the adoption of a new territorial tax system we recorded a transition tax expense of $176 million on deferred foreign earnings, long-term income taxes payable of $504 million, other tax liabilities of $19 million, and a reduction in our deferred tax liabilities of $347 million. We intend to elect to pay the federal transition tax over a period of eight years as permitted by the Tax Act. As a result, we reclassified $40 million from long-term income taxes payable to short-term income taxes payable for the first installment payment due in fiscal 2019.

We are a United States-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. A significant portion of our foreign earnings for the current fiscal year were earned by our Irish subsidiaries. As part of the adoption of a territorial tax system, the Tax Act also provides an exemption from federal income taxes for distributions from foreign subsidiaries made after December 31, 2017 that were not subject to the one-time transition tax. As we repatriate the undistributed earnings of our foreign subsidiaries for use in the U.S., the earnings from our foreign subsidiaries will generally not be subject to U.S. federal tax.

*See Note 9 of our Notes to the Consolidated Financial Statements for further information on our provision for income taxes.*

*Accounting for Uncertainty in Income Taxes*

The gross liabilities for unrecognized tax benefits excluding interest and penalties were $196.2 million, $172.9 million and $178.4 million for fiscal 2018, 2017 and 2016, respectively. If the total unrecognized tax benefits at November 30, 2018, December 1, 2017 and December 2, 2016 were recognized, $145.2 million, $135.0 million and $144.5 million would decrease the respective effective tax rates, which were net of estimated $51.0 million, $37.9 million, and $33.9 million federal benefits related to deducting certain payments on future federal and state tax returns for fiscal 2018, 2017, and 2016, respectively.

The combined amount of accrued interest and penalties related to tax positions taken on our tax returns were approximately $24.6 million and $23.6 million for fiscal 2018 and 2017, respectively. These amounts were included in long-term income taxes payable in their respective years.

The timing of the resolution of income tax examinations is highly uncertain as are the amounts and timing of tax payments that are part of any audit settlement process. These events could cause large fluctuations in the balance of short-term and long-term assets, liabilities and income taxes payable. We believe that within the next 12 months, it is reasonably possible that either certain audits will conclude or statutes of limitations on certain income tax examination periods will expire, or both. Given the uncertainties described above, we can only determine a range of estimated potential effect in underlying unrecognized tax benefits ranging from $0 to approximately $45 million.

## LIQUIDITY AND CAPITAL RESOURCES

This data should be read in conjunction with our Consolidated Statements of Cash Flows.

| (in millions) | As of November 30, 2018 | As of December 1, 2017 |
|---|---|---|
| Cash and cash equivalents | $ 1,642.8 | $ 2,306.1 |
| Short-term investments | $ 1,586.2 | $ 3,513.7 |
| Working capital | $ 555.9 | $ 3,720.4 |
| Stockholders’ equity | $ 9,362.1 | $ 8,459.9 |

A summary of our cash flows is as follows:

| (in millions) | Fiscal 2018 | Fiscal 2017 | Fiscal 2016 |
|---|---|---|---|
| Net cash provided by operating activities | $ 4,029.3 | $ 2,912.9 | $ 2,199.7 |
| Net cash used for investing activities | (4,685.3) | (442.9) | (960.0) |
| Net cash used for financing activities | (5.6) | (1,183.7) | (1,090.7) |
| Effect of foreign currency exchange rates on cash and cash equivalents | (1.7) | 8.5 | (14.2) |
| Net increase (decrease) in cash and cash equivalents | $ (663.3) | $ 1,294.8 | $ 134.8 |

Our primary source of cash is receipts from revenue and, to a lesser extent, proceeds from participation in the employee stock purchase plan. The primary uses of cash are our stock repurchase program as described below, payroll-related expenses, general operating expenses including marketing, travel and office rent, and cost of revenue. Other uses of cash include business acquisitions and purchases of property and equipment.

*Cash Flows from Operating Activities*

For fiscal 2018, net cash provided by operating activities of $4.03 billion was primarily comprised of net income plus the net effect of non-cash items, including adjustments to deferred income taxes related to the Tax Act. The primary working capital sources of cash were net income coupled with increases to taxes payable and deferred revenue. The increase in income taxes payable was primarily driven by the one-time transition tax recorded pursuant to the Tax Act. The increase in deferred revenue was principally due to increases in Digital Media site and term licenses and from our acquisition of Magento and Marketo in the third and fourth quarters of fiscal 2018, respectively. The primary working capital use of cash was the increase in prepaid expenses driven by the timing of billings and payments of maintenance and support services associated with our licensed technologies and increases in prepaid insurance.

For fiscal 2017, net cash provided by operating activities of $2.91 billion was primarily comprised of net income plus the net effect of non-cash items. The primary working capital sources of cash were net income coupled with increases in deferred revenue and accrued expenses. The increase in deferred revenue was primarily due to increased subscriptions for our Creative Cloud offerings and increases in Digital Experience hosted services. The increase in accrued expenses is primarily due to the increase in accruals for compensation costs and employee benefits driven by headcount growth, and increased accrued media costs associated with our Advertising Cloud offerings, including TubeMogul. The primary working capital uses of cash were increases in trade receivables, payments of trade payables assumed as part of the TubeMogul acquisition, and a decrease in income taxes payable. Trade receivables increased primarily due to revenue linearity, higher revenue levels, and increased media receivables attributable to TubeMogul. Income taxes payable decreased primarily due to taxes paid in excess of the tax provision increase.

For fiscal 2016, net cash provided by operating activities of $2.20 billion was primarily comprised of net income plus the net effect of non-cash items. The primary working capital sources of cash were net income coupled with increases in deferred revenue and accrued expenses. The increase in deferred revenue was primarily due to increased subscriptions for our Creative Cloud offerings and increases in Digital Experience hosted services. The increase in accrued expenses is primarily due to the increase in accruals for compensation costs and employee benefits driven by the increase in headcount. The primary working capital uses of cash were increases in trade receivables, prepaid expenses and other current assets, and a decrease in income taxes payable. Trade receivables increased primarily due to higher revenue levels. Prepaid expenses and other current assets increased primarily due to advanced tax payments made in the fourth quarter of fiscal 2016. Income taxes payable decreased primarily due to the completion of certain income tax audits in fiscal 2016, offset in part by increases to the tax provision in excess of taxes paid.

*Cash Flows from Investing Activities*

For fiscal 2018, net cash used for investing activities of $4.69 billion was primarily due to our acquisitions of Magento and Marketo during the third and fourth quarter of fiscal 2018, respectively. Other uses of cash included purchases of property and equipment and short-term investments. These cash outflows were offset in part by proceeds from sales and maturities of short-term investments.

For fiscal 2017, net cash used for investing activities of $442.9 million was primarily due to purchases of short-term investments and our acquisition of TubeMogul. Other uses of cash included purchases of property and equipment, including the Almaden Tower and long-term investments and other assets. These cash outflows were offset in part by sales and maturities of short-term investments.

For fiscal 2016, net cash used for investing activities of $960.0 million was primarily due to purchases of short-term investments. Other uses of cash represented purchases of property and equipment, purchases of long-term investments and other assets, and an immaterial acquisition. These cash outflows were offset in part by sales and maturities of short-term investments.

*See Note 2 of our Notes to Consolidated Financial Statements for more detailed information regarding our acquisitions.*

*Cash Flows from Financing Activities*

For fiscal 2018, net cash used for financing activities was $5.6 million. Primary uses of cash were payments made for our treasury stock repurchases and taxes related to net share settlement of equity awards. These were offset by the proceeds of our $2.25 billion senior unsecured term loan (the "Term Loan") which partially funded our acquisition of Marketo. Funds were received net of issuance costs on October 31, 2018 upon closing of the acquisition. The Term Loan will mature 18 months following the initial funding date.

For fiscal 2017, net cash used for financing activities of $1.18 billion was primarily due to payments for our treasury stock repurchases and costs associated with the issuance of treasury stock, offset in part by proceeds from the issuance of treasury stock.

For fiscal 2016, net cash used for financing activities of $1.09 billion was primarily due to payments for our treasury stock repurchases and costs associated with the issuance of treasury stock, offset in part by proceeds from the issuance of treasury stock and excess tax benefits from stock-based compensation.

*See Note 2 of our Notes to Consolidated Financial Statements for more detailed information regarding our acquisitions. See the section titled "Stock Repurchase Program" discussed below.*

We expect to continue our investing activities, including short-term and long-term investments, venture capital, facilities expansion and purchases of computer systems for research and development, sales and marketing, product support and administrative staff. Furthermore, cash reserves may be used to repurchase stock under our stock repurchase program and to strategically acquire companies, products or technologies that are complementary to our business.

**Other Liquidity and Capital Resources Considerations**

Our existing cash, cash equivalents and investment balances may fluctuate during fiscal 2019 due to changes in our planned cash outlay, including changes in incremental costs such as direct and integration costs related to our acquisitions.

Cash from operations could also be affected by various risks and uncertainties, including, but not limited to, the risks detailed in Part I, Item 1A titled "Risk Factors." However, based on our current business plan and revenue prospects, we believe that our existing cash, cash equivalents and investment balances, our anticipated cash flows from operations and our available credit facility will be sufficient to meet our working capital and operating resource expenditure requirements for the next twelve months.

On October 17, 2018, we entered into a credit agreement (the "Revolving Credit Agreement") with a syndicate of lenders, providing for a five-year $1 billion senior unsecured revolving credit facility, which replaces our previous five-year $1 billion senior unsecured revolving credit agreement dated as of March 2, 2012. The new credit agreement continues to provide for loans to us and certain of our subsidiaries through October 17, 2023. As of

November 30, 2018, there were no outstanding borrowings under this credit agreement and the entire $1 billion credit line remains available for borrowing.

As of November 30, 2018, we have a $2.25 billion Term Loan outstanding due April 30, 2020. As of November 30, 2018, the amount outstanding under our senior notes was $1.9 billion, consisting of $900 million of 4.75% senior notes due February 1, 2020 (the "2020 Notes") and $1 billion of 3.25% senior notes due February 1, 2025 (the "2025 Notes," and together with the 2020 Notes, the "Notes"). The Notes and Term Loan rank equally with our other unsecured and unsubordinated indebtedness.

Subsequent to November 30, 2018, we acquired the remaining interest in Allegorithmic for approximately $105.0 million in cash consideration. *See Note 2 of our Notes to Consolidated Financial Statements for more detailed information regarding our acquisition of Allegorithmic.*

Our short-term investment portfolio is primarily invested in corporate debt securities, U.S. Treasury securities, foreign government securities, municipal securities and asset-backed securities. We use professional investment management firms to manage a large portion of our invested cash.

**Stock Repurchase Program**

To facilitate our stock repurchase program, designed to return value to our stockholders and minimize dilution from stock issuances, we may repurchase shares in the open market or enter into structured repurchase agreements with third parties. In January 2017, our Board of Directors approved a stock repurchase program granting us authority to repurchase up to $2.5 billion in common stock through the end of fiscal 2019. In May 2018, our Board of Directors granted us additional authority to repurchase up to $8.0 billion in common stock through the end of fiscal 2021.

During fiscal 2018, 2017 and 2016, we entered into several structured stock repurchase agreements with large financial institutions, whereupon we provided them with prepayments totaling $2.05 billion, $1.10 billion, and $1.08 billion, respectively. We enter into these agreements in order to take advantage of repurchasing shares at a guaranteed discount to the Volume Weighted Average Price ("VWAP") of our common stock over a specified period of time. We only enter into such transactions when the discount that we receive is higher than our estimate of the expected foregone return on our cash prepayments to the financial institutions. There were no explicit commissions or fees on these structured repurchases. Under the terms of the agreements, there is no requirement for the financial institutions to return any portion of the prepayment to us.

The financial institutions agree to deliver shares to us at monthly intervals during the contract term. The parameters used to calculate the number of shares deliverable are: the total notional amount of the contract, the number of trading days in the contract, the number of trading days in the interval and the average VWAP of our stock during the interval less the agreed upon discount.

The following is a summary of our stock repurchases executed with large financial institutions during fiscal 2018, 2017 and 2016 *(in thousands, except average per share amounts)*:

| Board Approval Date | Repurchases Under the Plan | 2018 | | 2017 | | 2016 | |
|---|---|---|---|---|---|---|---|
| | | Shares | Average | Shares | Average | Shares | Average |
| January 2015 | Structured repurchases | — | $ — | 4,263 | $ 118.00 | 10,428 | $ 97.16 |
| January 2017 | Structured repurchases | 8,686 | $ 230.43 | 3,923 | $ 151.80 | — | $ — |
| Total shares | | 8,686 | $ 230.43 | 8,186 | $ 134.20 | 10,428 | $ 97.16 |
| Total cost | | $2,001,500 | | $1,098,595 | | $1,013,131 | |

For fiscal 2018, 2017 and 2016, the prepayments were classified as treasury stock on our Consolidated Balance Sheets at the payment date, though only shares physically delivered to us by November 30, 2018, December 1, 2017 and December 2, 2016 were excluded from the computation of earnings per share. As of November 30, 2018, $150.0 million of prepayments from our May 2018 authority remained under the agreement.

Subsequent to November 30, 2018, as part of the $8 billion stock repurchase authority, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of $500 million. This amount will be classified as treasury stock on our Consolidated Balance Sheets. Upon completion of the $500 million stock repurchase agreement, $7.35 billion remains under our May 2018 authority. As of November 30, 2018, there is no remaining balance under our January 2017 authority.

*See Item 5, Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities for share repurchases during the quarter ended November 30, 2018.*

**Off-Balance Sheet Arrangements and Aggregate Contractual Obligations**

Our principal commitments as of November 30, 2018 consist of obligations under operating leases, royalty agreements and various service agreements. *See Note 14 of our Notes to Consolidated Financial Statements for additional information regarding our contractual commitments.*

*Transition Taxes Liability*

As a result of the Tax Act enacted on December 22, 2017, all historical undistributed foreign subsidiary earnings were subject to a mandatory one-time transition tax. During fiscal 2018, we recorded a transition tax liability of $504 million and other tax liabilities, including state, of $6 million. Under an election of the Tax Act, the transition tax is payable over eight years beginning in fiscal 2019, with 8% due in each of the first five years, 15% in year six, 20% in year seven, and 25% in year eight. As we repatriate the undistributed earnings of our foreign subsidiaries for use in the U.S., the earnings from our foreign subsidiaries will generally not be subject to U.S. federal tax. We continuously evaluate the future cash needs of our global operations to determine the amount of foreign earnings that is not necessary to be permanently reinvested in our foreign subsidiaries.

*Contractual Obligations*

The following table summarizes our contractual obligations as of November 30, 2018 (in millions):

| | Payment Due by Period | | | | |
|---|---|---|---|---|---|
| | **Total** | **Less than 1 year** | **1-3 years** | **3-5 years** | **More than 5 years** |
| Notes and Term Loan, including interest | $ 4,538.5 | $ 153.3 | $ 3,271.2 | $ 65.0 | $ 1,049.0 |
| Operating lease obligations | 666.5 | 79.4 | 156.1 | 119.1 | 311.9 |
| Purchase obligations | 733.8 | 346.3 | 335.3 | 48.2 | 4.0 |
| Total | $ 5,938.8 | $ 579.0 | $ 3,762.6 | $ 232.3 | $ 1,364.9 |

*Term Loan*

As of November 30, 2018, our Term Loan's carrying value was $2.25 billion. At our election, the Term Loan will bear interest at either (i) the London Interbank Offered Rate ("LIBOR") plus a margin, based on our debt ratings, ranging from 0.500% to 1.000% or (ii) a base rate plus a margin, based on our debt ratings, ranging from 0.040% to 0.110%. Interest is payable periodically, in arrears, at the end of each interest period we elect. Based on the LIBOR rate at November 30, 2018, our estimated maximum commitment for interest payments was $112.8 million for the remaining duration of the Term Loan.

*Senior Notes*

As of November 30, 2018, our outstanding Notes payable consist of the 2020 Notes and 2025 Notes with a total carrying value of $1.88 billion. Interest on our Notes is payable semi-annually, in arrears on February 1 and August 1. At November 30, 2018, our maximum commitment for interest payments under the Notes was $275.4 million for the remaining duration of our Notes. In June 2014, we entered into interest rate swaps that effectively converted the fixed interest rate on our 2020 Notes to a floating interest rate based on LIBOR plus a fixed number of basis points through February 1, 2020.

*Covenants*

Our Term Loan and Revolving Credit Agreement contain similar financial covenants requiring us not to exceed a maximum leverage ratio. As of November 30, 2018, we were in compliance with the covenants. We believe these covenants will not impact our credit or cash in the coming fiscal year or restrict our ability to execute our business plan. Our Notes do not contain any financial covenants.

Under the terms of our Term Loan and Revolving Credit Agreement, we are not prohibited from paying cash dividends unless payment would trigger an event of default or if one currently exists. We do not anticipate paying any cash dividends in the foreseeable future.

*Accounting for Uncertainty in Income Taxes*

See Results of Operations - Provision for Income Taxes above for our discussion on accounting for uncertainty in income taxes.

*Royalties*

We have certain royalty commitments associated with the licensing of certain offerings and products. Royalty expense is generally based on a dollar amount per unit sold, or a percentage of the underlying revenue.

*Indemnifications*

In the normal course of business, we provide indemnifications of varying scope to customers against claims of intellectual property infringement made by third parties arising from the use of our products and from time to time, we are subject to claims by our customers under these indemnification provisions. Historically, costs related to these indemnification provisions have not been significant and we are unable to estimate the maximum potential impact of these indemnification provisions on our future results of operations.

To the extent permitted under Delaware law, we have agreements whereby we indemnify our directors and officers for certain events or occurrences while the director or officer is or was serving at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the director's or officer's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that limits our exposure and enables us to recover a portion of any future amounts paid.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

All market risk sensitive instruments were entered into for non-trading purposes.

### Foreign Currency Risk

*Foreign Currency Exposures and Hedging Instruments*

In countries outside the United States, we transact business in U.S. Dollars and various other currencies, which subject us to exposure from movements in exchange rates. We may use foreign exchange purchased options or forward contracts to hedge our foreign currency revenue. Additionally, we hedge our net recognized foreign currency assets and liabilities with foreign exchange forward contracts. We hedge these exposures to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates.

Our significant foreign currency revenue exposures for fiscal 2018, 2017 and 2016 were as follows (in millions, except Japanese Yen):

| | Fiscal 2018 | | Fiscal 2017 | | Fiscal 2016 | |
|---|---|---|---|---|---|---|
| Euro | € | 1,309.9 | € | 1,044.7 | € | 825.6 |
| Japanese Yen (in billions) | ¥ | 60.8 | ¥ | 51.0 | ¥ | 38.7 |
| British Pounds | £ | 423.1 | £ | 338.4 | £ | 263.5 |

As of November 30, 2018, the total absolute value of all outstanding foreign exchange contracts, including options and forwards, was $1.55 billion, which included the notional equivalent of $805.0 million in Euros, $275.3 million in British Pounds, $331.8 million in Japanese Yen and $140.3 million in other foreign currencies. As of November 30, 2018, all contracts were set to expire at various dates through June 2019. The bank counterparties in these contracts could expose us to credit-related losses that would be largely mitigated with collateral security agreements that provide for collateral to be received or posted when the net fair value of these contracts fluctuates from contractually established thresholds. In addition, we enter into master netting arrangements that have the ability to further limit credit-related losses with the same counterparty by permitting net settlement transactions.

A sensitivity analysis was performed on all of our foreign exchange derivatives as of November 30, 2018. This sensitivity analysis measures the hypothetical market value resulting from a 10% shift in the value of exchange rates relative to the U.S. Dollar. For option contracts, the Black-Scholes option pricing model was used. A 10% increase in the value of the U.S. Dollar and a corresponding decrease in the value of the hedged foreign currency asset would lead to an increase in the fair value of our financial hedging instruments by $48.2 million. Conversely, a 10% decrease in the value of the U.S. Dollar would result in a decrease in the fair value of these financial instruments by $60.7 million.

As a general rule, we do not use foreign exchange contracts to hedge local currency denominated operating expenses in countries where a natural hedge exists. For example, in many countries, revenue in the local currencies substantially offsets the local currency denominated operating expenses.

We also have long-term investment exposures consisting of the capitalization and retained earnings in our non-U.S. Dollar functional currency foreign subsidiaries. As of November 30, 2018 and December 1, 2017, this long-term investment exposure totaled an absolute notional equivalent of $292.3 million and $190.5 million, respectively, with the year-over-year increase primarily driven by earnings growth. At this time, we do not hedge these long-term investment exposures.

We do not use foreign exchange contracts for speculative trading purposes, nor do we hedge our foreign currency exposure in a manner that entirely offsets the effects of changes in foreign exchange rates. We regularly review our hedging program and assess the need to utilize financial instruments to hedge currency exposures on an ongoing basis.

*Cash Flow Hedging—Hedges of Forecasted Foreign Currency Revenue*

We may use foreign exchange purchased options or forward contracts to hedge foreign currency revenue denominated in Euros, British Pounds and Japanese Yen. We hedge these cash flow exposures to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates. These foreign exchange contracts, carried at fair value, may have maturities between one and twelve months. We enter into these foreign exchange contracts to hedge forecasted revenue in the normal course of business and accordingly, they are not speculative in nature.

We record changes in the intrinsic value of these cash flow hedges in accumulated other comprehensive income (loss) until the forecasted transaction occurs. When the forecasted transaction occurs, we reclassify the related gain or loss on the cash flow hedge to revenue. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, we reclassify the gain or loss on the related cash flow hedge from accumulated other comprehensive income (loss) to interest and other income, net on our Consolidated Statements of Income at that time. For the fiscal year ended November 30, 2018, there were no net gains or losses recognized in other income relating to hedges of forecasted transactions that did not occur.

*Balance Sheet Hedging—Hedging of Foreign Currency Assets and Liabilities*

We hedge exposures related to our net recognized foreign currency assets and liabilities with foreign exchange forward contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in foreign currency exchange rates. These foreign exchange contracts are carried at fair value with changes in the fair value recorded as interest and other income, net. These foreign exchange contracts do not subject us to material balance sheet risk due to exchange rate movements because gains and losses on these contracts are intended to offset gains and losses on the assets and liabilities being hedged. At November 30, 2018, the outstanding balance sheet hedging derivatives had maturities of 180 days or less.

*See Note 5 of our Notes to Consolidated Financial Statements for information regarding our hedging activities.*

**Interest Rate Risk**

*Short-Term Investments and Fixed Income Securities*

At November 30, 2018, we had debt securities classified as short-term investments of $1.59 billion. Changes in interest rates could adversely affect the market value of these investments. The following table separates these investments, based on stated maturities, to show the approximate exposure to interest rates (in millions):

| | | |
|---|---|---|
| Due within one year | $ | 612.1 |
| Due between one and two years | | 564.2 |
| Due between two and three years | | 282.2 |
| Due after three years | | 127.7 |
| Total | $ | 1,586.2 |

A sensitivity analysis was performed on our investment portfolio as of November 30, 2018. The analysis is based on an estimate of the hypothetical changes in market value of the portfolio that would result from an immediate parallel shift in the yield curve of various magnitudes.

The following tables present the hypothetical fair values of our debt securities classified as short-term investments assuming immediate parallel shifts in the yield curve of 50 basis points ("BPS"), 100 BPS and 150 BPS. The analysis is shown as of November 30, 2018 and December 1, 2017 (dollars in millions):

| -150 BPS | -100 BPS | -50 BPS | Fair Value 11/30/18 | +50 BPS | +100 BPS | +150 BPS |
|---|---|---|---|---|---|---|
| $ 1,617.5 | $ 1,607.1 | $ 1,596.6 | $ 1,586.2 | $ 1,575.7 | $ 1,565.3 | $ 1,554.8 |
| -150 BPS | -100 BPS | -50 BPS | Fair Value 12/1/17 | +50 BPS | +100 BPS | +150 BPS |
| $ 3,595.2 | $ 3,568.1 | $ 3,540.9 | $ 3,513.7 | $ 3,486.5 | $ 3,459.3 | $ 3,432.1 |

*Term Loan*

As of November 30, 2018, our Term Loan's carrying value was $2.25 billion. At our election, the Term Loan will bear interest at either (i) LIBOR plus a margin, based on our debt ratings, ranging from 0.500% to 1.000% or (ii) a base rate plus a margin, based on our debt ratings, ranging from 0.040% to 0.110%. Interest is payable periodically, in arrears, at the end of each interest period we elect. An immediate hypothetical 50 basis points increase or decrease in market interest rates would not have a significant impact on our results of operations.

*Senior Notes*

As of November 30, 2018, the amount outstanding under our Notes was $1.9 billion. In June 2014, we entered into interest rate swaps that effectively converted the fixed interest rate on our 2020 Notes to a floating interest rate based on LIBOR plus a fixed number of basis points through February 1, 2020. Accordingly, our exposure to fluctuations in market interest rates is on the hedged fixed-rate debt of $900 million. An immediate hypothetical 50 basis points increase or decrease in market interest rates would not have a significant impact on our results of operations.

As of November 30, 2018, the total carrying amount of the Notes was $1.88 billion and the related fair value based on observable market prices in less active markets was $1.89 billion.

**Other Market Risk**

*Privately Held Long-Term Investments*

The privately held companies in which we invest can still be considered in the start-up or development stages which are inherently risky. The technologies or products these companies have under development are typically in the early stages and may never materialize, which could result in a loss of a substantial part of our initial investment in these companies. The evaluation of privately held companies is based on information that we request from these companies, which is not subject to the same disclosure regulations as U.S. publicly traded companies, and as such, the basis for these evaluations is subject to the timing and accuracy of the data received from these companies. We have immaterial exposure on our long-term investments in privately held companies as these investments were not significant as of November 30, 2018 and December 1, 2017.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

## INDEX TO CONSOLIDATED FINANCIAL STATEMENTS



All financial statement schedules have been omitted, since the required information is not applicable or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Consolidated Financial Statements and Notes thereto.

**ADOBE INC.**

**CONSOLIDATED BALANCE SHEETS**

**(In thousands, except par value)**

| | November 30, 2018 | December 1, 2017 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 1,642,775 | $ 2,306,072 |
| Short-term investments | 1,586,187 | 3,513,702 |
| Trade receivables, net of allowances for doubtful accounts of $14,981 and $9,151, respectively | 1,315,578 | 1,217,968 |
| Prepaid expenses and other current assets | 312,499 | 210,071 |
| Total current assets | 4,857,039 | 7,247,813 |
| Property and equipment, net | 1,075,072 | 936,976 |
| Goodwill | 10,581,048 | 5,821,561 |
| Purchased and other intangibles, net | 2,069,001 | 385,658 |
| Other assets | 186,522 | 143,548 |
| Total assets | $ 18,768,682 | $ 14,535,556 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Trade payables | $ 186,258 | $ 113,538 |
| Accrued expenses | 1,163,185 | 993,773 |
| Income taxes payable | 35,709 | 14,196 |
| Deferred revenue | 2,915,974 | 2,405,950 |
| Total current liabilities | 4,301,126 | 3,527,457 |
| Long-term liabilities: | | |
| Debt | 4,124,800 | 1,881,421 |
| Deferred revenue | 137,630 | 88,592 |
| Income taxes payable | 644,101 | 173,088 |
| Deferred income taxes | 46,702 | 279,941 |
| Other liabilities | 152,209 | 125,188 |
| Total liabilities | 9,406,568 | 6,075,687 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, $0.0001 par value; 2,000 shares authorized; none issued | — | — |
| Common stock, $0.0001 par value; 900,000 shares authorized; 600,834 shares issued; 487,663 and 491,262 shares outstanding, respectively | 61 | 61 |
| Additional paid-in-capital | 5,685,337 | 5,082,195 |
| Retained earnings | 11,815,597 | 9,573,870 |
| Accumulated other comprehensive income (loss) | (148,130) | (111,821) |
| Treasury stock, at cost (113,171 and 109,572 shares, respectively), net of reissuances | (7,990,751) | (6,084,436) |
| Total stockholders' equity | 9,362,114 | 8,459,869 |
| Total liabilities and stockholders' equity | $ 18,768,682 | $ 14,535,556 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE INC.**

**CONSOLIDATED STATEMENTS OF INCOME**

**(In thousands, except per share data)**

| | Years Ended November 30, 2018 | Years Ended December 1, 2017 | Years Ended December 2, 2016 |
|---|---|---|---|
| Revenue: | | | |
| Subscription | $ 7,922,152 | $ 6,133,869 | $ 4,584,833 |
| Product | 622,153 | 706,767 | 800,498 |
| Services and support | 485,703 | 460,869 | 469,099 |
| Total revenue | 9,030,008 | 7,301,505 | 5,854,430 |
| Cost of revenue: | | | |
| Subscription | 807,221 | 623,048 | 461,860 |
| Product | 46,009 | 57,082 | 68,917 |
| Services and support | 341,769 | 330,361 | 289,131 |
| Total cost of revenue | 1,194,999 | 1,010,491 | 819,908 |
| Gross profit | 7,835,009 | 6,291,014 | 5,034,522 |
| Operating expenses: | | | |
| Research and development | 1,537,812 | 1,224,059 | 975,987 |
| Sales and marketing | 2,620,829 | 2,197,592 | 1,910,197 |
| General and administrative | 744,898 | 624,706 | 576,202 |
| Amortization of purchased intangibles | 91,101 | 76,562 | 78,534 |
| Total operating expenses | 4,994,640 | 4,122,919 | 3,540,920 |
| Operating income | 2,840,369 | 2,168,095 | 1,493,602 |
| Non-operating income (expense): | | | |
| Interest and other income (expense), net | 39,536 | 36,395 | 13,548 |
| Interest expense | (89,242) | (74,402) | (70,442) |
| Investment gains (losses), net | 3,213 | 7,553 | (1,570) |
| Total non-operating income (expense), net | (46,493) | (30,454) | (58,464) |
| Income before income taxes | 2,793,876 | 2,137,641 | 1,435,138 |
| Provision for income taxes | 203,102 | 443,687 | 266,356 |
| Net income | $ 2,590,774 | $ 1,693,954 | $ 1,168,782 |
| Basic net income per share | $ 5.28 | $ 3.43 | $ 2.35 |
| Shares used to compute basic net income per share | 490,564 | 493,632 | 498,345 |
| Diluted net income per share | $ 5.20 | $ 3.38 | $ 2.32 |
| Shares used to compute diluted net income per share | 497,843 | 501,123 | 504,299 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(In thousands)**

| | Years Ended | | |
|---|---|---|---|
| | November 30, 2018 | December 1, 2017 | December 2, 2016 |
| | Increase/(Decrease) | | |
| Net income | $ 2,590,774 | $ 1,693,954 | $ 1,168,782 |
| Other comprehensive income (loss), net of taxes: | | | |
| Available-for-sale securities: | | | |
| Unrealized gains / losses on available-for-sale securities | (24,464) | (2,503) | (1,618) |
| Reclassification adjustment for recognized gains / losses on available-for-sale securities | 10,650 | (947) | (1,895) |
| Net increase (decrease) from available-for-sale securities | (13,814) | (3,450) | (3,513) |
| Derivatives designated as hedging instruments: | | | |
| Unrealized gains / losses on derivative instruments | 74,080 | 6,917 | 35,199 |
| Reclassification adjustment for recognized gains / losses on derivative instruments | (48,981) | (31,973) | (16,425) |
| Net increase (decrease) from derivatives designated as hedging instruments | 25,099 | (25,056) | 18,774 |
| Foreign currency translation adjustments | (47,594) | 90,287 | (19,783) |
| Other comprehensive income (loss), net of taxes | (36,309) | 61,781 | (4,522) |
| Total comprehensive income, net of taxes | $ 2,554,465 | $ 1,755,735 | $ 1,164,260 |

*See accompanying Notes to Consolidated Financial Statements.*

## ADOBE INC.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

## (In thousands)

| | Common Stock | | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | | Total |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | | | | Shares | Amount | |
| Balances at November 27, 2015 | 600,834 | $ 61 | $ 4,184,883 | $ 7,253,431 | $ (169,080 ) | (103,025 ) | $ (4,267,715 ) | $ 7,001,580 |
| Net income | — | — | — | 1,168,782 | — | — | — | 1,168,782 |
| Other comprehensive income (losses), net of taxes | — | — | — | — | (4,522 ) | — | — | (4,522 ) |
| Re-issuance of treasury stock under stock compensation plans | — | — | 7,365 | (307,696 ) | — | 6,872 | 209,628 | (90,703 ) |
| Tax benefit from employee stock plans | — | — | 75,102 | — | — | — | — | 75,102 |
| Purchase of treasury stock | — | — | — | — | — | (10,427 ) | (1,075,000 ) | (1,075,000 ) |
| Stock-based compensation | — | — | 348,981 | — | — | — | — | 348,981 |
| Value of shares in deferred compensation plan | — | — | — | — | — | — | 615 | 615 |
| Balances at December 2, 2016 | 600,834 | $ 61 | $ 4,616,331 | $ 8,114,517 | $ (173,602 ) | (106,580 ) | $ (5,132,472 ) | $ 7,424,835 |
| Net income | — | — | — | 1,693,954 | — | — | — | 1,693,954 |
| Other comprehensive income (losses), net of taxes | — | — | — | — | 61,781 | — | — | 61,781 |
| Re-issuance of treasury stock under stock compensation plans | — | — | 1,768 | (234,601 ) | — | 5,194 | 151,058 | (81,775 ) |
| Purchase of treasury stock | — | — | — | — | — | (8,186 ) | (1,100,000 ) | (1,100,000 ) |
| Equity awards assumed for acquisition | — | — | 10,348 | — | — | — | — | 10,348 |
| Stock-based compensation | — | — | 453,748 | — | — | — | — | 453,748 |
| Value of shares in deferred compensation plan | — | — | — | — | — | — | (3,022 ) | (3,022 ) |
| Balances at December 1, 2017 | 600,834 | $ 61 | $ 5,082,195 | $ 9,573,870 | $ (111,821 ) | (109,572 ) | $ (6,084,436 ) | $ 8,459,869 |
| Net income | — | — | — | 2,590,774 | — | — | — | 2,590,774 |
| Other comprehensive income (losses), net of taxes | — | — | — | — | (36,309 ) | — | — | (36,309 ) |
| Re-issuance of treasury stock under stock compensation plans | — | — | (1,125 ) | (348,729 ) | — | 5,087 | 147,651 | (202,203 ) |
| Purchase of treasury stock | — | — | — | — | — | (8,686 ) | (2,050,000 ) | (2,050,000 ) |
| Equity awards assumed for acquisition | — | — | 2,784 | — | — | — | — | 2,784 |
| Stock-based compensation | — | — | 601,483 | — | — | — | — | 601,483 |
| Value of shares in deferred | — | — | — | — | — | — | (3,966 ) | (3,966 ) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| compensation plan | | | | | | | | |
| Impacts of the U.S. Tax Act | — | — | — | (318) | — | — | — | (318) |
| Balances at November 30, 2018 | 600,834 | $ 61 | $ 5,685,337 | $ 11,815,597 | $ (148,130) | (113,171) | $ (7,990,751) | $ 9,362,114 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands)**

| | Years Ended | | |
|---|---|---|---|
| | November 30, 2018 | December 1, 2017 | December 2, 2016 |
| Cash flows from operating activities: | | | |
| Net income | $ 2,590,774 | $ 1,693,954 | $ 1,168,782 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation, amortization and accretion | 346,492 | 325,997 | 331,535 |
| Stock-based compensation | 609,562 | 454,472 | 349,297 |
| Deferred income taxes | (468,936) | 51,605 | 24,222 |
| Unrealized losses (gains) on investments, net | 793 | (5,494) | 3,145 |
| Excess tax benefits from stock-based compensation | — | — | (75,105) |
| Other non-cash items | 7,193 | 4,625 | 2,022 |
| Changes in operating assets and liabilities, net of acquired assets and assumed liabilities: | | | |
| Trade receivables, net | (1,983) | (187,173) | (160,416) |
| Prepaid expenses and other current assets | (77,225) | 28,040 | (71,021) |
| Trade payables | 54,920 | (45,186) | (6,281) |
| Accrued expenses | 43,837 | 151,104 | 65,593 |
| Income taxes payable | 479,184 | (34,493) | 43,115 |
| Deferred revenue | 444,693 | 475,402 | 524,840 |
| Net cash provided by operating activities | 4,029,304 | 2,912,853 | 2,199,728 |
| Cash flows from investing activities: | | | |
| Purchases of short-term investments | (566,084) | (1,931,011) | (2,285,222) |
| Maturities of short-term investments | 765,860 | 759,737 | 769,228 |
| Proceeds from sales of short-term investments | 1,709,480 | 1,393,929 | 860,849 |
| Acquisitions, net of cash acquired | (6,314,382) | (459,626) | (48,427) |
| Purchases of property and equipment | (266,579) | (178,122) | (203,805) |
| Purchases of long-term investments, intangibles and other assets | (18,513) | (29,918) | (58,433) |
| Proceeds from sale of long-term investments and other assets | 4,923 | 2,134 | 5,777 |
| Net cash used for investing activities | (4,685,295) | (442,877) | (960,033) |
| Cash flows from financing activities: | | | |
| Purchases of treasury stock | (2,050,000) | (1,100,000) | (1,075,000) |
| Proceeds from issuance of treasury stock | 190,990 | 158,351 | 145,697 |
| Taxes paid related to net share settlement of equity awards | (393,193) | (240,126) | (236,400) |
| Excess tax benefits from stock-based compensation | — | — | 75,105 |
| Proceeds from debt issuance, net of costs | 2,248,342 | — | — |
| Repayment of capital lease obligations | (1,707) | (1,960) | (108) |
| Net cash used for financing activities | (5,568) | (1,183,735) | (1,090,706) |
| Effect of foreign currency exchange rates on cash and cash equivalents | (1,738) | 8,516 | (14,234) |
| Net increase (decrease) in cash and cash equivalents | (663,297) | 1,294,757 | 134,755 |
| Cash and cash equivalents at beginning of year | 2,306,072 | 1,011,315 | 876,560 |
| Cash and cash equivalents at end of year | $ 1,642,775 | $ 2,306,072 | $ 1,011,315 |
| Supplemental disclosures: | | | |
| Cash paid for income taxes, net of refunds | $ 210,369 | $ 396,668 | $ 249,884 |
| Cash paid for interest | $ 81,258 | $ 69,430 | $ 66,193 |
| Non-cash investing activities: | | | |

| | | | |
|---|---|---|---|
| Investment in lease receivable applied to building purchase | $ — | $ 80,439 | $ — |
| Issuance of common stock and stock awards assumed in business acquisitions | $ 2,784 | $ 10,348 | $ — |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## NOTE 1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

*Operations*

Founded in 1982, Adobe Inc. is one of the largest and most diversified software companies in the world. We offer a line of products and services used by creative professionals, marketers, knowledge workers, application developers, enterprises and consumers for creating, managing, delivering, measuring, optimizing and engaging with compelling content and experiences across personal computers, devices and media. We market and license our products and services directly to enterprise customers through our sales force and to end users through app stores and our own website at www.adobe.com. We offer many of our products via a Software-as-a-Service ("SaaS") model or a managed services model (both of which are referred to as a hosted or cloud-based) as well as through term subscription and pay-per-use models. We also distribute certain products and services through a network of distributors, value-added resellers ("VARs"), systems integrators ("SIs"), independent software vendors ("ISVs"), retailers, software developers and original equipment manufacturers ("OEMs"). In addition, we license our technology to hardware manufacturers, software developers and service providers for use in their products and solutions. Our products run on personal and server-based computers, as well as on smartphones, tablets and other devices, depending on the product. We have operations in the Americas, Europe, Middle East and Africa ("EMEA") and Asia-Pacific ("APAC").

*Basis of Presentation*

The accompanying Consolidated Financial Statements include those of Adobe and its subsidiaries, after elimination of all intercompany accounts and transactions. We have prepared the accompanying Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") and pursuant to the rules and regulations of the United States Securities and Exchange Commission (the "SEC").

*Use of Estimates*

In preparing Consolidated Financial Statements and related disclosures in conformity with GAAP and pursuant to the rules and regulations of the SEC, we must make estimates and judgments that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Estimates are used for, but not limited to, sales allowances and programs, bad debts, stock-based compensation, determining the fair value of acquired assets and assumed liabilities, excess inventory and purchase commitments, facilities lease losses, impairment of goodwill and intangible assets, litigation, income taxes and investments. Actual results may differ materially from these estimates.

*Fiscal Year*

Our fiscal year is a 52- or 53-week year that ends on the Friday closest to November 30. Our financial results for fiscal 2016 benefited from an extra week in the first quarter of fiscal 2016 due to our 52/53-week financial calendar whereby fiscal 2016 was a 53-week fiscal year compared with fiscal 2018 and 2017 which were 52-week fiscal years.

*Reclassifications*

Certain immaterial prior year amounts have been reclassified to conform to current year presentation in the Consolidated Statements of Cash Flows.

### Significant Accounting Policies

*Revenue Recognition*

Our revenue is derived from subscription offerings, non-software related hosted services, term-based and perpetual licensing of software products, associated software maintenance and support plans, consulting services, training, and technical support. Most of our enterprise customer arrangements are complex, involving multiple solutions and various license rights, bundled with post-contract customer support and other meaningful rights that together provide a complete end-to-end solution to the customer.

We recognize revenue when all four revenue recognition criteria have been met: persuasive evidence of an arrangement exists, we have delivered the product or performed the service, the fee is fixed or determinable and collection is probable.

Determining whether and when some of these criteria have been satisfied often involves assumptions and judgments that can have a significant impact on the timing and amount of revenue we report.

*Multiple Element Arrangements*

We enter into multiple element revenue arrangements in which a customer may purchase a combination of software, upgrades, maintenance and support, hosted services, and consulting.

For our software and software-related multiple element arrangements, we must: (1) determine whether and when each element has been delivered; (2) determine whether undelivered products or services are essential to the functionality of the delivered products and services; (3) determine the fair value of each undelivered element using vendor-specific objective evidence ("VSOE"); and (4) allocate the total price among the various elements. VSOE of fair value is used to allocate a portion of the price to the undelivered elements and the residual method is used to allocate the remaining portion to the delivered elements. Absent VSOE, revenue is deferred until the earlier of the point at which VSOE of fair value exists for any undelivered element or until all elements of the arrangement have been delivered. However, if the only undelivered element is maintenance and support, the entire arrangement fee is recognized ratably over the performance period. Changes in assumptions or judgments or changes to the elements in a software arrangement could cause a material increase or decrease in the amount of revenue that we report in a particular period.

We determine VSOE for each element based on historical stand-alone sales to third parties or from the stated renewal rate for the elements contained in the initial arrangement. In determining VSOE, we require that a substantial majority of the selling prices for a product or service fall within a reasonably narrow pricing range.

We have established VSOE for our software maintenance and support services, custom software development services, consulting services and training, when such services are sold optionally with software licenses.

For multiple-element arrangements containing our non-software services, we must: (1) determine whether and when each element has been delivered; (2) determine the fair value of each element using the selling price hierarchy of VSOE of selling price, third-party evidence ("TPE") of selling price or best-estimated selling price ("BESP"), as applicable; and (3) allocate the total price among the various elements based on the relative selling price method.

For multiple-element arrangements that contain both software and non-software elements, we allocate revenue to software or software-related elements as a group and any non-software elements separately based on the selling price hierarchy. We determine the selling price for each deliverable using VSOE of selling price, if it exists, or TPE of selling price. If neither VSOE nor TPE of selling price exist for a deliverable, we use BESP. Once revenue is allocated to software or software-related elements as a group, we recognize revenue in conformance with software revenue accounting guidance. Revenue is recognized when revenue recognition criteria are met for each element.

We are generally unable to establish VSOE or TPE for non-software elements and as such, we use BESP. BESP is generally used for offerings that are not typically sold on a stand-alone basis or for new or highly customized offerings. We determine BESP for a product or service by considering multiple factors including, but not limited to major product groupings, geographies, market conditions, competitive landscape, internal costs, gross margin objectives and pricing practices. Pricing practices taken into consideration include historic contractually stated prices, volume discounts where applicable and our price lists. We must estimate certain royalty revenue amounts due to the timing of securing information from our customers. While we believe we can make reliable estimates regarding these matters, these estimates are inherently subjective. Accordingly, our assumptions and judgments regarding future products and services as well as our estimates of royalty revenue could differ from actual events, thus materially impacting our financial position and results of operations.

*Subscription and Services and Support Revenue*

We recognize revenue for hosted services that are priced based on a committed number of transactions, ratably beginning on the date the services associated with the committed transactions are first made available to the customer and continuing through the end of the contractual service term. Over-usage fees, and fees billed based on the actual number of transactions from which we capture data, are billed in accordance with contract terms as these fees are incurred. We record amounts that have been invoiced in accounts receivable and in deferred revenue or revenue, depending on whether all revenue recognition criteria have been met.

Our services and support revenue is composed of consulting, training, and maintenance and support, primarily related to the licensing of our enterprise, mobile and device products and solutions. Our support revenue also includes technical support and developer support to partners and developer organizations related to our desktop products.

Our consulting revenue is recognized using a time and materials basis and is measured monthly based on input measures, such as hours incurred to date, with consideration given to output measures, such as contract milestones when applicable.

Our maintenance and support offerings, which entitle customers to receive product upgrades and enhancements on a when and if available basis or technical support, depending on the offering, are recognized ratably over the performance period of the arrangement.

Our software subscription offerings, which may include product upgrades and enhancements on a when and if available basis, hosted services, and online storage, are generally offered to our customers over a specified period of time and we recognize revenue associated with these arrangements ratably over the subscription period.

*Product Revenue*

We recognize our product revenue upon shipment, provided all other revenue recognition criteria have been met. Our desktop application product revenue from distributors is subject to agreements allowing limited rights of return, rebates and price protection. Our direct sales and OEM sales are also subject to limited rights of return. Accordingly, we reduce revenue recognized for estimated future returns, price protection and rebates at the time the related revenue is recorded. The estimates for returns are adjusted periodically based upon historical rates of returns, inventory levels in the distribution channel and other related factors.

We recognize OEM licensing revenue, primarily royalties, when OEMs ship products incorporating our software, provided collection of such revenue is deemed probable. For certain OEM customers, we must estimate royalty revenue due to the timing of securing customer information. This estimate is based on a combination of our generated forecasts and actual historical reporting by our OEM customers. To substantiate our ability to estimate revenue, we review license royalty revenue reports ultimately received from our significant OEM customers in comparison to the amounts estimated in the prior period.

Our product-related deferred revenue includes maintenance upgrade revenue and customer advances under OEM license agreements. Our maintenance upgrade revenue for our desktop application products is included in our product revenue line item as the maintenance primarily entitles customers to receive product upgrades. In cases where we provide a specified free upgrade to an existing product, we defer the fair value for the specified upgrade right until the future obligation is fulfilled or when the right to the specified free upgrade expires.

*Rights of Return, Rebates and Price Protection*

As discussed above, we offer limited rights of return, rebates and price protection of our products under various policies and programs with our distributors, resellers and/or end-user customers. We estimate and record reserves for these programs as an offset to revenue and accounts receivable. Below is a summary of each of the general provisions in our contracts:

- Distributors are allowed limited rights of return of products purchased during the previous quarter. In addition, distributors are allowed to return products that have reached the end of their lives, as defined by us, and products that are being replaced by new versions.

- We offer rebates to our distributors, resellers and/or end user customers. The amount of revenue that is reduced for distributor and reseller rebates is based on actual performance against objectives set forth by us for a particular reporting period (volume, timely reporting, etc.). If mail-in or other promotional rebates are offered, the amount of revenue reduced is based on the dollar amount of the rebate, taking into consideration an estimated redemption rate calculated using historical trends.

- From time to time, we may offer price protection to our distributors that allow for the right to a credit if we permanently reduce the price of a software product. The amount of revenue that is reduced for price protection is calculated as the difference between the old and new price of a software product on inventory held by the distributor immediately prior to the effective date of the decrease.

**ADOBE INC.**

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

Although our subscription contracts are generally non-cancellable, a limited number of customers have the right to cancel their contracts by providing prior written notice to us of their intent to cancel the remainder of the contract term. In the event a customer cancels its contract, they are not entitled to a refund for prior services we have provided to them.

On a quarterly basis, the amount of revenue that is reserved for future returns is calculated based on our historical trends and data specific to each reporting period. We review the actual returns evidenced in prior quarters as a percent of revenue to determine a historical returns rate. We then apply the historical rate to the current period revenue as a basis for estimating future returns. When necessary, we also provide a specific returns reserve for product in the distribution channel in excess of estimated requirements. This estimate can be affected by the amount of a particular product in the channel, the rate of sell-through, product plans and other factors.

*Revenue Reserve*

Revenue reserve rollforward (in thousands):

| | 2018 | 2017 | 2016 |
|---|---|---|---|
| Beginning balance | $ 22,006 | $ 23,096 | $ 19,446 |
| Amount charged to revenue | 65,241 | 61,031 | 55,739 |
| Actual returns | (61,822) | (62,121) | (52,089) |
| Ending balance | $ 25,425 | $ 22,006 | $ 23,096 |

*Deferred Revenue*

Deferred revenue consists of billings and payments received in advance of revenue recognition for our products and solutions described above. We recognize deferred revenue as revenue only when the revenue recognition criteria are met.

*Allowance for Doubtful Accounts*

We maintain an allowance for doubtful accounts which reflects our best estimate of potentially uncollectible trade receivables. The allowance is based on both specific and general reserves. We regularly review our trade receivables allowances by considering such factors as historical experience, credit-worthiness, the age of the trade receivable balances and current economic conditions that may affect a customer's ability to pay and we specifically reserve for those deemed uncollectible.

| (in thousands) | 2018 | 2017 | 2016 |
|---|---|---|---|
| Beginning balance | $ 9,151 | $ 6,214 | $ 7,293 |
| Increase due to acquisition | 5,602 | 2,391 | 77 |
| Charged to operating expenses | 5,962 | 4,411 | 1,337 |
| Deductions[1] | (5,734) | (3,865) | (2,493) |
| Ending balance | $ 14,981 | $ 9,151 | $ 6,214 |

(1) Deductions related to the allowance for doubtful accounts represent amounts written off against the allowance, less recoveries.

*Property and Equipment*

We record property and equipment at cost less accumulated depreciation and amortization. Property and equipment are depreciated using the straight-line method over their estimated useful lives ranging from 1 to 5 years for computers and equipment as well as server hardware under capital leases, 1 to 6 years for furniture and fixtures, 5 to 20 years for building improvements and up to 40 years for buildings. Leasehold improvements are amortized using the straight-line method over the lesser of the remaining respective lease term or estimated useful lives ranging from 1 to 15 years.

*Goodwill, Purchased Intangibles and Other Long-Lived Assets*

Goodwill is assigned to one or more reporting segments on the date of acquisition. We review our goodwill for impairment annually during our second quarter of each fiscal year and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of any one of our reporting units below its respective carrying amount. In performing our goodwill impairment test, we first perform a qualitative assessment, which requires that we consider events or circumstances including macroeconomic conditions, industry and market considerations, cost factors, overall financial performance, changes in management or key personnel, changes in strategy, changes in customers, changes in the composition or carrying amount of a reporting segment's net assets and changes in our stock price. If, after assessing the totality of events or circumstances, we determine that it is more likely than not that the fair values of our reporting segments are greater than the carrying amounts, then the quantitative goodwill impairment test is not performed.

If the qualitative assessment indicates that the quantitative analysis should be performed, we then evaluate goodwill for impairment by comparing the fair value of each of our reporting segments to its carrying value, including the associated goodwill. To determine the fair values, we use the equal weighting of the market approach based on comparable publicly traded companies in similar lines of businesses and the income approach based on estimated discounted future cash flows. Our cash flow assumptions consider historical and forecasted revenue, operating costs and other relevant factors.

We completed our annual goodwill impairment test in the second quarter of fiscal 2018. We determined, after performing a qualitative review of each reporting segment, that it is more likely than not that the fair value of each of our reporting segments substantially exceeds the respective carrying amounts. Accordingly, there was no indication of impairment and the quantitative goodwill impairment test was not performed. We did not identify any events or changes in circumstances since the performance of our annual goodwill impairment test that would require us to perform another goodwill impairment test during the fiscal year.

We amortize intangible assets with finite lives over their estimated useful lives and review them for impairment whenever an impairment indicator exists. We continually monitor events and changes in circumstances that could indicate carrying amounts of our long-lived assets, including our intangible assets may not be recoverable. When such events or changes in circumstances occur, we assess recoverability by determining whether the carrying value of such assets will be recovered through the undiscounted expected future cash flows. If the future undiscounted cash flows are less than the carrying amount of these assets, we recognize an impairment loss based on any excess of the carrying amount over the fair value of the assets. We did not recognize any intangible asset impairment charges in fiscal 2018, 2017 or 2016.

During fiscal 2018, our intangible assets were amortized over their estimated useful lives ranging from 1 to 14 years. Amortization is based on the pattern in which the economic benefits of the intangible asset will be consumed or on a straight-line basis when the consumption pattern is not apparent. The weighted average useful lives of our intangible assets were as follows:

| | Weighted Average Useful Life (years) |
|---|---|
| Purchased technology | 6 |
| Customer contracts and relationships | 9 |
| Trademarks | 9 |
| Acquired rights to use technology | 10 |
| Backlog | 2 |
| Other intangibles | 4 |

*Income Taxes*

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. We record a valuation allowance to reduce deferred tax assets to an amount for which realization is more likely than not.

**ADOBE INC.**

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

*Taxes Collected from Customers*

We net taxes collected from customers against those remitted to government authorities in our financial statements. Accordingly, taxes collected from customers are not reported as revenue.

*Treasury Stock*

We account for treasury stock under the cost method. When treasury stock is re-issued at a price higher than its cost, the difference is recorded as a component of additional paid-in-capital in our Consolidated Balance Sheets. When treasury stock is re-issued at a price lower than its cost, the difference is recorded as a component of additional paid-in-capital to the extent that there are previously recorded gains to offset the losses. If there are no treasury stock gains in additional paid-in-capital, the losses upon re-issuance of treasury stock are recorded as a reduction of retained earnings in our Consolidated Balance Sheets.

*Advertising Expenses*

Advertising costs are expensed as incurred. Advertising expenses for fiscal 2018, 2017 and 2016 were $173.6 million, $141.7 million and $135.8 million, respectively.

*Foreign Currency Translation*

We translate assets and liabilities of foreign subsidiaries, whose functional currency is their local currency, at exchange rates in effect at the balance sheet date. We translate revenue and expenses at the monthly average exchange rates. We include accumulated net translation adjustments in stockholders' equity as a component of accumulated other comprehensive income (loss).

*Foreign Currency and Other Hedging Instruments*

In countries outside the United States, we transact business in U.S. Dollars and in various other currencies. We may use foreign exchange option and forward contracts to hedge a portion of our forecasted foreign currency denominated revenue primarily in Euros, British Pounds and Japanese Yen. We hedge our net recognized foreign currency assets and liabilities with foreign exchange forward contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates.

We recognize all derivative instruments as either assets or liabilities in our Consolidated Balance Sheets and measure them at fair value. Gains and losses resulting from changes in fair value are accounted for depending on the use of the derivative and whether it is designated and qualifies for hedge accounting. Contracts that do not qualify for hedge accounting are adjusted to fair value through earnings. *See Note 5 for information regarding our hedging activities.*

Gains and losses from foreign exchange forward contracts which hedge certain balance sheet positions are recorded each period as a component of interest and other income, net in our Consolidated Statements of Income. Foreign exchange option contracts hedging forecasted foreign currency revenue are designated as cash flow hedges with gains and losses recorded net of tax, as a component of other comprehensive income in stockholders' equity and reclassified into revenue at the time the forecasted transactions occur.

*Concentration of Risk*

Financial instruments that potentially subject us to concentrations of credit risk are short-term fixed-income investments, structured repurchase transactions, foreign currency and interest rate hedge contracts and trade receivables.

Our investment portfolio consists of investment-grade securities diversified among security types, industries and issuers. Our cash and investments are held and primarily managed by recognized financial institutions that follow our investment policy. Our policy limits the amount of credit exposure to any one security issue or issuer and we believe no significant concentration of credit risk exists with respect to these investments.

We enter into foreign currency hedge contracts with bank counterparties that could expose us to credit related losses in the event of their nonperformance. This is largely mitigated with collateral security agreements that provide for collateral to be received or posted when the net fair value of certain financial instruments fluctuates from contractually established thresholds. In addition, we enter into master netting arrangements which have the ability to further limit credit related losses with the same counterparty by permitting net settlement transactions.

The aggregate fair value of foreign currency contracts in net asset positions as of November 30, 2018 and December 1, 2017 was $44.3 million and $14.2 million respectively. These amounts represent the maximum exposure to loss at the reporting date as a result of all of the counterparties failing to perform as contracted. These exposures could be reduced by certain immaterial liabilities included in master netting arrangements with those same counterparties.

Credit risk in receivables is limited to OEMs, dealers and distributors of hardware and software products to the retail market, customers to whom we license software directly and our SaaS offerings. A credit review is completed for our new distributors, dealers and OEMs. We also perform ongoing credit evaluations of our customers' financial condition and require letters of credit or other guarantees, whenever deemed necessary. The credit limit given to the customer is based on our risk assessment of their ability to pay, country risk and other factors and is not contingent on the resale of the product or on the collection of payments from their customers. If we license our software or provide SaaS services to a customer where we have a reason to believe the customer's ability to pay is not probable, due to country risk or credit risk, we will not recognize the revenue. We will revert to recognizing the revenue on a cash basis, assuming all other criteria for revenue recognition has been met.

**Recently Adopted Accounting Guidance**

On January 26, 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2017-04, Simplifying the Test for Goodwill Impairment, which eliminated step two from the goodwill impairment test. In assessing impairment of goodwill, if it is concluded that it is more likely than not that the carrying amount of a reportable segment exceeds its fair value during the qualitative assessment, a one-step goodwill impairment test will be performed. If it is concluded during the quantitative test that the carrying amount of a reportable segment exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess, limited to the total amount of goodwill allocated to that reportable segment. The effective date of the new standard for public companies is for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. Early adoption is permitted.

In the first quarter of 2018, we early adopted ASU 2017-04. The standard did not have an impact to our qualitative assessment for goodwill impairment that we performed in the second quarter of fiscal 2018.

There have been no other new accounting pronouncements made effective during fiscal 2018 that have significance, or potential significance, to our Consolidated Financial Statements.

**Recent Accounting Pronouncements Not Yet Effective**

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in GAAP when it becomes effective and permits the use of either the full retrospective or modified retrospective transition method. The updated standard is effective for us in the first quarter of fiscal 2019. We will adopt this updated standard in the first quarter of fiscal 2019 on a modified retrospective basis. We are currently evaluating the effect that the updated standard will have on our Consolidated Financial Statements and related disclosures.

While we are continuing to assess all potential impacts of the new standard, we believe there should not be a material change to the amount of consolidated revenues on an annual basis.

We expect revenue related to our cloud offerings, including Creative Cloud and Document Cloud for business enterprises, individuals and teams, to remain substantially unchanged. When sold with cloud-enabled services, Creative Cloud and Document Cloud require a significant level of integration and interdependency with software and the individual components are not considered distinct. Revenue for these offerings will continue to be recognized over the period in which the cloud services are provided.

We believe the most significant revenue-related impact relates to our accounting for arrangements that include on-premise term-based software licenses bundled with maintenance and support. Under current GAAP, the revenue attributable to these software licenses is recognized ratably over the term of the arrangement because VSOE does not exist for the undelivered maintenance and support element as it is not sold separately. The requirement to have VSOE for undelivered elements to enable the separation of revenue for the delivered software licenses is eliminated under the new standard. Accordingly, under the new standard we will be required to recognize as revenue a portion of the arrangement fee upon delivery of the software licenses and potentially classify such revenue as "product" instead of "subscription" revenue on the income statement. We offer on-premise term-based software licenses bundled with maintenance and support as a deployment model for certain offerings within our Digital Experience, Digital Media, and Publishing business units. We do not expect these arrangements to have a material impact to revenue reported in annual reporting periods subsequent to adoption, however they may result in a material balance sheet impact on the date of adoption due to the application of the modified retrospective transition method. The modified retrospective method requires upon adoption that we recognize the impact of applying the new standard to contracts that are not completed at the date of initial adoption, but under this adoption method, we do not restate prior financial statements. We will record a cumulative effect of initially applying the provisions of the new standard as an adjustment to increase the opening retained earnings balance and reduce the opening deferred revenue balance. Further, some of our enterprise agreements allow our customers to commit to prepaid bank of funds which can be utilized to purchase Adobe products or services, which includes customer option to purchase or renew on-premise term-based licenses on a monthly basis. Revenue associated with these term-license performance obligations would be recognized monthly.

Other expected impacts to our policies and disclosures include: earlier recognition of revenue for certain contracts due to the elimination of contingent revenue limitations, an unbilled receivable balance on our balance sheets, the requirement to estimate variable consideration for certain arrangements, increased allocation of revenue to and from professional services and other offerings, and changes to our financial statement disclosures such as remaining performance obligations.

Under current GAAP, we expense costs related to the acquisition of revenue-generating contracts as incurred. Under the new standard, we will be required to capitalize certain costs incremental to contract acquisition and amortize them over the expected period of benefit. We expect there will be a material balance sheet impact at the period of adoption to capitalize costs of obtaining the contract as an asset, with a corresponding adjustment to opening retained earnings at the date of initial adoption. Additionally, we may have to record related deferred income taxes. We continue to evaluate the magnitude of the impact and the impact recent acquisitions will have under current standards and the new standard.

Due to the complexity of certain of our contracts, the actual accounting treatment required under the new standard for these arrangements may be dependent on contract-specific terms and therefore may vary in some instances.

On February 24, 2016, the FASB issued ASU No. 2016-02, Leases, requiring lessees to recognize a right-of-use asset and a lease liability on the balance sheet for all leases with the exception of short-term leases with a lease term of twelve months or less. For lessees, leases will continue to be classified as either operating or finance leases in the income statement. Lessor accounting is similar to the current model but updated to align with certain changes to the lessee model. Lessors will continue to classify leases as operating, direct financing or sales-type leases. The effective date of the new leases standard for public companies is for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted. The updated standard is effective for us beginning in the first quarter of fiscal 2020 and we do not plan to early adopt.

The new leases standard must be adopted using a modified retrospective transition and allows for the application of the new guidance at the beginning of the earliest comparative period presented or at the adoption date. In July 2018, the FASB issued ASU No. 2018-11, Leases - Targeted Improvements, providing an optional transition method that allows entities to initially apply the new leases standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. We intend to adopt the new leases standard using this optional transition method.

While we are continuing to assess the potential impacts of the standard, we currently expect the most significant impact will be the recognition of right-of-use assets and lease liabilities on our consolidated balance sheet.

We are implementing a new lease accounting system and updating our processes in preparation for the adoption of the new leases standard.

On August 28, 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging, requiring expanded hedge accounting for both non-financial and financial risk components and refining the measurement of hedge results to better reflect an entity's hedging strategies. For example, adoption would result in reclassification of hedge costs from foreign currency hedges from interest and other income (expense), net to revenue in our Consolidated Statements of Income. The updated standard also amends the presentation and disclosure requirements and changes how entities assess hedge effectiveness. The effective date of the new standard for public companies is for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted. The new standard must be adopted using a modified retrospective transition with a cumulative effect adjustment recorded to opening retained earnings as of the initial adoption date. The updated standard is effective for us beginning in the first quarter of fiscal 2020. We are currently evaluating the effect that the updated standard will have on our Consolidated Financial Statements and related disclosures. While we are continuing to assess all potential impacts of the new standard, we believe there should not be a material impact on our Consolidated Financial Statements.

With the exception of the new standards discussed above, there have been no other new accounting pronouncements that have significance, or potential significance, to our Consolidated Financial Statements.

**NOTE 2. ACQUISITIONS**

*Marketo*

On October 31, 2018, we completed the acquisition of Marketo, a privately held marketing cloud platform company, for approximately $4.74 billion of cash consideration. Adding Marketo's engagement platform to Adobe Experience Cloud furthers our long-term plan for strategic growth in the Digital Experience segment and enables us to offer a comprehensive set of solutions to enable customers across industries and companies automate and orchestrate their marketing activities. Under the terms of the Share Purchase Agreement (the "Purchase Agreement"), we acquired all of the issued and outstanding shares of capital stock of Milestone Topco, Inc., a Delaware corporation ("Topco") and indirect parent company of Marketo, and other equity interests in Marketo. In connection with the acquisition, each Marketo equity award that was issued and outstanding was cancelled and extinguished in exchange for cash consideration. Also pursuant to the Purchase Agreement, upon closing of the transaction, cash was paid for the settlement of Marketo's long-term incentive plan, the settlement of Marketo's indebtedness and the acquisition of all remaining equity interests in Marketo K.K., a Japanese corporation and joint venture.

In connection with the acquisition of Marketo, we entered into a credit agreement providing for a $2.25 billion senior unsecured term loan (the "Term Loan"). The proceeds of the Term Loan were used to (i) fund a portion of the purchase price of the acquisition and (ii) to pay fees and expenses incurred in connection with the acquisition. The Term Loan funds were received on October 31, 2018 upon closing of the acquisition and will mature 18 months following the initial funding date. *See Note 15 for further details regarding our debt.*

Following the closing, we began integrating Marketo into our Digital Experience reportable segment. We have included the financial results of Marketo in our Consolidated Financial Statements beginning on the acquisition date. The amounts of net revenue and net loss of Marketo included in the Company's Consolidated Statements of Income from the acquisition date through November 30, 2018 were not material. The direct transaction costs associated with the acquisition were also not material.

*Purchase Price Allocation*

Under the purchase accounting method, the total preliminary purchase price was allocated to Marketo's net tangible and intangible assets based upon their estimated fair values as of the acquisition date. The excess purchase price over the value of the net tangible and identifiable intangible assets was recorded as goodwill.

**ADOBE INC.**

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

The table below represents the preliminary purchase price allocation to the acquired net tangible and intangible assets of Marketo based on their estimated fair values as of the acquisition date and the associated estimated useful lives at that date. The fair values assigned to assets acquired and liabilities assumed are based on management's best estimates and assumptions as of the reporting date and are considered preliminary pending finalization of valuation analyses pertaining to intangible assets acquired, deferred revenue and tax liabilities assumed including the calculation of deferred tax assets and liabilities.

| *(in thousands)* | Amount | Weighted Average Useful Life (years) |
|---|---|---|
| Customer contracts and relationships | $ 576,900 | 11 |
| Purchased technology | 444,500 | 7 |
| Backlog | 105,800 | 2 |
| Non-competition agreements | 12,100 | 2 |
| Trademarks | 328,500 | 9 |
| Total identifiable intangible assets | 1,467,800 | |
| Net liabilities assumed | (191,288) | N/A |
| Goodwill [(1)] | 3,459,751 | N/A |
| Total estimated purchase price | $ 4,736,263 | |

(1) Non-deductible for tax-purposes.

*Identifiable intangible assets*—Customer relationships consist of Marketo's contractual relationships and customer loyalty related to their enterprise and commercial customers as well as technology partner relationships. The estimated fair value of the customer contracts and relationships was determined based on projected cash flows attributable to the asset. Purchased technology acquired primarily consists of Marketo's cloud-based engagement marketing software platform. The estimated fair value of the purchased technology was determined based on the expected future cost savings resulting from ownership of the asset. Backlog relates to subscription contracts and professional services. Non-compete agreements include agreements with key Marketo employees that preclude them from competing against Marketo for a period of two years from the acquisition date. Trademarks include the Marketo trade name, which is well known in the marketing ecosystem. We amortize the fair value of these intangible assets on a straight-line basis over their respective estimated useful lives.

*Goodwill*—Approximately $3.46 billion has been allocated to goodwill, and has been allocated in full to the Digital Experience reportable segment. Goodwill represents the excess of the purchase price over the fair value of the underlying acquired net tangible and intangible assets. The factors that contributed to the recognition of goodwill included securing buyer-specific synergies that increase revenue and profits and are not otherwise available to a marketplace participant, acquiring a talented workforce and cost savings opportunities.

*Net liabilities assumed* —Marketo's tangible assets and liabilities as of October 31, 2018 were reviewed and adjusted to their fair value as necessary. The net liabilities assumed included, among other items, $100.1 million in accrued expenses, $74.8 million in deferred revenue and $182.6 million in deferred tax liabilities, which were partially offset by $54.9 million in cash and cash equivalents and $72.4 million in trade receivables acquired.

*Deferred revenue*—Included in net liabilities assumed is Marketo's deferred revenue which represents advance payments from customers related to subscription contracts and professional services. We estimated our obligation related to the deferred revenue using the cost build-up approach. The cost build-up approach determines fair value by estimating the direct and indirect costs related to supporting the obligation plus an assumed operating margin. The sum of the costs and assumed operating profit approximates, in theory, the amount that Marketo would be required to pay a third party to assume the obligation. The estimated costs to fulfill the obligation were based on the near-term projected cost structure for subscription and professional services. As a result, we recorded an adjustment to reduce

Marketo’s carrying value of deferred revenue to $74.8 million, which represents our estimate of the fair value of the contractual obligations assumed based on a preliminary valuation.

*Taxes*—As part of our accounting for the Marketo acquisition, a portion of the overall purchase price was allocated to goodwill and acquired intangible assets. Amortization expense associated with acquired intangible assets is not deductible for tax purposes. Thus, approximately $348.8 million, included in the net liabilities assumed, was established as a deferred tax liability for the future amortization of the intangible assets, and was partially offset by other tax assets of $166.2 million, which primarily consist of net operating loss carryforwards.

Any impairment charges made in the future associated with goodwill will not be tax deductible and will result in an increased effective income tax rate in the quarter the impairment is recorded.

*Unaudited Pro Forma Results*

The financial information in the table below summarizes the combined results of operations of Adobe and Marketo, on a pro forma basis, as though the companies had been combined as of the beginning of the periods presented. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place on December 3, 2016 or of results that may occur in the future.

The following unaudited pro forma financial information for fiscal 2018 and 2017 combines the historical results for Adobe for the years ended November 30, 2018 and December 1, 2017 and the historical results of Marketo for the period January 1, 2018 through October 31, 2018 and the year ended December 31, 2017, respectively (in thousands):

| | 2018 | 2017 |
|---|---|---|
| Net revenues | $ 9,338,790 | $ 7,568,713 |
| Net income | $ 2,362,238 | $ 1,404,864 |

*Magento*

On June 18, 2018, we completed our acquisition of Magento, a privately held commerce platform company. During the third quarter of fiscal 2018, we began integrating Magento into our Digital Experience reportable segment.

The table below represents the preliminary purchase price allocation to the acquired net tangible and intangible assets of Magento based on their estimated fair values as of the acquisition date and the associated estimated useful lives at that date. The fair values assigned to assets acquired and liabilities assumed are based on management's best estimates and assumptions as of the reporting date and are considered preliminary pending finalization of valuation analyses pertaining to tax liabilities assumed including the calculation of deferred tax assets and liabilities.

| *(in thousands)* | Amount | Weighted Average Useful Life (years) |
|---|---|---|
| Customer contracts and relationships | $ 208,000 | 8 |
| Purchased technology | 84,200 | 5 |
| In-process research and development [(1)] | 39,100 | N/A |
| Trademarks | 21,100 | 3 |
| Other intangibles | 43,400 | 3 |
| Total identifiable intangible assets | 395,800 | |
| Net liabilities assumed | (67,417) | N/A |
| Goodwill [(2)] | 1,316,217 | N/A |
| Total estimated purchase price | $ 1,644,601 | |

---

(1) Capitalized as purchased technology and are considered indefinite lived until the completion or abandonment of the associated research and development efforts.

(2) Non-deductible for tax-purposes.

Pro forma information has not been presented for the Magento acquisition as the impact to our Consolidated Financial Statements was not material.

*TubeMogul*

On December 19, 2016, we completed our acquisition of TubeMogul, a publicly held video advertising platform company. As of the end of fiscal 2018, we have integrated TubeMogul into our Digital Experience reportable segment.

Under the acquisition method of accounting, the total final purchase price was allocated to TubeMogul's net tangible and intangible assets based upon their estimated fair values as of December 19, 2016. During fiscal 2017, we recorded immaterial purchase accounting adjustments based on changes to management's estimates and assumptions in regards to tangible assets, liabilities assumed, and their related impact to goodwill. The total final purchase price for TubeMogul was $560.8 million of which $348.4 million was allocated to goodwill that was non-deductible for tax purposes, $113.1 million to identifiable intangible assets and $99.3 million to net assets acquired.

Pro forma information has not been presented for the TubeMogul acquisition as the impact to our Consolidated Financial Statements was not material.

*Other*

We also completed other immaterial business acquisitions during the fiscal years presented. Pro forma information has not been presented for these acquisitions as the impact to our Consolidated Financial Statements was not material.

*Allegorithmic*

Subsequent to November 30, 2018, we acquired the remaining interest in Allegorithmic SAS ("Allegorithmic"), a privately held 3D editing and authoring software company for gaming and entertainment, for approximately $105.0 million in cash consideration. The initial purchase accounting for this transaction has not yet been completed given the short period of time between the acquisition date and the issuance of these financial statements. Allegorithmic will be integrated into our Digital Media reportable segment for financial reporting purposes in the first quarter of fiscal 2019.

## NOTE 3. CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

Cash equivalents consist of instruments with remaining maturities of three months or less at the date of purchase. We classify all of our cash equivalents and short-term investments as "available-for-sale." In general, these investments are free of trading restrictions. We carry these investments at fair value, based on quoted market prices or other readily available market information. Unrealized gains and losses, net of taxes, are included in accumulated other comprehensive income (loss), which is reflected as a separate component of stockholders' equity in our Consolidated Balance Sheets. Gains and losses are recognized when realized in our Consolidated Statements of Income. When we have determined that an other-than-temporary decline in fair value has occurred, the amount of the decline that is related to a credit loss is recognized in income. Gains and losses are determined using the specific identification method.

**ADOBE INC.**

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

Cash, cash equivalents and short-term investments consisted of the following as of November 30, 2018 (in thousands):

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Current assets: | | | | |
| Cash | $ 368,564 | $ — | $ — | $ 368,564 |
| Cash equivalents: | | | | |
| Money market mutual funds | 1,234,188 | — | — | 1,234,188 |
| Time deposits | 40,023 | — | — | 40,023 |
| Total cash equivalents | 1,274,211 | — | — | 1,274,211 |
| Total cash and cash equivalents | 1,642,775 | — | — | 1,642,775 |
| Short-term fixed income securities: | | | | |
| Asset-backed securities | 41,875 | — | (367) | 41,508 |
| Corporate debt securities | 1,546,860 | 44 | (24,696) | 1,522,208 |
| Foreign government securities | 4,179 | — | (24) | 4,155 |
| Municipal securities | 18,601 | 1 | (286) | 18,316 |
| Total short-term investments | 1,611,515 | 45 | (25,373) | 1,586,187 |
| Total cash, cash equivalents and short-term investments | $ 3,254,290 | $ 45 | $ (25,373) | $ 3,228,962 |

Cash, cash equivalents and short-term investments consisted of the following as of December 1, 2017 (in thousands):

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Current assets: | | | | |
| Cash | $ 280,488 | $ — | $ — | $ 280,488 |
| Cash equivalents: | | | | |
| Money market mutual funds | 2,006,741 | — | — | 2,006,741 |
| Time deposits | 18,843 | — | — | 18,843 |
| Total cash equivalents | 2,025,584 | — | — | 2,025,584 |
| Total cash and cash equivalents | 2,306,072 | — | — | 2,306,072 |
| Short-term fixed income securities: | | | | |
| Asset-backed securities | 98,403 | 1 | (403) | 98,001 |
| Corporate debt securities | 2,461,691 | 2,694 | (10,125) | 2,454,260 |
| Foreign government securities | 2,396 | — | (8) | 2,388 |
| Municipal securities | 21,189 | 8 | (132) | 21,065 |
| U.S. Treasury securities | 941,538 | 2 | (3,552) | 937,988 |
| Total short-term investments | 3,525,217 | 2,705 | (14,220) | 3,513,702 |
| Total cash, cash equivalents and short-term investments | $ 5,831,289 | $ 2,705 | $ (14,220) | $ 5,819,774 |

*See Note 4 for further information regarding the fair value of our financial instruments.*

**ADOBE INC.**

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

The following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category, that have been in an unrealized loss position for less than twelve months, as of November 30, 2018 and December 1, 2017 (in thousands):

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Corporate debt securities | $ 538,109 | $ (7,966) | $ 1,338,232 | $ (5,459) |
| Asset-backed securities | 6,696 | (54) | 64,618 | (193) |
| Municipal securities | 6,599 | (81) | 11,805 | (115) |
| Foreign government securities | — | — | 2,388 | (8) |
| U.S. Treasury securities | — | — | 593,296 | (2,087) |
| Total | $ 551,404 | $ (8,101) | $ 2,010,339 | $ (7,862) |

There were 369 securities and 894 securities in an unrealized loss position for less than twelve months at November 30, 2018 and at December 1, 2017, respectively.

The following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category, that were in a continuous unrealized loss position for more than twelve months, as of November 30, 2018 and December 1, 2017 (in thousands):

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Corporate debt securities | $ 969,701 | $ (16,730) | $ 500,689 | $ (4,666) |
| Asset-backed securities | 34,812 | (313) | 32,383 | (210) |
| Municipal securities | 11,532 | (205) | 598 | (17) |
| Foreign government securities | 4,154 | (24) | — | — |
| U.S. Treasury securities | — | — | 338,950 | (1,465) |
| Total | $ 1,020,199 | $ (17,272) | $ 872,620 | $ (6,358) |

There were 577 securities and 360 securities in an unrealized loss position for more than twelve months at November 30, 2018 and at December 1, 2017, respectively.

The following table summarizes the cost and estimated fair value of short-term fixed income securities classified as short-term investments based on stated effective maturities as of November 30, 2018 (in thousands):

| | Amortized Cost | Estimated Fair Value |
|---|---|---|
| Due within one year | $ 615,867 | $ 612,104 |
| Due between one and two years | 574,554 | 564,199 |
| Due between two and three years | 289,033 | 282,144 |
| Due after three years | 132,061 | 127,740 |
| Total | $ 1,611,515 | $ 1,586,187 |

We review our debt and marketable equity securities classified as short-term investments on a regular basis to evaluate whether or not any security has experienced an other-than-temporary decline in fair value. We consider factors such as the length of time and extent to which the market value has been less than the cost, the financial condition and near-term prospects of the issuer and our intent to sell, or whether it is more likely than not we will be required to sell the investment before recovery of the investment's amortized cost basis. If we believe that an other-than-temporary decline exists in one of these securities, we write down these investments to fair value. For debt securities, the portion of the write-down related to credit loss would be recorded to interest and other income, net in our Consolidated Statements of Income. Any portion not related to credit loss would be recorded to accumulated other comprehensive income (loss), which is reflected as a separate component of stockholders' equity in our Consolidated Balance Sheets. For equity securities, the write-down would be recorded to investment gains (losses), net in our Consolidated Statements of Income. During fiscal 2018 and 2017, we did not consider any of our investments to be other-than-temporarily impaired. During fiscal 2016, we recorded immaterial other-than-temporary impairment losses associated with certain of our fixed income securities and wrote down the securities to fair value.

## NOTE 4. FAIR VALUE MEASUREMENTS

*Assets and Liabilities Measured and Recorded at Fair Value on a Recurring Basis*

We measure certain financial assets and liabilities at fair value on a recurring basis. There have been no transfers between fair value measurement levels during the year ended November 30, 2018.

The fair value of our financial assets and liabilities at November 30, 2018 was determined using the following inputs (in thousands):

| | Fair Value Measurements at Reporting Date Using | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Money market mutual funds | $ 1,234,188 | $ 1,234,188 | $ — | $ — |
| Time deposits | 40,023 | 40,023 | — | — |
| Short-term investments: | | | | |
| Asset-backed securities | 41,508 | — | 41,508 | — |
| Corporate debt securities | 1,522,208 | — | 1,522,208 | — |
| Foreign government securities | 4,155 | — | 4,155 | — |
| Municipal securities | 18,316 | — | 18,316 | — |
| Prepaid expenses and other current assets: | | | | |
| Foreign currency derivatives | 44,259 | — | 44,259 | — |
| Other assets: | | | | |
| Deferred compensation plan assets | 68,988 | 3,895 | 65,093 | — |
| Total assets | $ 2,973,645 | $ 1,278,106 | $ 1,695,539 | $ — |
| | | | | |
| Liabilities: | | | | |
| Accrued expenses: | | | | |
| Foreign currency derivatives | $ 816 | $ — | $ 816 | $ — |
| Other liabilities: | | | | |
| Interest rate swap derivatives | 9,744 | — | 9,744 | — |
| Total liabilities | $ 10,560 | $ — | $ 10,560 | $ — |

**ADOBE INC.**

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

The fair value of our financial assets and liabilities at December 1, 2017 was determined using the following inputs (in thousands):

| | Fair Value Measurements at Reporting Date Using | | | |
|---|---|---|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Money market mutual funds | $ 2,006,741 | $ 2,006,741 | $ — | $ — |
| Time deposits | 18,843 | 18,843 | — | — |
| Short-term investments: | | | | |
| Asset-backed securities | 98,001 | — | 98,001 | — |
| Corporate debt securities | 2,454,260 | — | 2,454,260 | — |
| Foreign government securities | 2,388 | — | 2,388 | — |
| Municipal securities | 21,065 | — | 21,065 | — |
| U.S. Treasury securities | 937,988 | — | 937,988 | — |
| Prepaid expenses and other current assets: | | | | |
| Foreign currency derivatives | 14,198 | — | 14,198 | — |
| Other assets: | | | | |
| Deferred compensation plan assets | 56,690 | 2,573 | 54,117 | — |
| Total assets | $ 5,610,174 | $ 2,028,157 | $ 3,582,017 | $ — |
| | | | | |
| Liabilities: | | | | |
| Accrued expenses: | | | | |
| Foreign currency derivatives | $ 1,598 | $ — | $ 1,598 | $ — |
| Other liabilities: | | | | |
| Interest rate swap derivatives | 1,058 | — | 1,058 | — |
| Total liabilities | $ 2,656 | $ — | $ 2,656 | $ — |

*See Note 3 for further information regarding the fair value of our financial instruments.*

Our fixed income available-for-sale debt securities consist of high quality, investment grade securities from diverse issuers with a weighted average credit rating of A+. We value these securities based on pricing from independent pricing vendors who use matrix pricing valuation techniques including market approach methodologies that model information generated by market transactions involving identical or comparable assets, as well as discounted cash flow methodologies. Inputs include quoted prices in active markets for identical assets or inputs other than quoted prices that are observable either directly or indirectly in determining fair value, including benchmark yields, issuer spreads off benchmark yields, interest rates and U.S. Treasury or swap curves. We therefore classify all of our fixed income available-for-sale securities as Level 2. We perform routine procedures such as comparing prices obtained from multiple independent sources to ensure that appropriate fair values are recorded.

The fair values of our money market mutual funds and time deposits are based on the closing price of these assets as of the reporting date. We classify our money market mutual funds and time deposits as Level 1.

Our Level 2 over-the-counter foreign currency and interest rate swap derivatives are valued using pricing models and discounted cash flow methodologies based on observable foreign exchange and interest rate data at the measurement date.

Our deferred compensation plan assets consist of money market mutual funds and other mutual funds.

*Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis*

We also have direct investments in privately held companies accounted for under the cost and equity method, which are periodically assessed for other-than-temporary impairment. If we determine that an other-than-temporary impairment has occurred, we write down the investment to its fair value. We estimate fair value of our cost and equity method investments considering available information such as pricing in recent rounds of financing, current cash positions, earnings and cash flow forecasts, recent operational performance and any other readily available market data. During fiscal 2018 and 2017, we determined there were no other-than-temporary impairments on our cost and equity method investments. During fiscal 2016, we determined there were immaterial other-than-temporary impairments on certain of our cost method investments and wrote down the investments to fair value.

The fair value of our senior notes was $1.89 billion as of November 30, 2018, based on observable market prices in less active markets and categorized as Level 2. *See Note 15 for further details regarding our debt.*

## NOTE 5. DERIVATIVES AND HEDGING ACTIVITIES

*Hedge Accounting and Hedging Programs*

We recognize derivative instruments and hedging activities as either assets or liabilities in our Consolidated Balance Sheets and measure them at fair value. Gains and losses resulting from changes in fair value are accounted for depending on the use of the derivative and whether it is designated and qualifies for hedge accounting.

We evaluate hedge effectiveness at the inception of the hedge prospectively as well as retrospectively, and record any ineffective portion of the hedging instruments in interest and other income (expense), net on our Consolidated Statements of Income. The net gain (loss) recognized in interest and other income (expense), net for cash flow hedges due to hedge ineffectiveness was insignificant for all fiscal years presented. The time value of purchased contracts is recorded in interest and other income (expense), net in our Consolidated Statements of Income.

The bank counterparties to these contracts expose us to credit-related losses in the event of their nonperformance which are largely mitigated with collateral security agreements that provide for collateral to be received or posted when the net fair value of certain financial instruments fluctuates from contractually established thresholds. In addition, we enter into master netting arrangements which have the ability to further limit credit-related losses with the same counterparty by permitting net settlement of transactions.

*Balance Sheet Hedging—Hedges of Foreign Currency Assets and Liabilities*

We also hedge our net recognized foreign currency denominated assets and liabilities with foreign exchange forward contracts to reduce the risk that the value of these assets and liabilities will be adversely affected by changes in exchange rates. These contracts hedge assets and liabilities that are denominated in foreign currencies and are carried at fair value with changes in the fair value recorded to interest and other income (expense), net in our Consolidated Statements of Income. These contracts do not subject us to material balance sheet risk due to exchange rate movements because gains and losses on these derivatives are intended to offset gains and losses on the assets and liabilities being hedged.

As of November 30, 2018, total notional amounts of outstanding contracts were $427.9 million which included the notional equivalent of $158.8 million in Euros, $51.5 million in British Pounds, $77.2 million in Japanese Yen, $50.7 million in Indian Rupees, and $89.7 million in other foreign currencies. As of December 1, 2017, total notional amounts of outstanding contracts were $333.9 million which included the notional equivalent of $105.0 million in Euros, $34.6 million in British Pounds, $45.4

million in Japanese Yen, $78.0 million in Indian Rupees, and $70.9 million in other foreign currencies. At November 30, 2018 and December 1, 2017, the outstanding balance sheet hedging derivatives had maturities of 180 days or less.

*Cash Flow Hedging—Hedges of Forecasted Foreign Currency Revenue*

In countries outside the United States, we transact business in U.S. Dollars and in various other currencies. We may use foreign exchange option contracts or forward contracts to hedge certain cash flow exposures resulting from changes in these foreign currency exchange rates. These foreign exchange contracts, carried at fair value, have maturities of up to twelve months. We enter into these foreign exchange contracts to hedge a portion of our forecasted foreign currency denominated revenue in the normal course of business and accordingly, they are not speculative in nature.

To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge, and the hedges must be highly effective in offsetting changes to future cash flows on hedged transactions. We record changes in the intrinsic value of these cash flow hedges in accumulated other comprehensive income (loss) in our Consolidated Balance Sheets, until the forecasted transaction occurs. When the forecasted transaction occurs, we reclassify the related gain or loss on the cash flow hedge to revenue. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, we reclassify the gain or loss on the related cash flow hedge from accumulated other comprehensive income (loss) to interest and other income (expense), net in our Consolidated Statements of Income at that time. If we do not elect hedge accounting, or the contract does not qualify for hedge accounting treatment, the changes in fair value from period to period are recorded in interest and other income (expense), net in our Consolidated Statements of Income.

For fiscal 2018, 2017, and 2016, there were no net gains or losses recognized in other income relating to hedges of forecasted transactions that did not occur.

*Fair Value Hedging—Hedges of Interest Rate Risks*

During the third quarter of fiscal 2014, we entered into interest rate swaps designated as a fair value hedge related to our $900 million of 4.75% fixed interest rate senior notes due February 1, 2020 (the "2020 Notes"). In effect, the interest rate swaps convert the fixed interest rate on our 2020 Notes to a floating interest rate based on the London Interbank Offered Rate ("LIBOR"). Under the terms of the swaps, we will pay monthly interest at the one-month LIBOR rate plus a fixed number of basis points on the $900 million notional amount through February 1, 2020. In exchange, we will receive 4.75% fixed rate interest from the swap counterparties. *See Note 15 for further details regarding our debt.*

The interest rate swaps are accounted for as fair value hedges and substantially offset the changes in fair value of the hedged portion of the underlying debt that are attributable to the changes in market risk. Therefore, the gains and losses related to changes in the fair value of the interest rate swaps are included in interest and other income (expense), net in our Consolidated Statements of Income. The fair value of the interest rate swaps is reflected in other liabilities or other assets in our Consolidated Balance Sheets.

The fair value of derivative instruments on our Consolidated Balance Sheets as of November 30, 2018 and December 1, 2017 were as follows (in thousands):

| | 2018 | | 2017 | |
|---|---|---|---|---|
| | Fair Value Asset Derivatives | Fair Value Liability Derivatives | Fair Value Asset Derivatives | Fair Value Liability Derivatives |
| Derivatives designated as hedging instruments: | | | | |
| Foreign exchange option contracts [1][2] | $ 40,191 | $ — | $ 12,918 | $ — |
| Interest rate swap [3] | — | 9,744 | — | 1,058 |
| Derivatives not designated as hedging instruments: | | | | |
| Foreign exchange forward contracts [1] | 4,068 | 816 | 1,280 | 1,598 |

| | | | | |
|---|---|---|---|---|
| Total derivatives | $ 44,259 | $ 10,560 | $ 14,198 | $ 2,656 |

**ADOBE INC.**

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

(1) Included in prepaid expenses and other current assets and accrued expenses for asset derivatives and liability derivatives, respectively, on our Consolidated Balance Sheets.

(2) Hedging effectiveness expected to be recognized to income within the next twelve months.

(3) Included in other liabilities on our Consolidated Balance Sheets.

The effect of foreign currency derivative instruments designated as cash flow hedges and of foreign currency derivative instruments not designated as hedges in our Consolidated Statements of Income for fiscal 2018, 2017 and 2016 were as follows (in thousands):

| | 2018 | | 2017 | | 2016 | |
|---|---|---|---|---|---|---|
| | Foreign Exchange Option Contracts | Foreign Exchange Forward Contracts | Foreign Exchange Option Contracts | Foreign Exchange Forward Contracts | Foreign Exchange Option Contracts | Foreign Exchange Forward Contracts |
| Derivatives in cash flow hedging relationships: | | | | | | |
| Net gain (loss) recognized in other comprehensive income, net of tax[1] | $ 74,080 | $ — | $ 6,917 | $ — | $ 36,511 | $ — |
| Net gain (loss) reclassified from accumulated other comprehensive income into income, net of tax[2] | $ 48,647 | $ — | $ 32,852 | $ — | $ 18,823 | $ — |
| Net gain (loss) recognized in income[3] | $ (41,179) | $ — | $ (30,243) | $ — | $ (29,169) | $ — |
| Derivatives not designated as hedging relationships: | | | | | | |
| Net gain (loss) recognized in income[4] | $ — | $ 1,529 | $ — | $ 6,586 | $ — | $ (1,308) |

(1) Net change in the fair value of the effective portion classified in other comprehensive income ("OCI").

(2) Effective portion classified as revenue.

(3) Ineffective portion and amount excluded from effectiveness testing classified in interest and other income (expense), net.

(4) Classified in interest and other income (expense), net.

Net gains (losses) recognized in interest and other income (expense), net relating to balance sheet hedging for fiscal 2018, 2017 and 2016 were as follows (in thousands):

| | 2018 | 2017 | 2016 |
|---|---|---|---|
| Gain (loss) on foreign currency assets and liabilities: | | | |
| Net realized gain (loss) recognized in other income | $ 882 | $ (6,142) | $ 832 |
| Net unrealized gain (loss) recognized in other income | (3,843) | (907) | (6,070) |
| | (2,961) | (7,049) | (5,238) |
| Gain (loss) on hedges of foreign currency assets and liabilities: | | | |
| Net realized gain (loss) recognized in other income | (2,042) | 5,415 | 174 |
| Net unrealized gain (loss) recognized in other income | 3,571 | 1,171 | (1,482) |
| | 1,529 | 6,586 | (1,308) |
| Net gain (loss) recognized in interest and other income (expense), net | $ (1,432) | $ (463) | $ (6,546) |

## NOTE 6. PROPERTY AND EQUIPMENT

Property and equipment, net consisted of the following as of November 30, 2018 and December 1, 2017 (in thousands):

| | 2018 | 2017 |
|---|---|---|
| Computers and equipment | $ 1,239,033 | $ 1,128,264 |
| Furniture and fixtures | 121,206 | 115,273 |
| Capital projects in-progress | 23,026 | 5,575 |
| Leasehold improvements | 181,990 | 120,165 |
| Land | 145,065 | 77,723 |
| Buildings | 485,024 | 490,665 |
| Building improvements | 285,564 | 265,829 |
| Total | 2,480,908 | 2,203,494 |
| Less accumulated depreciation and amortization | (1,405,836) | (1,266,518) |
| Property and equipment, net | $ 1,075,072 | $ 936,976 |

Depreciation and amortization expense of property and equipment for fiscal 2018, 2017 and 2016 was $157.1 million, $156.9 million and $157.6 million, respectively.

In March 2017, we exercised our option to purchase the Almaden Tower for a total purchase price of $103.6 million. We capitalized the Almaden Tower as property and equipment on our Consolidated Balance Sheets at $104.2 million, the lesser of cost or fair value, which represented the total purchase price plus other direct costs associated with the purchase.

## NOTE 7. GOODWILL AND PURCHASED AND OTHER INTANGIBLES

Goodwill by reportable segment and activity for the years ended November 30, 2018 and December 1, 2017 was as follows (in thousands):

| | 2016 | Acquisitions | Other[(1)] | 2017 | Acquisitions | Other[(1)] | 2018 |
|---|---|---|---|---|---|---|---|
| Digital Media | $ 2,796,590 | $ — | $ 4,501 | $ 2,801,091 | $ — | $ (2,481) | $ 2,798,610 |
| Digital Experience | 2,351,462 | 348,352 | 62,232 | 2,762,046 | 4,791,216 | (29,246) | 7,524,016 |
| Publishing | 258,422 | — | 2 | 258,424 | — | (2) | 258,422 |
| Goodwill | $ 5,406,474 | $ 348,352 | $ 66,735 | $ 5,821,561 | $ 4,791,216 | $ (31,729) | $ 10,581,048 |

(1) Amounts primarily consist of foreign currency translation adjustments.

Purchased and other intangible assets by reportable segment as of November 30, 2018 and December 1, 2017 were as follows (in thousands):

| | 2018 | 2017 |
|---|---|---|
| Digital Media | $ 408,602 | $ 128,243 |
| Digital Experience | 1,660,396 | 257,408 |
| Publishing | 3 | 7 |
| Purchased and other intangible assets, net | $ 2,069,001 | $ 385,658 |

Purchased and other intangible assets as of November 30, 2018 and December 1, 2017 were as follows (in thousands):

| | 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated Amortization | Net | Cost | Accumulated Amortization | Net |
| Purchased technology | $ 750,286 | $ (118,812) | $ 631,474 | $ 223,252 | $ (110,433) | $ 112,819 |
| Customer contracts and relationships | $ 1,329,432 | $ (416,176) | $ 913,256 | $ 577,484 | $ (356,613) | $ 220,871 |
| Trademarks | 384,855 | (25,968) | 358,887 | 76,255 | (56,094) | 20,161 |
| Acquired rights to use technology | 58,966 | (48,770) | 10,196 | 71,130 | (54,223) | 16,907 |
| Backlog | 147,300 | (13,299) | 134,001 | 4,813 | (3,037) | 1,776 |
| Other intangibles | 51,096 | (29,909) | 21,187 | 34,483 | (21,359) | 13,124 |
| Total other intangible assets | $ 1,971,649 | $ (534,122) | $ 1,437,527 | $ 764,165 | $ (491,326) | $ 272,839 |
| Purchased and other intangible assets, net | $ 2,721,935 | $ (652,934) | $ 2,069,001 | $ 987,417 | $ (601,759) | $ 385,658 |

In fiscal 2018 and 2017, certain purchased intangibles associated with our acquisitions in prior years became fully amortized and were removed from the Consolidated Balance Sheets.

Amortization expense related to purchased and other intangible assets was $182.6 million, $153.6 million, and $152.4 million for fiscal 2018, 2017 and 2016 respectively. Of these amounts, $91.3 million, $76.1 million, and $71.1 million were included in cost of sales for fiscal 2018, 2017 and 2016 respectively.

Purchased and other intangible assets are amortized over their estimated useful lives of 1 to 14 years. As of November 30, 2018, we expect amortization expense in future periods to be as follows (in thousands):

| Fiscal Year | Purchased Technology (*) | Other Intangible Assets |
|---|---|---|
| 2019 | $ 114,445 | $ 270,588 |
| 2020 | 112,153 | 233,064 |
| 2021 | 89,783 | 146,541 |
| 2022 | 82,119 | 132,188 |
| 2023 | 72,166 | 132,046 |
| Thereafter | 121,708 | 523,100 |
| Total expected amortization expense | $ 592,374 | $ 1,437,527 |

(*) Excludes $39.1 million of capitalized in-process research and development which are considered indefinite lived until the completion or abandonment of the associated research and development efforts

## NOTE 8. ACCRUED EXPENSES

Accrued expenses as of November 30, 2018 and December 1, 2017 consisted of the following (in thousands):

| | 2018 | 2017 |
|---|---|---|
| Accrued compensation and benefits | $ 313,874 | $ 256,862 |
| Accrued bonuses | 216,007 | 160,880 |
| Accrued media costs | 124,849 | 134,525 |
| Sales and marketing allowances | 44,968 | 47,389 |
| Accrued corporate marketing | 66,186 | 72,087 |
| Taxes payable | 57,525 | 49,550 |
| Royalties payable | 51,529 | 46,411 |
| Accrued interest expense | 29,481 | 25,594 |
| Other | 258,766 | 200,475 |
| Accrued expenses | $ 1,163,185 | $ 993,773 |

Accrued media costs primarily relate to our advertising platform offerings. We accrue for media costs related to impressions purchased from third-party ad inventory sources. Other primarily includes general corporate accruals for local and regional expenses. Other is also comprised of deferred rent related to office locations with rent escalations and foreign currency liability derivatives.

## NOTE 9. INCOME TAXES

Income before income taxes for fiscal 2018, 2017 and 2016 consisted of the following (in thousands):

| | 2018 | 2017 | 2016 |
|---|---|---|---|
| Domestic | $ 542,948 | $ 1,056,156 | $ 805,749 |
| Foreign | 2,250,928 | 1,081,485 | 629,389 |
| Income before income taxes | $ 2,793,876 | $ 2,137,641 | $ 1,435,138 |

The provision for income taxes for fiscal 2018, 2017 and 2016 consisted of the following (in thousands):

| | 2018 | 2017 | 2016 |
|---|---|---|---|
| Current: | | | |
| United States federal | $ 501,272 | $ 298,802 | $ 94,396 |
| Foreign | 140,308 | 60,962 | 59,749 |
| State and local | 28,612 | 33,578 | 15,222 |
| Total current | 670,192 | 393,342 | 169,367 |
| Deferred: | | | |
| United States federal | (466,113) | 48,905 | 33,924 |
| Foreign | (9,734) | (4,242) | (2,751) |
| State and local | 8,757 | 5,682 | (9,287) |
| Total deferred | (467,090) | 50,345 | 21,886 |
| Tax expense attributable to employee stock plans | — | — | 75,103 |
| Provision for income taxes | $ 203,102 | $ 443,687 | $ 266,356 |

*U.S. Tax Reform*

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was enacted into law, which significantly changes existing U.S. tax law and includes many provisions applicable to us, such as reducing the U.S. federal statutory tax rate, imposing a one-time transition tax on deemed repatriation of deferred foreign income, and adopting a territorial tax system. The Tax Act reduced the U.S. federal statutory tax rate from 35% to 21% effective January 1, 2018. For fiscal 2018, our blended U.S. federal statutory tax rate is 22.2%. This is the result of using the tax rate of 35% for the first month of fiscal 2018 and the reduced tax rate of 21% for the remaining eleven months of fiscal 2018. The Tax Act also required us to incur a one-time transition tax on deferred foreign income not previously subject to U.S. income tax at a rate of 15.5% for foreign cash and certain other net current assets, and 8% on the remaining income, in each case reduced by certain foreign tax credits. The Tax Act also includes a provision to tax global intangible low-taxed income of foreign subsidiaries, a special tax deduction for foreign-derived intangible income, and a base erosion anti-abuse tax measure that may tax certain payments between a U.S. corporation and its subsidiaries. These additional provisions of the Tax Act will be effective for us beginning December 1, 2018.

During fiscal 2018, we recorded tax charges for the impact of the Tax Act effects using the current available information and technical guidance on the interpretations of the Tax Act. As permitted by SEC Staff Accounting Bulletin 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act, we recorded provisional estimates and have subsequently finalized our accounting analysis based on the guidance, interpretations, and data available as of November 30, 2018. Adjustments made in the fourth quarter of fiscal 2018 upon finalization of our accounting analysis were not material to our Consolidated Financial Statements.

As a result of the reduction in the federal corporate tax rate, we remeasured our deferred taxes and recorded a tax charge of $10 million based on the tax rate that is expected to apply when such deferred taxes are settled or realized in future periods. To calculate the remeasurement of deferred taxes, we estimated when the existing deferred taxes will be settled or realized.

As part of the adoption of a new territorial tax system we recorded a transition tax expense of $176 million on deferred foreign earnings, long-term income taxes payable of $504 million, other tax liabilities of $19 million, and a reduction in our deferred tax liabilities of $347 million. We intend to elect to pay the federal transition tax over a period of eight years as permitted by the Tax Act. As a result, we reclassified $40 million from long-term income taxes payable to short-term income taxes payable for the first installment payment due in fiscal 2019.

Certain international provisions introduced in the Tax Act will be effective for us in fiscal 2019. As part of these provisions, an accounting policy election is available to either account for the tax effects of certain taxes in the period that is subject to such taxes or to provide deferred taxes for book and tax basis differences that upon reversal may be subject to such taxes. We elect to account for the tax effects of these provisions in the period that it is subject to such tax. Accordingly, we have not recorded any tax with respect to these provisions during fiscal 2018.

**ADOBE INC.**

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

*Reconciliation of Provision for Income Taxes*

Total income tax expense differs from the expected tax expense (computed by multiplying the U.S. federal statutory rate of 22.2% in 2018 and 35% in both 2017 and 2016 by income before income taxes) as a result of the following (in thousands):

| | 2018 | 2017 | 2016 |
|---|---|---|---|
| Computed "expected" tax expense | $ 620,240 | $ 748,174 | $ 502,298 |
| State tax expense, net of federal benefit | 25,214 | 25,131 | 10,636 |
| Tax credits | (110,849) | (38,000) | (48,383) |
| Differences between statutory rate and foreign effective tax rate | (384,393) | (215,490) | (133,778) |
| Stock-based compensation, net of tax deduction | (95,372) | (42,512) | 15,101 |
| Resolution of income tax examinations | (42,432) | (31,358) | (68,003) |
| Domestic manufacturing deduction benefit | (13,098) | (32,200) | (26,990) |
| Impacts of the U.S. Tax Act | 185,997 | — | — |
| Tax charge for licensing acquired company technology to foreign subsidiaries | — | 24,771 | 5,346 |
| Other | 17,795 | 5,171 | 10,129 |
| Provision for income taxes | $ 203,102 | $ 443,687 | $ 266,356 |

*Deferred Tax Assets and Liabilities*

The tax effects of the temporary differences that gave rise to significant portions of the deferred tax assets and liabilities as of November 30, 2018 and December 1, 2017 are presented below (in thousands):

| | 2018 | 2017 |
|---|---|---|
| Deferred tax assets: | | |
| Acquired technology | $ 9,561 | $ 4,846 |
| Reserves and accruals | 59,100 | 48,761 |
| Deferred revenue | 37,690 | 23,452 |
| Stock-based compensation | 89,240 | 74,942 |
| Net operating loss carryforwards of acquired companies | 209,445 | 44,465 |
| Credit carryforwards | 173,748 | 124,205 |
| Capitalized expenses | 19,074 | 13,428 |
| Benefits relating to tax positions | 51,965 | 33,318 |
| Other | 37,160 | 30,300 |
| Total gross deferred tax assets | 686,983 | 397,717 |
| Deferred tax asset valuation allowance | (174,496) | (93,568) |
| Total deferred tax assets | 512,487 | 304,149 |
| Deferred tax liabilities: | | |
| Depreciation and amortization | 40,425 | 84,064 |
| Undistributed earnings of foreign subsidiaries | 17,556 | 382,744 |
| Acquired intangible assets | 501,208 | 117,282 |
| Total deferred tax liabilities | 559,189 | 584,090 |
| Net deferred tax liabilities: | $ 46,702 | $ 279,941 |

Deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Included in the deferred tax assets and liabilities for fiscal 2018 and 2017 are amounts related to various acquisitions. In assessing the realizability of deferred tax assets, management determined that it is not more likely than not that we will have sufficient taxable income in certain states and foreign jurisdictions to fully utilize available tax credits and other attributes. The deferred tax assets are offset by a valuation allowance to the extent it is more likely than not that they are not expected to be realized.

We provide U.S. income taxes on the earnings of foreign subsidiaries unless the subsidiaries' earnings are considered permanently reinvested outside the United States or are exempted from taxation as a result of the new territorial tax system. To the extent that the foreign earnings previously treated as permanently reinvested are repatriated, the related U.S. tax liability may be reduced by any foreign income taxes paid on these earnings. As of November 30, 2018, the cumulative amount of earnings upon which U.S. income taxes have not been provided is approximately $275 million. The unrecognized deferred tax liability for these earnings is approximately $57.8 million.

As of November 30, 2018, we have net operating loss carryforwards of approximately $881.1 million for federal and $349.7 million for state. We also have federal, state and foreign tax credit carryforwards of approximately $8.8 million, $189.9 million and $14.9 million, respectively. The net operating loss carryforward assets and tax credits will expire in various years from fiscal 2019 through 2036. The state tax credit carryforwards and a portion of the federal net operating loss carryforwards can be carried forward indefinitely. The net operating loss carryforward assets and certain credits are reduced by the valuation allowance and are subject to an annual limitation under Internal Revenue Code Section 382, the carrying amount of which are expected to be fully realized.

As of November 30, 2018, a valuation allowance of $174.5 million has been established for certain deferred tax assets related to certain state and foreign assets. For fiscal 2018, the total change in the valuation allowance was $80.9 million.

*Accounting for Uncertainty in Income Taxes*

During fiscal 2018 and 2017, our aggregate changes in our total gross amount of unrecognized tax benefits are summarized as follows (in thousands):

| | 2018 | 2017 |
|---|---|---|
| Beginning balance | $ 172,945 | $ 178,413 |
| Gross increases in unrecognized tax benefits – prior year tax positions | 16,191 | 3,680 |
| Gross decreases in unrecognized tax benefits – prior year tax positions | (4,000) | (30,166) |
| Gross increases in unrecognized tax benefits – current year tax positions | 60,721 | 24,927 |
| Settlements with taxing authorities | — | (3,876) |
| Lapse of statute of limitations | (45,922) | (8,819) |
| Foreign exchange gains and losses | (3,783) | 8,786 |
| Ending balance | $ 196,152 | $ 172,945 |

The combined amount of accrued interest and penalties related to tax positions taken on our tax returns were approximately $24.6 million and $23.6 million for fiscal 2018 and 2017, respectively. These amounts were included in long-term income taxes payable in their respective years.

We file income tax returns in the United States on a federal basis and in many U.S. state and foreign jurisdictions. We are subject to the continual examination of our income tax returns by the IRS and other domestic and foreign tax authorities. Our major tax jurisdictions are Ireland, California and the United States. For Ireland, California and the United States, the earliest fiscal years open for examination are 2008, 2014 and 2015, respectively. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from these examinations. We believe such estimates to be reasonable; however, there can be no assurance that the final determination of any of these examinations will not have an adverse effect on our operating results and financial position.

The timing of the resolution of income tax examinations is highly uncertain as are the amounts and timing of tax payments that are part of any audit settlement process. These events could cause large fluctuations in the balance of short-term and long-term assets, liabilities and income taxes payable. We believe that within the next 12 months, it is reasonably possible that either certain audits will conclude or statutes of limitations on certain income tax examination periods will expire, or both. Given the uncertainties described above, we can only determine a range of estimated potential effect in underlying unrecognized tax benefits ranging from $0 to approximately $45 million.

**ADOBE INC.**

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

## NOTE 10. BENEFIT PLANS

*Retirement Savings Plan*

In 1987, we adopted an Employee Investment Plan, qualified under Section 401(k) of the Internal Revenue Code, which is a retirement savings plan covering substantially all of our U.S. employees, now referred to as the Adobe 401(k) Retirement Savings Plan. Under the plan, eligible employees may contribute up to 65% of their pretax or after-tax salary, subject to the Internal Revenue Service annual contribution limits. In fiscal 2018, we matched 50% of the first 6% of the employee's eligible compensation. We contributed $41.0 million, $34.3 million and $33.4 million in fiscal 2018, 2017 and 2016, respectively. We are under no obligation to continue matching future employee contributions and, at our discretion, may change our practices at any time.

*Deferred Compensation Plan*

On September 21, 2006, the Board of Directors approved the Adobe Inc. Deferred Compensation Plan, effective December 2, 2006 (the "Deferred Compensation Plan"). The Deferred Compensation Plan is an unfunded, non-qualified, deferred compensation arrangement under which certain executives and members of the Board of Directors are able to defer a portion of their annual compensation. Participants may elect to contribute up to 75% of their base salary and 100% of other specified compensation, including commissions, bonuses, performance-based and time-based restricted stock units, and directors' fees. Participants are able to elect the payment of benefits to begin on a specified date at least three years after the end of the plan year in which election is made or vests. For cash benefit elections, distributions are made in cash and in the form of a lump sum, or five, ten, or fifteen-year annual installments. For stock benefit elections, distributions are settled in stock and in the form of a lump sum payment only.

As of November 30, 2018 and December 1, 2017, the invested amounts under the Deferred Compensation Plan total $69.0 million and $56.7 million, respectively and were recorded as other assets on our Consolidated Balance Sheets. As of November 30, 2018 and December 1, 2017, $84.0 million and $67.2 million, respectively, was recorded as long-term liabilities to recognize undistributed deferred compensation due to employees.

## NOTE 11. STOCK-BASED COMPENSATION

Our stock-based compensation programs are long-term retention programs that are intended to attract, retain and provide incentives for employees, officers and directors, and to align stockholder and employee interests. We have the following stock-based compensation plans and programs:

*Restricted Stock Units*

We grant restricted stock units to eligible employees under our 2003 Equity Incentive Plan, as amended ("2003 Plan"). Restricted stock units granted as part of our annual review process or for promotions vest annually over three years. Restricted stock units granted to new hires generally vest over four years. Certain grants have other vesting periods approved by our Board of Directors or an authorized committee.

We grant performance awards to officers and key employees under our 2003 Plan which cliff-vest after three years.

As of November 30, 2018, we had reserved 124.5 million shares of common stock for issuance under our 2003 Plan and had 54.1 million shares available for grant.

*Employee Stock Purchase Plan*

Our 1997 Employee Stock Purchase Plan ("ESPP") allows eligible employee participants to purchase shares of our common stock at a discount through payroll deductions. The ESPP consists of a twenty-four-month offering period with four six-month purchase periods in each offering period. Employees purchase shares in each purchase period at 85% of the market value of our common stock at either the beginning of the offering period or the end of the purchase period, whichever price is lower. The ESPP will continue until the earlier of (i) termination by the Board or (ii) the date on which all of the shares available for issuance under the plan have been issued.

As of November 30, 2018, we had reserved 93.0 million shares of our common stock for issuance under the ESPP and approximately 5.3 million shares remain available for future issuance.

**ADOBE INC.**

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

*Stock Options*

The 2003 Plan allows us to grant options to all employees, including executive officers, outside consultants and non-employee directors. This plan will continue until the earlier of (i) termination by the Board or (ii) the date on which all of the shares available for issuance under the plan have been issued and restrictions on issued shares have lapsed. Option vesting periods used in the past were generally four years and expire seven years from the effective date of grant.

We eliminated the use of stock option grants for all employees and non-employee directors but may choose to issue stock options in the future.

*Performance Share Programs*

Our 2018, 2017 and 2016 Performance Share Programs aim to help focus key employees on building stockholder value, provide significant award potential for achieving outstanding Company performance and enhance the ability of the Company to attract and retain highly talented and competent individuals. The Executive Compensation Committee of our Board of Directors approves the terms of each of our Performance Share Programs, including the award calculation methodology, under the terms of our 2003 Plan. Shares may be earned based on the achievement of an objective relative total stockholder return measured over a three-year performance period. Performance share awards will be awarded and fully vest upon the later of the Executive Compensation Committee's certification of the level of achievement or the three-year anniversary of each grant. Program participants generally have the ability to receive up to 200% of the target number of shares originally granted.

On January 24, 2018, the Executive Compensation Committee approved the 2018 Performance Share Program, the terms of which are similar to prior year performance share programs as discussed above.

As of November 30, 2018, the shares awarded under our 2018, 2017 and 2016 Performance Share Programs are yet to be achieved.

*Issuance of Shares*

Upon exercise of stock options, vesting of restricted stock units and performance shares, and purchases of shares under the ESPP, we will issue treasury stock. If treasury stock is not available, common stock will be issued. In order to minimize the impact of on-going dilution from exercises of stock options and vesting of restricted stock units and performance shares, we instituted a stock repurchase program. *See Note 12 for information regarding our stock repurchase programs.*

*Valuation of Stock-Based Compensation*

Stock-based compensation cost is measured at the grant date based on the fair value of the award.

Our performance share awards are valued using a Monte Carlo Simulation model. The fair value of the awards are fixed at grant date and amortized over the longer of the remaining performance or service period.

We use the Black-Scholes option pricing model to determine the fair value of ESPP shares. The determination of the fair value of stock-based payment awards on the date of grant using an option pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the expected term of the awards, actual and projected employee stock option exercise behaviors, a risk-free interest rate and any expected dividends.

The expected term of ESPP shares is the average of the remaining purchase periods under each offering period. The assumptions used to value employee stock purchase rights were as follows:

| | 2018 | 2017 | 2016 |
|---|---|---|---|
| Expected life (in years) | 0.5 - 2.0 | 0.5 - 2.0 | 0.5 - 2.0 |

| | | | |
|---|---|---|---|
| Volatility | 26% - 29% | 22% - 27% | 26 - 29% |
| Risk free interest rate | 1.54% - 2.52% | 0.62% - 1.41% | 0.37 - 1.06% |

**ADOBE INC.**

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

*Summary of Restricted Stock Units*

Restricted stock unit activity for fiscal 2018, 2017 and 2016 was as follows (in thousands):

| | 2018 | 2017 | 2016 |
|---|---|---|---|
| Beginning outstanding balance | 9,304 | 8,316 | 10,069 |
| Awarded | 4,012 | 5,018 | 4,440 |
| Released | (3,988) | (3,859) | (5,471) |
| Forfeited | (660) | (766) | (722) |
| Increase due to acquisition | — | 595 | — |
| Ending outstanding balance | 8,668 | 9,304 | 8,316 |

The weighted average grant date fair values of restricted stock units granted during fiscal 2018, 2017 and 2016 were $208.73, $120.33 and $89.87, respectively. The total fair value of restricted stock units vested during fiscal 2018, 2017 and 2016 was $837.3 million, $472.0 million and $499.8 million, respectively.

Information regarding restricted stock units outstanding at November 30, 2018, December 1, 2017 and December 2, 2016 is summarized below:

| | Number of Shares (thousands) | Weighted Average Remaining Contractual Life (years) | Aggregate Intrinsic Value(*) (millions) |
|---|---|---|---|
| **2018** | | | |
| Restricted stock units outstanding | 8,668 | 1.06 | $ 2,174.7 |
| Restricted stock units vested and expected to vest | 8,049 | 1.01 | $ 2,019.5 |
| **2017** | | | |
| Restricted stock units outstanding | 9,304 | 1.11 | $ 1,670.2 |
| Restricted stock units vested and expected to vest | 8,608 | 1.05 | $ 1,545.3 |
| **2016** | | | |
| Restricted stock units outstanding | 8,316 | 1.11 | $ 829.4 |
| Restricted stock units vested and expected to vest | 7,613 | 1.04 | $ 759.3 |

(*) The intrinsic value is calculated as the market value as of the end of the fiscal period. As reported by the NASDAQ Global Select Market, the market values as of November 30, 2018, December 1, 2017 and December 2, 2016 were $250.89, $179.52 and $99.73, respectively.

*Summary of Performance Shares*

In the first quarter of fiscal 2018, the Executive Compensation Committee certified the actual performance achievement of participants in the 2015 Performance Share Program. Actual performance resulted in participants achieving 200% of target or approximately 0.5 million additional shares. The shares granted and achieved under the 2015 Performance Share Program fully vested on the three-year anniversary of the grant on January 24, 2018, if not forfeited.

In the first quarter of fiscal 2017, the Executive Compensation Committee certified the actual performance achievement of participants in the 2014 Performance Share Program. Actual performance resulted in participants achieving 198% of target or approximately 0.6 million additional shares. The shares granted and achieved under the 2014 Performance Share Program fully vested on the three-year anniversary of the grant on January 24, 2017, if not forfeited.

In the first quarter of fiscal 2016, the Executive Compensation Committee certified the actual performance achievement of participants in the 2013 Performance Share Program. Actual performance resulted in participants achieving 198% of target or approximately 0.7 million additional shares. The shares granted and achieved under the 2013 Performance Share Program fully vested on the three-year anniversary of the grant on January 24, 2016, if not forfeited.

Performance share activity for fiscal 2018, 2017 and 2016 was as follows (in thousands):

| | 2018 | | 2017 | | 2016 | |
|---|---|---|---|---|---|---|
| | Shares Granted | Maximum Shares Eligible to Receive | Shares Granted | Maximum Shares Eligible to Receive | Shares Granted | Maximum Shares Eligible to Receive |
| Beginning outstanding balance | 1,534 | 3,068 | 1,630 | 3,261 | 1,940 | 3,881 |
| Awarded | 837 (1) | 628 | 1,082 (2) | 1,040 | 1,206 (3) | 1,053 |
| Achieved | (1,050) (4) | (1,053) | (1,135) (5) | (1,147) | (1,373) (5) | (1,387) |
| Forfeited | (173) | (347) | (43) | (86) | (143) | (286) |
| Ending outstanding balance | 1,148 | 2,296 | 1,534 | 3,068 | 1,630 | 3,261 |

(1) Included in the 0.8 million shares awarded during fiscal 2018 were 0.5 million additional shares awarded for the final achievement of the 2015 Performance Share program. The remaining awarded shares were for the 2018 Performance Share Program.

(2) Included in the 1.1 million shares awarded during fiscal 2017 were 0.6 million additional shares awarded for the final achievement of the 2014 Performance Share program. The remaining awarded shares were for the 2017 Performance Share Program.

(3) Included in the 1.2 million shares awarded during fiscal 2016 were 0.7 million additional shares awarded for the final achievement of the 2013 Performance Share program. The remaining awarded shares were for the 2016 Performance Share Program.

(4) Shares achieved under our 2015, Performance Share program which resulted from 200% achievement of target.

(5) Shares achieved under our 2014 and 2013 Performance Share programs which resulted from 198% achievement of target for both programs.

The total fair value of performance awards vested during fiscal 2018, 2017 and 2016 was $208.2 million, $127.4 million and $123.1 million, respectively.

*Summary of Employee Stock Purchase Plan Shares*

The weighted average subscription date fair value of shares under the ESPP during fiscal 2018, 2017 and 2016 were $53.12, $29.86 and $24.84, respectively. Employees purchased 1.8 million shares at an average price of $104.94, 1.9 million shares at an average price of $77.63, and 1.9 million shares at an average price of $66.13, respectively, for fiscal 2018, 2017 and 2016. The intrinsic value of shares purchased during fiscal 2018, 2017 and 2016 was $198.9 million, $97.7 million and $54.3 million, respectively. The intrinsic value is calculated as the difference between the market value on the date of purchase and the purchase price of the shares.

*Summary of Stock Options*

As of November 30, 2018 and December 1, 2017, we had 0.3 million stock options outstanding.

*Grants to Executive Officers*

All equity awards granted to executive officers are made after a review by and with the approval of the Executive Compensation Committee of the Board of Directors.

*Grants to Non-Employee Directors*

Although the 2003 Plan provides for the granting of non-qualified stock options and restricted stock units to non-employee directors, restricted stock units are the primary form of our grants to non-employee directors. The initial equity grant to a new non-employee director is a restricted stock unit award having an aggregate value of $0.3 million based on the average stock price over the 30 calendar days ending on the day before the date of grant and vest 100% on the day preceding the next annual meeting. The actual target grant value will be prorated based on the number of days remaining before the next annual meeting or the date of the first anniversary of our last annual meeting if the next annual meeting is not yet scheduled.

Annual equity grants to non-employee directors in the form of restricted stock units shall have an aggregate value of $0.3 million as based on the average stock price over the 30 calendar days ending on the day before the date of grant and vest 100% on the day preceding the next annual meeting.

Restricted stock units granted to directors for fiscal 2018, 2017 and 2016 were as follows (in thousands):

| | 2018 | 2017 | 2016 |
|---|---|---|---|
| Restricted stock units granted to existing directors | 11 | 18 | 25 |
| Restricted stock units granted to new directors | 1 | — | — |

*Compensation Costs*

We recognize the estimated compensation cost of restricted stock units, net of estimated forfeitures, on a straight-line basis over the requisite service period of the entire award, which is generally the vesting period. The estimated compensation cost is based on the fair value of our common stock on the date of grant.

We recognize the estimated compensation cost of performance shares, net of estimated forfeitures, on a straight-line basis over the requisite service period of the entire award. Our performance share awards are earned upon achievement of an objective total stockholder return measure at the end of the three-year performance period, as described above.

We estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate forfeitures and record stock-based compensation expense only for those awards that are expected to vest.

As of November 30, 2018, there was $978.2 million of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock-based awards which will be recognized over a weighted average period of 1.7 years. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

Total stock-based compensation costs that have been included in our Consolidated Statements of Income for fiscal 2018, 2017 and 2016 were as follows (in thousands):

| | Income Statement Classifications | | | | | |
|---|---|---|---|---|---|---|
| | Cost of Revenue–Subscription | Cost of Revenue–Services and Support | Research and Development | Sales and Marketing | General and Administrative | Total[1] |
| **Stock Purchase Rights and Option Grants** | | | | | | |
| 2018 | $ 4,102 | $ 8,286 | $ 23,918 | $ 27,252 | $ 7,290 | $ 70,848 |
| 2017 | $ 180 | $ 6,661 | $ 20,126 | $ 18,592 | $ 4,973 | $ 50,532 |
| 2016 | $ 1,474 | $ 5,514 | $ 13,932 | $ 16,534 | $ 4,371 | $ 41,825 |
| **Restricted Stock Units and Performance Share Awards** | | | | | | |
| 2018 | $ 17,515 | $ 12,111 | $ 253,078 | $ 178,548 | $ 77,462 | $ 538,714 |
| 2017 | $ 16,792 | $ 9,602 | $ 161,366 | $ 139,047 | $ 77,133 | $ 403,940 |
| 2016 | $ 6,632 | $ 7,522 | $ 109,249 | $ 113,757 | $ 70,312 | $ 307,472 |

(1) During fiscal 2018, 2017 and 2016, we recorded tax benefits of $222.4 million, $153.2 million and $71.7 million, respectively.

## NOTE 12. STOCKHOLDERS' EQUITY

*Comprehensive Income (Loss)*

The components of accumulated other comprehensive income (loss) and activity, net of related taxes, for fiscal 2018 were as follows (in thousands):

| | December 1, 2017 | Increase / Decrease | Reclassification Adjustments | | November 30, 2018 |
|---|---|---|---|---|---|
| Net unrealized gains / losses on available-for-sale securities: | | | | | |
| Unrealized gains on available-for-sale securities | $ 2,704 | $ (2,005) | $ (655) | | $ 44 |
| Unrealized losses on available-for-sale securities | (14,220) | (22,459) | 11,305 | | (25,374) |
| Total net unrealized gains / losses on available-for-sale securities | (11,516) | (24,464) | 10,650 | (1) | (25,330) |
| Net unrealized gains / losses on derivative instruments designated as hedging instruments | (3,367) | 74,080 | (48,981) | (2) | 21,732 |
| Cumulative foreign currency translation adjustments | (96,938) | (47,594) | — | | (144,532) |
| Total accumulated other comprehensive income (loss), net of taxes | $ (111,821) | $ 2,022 | $ (38,331) | | $ (148,130) |

(1) Reclassification adjustments for gains / losses on available-for-sale securities are classified in interest and other income (expense), net.

(2) Reclassification adjustments for gains / losses on other derivative instruments are classified in revenue.

The following table sets forth the taxes related to each component of other comprehensive income for fiscal 2018, 2017 and 2016 (in thousands):

| | 2018 | 2017 | 2016 |
|---|---|---|---|
| Available-for-sale securities: | | | |
| Unrealized gains / losses | $ — | $ 663 | $ (299) |
| Reclassification adjustments | — | (491) | 108 |
| Subtotal available-for-sale securities | — | 172 | (191) |
| Derivatives designated as hedging instruments: | | | |
| Reclassification adjustments | (1,946) | (732) | (552) |
| Subtotal derivatives designated as hedging instruments | (1,946) | (732) | (552) |
| Foreign currency translation adjustments | (1,742) | 3,005 | 24 |
| Total taxes, other comprehensive income (loss) | $ (3,688) | $ 2,445 | $ (719) |

*Stock Repurchase Program*

To facilitate our stock repurchase program, designed to return value to our stockholders and minimize dilution from stock issuances, we may repurchase shares in the open market or enter into structured repurchase agreements with third parties. In January 2017, our Board of Directors approved a stock repurchase program granting us authority to repurchase up to $2.5 billion in common stock through the end of fiscal 2019. In May 2018, our Board of Directors granted us another authority to repurchase up to $8.0 billion in common stock through the end of fiscal 2021. The new stock repurchase program approved by our Board of Directors is similar to our previous stock repurchase programs.

During fiscal 2018, 2017 and 2016, we entered into several structured stock repurchase agreements with large financial institutions, whereupon we provided them with prepayments totaling $2.05 billion, $1.10 billion, and $1.08 billion, respectively. We enter into these agreements in order to take advantage of repurchasing shares at a guaranteed discount to the Volume Weighted Average Price (“VWAP”) of our common stock over a specified period of time. We only enter into such transactions when the discount that we receive is higher than our estimate of the expected foregone return on our cash prepayments to the financial institutions. There were no explicit commissions or fees on these structured repurchases. Under the terms of the agreements, there is no requirement for the financial institutions to return any portion of the prepayment to us.

The financial institutions agree to deliver shares to us at monthly intervals during the contract term. The parameters used to calculate the number of shares deliverable are: the total notional amount of the contract, the number of trading days in the contract, the number of trading days in the interval and the average VWAP of our stock during the interval less the agreed upon discount. During fiscal 2018, we repurchased approximately 8.7 million shares at an average price per share of $230.43 through structured repurchase agreements entered into during fiscal 2018 and fiscal 2017. During fiscal 2017, we repurchased approximately 8.2 million shares at an average price per share of $134.20 through structured repurchase agreements entered into during fiscal 2017 and fiscal 2016. During fiscal 2016, we repurchased approximately 10.4 million shares at an average price per share of $97.16 through structured repurchase agreements entered into during fiscal 2016 and fiscal 2015.

For fiscal 2018, 2017 and 2016, the prepayments were classified as treasury stock on our Consolidated Balance Sheets at the payment date, though only shares physically delivered to us by November 30, 2018, December 1, 2017 and December 2, 2016 were excluded from the computation of earnings per share. As of November 30, 2018, $150.0 million of prepayments from our May 2018 authority remained under the agreement.

Subsequent to November 30, 2018, as part of the 2018 stock repurchase authority, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of $500 million. This amount will be classified as treasury stock on our Consolidated Balance Sheets. Upon completion of the $500 million stock repurchase agreement, $7.35 billion remains under our May 2018 authority. As of November 30, 2018, there is no remaining balance under our January 2017 authority.

## NOTE 13. NET INCOME PER SHARE

Basic net income per share is computed using the weighted average number of common shares outstanding for the period, excluding unvested restricted stock units and performance awards. Diluted net income per share is based upon the weighted average common shares outstanding for the period plus dilutive potential common shares, including unvested restricted stock units, performance share awards, and stock options using the treasury stock method.

The following table sets forth the computation of basic and diluted net income per share for fiscal 2018, 2017 and 2016 (in thousands, except per share data):

| | 2018 | 2017 | 2016 |
|---|---|---|---|
| Net income | $ 2,590,774 | $ 1,693,954 | $ 1,168,782 |
| Shares used to compute basic net income per share | 490,564 | 493,632 | 498,345 |
| Dilutive potential common shares: | | | |
| Unvested restricted stock units and performance share awards | 7,142 | 7,161 | 5,455 |
| Stock options | 137 | 330 | 499 |
| Shares used to compute diluted net income per share | 497,843 | 501,123 | 504,299 |
| Basic net income per share | $ 5.28 | $ 3.43 | $ 2.35 |
| Diluted net income per share | $ 5.20 | $ 3.38 | $ 2.32 |

ADOBE INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 14. COMMITMENTS AND CONTINGENCIES

*Lease Commitments*

We lease certain of our facilities and some of our equipment under non-cancellable operating lease arrangements that expire at various dates through 2031. We also have one land lease that expires in 2091. Rent expense includes base contractual rent and variable costs such as building expenses, utilities, taxes, insurance and equipment rental. Rent expense for these leases was approximately $137.2 million in fiscal 2018, $115.4 million in fiscal 2017, and $92.9 million in fiscal 2016. Our sublease income was immaterial for all periods presented.

We occupy three office buildings in San Jose, California where our corporate headquarters are located. We reference these office buildings as the Almaden, East and West Towers.

In March 2017, we exercised our option to purchase the Almaden Tower for a total purchase price of $103.6 million. Upon purchase, our investment in the lease receivable of $80.4 million was credited against the total purchase price. We capitalized the Almaden Tower as property and equipment on our Consolidated Balance Sheets at $104.2 million, the lesser of cost or fair value, which represented the total purchase price plus other direct costs associated with the purchase. As of November 30, 2018, we own the buildings and the underlying land that make up our corporate headquarters in San Jose, California, including the Almaden Tower.

*Unconditional Purchase Obligations*

Our purchase obligations consist of agreements to purchase goods and services entered into in the ordinary course of business. The following table summarizes our non-cancellable unconditional purchase obligations and operating leases for each of the next five years and thereafter as of November 30, 2018 (in thousands):

| | | Operating Leases | |
|---|---|---|---|
| Fiscal Year | Purchase Obligations | Future Minimum Lease Payments | Future Minimum Sublease Income |
| 2019 | $ 346,334 | $ 88,554 | $ 9,173 |
| 2020 | 172,883 | 93,509 | 8,981 |
| 2021 | 162,421 | 80,408 | 8,837 |
| 2022 | 20,866 | 71,425 | 6,451 |
| 2023 | 27,352 | 56,490 | 2,325 |
| Thereafter | 3,977 | 311,937 | — |
| Total | $ 733,833 | $ 702,323 | $ 35,767 |

*Royalties*

We have royalty commitments associated with the licensing of certain offerings and products. Royalty expense is generally based on a dollar amount per unit or a percentage of the underlying revenue. Royalty expense, which was recorded under our cost of revenue on our Consolidated Statements of Income, was approximately $119.1 million, $100.9 million and $79.8 million in fiscal 2018, 2017 and 2016, respectively.

*Indemnifications*

In the ordinary course of business, we provide indemnifications of varying scope to customers against claims of intellectual property infringement made by third parties arising from the use of our products and from time to time, we are subject to claims by our customers under these indemnification provisions. Historically, costs related to these indemnification provisions have not been significant and we are unable to estimate the maximum potential impact of these indemnification provisions on our future results of operations.

To the extent permitted under Delaware law, we have agreements whereby we indemnify our officers and directors for certain events or occurrences while the officer or director is or was serving at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the officer's or director's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that reduces our exposure and enables us to recover a portion of any future amounts paid. We believe the estimated fair value of these indemnification agreements in excess of applicable insurance coverage is minimal.

*Legal Proceedings*

In connection with disputes relating to the validity or alleged infringement of third-party intellectual property rights, including patent rights, we have been, are currently and may in the future be subject to claims, negotiations or complex, protracted litigation. Intellectual property disputes and litigation may be very costly and can be disruptive to our business operations by diverting the attention and energies of management and key technical personnel. Although we have successfully defended or resolved past litigation and disputes, we may not prevail in any ongoing or future litigation and disputes. Third-party intellectual property disputes could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from licensing certain of our products or offering certain of our services, subject us to injunctions restricting our sale of products or services, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers including contractual provisions under various license arrangements and service agreements.

In addition to intellectual property disputes, we are subject to legal proceedings, claims and investigations in the ordinary course of business, including claims relating to commercial, employment and other matters. Some of these disputes and legal proceedings may include speculative claims for substantial or indeterminate amounts of damages. We consider all claims on a quarterly basis in accordance with GAAP and based on known facts assess whether potential losses are considered reasonably possible, probable and estimable. Based upon this assessment, we then evaluate disclosure requirements and whether to accrue for such claims in our financial statements. This determination is then reviewed and discussed with our Audit Committee and our independent registered public accounting firm.

We make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Unless otherwise specifically disclosed in this note, we have determined that no provision for liability nor disclosure is required related to any claim against us because: (a) there is not a reasonable possibility that a loss exceeding amounts already recognized (if any) may be incurred with respect to such claim; (b) a reasonably possible loss or range of loss cannot be estimated; or (c) such estimate is immaterial.

All legal costs associated with litigation are expensed as incurred. Litigation is inherently unpredictable. However, we believe that we have valid defenses with respect to the legal matters pending against us. It is possible, nevertheless, that our consolidated financial position, cash flows or results of operations could be negatively affected by an unfavorable resolution of one or more of such proceedings, claims or investigations.

In connection with our anti-piracy efforts, conducted both internally and through organizations such as the Business Software Alliance, from time to time we undertake litigation against alleged copyright infringers. Such lawsuits may lead to counter-claims alleging improper use of litigation or violation of other laws. We believe we have valid defenses with respect to such counter-claims; however, it is possible that our consolidated financial position, cash flows or results of operations could be negatively affected in any particular period by the resolution of one or more of these counter-claims.

## NOTE 15. DEBT

Our long-term debt as of November 30, 2018 and December 1, 2017 consisted of the following (in thousands):

| | 2018 | 2017 |
|---|---|---|
| Term loan | $ 2,248,427 | $ — |
| Notes | 1,886,117 | 1,882,479 |
| Fair value of interest rate swap | (9,744) | (1,058) |
| Adjusted carrying value of long-term debt | $ 4,124,800 | $ 1,881,421 |

*Term Loan Credit Agreement*

In October 2018, we entered into a credit agreement providing for an up to $2.25 billion senior unsecured term loan for the purpose of partially funding the purchase price for our acquisition of Marketo and the related fees and expenses incurred in connection with the acquisition. The Term Loan funds were received on October 31, 2018 upon closing of the acquisition and will mature 18 months following the initial funding date. In addition, we incurred issuance costs of $0.7 million which are amortized to interest expense over the term using the straight-line method. The Term Loan ranks equally with our other unsecured and unsubordinated indebtedness. There are no scheduled principal amortization payments prior to maturity and the term loan may be prepaid and terminated at our election at any time without penalty or premium. At our election, the Term Loan will bear interest at either (i) LIBOR plus a margin, based on our debt ratings, ranging from 0.500% to 1.000% or (ii) a base rate plus a margin, based on our debt ratings, ranging from 0.040% to 0.110%. Interest is payable periodically, in arrears, at the end of each interest period we elect.

The Term Loan credit agreement contains customary representations, warranties, affirmative and negative covenants, events of default and indemnification provisions in favor of the lenders similar to those contained in the Revolving Credit Agreement, including the financial covenant. As of November 30, 2018, we were in compliance with all covenants.

As of November 30, 2018, there were $2.25 billion outstanding borrowings under the Term Loan, which is included in long-term liabilities on our Consolidated Balance Sheets. In November 2018, we made interest payments of approximately $5.7 million.

*Senior Notes*

In February 2010, we issued $900 million of 4.75% senior notes due February 1, 2020. Our proceeds were $900 million and were net of an issuance discount of $5.5 million. In addition, we incurred issuance costs of $6.4 million. Both the discount and issuance costs are being amortized to interest expense over the term of the 2020 Notes using the effective interest method. The 2020 Notes rank equally with our other unsecured and unsubordinated indebtedness. The effective interest rate including the discount and issuance costs was 4.92%. Interest is payable semi-annually, in arrears, on February 1 and August 1, and commenced on August 1, 2010.

In June 2014, we entered into interest rate swaps with a total notional amount of $900 million designated as a fair value hedge related to our 2020 Notes. The interest rate swaps effectively convert the fixed interest rate on our 2020 Notes to a floating interest rate based on LIBOR. Under the terms of the swap, we will pay monthly interest at the one-month LIBOR interest rate plus a fixed number of basis points on the $900 million notional amount. In exchange, we will receive 4.75% fixed rate interest from the swap counterparties. *See Note 5 for further details regarding our interest rate swap derivatives.*

In January 2015, we issued $1 billion of 3.25% senior notes due February 1, 2025 (the "2025 Notes"). Our proceeds were approximately $989.3 million which is net of an issuance discount of $10.7 million. In addition, we incurred issuance costs of $7.9 million. Both the discount and issuance costs are being amortized to interest expense over the term of the 2025 Notes using the effective interest method. The 2025 Notes rank equally with our other unsecured and unsubordinated indebtedness. The effective interest rate including the discount, issuance costs and interest rate agreement is 3.67%. Interest is payable semi-annually, in arrears on February 1 and August 1, and commenced on August 1, 2015.

As of November 30, 2018, our outstanding notes payable consist of the 2020 Notes and 2025 Notes (the “Notes”) with a total carrying value of $1.88 billion, which includes the fair value of the interest rate swaps and is net of debt issuance costs. Based on quoted prices in inactive markets, the fair value of the Notes was $1.89 billion as of November 30, 2018, which excludes the effect of the fair value of the interest rate swaps described above.

We may redeem the Notes at any time, subject to a make-whole premium. In addition, upon the occurrence of certain change of control triggering events, we may be required to repurchase the Notes, at a price equal to 101% of their principal amount, plus accrued and unpaid interest to the date of repurchase. The Notes also include covenants that limit our ability to grant liens on assets and to enter into sale and leaseback transactions, subject to significant allowances. As of November 30, 2018, we were in compliance with all of the covenants.

In February and August 2018, we made semi-annual interest payments on our 2020 and 2025 Notes each totaling $37.6 million.

*Credit Agreement*

On October 17, 2018, we entered into a credit agreement (the “Revolving Credit Agreement”), providing for a five-year $1 billion senior unsecured revolving credit facility, which replaces our previous five-year $1 billion senior unsecured revolving credit agreement dated as of March 2, 2012 (as amended, the “Prior Revolving Credit Agreement”). In addition, we incurred issuance costs of $0.8 million which is amortized to interest expense over the term using the straight-line method. The Revolving Credit Agreement provides for loans to Adobe and certain of its subsidiaries that may be designated from time to time as additional borrowers. Pursuant to the terms of the Revolving Credit Agreement, we may, subject to the agreement of lenders to provide additional commitments, obtain up to an additional $500 million in commitments, for a maximum aggregate commitment of $1.5 billion. At our election, loans under the Revolving Credit Agreement will bear interest at either (i) LIBOR plus a margin, based on our debt ratings, ranging from 0.585% to 1.015% or (ii) a base rate, which is defined as the highest of (a) the agent’s prime rate, (b) the federal funds effective rate plus 0.500% or (c) LIBOR plus 1.00% plus a margin, based on our debt ratings, ranging from 0.000% to 0.015%. In addition, facility fees determined according to our debt ratings are payable on the aggregate commitments, regardless of usage, quarterly in an amount ranging from 0.040% to 0.110% per annum. We are permitted to permanently reduce the aggregate commitment under the Revolving Credit Agreement at any time. Subject to certain conditions stated in the Revolving Credit Agreement, Adobe and any of its subsidiaries designated as additional borrowers may borrow, prepay and re-borrow amounts at any time during the term of the Revolving Credit Agreement.

In connection with and at the time that we entered into the Revolving Credit Agreement, the Prior Revolving Credit Agreement originally scheduled to expire on July 27, 2020 was terminated. There were no outstanding borrowings or letters of credit issued under the Prior Revolving Credit Agreement at the time of termination. There were no penalties paid as a result of the termination of the Prior Revolving Credit Agreement.

The Revolving Credit Agreement contains customary representations, warranties, affirmative and negative covenants, including a financial covenant, events of default and indemnification provisions in favor of the lenders. The negative covenants include restrictions regarding the incurrence of liens and indebtedness, certain merger and acquisition transactions, dispositions and other matters, all subject to certain exceptions. The financial covenant, based on a quarterly financial test, requires us not to exceed a maximum leverage ratio.

The facility will terminate and all amounts owing thereunder will be due and payable on the maturity date unless (a) the commitments are terminated earlier upon the occurrence of certain events, including an event of default, or (b) the maturity date is further extended upon our request, subject to the agreement of the lenders.

As of November 30, 2018, there were no outstanding borrowings under the Revolving Credit Agreement and we were in compliance with all covenants.

## NOTE 16. NON-OPERATING INCOME (EXPENSE)

Non-operating income (expense) for fiscal 2018, 2017 and 2016 included the following (in thousands):

| | 2018 | 2017 | 2016 |
|---|---|---|---|
| Interest and other income (expense), net: | | | |
| Interest income | $ 92,540 | $ 66,069 | $ 47,340 |
| Foreign exchange gains (losses) | (42,612) | (30,705) | (35,716) |
| Realized gains on fixed income investment | 655 | 1,673 | 2,880 |
| Realized losses on fixed income investment | (11,305) | (725) | (985) |
| Other | 258 | 83 | 29 |
| Interest and other income (expense), net | $ 39,536 | $ 36,395 | $ 13,548 |
| Interest expense | $ (89,242) | $ (74,402) | $ (70,442) |
| Investment gains (losses), net: | | | |
| Realized investment gains | $ 6,128 | $ 3,279 | $ 4,964 |
| Unrealized investment gains | — | 4,274 | 186 |
| Realized investment losses | — | — | (6,720) |
| Unrealized investment losses | (2,915) | — | — |
| Investment gains (losses), net | $ 3,213 | $ 7,553 | $ (1,570) |
| Non-operating income (expense), net | $ (46,493) | $ (30,454) | $ (58,464) |

## NOTE 17. INDUSTRY SEGMENT, GEOGRAPHIC INFORMATION AND SIGNIFICANT CUSTOMERS

We report segment information based on the “management” approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of our reportable segments.

Our CEO, the chief operating decision maker, reviews revenue and gross margin information for each of our reportable segments, but does not review operating expenses on a segment by segment basis. In addition, with the exception of goodwill and intangible assets, we do not identify or allocate our assets by the reportable segments.

Our business is organized into three reportable segments: Digital Media, Digital Experience (formerly Digital Marketing), and Publishing (formerly Print and Publishing). These segments provide our senior management with a comprehensive financial view of our key businesses. Our segments are aligned around our two strategic growth opportunities described above, placing our Publishing business in a third segment that contains some of our mature products and solutions.

For fiscal 2018, we have the following reportable segments:

- *Digital Media*—Our Digital Media segment provides tools and solutions that enable individuals, small and medium businesses and enterprises to create, publish, promote and monetize their digital content anywhere. Our customers include traditional content creators, web application developers and digital media professionals, as well as their management in marketing departments and agencies, companies and publishers. Our customers also include knowledge workers who create, collaborate and distribute documents.

- *Digital Experience*—Our Digital Experience segment provides solutions and services for how digital advertising and marketing are created, managed, executed, measured and optimized. Our customers include digital marketers, advertisers, publishers, merchandisers, web analysts, chief marketing officers, chief information officers and chief revenue officers. This segment also includes our marketing cloud platform offerings and commerce platform offerings from the Magento and Marketo acquisitions in the third and fourth quarter of fiscal 2018, respectively.

**ADOBE INC.**

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

- *Publishing*—Our Publishing segment addresses market opportunities ranging from the diverse authoring and publishing needs of technical and business publishing to our legacy type and OEM printing businesses. It also includes our web conferencing and document and forms platforms effective fiscal 2018.

In fiscal 2018, we moved our legacy enterprise offerings—Adobe Connect web conferencing platform and Adobe LiveCycle, an enterprise document and forms platform—from our Digital Experience segment into Publishing, in order to more closely align our Digital Experience business with the strategic growth opportunity. Prior year information in the tables below have been reclassified to reflect this change.

Our segment results for fiscal 2018, 2017 and 2016 were as follows (dollars in thousands):

| | Digital Media | Digital Experience | Publishing | Total |
|---|---|---|---|---|
| **Fiscal 2018** | | | | |
| Revenue | $ 6,325,315 | $ 2,443,745 | $ 260,948 | $ 9,030,008 |
| Cost of revenue | 249,386 | 922,414 | 23,199 | 1,194,999 |
| Gross profit | $ 6,075,929 | $ 1,521,331 | $ 237,749 | $ 7,835,009 |
| Gross profit as a percentage of revenue | 96 % | 62 % | 91 % | 87 % |
| **Fiscal 2017** | | | | |
| Revenue | $ 5,010,579 | $ 2,030,324 | $ 260,602 | $ 7,301,505 |
| Cost of revenue | 239,994 | 747,005 | 23,492 | 1,010,491 |
| Gross profit | $ 4,770,585 | $ 1,283,319 | $ 237,110 | $ 6,291,014 |
| Gross profit as a percentage of revenue | 95 % | 63 % | 91 % | 86 % |
| **Fiscal 2016** | | | | |
| Revenue | $ 3,941,011 | $ 1,631,426 | $ 281,993 | $ 5,854,430 |
| Cost of revenue | 231,074 | 559,938 | 28,896 | 819,908 |
| Gross profit | $ 3,709,937 | $ 1,071,488 | $ 253,097 | $ 5,034,522 |
| Gross profit as a percentage of revenue | 94 % | 66 % | 90 % | 86 % |

The tables below list our revenue and property and equipment, net, by geographic area for fiscal 2018, 2017 and 2016 (in thousands). With the exception of property and equipment, we do not identify or allocate our assets (including long-lived assets) by geographic area.

| **Revenue** | 2018 | 2017 | 2016 |
|---|---|---|---|
| Americas: | | | |
| United States | $ 4,632,469 | $ 3,830,845 | $ 3,087,764 |
| Other | 484,296 | 385,686 | 312,371 |
| Total Americas | 5,116,765 | 4,216,531 | 3,400,135 |
| EMEA | 2,550,062 | 1,985,105 | 1,619,153 |
| APAC: | | | |
| Japan | 609,361 | 524,254 | 401,205 |
| Other | 753,820 | 575,615 | 433,937 |
| Total APAC | 1,363,181 | 1,099,869 | 835,142 |

| | | |
|---|---|---|
| Revenue | $ 9,030,008 | $ 7,301,505 | $ 5,854,430 |

| **Property and Equipment** | 2018 | 2017 | 2016 |
|---|---|---|---|
| Americas: | | | |
| United States | $ 882,145 | $ 753,393 | $ 642,823 |
| Other | 30,475 | 2,797 | 559 |
| Total Americas | 912,620 | 756,190 | 643,382 |
| EMEA | 51,033 | 54,181 | 48,662 |
| APAC: | | | |
| India | 93,259 | 109,051 | 106,322 |
| Other | 18,160 | 17,554 | 17,898 |
| Total APAC | 111,419 | 126,605 | 124,220 |
| Property and equipment, net | $ 1,075,072 | $ 936,976 | $ 816,264 |

*Significant Customers*

For fiscal 2018, 2017 and 2016 there were no customers that represented at least 10% of net revenue. As of fiscal year end 2018 and 2017, no single customer was responsible for over 10% of our trade receivables.

## NOTE 18. SELECTED QUARTERLY FINANCIAL DATA (unaudited)

| | 2018 | | | |
|---|---|---|---|---|
| **(in thousands, except per share data)** | Quarter Ended | | | |
| | March 2 | June 1 | August 31 | November 30 |
| Revenue | $ 2,078,947 | $ 2,195,360 | $ 2,291,076 | $ 2,464,625 |
| Gross profit | $ 1,820,045 | $ 1,914,016 | $ 1,995,584 | $ 2,105,364 |
| Income before income taxes | $ 702,502 | $ 690,799 | $ 701,358 | $ 699,217 |
| Net income | $ 583,076 | $ 663,167 | $ 666,291 | $ 678,240 |
| Basic net income per share | $ 1.18 | $ 1.35 | $ 1.36 | $ 1.39 |
| Diluted net income per share | $ 1.17 | $ 1.33 | $ 1.34 | $ 1.37 |

| | 2017 | | | |
|---|---|---|---|---|
| **(in thousands, except per share data)** | Quarter Ended | | | |
| | March 3 | June 2 | September 1 | December 1 |
| Revenue | $ 1,681,646 | $ 1,772,190 | $ 1,841,074 | $ 2,006,595 |
| Gross profit | $ 1,444,309 | $ 1,532,830 | $ 1,578,152 | $ 1,735,723 |
| Income before income taxes | $ 460,632 | $ 492,618 | $ 541,379 | $ 643,012 |
| Net income | $ 398,446 | $ 374,390 | $ 419,569 | $ 501,549 |
| Basic net income per share | $ 0.81 | $ 0.76 | $ 0.85 | $ 1.02 |
| Diluted net income per share | $ 0.80 | $ 0.75 | $ 0.84 | $ 1.00 |

Our fiscal year is a 52- or 53-week year that ends on the Friday closest to November 30. Each of the fiscal quarters presented were comprised of 13 weeks.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors
Adobe Inc.:

*Opinions on the Consolidated Financial Statements and Internal Control Over Financial Reporting*

We have audited the accompanying consolidated balance sheets of Adobe Inc. and subsidiaries (the Company) as of November 30, 2018 and December 1, 2017, the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended November 30, 2018, and the related notes (collectively, the consolidated financial statements). We also have audited the Company's internal control over financial reporting as of November 30, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of November 30, 2018 and December 1, 2017, and the results of its operations and its cash flows for each of the years in the three-year period ended November 30, 2018, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of November 30, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

The Company acquired Magento on June 18, 2018 and Marketo on October 31, 2018, as discussed in Note 2 to the consolidated financial statements. As discussed in Management's Annual Report on Internal Control over Financial Reporting appearing under Item 9A, management excluded from its assessment of the effectiveness of Adobe Inc.'s internal control over financial reporting as of November 30, 2018, Magento and Marketo's internal control over financial reporting associated with consolidated total assets of approximately 1.1%, and consolidated total revenues of approximately 1.0%, included in the Company's consolidated financial statements as of and for the year ended November 30, 2018. Our audit of internal control over financial reporting of Adobe Inc. as of November 30, 2018, also excluded an evaluation of the internal control over financial reporting of Magento and Marketo.

*Basis for Opinions*

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Controls over Financial Reporting appearing under Item 9A. Our responsibility is to express an opinion on the Company's consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

*Definition and Limitations of Internal Control Over Financial Reporting*

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

(signed) KPMG LLP

We have served as the Company's auditor since 1983.

Santa Clara, California
January 25, 2019

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

## ITEM 9A. CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of November 30, 2018. Based on their evaluation as of November 30, 2018, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective at the reasonable assurance level to ensure that the information required to be disclosed by us in this Annual Report on Form 10-K was (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Adobe have been detected.

### Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Our management assessed the effectiveness of our internal control over financial reporting as of November 30, 2018. In making this assessment, our management used the criteria established in Internal Control - Integrated Framework (2013) issued by the COSO. Our management has concluded that, as of November 30, 2018, our internal control over financial reporting is effective based on these criteria.

We acquired Magento on June 18, 2018 and Marketo on October 31, 2018, as discussed in Note 2 to the Consolidated Financial Statements. As permitted by the SEC staff's Frequently Asked Question 3 on Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports (revised September 24, 2007), our management excluded from our assessment of internal control over financial reporting effectiveness as of November 30, 2018, Magento and Marketo's internal control over financial reporting associated with consolidated total assets of approximately 1.1%, and consolidated total revenues of approximately 1.0%, included in our Consolidated Financial Statements as of and for the year ended November 30, 2018. We will include Magento and Marketo in our assessment of the effectiveness of internal control over financial reporting starting fiscal 2019.

KPMG LLP, the independent registered public accounting firm that audited our financial statements included in this Annual Report on Form 10-K, has issued an attestation report on our internal control over financial reporting, which is included herein.

### Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended November 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## ITEM 9B. OTHER INFORMATION

None.

# PART III

## ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item 10 of Form 10-K that is found in our 2019 Proxy Statement to be filed with the SEC in connection with the solicitation of proxies for the Company's 2019 Annual Meeting of Stockholders ("2019 Proxy Statement") is incorporated herein by reference to our 2019 Proxy Statement. The 2019 Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year to which this report relates. For information with respect to our executive officers, see "Executive Officers" at the end of Part I, Item 1 of this report.

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by this Item 11 of Form 10-K is incorporated herein by reference to our 2019 Proxy Statement.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this Item 12 of Form 10-K is incorporated herein by reference to our 2019 Proxy Statement.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by this Item13 of Form 10-K is incorporated herein by reference to our 2019 Proxy Statement.

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information required by this Item 14 of Form 10-K is incorporated herein by reference to our 2019 Proxy Statement.

**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

1. Financial Statements. See Index to Consolidated Financial Statements in Part II, Item 8 of this Form 10-K.

| | | Incorporated by Reference** | | | | |
|---|---|---|---|---|---|---|
| Exhibit Number | Exhibit Description | Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
| 3.1 | Restated Certificate of Incorporation of Adobe | 8-K | 4/26/11 | 3.3 | 000-15175 | |
| 3.2 | Certificate of Amendment to Restated Certificate of Adobe | 8-K | 10/9/18 | 3.1 | 000-15175 | |
| 3.3 | Amended and Restated Bylaws | 8-K | 10/9/18 | 3.2 | 000-15175 | |
| 4.1 | Specimen Common Stock Certificate | | | | | X |
| 4.2 | Form of Indenture dated as of January 25, 2010 by and between Adobe and Wells Fargo Bank, National Association, as trustee | S-3 | 2/26/16 | 4.1 | 333-209764 | |
| 4.3 | Form of Global Note for Adobe Systems Incorporated's 4.750% Notes due 2020, together with Form of Officer's Certificate setting forth the terms of the Note | 8-K | 1/26/10 | 4.1 | 000-15175 | |
| 4.4 | Form of Global Note for Adobe's 3.250% Notes due 2025, together with Form of Officer's Certificate setting forth the terms of the Note | 8-K | 1/26/15 | 4.1 | 000-15175 | |

| | | | | | |
|---|---|---|---|---|---|
| 10.1A | Amended 1994 Performance and Restricted Stock Plan* | 10-Q | 4/9/10 | 10.1 | 000-15175 |
| 10.1B | Form of Restricted Stock Agreement used in connection with the Amended 1994 Performance and Restricted Stock Plan* | 10-K | 1/23/09 | 10.3 | 000-15175 |
| 10.1C | Form of Restricted Stock Unit Agreement used in connection with the Amended 1994 Performance and Restricted Stock Plan* | 10-K | 1/26/12 | 10.13 | 000-15175 |

Table of Contents

| Exhibit Number | Exhibit Description | Incorporated by Reference** Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
|---|---|---|---|---|---|---|
| 10.2 | 1997 Employee Stock Purchase Plan, as amended* | 10-Q | 6/29/16 | 10.3 | 000-15175 | |
| 10.3A | 2003 Equity Incentive Plan, as amended* | 8-K | 4/13/18 | 10.2 | 000-15175 | |
| 10.3B | Form of Stock Option Agreement used in connection with the 2003 Equity Incentive Plan* | 8-K | 12/20/10 | 99.4 | 000-15175 | |
| 10.3C | Form of RSU Grant Notice and Award Agreement pursuant to 2003 Equity Incentive Plan* | 8-K | 1/26/18 | 10.6 | 000-15175 | |
| 10.3D | Form of Restricted Stock Agreement used in connection with the 2003 Equity Incentive Plan* | 10-Q | 10/7/04 | 10.11 | 000-15175 | |
| 10.3E | 2015 Performance Share Program pursuant to the 2003 Equity Incentive Plan* | 8-K | 1/28/15 | 10.2 | 000-15175 | |
| 10.3F | Form of 2015 Performance Share Award Grant Notice and Award Agreement pursuant to the 2003 Equity Incentive Plan (applicable to the 2015 Performance Share Program)* | 8-K | 1/28/15 | 10.3 | 000-15175 | |
| 10.3G | 2016 Performance Share Program pursuant to the 2003 Equity Incentive Plan* | 8-K | 1/29/16 | 10.2 | 000-15175 | |
| 10.3H | Form of 2016 Performance Share Award Grant Notice and Award Agreement pursuant to the 2003 Equity Incentive Plan (applicable to the 2016 Performance Share Program)* | 8-K | 1/29/16 | 10.3 | 000-15175 | |
| 10.3I | 2017 Performance Share Program pursuant to the 2003 Equity Incentive Plan* | 8-K | 1/27/17 | 10.2 | 000-15175 | |
| 10.3J | Form of 2017 Performance Share Award Grant Notice and Award Agreement pursuant to 2017 Performance Share Program and 2003 Equity Incentive Plan* | 8-K | 1/27/17 | 10.3 | 000-15175 | |
| 10.3K | 2018 Performance Share Program pursuant to the 2003 Equity Incentive Plan* | 8-K | 1/26/18 | 10.2 | 000-15175 | |
| 10.3L | Form of 2018 Performance Share Award Grant Notice and Award Agreement pursuant to 2018 Performance Share Program and 2003 Equity Incentive Plan* | 8-K | 1/26/18 | 10.3 | 000-15175 | |
| 10.3M | | 8-K | 12/20/10 | 99.6 | 000-15175 | |

| | | | | | |
|---|---|---|---|---|---|
| | Form of Director Initial Grant Restricted Stock Unit Award Agreement used in connection with the 2003 Equity Incentive Plan* | | | | |
| 10.3N | Form of Director Annual Grant Restricted Stock Unit Award Agreement used in connection with the 2003 Equity Incentive Plan* | 8-K | 12/20/10 | 99.7 | 000-15175 |

| Exhibit Number | Exhibit Description | Incorporated by Reference** Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
|---|---|---|---|---|---|---|
| 10.3O | Form of Director Annual Grant Stock Option Agreement used in connection with the 2003 Equity Incentive Plan* | 8-K | 12/20/10 | 99.8 | 000-15175 | |
| 10.4A | 2005 Equity Incentive Assumption Plan, as amended and restated* | 10-Q | 6/28/13 | 10.17 | 000-15175 | |
| 10.4B | Form of Stock Option Agreement used in connection with the 2005 Equity Incentive Assumption Plan* | 8-K | 12/20/10 | 99.10 | 000-15175 | |
| 10.4C | Form of RSU Grant Notice and Award Agreement pursuant to the 2005 Equity Incentive Assumption Plan* | 8-K | 1/28/13 | 10.7 | 000-15175 | |
| 10.5 | Retention Agreement between Adobe and Shantanu Narayen, effective December 5, 2014* | 8-K | 12/11/14 | 10.2 | 000-15175 | |
| 10.6 | Form of Indemnity Agreement* | 10-Q | 6/26/09 | 10.12 | 000-15175 | |
| 10.7 | Adobe Deferred Compensation Plan, as Amended and Restated* | 10-K | 1/20/15 | 10.19 | 000-15175 | |
| 10.8 | Credit Agreement, dated as of October 17, 2018, among Adobe Inc. and certain subsidiaries as Borrowers, JPMorgan Chase Bank, N.A., Wells Fargo Bank National Association, U.S Bank National Association, Societe Generale S.A. as Co-Syndication Agents, Bank of America, N.A. as Administrative Agent and Swing Line Lender, and the Other Lenders Party Thereto | 8-K | 10/19/18 | 10.1 | 000-15175 | |
| 10.9 | Credit Agreement, dated as of October 17, 2018, among Adobe Inc. as Borrower, JPMorgan Chase Bank, N.A. as Syndication Agent, Wells Fargo Bank National Association as Documentation Agent, Bank of America, N.A. as Administrative Agent, and the Other Lenders Party Thereto | 8-K | 10/19/18 | 10.2 | 000-15175 | |
| 10.10 | Omniture, Inc. 2006 Equity Incentive Plan and related forms* | 10-Q | 8/6/09 | 10.3 | 000-52076 | |
| 10.11 | Omniture, Inc. 2008 Equity Incentive Plan and related forms* | 10-K | 2/27/09 | 10.10 | 000-52076 | |
| 10.12 | Demdex, Inc. 2008 Stock Plan, as amended* | S-8 | 1/27/11 | 99.1 | 333-171902 | |
| 10.13 | EchoSign, Inc. 2005 Stock Plan, as amended* | S-8 | 7/29/11 | 99.1 | 333-175910 | |

| | | | | | |
|---|---|---|---|---|---|
| 10.14 | TypeKit, Inc. 2009 Equity Incentive Plan, as amended* | S-8 | 10/7/11 | 99.1 | 333-177229 |
| 10.15 | Auditude, Inc. 2009 Equity Incentive Plan, as amended* | S-8 | 11/18/11 | 99.1 | 333-178065 |
| 10.16 | Efficient Frontier, Inc. 2003 Stock Option/Stock Issuance Plan, as Amended and Restated* | S-8 | 1/27/12 | 99.1 | 333-179221 |

Table of Contents

| Exhibit Number | Exhibit Description | Incorporated by Reference** Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
|---|---|---|---|---|---|---|
| 10.17A | Behance, Inc. 2012 Equity Incentive Plan* | S-8 | 1/23/13 | 99.1 | 333-186143 | |
| 10.17B | Amendment No. 1 to the Behance, Inc. 2012 Equity Incentive Plan* | S-8 | 1/23/13 | 99.2 | 333-186143 | |
| 10.18 | Neolane 2008 Stock Option Plan* | S-8 | 8/27/13 | 99.1 | 333-190846 | |
| 10.19 | 2012 Neolane Stock Option Plan for The United States* | S-8 | 8/27/13 | 99.2 | 333-190846 | |
| 10.20A | Aviary, Inc. 2008 Stock Plan, as amended* | S-8 | 9/26/14 | 99.1 | 333-198973 | |
| 10.20B | Form of Stock Option Grant Notice and Award Agreement pursuant to the Aviary, Inc. 2008 Stock Plan (Installment Vesting)* | S-8 | 9/26/14 | 99.2 | 333-198973 | |
| 10.20C | Form of Stock Option Grant Notice and Award Agreement pursuant to the Aviary, Inc. 2008 Stock Plan (Installment Vesting, Non- U.S.)* | S-8 | 9/26/14 | 99.3 | 333-198973 | |
| 10.21 | Picasso Acquisition Holding 1, Inc. 2012 Stock Option and Grant Plan* | S-8 | 3/13/15 | 99.1 | 333-202732 | |
| 10.22 | TubeMogul, Inc. 2007 Equity Compensation Plan, as amended, and forms of agreement thereunder††* | S-1 | 3/26/14 | 10.2 | 333-194817 | |
| 10.23 | TubeMogul, Inc. 2014 Equity Incentive Plan, and forms of agreement thereunder††* | S-1A | 7/7/14 | 10.3 | 333-194817 | |
| 10.24 | MagentoTech LLC Unit Option Plan, as amended* | S-8 | 6/27/18 | 99.14 | 333-225922 | |
| 10.25 | Adobe Systems Incorporated 2017 Executive Severance Plan in the Event of a Change of Control* | 8-K | 12/14/17 | 10.1 | 000-15175 | |
| 10.26 | 2015 Executive Annual Incentive Plan* | 8-K | 1/28/15 | 10.5 | 000-15175 | |
| 10.27 | 2016 Executive Annual Incentive Plan* | 8-K | 1/29/16 | 10.5 | 000-15175 | |
| 10.28 | 2016 Executive Cash Performance Bonus Plan* | 8-K | 1/29/16 | 10.4 | 000-15175 | |
| 10.29 | 2017 Executive Annual Incentive Plan* | 8-K | 1/27/17 | 10.5 | 000-15175 | |
| 10.30 | 2018 Executive Annual Incentive Plan* | 8-K | 1/26/18 | 10.5 | 000-15175 | |

| | | | | | |
|---|---|---|---|---|---|
| 10.31 | Description of 2016 Director Compensation* | 10-K | 1/19/16 | 10.32 | 000-15175 |
| 10.32 | Description of 2017 Director Compensation* | 10-K | 1/20/17 | 10.32 | 000-15175 |
| 10.33 | Description of 2018 Director Compensation* | 10-K | 1/22/18 | 10.29 | 000-15175 |
| 10.34 | Description of 2019 and 2020 Director Compensation* | 8-K | 1/24/19 | 10.1 | 000-15175 |

| Exhibit Number | Exhibit Description | Incorporated by Reference** Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
|---|---|---|---|---|---|---|
| 10.35 | Share Purchase Agreement by and among: Adobe, a Delaware corporation; Milestone Topco, Inc., a Delaware corporation; Vista Equity Partners Fund V, L.P., a Delaware limited partnership; Vista Equity Partners Fund V-A, L.P., a Cayman Island exempted limited partnership; Vista Equity Partners Fund V-B, L.P., a Cayman Island exempted limited partnership; VEPF V FAF, L.P., a Delaware limited partnership; Vista Equity Partners Fund V Executive, L.P., a Delaware limited partnership; Vista Equity Associates V, LLC, a Delaware limited liability company; Vista Equity Partners Fund VI, L.P., a Cayman Island exempted limited partnership; Vista Equity Partners Fund VI-A, L.P., a Cayman Island exempted limited partnership; VEPF VI FAF, L.P., a Cayman Island exempted limited partnership; and Vista Equity Partners Management, LLC, a Delaware limited liability company, as the Sellers' Representative | 8-K | 9/21/18 | 2.1 | 000-15175 | |
| 21 | Subsidiaries of the Registrant | | | | | X |
| 23.1 | Consent of Independent Registered Public Accounting Firm, KPMG LLP | | | | | X |
| 24.1 | Power of Attorney (set forth on the signature page to this Annual Report on Form 10-K) | | | | | X |
| 31.1 | Certification of Chief Executive Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934 | | | | | X |
| 31.2 | Certification of Chief Financial Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934 | | | | | X |
| 32.1 | Certification of Chief Executive Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934† | | | | | X |
| 32.2 | Certification of Chief Financial Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934† | | | | | X |
| 101.INS | XBRL Instance | | | | | X |
| 101.SCH | XBRL Taxonomy Extension Schema | | | | | X |
| 101.CAL | XBRL Taxonomy Extension Calculation | | | | | X |

| | | |
|---|---|---|
| 101.LAB | XBRL Taxonomy Extension Labels | X |
| 101.PRE | XBRL Taxonomy Extension Presentation | X |
| 101.DEF | XBRL Taxonomy Extension Definition | X |

| | |
|---|---|
| * | Compensatory plan or arrangement. |
| ** | References to Exhibits 10.11 and 10.12 are to filings made by Omniture, Inc. |
| † | The certifications attached as Exhibits 32.1 and 32.2 that accompany this Annual Report on Form 10-K, are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Adobe Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Form 10-K, irrespective of any general incorporation language contained in such filing. |
| †† | References to Exhibits 10.22 through 10.23 are to filings made by TubeMogul, Inc. |

**ITEM 16. FORM 10-K SUMMARY**

None.

Table of Contents

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ADOBE INC.

By: /s/ JOHN MURPHY
John Murphy
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: January 25, 2019

**POWER OF ATTORNEY**

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Shantanu Narayen and John Murphy, and each or any one of them, his or her lawful attorneys-in-fact and agents, for such person in any and all capacities, to sign any and all amendments to this report and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that either of said attorneys-in-fact and agent, or substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ SHANTANU NARAYEN<br>Shantanu Narayen | Chairman of the Board of Directors, President and Chief Executive Officer (Principal Executive Officer) | January 25, 2019 |
| /s/ JOHN MURPHY<br>John Murphy | Executive Vice President, Chief Financial Officer (Principal Financial Officer) | January 25, 2019 |
| /s/ MARK GARFIELD<br>Mark Garfield | Vice President, Corporate Controller and Chief Accounting Officer (Principal Accounting Officer) | January 25, 2019 |
| /s/ JAMES DALEY<br>James Daley | Director | January 25, 2019 |
| /s/ AMY BANSE<br>Amy Banse | Director | January 25, 2019 |

| Signature | Title | Date |
| --- | --- | --- |
| /s/ EDWARD BARNHOLT<br>Edward Barnholt | Director | January 25, 2019 |
| /s/ ROBERT BURGESS<br>Robert Burgess | Director | January 25, 2019 |
| /s/ FRANK CALDERONI<br>Frank Calderoni | Director | January 25, 2019 |
| /s/ LAURA DESMOND<br>Laura Desmond | Director | January 25, 2019 |
| /s/ CHARLES GESCHKE<br>Charles Geschke | Director | January 25, 2019 |
| /s/ DAVID RICKS<br>David Ricks | Director | January 25, 2019 |
| /s/ DANIEL ROSENSWEIG<br>Daniel Rosensweig | Director | January 25, 2019 |
| /s/ JOHN WARNOCK<br>John Warnock | Director | January 25, 2019 |

Table of Contents

**SUMMARY OF TRADEMARKS**

The following trademarks of Adobe Inc. or its subsidiaries, which may be registered in the United States and/or other countries, are referenced in this Form 10-K:

Acrobat
Adobe
Adobe Connect
Adobe CreativeSync
Adobe Dimension
Adobe Premiere
Adobe Sensei
After Effects
Behance
Creative Cloud
Illustrator
InCopy
InDesign
Lightroom
LiveCycle
Magento
Marketo
Photoshop
PostScript
Reader
Sensei
TubeMogul
Typekit

All other trademarks are the property of their respective owners.



10-K 1 adbe10kfy17.htm 10-K

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**Washington, D.C. 20549**

# FORM 10-K

**(Mark One)**

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

**For the fiscal year ended December 1, 2017**

**or**

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

**For the transition period from_________to_________**

**Commission File Number: 0-15175**

# ADOBE SYSTEMS INCORPORATED
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **77-0019522** |
| (State or other jurisdiction of | (I.R.S. Employer |

| | |
|---|---|
| incorporation or organization) | Identification No.) |

**345 Park Avenue, San Jose, California 95110-2704**
(Address of principal executive offices)

**(408) 536-6000**
(Registrant's telephone number, including area code)

**Securities registered pursuant to Section 12(b) of the Act:**

| Title of Each Class | Name of Each Exchange on Which Registered |
|---|---|
| Common Stock, $0.0001 par value per share | The NASDAQ Stock Market LLC<br>(NASDAQ Global Select Market) |

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | | | | |
|---|---|---|---|---|
| Large accelerated filer ☒ | Accelerated filer ☐ | Non-accelerated filer ☐<br>(Do not check if a smaller reporting company) | Smaller reporting company ☐ | Emerging growth company ☐ |

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

The aggregate market value of the registrant's common stock, $0.0001 par value per share, held by non-affiliates of the registrant on June 2, 2017, the last business day of the registrant's most recently completed second fiscal quarter, was $52,575,558,763 (based on the closing sales price of the registrant's common stock on that date). Shares of the registrant's common stock held by each officer and director and each person who owns 5% or more of the outstanding common stock of the registrant have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes. As of January 12, 2018, 491,578,529 shares of the registrant's common stock, $0.0001 par value per share, were issued and outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the registrant's 2018 Annual Meeting of Stockholders (the "Proxy Statement"), to be filed within 120 days of the end of the fiscal year ended December 1, 2017, are incorporated by reference in Part III hereof. Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part hereof.

**ADOBE SYSTEMS INCORPORATED**
**FORM 10-K**

**TABLE OF CONTENTS**

**Forward-Looking Statements**

*In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements, including statements regarding product plans, future growth, market opportunities, strategic initiatives, industry positioning, customer acquisition and retention, the amount of recurring revenue and revenue growth. In addition, when used in this report, the words "will," "expects," "could," "would," "may," "anticipates," "intends," "plans," "believes," "seeks," "targets," "estimates," "looks for," "looks to," "continues" and similar expressions, as well as statements regarding our focus for the future, are generally intended to identify forward-looking statements. Each of the forward-looking statements we make in this report involves risks and uncertainties that could cause actual results to differ materially from these forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Risk Factors" in Part I, Item 1A of this report. You should carefully review the risks described herein and in other documents we file from time to time with the U.S. Securities and Exchange Commission (the "SEC"), including our Quarterly Reports on Form 10-Q to be filed in 2018. You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document, except as required by law.*

**PART I**

**ITEM 1. BUSINESS**

Founded in 1982, Adobe Systems Incorporated is one of the largest and most diversified software companies in the world. We offer a line of products and services used by creative professionals, marketers, knowledge workers, application developers, enterprises and consumers for creating, managing, delivering, measuring, optimizing and engaging with compelling content and experiences across personal computers, devices and media. We market our products and services directly to enterprise customers through our sales force and certain local field offices. We license our products to end users through app stores and our own website at www.adobe.com. We offer many of our products via a Software-as-a-Service ("SaaS") model or a managed services model (both of which are referred to as hosted or cloud-based) as well as through term subscription and pay-per-use models. We also distribute certain products and services through a network of distributors, value-added resellers ("VARs"), systems integrators ("SIs"), independent software vendors ("ISVs"), retailers, software developers and original equipment manufacturers ("OEMs"). In addition, we license our technology to hardware manufacturers, software developers and service providers for use in their products and solutions. Our products run on personal and server-based computers, as well as on smartphones, tablets and other devices, depending on the product. We have operations in the Americas, Europe, Middle East and Africa ("EMEA") and Asia-Pacific ("APAC"). *See Note 17 of our Notes to Consolidated Financial Statements for further geographical information.*

Adobe was originally incorporated in California in October 1983 and was reincorporated in Delaware in May 1997. Our executive offices and principal facilities are located at 345 Park Avenue, San Jose, California 95110-2704. Our telephone number is 408-536-6000 and our website is www.adobe.com. Investors can obtain copies of our SEC filings from this site free of charge, as well as from the SEC website at www.sec.gov. The information posted to our website is not incorporated into this Annual Report on Form 10-K.

**BUSINESS OVERVIEW**

For over 35 years, Adobe's innovations have transformed how individuals, teams, businesses and governments interact. We help our customers create and deliver the most compelling experiences in a streamlined workflow, and optimize those experiences for greater return on investment. Our solutions turn ordinary interactions into valuable digital experiences, across media and devices, anytime, anywhere.

While we continue to offer a broad portfolio of products, services, and solutions, we focus our investments in two strategic growth areas:

Digital Media—providing products, services and solutions that enable individuals, teams and enterprises to create, publish and promote their content anywhere. Our customers include content creators, web designers, app developers and digital media professionals, as well as management in marketing departments and agencies, companies and publishers. Our customers also include knowledge workers who create, collaborate and distribute documents. This is the core of what we have delivered for over 25 years, and we have evolved our business model to provide our customers with a range of flexible solutions that allow them to reach their full creative potential anytime, anywhere, on any device on projects of all types.

Digital Experience—providing solutions and services for creating, managing, executing, measuring and optimizing digital marketing and advertising campaigns across multiple channels. Our customers include marketers, advertisers, agencies, publishers, merchandisers, web analysts, marketing executives, information management executives, product development executives, and sales and support executives. In fiscal 2017, we processed 186 trillion data transactions with our analytics products, providing our customers with a robust data platform that can be used to gain insight and optimize digital experiences delivered with our Adobe Experience Cloud solutions. By combining the creativity of our Digital Media business with the science of our Digital Experience offerings, we help our customers more efficiently and effectively make, manage, measure and monetize their content across every channel with an end-to-end workflow and feedback loop.

We believe we are uniquely positioned to be a leader in both the Digital Media and Digital Experience markets, where our mission is to change the world through digital experiences. By integrating products from each of these two areas of Adobe's business, our customers are able to utilize a comprehensive suite of solutions and services that no other company currently offers. In addition, our ability to deliver innovation and productivity improvements across customer workflows involving the creation, management, delivery, measurement and optimization of engaging content favorably positions Adobe as our customers continue investing in engaging their constituents digitally.

## SEGMENTS

Effective in fiscal 2018, our business is organized into three reportable segments: Digital Media, Digital Experience (formerly Digital Marketing), and Publishing (formerly Print and Publishing). These segments provide Adobe's senior management with a comprehensive financial view of our key businesses. Our segments are aligned around our two strategic growth opportunities described above, placing our Publishing business in a third segment that contains some of our mature products and solutions.

This overview provides an explanation of our markets and a discussion of strategic opportunities in fiscal 2018 and beyond for each of our segments. *See "Results of Operations" within Part II, Item 7 titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 17 of our Notes to Consolidated Financial Statements for further segment information.*

## MARKET OVERVIEW

### Digital Media

*Digital Media Opportunity*

Recent technology trends in digital communications continue to provide a significant market opportunity for Adobe in digital media. In today's world where the velocity of creation and consumption of digital content is ever increasing, customers are looking for a way to meet demand with engaging online experiences. Adobe is in a strong position to capitalize on this opportunity by driving modernization and innovation that will accelerate the creative process across all platforms and devices, deepen engagement with communities, and accelerate long-term revenue growth by focusing on cloud-based offerings, which are licensed on a subscription basis.

The flagship of our Digital Media business is Adobe Creative Cloud—a subscription service that allows members to use Adobe's creative products integrated with cloud-delivered services across desktop, web and mobile devices. Creative Cloud members can download and access the latest versions of our creative products such as Photoshop CC, Illustrator CC, Premiere Pro CC, Lightroom CC, InDesign CC, Adobe XD CC and many more creative applications. In addition, members can access built-in templates to jumpstart designs and step-by-step tutorials to sharpen skills and get up to speed quickly. Through Creative Cloud, members can access online services to sync, store, and share files across users' machines, access marketplace, social and community-based features within our Adobe Stock and Behance services, and create apps and websites, all at affordable subscription pricing for cost-sensitive customers.

Adobe continues to redefine the creative process with Creative Cloud so that our customers can obtain everything they need to create, collaborate and be inspired. A core part of our strategy is Adobe Sensei, a proprietary framework and set of intelligent services for dramatically improving the design and delivery of digital experiences. Adobe Sensei leverages Adobe's massive content and data assets, as well as its deep domain expertise in the creative, marketing and document segments, within a unified artificial intelligence ("AI") and machine learning framework to tackle today's complex creative experience challenges.

Creative Cloud addresses the needs of creative professionals such as artists, designers, developers, students and administrators. They rely on our products for publishing, web design and development, video and animation production, mobile app and gaming development, and document creation and collaboration. End users of our creative products work in businesses ranging from large publishers, media companies and global enterprises, to smaller design agencies, and individual freelancers. Moreover, our creative products are used to create much of the printed and online information people see, read and interact with every day, including video, animation, mobile and advertising content. Knowledge workers, educators, hobbyists and consumers also use our products to create and deliver content. We have introduced new products, features and services to address emerging categories of content creation such as 3D, augmented reality, virtual reality and user experience design. New solutions include Adobe Dimension, a tool that enables the creation of high-quality, photorealistic 3D images; Adobe XD, a solution for creating user experiences and screen designs as part of designing websites and mobile apps; and Adobe Spark, a set of capabilities that enables anyone to create impactful graphics, web pages and video stories in minutes.

Adobe's Digital Media segment includes our Document Cloud business, built around our Acrobat family of products, the Adobe Acrobat Reader and a set of integrated, cloud-based document services. Tens of millions of knowledge workers worldwide interact with documents daily. For over 25 years, Adobe Acrobat has provided for the reliable creation and exchange of electronic documents, regardless of platform or application source type. Users can collaborate on documents with electronic comments and tailor the security of a file in order to distribute reliable Adobe PDF documents that can be viewed, printed or filled out utilizing our free Adobe Acrobat Reader. Acrobat provides essential electronic document capabilities and services to help knowledge workers accomplish a wide variety of tasks ranging from simple publications and forms to mission-critical engineering documentation and architectural plans. With our Acrobat product and its innovative cloud services, we have extended the capabilities of our solutions. Users can turn slow, manual signing processes into automated experiences and collect signatures with Adobe Scan, Adobe Sign and Adobe Send & Track.

*Digital Media Strategy*

Our goal is to be the leading platform for creativity where we offer a range of products and services that allow individuals, teams and enterprises to design and deliver amazing digital content.

We believe there is significant opportunity for growth across all customer segments and expect Creative Cloud will drive sustained long-term revenue growth through a continued expansion of our customer base by acquiring new users in North America and international markets. We will continue to seek to deepen our relationship with existing users through meeting their needs holistically and delivering additional features and value. As appropriate, we plan to optimize our pricing strategy and move our customers to higher priced and better value offerings and continue to employ targeted promotions that attract past customers and potential users to try out and ultimately subscribe to Creative Cloud. To target new customers and better address the needs of our existing customers, we will continue to invest in driving innovation to maintain the leadership position that we have established. We have also built a marketplace for Creative Cloud subscribers to enable the delivery and purchase of stock content in our Adobe Stock service. Overall, our strategy with Creative Cloud is designed to enable us to increase our revenue with users, attract more new customers, and grow a recurring and predictable revenue stream that is recognized ratably.

As part of our Creative Cloud strategy, we utilize our Experience Cloud solutions to drive customer awareness and licensing of our creative products and services through our website and across other channels. Adobe.com is increasingly becoming the destination site where we engage individual and small business customers to sign up for and renew Creative Cloud subscriptions. We utilize channel partners to target mid-size creative customers with our Creative Cloud for teams offering. Our direct sales force is focused on building relationships with our largest customers and driving adoption of our Creative Cloud for enterprise offering.

We offer many of the products included in Creative Cloud on a standalone basis, including subscriptions to the Creative Cloud version of certain point products. We also offer a range of other creative tools and services, including our hobbyist products such as Photoshop Elements and Premiere Elements, Typekit and mobile apps such as Photoshop Mix, Photoshop Sketch, Photoshop Fix, Adobe Capture CC, and Adobe Spark. Further descriptions of our Digital Media products are included below under "Principal Products and Services."

In our Document Cloud business, although Acrobat has achieved strong market adoption in document-intensive industries such as government, financial services, pharmaceutical, legal, aerospace, insurance and technical publishing, we believe there are tens of millions of users who need the capabilities provided by Acrobat and the service capabilities found in Document Cloud. We plan to continue marketing the benefits of our Document Cloud solutions, combined with the low entry point of subscription-based pricing, to individuals as well as small and medium-sized businesses, large enterprises and government institutions around the world. We aim to increase our seat penetration in these markets through the utilization of our corporate and volume licensing programs. We will continue to engage in strategic partnerships to help drive the business, including the recently announced Adobe Sign partnership with Microsoft. We also intend to increase our focus on marketing and licensing Acrobat in targeted vertical markets such as education, financial services, telecommunications and government, as well as on expanding into emerging markets, while simultaneously enhancing and building out the delivery of cloud-based document services to our Acrobat and Adobe Acrobat Reader users. We intend to continue promoting the capabilities of our cloud-based document solutions to millions of Acrobat users and hundreds of millions of Adobe Acrobat Reader users. Our Adobe Sign services provide a green alternative to costly paper-based solutions, and are an easier way for customers to manage their contract workflows. The Adobe Scan app for mobile devices can be used to capture paper documents as images and transform them into full-featured PDFs via Adobe Document Cloud services that can be shared immediately, essentially putting scanning capabilities in the pocket of every person. We believe that by growing the awareness of electronic signatures in the broader contract delivery and signing market and continuing to add new capabilities to our Adobe Scan and Sign offerings, we can help our customers migrate away from paper-based express mailing and adopt our solution, growing our revenue with this business in the process.

**Digital Experience**

*Digital Experience Opportunity*

Consumers today increasingly demand personalized content and experiences in their digital interactions, across multiple channels and devices. As a result, businesses must figure out how to best attract, engage, acquire and retain customers in a digital world where the reach and quality of experiences directly impact success. Delivering the best experience to a consumer at a given moment requires the right combination of data, insights and content. Executives are increasingly demanding solutions that optimize their consumers' experiences and deliver the greatest return on their marketing and IT spend so they can demonstrate the success of their programs using objective metrics.

We believe there is a significant opportunity to address these challenges and help customers transform their businesses. The world's leading brands are increasingly steering their marketing, advertising, and development budgets toward digital experiences. As enterprises make this move to digital, our opportunity is accelerating as customers look for vendors to help them navigate this transition. Enterprises need to ensure they deliver meaningful experiences to their consumers across digital channels and in areas such as sales, support, and product interactions where consumers expect experiences to be consistent and personalized.

Our Experience Cloud business targets this large and growing opportunity by providing comprehensive solutions that include analytics, targeting, advertising optimization, digital experience management, cross-channel campaign management, audience management, premium video delivery and monetization. These comprehensive solutions enable marketers to measure, personalize and optimize digital experiences across channels for optimal performance.

We believe the market for Experience Cloud is rapidly expanding, and industry analysts predict more advertising dollars will be spent in digital than in traditional media in the future.

*Digital Experience Strategy*

Our goal is to be the leading provider of solutions that enable our customers to provide exceptional digital experiences. Our integrated cloud-based solutions enable enterprises to build personalized campaigns, manage advertising, and gain deep intelligence about their customers. Our content and data platform provides differentiation and competitive advantage.

In March 2017, we migrated our hierarchy of solutions under what was formerly known as Adobe Marketing Cloud to our next generation offering referred to as Adobe Experience Cloud.

Adobe Experience Cloud consists of the following cloud offerings:

- Adobe Marketing Cloud—provides an integrated set of solutions to help marketers differentiate their brands and engage their customers, helping businesses manage, personalize, and orchestrate campaigns and customer journeys; includes Adobe Experience Manager ("AEM"), Adobe Campaign, Adobe Target and Adobe Primetime.

- Adobe Analytics Cloud—enables businesses to move from insights to actions in real time by uniquely integrating audiences as the core system of intelligence for the enterprise; makes data available across all Adobe clouds through the capture, aggregation, rationalization and understanding of vast amounts of disparate data and then translating that data into singular customer profiles; includes Adobe Analytics and Adobe Audience Manager.

- Adobe Advertising Cloud—delivers an end-to-end platform for managing advertising across traditional TV and digital formats, and simplifies the delivery of video, display and search advertising across channels and screens; combines capabilities from Adobe Media Optimizer ("AMO") and Adobe's acquisition of TubeMogul during the first quarter of fiscal 2017.

We believe the artificial intelligence and machine learning framework enabled by our strategy with Adobe Sensei enhances the delivery of digital experiences. By building on existing features such as Enhanced Anomaly

Detection, Auto-Target, and other capabilities, we believe Adobe Sensei will increase the value we provide our customers and create a competitive differentiation in the market.

To drive growth of Experience Cloud, we also intend to focus on customer engagement, partner leverage, and product differentiation. We utilize a direct sales force to market and license our Experience Cloud solutions, as well as an extensive ecosystem of partners, including marketing agencies, SIs and independent software vendors that help license and deploy our solutions to their customers. Strategic partnerships, such as the one we have formed with Microsoft, continue to increase our market reach. We have made significant investments to broaden the scale and size of all of these routes to market, and believe these investments will result in continued growth in revenue in our Digital Experience segment in fiscal 2018 and beyond.

**Publishing**

Our Publishing segment contains legacy products and services that address diverse market opportunities including eLearning solutions, technical document publishing, web application development and high-end printing. Graphics professionals and professional publishers continue to require quality, reliability and efficiency in production printing, and our Adobe PostScript and Adobe PDF printing technologies provide advanced functionality to meet the sophisticated requirements of this marketplace. As high-end printing systems evolve and transition to fully digital, composite workflows, we believe we are well positioned to be a supplier of software and technology based on the PostScript and Adobe PDF standards for use by this industry.

We generate revenue by licensing our technology to OEMs that manufacture workflow software, printers and other output devices. In fiscal 2017, we maintained a relatively consistent quarterly revenue run-rate with the mature products we market and license in our Publishing business.

In December 2017, in order to more closely align our Digital Experience business with the strategic growth opportunity, we moved two legacy enterprise software offerings from our Digital Experience segment to Publishing: our Adobe Connect web conferencing platform and Adobe LiveCycle, an enterprise document and forms platform. Since fiscal 2012, the focus of marketing and licensing these products has been to financial services and government markets, driven by a subset of our enterprise sales force. We have also been focused on migrating some legacy LiveCycle customers to an updated offering with similar capabilities based on our Adobe Experience Manager solution.

## COMPETITION

The markets for our products and services are characterized by intense competition, new industry standards, evolving distribution models, disruptive technology developments, frequent product introductions, short product life cycles, price cutting with resulting downward pressure on gross margins and price sensitivity on the part of consumers. Our future success will depend on our ability to enhance and better integrate our existing products, introduce new products on a timely and cost-effective basis, meet changing customer needs, provide best-in-class information security to build customer confidence and combat cyber-attacks, extend our core technology into new applications and anticipate emerging standards, business models, software delivery methods and other technological changes.

**Digital Media**

No single company has offerings that match the capabilities of our Creative Cloud products and services, but we face collective competition from a variety of point offerings, free products and downloadable apps. Our competition includes offerings from companies such as Apple, Autodesk, Avid, Facebook, Corel, Microsoft, Quark and others, as well as from many lower-end offerings. We believe our greatest advantage in this space is the performance and scope of our integrated solutions, which work together as part of Creative Cloud. With Creative Cloud, we compete favorably on the basis of features and functionality, ease of use, product reliability, value and performance characteristics.

Professional digital imaging, drawing and illustration products are characterized by feature-rich competition, brand awareness and price sensitivity. Competition in this space is also emerging with drawing and illustration applications on tablet and smartphone platforms. The demand for professional web page layout and professional web content creation tools is constantly evolving and highly volatile. In this area, we face direct and indirect competition from desktop software companies and various proprietary and open source web-authoring tools.

We face competition from device, hardware and camera manufacturers as they try to differentiate their offerings by bundling, for free, their own digital imaging software or those of our competitors. Similarly, we face potential competition from operating system manufacturers as they integrate or offer hobbyist-level digital imaging and image management features with their operating systems. We also face competition from smartphone and tablet manufacturers that integrate imaging and video software into their devices to work with cameras that come as part of their smartphone and tablet offerings. In addition, social networking platforms such as Facebook (including Instagram), Snapchat, Twitter and Pinterest, as well as portal sites such as Google, Bing and Yahoo! are becoming a direct means to post, edit and share images, bypassing the step of using image editing and sharing software. Online storage and synchronization are becoming free and ubiquitous. Consumers will be encouraged to use the image and video editing software offered by those storage products, thus competing with our software.

In addition, the needs of digital imaging and video editing software users are constantly evolving due to rapid technology and hardware advancements in digital cameras, digital video cameras, printers, personal computers, tablets, smartphones and other new devices. Our imaging and video offerings, including Photoshop, Lightroom, After Effects and Premiere Pro, face competition from established and emerging companies offering similar products.

New image editing applications for mobile devices and tablets with features that compete with our professional tools are also emerging as adoption of these devices grows. Our consumer digital imaging and video editing offerings are subject to intense competition, including customer price sensitivity and competitor brand awareness. We face direct and indirect competition in the consumer digital imaging space from a number of companies whose market software competes with our offerings.

The stock content marketplace has significant competition, especially in the microstock segment, where Adobe primarily operates today with our Adobe Stock offering. Key competitors in this segment include Shutterstock, Getty Images and a number of smaller companies. Adobe Stock's deep product integration with Creative Cloud and superior reach and relationships with creative professionals around the world differentiate our offerings.

The nature of traditional digital document creation, storage, and collaboration has been rapidly evolving as knowledge workers and consumers shift their behavior increasingly to non-desktop workflows. Competitors like Microsoft, Google, Box and Dropbox all offer competitive alternatives to our Document Cloud business for creating and managing PDFs. In addition, other PDF creation solutions can be found at a low cost or for free on the web or via mobile applications. To address these competitive threats, we are working to ensure our Adobe Document Cloud applications stay at the forefront of innovation in emerging opportunities such as PDF document generation, document collaboration and document security, and have developed mobile solutions such as Adobe Scan.

As e-signatures are quickly becoming a core element of digital documents, competitors to Adobe Sign such as DocuSign have emerged. Partnerships and integrations between these companies and third-parties create an increasingly competitive landscape in this space.

**Digital Experience**

The markets in which our Digital Experience business unit competes are growing rapidly and characterized by intense competition. Our Experience Cloud solutions face competition from large companies such as Google, IBM, Marketo, Oracle, salesforce.com, SAP, SAS, Verizon, Teradata and others, in addition to point product solutions and focused competitors. Additionally, new competitors are constantly entering these markets. Some of these competitors provide SaaS solutions to customers, generally through a web browser, while others provide software that is installed by customers directly on their servers. In addition, we compete at times with our customers' or potential customers' internally developed applications. Of the competitors listed above, no single company has products identical to our Experience Cloud offerings. Experience Cloud competes in a variety of areas, including: reporting and analytics; cross-channel marketing and optimization; online and social marketing; audience management; advertising and real-time bidding technology; video delivery and monetization; web experience management and others.

Large software, internet and database management companies have expanded their offerings in the digital experience area, either by developing competing services or by acquiring existing competitors or strategic partners of ours. We believe competitive factors in our markets include the proven performance, security, scalability, flexibility and reliability of services; the strategic relationships and integration with third-party applications; the intuitiveness and visual appeal of user interfaces; demonstrable cost-effective benefits to customers; pricing; the flexibility of services to match changing business demands; enterprise-level customer service and training; perceived market leadership; the usability of services; real-time data and reporting; independence from portals and search engines; the ability to deploy the services globally; and success in educating customers in how to utilize services effectively. We believe we compete favorably with both the enterprise and low-cost alternatives based on many of these competitive factors including our strong feature set, the breadth of our offerings, our focus on global, multi-brand companies, our superior user experience, tools for building multi-screen, cross-channel applications, standards-based architecture, scalability and performance and leadership in industry standards efforts.

Creative and digital agencies, as well as SIs, are increasingly investing in acquiring their own digital experience technology to complement their creative services offerings. Adobe may face competition from these agencies and SIs as they come to market with best-of-breed offerings in one or more digital experience capabilities, or if agencies attempt to create a more complete technology platform offering. We believe our creative tools heritage differentiates us from our competitors. We have worked closely with marketing and creative customers for over 30 years. We also believe we have leadership in this space, with current customers representing leading global brands. Our comprehensive solutions extend more broadly than any other company in serving the needs of marketers and addressing this market opportunity; we integrate content and data, analytics, personalization, digital experience management, cross-channel campaign management, audience management, video delivery and monetization and social capabilities in our Experience Cloud. Most importantly, we provide a vision for our digital experience customers as we engage with them across the important aspects of their business, extending from their use of Creative Cloud and Document Cloud to how they manage, deliver, measure and monetize their content with our Experience Cloud.

**Publishing**

Our Publishing product offerings face competition from large-scale publishing systems, XML-based publishing companies, as well as lower-end desktop publishing products. Similarly, our web conferencing product faces competition from a number of established products from other companies, including Cisco, Citrix and Microsoft. Competition involves a number of factors, including: product features, ease-of-use, printer service support, the level of customization and integration with other publishing system components, the number of hardware platforms supported, service and price. We believe we can successfully compete based upon the quality and features of our products, our strong brand among users, the widespread adoption of our products among printer service bureaus, and our extensive application programming interfaces.

In printing technologies, we believe the principal competitive factors for OEMs in selecting a page description language or a printing technology are product capabilities, market leadership, reliability, price, support and engineering development assistance. We believe that our competitive advantages include our technology competency, OEM customer relationships and our intellectual property portfolio.

## PRINCIPAL PRODUCTS AND SERVICES

**Digital Media Offerings**

***Creative Cloud***

Adobe Creative Cloud is a cloud-based subscription offering that enables creative professionals and enthusiasts alike to express themselves with apps and services that connect across devices, platforms and geographies. Members have access to a vibrant creative community, publishing services to deliver apps and websites, cloud storage to easily access their work, the ability to sync their files to virtually any device, collaboration capabilities with team members, and new products and exclusive updates as they are developed. Creative Cloud members can build a Creative Profile which persists wherever they are. A user's Creative Profile moves with them via Creative Cloud services from app to app and device to device, giving them immediate access to their personal files, photos, brushes, graphics, colors, fonts, text styles, desktop setting customizations and other important assets. Creative Cloud subscriptions include all of the applications listed below and many more.

*Photoshop and Lightroom*

Adobe Photoshop is the world's most advanced digital imaging solution. It is used by photographers, designers, animators, web professionals, and video professionals, and is available to Creative Cloud subscribers. Lightroom CC, our new cloud-based photo service for editing, organizing, storing and sharing photos, is also available to Creative Cloud subscribers. Customers can also subscribe to Photoshop or Lightroom CC as individual cloud-enabled subscription products, or through our Photography Plan, which is a cloud-enabled offering targeted at photographers and photo hobbyists and includes Lightroom CC, integrated cloud services, and Lightroom Classic.

We also offer Photoshop Elements, which is targeted at consumers who desire the brand and power of Photoshop through an easy-to-use interface. For tablet and smartphone users, we offer several mobile apps including Photoshop Sketch, Photoshop Mix, Photoshop Express, Lightroom for mobile and Photoshop Fix—all of which enable sophisticated photo editing and content creation using a touch-based interface on tablet and mobile devices.

*Illustrator*

Adobe Illustrator is our industry-standard vector graphics solution used worldwide by designers of all types who want to create digital graphics and illustrations for all kinds of media: print, web, interactive, video, and mobile. Illustrator is available to Creative Cloud subscribers, and customers can also subscribe to use it as an individual subscription product. Users can also utilize mobile apps such as Illustrator Draw to gain access to Illustrator capabilities on their tablets and mobile devices, and sync their work through CreativeSync for use with Illustrator on their desktop.

*Adobe XD*

Adobe XD is our all-in-one UX/UI solution for designing websites, mobile apps and more that is designed to enable users to go from concept to prototype faster. It contains intuitive tools that deliver precision and performance using timesaving features like Repeat Grid and flexible artboards to create everything from low-fidelity wireframes to fully interactive prototypes for any screen in minutes. Adobe XD also makes it easy to share prototypes with teammates via the web and show colleagues how multiscreen experiences look, feel and work with a single click. Adobe XD is available to Creative Cloud subscribers, and customers can also subscribe to use it as an individual cloud-enabled subscription product.

*InDesign*

Adobe InDesign is the leading professional page layout software for print and digital publishing. Our customers use it to design, preflight, and publish a broad range of content including newspapers and magazines for print, online, and tablet app delivery. Customers can create simple or complex layouts quickly and efficiently with precise control over typography, built-in creative tools, and an intuitive design environment. Tight integration with other Adobe offerings such as Photoshop, Illustrator, and Acrobat enables customers to work productively in print and digital workflows. Customers can also access Adobe digital publishing capabilities from within InDesign to create and publish engaging apps for a broad range of devices, including iOS, Android and Amazon-based devices. InDesign is available to Creative Cloud subscribers, and customers can also subscribe to use InDesign as an individual cloud-enabled subscription product.

*Adobe Premiere Pro*

Adobe Premiere Pro is a leading nonlinear video editing tool used by video professionals. Customers can import and combine various types of media, from video shot on a smartphone to 8K to virtual reality, and then edit in its native format without transcoding. Premiere Pro supports a vast majority of formats, and customers can use multiple graphics cards to accelerate render and export times. As part of Creative Cloud, Premiere Pro tightly integrates with other Adobe creative applications. Customers can also subscribe to use it as an individual cloud-enabled subscription product.

*Adobe Dimension*

Adobe Dimension (formerly Project Felix) is our newly released product that is designed to make it easy for graphic designers to create high-quality, photorealistic 3D images. Users can composite 2D and 3D assets to build product shots, scene visualizations, and abstract art. Dimension integrates well with other Adobe apps. Users can drag and drop background images from Photoshop and 3D models from Adobe Stock - without leaving Dimension. Dimension is available to Creative Cloud subscribers, and customers can also subscribe to use it as an individual cloud-enabled subscription product.

*After Effects*

Adobe After Effects is our industry-leading animation and creative compositing solution used by a wide variety of motion graphics and visual effects artists. It offers superior control, a wealth of creative options, and integration with other post-production applications. After Effects works together seamlessly with other Adobe apps such as Premiere Pro, Photoshop, Illustrator, and Audition. After Effects is available to Creative Cloud subscribers, and customers can also subscribe to use it as an individual cloud-enabled subscription product.

*Typekit*

Adobe Typekit brings thousands of fonts from foundry partners into one library for quick browsing, easy use on the web or on the user’s desktop, and endless typographic inspiration. Our full library of commercially-licensed fonts is offered through Creative Cloud. In addition, customers may subscribe to the standalone Typekit portfolio plan, or license individual fonts in the Adobe Typekit Marketplace.

*Behance*

Behance is the leading social community to showcase and discover creative work online. Adobe Portfolio allows users to quickly and simply build a fully customizable and hosted website that seamlessly syncs with Behance.

*Adobe Spark*

Adobe Spark is our integrated web and mobile software for creating and sharing impactful visual stories. Designed for everyday communication, AdobeSpark empowers users to create stunning visual content that engages audiences across multiple channels and on any device. The Adobe Spark web app seamlessly syncs with Spark Post, Spark Page and Spark Video iOS mobile apps, allowing users to create, edit and share their story from any location regardless of their design experience. Adobe Spark with premium features allows users to apply custom branding to anything they create; the premium product is offered as part of any Creative Cloud plan or as a standalone subscription. A free version is also still available to attract new users.

***Acrobat and Adobe Document Cloud***

Adobe Document Cloud is a complete portfolio of secure digital document solutions that speed business transactions through streamlined digital workflows. With Adobe Document Cloud, users can create, review, approve, sign and track documents, whether on a desktop or mobile device.

At the heart of Adobe Document Cloud is Adobe Acrobat DC, the industry standard for PDF creation and conversion. Acrobat enables users to create secure, reliable and compact Adobe PDF documents from desktop authoring applications such as Microsoft Office software, graphics applications and more. Acrobat enables automated collaborative workflows with a rich set of commenting tools and review tracking features and includes everything needed to create and distribute rich, secure electronic documents that can be viewed easily within leading web browsers or on computer desktops via the free Adobe Acrobat Reader DC.

Acrobat is available to both Creative Cloud and Document Cloud subscribers. Customers can also license Acrobat Pro or Acrobat Standard (which has a subset of Acrobat Pro features) as individual point products, either as a cloud-enabled subscription or in the form of desktop software. Acrobat is also available as a free mobile app that allows users to view, annotate, and scan documents. Acrobat Reader is our free software for reliable viewing, searching, reviewing and printing of Adobe PDF documents on a variety of hardware and operating system platforms. Users of both Acrobat and Acrobat Reader can also access, edit and save changes to their PDF files stored on the Dropbox website or mobile app.

Adobe Scan can be used on mobile devices to provide scanning capabilities in the pocket of every person. It captures paper documents as images and transforms them into full-featured and versatile PDFs via Document Cloud services for instant sharing with others.

Our Adobe Sign e-signature services, which can be accessed as part of Document Cloud, allow users to securely electronically send and sign any document from any device. Adobe Sign has a mobile app companion allowing users to e-sign documents and forms, send them for signature, track responses in real-time, and obtain instant signatures with in-person signing. It integrates with users' enterprise systems through a comprehensive set of applicable programming interfaces, and Adobe Experience Manager Forms and Advanced Workflows for Adobe Sign to create forms and provide seamless experiences to customers across web and mobile sites. Adobe Sign is Microsoft's preferred e-sign solution and is integrated into Microsoft Office 365, Microsoft Dynamics 365, and Microsoft SharePoint.

**Adobe Experience Cloud Products and Services**

Adobe Experience Cloud includes our Marketing Cloud, Analytics Cloud, and Advertising Cloud offerings, which are each described below.

***Adobe Marketing Cloud***

Adobe Marketing Cloud provides a complete set of integrated digital marketing solutions. It contains everything necessary to deliver first-class digital experiences. Adobe Marketing Cloud enables our customers to manage their content and assets, grow audiences and increase engagement to optimize customer experiences; personalize content and deliver optimized experiences at scale that are meaningful to each of their customers; and orchestrate individual cross-channel campaigns that encourage meaningful customer experiences. Adobe Marketing Cloud also provides a solution that allows our customers to monetize video experiences. The following is a brief description of the solutions that comprise the Adobe Marketing Cloud.

*Adobe Experience Manager*

Adobe Experience Manager is a leading digital experience management solution that helps customers organize, create, and manage the delivery of creative assets and other content across digital marketing channels, including web, mobile, email, communities and video. It enables customers to manage content on premise or host it in the cloud, delivering agile and rapid deployment. With this ultimate control of content and campaigns, our customers can deliver real-time and personalized experiences to their consumers that help build the customers' brand, drive demand and extend reach. Adobe Experience Manager includes digital asset management, web content management, digital publishing, integrated mobile app development, enterprise-level forms management, and social capabilities, providing customers with tools enabling users to improve their market and brand perception and provide a personalized experience to their consumers.

*Adobe Campaign*

Adobe Campaign enables marketers to orchestrate personalized experiences determined by each consumer's behaviors and preferences. As part of its feature set, Adobe Campaign provides visual campaign orchestration, allowing for intuitive design and automated consumer experiences across channels, from one-off campaigns to triggered messages, with a graphically rich interface. Marketers can also integrate consumer data from across marketing channels to develop and deliver more relevant marketing experiences to their consumers. Features also include targeted segmentation, multilingual email execution, real-time interaction, in-app messaging, and operational reporting to easily see how well campaigns are performing.

*Adobe Target*

Adobe Target lets our customers test, target and personalize content across multiple devices. With Adobe Target, our customers have the tools they need to quickly discover what gets noticed, what increases conversion, and what keeps consumers coming back for more. It paves a path from simple testing to targeting to true segmentation and optimization through A/B and multivariate testing, content targeting and automated decision-making. Adobe Target capabilities also enable our customers to test and target adaptive or responsive mobile web experiences.

*Adobe Primetime*

Adobe Primetime is a multiscreen TV platform that helps broadcasters, cable networks, and service providers create and monetize engaging, personalized viewing experiences. When integrated with Adobe Experience Cloud solutions, media sellers can optimize campaign and advertisement delivery in real time.

***Adobe Analytics Cloud***

Adobe Analytics Cloud provides a core intelligence engine for enterprises that allow customers to put real-time insights into action. With Adobe Analytics Cloud, enterprise-level marketing analytics is made understandable and accessible to everyone in the organization; targeting is improved, as our customers can connect their analytics with real-time activation so the transition from insight to action is fast; users are provided with an objective view of their customers' journeys across every device and channel that helps them achieve better understanding of their ROI; and segmentation is more precise as our customers can discover and create high-value audiences and understand the best way to reach them. The following is a brief description of the solutions that comprise the Adobe Analytics Cloud.

*Adobe Analytics*

Adobe Analytics is our industry leading solution that helps our customers create a holistic view of their business by turning consumer interactions into actionable insights. With intuitive and interactive dashboards and reports, our customers can sift, sort, and share real-time information to provide insights that can be used to identify problems and opportunities and to drive conversion and relevant consumer experiences. Adobe Analytics enables web, social, video, mobile, attribution, and predictive analytics across online and offline channels to continuously improve the performance of marketing activities. It also provides the ability to perform advanced ad-hoc segmentation and to integrate data from offline and third-party sources. Adobe Analytics is available in four plans that contain various features and add-ons to meet the needs of our customers' businesses.

*Adobe Audience Manager*

Adobe Audience Manager is a data management platform that helps digital publishers build unique audience profiles to identify the most valuable segments and use them across any digital channel. Adobe Audience Manager consolidates audience information from all available sources. It then identifies, quantifies, and optimizes high-value target audiences, which can then be offered to advertisers via an integrated, secure, privacy-friendly management system that works across all advertising distribution platforms. Adobe Audience Manager provides access to multiple data sources, offering digital publishers the ability to use a wide variety of third-party data as well as Audience Manager's private data co-op.

***Adobe Advertising Cloud***

Adobe Advertising Cloud is an end-to-end platform for managing advertising across traditional TV and digital formats. With Adobe Advertising Cloud, customers can identify and amplify their high-value audiences for more personal and accurate targeting; seamlessly unite creative, data, and media buying across all screens and formats; protect their brand by preventing their campaigns from mixing with content and properties that do not align with their image; and use data insights that reveal customers' interests and past behaviors to create relevant, targeted ads. Adobe Advertising is comprised of the Adobe Media Optimizer offerings described below.

*Adobe Media Optimizer Search*

Adobe Media Optimizer Search allows customers to simulate and quickly act upon the best and most profitable options in their search marketing strategy. Specifically, it provides customers with sophisticated models to test and visualize the expected traffic and conversion for keywords, ad placements, and product targets. Adobe Media Optimizer Search also enables customers to run models to determine the highest performing mix of advertising at varied spend levels across portfolios and then validate assumptions with reports based on models and data.

*Adobe Media Optimizer Demand Side Platform (DSP)*

Adobe Media Optimizer DSP (formerly TubeMogul) is a unified cross-channel solution that allows customers to streamline global advertising from a single platform. With Adobe Media Optimizer DSP, customers can intelligently target their most valuable audiences by optimizing display ad campaigns in real time. Adobe Media Optimizer DSP's programmatic TV buying solution extends many of the benefits digital buying offers - like targeting and reporting insights - to television advertising. It helps advertisers plan campaigns holistically, across every screen, while providing more flexibility to shift spend and optimize reach and frequency. Adobe Media Optimizer DSP also provides users with the tools to create, manage, optimize and scale ads for Facebook and Instagram.

*Adobe Media Optimizer Dynamic Creative Optimization (DCO)*

Adobe Media Optimizer DCO enables advertisers to reach specific audiences with flexible creative content that's personalized in real time based on site actions, customer and partner data, and third-party demographic data. Adobe Media Optimizer DCO provides customers with robust campaign options, from retargeting and loyalty programs to prospecting and awareness campaigns; site visitor, partner, third-party and location data to improve audience targeting; flexibility to deliver the right content across device types; and reports and algorithms to help optimize creative elements.

**Other Products and Services**

We also offer a broad range of other enterprise and digital media products and services. Information about other products not referenced here can be found on our corporate website, www.adobe.com.

## OPERATIONS

**Marketing and Sales**

We market and license our products directly using our sales force and certain local offices and through our own website at www.adobe.com. We also market and distribute our products through sales channels, which include distributors, retailers, software developers, SIs, ISVs and VARs, as well as through OEM and hardware bundle customers.

Our local field offices include locations in Australia, Austria, Belgium, Brazil, Canada, Chile, China, Columbia, Czech Republic, Denmark, Finland, France, Germany, Hong Kong, India, Ireland, Israel, Italy, Japan, Mexico, Moldova, the Netherlands, New Zealand, Norway, Poland, Romania, Singapore, South Africa, South Korea, Spain, Sweden, Switzerland, Taiwan, United Arab Emirates, the United Kingdom and the United States.

We sell the majority of our products through a software subscription model where our customers purchase access to a product for a specific period of time during which they always have rights to use the most recent version of that product. We also license perpetual versions of our software with maintenance and support, which includes rights to upgrades, when and if available, support, updates and enhancements.

For fiscal 2017, 2016 and 2015, there were no customers that represented at least 10% of net revenue. As of fiscal year end 2017 and 2016, no single customer was responsible for over 10% of our trade receivables.

**Services and Support**

We provide expert consulting, customer success management, technical support, and learning services across all our customer segments, including enterprises, small and medium businesses, creative professionals, and consumers. With a focus on ensuring sustained customer success and realized value, this comprehensive portfolio of services is designed to help customers and partners maximize the return on their investments in our cloud solutions and licensed products. Our service and support revenue consists primarily of consulting fees, software maintenance, technical support fees and training fees.

*Consulting Services*

We have a global professional services team dedicated to designing and implementing solutions for our largest customers. Our professional services team uses a comprehensive, customer-focused methodology that has been refined over years of capturing and analyzing best practices from numerous customer engagements across a diverse mix of solutions, industries, and customer segments. Increasingly, our customers seek to integrate across Adobe's products and cloud solutions, and engage our professional services teams to share their expertise in leading customers' digital strategies and multi-solution integrations. Using our methodology, our professional services teams are able to accelerate customers' time to value, and maximize the return customers earn on their investment in Adobe solutions.

A key component of Adobe's strategy is developing a large partner ecosystem to expand the reach and breadth of Adobe solutions in the global marketplace. In order to assist partners in building their respective digital practices, Adobe Global Services provides a comprehensive set of deliverables through Adobe's Solution Partner Program. The breadth of services described in the program provides system integrators, agencies, and regional partners the tools required to develop core capabilities for positioning and building with Adobe technology, as well as implementing and running customer platforms. We believe that through these programmatic services and support, our joint customers benefit greatly by the combination of Adobe technology and the deep customer context that our global partners represent.

*Customer Success Account Management*

For our largest Digital Experience and Digital Media customers, Adobe Global Services provides post-sales Customer Success Managers, who work individually with customers on an ongoing basis to understand their current and future business needs, promote faster solution adoption, and align product capabilities to customers' business objectives to maximize the return on their investment in Adobe's offerings. We engage customers to share innovative best practices, relevant industry and vertical knowledge, and proven success strategies based on our extensive engagements with leading marketers and brands. The performance of these teams is directly associated with customer-focused outcomes, notably ongoing customer retention.

*Technical Support*

Adobe provides enterprise maintenance and support services to customers of subscription products as part of the subscription entitlement, and to perpetual license customers via annual fee-based maintenance and support programs. These offerings provide:

- technical support on the products they have purchased from Adobe;
- "how to" help in using our products; and
- product upgrades and enhancements during the term of the maintenance and support or subscription period, which is typically one to three years.

We provide product support through a global support organization that includes several regional and global support centers, supplemented with outsourced vendors for specific services. Customers can seek help through multiple channels including phone, chat, web, social media, and email, allowing quick and easy access to the information they need. These teams are responsible for providing timely, high-quality technical expertise on all our products.

As registered owners of the current version of an Adobe desktop product, consumers are eligible to receive Getting Started support on certain matters, to support easy adoption of their products. Support for some products and in some countries may vary. For enterprise customers with greater support needs, we offer personalized service options through Premium Services options, delivered by technical account managers who can also provide proactive risk mitigation services and on-site support services for those with business critical deployments.

Lastly, we also offer delivery assurance, technical support, and enablement services to partners and developer organizations. Through the Adobe Partner Connection Program, we provide developers with high-quality tools, software development kits, information and services.

*Digital Learning Services*

Adobe Global Services offers a comprehensive portfolio of learning and enablement services to assist our customer and partner teams in the use of our products, including those within Digital Marketing, Digital Media and other legacy products and solutions. Our training portfolio includes a large number of free online self-service learning options on www.training.adobe.com. Adobe Digital Learning Services also has an extensive portfolio of fee-based learning programs including a wide range of traditional classroom, virtual, and on-demand training and certifications delivered by our team of training professionals and partners across the globe.

These core offerings are complemented by our custom learning services, which support our largest enterprise customers and their unique requirements. Solution-specific skills assessments help our enterprise customers objectively assess the knowledge and competencies within their marketing teams and tailor their learning priorities accordingly. Finally, aligned with our cloud strategy, we have introduced a new learning subscription service that enables customers to access both business and technical Digital Marketing training over a 12-month period, which is a scalable approach to supporting long-term learning.

**Investments**

From time to time we make direct investments in privately held companies. We enter into these investments with the intent of securing financial returns as well as for strategic purposes, as they often increase our knowledge of emerging markets and technologies and expand our opportunities to provide Adobe products and services.

## PRODUCT DEVELOPMENT

A continuous high level of investment is required for the enhancement of existing solutions and the development of new solutions due to the speed of technological change that characterizes the software industry. We develop our software internally, as well as acquire products or technology developed by others by purchasing the stock or assets of the business entity that owns the technology. In other instances, we have licensed or purchased the intellectual property ownership rights of programs developed by others with license or technology transfer agreements that may obligate us to pay a flat license fee or royalties, typically based on a dollar amount per unit or a percentage of the revenue generated by those programs.

During fiscal 2017, 2016 and 2015, our research and development expenses were $1.22 billion, $976.0 million and $862.7 million, respectively.

## PROTECTING AND LICENSING OUR PRODUCTS

We protect our intellectual property through a combination of patents, copyrights, trademarks and trade secrets, foreign intellectual property laws, confidentiality procedures and contractual provisions. We have United States and foreign patents and pending applications that relate to various aspects of our products and technology. Although our patents have value, no single patent is essential to any of our principal businesses. We have also registered, and applied for the registration of, U.S. and international trademarks, service marks, domain names and copyrights.

Our enterprise customers license our hosted offerings as On-demand Services or Managed Services, and consumers primarily use our desktop software and mobile apps. We license our desktop software to users under ‘click through’ or signed license agreements containing restrictions on duplication, disclosure, and transfer. Similarly, cloud products and services are provided to users under ‘click through’ or signed agreements containing restrictions on access and use.

Despite our efforts to protect our proprietary technology and our intellectual property rights, unauthorized parties may attempt to copy or obtain and use our technology to develop applications with the same functionality as our application. Policing unauthorized use of our technology and intellectual property rights is difficult. We believe that our transition from perpetual-use software licenses to a subscription-based business model combined with the increased focus on cloud-based computing may improve our efforts to combat the pirating of our products.

## EMPLOYEES

As of December 1, 2017, we employed 17,973 people. We have not experienced work stoppages and believe our employee relations are good.

## AVAILABLE INFORMATION

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed or furnished pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge on our Investor Relations website at www.adobe.com/adbe as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information posted on our website is not incorporated into this report.

## EXECUTIVE OFFICERS

Adobe’s executive officers as of January 12, 2018 are as follows:

| Name | Age | Positions |
|---|---|---|
| Shantanu Narayen | 54 | President, Chief Executive Officer, and Chairman of the Board<br><br>Mr. Narayen currently serves as our President, Chief Executive Officer, and Chairman of the Board. He joined Adobe in January 1998 as Vice President and General Manager of our engineering technology group. In January 1999, he was promoted to Senior Vice President, Worldwide Products, and in March 2001 he was promoted to Executive Vice President, Worldwide Product Marketing and Development. In January 2005, Mr. Narayen was promoted to President and Chief Operating Officer, and effective December 2007, he was appointed our Chief Executive Officer and joined our Board of Directors. In January 2017, Mr. Narayen was selected by our Board of Directors as |

Chairman of the Board. Mr. Narayen serves on the board of directors of Pfizer Inc., a multinational pharmaceutical corporation. He previously served as a director of Dell Inc. from September 2009 to October 2013. Mr. Narayen holds a B.S. in Electronics Engineering from Osmania University in India, a M.S. in Computer Science from Bowling Green State University and an M.B.A. from the Haas School of Business, University of California, Berkeley.

| Name | Age | Positions |
|---|---|---|
| Mark Garrett | 60 | Executive Vice President, Chief Financial Officer<br><br>Mr. Garrett joined Adobe in February 2007 as Executive Vice President and Chief Financial Officer. Mr. Garrett served as Senior Vice President and Chief Financial Officer of the Software Group of EMC Corporation, a products, services and solutions provider for information management and storage, from June 2004 to January 2007, his most recent position since EMC's acquisition of Documentum, Inc., an enterprise content management company, in December 2003. Mr. Garrett first joined Documentum as Executive Vice President and Chief Financial Officer in 1997, holding that position through October 1999 and then re-joining Documentum as Executive Vice President and Chief Financial Officer in 2002. Mr. Garrett is also a director of Pure Storage, Inc., the Adobe Foundation, and the Children's Discovery Museum of San Jose. |
| Matthew Thompson | 59 | Executive Vice President, Worldwide Field Operations<br><br>Mr. Thompson currently serves as Executive Vice President, Worldwide Field Operations. Mr. Thompson joined Adobe in January 2007 as Senior Vice President, Worldwide Field Operations. In January 2013, he was promoted to Executive Vice President, Worldwide Field Operations. Prior to joining Adobe, Mr. Thompson served as Senior Vice President of Worldwide Sales at Borland Software Corporation, a software delivery optimization solutions provider, from October 2003 to December 2006. Prior to joining Borland, Mr. Thompson was Vice President of Worldwide Sales and Field Operations for Marimba, Inc., a provider of products and services for software change and configuration management, from February 2001 to January 2003. From July 2000 to January 2001, Mr. Thompson was Vice President of Worldwide Sales for Calico Commerce, Inc., a provider of eBusiness applications. Prior to joining Calico, Mr. Thompson spent six years at Cadence Design Systems, Inc., a provider of electronic design technologies. While at Cadence, from January 1998 to June 2000, Mr. Thompson served as Senior Vice President, Worldwide Sales and Field Operations and from April 1994 to January 1998 as Vice President, Worldwide Professional Services. Mr. Thompson is a board member of NCR Corporation. |
| Michael Dillon | 59 | Executive Vice President, General Counsel and Corporate Secretary<br><br>Mr. Dillon joined Adobe in August 2012 as Senior Vice President, General Counsel and Corporate Secretary. Prior to joining Adobe, Mr. Dillon served as General Counsel and Corporate Secretary of Silver Spring Networks, a networking solutions provider, from November 2010 to August 2012. Before joining Silver Spring Networks, Mr. Dillon served in various capacities at Sun Microsystems, a diversified computer networking company, prior to its acquisition by Oracle Corporation. While at Sun Microsystems, from April 2006 to January 2010, Mr. Dillon served as Executive Vice President, General Counsel and Secretary, from April 2004 to April 2006, as Senior Vice President, General Counsel and Corporate Secretary, and from July 2002 to March 2004 as Vice President, Products Law Group. From October 1999 until June 2002, Mr. Dillon served as Vice President, General Counsel and Corporate Secretary of ONI Systems Corp, an optical networking company. Mr. Dillon is a board member of the Adventure Cycling Association, Business Software Alliance, and the Adobe Foundation. |
| Bryan Lamkin | 57 | Executive Vice President and General Manager, Digital Media<br><br>Mr. Lamkin currently serves as Executive Vice President and General Manager, Digital Media. He rejoined Adobe in February 2013 as Senior Vice President, Technology and Corporate Development. From June 2011 to May 2012, Mr. Lamkin served as President and Chief Executive Officer of Clover, a mobile payments platform. Prior to Clover, Mr. Lamkin co-founded and served as the Chief Executive Officer of Bagcheck, a sharing and discovery platform, from June 2010 to May 2011. From April 2009 to June 2010, Mr. Lamkin served as Senior Vice President of Consumer Products and Applications at Yahoo!, a global technology company providing online search, content and communication tools. From May 2008 to April |

| | | |
|---|---|---|
| | | 2009, Mr. Lamkin served as Executive in Residence at Sutter Hill Ventures. Mr. Lamkin previously was with Adobe from 1992 to 2006 and held various senior management positions including Senior Vice President, Creative Solutions Business Unit. |
| Ann Lewnes | 56 | Executive Vice President and Chief Marketing Officer<br><br>Ms. Lewnes joined Adobe in November 2006 and currently serves as Executive Vice President and Chief Marketing Officer. Prior to joining Adobe, Ms. Lewnes spent 20 years at Intel Corporation, where she was Vice President of Sales and Marketing. Ms. Lewnes is a board member of Mattel, The Ad Council, and the Adobe Foundation. |

| Name | Age | Positions |
|---|---|---|
| Donna Morris | 50 | Executive Vice President, Customer and Employee Experience<br><br>Ms. Morris currently serves as Executive Vice President of Adobe's Global Customer and Employee Experience organization. Ms. Morris joined Adobe as Senior Director of Global Talent Management in April 2002 through the acquisition of Accelio Corporation, a Canadian software company, where she served as Vice President of Human Resources and Learning. In December 2005, Ms. Morris was promoted to Vice President, Global Human Resources Operations and subsequently to Senior Vice President, Human Resources in March 2007. Ms. Morris is a director of the Society for Human Resource Management and the Adobe Foundation. |
| Abhay Parasnis | 43 | Executive Vice President and Chief Technology Officer<br><br>Mr. Parasnis joined Adobe in July 2015 as Senior Vice President of Adobe's Cloud Technology & Services organization and Chief Technology Officer. Prior to joining Adobe, he served as President and Chief Operating Officer at Kony, Inc. from March 2013 to March 2015. From January 2012 to November 2013, Mr. Parasnis was a Senior Vice President and later Strategic Advisor for the Oracle Public Cloud at Oracle. Prior to joining Oracle, he was General Manager of Microsoft Azure AppFabric at Microsoft from April 2009 to December 2011. |
| Bradley Rencher | 44 | Executive Vice President and General Manager, Digital Experience<br><br>Mr. Rencher serves as Executive Vice President and General Manager of Adobe's Digital Experience business unit. Mr. Rencher joined Omniture, Inc. in January 2008 as Vice President of Corporate Development and was promoted to Senior Vice President of Business Operations prior to Adobe's acquisition of Omniture in 2009. Following the acquisition he joined Adobe as Vice President of Business Operations. Mr. Rencher was promoted to Vice President and General Manager, Omniture business unit in 2010 and subsequently to Senior Vice President in 2011. Prior to joining Omniture, Mr. Rencher was a member of the technology investment banking team at Morgan Stanley from 2005 to 2008 and a member of the investment banking team at RBC Capital Markets from 1998 to 2004. Mr. Rencher is a director of Pluralsight and the Utah Symphony. |
| Scott Belsky | 37 | Chief Product Officer and Executive Vice President, Creative Cloud<br><br>Mr. Belsky joined Adobe in December 2017 as Executive Vice President and Chief Product Officer, Creative Cloud. Prior to joining Adobe in December 2017, Belsky was a venture investor at Benchmark in San Francisco from February 2016 to December 2017. Prior to Benchmark, Belsky led Adobe's mobile strategy for Creative Cloud from December 2012 to January 2016, having joined the company through the acquisition of Behance. Belsky co-founded Behance in 2006 and served as its CEO for over 6 years. He is an early advisor and investor to Pinterest, Uber, and Warby Parker among other early-stage companies, and co-founded and serves on the Board of Prefer, a referrals platform that empowers the careers of independent professionals. Mr. Belsky serves on the advisory board of Cornell University's Entrepreneurship Program and is President of the Smithsonian Cooper-Hewitt National Design Museum board of trustees. |
| John Murphy | 49 | Senior Vice President, Chief Accounting Officer and Corporate Controller<br><br>Mr. Murphy joined Adobe in March 2017 as our Senior Vice President, Chief Accounting Officer and Corporate Controller. Prior to joining Adobe, Mr. Murphy served as Senior Vice President, Chief Accounting Officer and Corporate Controller of Qualcomm Incorporated from September 2014 to March 2017. He previously served as Senior Vice President, Controller and Chief Accounting Officer of DIRECTV Inc. from November 2007 until August 2014, and Vice President and General Auditor of DIRECTV from October 2004 to November 2007. Prior to joining DIRECTV he worked at several global companies, including Experian, Nestle, and Atlantic Richfield (ARCO), in a variety of finance and accounting roles. He served as Director of DirecTV Holdings LLC from November 2007 until August 2014. Mr. Murphy serves on the Corporate Advisory Board of the Marshall School of Business at the University of Southern California. He holds an MBA from the Marshall School of Business at the University of Southern California, a B.S. in Accounting from Fordham University and is a Certified Public Accountant. |

## ITEM 1A. RISK FACTORS

As previously discussed, our actual results could differ materially from our forward-looking statements. Below we discuss some of the factors that could cause these differences. These and many other factors described in this report could adversely affect our operations, performance and financial condition.

***If we cannot continue to develop, acquire, market and offer new products and services or enhancements to existing products and services that meet customer requirements, our operating results could suffer.***

The process of developing and acquiring new technology products and services and enhancing existing offerings is complex, costly and uncertain. If we fail to anticipate customers' rapidly changing needs and expectations or adapt to emerging technological trends, our market share and results of operations could suffer. We must make long-term investments, develop, acquire or obtain appropriate intellectual property and commit significant resources before knowing whether our predictions will accurately reflect customer demand for our products and services. If we misjudge customer needs in the future, our new products and services may not succeed and our revenues and earnings may be harmed. Additionally, any delay in the development, acquisition, marketing or launch of a new offering or enhancement to an existing offering could result in customer attrition or impede our ability to attract new customers, causing a decline in our revenue, earnings or stock price and weakening our competitive position.

We offer our products on a variety of hardware platforms. Consumers continue to migrate from personal computers to tablet and mobile devices. If we cannot continue adapting our products to tablet and mobile devices, or if our competitors can adapt their products more quickly than us, our business could be harmed. Releases of new devices or operating systems may make it more difficult for our products to perform or may require significant costs in order for us to adapt our solutions to such devices or operating systems. These potential costs and delays could harm our business.

***Our competitive position and results of operations could be harmed if we do not compete effectively.***

The markets for our products and services are characterized by intense competition, new industry standards, evolving distribution models, limited barriers to entry, disruptive technology developments, short product life cycles, customer price sensitivity and frequent product introductions (including alternatives with limited functionality available at lower costs or free of charge). Any of these factors could create downward pressure on pricing and gross margins and could adversely affect our renewal and upsell and cross-sell rates, as well as our ability to attract new customers. Our future success will depend on our continued ability to enhance and integrate our existing products and services, introduce new products and services in a timely and cost-effective manner, meet changing customer expectations and needs, extend our core technology into new applications, and anticipate emerging standards, business models, software delivery methods and other technological developments. Furthermore, some of our competitors and potential competitors enjoy competitive advantages such as greater financial, technical, sales, marketing and other resources, broader brand awareness, and access to larger customer bases. As a result of these advantages, potential and current customers might select the products and services of our competitors, causing a loss of our market share. In addition, consolidation has occurred among some of our competitors. Further consolidations in these markets may subject us to increased competitive pressures and may harm our results of operations.

*For additional information regarding our competition and the risks arising out of the competitive environment in which we operate, see the section entitled "Competition" contained in Part I. Item 1 of this report.*

***Introduction of new technology could harm our business and results of operations.***

The expectations and needs of technology consumers are constantly evolving. Our future success depends on a variety of factors, including our continued ability to innovate, introduce new products and services efficiently, enhance and integrate our products and services in a timely and cost-effective manner, extend our core technology into new applications, and anticipate emerging standards, business models, software delivery methods and other technological developments. Integration of our products and services with one another and other companies' offerings creates an increasingly complex ecosystem that is partly reliant on third parties. If any disruptive technology, or competing products, services or operating systems that are not compatible with our solutions, achieve widespread acceptance, our operating results could suffer and our business could be harmed.

The introduction of certain technologies may reduce the effectiveness of our products. For example, some of our products rely on third-party cookies, which are placed on individual browsers when consumers visit websites that contain advertisements. We use these cookies to help our customers more effectively advertise, gauge the

performance of their advertisements, and detect and prevent fraudulent activity. Consumers can block or delete cookies through their browsers or “ad-blocking” software or applications. The most common Internet browsers allow consumers to modify their browser settings to prevent cookies from being accepted by their browsers, or are set to block third-party cookies by default. Increased use of methods, software or applications that block cookies could harm our business.

***Some of our enterprise offerings have extended and complex sales cycles, which can make our sales cycles unpredictable.***

Sales cycles for some of our enterprise offerings, including our Adobe Experience Cloud solutions and ETLAs in our Digital Media business, are multi-phased and complex. The complexity in these sales cycles is due to several factors, including:

- the need for our sales representatives to educate customers about the use and benefit of large-scale deployments of our products and services, including technical capabilities, security features, potential cost savings and return on investment;
- the desire of organizations to undertake significant evaluation processes to determine their technology requirements prior to making information technology expenditures;
- the need for our representatives to spend a significant amount of time assisting potential customers in their testing and evaluation of our products and services;
- intensifying competition within the industry;
- the negotiation of large, complex, enterprise-wide contracts;
- the need for our customers to obtain requisition approvals from various decision makers within their organizations due to the complexity of our solutions touching multiple departments within customers' organizations; and
- customer budget constraints, economic conditions and unplanned administrative delays.

We spend substantial time and expense on our sales efforts without assurance that potential customers will ultimately purchase our solutions. As we target our sales efforts at larger enterprise customers, these trends are expected to continue and could have a greater impact on our results of operations. Additionally, our enterprise sales pattern has historically been uneven, where a higher percentage of a quarter's total sales occur during the final weeks of each quarter, which is common in our industry. Our extended sales cycle for these products and services makes it difficult to predict when a given sales cycle will close.

***Subscription offerings could create risks related to the timing of revenue recognition.***

We generally recognize revenue from subscription offerings ratably over the terms of their subscription agreements, which range from 1 to 36 months. As a result, most of the subscription revenue we report in each quarter is the result of subscription agreements entered into during previous quarters. Any reduction in new or renewed subscriptions in a quarter may not be reflected in our revenue results until a later quarter. Declines in new or renewed subscriptions may decrease our revenue in future quarters. Lower sales, reduced demand for our products and services, and increases in our attrition rate may not be fully reflected in our results of operations until future periods. Our subscription model could also make it difficult for us to rapidly increase our revenue from subscription-based or hosted services through additional sales in any period, as revenue from new customers will be recognized over the applicable subscription term.

Additionally, in connection with our sales efforts to enterprise customers and our use of ETLAs, a number of factors could affect our revenue, including longer-than-expected sales and implementation cycles, potential deferral of revenue due to multiple-element revenue arrangements and alternative licensing arrangements. If any of our assumptions about revenue from our subscription-based offerings prove incorrect, our actual results may vary materially from those anticipated.

***If our customers fail to renew subscriptions in accordance with our expectations, our future revenue and operating results could suffer.***

Our Adobe Experience Cloud, Creative Cloud, and Document Cloud offerings typically involve subscription based offerings pursuant to product and service agreements. Revenue from our subscription customers is generally recognized ratably over the term of their agreements, which typically range from 1 to 36 months. Our customers have no obligation to renew their subscriptions for our services after the expiration of their initial subscription period, and customers may not renew their subscriptions at the same or higher level of service, for the same number of seats or for the same duration of time, if at all. Moreover, under certain circumstances, some of our customers have the right to cancel their agreements prior to the expiration of the terms. Our varied customer base combined with the flexibility we offer in the length of our subscription-based agreements complicates our ability to precisely forecast renewal rates. Therefore, we cannot provide assurance that we will be able to accurately predict future customer renewal rates.

Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their level of satisfaction with our services, our ability to continue enhancing features and functionality, the reliability (including uptime) of our subscription offerings, the prices of offerings and those offered by our competitors, the actual or perceived information security of our systems and services, decreases in the size of our customer base, reductions in our customers' spending levels or declines in customer activity as a result of economic downturns or uncertainty in financial markets. If our customers do not renew their subscriptions or if they renew on terms less favorable to us, our revenue may decline.

***Security breaches in data centers we manage, or third parties manage on our behalf, may compromise the confidentiality, integrity, or availability of employee and customer data, which could expose us to liability and adversely affect our reputation and business.***

We process and store significant amounts of employee and customer data, most of which is hosted by third-party service providers. A security incident impacting our own data centers or those controlled by our service providers may compromise the confidentiality, integrity or availability of this data. Unauthorized access to or disclosure of data stored by Adobe or our service providers may occur through break-ins, breaches of a secure network by an unauthorized party, employee theft or misuse or other misconduct. It is also possible that unauthorized access to or disclosure of customer data may be obtained through inadequate use of security controls by customers or employees. Accounts created with weak or recycled passwords could allow cyber-attackers to gain access to customer data. Additionally, failure by customers to remove accounts of their own employees, or the granting of accounts by the customer in an uncontrolled manner, may allow for access by former or unauthorized customer representatives. If there were an inadvertent disclosure of customer information, or if a third party were to gain unauthorized access to the information we possess on behalf of our customers, our operations could be disrupted, our reputation could be damaged and we could be subject to claims or other liabilities, regulatory investigations, or fines. In addition, such perceived or actual unauthorized disclosure of the information we collect or breach of our security could damage our reputation, result in the loss of customers and harm our business.

***We rely on data centers managed both by Adobe and third parties to host and deliver our services, as well as access, collect, use, transmit, and store data, and any interruptions or delays in these hosted services, or failures in data collection or transmission could expose us to liability and harm our business and reputation.***

Much of our business relies on hardware and services that are hosted, managed, and controlled directly by Adobe or third-party service providers, including our online store at adobe.com, Creative Cloud, Document Cloud, and Experience Cloud solutions. We do not have redundancy for all of our systems, many of our critical applications reside in only one of our data centers, and our disaster recovery planning may not account for all eventualities. If our business relationship with a third-party provider of hosting or content delivery services is negatively affected, or if one of our content delivery suppliers were to terminate its agreement with us, we might not be able to deliver the corresponding hosted offerings to our customers, which could subject us to reputational harm, costly and time intensive notification requirements, and cause us to lose customers and future business. Occasionally, we migrate data among data centers and to third-party hosted environments. If a transition among data centers or to third-party service providers encounters unexpected interruptions, unforeseen complexity, or unplanned disruptions despite precautions undertaken during the process, this may impair our delivery of products and services to customers and result in increased costs and liabilities, which may harm our operating results and our business.

It is also possible that hardware or software failures or errors in our systems (or those of our third-party service providers) could result in data loss or corruption, cause the information that we collect or maintain to be incomplete or contain inaccuracies that our customers regard as significant, or cause us to fail to meet committed service levels or comply with regulatory notification requirements. Furthermore, our ability to collect and report data may be delayed or interrupted by a number of factors, including access to the Internet, the failure of our network or software systems, security breaches or significant variability in visitor traffic on customer websites. In addition, computer viruses, worms, or other malware may harm our systems, causing us to lose data, and the transmission of computer viruses or other malware could expose us to litigation or regulatory investigation, and costly and time intensive notification requirements.

We may also find, on occasion, that we cannot deliver data and reports to our customers in near real time because of a number of factors, including significant spikes in customer activity on their websites or failures of our network or software. If we fail to plan infrastructure capacity appropriately and expand it proportionally with the needs of our customer base, and we experience a rapid and significant demand on the capacity of our data centers or those of third parties, service outages could occur and our customers could suffer impaired performance of our services. Such a strain on our infrastructure capacity could subject us to regulatory notification requirements, violations of service level agreement commitments, financial liabilities, result in customer dissatisfaction, or harm our business. If we supply inaccurate information or experience interruptions in our ability to capture, store and supply information in near real time or at all, our reputation could be harmed and we could lose customers, or we could be found liable for damages or incur other losses.

***Increasing regulatory focus on privacy issues and expanding laws could impact our business models and expose us to increased liability.***

U.S. privacy and data security laws apply to our various businesses. We also do business globally in countries that have more stringent data protection laws than those in the United States that may be inconsistent across jurisdictions and are subject to evolving and differing interpretations. Governments, privacy advocates and class action attorneys are increasingly scrutinizing how companies collect, process, use, store, share and transmit personal data. Globally, new laws, such as the General Data Protection Regulation ("GDPR") in Europe, and industry self-regulatory codes have been enacted and more are being considered that may affect our ability (and our enterprise customers' ability) to reach current and prospective customers, to respond to both enterprise and individual customer requests under the laws (such as individual rights of access, correction, and deletion of their personal information), and to implement our business models effectively. These new laws may also impact our innovation and business drivers in developing new and emerging technologies (e.g., artificial intelligence and machine learning). These requirements, among others, may impact demand for our offerings and force us to bear the burden of more onerous obligations in our contracts. Any perception of our practices, products or services as a violation of individual privacy rights may subject us to public criticism, class action lawsuits, reputational harm, or investigations or claims by regulators, industry groups or other third parties, all of which could disrupt our business and expose us to increased liability. Additionally, we store information on behalf of our customers and if our customers fail to comply with contractual obligations or applicable laws, it could result in litigation or reputational harm to us.

Transferring personal information across international borders is becoming increasingly complex. For example, European data transfers outside the European Economic Area are highly regulated. The mechanisms that we and many other companies rely upon for European data transfers (e.g. Privacy Shield and Model Clauses) are being contested in the European court system. We are closely monitoring developments related to requirements for transferring personal data outside the EU. These requirements may result in an increase in the obligations required to provide our services in the EU or in sanctions and fines for non-compliance. Several other countries, including Australia and Japan, have also established specific legal requirements for cross-border transfers of personal information. These developments in Europe and elsewhere could harm our business, financial condition and results of operations.

***Security vulnerabilities in our products and systems could lead to reduced revenue or to liability claims.***

Maintaining the security of our products, computers and networks is a critical issue for us and our customers. Security researchers, criminal hackers and other third parties regularly develop new techniques to penetrate computer and network security measures and, as we have previously disclosed, certain parties have in the past managed to breach our data security systems and misused some of our systems and software in order to access our end users' authentication and payment information. In addition, cyber-attackers also develop and deploy viruses, worms, credential stuffing attack tools, and other malicious software programs, some of which may be specifically designed to attack our products, systems, computers or networks. Sophisticated hardware and operating system applications that we develop or procure from third parties may contain defects in design or manufacture, including bugs and other problems that could unexpectedly compromise the security of the system or impair a customer's ability to operate or use our products. The costs to prevent, eliminate, notify affected parties of, or alleviate cyber- or other security problems, bugs, viruses, worms, malicious software programs and security vulnerabilities are significant, and our efforts to address these problems may not be successful or may be delayed and could result in interruptions, delays, cessation of service and loss of existing or potential customers. It is impossible to predict the extent, frequency or impact these problems may have on us.

Outside parties have in the past and may in the future attempt to fraudulently induce our employees or users of our products or services to disclose sensitive information via illegal electronic spamming, phishing or other tactics. Unauthorized parties may also attempt to gain physical access to our facilities in order to infiltrate our information systems or attempt to gain logical access to our products, services, or information systems for the purpose of exfiltrating content and data. These actual and potential breaches of our security measures and the accidental loss, inadvertent disclosure or unauthorized dissemination of proprietary information or sensitive, personal or confidential data about us, our employees, our customers or their end users, including the potential loss or disclosure of such information or data as a result of hacking, fraud, trickery or other forms of deception, could expose us, our employees, our customers or the individuals affected to a risk of loss or misuse of this information. This may result in litigation and liability or fines, our compliance with costly and time intensive notice requirements, governmental inquiry or oversight or a loss of customer confidence, any of which could harm our business or damage our brand and reputation, possibly impeding our present and future success in retaining and attracting new customers and thereby requiring time and resources to repair our brand and reputation. These risks will likely increase as we expand our hosted offerings, integrate our products and services, and store and process more data, including personal information.

These problems affect our products and services in particular because cyber-attackers tend to focus their efforts on popular offerings with a large user base, and we expect them to continue to do so. Critical vulnerabilities may be identified in some of our applications. These vulnerabilities could cause such applications to crash and could allow an attacker to take control of the affected system, which could result in liability to us or limit our ability to conduct our business and deliver our products and services to customers. We devote significant resources to address security vulnerabilities through engineering more secure products, enhancing security and reliability features in our products and systems, code hardening, conducting rigorous penetration tests, deploying updates to address security vulnerabilities and improving our incident response time, but these security vulnerabilities cannot be totally eliminated. The cost of these steps could reduce our operating margins, and we may be unable to implement these measures quickly enough to prevent cyber-attackers from gaining unauthorized access into our systems and products. Despite our preventative efforts, actual or perceived security vulnerabilities in our products and systems may harm our reputation or lead to claims against us (and have in the past led to such claims), and could lead some customers to stop using certain products or services, to reduce or delay future purchases of products or services, or to use competing products or services. If we do not make the appropriate level of investment in our technology systems or if our systems become out-of-date or obsolete and we are not able to deliver the quality of data security customers require, our business could be adversely affected. Customers may also adopt security measures designed to protect their existing computer systems from attack, which could delay adoption of new technologies. Further, if we or our customers are subject to a future attack, or our technology is used in a third-party attack, we could be subject to costly and time intensive notice requirements, and it may be necessary for us to take additional extraordinary measures and make additional expenditures to take appropriate responsive and preventative steps. Any of these events could adversely affect our revenue or margins. Moreover, delayed sales, lower margins or lost customers resulting from disruptions caused by cyber-attacks or preventative measures could adversely affect our financial results, stock price and reputation.

***We may not realize the anticipated benefits of past or future investments or acquisitions, and integration of acquisitions may disrupt our business and management.***

We may not realize the anticipated benefits of an investment or acquisition of a company, division, product or technology, each of which involves numerous risks. These risks include:

- inability to achieve the financial and strategic goals for the acquired and combined businesses;
- difficulty in, and the cost of, effectively integrating the operations, technologies, products or services, and personnel of the acquired business;
- entry into markets in which we have minimal prior experience and where competitors in such markets have stronger market positions;
- disruption of our ongoing business and distraction of our management and other employees from other opportunities and challenges;
- inability to retain personnel of the acquired business;
- inability to retain key customers, distributors, vendors and other business partners of the acquired business;
- inability to take advantage of anticipated tax benefits;
- incurring acquisition-related costs or amortization costs for acquired intangible assets that could impact our operating results;
- elevated delinquency or bad debt write-offs related to receivables of the acquired business we assume;
- increased accounts receivables collection times and working capital requirements associated with acquired business models;
- additional costs of bringing acquired companies into compliance with laws and regulations applicable to a multinational corporation;

- difficulty in maintaining controls, procedures and policies during the transition and integration;
- impairment of our relationships with employees, customers, partners, distributors or third-party providers of our technologies, products or services;
- failure of our due diligence processes to identify significant problems, liabilities or other challenges of an acquired company or technology;
- exposure to litigation or other claims in connection with, or inheritance of claims or litigation risk as a result of, an acquisition, such as claims from terminated employees, customers, former stockholders or other third parties;

- incurring significant exit charges if products or services acquired in business combinations are unsuccessful;

- inability to conclude that our internal controls over financial reporting are effective;

- inability to obtain, or obtain in a timely manner, approvals from governmental authorities, which could delay or prevent such acquisitions;

- the failure of strategic investments to perform as expected or to meet financial projections;

- delay in customer and distributor purchasing decisions due to uncertainty about the direction of our product and service offerings; and

- incompatibility of business cultures.

Mergers and acquisitions of technology companies are inherently risky. If we do not complete an announced acquisition transaction or integrate an acquired business successfully and in a timely manner, we may not realize the benefits of the acquisition to the extent anticipated, and in certain circumstances an acquisition could harm our financial position.

***Changes in accounting principles, or interpretations thereof, could have a significant impact on our financial position and results of operations.***

We prepare our condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP"). These principles are subject to interpretation by the SEC and various bodies formed to interpret and create appropriate accounting principles. A change in these principles, how the principles are interpreted, or the adoption of new accounting principles can have a significant effect on our reported results, and could even retroactively affect previously reported transactions, and may require that we make significant changes to our systems, processes and controls.

Changes resulting from these new standards may result in materially different financial results and may require that we change how we process, analyze and report financial information and that we change financial reporting controls. For additional information regarding these updated standards, see the section titled "Recent Accounting Pronouncements Not Yet Effective" within Part II. Item 8, Note 1. Basis of Presentation and Summary of Significant Accounting Policies.

Such changes in accounting principles may have an adverse effect on our business, financial position, and income, or cause an adverse deviation from our revenue and profitability targets, which may negatively impact our financial results.

***Changes in tax rules and regulations, or interpretations thereof, may adversely affect our effective tax rates.***

We are a U.S.-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. A significant portion of our foreign earnings for the current fiscal year were earned by our Irish subsidiaries. In addition to providing for U.S. income taxes on earnings from the United States, we provide for U.S. income taxes on the earnings of foreign subsidiaries unless the subsidiaries' earnings are considered permanently reinvested outside the United States. While, as of the balance sheet date, we do not anticipate changing our intention regarding permanently reinvested earnings, if certain foreign earnings previously treated as permanently reinvested are repatriated, the related U.S. tax liability may be reduced by any foreign income taxes paid on these earnings.

Our income tax expense has differed from the tax computed at the U.S. federal statutory income tax rate due primarily to discrete items and to earnings considered as permanently reinvested in foreign operations. Unanticipated changes in our tax rates could affect our future results of operations. Our future effective tax rates could be unfavorably affected by changes in the tax rates in jurisdictions where our income is earned, by changes in or our interpretation of tax rules and regulations in the jurisdictions in which we do business, by unanticipated decreases in the amount of earnings in countries with low statutory tax rates, by unexpected negative changes in business and market conditions that could reduce certain tax benefits, or by changes in the valuation of our deferred tax assets and liabilities.

In addition, in the United States, the European Commission, countries in the European Union and other countries where we do business, we are subject to potential changes in relevant tax, accounting and other laws, regulations and interpretations, including changes to tax laws applicable to corporate multinationals such as Adobe. These countries and other governmental bodies have or could make unprecedented assertions about how earnings in their jurisdictions might be determined that are contrary to the way in which we have interpreted and historically applied the rules and regulations described above in our income tax returns filed in such jurisdictions. In the current global tax policy environment, any changes in laws, regulations and interpretations related to these assertions could adversely affect our effective tax rates or result in other costs to us which could adversely affect our operations and financial results.

Moreover, we are subject to the continual examination of our income tax returns by the U.S. Internal Revenue Service ("IRS") and other domestic and foreign tax authorities. These tax examinations are expected to focus on our intercompany transfer pricing practices as well as other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for adjustments that may result from these examinations. We cannot provide assurance that the final determination of any of these examinations will not have an adverse effect on our operating results and financial position.

***The success of some of our product and service offerings depends on our ability to continue to attract and retain customers of and contributors to our online marketplaces for creative content.***

The success of some of our product and service offerings, such as Adobe Stock, depends on our ability to continue to attract new customers and contributors to these online marketplaces for creative content, as well as our ability to continue to retain existing customers and contributors. An increase in paying customers has generally resulted in more content from contributors, which increases the size of our collection and in turn attracts new paying customers. We rely on the functionality and features of our online marketplaces, the size and content of our collection and the effectiveness of our marketing efforts to attract new customers and contributors and retain existing ones. New technologies may render the features of our online marketplaces obsolete, our collection may fail to grow as anticipated or our marketing efforts may be unsuccessful, any of which may adversely affect our results of operations.

***We face various risks associated with our operating as a multinational corporation.***

As a global business that generates approximately 42% of our total revenue from sales to customers outside of the Americas, we are subject to a number of risks, including:

- foreign currency fluctuations and controls;
- international and regional economic, political and labor conditions, including any instability or security concerns abroad;
- tax laws (including U.S. taxes on foreign subsidiaries);
- increased financial accounting and reporting burdens and complexities;
- changes in, or impositions of, legislative or regulatory requirements;
- changes in laws governing the free flow of data across international borders;
- failure of laws to protect our intellectual property rights adequately;
- inadequate local infrastructure and difficulties in managing and staffing international operations;
- delays resulting from difficulty in obtaining export licenses for certain technology, tariffs, quotas and other trade barriers;
- the imposition of governmental economic sanctions on countries in which we do business or where we plan to expand our business;
- costs and delays associated with developing products in multiple languages;

- operating in locations with a higher incidence of corruption and fraudulent business practices; and

- other factors beyond our control, such as terrorism, war, natural disasters and pandemics.

Some of our third-party business partners have international operations and are also subject to these risks and if our third-party business partners are unable to appropriately manage these risks, our business may be harmed. If sales to any of our customers outside of the Americas are reduced, delayed or canceled because of any of the above factors, our revenue may decline.

***We are subject to risks associated with compliance with laws and regulations globally, which may harm our business.***

We are a global company subject to varied and complex laws, regulations and customs, both domestically and internationally. These laws and regulations relate to a number of aspects of our business, including trade protection, import and export control, data and transaction processing security, payment card industry data security standards, records management, user-generated content hosted on websites we operate, privacy practices, data residency, corporate governance, anti-trust and competition, employee and third-party complaints, anti-corruption, gift policies, conflicts of interest, securities regulations and other regulatory requirements affecting trade and investment. The application of these laws and regulations to our business is often unclear and may at times conflict. For example, in many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by U.S. regulations applicable to us, including the Foreign Corrupt Practices Act. We cannot provide assurance that our employees, contractors, agents, and business partners will not take actions in violation of our internal policies or U.S. laws. Compliance with these laws and regulations may involve significant costs or require changes in our business practices that result in reduced revenue and profitability. Non-compliance could also result in fines, damages, criminal sanctions against us, our officers or our employees, prohibitions on the conduct of our business, and damage to our reputation.

In addition, approximately 52% of our employees are located outside the United States. Accordingly, we are exposed to changes in laws governing our employee relationships in various U.S. and foreign jurisdictions, including laws and regulations regarding wage and hour requirements, fair labor standards, employee data privacy, unemployment tax rates, workers' compensation rates, citizenship requirements and payroll and other taxes, which likely would have a direct impact on our operating costs.

***Uncertainty about current and future economic conditions and other adverse changes in general political conditions in any of the major countries in which we do business could adversely affect our operating results.***

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in economic and political conditions, both domestically and globally. Uncertainty about the effects of current and future economic and political conditions on us, our customers, suppliers and partners makes it difficult for us to forecast operating results and to make decisions about future investments. If economic growth in countries where we do business slows, customers may delay or reduce technology purchases, advertising spending or marketing spending. This could result in reductions in sales of our products and services, more extended sales cycles, slower adoption of new technologies and increased price competition. Among our customers are government entities, including the U.S. federal government, and our revenue could decline if spending cuts impact the government's ability to purchase our products and services. Deterioration in economic conditions in any of the countries in which we do business could also cause slower or impaired collections on accounts receivable, which may adversely impact our liquidity and financial condition.

A disruption in financial markets could impair our banking partners, on which we rely for operating cash management and affect our derivative counterparties. Any of these events would likely harm our business, financial condition, and results of operations.

Political instability or adverse political developments in or around any of the major countries in which we do business would also likely harm our business, results of operations and financial condition.

***Our intellectual property portfolio is a valuable asset and we may not be able to protect our intellectual property rights, including our source code, from infringement or unauthorized copying, use or disclosure.***

Our intellectual property portfolio is a valuable asset. Infringement or misappropriation of our patents, trademarks, trade secrets, copyrights and other intellectual property rights could result in lost revenues and ultimately reduce their value. Preventing unauthorized use or infringement of our intellectual property rights is inherently difficult. We actively combat software piracy as we enforce our intellectual property rights, but we nonetheless lose significant revenue due to illegal use of our software. If piracy activities continue at historical levels or increase, they may further harm our business. We apply for patents in the U.S. and internationally to protect our newly created technology and if we are unable to obtain patent protection for the technology described in our pending patent, or if the patent is not obtained timely, this could result in revenue loss, adverse effects on operations, and harm to our business. We offer our products and services in foreign countries and we may seek intellectual property protection from those foreign legal systems. Some of those foreign countries may not have as robust or comprehensive of intellectual property protection laws and schemes as those offered in the U.S. In some foreign countries, the mechanisms to enforce intellectual property rights may be inadequate to protect our technology, which could harm our business.

If unauthorized disclosure of our source code occurs through security breach, cyber-attack or otherwise, we could lose future trade secret protection for that source code. The loss of future trade secret protection could make it easier for third parties to compete with our products by copying functionality, which could cause us to lose customers and could adversely affect our revenue and operating margins. We also seek to protect our confidential information and trade secrets through the use of non-disclosure agreements with our customers, contractors, vendors and partners. However, there is a risk that our confidential information and trade secrets may be disclosed or published without our authorization, and in these situations, enforcing our rights may be difficult or costly.

***We may incur substantial costs defending against third parties alleging that we infringe their proprietary rights.***

We have been, are currently, and may in the future be, subject to claims, negotiations and complex, protracted litigation relating to disputes regarding the validity or alleged infringement of third-party intellectual property rights, including patent rights. Intellectual property disputes and litigation are typically costly and can be disruptive to our business operations by diverting the attention of management and key personnel. We may not prevail in every lawsuit or dispute. Third-party intellectual property disputes, including those initiated by patent assertion entities, could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from licensing certain of our products or offering certain of our services, subject us to injunctions restricting our sale of products or services, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers, including contractual provisions under various license arrangements and service agreements. In addition, we may incur significant costs in acquiring the necessary third-party intellectual property rights for use in our products, in some cases to fulfill contractual obligations with our customers. Any of these occurrences could significantly harm our business.

***We may incur losses associated with currency fluctuations and may not be able to effectively hedge our exposure.***

Our operating results are subject to fluctuations in foreign currency exchange rates due to the global scope of our business. We attempt to mitigate a portion of these risks through foreign currency hedging based on our judgment of the appropriate trade-offs among risk, opportunity and expense. We regularly review our program to partially hedge our exposure to foreign currency fluctuations and make adjustments as necessary. Our hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movement in foreign currency exchange rates, which could adversely affect our financial condition or results of operations.

***Failure of our third-party customer service and technical support providers to adequately address customers' requests could harm our business and adversely affect our financial results.***

Our customers rely on our customer service support organization to resolve issues with our products and services. We outsource a substantial portion of our customer service and technical support activities to third-party service providers. We depend heavily on these third-party customer service and technical support representatives working on our behalf, and we expect to continue to rely heavily on third parties in the future. This strategy presents risks to our business due to the fact that we may not be able to influence the quality of support as directly as we would be able to do if our own employees performed these activities. Our customers may react negatively to providing information to, and receiving support from, third-party organizations, especially if these third-party organizations are based overseas. If we encounter problems with our third-party customer service and technical support providers, our reputation may be harmed, our ability to sell our offerings could be adversely affected, and we could lose customers and associated revenue.

***Failure to manage our sales and distribution channels effectively could result in a loss of revenue and harm to our business.***

We contract with a number of software distributors and other strategic partners, none of which is individually responsible for a material amount of our total net revenue for any recent period. Nonetheless, if any single agreement with one of our distributors were terminated, any prolonged delay in securing a replacement distributor could have a negative impact on our results of operations.

Successfully managing our indirect distribution channel efforts to reach various customer segments for our products and services is a complex process across the broad range of geographies where we do business or plan to do business. Our distributors and other channel partners are independent businesses that we do not control. Notwithstanding the independence of our channel partners, we face legal risk and potential reputational harm from the activities of these third parties including, but not limited to, export control violations, workplace conditions, corruption and anti-competitive behavior.

We cannot be certain that our distribution channel will continue to market or sell our products and services effectively. If our distribution channel is not successful, we may lose sales opportunities, customers and revenue. Our distributors also sell our competitors' products and services, and if they favor our competitors' products or services for any reason, they may fail to market our products or services effectively or to devote resources necessary to provide effective sales, which would cause our results to suffer. We also distribute some products and services through our OEM channel, and if our OEMs decide not to bundle our applications on their devices, our results could suffer. In addition, the financial health of our distributors and our continuing relationships with them are important to our success. Some of these distributors may be unable to withstand adverse changes in economic conditions, which could result in insolvency, the inability of such distributors to obtain credit to finance purchases of our products and services, or a delay in paying their obligations to us.

We also sell some of our products and services through our direct sales force. Risks associated with this sales channel include more extended sales and collection cycles associated with direct sales efforts, challenges related to hiring, retaining and motivating our direct sales force, and substantial amounts of ongoing training for sales representatives. Moreover, recent hires may not become as productive as we would like, as in most cases it takes a significant period of time before they achieve full productivity. Our business could be seriously harmed if our expansion efforts do not generate a corresponding significant increase in revenue and we are unable to achieve the efficiencies we anticipate. In addition, the loss of key sales employees could impact our customer relationships and future ability to sell to certain accounts covered by such employees.

***Contracting with government entities exposes us to additional risks inherent in the government procurement process.***

We provide products and services, directly and indirectly, to a variety of government entities, both domestically and internationally. Risks associated with licensing and selling products and services to government entities include more extended sales and collection cycles, varying governmental budgeting processes and adherence to complex procurement regulations and other government-specific contractual requirements. We may be subject to audits and investigations relating to our government contracts and any violations could result in various civil and criminal penalties and administrative sanctions, including termination of contracts, payment of fines, and suspension or debarment from future government business, as well as harm to our reputation and financial results.

***Revenue, margin or earnings shortfalls or the volatility of the market generally may cause the market price of our stock to decline.***

In the past, the market price for our common stock experienced significant fluctuations and it may do so in the future. A number of factors may affect the market price for our common stock, such as:

- shortfalls in, or changes in expectations about our revenue, margins, earnings, Annualized Recurring Revenue (“ARR”), sales of our Adobe Experience Cloud offerings, or other key performance metrics;
- changes in estimates or recommendations by securities analysts;
- whether our results meet analysts’ expectations;
- compression or expansion of multiples used by investors and analysts to value high technology SaaS companies;
- the announcement of new products or services, product enhancements, service introductions, strategic alliances or significant agreements by us or our competitors;
- the loss of large customers or our inability to increase sales to existing customers, retain customers or attract new customers;
- recruitment or departure of key personnel;
- variations in our or our competitors’ results of operations, changes in the competitive landscape generally and developments in our industry;
- general socio-economic, political or market conditions; and
- unusual events such as significant acquisitions by us or our competitors, divestitures, litigation, regulatory actions and other factors, including factors unrelated to our operating performance.

In addition, the market for technology stocks or the stock market in general may experience uneven investor confidence, which may cause the market price for our common stock to decline for reasons unrelated to our operating performance. Volatility in the market price of a company's securities for a period of time may increase the company's susceptibility to securities class action litigation. Oftentimes, this type of litigation is expensive and diverts management's attention and resources which may adversely affect our business.

***If we are unable to recruit and retain key personnel, our business may be harmed.***

Much of our future success depends on the continued service, availability and performance of our senior management. These individuals have acquired specialized knowledge and skills with respect to Adobe. The loss of any of these individuals could harm our business, especially if we have not been successful in developing adequate succession plans. Our business is also dependent on our ability to retain, hire and motivate talented, highly skilled personnel across all levels of our organization. Experienced personnel in the information technology industry are in high demand and competition for their talents is intense in many areas where our employees are located. We may experience higher compensation costs to retain senior management and experienced personnel that may not be offset by improved productivity or increased sales. If we are unable to continue to successfully attract and retain key personnel, our business may be harmed.

We continue to hire personnel in countries where exceptional technical knowledge and other expertise are offered at lower costs, which increases the efficiency of our global workforce structure and reduces our personnel related expenditures. Nonetheless, as globalization continues, competition for these employees in these countries has increased, which may impact our ability to retain these employees and increase our expenses resulting from competitive compensation. We may continue to expand our international operations and international sales and marketing activities, which would require significant management attention and resources. We may be unable to scale our infrastructure effectively or as quickly as our competitors in these markets, and our revenue may not increase to offset these expected increases in costs and operating expenses, causing our results to suffer.

We believe that a critical contributor to our success to date has been our corporate culture, which we have built to foster innovation, teamwork and employee satisfaction. As we grow, including from the integration of employees and businesses acquired in connection with previous or future acquisitions, we may find it difficult to maintain important aspects of our corporate culture, which could negatively affect our ability to retain and recruit personnel who are essential to our future success.

***If our goodwill or amortizable intangible assets become impaired, then we could be required to record a significant charge to earnings.***

GAAP requires us to test for goodwill impairment at least annually. In addition, we review our goodwill and amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable include declines in stock price, market capitalization or cash flows, and slower growth rates in our industry. Depending on the results of our review, we could be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets were determined, negatively impacting our results of operations.

***We have issued $1.9 billion of notes in debt offerings and may incur other debt in the future, which may adversely affect our financial condition and future financial results.***

We have $1.9 billion in senior unsecured notes outstanding. We also have a $1 billion senior unsecured revolving credit agreement, which is currently undrawn. This debt may adversely affect our financial condition and future financial results by, among other things:

- increasing our vulnerability to adverse changes in general economic and industry conditions;
- requiring the dedication of a portion of our expected cash flow from operations to service our indebtedness, thereby reducing the amount of expected cash flow available for other purposes, including capital expenditures and acquisitions; and
- limiting our flexibility in planning for, or reacting to, changes in our business and our industry.

Our senior unsecured notes and senior unsecured revolving credit agreement impose restrictions on us and require us to maintain compliance with specified covenants. Our ability to comply with these covenants may be affected by events beyond our control. If we breach any of the covenants and do not obtain a waiver from the lenders or noteholders, then, subject to applicable cure periods, any outstanding indebtedness may be declared immediately due and payable.

In addition, changes by any rating agency to our credit rating may negatively impact the value and liquidity of both our debt and equity securities, as well as the potential costs associated with a refinancing of our debt. Under certain circumstances, if our credit ratings are downgraded or other negative action is taken, the interest rate payable by us under our revolving credit facility could increase. Downgrades in our credit ratings could also affect the terms of any such financing and restrict our ability to obtain additional financing in the future.

***Catastrophic events may disrupt our business.***

We are a highly automated business and rely on our network infrastructure and enterprise applications, internal technology systems and website for our development, marketing, operations, support, hosted services and sales activities. In addition, some of our businesses rely on third-party hosted services, and we do not control the operation of third-party data center facilities serving our customers from around the world, which increases our vulnerability. A disruption, infiltration or failure of these systems or third-party hosted services in the event of a major earthquake, fire, flood, tsunami or other weather event, power loss, telecommunications failure, software or hardware malfunctions, pandemics, cyber-attack, war, terrorist attack or other catastrophic event that our disaster recovery plans do not adequately address, could cause system interruptions, reputational harm, loss of intellectual property, delays in our product development, lengthy interruptions in our services, breaches of data security and loss of critical data. Any of these events could prevent us from fulfilling our customers' orders or could negatively impact a country or region in which we sell our products, which could in turn decrease that country's or region's demand for our products. Our corporate headquarters, a significant portion of our research and development activities, certain of our data centers and certain other critical business operations are located in the San Francisco Bay Area, and additional facilities where we conduct significant operations are located in the Salt Lake Valley Area, both of which are near major earthquake faults. A catastrophic event that results in the destruction or disruption of any of our data centers or our critical business or information technology systems could severely affect our ability to conduct normal business operations and, as a result, our future operating results could be adversely affected.

***Climate change may have a long-term impact on our business.***

While we seek to partner with organizations that mitigate their business risks associated with climate change, we recognize that there are inherent risks wherever business is conducted. Access to clean water and reliable energy in the communities where we conduct our business, whether for our offices or for our vendors, is a priority. Our major sites in California, Utah and India are vulnerable to prolonged droughts due to climate change. In the event of a natural disaster that disrupts business due to limited access to these resources, we have the potential to experience losses to our business, and added costs to resume operations.

***Our investment portfolio may become impaired by deterioration of the financial markets.***

Our cash equivalent and short-term investment portfolio as of December 1, 2017 consisted of corporate bonds and commercial paper, foreign government securities and U.S. Treasury securities, money market mutual funds, municipal securities, time deposits and asset-backed securities. We follow an established investment policy and set of guidelines to monitor and help mitigate our exposure to interest rate and credit risk. The policy sets forth credit quality standards and limits our exposure to any one issuer, as well as our maximum exposure to various asset classes.

Should financial market conditions worsen in the future, investments in some financial instruments may pose risks arising from market liquidity and credit concerns. In addition, any deterioration of the capital markets could cause our other income and expense to vary from expectations. As of December 1, 2017, we had no material impairment charges associated with our short-term investment portfolio, and although we believe our current investment portfolio has little risk of material impairment, we cannot predict future market conditions, market liquidity or credit availability, and can provide no assurance that our investment portfolio will remain materially unimpaired.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

Table of Contents

## ITEM 2. PROPERTIES

We own and occupy three office buildings and land in San Jose, California where our corporate headquarters is located. We also own buildings and land in Lehi, Utah, and at 601 and 625 Townsend Street in San Francisco, California, and the data center in Hillsboro, Oregon. Outside of the United States, we own certain land and buildings we occupy in Bangalore, India and Noida, India. We lease or sublease the rest of the properties we occupy under operating leases. Such leases expire at various times through 2031, with the exception of our land lease in Noida, India that expires in 2091.

The following table sets forth the location, approximate square footage and use of each of the principal properties used by Adobe during fiscal 2017.

| Location | Approximate Square Footage | | Use |
|---|---|---|---|
| North America: | | | |
| West Tower, 345 Park Avenue<br>San Jose, CA 95110, USA | 391,000 | | Research, product development, sales, marketing and administration |
| East Tower, 321 Park Avenue<br>San Jose, CA 95110, USA | 325,000 | | Research, product development, sales, marketing and administration |
| Almaden Tower, 151 Almaden Boulevard<br>San Jose, CA 95110, USA | 273,000 | | Research, product development, sales, marketing and administration |
| 601 and 625 Townsend Street<br>San Francisco, CA 94103, USA | 346,000 | | Research, product development, sales, marketing and administration |
| 410 Townsend Street<br>San Francisco, CA 94107, USA | 47,000 | | Research, product development, sales, marketing and administration |
| 3900 Adobe Way<br>Lehi, UT 84043, USA | 257,000 | | Research, product development, sales, marketing and administration |
| 801 N. 34th Street-Waterfront<br>Seattle, WA 98103, USA | 161,000 | | Product development, sales, marketing and administration |
| 1540 Broadway<br>New York, NY 10036, USA | 55,000 | | Sales, marketing and administration |
| 343 Preston Street<br>Ottawa, Ontario K1S 5N4, Canada | 122,000 | (1) | Research, product development, sales, marketing and administration |
| 25100 NW Evergreen Rd<br>Hillsboro, OR 97124, USA | 85,000 | | Data center |
| India: | | | |
| Adobe Towers, 1-1A, Sector 25A<br>Noida, U.P. | 191,000 | | Product development and administration |
| Plot No. 05, Block A, Sector 132<br>Noida, U.P. | 363,000 | | Product development and administration |
| Prestige Platina Technology Park<br>Building 1, Block A<br>Bangalore | 250,000 | | Research, product development, sales and administration |
| Prestige Trinity Centre<br>Bhoganahalli Village, Varthur Hobli<br>Bangalore | 149,000 | | Research, product development, sales and administration |
| Japan: | | | |
| Gate City Osaki East Tower<br>1-11 Osaki<br>Shinagawa-ku, Tokyo | 56,000 | | Product development, sales, marketing and administration |
| Romania: | | | |
| 26 Z Timisoara Blvd, Anchor Plaza<br>Lujerului, Sector 6<br>Bucharest | 71,000 | | Research and product development |
| UK: | | | |

| | | |
|---|---|---|
| Market House<br>Providence Place<br>Maidenhead, Berkshire, SL6 8AD | 49,000 | Product development, sales, marketing and administration |

(1) The total square footage is 122,000, of which we occupy 59,000 square feet, or approximately 48% of this facility; 6,000 square feet is unoccupied. The remaining square footage is subleased.

In general, all facilities are in good condition, suitable for the conduct of our business and are operating at an average capacity of approximately 83%.

## ITEM 3. LEGAL PROCEEDINGS

In connection with disputes relating to the validity or alleged infringement of third-party intellectual property rights, including patent rights, we have been, are currently and may in the future be subject to claims, negotiations or complex, protracted litigation. Intellectual property disputes and litigation may be very costly and can be disruptive to our business operations by diverting the attention and energies of management and key technical personnel. Although we have successfully defended or resolved past litigation and disputes, we may not prevail in any ongoing or future litigation and disputes. Third-party intellectual property disputes could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from licensing certain of our products or offering certain of our services, subject us to injunctions restricting our sale of products or services, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers including contractual provisions under various license arrangements and service agreements.

In addition to intellectual property disputes, we are subject to legal proceedings, claims and investigations in the ordinary course of business, including claims relating to commercial, employment and other matters. Some of these disputes and legal proceedings may include speculative claims for substantial or indeterminate amounts of damages. We consider all claims on a quarterly basis in accordance with GAAP and, based on known facts, assess whether potential losses are considered reasonably possible, probable and estimable. Based upon this assessment, we then evaluate disclosure requirements and whether to accrue for such claims in our financial statements. This determination is then reviewed and discussed with the Audit Committee of the Board of Directors and our independent registered public accounting firm.

We make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Unless otherwise specifically disclosed in our Consolidated Financial Statements and notes thereto, we have determined that no provision for liability nor disclosure is required related to any claim against us because: (a) there is not a reasonable possibility that a loss exceeding amounts already recognized (if any) may be incurred with respect to such claim; (b) a reasonably possible loss or range of loss cannot be estimated; or (c) such estimate is immaterial.

All legal costs associated with litigation are expensed as incurred. Litigation is inherently unpredictable. However, we believe that we have valid defenses with respect to the legal matters pending against us. It is possible, nevertheless, that our consolidated financial position, cash flows or results of operations could be negatively affected by an unfavorable resolution of one or more of such proceedings, claims or investigations.

In connection with our piracy conversion efforts, conducted both internally and through organizations such as the Business Software Alliance, from time to time we undertake litigation against alleged copyright infringers. Such lawsuits may lead to counter-claims alleging improper use of litigation or violation of other laws. We believe we have valid defenses with respect to such counter-claims; however, it is possible that our consolidated financial position, cash flows or results of operations could be negatively affected in any particular period by the resolution of one or more of these counter-claims.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

*Market Information for Common Stock*

Our common stock is traded on the NASDAQ Global Select Market under the symbol "ADBE." The following table sets forth the high and low sales price per share of our common stock for the periods indicated.

| | Price Range | |
|---|---|---|
| | **High** | **Low** |
| Fiscal 2017: | | |
| First Quarter | $ 120.35 | $ 101.55 |
| Second Quarter | $ 143.48 | $ 119.60 |
| Third Quarter | $ 155.16 | $ 137.25 |
| Fourth Quarter | $ 185.40 | $ 144.57 |
| Fiscal Year | $ 185.40 | $ 101.55 |
| Fiscal 2016: | | |
| First Quarter | $ 95.56 | $ 73.85 |
| Second Quarter | $ 100.17 | $ 84.35 |
| Third Quarter | $ 103.57 | $ 90.85 |
| Fourth Quarter | $ 110.81 | $ 98.77 |
| Fiscal Year | $ 110.81 | $ 73.85 |

*Stockholders*

According to the records of our transfer agent, there were 1,091 holders of record of our common stock on January 12, 2018. Because many of such shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

*Dividends*

We did not declare or pay any cash dividends on our common stock during fiscal 2017 or fiscal 2016. Under the terms of our credit agreement and lease agreements, we are not prohibited from paying cash dividends unless payment would trigger an event of default or one currently exists. We do not anticipate paying any cash dividends in the foreseeable future.

**Issuer Purchases of Equity Securities**

Below is a summary of stock repurchases for the three months ended December 1, 2017. *See Note 12 of our Notes to Consolidated Financial Statements for information regarding our stock repurchase programs.*

| Period | Total Number of Shares Repurchased | Average Price Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans | Approximate Dollar Value that May Yet be Purchased Under the Plan[1] |
|---|---|---|---|---|
| | (in thousands, except average price per share) | | | |
| Beginning repurchase authority | | | | $ 2,298,777 |
| September 2 — September 29, 2017 | | | | |
| Shares repurchased | 642 | $ 154.03 | 642 | $ (98,777) |
| September 30 — October 27, 2017 | | | | |
| Shares repurchased | 662 | $ 151.04 | 662 | $ (100,000) [2] |
| October 28 — December 1, 2017 | | | | |
| Shares repurchased | 552 | $ 178.36 | 552 | $ (98,500) [2] |
| Total | 1,856 | | 1,856 | $ 2,001,500 |

(1) In January 2017, the Board of Directors granted authority to repurchase up to $2.5 billion in common stock through the end of fiscal 2019.

(2) In September 2017, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of $300 million. As of December 1, 2017, approximately $101.5 million of the prepayment remained under this agreement.

## ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data (presented in thousands, except per share amounts and employee data) is derived from our Consolidated Financial Statements. As our historical operating results are not necessarily indicative of future operating results, this data should be read in conjunction with the Consolidated Financial Statements and notes thereto, and with Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

| | Fiscal Years | | | | |
|---|---|---|---|---|---|
| | 2017 | 2016 | 2015 | 2014 | 2013 |
| Operations: | | | | | |
| Revenue | $ 7,301,505 | $ 5,854,430 | $ 4,795,511 | $ 4,147,065 | $ 4,055,240 |
| Gross profit | $ 6,291,014 | $ 5,034,522 | $ 4,051,194 | $ 3,524,985 | $ 3,468,683 |
| Income before income taxes | $ 2,137,641 | $ 1,435,138 | $ 873,781 | $ 361,376 | $ 356,141 |
| Net income | $ 1,693,954 | $ 1,168,782 | $ 629,551 | $ 268,395 | $ 289,985 |
| Net income per share: | | | | | |
| Basic | $ 3.43 | $ 2.35 | $ 1.26 | $ 0.54 | $ 0.58 |
| Diluted | $ 3.38 | $ 2.32 | $ 1.24 | $ 0.53 | $ 0.56 |
| Shares used to compute basic net income per share | 493,632 | 498,345 | 498,764 | 497,867 | 501,372 |
| Shares used to compute diluted net income per share | 501,123 | 504,299 | 507,164 | 508,480 | 513,476 |
| Cash dividends declared per common share | $ — | $ — | $ — | $ — | $ — |
| Financial position:(1) | | | | | |
| Cash, cash equivalents and short-term investments | $ 5,819,774 | $ 4,761,300 | $ 3,988,084 | $ 3,739,491 | $ 3,173,752 |
| Working capital(2) | $ 3,720,356 | $ 3,028,139 | $ 2,608,336 | $ 2,107,893 | $ 2,520,281 |
| Total assets | $ 14,535,556 | $ 12,697,246 | $ 11,714,500 | $ 10,781,991 | $ 10,374,940 |
| Debt and capital lease obligations, non-current | $ 1,881,421 | $ 1,892,200 | $ 1,895,259 | $ 907,248 | $ 1,493,939 |
| Stockholders' equity | $ 8,459,869 | $ 7,424,835 | $ 7,001,580 | $ 6,775,905 | $ 6,724,634 |
| Additional data: | | | | | |
| Worldwide employees | 17,973 | 15,706 | 13,893 | 12,499 | 11,847 |

(1) Information associated with our financial position is as of the Friday closest to November 30 for the five fiscal periods through 2017.

(2) For fiscal 2014 and prior, our working capital did not include the effects of the adoption of ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes, which required all deferred tax assets and liabilities and any related valuation allowance to be classified as non-current on our Consolidated Balance Sheets. The new standard was adopted prospectively starting fiscal 2015.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion should be read in conjunction with our Consolidated Financial Statements and Notes thereto.*

### ACQUISITIONS

During fiscal 2017, we completed our acquisition of TubeMogul, a publicly held video advertising platform company, for $560.8 million. As of the end of fiscal 2017, we are continuing to integrate TubeMogul into our Digital Marketing reportable segment.

During fiscal 2015, we completed our acquisition of privately held Fotolia, a leading marketplace for royalty-free photos, images, graphics and HD videos, for $807.5 million. During fiscal 2015, we integrated Fotolia into our Digital Media reportable segment.

We also completed other immaterial business acquisitions during the fiscal years presented. Pro forma information has not been presented for any of our fiscal 2017, 2016 and 2015 acquisitions as the impact to our Consolidated Financial Statements was not material.

*See Note 2 of our Notes to Consolidated Financial Statements for further information regarding these acquisitions.*

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

In preparing our Consolidated Financial Statements in accordance with GAAP and pursuant to the rules and regulations of the SEC, we make assumptions, judgments and estimates that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosures of contingent assets and liabilities. We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. On a regular basis, we evaluate our assumptions, judgments and estimates. We also discuss our critical accounting policies and estimates with the Audit Committee of the Board of Directors.

We believe that the assumptions, judgments and estimates involved in the accounting for revenue recognition and income taxes have the greatest potential impact on our Consolidated Financial Statements. These areas are key components of our results of operations and are based on complex rules requiring us to make judgments and estimates, so we consider these to be our critical accounting policies. Historically, our assumptions, judgments and estimates relative to our critical accounting policies have not differed materially from actual results.

**Revenue Recognition**

Our revenue is derived from the subscription, non-software related hosted services, perpetual and term-based licensing of software products, associated software maintenance and support plans, consulting services, training and technical support. Most of our enterprise customer arrangements are complex, involving multiple solutions and various license rights, bundled with post-contract customer support and other meaningful rights that together provide a complete end-to-end solution to the customer. Throughout the contract period, customers use our solutions to complete various phases of the creative and/or marketing processes allowing them to concurrently work on multiple projects. In response to evolving customer and market expectations, we frequently expand and improve our technology to keep up with the pace of change, to provide enhancements to our tools to meet industry needs and to provide support at each stage of the customer's life cycle.

We recognize revenue when all four revenue recognition criteria have been met: persuasive evidence of an arrangement exists; we have delivered the product or performed the service; the fee is fixed or determinable; and collection is probable. Determining whether and when some of these criteria have been satisfied often involves assumptions and judgments that can have a significant impact on the timing and amount of revenue we report.

We enter into multiple element revenue arrangements in which a customer may purchase a combination of software, upgrades, maintenance and support, hosted services and consulting.

For our software and software-related multiple element arrangements, we must: (1) determine whether and when each element has been delivered; (2) determine whether undelivered products or services are essential to the functionality of the delivered products and services; (3) determine the fair value of each undelivered element using vendor-specific objective evidence ("VSOE"); and (4) allocate the total price among the various elements. VSOE of fair value is used to allocate a portion of the price to the undelivered elements and the residual method is used to allocate the remaining portion to the delivered elements. Absent VSOE, revenue is deferred until the earlier of the point at which VSOE of fair value exists for any undelivered element or until all elements of the arrangement have been delivered. However, if the only undelivered element is maintenance and support, the entire arrangement fee is recognized ratably over the performance period. Changes in assumptions or judgments or changes to the elements in a software arrangement could cause a material increase or decrease in the amount of revenue that we report in a particular period.

We determine VSOE for each element based on historical stand-alone sales to third parties or from the stated renewal rate for the elements contained in the initial arrangement. In determining VSOE, we require that a substantial majority of the selling prices for a product or service fall within a reasonably narrow pricing range.

We have established VSOE for our software maintenance and support services, custom software development services, consulting services and training, when such services are sold optionally with software licenses.

For multiple-element arrangements containing our non-software services, we must: (1) determine whether and when each element has been delivered; (2) determine the fair value of each element using the selling price hierarchy of VSOE of selling price, third-party evidence ("TPE") of selling price or best-estimated selling price ("BESP"), as applicable; and (3) allocate the total price among the various elements based on the relative selling price method.

For multiple-element arrangements that contain both software and non-software elements, we allocate revenue to software or software-related elements as a group and any non-software elements separately based on the selling price hierarchy. We determine the selling price for each deliverable using VSOE of selling price, if it exists, or TPE of selling price. If neither VSOE nor TPE of selling price exist for a deliverable, we use BESP. Once revenue is allocated to software or software-related elements as a group, we recognize revenue in conformance with software revenue accounting guidance. Revenue is recognized when revenue recognition criteria are met for each element.

We are generally unable to establish VSOE or TPE for non-software elements and as such, we use BESP. BESP is generally used for offerings that are not typically sold on a stand-alone basis or for new or highly customized offerings. We determine BESP for a product or service by considering multiple factors including, but not limited to, major product groupings, geographies, market conditions, competitive landscape, internal costs, gross margin objectives and pricing practices. Pricing practices taken into consideration include historic contractually stated prices, volume discounts where applicable and our price lists. We must estimate certain royalty revenue amounts due to the timing of securing information from our customers. While we believe we can make reliable estimates regarding these matters, these estimates are inherently subjective. Accordingly, our assumptions and judgments regarding future products and services as well as our estimates of royalty revenue could differ from actual events, thus materially impacting our financial position and results of operations.

Product revenue is recognized when the above criteria are met. We reduce the revenue recognized for estimated future returns, rebates and price protection at the time the related revenue is recorded. In determining our estimate for returns and in accordance with our internal policy regarding global channel inventory which is used to determine the level of product held by our distributors on which we have recognized revenue, we rely upon historical data, the estimated amount of product inventory in our distribution channel, the rate at which our product sells through to the end user, product plans and other factors. Our estimated provisions for returns can vary from what actually occurs. Product returns may be more or less than what was estimated. The amount of inventory in the channel could be different than what is estimated. Our estimate of the rate of sell-through for product in the channel could be different than what actually occurs. These factors and unanticipated changes in the economic and industry environment could make our return estimates differ from actual returns, thus impacting our financial position and results of operations.

In the future, actual returns and price protection may exceed our estimates as unsold products in the distribution channels are exposed to rapid changes in consumer preferences, market conditions or technological obsolescence due to new platforms, product updates or competing products. While we believe we can make reliable estimates regarding these matters, these estimates are inherently subjective. Accordingly, if our estimates change, our returns and price protection reserves would change, which would impact the total net revenue we report.

We recognize revenue for hosted services that are priced based on a committed number of transactions ratably beginning on the date the services associated with the committed transactions are first made available to the customer and continuing through the end of the contractual service term. Over-usage fees, and fees billed based on the actual number of transactions from which we capture data, are billed in accordance with contract terms as these fees are incurred. We record amounts that have been invoiced in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

Our consulting revenue is recognized on a time and materials basis and is measured monthly based on input measures, such as on hours incurred to date compared to total estimated hours to complete, with consideration given to output measures, such as contract milestones, when applicable.

**Accounting for Income Taxes**

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Management must make assumptions, judgments and estimates to determine our current provision for income taxes and also our deferred tax assets and liabilities and any valuation allowance to be recorded against a deferred tax asset.

Our assumptions, judgments and estimates relative to the current provision for income taxes take into account current tax laws, our interpretation of current tax laws and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. We have established reserves for income taxes to address potential exposures involving tax positions that could be challenged by tax authorities. In addition, we are subject to the continual examination of our income tax returns by the U.S. Internal Revenue Service ("IRS") and other domestic and foreign tax authorities. We expect future examinations to focus on our intercompany transfer pricing practices as well as other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from such examinations. We believe such estimates to be reasonable; however, the final determination of any of these examinations could significantly impact the amounts provided for income taxes in our Consolidated Financial Statements.

Our assumptions, judgments and estimates relative to the value of a deferred tax asset take into account predictions of the amount and category of future taxable income, such as income from operations or capital gains income. Actual operating results and the underlying amount and category of income in future years could render our current assumptions, judgments and estimates of recoverable net deferred taxes inaccurate. Any of the assumptions, judgments and estimates mentioned above could cause our actual income tax obligations to differ from our estimates, thus materially impacting our financial position and results of operations.

We are a United States-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. A significant portion of our foreign earnings for the current fiscal year were earned by our Irish subsidiaries. In addition to providing for U.S. income taxes on earnings from the United States, we provide for U.S. income taxes on the earnings of foreign subsidiaries unless the subsidiaries' earnings are considered permanently reinvested outside the United States. While we do not anticipate changing our intention regarding permanently reinvested earnings as of the balance sheet date, if certain foreign earnings previously treated as permanently reinvested are repatriated, the related U.S. tax liability may be reduced by any foreign income taxes paid on these earnings.

Our income tax expense has differed from the tax computed at the U.S. federal statutory income tax rate due primarily to discrete items and to earnings considered as permanently reinvested in foreign operations. Unanticipated changes in our tax rates could affect our future results of operations. Our future effective tax rates could be unfavorably affected by changes in the tax rates in jurisdictions where our income is earned, by changes in or our interpretation of tax rules and regulations in the jurisdictions in which we do business, by unanticipated decreases in the amount of earnings in countries with low statutory tax rates, by unexpected negative changes in business and market conditions that could reduce certain tax benefits, or by changes in the valuation of our deferred tax assets and liabilities.

In addition, in the United States, the European Commission, countries in the European Union and other countries where we do business, we are subject to potential changes in relevant tax, accounting and other laws, regulations and interpretations, including changes to tax laws applicable to corporate multinationals such as Adobe. These countries and other governmental bodies have or could make unprecedented assertions about how earnings in their jurisdictions might be determined that are contrary to the way in which we have interpreted and historically applied the rules and regulations described above in our income tax returns filed in such jurisdictions. In the current global tax policy environment, any changes in laws, regulations and interpretations related to these assertions could adversely affect our effective tax rates or result in other costs to us, which could adversely affect our operations and financial results.

Moreover, we are subject to the continual examination of our income tax returns by the IRS and other domestic and foreign tax authorities. These tax examinations are expected to focus on our intercompany transfer pricing practices as well as other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for adjustments that may result from these examinations. We cannot provide assurance that the final determination of any of these examinations will not have an adverse effect on our operating results and financial position.

**Recent Accounting Pronouncements**

*See Note 1 of our Notes to Consolidated Financial Statements for information regarding recent accounting pronouncements that are of significance, or potential significance to us.*

## RESULTS OF OPERATIONS

### Overview of 2017

For fiscal 2017, we reported strong financial results consistent with the continued execution of our long-term plans for our two strategic growth areas, Digital Media and Digital Marketing, while continuing to market and license a broad portfolio of products and solutions.

In our Digital Media segment, we are a market leader with Creative Cloud, our subscription-based offering for creating and publishing content and applications. Creative Cloud delivers value through frequent product updates, storage and access to user files stored in the cloud with syncing of files across users' machines, access to marketplace, social and community-based features with our Adobe Stock and Behance services, app creation capabilities and affordable pricing for cost-sensitive customers.

We offer Creative Cloud for individuals, students, teams and enterprises. We expect Creative Cloud will drive sustained long-term revenue growth through a continued expansion of our customer base by acquiring new users on account of Creative Cloud's low cost of entry and delivery of additional features and value, as well as keeping existing customers current on our latest release. We have also built out a marketplace for Creative Cloud subscribers to enable the delivery and purchase of stock content in our Adobe Stock service. Overall, our strategy with Creative Cloud is designed to enable us to increase our revenue with users, attract more new customers, and grow a recurring and predictable revenue stream that is recognized ratably.

We continue to implement strategies that will accelerate awareness, consideration and purchase of subscriptions to our Creative Cloud offerings. These strategies include increasing the value Creative Cloud users receive, such as offering new mobile applications, as well as targeted promotions and offers that attract past customers and potential users to try out and ultimately subscribe to Creative Cloud. Because of the shift towards Creative Cloud subscriptions and Enterprise Term License Agreements ("ETLAs"), revenue from perpetual licensing of our Creative products has been immaterial to our business.

We are also a market leader with our Adobe Document Cloud offerings built around our Adobe Acrobat family of products, the Adobe Reader and a set of integrated cloud-based document services, including Adobe Sign. Acrobat provides reliable creation and exchange of electronic documents, regardless of platform or application source type. Document Cloud, which we believe enhances the way people manage critical documents at home, in the office and across devices, includes Adobe Acrobat DC and Adobe Sign, and a set of integrated services enabling users to create, review, approve, sign and track documents whether on a desktop or mobile device. Adobe Acrobat DC, with a touch-enabled user interface, is offered both through subscription and perpetual licenses.

Annualized Recurring Revenue ("ARR") is currently the key performance metric our management uses to assess the health and trajectory of our overall Digital Media segment. ARR should be viewed independently of revenue, deferred revenue and unbilled deferred revenue as ARR is a performance metric and is not intended to be combined with any of these items. We adjust our reported ARR on an annual basis to reflect any material exchange rates changes. Our reported ARR results in fiscal 2017 are based on currency rates set at the start of fiscal 2017 and held constant throughout the year. We calculate ARR as follows:

| | |
|---|---|
| Creative ARR | Annual Value of Creative Cloud Subscriptions and Services<br>+<br>Annual Digital Publishing Suite Contract Value<br>+<br>Annual Creative ETLA Contract Value |
| Document Cloud ARR | Annual Value of Document Cloud Subscriptions and Services<br>+<br>Annual Document Cloud ETLA Contract Value |
| Digital Media ARR | Creative ARR<br>+<br>Document Cloud ARR |

Creative ARR exiting fiscal 2017 was $4.63 billion, up from $3.52 billion at the end of fiscal 2016. Document Cloud ARR exiting fiscal 2017 was $600 million, up from $472 million at the end of fiscal 2016. Total Digital Media ARR grew to $5.23 billion at the end of fiscal 2017, up from $3.99 billion at the end of fiscal 2016. Revaluing our ending ARR for fiscal 2017 using currency rates at the beginning of fiscal 2018, our Digital Media ARR at the end of fiscal 2017 would be $5.39 billion or approximately $154 million higher than the ARR reported above.

Our success in driving growth in ARR has positively affected our revenue growth. Creative revenue in fiscal 2017 was $4.17 billion, up from $3.18 billion in fiscal 2016 and representing 31% year-over-year growth. Document Cloud revenue in fiscal 2017 was $836.7 million, up from $764.9 million in fiscal 2016 and representing 9% year-over-year revenue growth as we continue to transition Document Cloud to a subscription-based model. Total Digital Media segment revenue grew to $5.01 billion in fiscal 2017, up from $3.94 billion in fiscal 2016 and representing 27% year-over-year growth.

We are a market leader in the fast-growing category addressed by our Digital Marketing segment. Our Digital Marketing business provides comprehensive solutions that include analytics, social marketing, targeting, media optimization, digital experience management, cross-channel campaign management, audience management, premium video delivery and monetization. These comprehensive solutions enable marketers to measure, personalize and optimize marketing campaigns and digital experiences across channels for optimal marketing performance. In March 2017, we migrated our hierarchy of solutions under what was formerly known as Adobe Marketing Cloud to our next generation offering referred to as Adobe Experience Cloud.

Adobe Experience Cloud consists of the following cloud offerings:

- Adobe Marketing Cloud—provides an integrated set of solutions to help marketers differentiate their brands and engage their customers, helping businesses manage, personalize, and orchestrate campaigns and customer journeys; includes Adobe Experience Manager ("AEM"), Adobe Campaign, Adobe Target, Adobe Social and Adobe Primetime.

- Adobe Analytics Cloud—enables businesses to move from insights to actions in real time by uniquely integrating audiences as the core system of intelligence for the enterprise; makes data available across all Adobe clouds through the capture, aggregation, rationalization and understanding of vast amounts of disparate data and then translating that data into singular customer profiles; includes Adobe Analytics and Adobe Audience Manager.

- Adobe Advertising Cloud—delivers an end-to-end platform for managing advertising across traditional TV and digital formats, and simplifies the delivery of video, display and search advertising across channels and screens; combines capabilities from Adobe Media Optimizer ("AMO") and Adobe's acquisition of TubeMogul during the first quarter of fiscal 2017.

In addition to chief marketing officers and digital marketers, users of our Adobe Experience Cloud solutions include advertisers, campaign managers, digital marketers, publishers, data analysts, content managers, social marketers and marketing executives. These customers often are involved in workflows that utilize other Adobe products, such as our Digital Media offerings. By combining the creativity of our Digital Media business with the science of our Digital Marketing business, we help our customers to more efficiently and effectively make, manage, measure and monetize their content across every channel with an end-to-end workflow and feedback loop.

We utilize a direct sales force to market and license our Adobe Experience Cloud solutions, as well as an extensive ecosystem of partners, including marketing agencies, systems integrators and independent software vendors that help license and deploy our solutions to their customers. We have made significant investments to broaden the scale and size of all of these routes to market, and our recent financial results reflect the success of these investments. We achieved record Adobe Experience Cloud revenue of $2.03 billion in fiscal 2017, which represents 24% year-over-year growth.

*Financial Performance Summary for Fiscal 2017*

•

Total Digital Media ARR of approximately $5.23 billion as of December 1, 2017 increased by $1.24 billion, or 31%, from $3.99 billion as of December 2, 2016. The change in our Digital Media ARR was primarily due to strong adoption of our Creative Cloud and Adobe Document Cloud offerings.

- Creative revenue of $4.17 billion increased by $997.8 million, or 31%, during fiscal 2017, from $3.18 billion in fiscal 2016. The increase was primarily due to the increase in subscription revenue associated with our Creative Cloud offerings.

- Adobe Experience Cloud revenue of $2.03 billion increased by $398.9 million, or 24%, during fiscal 2017, from $1.63 billion in fiscal 2016. The increase was primarily due to increases in revenue associated with our Advertising Cloud offerings, including TubeMogul which we acquired in the first quarter of fiscal 2017, and increases in subscription revenue associated with our Adobe Marketing Cloud offerings, including AEM and Adobe Campaign.

- Our total deferred revenue of $2.49 billion as of December 1, 2017 increased by $479.8 million, or 24%, from $2.01 billion as of December 2, 2016. The increase was primarily due to increases in Creative Cloud team and individual subscriptions, and new contracts and the timing of renewals for our Adobe Experience Cloud services.

- Cost of revenue of $1.01 billion increased by $190.6 million, or 23%, during fiscal 2017, from $819.9 million in fiscal 2016. The increase was primarily due to increases in media costs associated with our Advertising Cloud offerings, data center and hosting costs and increased headcount.

- Operating expenses of $4.12 billion increased by $582.0 million, or 16%, during fiscal 2017, from $3.54 billion in fiscal 2016. The increase was primarily due to increased headcount and stock based compensation expense.

- Net income of $1.69 billion increased by $525.2 million, or 45%, during fiscal 2017 from $1.17 billion in fiscal 2016 primarily due to increases in subscription revenue.

- Net cash flow from operations of $2.91 billion during fiscal 2017 increased by $713.1 million, or 32%, from $2.20 billion during fiscal 2016 primarily due to higher net income.

**Revenue (dollars in millions)**

Revenue for fiscal 2016 benefited from an extra week in the first quarter of fiscal 2016 due to our 52/53 week financial calendar whereby fiscal 2016 was a 53-week year compared with fiscal 2017 and 2015, which were 52-week years.

| | Fiscal 2017 | Fiscal 2016 | Fiscal 2015 | % Change 2017-2016 | % Change 2016-2015 |
|---|---|---|---|---|---|
| Subscription | $ 6,133.9 | $ 4,584.8 | $ 3,223.9 | 34 % | 42 % |
| Percentage of total revenue | 84 % | 78 % | 67 % | | |
| Product | 706.7 | 800.5 | 1,125.1 | (12 %) | (29 %) |
| Percentage of total revenue | 10 % | 14 % | 24 % | | |
| Services and support | 460.9 | 469.1 | 446.5 | (2 %) | 5 % |
| Percentage of total revenue | 6 % | 8 % | 9 % | | |
| Total revenue | $ 7,301.5 | $ 5,854.4 | $ 4,795.5 | 25 % | 22 % |

Our subscription revenue is comprised primarily of fees we charge for our subscription and hosted service offerings including Creative Cloud and certain of our Adobe Experience Cloud and Document Cloud services. We recognize subscription revenue ratably over the term of agreements with our customers, beginning with commencement of the service.

We have the following reportable segments—Digital Media, Digital Marketing and Print and Publishing. Subscription revenue by reportable segment for fiscal 2017, 2016 and 2015 is as follows (dollars in millions):

| | Fiscal 2017 | Fiscal 2016 | Fiscal 2015 | % Change 2017-2016 | % Change 2016-2015 |
|---|---|---|---|---|---|

| | | | | | |
|---|---|---|---|---|---|
| Digital Media | $ 4,480.8 | $ 3,370.8 | $ 2,264.7 | 33 % | 49 % |
| Digital Marketing | 1,609.5 | 1,180.4 | 937.0 | 36 % | 26 % |
| Print and Publishing | 43.6 | 33.6 | 22.2 | 30 % | 51 % |
| Total subscription revenue | $ 6,133.9 | $ 4,584.8 | $ 3,223.9 | 34 % | 42 % |

Our services and support revenue is comprised of consulting, training and maintenance and support, primarily related to the licensing of our enterprise offerings and the sale of our hosted Adobe Experience Cloud services. Our support revenue also includes technical support and developer support to partners and developer organizations related to our desktop products. Our maintenance and support offerings, which entitle customers to receive desktop product upgrades and enhancements or technical support, depending on the offering, are generally recognized ratably over the term of the arrangement.

*Segments*

In fiscal 2017, we categorized our products into the following reportable segments:

- *Digital Media*—Our Digital Media segment provides tools and solutions that enable individuals, small and medium businesses and enterprises to create, publish, promote and monetize their digital content anywhere. Our customers include traditional content creators, web application developers and digital media professionals, as well as their management in marketing departments and agencies, companies and publishers. Our customers also include knowledge workers who create, collaborate and distribute documents.

- *Digital Marketing*—Our Digital Marketing segment provides solutions and services for how digital advertising and marketing are created, managed, executed, measured and optimized. Our customers include digital marketers, advertisers, publishers, merchandisers, web analysts, chief marketing officers, chief information officers and chief revenue officers.

- *Print and Publishing*—Our Print and Publishing segment addresses market opportunities ranging from the diverse authoring and publishing needs of technical and business publishing to our legacy type and OEM printing businesses.

*Segment Information (dollars in millions)*

| | Fiscal 2017 | Fiscal 2016 | Fiscal 2015 | % Change 2017-2016 | % Change 2016-2015 |
|---|---|---|---|---|---|
| Digital Media | $ 5,010.6 | $ 3,941.0 | $ 3,095.2 | 27 % | 27 % |
| Percentage of total revenue | 69 % | 67 % | 65 % | | |
| Digital Marketing | 2,120.0 | 1,736.6 | 1,508.9 | 22 % | 15 % |
| Percentage of total revenue | 29 % | 30 % | 31 % | | |
| Print and Publishing | 170.9 | 176.8 | 191.4 | (3 )% | (8 )% |
| Percentage of total revenue | 2 % | 3 % | 4 % | | |
| Total revenue | $ 7,301.5 | $ 5,854.4 | $ 4,795.5 | 25 % | 22 % |

*Fiscal 2017 Revenue Compared to Fiscal 2016 Revenue*

*Digital Media*

Revenue from Digital Media increased $1.07 billion during fiscal 2017 as compared to fiscal 2016, primarily driven by increases in revenue associated with our creative offerings.

Revenue associated with our creative offerings, which includes our Creative Cloud, perpetually licensed creative and stock photography offerings, increased during fiscal 2017. The increase was primarily due to an increase in subscription revenue associated with our Creative Cloud offerings driven by increases in individual, team and enterprise subscriptions. Also contributing to the increase in revenue was revenue growth associated with our Creative Cloud Photography Plan subscription offering.

Adobe Document Cloud revenue, which includes our Acrobat product family and Adobe Sign service, increased during fiscal 2017 as compared to fiscal 2016 primarily due to increases in Document Cloud subscriptions revenue, offset in part by expected declines in revenue associated with our perpetually licensed Acrobat offering. Also contributing to the increase in Document Cloud revenue was an increase in Adobe Sign revenue.

*Digital Marketing*

Revenue from Digital Marketing increased $383.4 million during fiscal 2017, as compared to fiscal 2016 primarily due to subscription revenue growth associated with our Adobe Experience Cloud. The increase in subscription revenue was driven by strong performance with our Adobe Marketing Cloud offerings, which include AEM and Adobe Campaign, and our Adobe Analytics Cloud offerings, which includes Audience Manager. Also contributing to the increase in Adobe Experience Cloud revenue were increases in revenue associated with our Adobe Advertising Cloud offerings, including Tubemogul which we acquired in the first quarter of fiscal 2017.

*Fiscal 2016 Revenue Compared to Fiscal 2015 Revenue*

*Digital Media*

Revenue from Digital Media increased $845.8 million during fiscal 2016 as compared to fiscal 2015, primarily driven by increases in revenue associated with our creative offerings.

Revenue associated with our creative offerings, which includes our Creative Cloud, perpetually licensed creative and stock photography offerings, increased during fiscal 2016 as compared to fiscal 2015 primarily due to the increase in subscription revenue associated with our Creative Cloud offerings driven by increases in the number of paid Creative Cloud individual and team subscriptions, and continued adoption of our ETLAs. To a lesser extent, increases in revenue associated with our Creative Cloud Photography Plan subscription offering and stock photography offerings also contributed to the increase in revenue associated with our creative offerings. Increases associated with our creative offerings were slightly offset by expected declines in revenue associated with our perpetual creative offerings and distribution of third-party software downloads.

Document Cloud revenue, which includes our Acrobat product family and Adobe Sign service, decreased slightly during fiscal 2016 as compared to fiscal 2015, primarily due to expected decreases in revenue associated with our Acrobat perpetual license offering. Decreases were partially offset by increases in revenue associated with our Document Cloud subscription offerings as we continue to migrate more customers to our Document Cloud, along with increases in Adobe Sign revenue.

*Digital Marketing*

Revenue from Digital Marketing increased $227.7 million during fiscal 2016, as compared to fiscal 2015 primarily due to continued revenue growth associated with our Adobe Experience Cloud, which increased 20% year over year. Increases in Adobe Experience Cloud revenue were largely driven by the continued adoption of our AEM offerings and, to a lesser extent, the increase in revenue associated with Adobe Campaign. Also contributing to the increase in Digital Marketing revenue was the increase in Adobe Analytics Cloud revenue.

*Geographical Information (dollars in millions)*

| | Fiscal 2017 | Fiscal 2016 | Fiscal 2015 | % Change 2017-2016 | % Change 2016-2015 |
|---|---|---|---|---|---|
| Americas | $ 4,216.5 | $ 3,400.1 | $ 2,788.1 | 24% | 22% |
| Percentage of total revenue | 58% | 58% | 58% | | |
| EMEA | 1,985.1 | 1,619.2 | 1,336.4 | 23% | 21% |
| Percentage of total revenue | 27% | 28% | 28% | | |
| APAC | 1,099.9 | 835.1 | 671.0 | 32% | 24% |
| Percentage of total revenue | 15% | 14% | 14% | | |
| Total revenue | $ 7,301.5 | $ 5,854.4 | $ 4,795.5 | 25% | 22% |

*Fiscal 2017 Revenue by Geography Compared to Fiscal 2016 Revenue by Geography*

Overall revenue during fiscal 2017 increased in all geographic regions as compared to fiscal 2016 primarily due to increases in Digital Media and Digital Marketing revenue. Within each geographic region, the fluctuations in revenue by reportable segment were attributable to the factors noted in the segment information above. Further, the overall increase in EMEA revenue was slightly offset by declines due to the relative strength of the U.S. Dollar against EMEA currencies as discussed below.

*Fiscal 2016 Revenue by Geography Compared to Fiscal 2015 Revenue by Geography*

Overall revenue during fiscal 2016 increased in all geographic regions as compared to fiscal 2015 primarily due to increases in Digital Media and Digital Marketing revenue, slightly offset by a decrease in Print and Publishing revenue. Within each geographic region, fluctuations in revenue by reportable segment were attributable to the factors noted in the segment information above. Further, the overall increase in EMEA revenue was partially offset by declines due to the relative strength of the U.S. Dollar against EMEA currencies as discussed below.

Included in the overall change in revenue for fiscal 2017 and fiscal 2016 were impacts associated with foreign currency as shown below. Our currency hedging program is used to mitigate a portion of the foreign currency impact to revenue.

| (in millions) | Fiscal 2017 | Fiscal 2016 |
|---|---|---|
| **Revenue impact:** | Increase/(Decrease) | |
| Euro | $ (2.3) | $ (50.2) |
| British Pound | (46.1) | (36.2) |
| Japanese Yen | 4.0 | 15.0 |
| Other currencies | 6.1 | (21.7) |
| Total revenue impact | (38.3) | (93.1) |
| **Hedging impact:** | | |
| Euro | 13.7 | 4.2 |
| British Pound | 7.1 | 14.5 |
| Japanese Yen | 12.1 | 0.1 |
| Total hedging impact | 32.9 | 18.8 |
| Total impact | $ (5.4) | $ (74.3) |

During fiscal 2017, the U.S. Dollar strengthened against the British Pound, which negatively impacted revenue in EMEA measured in U.S. Dollar equivalents. The net foreign currency impact to revenue was offset in part by hedging gains from our EMEA and Japanese Yen currencies hedging programs during fiscal 2017.

During fiscal 2016, the U.S. Dollar strengthened against the Euro and British Pound which negatively impacted revenue in EMEA measured in U.S. Dollar equivalents. This impact was partially offset by hedging gains from our EMEA currencies hedging programs during fiscal 2016. During fiscal 2016, the U.S. Dollar weakened against the Japanese Yen, the impact of which was offset by the impact of the U.S. Dollar strengthening against other Asian currencies.

*See Note 17 of our Notes to Consolidated Financial Statements for further geographic information.*

*Backlog*

Deferred revenue on our consolidated balance sheet consists of billings and payments received in advance of revenue recognition for our products and solutions and does not represent the total contract value of existing annual or multi-year, non-cancelable commercial subscription, SaaS and managed services agreements or government contracts with fiscal funding clauses. Unbilled deferred revenue represents expected future billings that are contractually committed under our existing subscription, SaaS and managed services agreements that have not been invoiced and are not recorded in deferred revenue within our financial statements. Our presentation of unbilled deferred revenue backlog may differ from that of other companies in the industry. As of December 1, 2017, we had unbilled deferred revenue backlog of approximately $3.94 billion of which approximately 40% to 50% is not reasonably expected to be billed during fiscal 2018. Comparatively, we had unbilled deferred revenue backlog of approximately $3.42 billion as of December 2, 2016, of which approximately 40% to 50% was not reasonably expected to be billed during fiscal 2017.

We expect that the amount of unbilled deferred revenue backlog will change from period to period due to certain factors, including the timing and duration of large customer subscriptions, SaaS and managed service agreements, varying billing cycles of these agreements, the timing of customer renewals, the timing of when unbilled deferred revenue backlog is to be billed, changes in customer financial circumstances and foreign currency fluctuations. Additionally, the unbilled deferred revenue backlog for multi-year subscription agreements that are billed annually is typically higher at the beginning of the contract period, lower prior to renewal and typically increases when the agreement is renewed. Accordingly, fluctuations in unbilled deferred revenue backlog may not be a reliable indicator of future business prospects and the related revenue associated with these contractual commitments.

**Cost of Revenue (dollars in millions)**

| | Fiscal 2017 | Fiscal 2016 | Fiscal 2015 | % Change 2017-2016 | % Change 2016-2015 |
|---|---|---|---|---|---|
| Subscription | $ 623.0 | $ 461.9 | $ 409.2 | 35 % | 13 % |
| Percentage of total revenue | 9 % | 8 % | 9 % | | |
| Product | 57.1 | 68.9 | 90.0 | (17 )% | (23 )% |
| Percentage of total revenue | 1 % | 1 % | 2 % | | |
| Services and support | 330.4 | 289.1 | 245.1 | 14 % | 18 % |
| Percentage of total revenue | 5 % | 5 % | 5 % | | |
| Total cost of revenue | $ 1,010.5 | $ 819.9 | $ 744.3 | 23 % | 10 % |

*Subscription*

Cost of subscription revenue consists of third-party royalties and expenses related to operating our network infrastructure, including depreciation expense and operating lease payments associated with computer equipment, data center costs, salaries and related expenses of network operations, implementation, account management and technical support personnel, amortization of certain intangible assets and allocated overhead. We enter into contracts with third parties for hosting services and use of data center facilities. Our data center costs largely consist of the amounts we pay to these third parties for rack space, power and similar items. Cost of subscription revenue also includes media costs related to impressions purchased from third-party ad inventory sources for our Adobe Advertising Cloud offerings.

Cost of subscription revenue increased due to the following:

| | % Change 2017-2016 | % Change 2016-2015 |
|---|---|---|
| Media costs | 9 | — |
| Hosting services and data center costs | 7 | 9 |
| Royalty costs | 6 | 2 |
| Base compensation and related benefits associated with headcount | 6 | 2 |
| Incentive compensation, cash and stock based | 5 | — |
| Amortization of purchased intangibles | 2 | (4 ) |
| Depreciation expense | (1 ) | 2 |
| Various individually insignificant items | 1 | 2 |
| Total change | 35 % | 13 % |

Media costs increased during fiscal 2017 as compared to fiscal 2016 primarily due to our TubeMogul advertising platform offerings, which are part of the Adobe Advertising Cloud and were acquired through our acquisition of TubeMogul in the first quarter of fiscal 2017. Royalty costs increased due to increases in obligations to certain key vendors for technology use.

Hosting services and data center costs increased in all periods presented primarily due to the continued increase in transaction volumes in our Adobe Experience Cloud and Creative Cloud offerings.

The increase in cost of subscription revenue during fiscal 2016 compared to fiscal 2015 were partially offset by decreases in amortization of purchased intangibles driven by the decrease in amortization expense associated with intangible assets purchased through our acquisitions of Omniture and Efficient Frontier that became fully amortized in the latter part of fiscal 2015.

*Product*

Cost of product revenue includes product packaging, third-party royalties, excess and obsolete inventory, amortization related to localization costs, purchased intangibles and acquired rights to use technology and the costs associated with the manufacturing of our products.

As a result of redirecting our focus and development efforts towards our Creative Cloud and Adobe Experience Cloud subscription offerings, our cost of product revenue declined in all periods presented due to the following:

| | % Change 2017-2016 | % Change 2016-2015 |
|---|---|---|
| Amortization of purchased intangibles | (7)% | (16)% |
| Localization costs | — % | (10)% |
| Royalty costs | (8)% | 10 % |
| Cost of sales | (2)% | (2)% |
| Excess and obsolete inventory | — | (3) |
| Various individually insignificant items | — | (2) |
| Total change | (17)% | (23)% |

The decrease in cost of product revenue during fiscal 2016 as compared to fiscal 2015 was partially offset by an increase in royalty payments related to our stock photography perpetual offering.

*Services and Support*

Cost of services and support revenue is primarily comprised of employee-related costs and associated costs incurred to provide consulting services, training and product support.

Cost of services and support revenue increased due to the following:

| | % Change 2017-2016 | % Change 2016-2015 |
|---|---|---|
| Base compensation and related benefits associated with headcount | 13 % | 9 % |
| Incentive compensation, cash and stock based | 1 | 6 |
| Professional and consulting fees | (3) | 3 |
| Various individually insignificant items | 3 | — |
| Total change | 14 % | 18 % |

Compensation costs increased during fiscal 2017 and fiscal 2016 as compared to the corresponding year ago periods primarily due to increases in headcount resulting from decreased usage of outside consultants that were providing consulting and training services to customers.

**Operating Expenses (dollars in millions)**

| | Fiscal 2017 | Fiscal 2016 | Fiscal 2015 | % Change 2017-2016 | % Change 2016-2015 |
|---|---|---|---|---|---|
| Research and development | $ 1,224.1 | $ 976.0 | $ 862.7 | 25 % | 13 % |
| Percentage of total revenue | 17 % | 17 % | 18 % | | |
| Sales and marketing | 2,197.6 | 1,910.2 | 1,683.2 | 15 % | 13 % |
| Percentage of total revenue | 30 % | 33 % | 35 % | | |

| | | | | | |
|---|---|---|---|---|---|
| General and administrative | 624.7 | 576.2 | 533.5 | 8 % | 8 % |
| Percentage of total revenue | 9 % | 10 % | 11 % | | |
| Amortization of purchased intangibles | 76.5 | 78.5 | 68.7 | (3 %) | 14 % |
| Percentage of total revenue | 1 % | 1 % | 1 % | | |
| Total operating expenses | $ 4,122.9 | $ 3,540.9 | $ 3,148.1 | 16 % | 12 % |

*Research and Development, Sales and Marketing and General and Administrative Expenses*

Research and development, sales and marketing and general and administrative expenses increased during fiscal 2017 as compared to fiscal 2016 primarily due to increases in compensation costs driven by headcount increases and stock-based compensation expense.

Research and development, sales and marketing and general and administrative expenses increased during 2016 as compared to fiscal 2015 primarily due to increases in compensation and related benefits associated with headcount increases.

*Research and Development*

Research and development expenses consist primarily of salary and benefit expenses for software developers, contracted development efforts, related facilities costs and expenses associated with computer equipment used in software development.

Research and development expenses increased due to the following:

| | % Change 2017-2016 | % Change 2016-2015 |
|---|---|---|
| Base compensation and related benefits associated with headcount | 11 % | 6 % |
| Incentive compensation, cash and stock based | 9 | 4 |
| Professional and consulting fees | 4 | 4 |
| Various individually insignificant items | 1 | (1 ) |
| Total change | 25 % | 13 % |

We believe that investments in research and development, including the recruiting and hiring of software developers, are critical to remain competitive in the marketplace and are directly related to continued timely development of new and enhanced offerings and solutions. We will continue to focus on long-term opportunities available in our end markets and make significant investments in the development of our subscription and service offerings, applications and tools.

*Sales and Marketing*

Sales and marketing expenses consist primarily of salary and benefit expenses, sales commissions, travel expenses and related facilities costs for our sales, marketing, order management and global supply chain management personnel. Sales and marketing expenses also include the costs of programs aimed at increasing revenue, such as advertising, trade shows, public relations and other market development programs.

Sales and marketing expenses increased due to the following:

| | % Change 2017-2016 | % Change 2016-2015 |
|---|---|---|
| Base compensation and related benefits associated with headcount | 5 % | 5 % |
| Incentive compensation, cash and stock based | 2 | 2 |
| Professional and consulting fees | 2 | 1 |
| Marketing spending related to product launches and overall marketing efforts | 4 | 4 |
| Various individually insignificant items | 2 | 1 |
| Total change | 15 % | 13 % |

*General and Administrative*

General and administrative expenses consist primarily of compensation and benefit expenses, travel expenses and related facilities costs for our finance, facilities, human resources, legal, information services and executive personnel. General and administrative expenses also include outside legal and accounting fees, provision for bad debts, expenses associated with computer equipment and software used in the administration of the business, charitable contributions and various forms of insurance.

General and administrative expenses increased due to the following:

| | % Change 2017-2016 | % Change 2016-2015 |
|---|---|---|
| Base compensation and related benefits associated with headcount | 2 % | 3 % |
| Incentive compensation, cash and stock based | 3 | 3 |
| Professional and consulting fees | 1 | 1 |
| Facilities and telecom | 2 | 1 |
| Total change | 8 % | 8 % |

*Amortization of Purchased Intangibles*

During the last several years, we have completed a number of business combinations and asset acquisitions. As a result of these acquisitions, we purchased intangible assets that are being amortized over their estimated useful lives ranging from one to fourteen years.

Amortization expense remained relatively consistent during fiscal 2017 as compared to fiscal 2016. The decreases associated with certain fully amortized acquired intangible assets from previous acquisitions were offset by increases associated with intangible assets purchased through our acquisition of TubeMogul in the first quarter of fiscal 2017.

Amortization expense increased during fiscal 2016 as compared to fiscal 2015 primarily due to the write-off of certain acquired intangible assets from a previous acquisition and the increase in amortization expense associated with intangible assets purchased in fiscal 2016.

**Non-Operating Income (Expense), Net (dollars in millions)**

| | Fiscal 2017 | Fiscal 2016 | Fiscal 2015 | % Change 2017-2016 | % Change 2016-2015 |
|---|---|---|---|---|---|
| Interest and other income (expense), net | $ 36.4 | $ 13.5 | $ 33.9 | 170 % | (60 )% |
| Percentage of total revenue | ** | ** | ** | | |
| Interest expense | (74.4 ) | (70.4 ) | (64.2 ) | 6 % | 10 % |
| Percentage of total revenue | (1 )% | (1 )% | (1 )% | | |
| Investment gains (losses), net | 7.5 | (1.6 ) | 1.0 | * | * |
| Percentage of total revenue | ** | ** | ** | | |
| Total non-operating income (expense), net | $ (30.5 ) | $ (58.5 ) | $ (29.3 ) | (48 )% | 100 % |

(*) Percentage is not meaningful.
(**) Percentage is less than 1%.

*Interest and Other Income (Expense), Net*

Interest and other income (expense), net consists primarily of interest earned on cash, cash equivalents and short-term fixed income investments. Interest and other income (expense), net also includes gains and losses on fixed income investments and foreign exchange gains and losses other than any gains recorded to revenue from our hedging programs.

Interest and other income (expense), net increased in fiscal 2017 as compared to fiscal 2016 due to higher average invested balances and interest rates and a decline in foreign exchange hedging costs.

Interest and other income (expense), net decreased in fiscal 2016 as compared to fiscal 2015 due to a gain on the sale of certain property assets that occurred in fiscal 2015 and an increase in foreign exchange hedging costs, offset in part by an increase in interest income due to higher average invested balances and interest rates.

*Interest Expense*

Interest expense primarily represents interest associated with our senior notes and interest rate swaps. Interest on our senior notes is payable semi-annually, in arrears, on February 1 and August 1. Floating interest payments on the interest rate swaps are paid monthly. The fixed-rate interest receivable on the swaps is received semi-annually concurrent with the senior notes interest payments. *See Notes 5 and 15 of our Notes to Consolidated Financial Statements for further details regarding our interest rate swaps.*

Interest expense increased during fiscal 2017 as compared to fiscal 2016 primarily due to higher short-term floating interest rates on interest rate swaps.

Interest expense increased during fiscal 2016 as compared to fiscal 2015 primarily due to higher short-term floating interest rates on interest rate swaps and higher average debt balances.

*Investment Gains (Losses), Net*

Investment gains (losses), net consists principally of unrealized holding gains and losses associated with our deferred compensation plan assets which are classified as trading securities, and gains and losses associated with our direct and indirect investments in privately held companies.

**Provision for Income Taxes (dollars in millions)**

| | Fiscal 2017 | Fiscal 2016 | Fiscal 2015 | % Change 2017-2016 | % Change 2016-2015 |
|---|---|---|---|---|---|
| Provision | $ 443.7 | $ 266.4 | $ 244.2 | 67 % | 9 % |
| Percentage of total revenue | 6 % | 5 % | 5 % | | |
| Effective tax rate | 21 % | 19 % | 28 % | | |

As described in *Note 1 of our Notes to Consolidated Financial Statements*, we early adopted the updated accounting standard for share-based payment accounting during fiscal 2017. As a result, we recorded deferred tax attributes that we were previously tracking pursuant to the rules that preceded this standard. The deferred tax asset recorded with the adoption was offset by the establishment of a valuation allowance.

Our effective tax rate increased by approximately two percentage points during fiscal 2017 as compared to fiscal 2016. The increase was partially related to a one-time tax cost associated with licensing acquired company assets to our trading subsidiaries, offset in part by the recognition of excess tax benefits due to our adoption of new accounting guidance related to stock-based compensation and the completion of certain income tax examinations. In addition to the above noted items, the effective tax rate for fiscal 2016 included tax benefits recognized as a result of the completion of certain income tax examinations, and to a lesser extent, a one-time tax benefit related to the retroactive reinstatement of the fiscal 2015 U.S. Research and Development credit.

Our effective tax rate decreased by approximately nine percentage points during fiscal 2016 as compared to fiscal 2015. The decrease was primarily due to tax benefits recognized as a result of the completion of certain income tax examinations and the permanent extension of the U.S. Research and Development credit for 2015 and onward. The reinstatement of the credit was retroactive to January 1, 2015. A tax benefit for the credit relating to fiscal 2015 was reflected in its entirety in the first quarter of fiscal 2016. The decrease was partially offset by stronger domestic profits for fiscal 2016. In addition, the fiscal 2015 effective tax rate included one-time tax costs associated with licensing acquired company assets to Adobe's trading companies, offset by tax benefits for the temporary reinstatement of the U.S. Research and Development credit in December 2014.

We are a United States-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. A significant portion of our foreign earnings for the current fiscal year was earned by our Irish subsidiaries. In addition to providing for U.S. income taxes on earnings from the United States, we provide for U.S. income taxes on the earnings of foreign subsidiaries unless the subsidiaries' earnings are considered permanently reinvested outside the United States. While we do not anticipate changing our intention regarding permanently reinvested earnings as of the balance sheet date, if certain foreign earnings previously treated as permanently reinvested are repatriated, the related U.S. tax liability may be reduced by any foreign income taxes paid on these earnings. Currently, there is a significant amount of foreign earnings upon which U.S. income taxes have not been provided.

*See Note 9 of our Notes to the Consolidated Financial Statements for further information on our provision for income taxes.*

*Accounting for Uncertainty in Income Taxes*

The gross liabilities for unrecognized tax benefits excluding interest and penalties were $172.9 million, $178.4 million and $258.7 million for fiscal 2017, 2016 and 2015, respectively, of which, $135.0 million, $144.5 million and

$220.2 million if recognized, would affect our effective tax rates for fiscal 2017, 2016 and 2015, respectively, which were net of the estimated $37.9 million, $33.9 million and $38.5 million federal benefits related to deducting certain payments on future federal and state tax returns for fiscal 2017, 2016 and 2015, respectively.

The combined amount of accrued interest and penalties related to tax positions taken on our tax returns were approximately $23.6 million and $22.4 million for fiscal 2017 and 2016, respectively. These amounts were included in non-current income taxes payable in their respective years.

The timing of the resolution of income tax examinations is highly uncertain as are the amounts and timing of tax payments that are part of any audit settlement process. These events could cause large fluctuations in the balance of current and non-current assets, liabilities and income taxes payable. We believe that within the next 12 months, it is reasonably possible that either certain audits will conclude or statutes of limitations on certain income tax examination periods will expire, or both. Given the uncertainties described above, we can only determine a range of estimated potential decreases in underlying unrecognized tax benefits ranging from $0 to approximately $40 million.

## LIQUIDITY AND CAPITAL RESOURCES

This data should be read in conjunction with our Consolidated Statements of Cash Flows.

| | As of | |
|---|---|---|
| (in millions) | December 1, 2017 | December 2, 2016 |
| Cash and cash equivalents | $ 2,306.1 | $ 1,011.3 |
| Short-term investments | $ 3,513.7 | $ 3,750.0 |
| Working capital | $ 3,720.4 | $ 3,028.1 |
| Stockholders' equity | $ 8,459.9 | $ 7,424.8 |

A summary of our cash flows is as follows:

| (in millions) | Fiscal 2017 | Fiscal 2016 | Fiscal 2015 |
|---|---|---|---|
| Net cash provided by operating activities | $ 2,912.9 | $ 2,199.7 | $ 1,469.5 |
| Net cash used for investing activities | (442.9) | (960.0) | (1,488.4) |
| Net cash used for financing activities | (1,183.7) | (1,090.7) | (200.7) |
| Effect of foreign currency exchange rates on cash and cash equivalents | 8.5 | (14.2) | (21.2) |
| Net increase (decrease) in cash and cash equivalents | $ 1,294.8 | $ 134.8 | $ (240.8) |

Our primary source of cash is receipts from revenue. The primary uses of cash are payroll related expenses, general operating expenses including marketing, travel and office rent, and cost of revenue. Other sources of cash are proceeds from participation in the employee stock purchase plan. Other uses of cash include our stock repurchase program, which is described below, business acquisitions and purchases of property and equipment.

*Cash Flows from Operating Activities*

For fiscal 2017, net cash provided by operating activities of $2.91 billion was primarily comprised of net income plus the net effect of non-cash items. The primary working capital sources of cash were net income coupled with increases in deferred revenue and accrued expenses. The increase in deferred revenue was primarily due to increased subscriptions for our Creative Cloud offerings and increases in Digital Marketing hosted services. The increase in accrued expenses is primarily due to the increase in accruals for compensation costs and employee benefits driven by headcount growth, and increased accrued media costs associated with our Advertising Cloud offerings, including TubeMogul. The primary working capital uses of cash were increases in trade receivables, payments of trade payables assumed as part of the TubeMogul acquisition, and a decrease in income taxes payable. Trade receivables increased primarily due to revenue linearity, higher revenue levels, and increased media rebill receivables attributable to TubeMogul. Income taxes payable decreased primarily due to taxes paid in excess of the tax provision increase.

For fiscal 2016, net cash provided by operating activities of $2.20 billion was primarily comprised of net income plus the net effect of non-cash items. The primary working capital sources of cash were net income coupled with increases in deferred revenue and accrued expenses. The increase in deferred revenue was primarily due to increased subscriptions for our Creative Cloud offerings and increases in Digital Marketing hosted services. The increase in accrued expenses is primarily due to the increase in accruals for compensation costs and employee benefits driven by the increase in headcount. The primary working capital uses of cash were increases in trade receivables, prepaid expenses and other current assets, and a decrease in income taxes payable. Trade receivables increased primarily due to higher revenue levels. Prepaid expenses and other current assets increased primarily due to advanced tax payments made in the fourth quarter of fiscal 2016. Income taxes payable decreased primarily due to the completion of certain income tax audits in fiscal 2016, offset in part by increases to the tax provision in excess of taxes paid.

For fiscal 2015, net cash provided by operating activities of $1.47 billion was primarily comprised of net income plus the net effect of non-cash items. The primary working capital sources of cash were net income coupled with increases in deferred revenue, income taxes payable and trade payables. The increase in deferred revenue was primarily due to increased subscriptions for our team, individual and enterprise Creative Cloud offerings and increases in Digital Marketing hosted services. The increase in income taxes payable was primarily due to higher taxable income levels during fiscal 2015. Trade payables increased primarily due to the timing of payments to web services vendors as certain invoices were received in the final weeks of fiscal 2015. The primary working capital uses of cash were increases in trade receivables which were principally due to higher revenue levels.

*Cash Flows from Investing Activities*

For fiscal 2017, net cash used for investing activities of $442.9 million was primarily due to purchases of short-term investments and our acquisition of TubeMogul. Other uses of cash included purchases of property and equipment, including the Almaden Tower and long-term investments and other assets. These cash outflows were offset in part by sales and maturities of short-term investments.

For fiscal 2016, net cash used for investing activities of $960.0 million was primarily due to purchases of short-term investments. Other uses of cash represented purchases of property and equipment, purchases of long-term investments and other assets, and an immaterial acquisition. These cash outflows were offset in part by sales and maturities of short-term investments.

For fiscal 2015, net cash used for investing activities of $1.49 billion was primarily due to purchases of short-term investments and our acquisition of Fotolia. Other uses of cash during fiscal 2015 represented purchases of property and equipment and long-term investments and other assets. These cash outflows were offset in part by sales and maturities of short-term investments and proceeds received from the sale of certain property assets.

*See Note 2 and Note 6 of our Consolidated Financial Statements for more detailed information regarding our acquisitions and the Almaden Tower purchase, respectively.*

*Cash Flows from Financing Activities*

For fiscal 2017, net cash used for financing activities of $1.18 billion was primarily due to payments for our treasury stock repurchases and costs associated with the issuance of treasury stock, offset in part by proceeds from the issuance of treasury stock.

For fiscal 2016, net cash used for financing activities of $1.09 billion was primarily due to payments for our treasury stock repurchases and costs associated with the issuance of treasury stock, offset in part by proceeds from the issuance of treasury stock and excess tax benefits from stock-based compensation.

In January 2015, we issued $1 billion of 3.25% senior notes due February 1, 2025 (the “2025 Notes”). Our proceeds were approximately $989.3 million which is net of an issuance discount of $10.7 million. In addition, we incurred issuance costs of $7.9 million. Both the discount and issuance costs are being amortized to interest expense over the term of the 2025 Notes using the effective interest method. The 2025 Notes rank equally with our other unsecured and unsubordinated indebtedness.

We used $600 million of the proceeds from the 2025 Notes offering to repay the outstanding balance plus accrued and unpaid interest of the $600 million 3.25% senior notes due February 1, 2015 (“2015 Notes”). The remaining proceeds were used for general corporate purposes. *See Note 15 of our Consolidated Financial Statements for more detailed information.*

In addition to the 2025 Notes issuance and 2015 Notes repayment, other financing activities during fiscal 2015 included payments for our treasury stock repurchases and costs associated with the issuance of treasury stock, offset in part by proceeds from the issuance of treasury stock and excess tax benefits from stock-based compensation. *See the section titled “Stock Repurchase Program” discussed below.*

We expect to continue our investing activities, including short-term and long-term investments, venture capital, facilities expansion and purchases of computer systems for research and development, sales and marketing, product support and administrative staff. Furthermore, cash reserves may be used to repurchase stock under our stock repurchase program and to strategically acquire companies, products or technologies that are complementary to our business.

**Other Liquidity and Capital Resources Considerations**

Our existing cash, cash equivalents and investment balances may fluctuate during fiscal 2018 due to changes in our planned cash outlay, including changes in incremental costs such as direct and integration costs related to our acquisitions. Our cash and investments totaled $5.82 billion as of December 1, 2017. Of this amount, approximately 89% was held by our foreign subsidiaries and subject to material repatriation tax effects. As of our balance sheet date, our intent is to permanently reinvest a significant portion of our earnings from foreign operations, and current plans do not anticipate that we will need funds generated from foreign operations to fund our domestic operations. In the event funds from foreign operations are needed to fund operations in the United States and if U.S. tax has not already been previously provided, we would provide for and pay additional U.S. taxes in connection with repatriating these funds.

Subsequent to December 1, 2017, the “Tax Cuts and Jobs Act” (the “Act”) was enacted and included broad tax reforms that are applicable to Adobe. Under the provisions of the Act, the U.S. corporate tax rate decreased from 35% to 21% effective January 1, 2018, our undistributed foreign earnings amount of approximately $4 billion are subject to taxation in fiscal 2018 and are available for repatriation, and our future foreign earnings are subject to U.S. taxation. These changes will require us to remeasure our deferred tax assets and liabilities and reclassify approximately $380 million of deferred tax liabilities related to undistributed foreign earnings to long-term income taxes payable due over eight years. In addition, based on preliminary estimates, we anticipate a tax provision charge of approximately $85 million in fiscal 2018 predominately due to the taxation of undistributed foreign earnings.

Cash from operations could also be affected by various risks and uncertainties, including, but not limited to the risks detailed in Part I, Item 1A titled “Risk Factors.” However, based on our current business plan and revenue prospects, we believe that our existing cash, cash equivalents and investment balances, our anticipated cash flows from operations and our available credit facility will be sufficient to meet our working capital and operating resource expenditure requirements for the next twelve months.

On March 2, 2012, we entered into a five-year $1 billion senior unsecured revolving credit agreement (the “Credit Agreement”), providing for loans to us and certain of our subsidiaries. On March 1, 2013, we exercised our option under the Credit Agreement to extend the maturity date of the Credit Agreement by one year to March 2, 2018. On July 27, 2015, we entered into an amendment to further extend the maturity date of the Credit Agreement to July 27, 2020 and reallocated the facility among the syndicate of lenders that are parties to the Credit Agreement. As of December 1, 2017, there were no outstanding borrowings under this Credit Agreement and the entire $1 billion credit line remains available for borrowing.

As of December 1, 2017, the amount outstanding under our senior notes was $1.9 billion, consisting of $900 million of 4.75% senior notes due February 1, 2020 (the “2020 Notes”) and $1 billion of 3.25% senior notes due February 1, 2025 (together with the 2020 Notes, the “Notes”).

Our short-term investment portfolio is primarily invested in corporate bonds and commercial paper, U.S. Treasury securities, foreign government securities, municipal securities and asset-backed securities. We use professional investment management firms to manage a large portion of our invested cash.

**Stock Repurchase Program**

To facilitate our stock repurchase program, designed to return value to our stockholders and minimize dilution from stock issuances, we may repurchase shares in the open market or enter into structured repurchase agreements with third parties. In January 2017, our Board of Directors approved a new stock repurchase program granting us authority to repurchase up to $2.5 billion in common stock through the end of fiscal 2019.

During fiscal 2017, 2016 and 2015, we entered into several structured stock repurchase agreements with large financial institutions, whereupon we provided them with prepayments totaling $1.10 billion, $1.08 billion, and $625 million, respectively. We enter into these agreements in order to take advantage of repurchasing shares at a guaranteed discount to the Volume Weighted Average Price (“VWAP”) of our common stock over a specified period of time. We only enter into such transactions when the discount that we receive is higher than our estimate of the expected foregone return on our cash prepayments to the financial institutions. There were no explicit commissions or fees on these structured repurchases. Under the terms of the agreements, there is no requirement for the financial institutions to return any portion of the prepayment to us.

The financial institutions agree to deliver shares to us at monthly intervals during the contract term. The parameters used to calculate the number of shares deliverable are: the total notional amount of the contract, the number of trading days in the contract, the number of trading days in the interval and the average VWAP of our stock during the interval less the agreed upon discount. During fiscal 2017, we repurchased approximately 8.2 million shares at an average price per share of $134.20 through structured repurchase agreements entered into during fiscal 2017 and fiscal 2016. During fiscal 2016, we repurchased approximately 10.4 million shares at an average price per share of $97.16 through structured repurchase agreements entered into during fiscal 2016 and fiscal 2015. During fiscal 2015, we repurchased approximately 8.1 million shares at an average price per share of $77.38 through structured repurchase agreements entered into during fiscal 2015 and fiscal 2014.

For fiscal 2017, 2016 and 2015, the prepayments were classified as treasury stock on our Consolidated Balance Sheets at the payment date, though only shares physically delivered to us by December 1, 2017, December 2, 2016 and November 27, 2015 were excluded from the computation of earnings per share. As of December 1, 2017, $101.5 million of prepayments remained under the agreement.

Subsequent to December 1, 2017, as part of the 2017 stock repurchase authority, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of $300 million. This amount will be classified as treasury stock on our Consolidated Balance Sheets. Upon completion of the $300 million stock repurchase agreement, $1.6 billion remains under our current authority.

*See Item 5, Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities for share repurchases during the quarter ended December 1, 2017.*

**Summary of Stock Repurchases for Fiscal 2017, 2016 and 2015**
**(in thousands, except average amounts)**

| Board Approval Date | Repurchases Under the Plan [1] | 2017 | | 2016 | | 2015 | |
|---|---|---|---|---|---|---|---|
| | | Shares | Average | Shares | Average | Shares | Average |
| April 2012 | Structured repurchases | — | $ — | — | $ — | 3,255 | $ 73.83 |
| January 2015 | Structured repurchases | 4,263 | $ 118.00 | 10,428 | $ 97.16 | 4,849 | $ 79.76 |
| January 2017 | Structured repurchases | 3,923 | $ 151.80 | — | $ — | — | $ — |
| Total shares | | 8,186 | $ 134.20 | 10,428 | $ 97.16 | 8,104 | $ 77.38 |
| Total cost | | $1,098,595 | | $1,013,131 | | $627,082 | |

(1) Stock repurchase agreements executed with large financial institutions. *See Stock Repurchase Program above.*

**Off-Balance Sheet Arrangements and Aggregate Contractual Obligations**

Our principal commitments as of December 1, 2017 consist of obligations under operating leases, royalty agreements and various service agreements. *See Note 14 of our Notes to Consolidated Financial Statements for additional information regarding our contractual commitments.*

*Contractual Obligations*

The following table summarizes our contractual obligations as of December 1, 2017 (in millions):

| | Payment Due by Period | | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| Notes, including interest | $ 2,250.6 | $ 75.3 | $ 1,061.6 | $ 65.0 | $ 1,048.7 |
| Operating lease obligations | 525.1 | 57.5 | 120.5 | 95.6 | 251.5 |
| Purchase obligations | 695.3 | 449.8 | 245.5 | — | — |
| Total | $ 3,471.0 | $ 582.6 | $ 1,427.6 | $ 160.6 | $ 1,300.2 |

*Other*

Subsequent to December 1, 2017, we purchased land near our headquarters in San Jose, California for a total purchase price of $68 million.

*Senior Notes*

As of December 1, 2017, our outstanding notes payable consist of the 2020 Notes and 2025 Notes with a total carrying value of $1.88 billion. Interest on our senior notes is payable semi-annually, in arrears on February 1 and August 1. At December 1, 2017, our maximum commitment for interest payments under the Notes was $350.6 million for the remaining duration of our Notes. In June 2014, we entered into interest rate swaps that effectively converted the fixed interest rate on our 2020 Notes to a floating interest rate based on the London Interbank Offered Rate ("LIBOR") plus a fixed number of basis points through February 1, 2020.

*Covenants*

Our credit facility contains a financial covenant requiring us not to exceed a maximum leverage ratio. As of December 1, 2017, we were in compliance with this covenant. We believe this covenant will not impact our credit or cash in the coming fiscal year or restrict our ability to execute our business plan. Our Notes do not contain any financial covenants.

Under the terms of our credit agreement, we are not prohibited from paying cash dividends unless payment would trigger an event of default or one currently exists. We do not anticipate paying any cash dividends in the foreseeable future.

*Accounting for Uncertainty in Income Taxes*

See Results of Operations - Provision for Income Taxes above for our discussion on accounting for uncertainty in income taxes.

*Royalties*

We have certain royalty commitments associated with the licensing of certain offerings and products. Royalty expense is generally based on a dollar amount per unit sold, or a percentage of the underlying revenue.

*Indemnifications*

In the normal course of business, we provide indemnifications of varying scope to customers against claims of intellectual property infringement made by third parties arising from the use of our products and from time to time, we are subject to claims by our customers under these indemnification provisions. Historically, costs related to these indemnification provisions have not been significant and we are unable to estimate the maximum potential impact of these indemnification provisions on our future results of operations.

To the extent permitted under Delaware law, we have agreements whereby we indemnify our directors and officers for certain events or occurrences while the director or officer is or was serving at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the director's or officer's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that limits our exposure and enables us to recover a portion of any future amounts paid.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

All market risk sensitive instruments were entered into for non-trading purposes.

### Foreign Currency Risk

*Foreign Currency Exposures and Hedging Instruments*

In countries outside the United States, we transact business in U.S. Dollars and various other currencies, which subject us to exposure from movements in exchange rates. We may use foreign exchange purchased options or forward contracts to hedge our foreign currency revenue. Additionally, we hedge our net recognized foreign currency assets and liabilities with foreign exchange forward contracts. We hedge these exposures to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates.

Our significant foreign currency revenue exposures for fiscal 2017, 2016 and 2015 were as follows (in millions, except Japanese Yen):

| | Fiscal 2017 | | Fiscal 2016 | | Fiscal 2015 | |
|---|---|---|---|---|---|---|
| Euro | € | 1,044.7 | € | 825.6 | € | 589.6 |
| Japanese Yen (in billions) | ¥ | 51.0 | ¥ | 38.7 | ¥ | 29.7 |
| British Pounds | £ | 338.4 | £ | 263.5 | £ | 192 |

As of December 1, 2017, the total absolute value of all outstanding foreign exchange contracts, including options and forwards, was $1.24 billion, which included the notional equivalent of $618.4 million in Euros, $225.3 million in British Pounds, $244.5 million in Japanese Yen and $148.9 million in other foreign currencies. As of December 1, 2017, all contracts were set to expire at various dates through June 2018. The bank counterparties in these contracts could expose us to credit-related losses that would be largely mitigated with collateral security agreements that provide for collateral to be received or posted when the net fair value of these contracts fluctuates from contractually established thresholds. In addition, we enter into master netting arrangements that have the ability to further limit credit-related losses with the same counterparty by permitting net settlement transactions.

A sensitivity analysis was performed on all of our foreign exchange derivatives as of December 1, 2017. This sensitivity analysis measures the hypothetical market value resulting from a 10% shift in the value of exchange rates relative to the U.S. Dollar. For option contracts, the Black-Scholes option pricing model was used. A 10% increase in the value of the U.S. Dollar and a corresponding decrease in the value of the hedged foreign currency asset would lead to an increase in the fair value of our financial hedging instruments by $79.7 million. Conversely, a 10% decrease in the value of the U.S. Dollar would result in a decrease in the fair value of these financial instruments by $23.6 million.

As a general rule, we do not use foreign exchange contracts to hedge local currency denominated operating expenses in countries where a natural hedge exists. For example, in many countries, revenue in the local currencies substantially offsets the local currency denominated operating expenses.

We also have long-term investment exposures consisting of the capitalization and retained earnings in our non-U.S. Dollar functional currency foreign subsidiaries. As of December 1, 2017 and December 2, 2016, this long-term investment exposure totaled an absolute notional equivalent of $190.5 million and $70.2 million, respectively. At this time, we do not hedge these long-term investment exposures.

We do not use foreign exchange contracts for speculative trading purposes, nor do we hedge our foreign currency exposure in a manner that entirely offsets the effects of changes in foreign exchange rates. We regularly review our hedging program and assess the need to utilize financial instruments to hedge currency exposures on an ongoing basis.

*Cash Flow Hedging—Hedges of Forecasted Foreign Currency Revenue*

We may use foreign exchange purchased options or forward contracts to hedge foreign currency revenue denominated in Euros, British Pounds and Japanese Yen. We hedge these cash flow exposures to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates. These foreign exchange contracts, carried at fair value, may have maturities between one and twelve months. We enter into these foreign exchange contracts to hedge forecasted revenue in the normal course of business and accordingly, they are not speculative in nature.

We record changes in the intrinsic value of these cash flow hedges in accumulated other comprehensive income (loss) until the forecasted transaction occurs. When the forecasted transaction occurs, we reclassify the related gain or loss on the cash flow hedge to revenue. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, we reclassify the gain or loss on the related cash flow hedge from accumulated other comprehensive income (loss) to interest and other income, net on our Consolidated Statements of Income at that time. For the fiscal year ended December 1, 2017, there were no net gains or losses recognized in other income relating to hedges of forecasted transactions that did not occur.

*Balance Sheet Hedging—Hedging of Foreign Currency Assets and Liabilities*

We hedge exposures related to our net recognized foreign currency assets and liabilities with foreign exchange forward contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in foreign currency exchange rates. These foreign exchange contracts are carried at fair value with changes in the fair value recorded as interest and other income, net. These foreign exchange contracts do not subject us to material balance sheet risk due to exchange rate movements because gains and losses on these contracts are intended to offset gains and losses on the assets and liabilities being hedged. At December 1, 2017, the outstanding balance sheet hedging derivatives had maturities of 180 days or less.

*See Note 5 of our Notes to Consolidated Financial Statements for information regarding our hedging activities.*

**Interest Rate Risk**

*Short-Term Investments and Fixed Income Securities*

At December 1, 2017, we had debt securities classified as short-term investments of $3.51 billion. Changes in interest rates could adversely affect the market value of these investments. The following table separates these investments, based on stated maturities, to show the approximate exposure to interest rates (in millions):

| | | |
|---|---|---|
| Due within one year | $ | 1,023.7 |
| Due between one and two years | | 1,289.3 |
| Due between two and three years | | 812.8 |
| Due after three years | | 387.9 |
| Total | $ | 3,513.7 |

A sensitivity analysis was performed on our investment portfolio as of December 1, 2017. The analysis is based on an estimate of the hypothetical changes in market value of the portfolio that would result from an immediate parallel shift in the yield curve of various magnitudes.

The following tables present the hypothetical fair values of our debt securities classified as short-term investments assuming immediate parallel shifts in the yield curve of 50 basis points ("BPS"), 100 BPS and 150 BPS. The analysis is shown as of December 1, 2017 and December 2, 2016 (dollars in millions):

| -150 BPS | -100 BPS | -50 BPS | Fair Value 12/1/17 | +50 BPS | +100 BPS | +150 BPS |
|---|---|---|---|---|---|---|
| $ 3,595.2 | $ 3,568.1 | $ 3,540.9 | $ 3,513.7 | $ 3,486.5 | $ 3,459.3 | $ 3,432.1 |

| -150 BPS | -100 BPS | -50 BPS | Fair Value 12/2/16 | +50 BPS | +100 BPS | +150 BPS |
|---|---|---|---|---|---|---|
| $ 3,828.5 | $ 3,805.9 | $ 3,778.4 | $ 3,750.0 | $ 3,721.6 | $ 3,693.2 | $ 3,664.8 |

*Senior Notes*

As of December 1, 2017, the amount outstanding under our senior notes was $1.9 billion. In June 2014, we entered into interest rate swaps that effectively converted the fixed interest rate on our 2020 Notes to a floating interest rate based on the LIBOR plus a fixed number of basis points through February 1, 2020. Accordingly, our exposure to fluctuations in market interest rates is on the hedged fixed-rate debt of $900 million. An immediate hypothetical 50 basis points increase or decrease in market interest rates would not have a significant impact on our results of operations.

As of December 1, 2017, the total carrying amount of the Notes was $1.88 billion and the related fair value based on observable market prices in less active markets was $1.98 billion.

**Other Market Risk**

*Privately Held Long-Term Investments*

The privately held companies in which we invest can still be considered in the start-up or development stages which are inherently risky. The technologies or products these companies have under development are typically in the early stages and may never materialize, which could result in a loss of a substantial part of our initial investment in these companies. The evaluation of privately held companies is based on information that we request from these companies, which is not subject to the same disclosure regulations as U.S. publicly traded companies, and as such, the basis for these evaluations is subject to the timing and accuracy of the data received from these companies. We have immaterial exposure on our long-term investments in privately held companies as these investments were insignificant as of December 1, 2017 and December 2, 2016.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

## INDEX TO CONSOLIDATED FINANCIAL STATEMENTS



All financial statement schedules have been omitted, since the required information is not applicable or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the Consolidated Financial Statements and Notes thereto.

Table of Contents

**ADOBE SYSTEMS INCORPORATED**

**CONSOLIDATED BALANCE SHEETS**

**(In thousands, except par value)**

| | December 1, 2017 | December 2, 2016 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 2,306,072 | $ 1,011,315 |
| Short-term investments | 3,513,702 | 3,749,985 |
| Trade receivables, net of allowances for doubtful accounts of $9,151 and $6,214, respectively | 1,217,968 | 833,033 |
| Prepaid expenses and other current assets | 210,071 | 245,441 |
| Total current assets | 7,247,813 | 5,839,774 |
| Property and equipment, net | 936,976 | 816,264 |
| Goodwill | 5,821,561 | 5,406,474 |
| Purchased and other intangibles, net | 385,658 | 414,405 |
| Investment in lease receivable | — | 80,439 |
| Other assets | 143,548 | 139,890 |
| Total assets | $ 14,535,556 | $ 12,697,246 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Trade payables | $ 113,538 | $ 88,024 |
| Accrued expenses | 993,773 | 739,630 |
| Income taxes payable | 14,196 | 38,362 |
| Deferred revenue | 2,405,950 | 1,945,619 |
| Total current liabilities | 3,527,457 | 2,811,635 |
| Long-term liabilities: | | |
| Debt and capital lease obligations | 1,881,421 | 1,892,200 |
| Deferred revenue | 88,592 | 69,131 |
| Income taxes payable | 173,088 | 184,381 |
| Deferred income taxes | 279,941 | 217,660 |
| Other liabilities | 125,188 | 97,404 |
| Total liabilities | 6,075,687 | 5,272,411 |
| | | |
| Commitments and contingencies | | |
| | | |
| Stockholders' equity: | | |
| Preferred stock, $0.0001 par value; 2,000 shares authorized; none issued | — | — |
| Common stock, $0.0001 par value; 900,000 shares authorized; 600,834 shares issued; 491,262 and 494,254 shares outstanding, respectively | 61 | 61 |
| Additional paid-in-capital | 5,082,195 | 4,616,331 |
| Retained earnings | 9,573,870 | 8,114,517 |
| Accumulated other comprehensive income (loss) | (111,821) | (173,602) |
| Treasury stock, at cost (109,572 and 106,580 shares, respectively), net of reissuances | (6,084,436) | (5,132,472) |
| Total stockholders' equity | 8,459,869 | 7,424,835 |
| Total liabilities and stockholders' equity | $ 14,535,556 | $ 12,697,246 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE SYSTEMS INCORPORATED**

**CONSOLIDATED STATEMENTS OF INCOME**

**(In thousands, except per share data)**

| | Years Ended | | |
|---|---|---|---|
| | **December 1, 2017** | **December 2, 2016** | **November 27, 2015** |
| Revenue: | | | |
| Subscription | $ 6,133,869 | $ 4,584,833 | $ 3,223,904 |
| Product | 706,767 | 800,498 | 1,125,146 |
| Services and support | 460,869 | 469,099 | 446,461 |
| Total revenue | 7,301,505 | 5,854,430 | 4,795,511 |
| | | | |
| Cost of revenue: | | | |
| Subscription | 623,048 | 461,860 | 409,194 |
| Product | 57,082 | 68,917 | 90,035 |
| Services and support | 330,361 | 289,131 | 245,088 |
| Total cost of revenue | 1,010,491 | 819,908 | 744,317 |
| | | | |
| Gross profit | 6,291,014 | 5,034,522 | 4,051,194 |
| | | | |
| Operating expenses: | | | |
| Research and development | 1,224,059 | 975,987 | 862,730 |
| Sales and marketing | 2,197,592 | 1,910,197 | 1,683,242 |
| General and administrative | 624,706 | 576,202 | 533,478 |
| Amortization of purchased intangibles | 76,562 | 78,534 | 68,649 |
| Total operating expenses | 4,122,919 | 3,540,920 | 3,148,099 |
| | | | |
| Operating income | 2,168,095 | 1,493,602 | 903,095 |
| | | | |
| Non-operating income (expense): | | | |
| Interest and other income (expense), net | 36,395 | 13,548 | 33,909 |
| Interest expense | (74,402) | (70,442) | (64,184) |
| Investment gains (losses), net | 7,553 | (1,570) | 961 |
| Total non-operating income (expense), net | (30,454) | (58,464) | (29,314) |
| Income before income taxes | 2,137,641 | 1,435,138 | 873,781 |
| Provision for income taxes | 443,687 | 266,356 | 244,230 |
| Net income | $ 1,693,954 | $ 1,168,782 | $ 629,551 |
| Basic net income per share | $ 3.43 | $ 2.35 | $ 1.26 |
| Shares used to compute basic net income per share | 493,632 | 498,345 | 498,764 |
| Diluted net income per share | $ 3.38 | $ 2.32 | $ 1.24 |
| Shares used to compute diluted net income per share | 501,123 | 504,299 | 507,164 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE SYSTEMS INCORPORATED**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(In thousands)**

| | Years Ended | | |
|---|---|---|---|
| | December 1, 2017 | December 2, 2016 | November 27, 2015 |
| | Increase/(Decrease) | | |
| Net income | $ 1,693,954 | $ 1,168,782 | $ 629,551 |
| Other comprehensive income (loss), net of taxes: | | | |
| Available-for-sale securities: | | | |
| Unrealized gains / losses on available-for-sale securities | (2,503) | (1,618) | (9,226) |
| Reclassification adjustment for recognized gains / losses on available-for-sale securities | (947) | (1,895) | (2,955) |
| Net increase (decrease) from available-for-sale securities | (3,450) | (3,513) | (12,181) |
| Derivatives designated as hedging instruments: | | | |
| Unrealized gains / losses on derivative instruments | 6,917 | 35,199 | 29,795 |
| Reclassification adjustment for recognized gains / losses on derivative instruments | (31,973) | (16,425) | (55,535) |
| Net increase (decrease) from derivatives designated as hedging instruments | (25,056) | 18,774 | (25,740) |
| Foreign currency translation adjustments | 90,287 | (19,783) | (123,065) |
| Other comprehensive income (loss), net of taxes | 61,781 | (4,522) | (160,986) |
| Total comprehensive income, net of taxes | $ 1,755,735 | $ 1,164,260 | $ 468,565 |

*See accompanying Notes to Consolidated Financial Statements.*

Table of Contents

## ADOBE SYSTEMS INCORPORATED

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

## (In thousands)

| | Common Stock | | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | | Total |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | | | | Shares | Amount | |
| Balances at November 28, 2014 | 600,834 | $ 61 | $ 3,778,495 | $ 6,924,294 | $ (8,094) | (103,350) | $ (3,918,851) | $ 6,775,905 |
| Net income | — | — | — | 629,551 | — | — | — | 629,551 |
| Other comprehensive income (losses), net of taxes | — | — | — | — | (160,986) | — | — | (160,986) |
| Re-issuance of treasury stock under stock compensation plans | — | — | — | (300,414) | — | 8,429 | 278,311 | (22,103) |
| Tax benefit from employee stock plans | — | — | 68,133 | — | — | — | — | 68,133 |
| Purchase of treasury stock | — | — | — | — | — | (8,104) | (625,000) | (625,000) |
| Equity awards assumed for acquisition | — | — | 677 | — | — | — | — | 677 |
| Stock-based compensation | — | — | 337,578 | — | — | — | — | 337,578 |
| Value of shares in deferred compensation plan | — | — | — | — | — | — | (2,175) | (2,175) |
| Balances at November 27, 2015 | 600,834 | $ 61 | $ 4,184,883 | $ 7,253,431 | $ (169,080) | (103,025) | $ (4,267,715) | $ 7,001,580 |
| Net income | — | — | — | 1,168,782 | — | — | — | 1,168,782 |
| Other comprehensive income (losses), net of taxes | — | — | — | — | (4,522) | — | — | (4,522) |
| Re-issuance of treasury stock under stock compensation plans | — | — | 7,365 | (307,696) | — | 6,872 | 209,628 | (90,703) |
| Tax benefit from employee stock plans | — | — | 75,102 | — | — | — | — | 75,102 |
| Purchase of treasury stock | — | — | — | — | — | (10,427) | (1,075,000) | (1,075,000) |
| Stock-based compensation | — | — | 348,981 | — | — | — | — | 348,981 |
| Value of shares in deferred compensation plan | — | — | — | — | — | — | 615 | 615 |
| Balances at December 2, 2016 | 600,834 | $ 61 | $ 4,616,331 | $ 8,114,517 | $ (173,602) | (106,580) | $ (5,132,472) | $ 7,424,835 |
| Net income | — | — | — | 1,693,954 | — | — | — | 1,693,954 |
| Other comprehensive income (losses), net of taxes | — | — | — | — | 61,781 | — | — | 61,781 |
| Re-issuance of treasury stock under stock compensation plans | — | — | 1,768 | (234,601) | — | 5,194 | 151,058 | (81,775) |
| Purchase of treasury stock | — | — | — | — | — | (8,186) | (1,100,000) | (1,100,000) |
| Equity awards assumed for acquisition | — | — | 10,348 | — | — | — | — | 10,348 |
| Stock-based compensation | — | — | 453,748 | — | — | — | — | 453,748 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Value of shares in deferred compensation plan | — | — | — | — | — | — | (3,022 ) | (3,022 ) |
| Balances at December 1, 2017 | 600,834 | $ 61 | $ 5,082,195 | $ 9,573,870 | $ (111,821 ) | (109,572 ) | $ (6,084,436 ) | $ 8,459,869 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE SYSTEMS INCORPORATED**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands)**

| | Years Ended | | |
|---|---|---|---|
| | **December 1, 2017** | **December 2, 2016** | **November 27, 2015** |
| Cash flows from operating activities: | | | |
| Net income | $ 1,693,954 | $ 1,168,782 | $ 629,551 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation, amortization and accretion | 325,997 | 331,535 | 339,473 |
| Stock-based compensation | 451,451 | 349,912 | 335,859 |
| Deferred income taxes | 51,605 | 24,222 | (69,657) |
| Gain on the sale of property | — | — | (21,415) |
| Unrealized (gains) losses on investments | (5,494) | 3,145 | (9,210) |
| Excess tax benefits from stock-based compensation | — | (75,105) | (68,153) |
| Other non-cash items | 4,625 | 2,022 | 1,216 |
| Changes in operating assets and liabilities, net of acquired assets and assumed liabilities: | | | |
| Trade receivables, net | (187,173) | (160,416) | (79,502) |
| Prepaid expenses and other current assets | 28,040 | (71,021) | (7,701) |
| Trade payables | (45,186) | (6,281) | 22,870 |
| Accrued expenses | 154,125 | 64,978 | (22,564) |
| Income taxes payable | (34,493) | 43,115 | 97,934 |
| Deferred revenue | 475,402 | 524,840 | 320,801 |
| Net cash provided by operating activities | 2,912,853 | 2,199,728 | 1,469,502 |
| Cash flows from investing activities: | | | |
| Purchases of short-term investments | (1,931,011) | (2,285,222) | (2,064,833) |
| Maturities of short-term investments | 759,737 | 769,228 | 371,790 |
| Proceeds from sales of short-term investments | 1,393,929 | 860,849 | 1,176,476 |
| Acquisitions, net of cash acquired | (459,626) | (48,427) | (826,004) |
| Purchases of property and equipment | (178,122) | (203,805) | (184,936) |
| Proceeds from sale of property | — | — | 57,779 |
| Purchases of long-term investments, intangibles and other assets | (29,918) | (58,433) | (22,779) |
| Proceeds from sale of long-term investments | 2,134 | 5,777 | 4,149 |
| Net cash used for investing activities | (442,877) | (960,033) | (1,488,358) |
| Cash flows from financing activities: | | | |
| Purchases of treasury stock | (1,100,000) | (1,075,000) | (625,000) |
| Proceeds from issuance of treasury stock | 158,351 | 145,697 | 164,270 |
| Taxes paid related to net share settlement of equity awards | (240,126) | (236,400) | (186,373) |
| Excess tax benefits from stock-based compensation | — | 75,105 | 68,153 |
| Proceeds from debt issuance | — | — | 989,280 |
| Repayment of debt and capital lease obligations | (1,960) | (108) | (602,189) |
| Debt issuance costs | — | — | (8,828) |
| Net cash used for financing activities | (1,183,735) | (1,090,706) | (200,687) |
| Effect of foreign currency exchange rates on cash and cash equivalents | 8,516 | (14,234) | (21,297) |
| Net increase (decrease) in cash and cash equivalents | 1,294,757 | 134,755 | (240,840) |
| Cash and cash equivalents at beginning of year | 1,011,315 | 876,560 | 1,117,400 |
| Cash and cash equivalents at end of year | $ 2,306,072 | $ 1,011,315 | $ 876,560 |
| Supplemental disclosures: | | | |

| | | | |
|---|---|---|---|
| Cash paid for income taxes, net of refunds | $ 396,668 | $ 249,884 | $ 203,010 |
| Cash paid for interest | $ 69,430 | $ 66,193 | $ 56,014 |
| Non-cash investing activities: | | | |
| Investment in lease receivable applied to building purchase | $ 80,439 | $ — | $ — |
| Issuance of common stock and stock awards assumed in business acquisitions | $ 10,348 | $ — | $ 677 |

*See accompanying Notes to Consolidated Financial Statements.*

**ADOBE SYSTEMS INCORPORATED**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## NOTE 1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

*Operations*

Founded in 1982, Adobe Systems Incorporated is one of the largest and most diversified software companies in the world. We offer a line of products and services used by creative professionals, marketers, knowledge workers, application developers, enterprises and consumers for creating, managing, delivering, measuring, optimizing and engaging with compelling content and experiences across personal computers, devices and media. We market and license our products and services directly to enterprise customers through our sales force and to end users through app stores and our own website at www.adobe.com. We offer many of our products via a Software-as-a-Service ("SaaS") model or a managed services model (both of which are referred to as a hosted or cloud-based) as well as through term subscription and pay-per-use models. We also distribute certain products and services through a network of distributors, value-added resellers ("VARs"), systems integrators ("SIs"), independent software vendors ("ISVs"), retailers, software developers and original equipment manufacturers ("OEMs"). In addition, we license our technology to hardware manufacturers, software developers and service providers for use in their products and solutions. Our products run on personal and server-based computers, as well as on smartphones, tablets and other devices, depending on the product. We have operations in the Americas, Europe, Middle East and Africa ("EMEA") and Asia-Pacific ("APAC").

*Basis of Presentation*

The accompanying Consolidated Financial Statements include those of Adobe and its subsidiaries, after elimination of all intercompany accounts and transactions. We have prepared the accompanying Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") and pursuant to the rules and regulations of the United States Securities and Exchange Commission (the "SEC").

*Use of Estimates*

In preparing Consolidated Financial Statements and related disclosures in conformity with GAAP and pursuant to the rules and regulations of the SEC, we must make estimates and judgments that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Estimates are used for, but not limited to, sales allowances and programs, bad debts, stock-based compensation, determining the fair value of acquired assets and assumed liabilities, excess inventory and purchase commitments, facilities lease losses, impairment of goodwill and intangible assets, litigation, income taxes and investments. Actual results may differ materially from these estimates.

*Fiscal Year*

Our fiscal year is a 52- or 53-week year that ends on the Friday closest to November 30. Our financial results for fiscal 2016 benefited from an extra week in the first quarter of fiscal 2016 due to our 52/53 week financial calendar whereby fiscal 2016 was a 53-week fiscal year compared with fiscal 2017 and 2015 which were 52-week fiscal years.

*Reclassifications*

Certain immaterial prior year amounts have been reclassified to conform to current year presentation in the Consolidated Balance Sheets, Consolidated Statements of Income and Consolidated Statements of Cash Flows.

**Significant Accounting Policies**

*Revenue Recognition*

Our revenue is derived from the subscription, non-software related hosted services, term-based and perpetual licensing of software products, associated software maintenance and support plans, consulting services, training, and technical support. Most of our enterprise customer arrangements are complex, involving multiple solutions and various license rights, bundled with post-contract customer support and other meaningful rights that together provide a complete end-to-end solution to the customer.

We recognize revenue when all four revenue recognition criteria have been met: persuasive evidence of an arrangement exists, we have delivered the product or performed the service, the fee is fixed or determinable and collection is probable.

**ADOBE SYSTEMS INCORPORATED**

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

Determining whether and when some of these criteria have been satisfied often involves assumptions and judgments that can have a significant impact on the timing and amount of revenue we report.

*Multiple Element Arrangements*

We enter into multiple element revenue arrangements in which a customer may purchase a combination of software, upgrades, maintenance and support, hosted services, and consulting.

For our software and software-related multiple element arrangements, we must: (1) determine whether and when each element has been delivered; (2) determine whether undelivered products or services are essential to the functionality of the delivered products and services; (3) determine the fair value of each undelivered element using vendor-specific objective evidence ("VSOE"); and (4) allocate the total price among the various elements. VSOE of fair value is used to allocate a portion of the price to the undelivered elements and the residual method is used to allocate the remaining portion to the delivered elements. Absent VSOE, revenue is deferred until the earlier of the point at which VSOE of fair value exists for any undelivered element or until all elements of the arrangement have been delivered. However, if the only undelivered element is maintenance and support, the entire arrangement fee is recognized ratably over the performance period. Changes in assumptions or judgments or changes to the elements in a software arrangement could cause a material increase or decrease in the amount of revenue that we report in a particular period.

We determine VSOE for each element based on historical stand-alone sales to third parties or from the stated renewal rate for the elements contained in the initial arrangement. In determining VSOE, we require that a substantial majority of the selling prices for a product or service fall within a reasonably narrow pricing range.

We have established VSOE for our software maintenance and support services, custom software development services, consulting services and training, when such services are sold optionally with software licenses.

For multiple-element arrangements containing our non-software services, we must: (1) determine whether and when each element has been delivered; (2) determine the fair value of each element using the selling price hierarchy of VSOE of selling price, third-party evidence ("TPE") of selling price or best-estimated selling price ("BESP"), as applicable; and (3) allocate the total price among the various elements based on the relative selling price method.

For multiple-element arrangements that contain both software and non-software elements, we allocate revenue to software or software-related elements as a group and any non-software elements separately based on the selling price hierarchy. We determine the selling price for each deliverable using VSOE of selling price, if it exists, or TPE of selling price. If neither VSOE nor TPE of selling price exist for a deliverable, we use BESP. Once revenue is allocated to software or software-related elements as a group, we recognize revenue in conformance with software revenue accounting guidance. Revenue is recognized when revenue recognition criteria are met for each element.

We are generally unable to establish VSOE or TPE for non-software elements and as such, we use BESP. BESP is generally used for offerings that are not typically sold on a stand-alone basis or for new or highly customized offerings. We determine BESP for a product or service by considering multiple factors including, but not limited to major product groupings, geographies, market conditions, competitive landscape, internal costs, gross margin objectives and pricing practices. Pricing practices taken into consideration include historic contractually stated prices, volume discounts where applicable and our price lists. We must estimate certain royalty revenue amounts due to the timing of securing information from our customers. While we believe we can make reliable estimates regarding these matters, these estimates are inherently subjective. Accordingly, our assumptions and judgments regarding future products and services as well as our estimates of royalty revenue could differ from actual events, thus materially impacting our financial position and results of operations.

*Subscription and Services and Support Revenue*

We recognize revenue for hosted services that are priced based on a committed number of transactions, ratably beginning on the date the services associated with the committed transactions are first made available to the customer and continuing through the end of the contractual service term. Over-usage fees, and fees billed based on the actual number of transactions from which we capture data, are billed in accordance with contract terms as these fees are incurred. We record amounts that have been invoiced in accounts receivable and in deferred revenue or revenue, depending on whether all revenue recognition criteria have been met.

ADOBE SYSTEMS INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Our services and support revenue is composed of consulting, training, and maintenance and support, primarily related to the licensing of our enterprise, mobile and device products and solutions. Our support revenue also includes technical support and developer support to partners and developer organizations related to our desktop products.

Our consulting revenue is recognized using a time and materials basis and is measured monthly based on input measures, such as hours incurred to date, with consideration given to output measures, such as contract milestones when applicable.

Our maintenance and support offerings, which entitle customers to receive product upgrades and enhancements on a when and if available basis or technical support, depending on the offering, are recognized ratably over the performance period of the arrangement.

Our software subscription offerings, which may include product upgrades and enhancements on a when and if available basis, hosted services, and online storage, are generally offered to our customers over a specified period of time and we recognize revenue associated with these arrangements ratably over the subscription period.

*Product Revenue*

We recognize our product revenue upon shipment, provided all other revenue recognition criteria have been met. Our desktop application product revenue from distributors is subject to agreements allowing limited rights of return, rebates and price protection. Our direct sales and OEM sales are also subject to limited rights of return. Accordingly, we reduce revenue recognized for estimated future returns, price protection and rebates at the time the related revenue is recorded. The estimates for returns are adjusted periodically based upon historical rates of returns, inventory levels in the distribution channel and other related factors.

We recognize OEM licensing revenue, primarily royalties, when OEMs ship products incorporating our software, provided collection of such revenue is deemed probable. For certain OEM customers, we must estimate royalty revenue due to the timing of securing customer information. This estimate is based on a combination of our generated forecasts and actual historical reporting by our OEM customers. To substantiate our ability to estimate revenue, we review license royalty revenue reports ultimately received from our significant OEM customers in comparison to the amounts estimated in the prior period.

Our product-related deferred revenue includes maintenance upgrade revenue and customer advances under OEM license agreements. Our maintenance upgrade revenue for our desktop application products is included in our product revenue line item as the maintenance primarily entitles customers to receive product upgrades. In cases where we provide a specified free upgrade to an existing product, we defer the fair value for the specified upgrade right until the future obligation is fulfilled or when the right to the specified free upgrade expires.

*Rights of Return, Rebates and Price Protection*

As discussed above, we offer limited rights of return, rebates and price protection of our products under various policies and programs with our distributors, resellers and/or end-user customers. We estimate and record reserves for these programs as an offset to revenue and accounts receivable. Below is a summary of each of the general provisions in our contracts:

- Distributors are allowed limited rights of return of products purchased during the previous quarter. In addition, distributors are allowed to return products that have reached the end of their lives, as defined by us, and products that are being replaced by new versions.

- We offer rebates to our distributors, resellers and/or end user customers. The amount of revenue that is reduced for distributor and reseller rebates is based on actual performance against objectives set forth by us for a particular reporting period (volume, timely reporting, etc.). If mail-in or other promotional rebates are offered, the amount of revenue reduced is based on the dollar amount of the rebate, taking into consideration an estimated redemption rate calculated using historical trends.

- From time to time, we may offer price protection to our distributors that allow for the right to a credit if we permanently reduce the price of a software product. The amount of revenue that is reduced for price protection is calculated as the difference between the old and new price of a software product on inventory held by the distributor immediately prior to the effective date of the decrease.

Although our subscription contracts are generally non-cancellable, a limited number of customers have the right to cancel their contracts by providing prior written notice to us of their intent to cancel the remainder of the contract term. In the event a customer cancels its contract, they are not entitled to a refund for prior services we have provided to them.

On a quarterly basis, the amount of revenue that is reserved for future returns is calculated based on our historical trends and data specific to each reporting period. We review the actual returns evidenced in prior quarters as a percent of revenue to determine a historical returns rate. We then apply the historical rate to the current period revenue as a basis for estimating future returns. When necessary, we also provide a specific returns reserve for product in the distribution channel in excess of estimated requirements. This estimate can be affected by the amount of a particular product in the channel, the rate of sell-through, product plans and other factors.

*Revenue Reserve*

Revenue reserve rollforward (in thousands):

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Beginning balance | $ 23,096 | $ 19,446 | $ 17,402 |
| Amount charged to revenue | 61,031 | 55,739 | 45,676 |
| Actual returns | (62,121) | (52,089) | (43,632) |
| Ending balance | $ 22,006 | $ 23,096 | $ 19,446 |

*Deferred Revenue*

Deferred revenue consists of billings and payments received in advance of revenue recognition for our products and solutions described above. We recognize deferred revenue as revenue only when the revenue recognition criteria are met.

*Allowance for Doubtful Accounts*

We maintain an allowance for doubtful accounts which reflects our best estimate of potentially uncollectible trade receivables. The allowance is based on both specific and general reserves. We regularly review our trade receivables allowances by considering such factors as historical experience, credit-worthiness, the age of the trade receivable balances and current economic conditions that may affect a customer's ability to pay and we specifically reserve for those deemed uncollectible.

| (in thousands) | 2017 | 2016 | 2015 |
|---|---|---|---|
| Beginning balance | $ 6,214 | $ 7,293 | $ 7,867 |
| Increase due to acquisition | 2,391 | 77 | 326 |
| Charged to operating expenses | 4,411 | 1,337 | 1,472 |
| Deductions[(1)] | (3,865) | (2,493) | (2,372) |
| Ending balance | $ 9,151 | $ 6,214 | $ 7,293 |

_________________

(1) Deductions related to the allowance for doubtful accounts represent amounts written off against the allowance, less recoveries.

*Property and Equipment*

We record property and equipment at cost less accumulated depreciation and amortization. Property and equipment are depreciated using the straight-line method over their estimated useful lives ranging from 1 to 5 years for computers and equipment as well as server hardware under capital leases, 1 to 6 years for furniture and fixtures, 5 to 20 years for building improvements and up to 40 years for buildings. Leasehold improvements are amortized using the straight-line method over the lesser of the remaining respective lease term or estimated useful lives ranging from 1 to 15 years.

*Goodwill, Purchased Intangibles and Other Long-Lived Assets*

Goodwill is assigned to one or more reporting segments on the date of acquisition. We review our goodwill for impairment annually during our second quarter of each fiscal year. In performing our goodwill impairment test, we first evaluate goodwill to determine if it is more likely than not that the occurrence of an event or change in circumstances has reduced the fair value of a reporting segment below its carrying value. The qualitative assessment requires that we consider events or circumstances that may include macroeconomic conditions, industry and market considerations, cost factors, overall financial performance, changes in management or key personnel, changes in strategy, changes in customers, changes in the composition or carrying amount of a reporting segments' net assets, and changes in our stock price. If, after assessing the totality of events or circumstances, we determine that it is more likely than not that the fair value of our reporting segments are greater than the carrying amounts, then the two-step goodwill impairment test is not performed.

If the qualitative assessment indicates that the two-step quantitative analysis should be performed, we evaluate goodwill for impairment by comparing the fair value of each of our reporting segments to its carrying value, including the associated goodwill. To determine the fair values, we use the equal weighting of the market approach based on comparable publicly traded companies in similar lines of businesses and the income approach based on estimated discounted future cash flows. Our cash flow assumptions consider historical and forecasted revenue, operating costs and other relevant factors.

We completed our annual goodwill impairment test in the second quarter of fiscal 2017. We determined, after performing a qualitative review of each reporting segment, that it is more likely than not that the fair value of each of our reporting segments substantially exceeds the respective carrying amounts. Accordingly, there was no indication of impairment, and the two-step quantitative goodwill impairment test was not performed.

We amortize intangible assets with finite lives over their estimated useful lives and review them for impairment whenever an impairment indicator exists. We continually monitor events and changes in circumstances that could indicate carrying amounts of our long-lived assets, including our intangible assets may not be recoverable. When such events or changes in circumstances occur, we assess recoverability by determining whether the carrying value of such assets will be recovered through the undiscounted expected future cash flows. If the future undiscounted cash flows are less than the carrying amount of these assets, we recognize an impairment loss based on any excess of the carrying amount over the fair value of the assets. We did not recognize any intangible asset impairment charges in fiscal 2017, 2016 or 2015.

During fiscal 2017, our intangible assets were amortized over their estimated useful lives ranging from 1 to 14 years. Amortization is based on the pattern in which the economic benefits of the intangible asset will be consumed or on a straight-line basis when the consumption pattern is not apparent. The weighted average useful lives of our intangible assets were as follows:

| | **Weighted Average Useful Life (years)** |
|---|---|
| Purchased technology | 5 |
| Customer contracts and relationships | 9 |
| Trademarks | 8 |
| Acquired rights to use technology | 9 |
| Localization | 1 |
| Other intangibles | 5 |

*Internal Use Software*

We capitalize costs associated with customized internal-use software systems that have reached the application development stage. Such capitalized costs include external direct costs utilized in developing or obtaining the applications and payroll and payroll-related expenses for employees who are directly associated with the development of the applications. Capitalization of such costs begins when the preliminary project stage is complete and ceases at the point in which the project is substantially complete and is ready for its intended purpose.

*Income Taxes*

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. We record a valuation allowance to reduce deferred tax assets to an amount for which realization is more likely than not.

*Taxes Collected from Customers*

We net taxes collected from customers against those remitted to government authorities in our financial statements. Accordingly, taxes collected from customers are not reported as revenue.

*Treasury Stock*

We account for treasury stock under the cost method. When treasury stock is re-issued at a price higher than its cost, the difference is recorded as a component of additional paid-in-capital in our Consolidated Balance Sheets. When treasury stock is re-issued at a price lower than its cost, the difference is recorded as a component of additional paid-in-capital to the extent that there are previously recorded gains to offset the losses. If there are no treasury stock gains in additional paid-in-capital, the losses upon re-issuance of treasury stock are recorded as a reduction of retained earnings in our Consolidated Balance Sheets.

*Advertising Expenses*

Advertising costs are expensed as incurred. Advertising expenses for fiscal 2017, 2016 and 2015 were $141.7 million, $135.8 million and $113.6 million, respectively.

*Foreign Currency Translation*

We translate assets and liabilities of foreign subsidiaries, whose functional currency is their local currency, at exchange rates in effect at the balance sheet date. We translate revenue and expenses at the monthly average exchange rates. We include accumulated net translation adjustments in stockholders' equity as a component of accumulated other comprehensive income (loss).

*Foreign Currency and Other Hedging Instruments*

In countries outside the United States, we transact business in U.S. Dollars and in various other currencies. We use foreign exchange option and forward contracts for revenue denominated in Euros, British Pounds and Japanese Yen. We hedge our net recognized foreign currency assets and liabilities with foreign exchange forward contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates.

We recognize all derivative instruments as either assets or liabilities in our Consolidated Balance Sheets and measure them at fair value. Gains and losses resulting from changes in fair value are accounted for depending on the use of the derivative and whether it is designated and qualifies for hedge accounting. Contracts that do not qualify for hedge accounting are adjusted to fair value through earnings. *See Note 5 for information regarding our hedging activities.*

Gains and losses from foreign exchange forward contracts which hedge certain balance sheet positions are recorded each period as a component of interest and other income, net in our Consolidated Statements of Income. Foreign exchange option contracts hedging forecasted foreign currency revenue are designated as cash flow hedges with gains and losses recorded net of tax, as a component of other comprehensive income in stockholders' equity and reclassified into revenue at the time the forecasted transactions occur.

*Concentration of Risk*

Financial instruments that potentially subject us to concentrations of credit risk are short-term fixed-income investments, structured repurchase transactions, foreign currency and interest rate hedge contracts and trade receivables.

Our investment portfolio consists of investment-grade securities diversified among security types, industries and issuers. Our cash and investments are held and primarily managed by recognized financial institutions that follow our investment policy. Our policy limits the amount of credit exposure to any one security issue or issuer and we believe no significant concentration of credit risk exists with respect to these investments.

We enter into foreign currency hedge contracts with bank counterparties that could expose us to credit related losses in the event of their nonperformance. This is largely mitigated with collateral security agreements that provide for collateral to be received or posted when the net fair value of certain financial instruments fluctuates from contractually established thresholds. In addition, we enter into master netting arrangements which have the ability to further limit credit related losses with the same counterparty by permitting net settlement transactions.

The aggregate fair value of foreign currency contracts in net asset positions as of December 1, 2017 and December 2, 2016 was $14.2 million and $38.1 million respectively. These amounts represent the maximum exposure to loss at the reporting date as a result of all of the counterparties failing to perform as contracted. These exposures could be reduced by certain immaterial liabilities included in master netting arrangements with those same counterparties.

Credit risk in receivables is limited to OEMs, dealers and distributors of hardware and software products to the retail market, customers to whom we license software directly and our SaaS offerings. A credit review is completed for our new distributors, dealers and OEMs. We also perform ongoing credit evaluations of our customers' financial condition and require letters of credit or other guarantees, whenever deemed necessary. The credit limit given to the customer is based on our risk assessment of their ability to pay, country risk and other factors and is not contingent on the resale of the product or on the collection of payments from their customers. If we license our software or provide SaaS services to a customer where we have a reason to believe the customer's ability to pay is not probable, due to country risk or credit risk, we will not recognize the revenue. We will revert to recognizing the revenue on a cash basis, assuming all other criteria for revenue recognition has been met.

**Recently Adopted Accounting Guidance**

On March 30, 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") No. 2016-09, Improvements to Employee Share-Based Payment Accounting, which simplifies various aspects related to the accounting and presentation of share-based payments. The amendments require entities to record all tax effects related to share-based payments at settlement or expiration through the income statement and the windfall tax benefit to be recorded when it arises, subject to normal valuation allowance considerations. Tax-related cash flows resulting from share-based payments are required to be reported as operating activities in the statement of cash flows. The updates relating to the income tax effects of the share-based payments including the cash flow presentation must be adopted either prospectively or retrospectively. Further, the amendments allow the entities to make an accounting policy election to either estimate forfeitures or recognize forfeitures as they occur. If an election is made, the change to recognize forfeitures as they occur must be adopted using a modified retrospective approach with a cumulative effect adjustment recorded to opening retained earnings. The effective date of the new standard for public companies is for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years. Early adoption is permitted.

We early adopted this standard during the first quarter of fiscal 2017. As required by the standard, excess tax benefits recognized on stock-based compensation expense were reflected in our Consolidated Statements of Income as a component of the provision for income taxes rather than paid-in capital on a prospective basis. Accordingly, we recorded excess tax benefits within our provision for income taxes, rather than additional paid-in capital upon adoption. The cumulative effect to retained earnings from previously unrecognized excess tax benefits, after offset by the related valuation allowance, was not significant to our Consolidated Balance Sheets.

We also elected to prospectively apply the change in presentation of excess tax benefits wherein excess tax benefits recognized on stock-based compensation expense were classified as operating activities in our Consolidated Statements of Cash Flows for fiscal 2017. Prior period classification of cash flows related to excess tax benefits were not adjusted in our Consolidated Statements of Cash Flows. Presentation requirements for cash flows related to employee taxes paid for withheld shares had no impact to all periods presented as such cash flows have historically been presented as financing activities. Further, we did not elect an accounting policy change to record forfeitures as they occur and thus we continue to estimate forfeitures at each period.

There have been no other new accounting pronouncements made effective during fiscal 2017 that have significance, or potential significance, to our Consolidated Financial Statements.

**Recent Accounting Pronouncements Not Yet Effective**

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either the full retrospective or modified retrospective transition method. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date, which deferred the effective date of the new revenue standard for periods beginning after December 15, 2016 to December 15, 2017, with early adoption permitted but not earlier than the original effective date. Accordingly, the updated standard is effective for us in the first quarter of fiscal 2019. We expect to adopt this updated standard in the first quarter of fiscal 2019 on a modified retrospective basis. We are currently evaluating the effect that the updated standard will have on our Consolidated Financial Statements and related disclosures.

While we are continuing to assess all potential impacts of the new standard, we currently believe that the most significant impact relates to our accounting for arrangements that include on-premise term-based software licenses bundled with maintenance and support. Under current GAAP, the revenue attributable to these software licenses is recognized ratably over the term of the arrangement because VSOE does not exist for the undelivered maintenance and support element as it is not sold separately. The requirement to have VSOE for undelivered elements to enable the separation of revenue for the delivered software licenses is eliminated under the new standard. Accordingly, under the new standard we will be required to recognize as revenue a portion of the arrangement fee upon delivery of the software licenses. We expect revenue related to our professional services and cloud offerings, including Creative Cloud and Document Cloud for business enterprises, individuals and teams, to remain substantially unchanged. When sold with cloud-enabled services, Creative Cloud and Document Cloud require a significant level of integration and interdependency with software and the individual components are not considered distinct. Revenue for these offerings will continue to be recognized over the period in which the cloud services are provided. Under current GAAP, we expense costs related to the acquisition of revenue-generating contracts as incurred. Under the new standard, we will be required to capitalize certain costs incremental to contract acquisition and amortize them over the expected period of benefit. Due to the complexity of certain of our contracts, the actual accounting treatment required under the new standard for these arrangements may be dependent on contract-specific terms and therefore may vary in some instances.

On February 24, 2016, the FASB issued ASU No. 2016-02, Leases, requiring lessees to recognize a right-of-use asset and a lease liability on the balance sheet for all leases with the exception of short-term leases with a lease term of twelve months or less. For lessees, leases will continue to be classified as either operating or finance leases in the income statement. Lessor accounting is similar to the current model but updated to align with certain changes to the lessee model. Lessors will continue to classify leases as operating, direct financing or sales-type leases. The effective date of the new standard for public companies is for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted. The new standard must be adopted using a modified retrospective transition and requires application of the new guidance at the beginning of the earliest comparative period presented. The updated standard is effective for us beginning in the first quarter of fiscal 2020 and we do not plan to early adopt. We are currently evaluating the effect that the updated standard will have on our Consolidated Financial Statements and related disclosures.

On August 28, 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging, requiring expanded hedge accounting for both non-financial and financial risk components and refining the measurement of hedge results to better reflect an entity's hedging strategies. The updated standard also amends the presentation and disclosure requirements and changes how entities assess hedge effectiveness. The effective date of the new standard for public companies is for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted. The new standard must be adopted using a modified retrospective transition with a cumulative effect adjustment recorded to opening retained earnings as of the initial adoption date. The updated standard is effective for us beginning in the first quarter of fiscal 2020 and we do not plan to early adopt. We are currently evaluating the effect that the updated standard will have on our Consolidated Financial Statements and related disclosures.

With the exception of the new standards discussed above, there have been no other new accounting pronouncements that have significance, or potential significance, to our Consolidated Financial Statements.

## NOTE 2. ACQUISITIONS

*TubeMogul*

On December 19, 2016, we completed our acquisition of TubeMogul, a publicly held video advertising platform company. As of the end of fiscal 2017, we are continuing to integrate TubeMogul into our Digital Marketing reportable segment.

Under the acquisition method of accounting, the total final purchase price was allocated to TubeMogul's net tangible and intangible assets based upon their estimated fair values as of December 19, 2016. During fiscal 2017, we recorded immaterial purchase accounting adjustments based on changes to management's estimates and assumptions in regards to tangible assets, liabilities assumed, and their related impact to goodwill. The total final purchase price for TubeMogul was $560.8 million of which $348.4 million was allocated to goodwill that was non-deductible for tax purposes, $113.1 million to identifiable intangible assets and $99.3 million to net assets acquired.

*Fotolia*

On January 27, 2015, we completed our acquisition of privately held Fotolia, a leading marketplace for royalty-free photos, images, graphics and HD videos. During fiscal 2015, we integrated Fotolia into our Digital Media reportable segment.

Under the acquisition method of accounting, the total final purchase price was allocated to Fotolia's net tangible and intangible assets based upon their estimated fair values as of January 27, 2015. During fiscal 2015, we recorded immaterial purchase accounting adjustments based on changes to management's estimates and assumptions in regards to assumed intangible assets, calculation of deferred tax assets, liabilities and equity awards. The total final purchase price for Fotolia was $807.5 million of which $745.1 million was allocated to goodwill that was non-deductible for tax purposes, $204.4 million to identifiable intangible assets and $142.0 million to net liabilities assumed.

We also completed other immaterial business acquisitions during the fiscal years presented. Pro forma information has not been presented for any of our fiscal 2017, 2016 and 2015 acquisitions as the impact to our Consolidated Financial Statements was not material.

## NOTE 3. CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

Cash equivalents consist of instruments with remaining maturities of three months or less at the date of purchase. We classify all of our cash equivalents and short-term investments as "available-for-sale." In general, these investments are free of trading restrictions. We carry these investments at fair value, based on quoted market prices or other readily available market information. Unrealized gains and losses, net of taxes, are included in accumulated other comprehensive income (loss), which is reflected as a separate component of stockholders' equity in our Consolidated Balance Sheets. Gains and losses are recognized when realized in our Consolidated Statements of Income. When we have determined that an other-than-temporary decline in fair value has occurred, the amount of the decline that is related to a credit loss is recognized in income. Gains and losses are determined using the specific identification method.

**ADOBE SYSTEMS INCORPORATED**

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

Cash, cash equivalents and short-term investments consisted of the following as of December 1, 2017 (in thousands):

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Current assets: | | | | |
| Cash | $ 280,488 | $ — | $ — | $ 280,488 |
| Cash equivalents: | | | | |
| Money market mutual funds | 2,006,741 | — | — | 2,006,741 |
| Time deposits | 18,843 | — | — | 18,843 |
| Total cash equivalents | 2,025,584 | — | — | 2,025,584 |
| Total cash and cash equivalents | 2,306,072 | — | — | 2,306,072 |
| Short-term fixed income securities: | | | | |
| Asset-backed securities | 98,403 | 1 | (403) | 98,001 |
| Corporate bonds and commercial paper | 2,461,691 | 2,694 | (10,125) | 2,454,260 |
| Foreign government securities | 2,396 | — | (8) | 2,388 |
| Municipal securities | 21,189 | 8 | (132) | 21,065 |
| U.S. Treasury securities | 941,538 | 2 | (3,552) | 937,988 |
| Total short-term investments | 3,525,217 | 2,705 | (14,220) | 3,513,702 |
| Total cash, cash equivalents and short-term investments | $ 5,831,289 | $ 2,705 | $ (14,220) | $ 5,819,774 |

Cash, cash equivalents and short-term investments consisted of the following as of December 2, 2016 (in thousands):

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Current assets: | | | | |
| Cash | $ 208,635 | $ — | $ — | $ 208,635 |
| Cash equivalents: | | | | |
| Corporate bonds and commercial paper | 1,249 | — | — | 1,249 |
| Money market mutual funds | 782,210 | — | — | 782,210 |
| Municipal securities | 1,301 | — | — | 1,301 |
| Time deposits | 17,920 | — | — | 17,920 |
| Total cash equivalents | 802,680 | — | — | 802,680 |
| Total cash and cash equivalents | 1,011,315 | — | — | 1,011,315 |
| Short-term fixed income securities: | | | | |
| Asset backed securities | 111,009 | 95 | (190) | 110,914 |
| Corporate bonds and commercial paper | 2,464,769 | 3,135 | (9,554) | 2,458,350 |
| Municipal securities | 134,710 | 37 | (525) | 134,222 |
| U.S. agency securities | 39,538 | 42 | — | 39,580 |
| U.S. Treasury securities | 1,008,195 | 194 | (1,470) | 1,006,919 |
| Total short-term investments | 3,758,221 | 3,503 | (11,739) | 3,749,985 |
| Total cash, cash equivalents and short-term investments | $ 4,769,536 | $ 3,503 | $ (11,739) | $ 4,761,300 |

*See Note 4 for further information regarding the fair value of our financial instruments.*

**ADOBE SYSTEMS INCORPORATED**

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

The following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category, that have been in an unrealized loss position for less than twelve months, as of December 1, 2017 and December 2, 2016 (in thousands):

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Corporate bonds and commercial paper | $ 1,338,232 | $ (5,459) | $ 1,282,076 | $ (9,474) |
| Asset-backed securities | 64,618 | (193) | 54,063 | (189) |
| Municipal securities | 11,805 | (115) | 114,810 | (525) |
| Foreign government securities | 2,388 | (8) | — | — |
| U.S. Treasury and agency securities | 593,296 | (2,087) | 580,529 | (1,470) |
| Total | $ 2,010,339 | $ (7,862) | $ 2,031,478 | $ (11,658) |

There were 894 securities and 1,052 securities in an unrealized loss position for less than twelve months at December 1, 2017 and at December 2, 2016, respectively.

The following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category, that were in a continuous unrealized loss position for more than twelve months, as of December 1, 2017 and December 2, 2016 (in thousands):

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Corporate bonds and commercial paper | $ 500,689 | $ (4,666) | $ 39,162 | $ (80) |
| Asset-backed security | 32,383 | (210) | 1,331 | (1) |
| Municipal securities | 598 | (17) | — | — |
| U.S. Treasury securities | 338,950 | (1,465) | — | — |
| Total | $ 872,620 | $ (6,358) | $ 40,493 | $ (81) |

There were 360 securities and 23 securities in an unrealized loss position for more than twelve months at December 1, 2017 and at December 2, 2016, respectively.

The following table summarizes the cost and estimated fair value of short-term fixed income securities classified as short-term investments based on stated effective maturities as of December 1, 2017 (in thousands):

| | Amortized Cost | Estimated Fair Value |
|---|---|---|
| Due within one year | $ 1,025,894 | $ 1,023,639 |
| Due between one and two years | 1,294,919 | 1,289,307 |
| Due between two and three years | 815,254 | 812,828 |
| Due after three years | 389,150 | 387,928 |
| Total | $ 3,525,217 | $ 3,513,702 |

We review our debt and marketable equity securities classified as short-term investments on a regular basis to evaluate whether or not any security has experienced an other-than-temporary decline in fair value. We consider factors such as the length of time and extent to which the market value has been less than the cost, the financial condition and near-term prospects of the issuer and our intent to sell, or whether it is more likely than not we will be required to sell the investment before recovery of the investment's amortized cost basis. If we believe that an other-than-temporary decline exists in one of these securities, we write down these investments to fair value. For debt securities, the portion of the write-down related to credit loss would be recorded to interest and other income, net in our Consolidated Statements of Income. Any portion not related to credit loss would be recorded to accumulated other comprehensive income (loss), which is reflected as a separate component of stockholders' equity in our Consolidated Balance Sheets. For equity securities, the write-down would be recorded to investment gains (losses), net in our Consolidated Statements of Income. During fiscal 2017 and 2015, we did not consider any of our investments to be other-than-temporarily impaired. During fiscal 2016, we recorded immaterial other-than-temporary impairment losses associated with certain of our fixed income securities and wrote down the securities to fair value.

## NOTE 4. FAIR VALUE MEASUREMENTS

*Assets and Liabilities Measured and Recorded at Fair Value on a Recurring Basis*

We measure certain financial assets and liabilities at fair value on a recurring basis. There have been no transfers between fair value measurement levels during the year ended December 1, 2017.

The fair value of our financial assets and liabilities at December 1, 2017 was determined using the following inputs (in thousands):

| | Fair Value Measurements at Reporting Date Using | | | |
|---|---|---|---|---|
| | | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs |
| | Total | (Level 1) | (Level 2) | (Level 3) |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Money market mutual funds | $ 2,006,741 | $ 2,006,741 | $ — | $ — |
| Time deposits | 18,843 | 18,843 | — | — |
| Short-term investments: | | | | |
| Asset-backed securities | 98,001 | — | 98,001 | — |
| Corporate bonds and commercial paper | 2,454,260 | — | 2,454,260 | — |
| Foreign government securities | 2,388 | — | 2,388 | — |
| Municipal securities | 21,065 | — | 21,065 | — |
| U.S. Treasury securities | 937,988 | — | 937,988 | — |
| Prepaid expenses and other current assets: | | | | |
| Foreign currency derivatives | 14,198 | — | 14,198 | — |
| Other assets: | | | | |
| Deferred compensation plan assets | 56,690 | 2,573 | 54,117 | — |
| Total assets | $ 5,610,174 | $ 2,028,157 | $ 3,582,017 | $ — |
| | | | | |
| Liabilities: | | | | |
| Accrued expenses: | | | | |
| Foreign currency derivatives | $ 1,598 | $ — | $ 1,598 | $ — |
| Other liabilities: | | | | |
| Interest rate swap derivatives | 1,058 | — | 1,058 | — |
| Total liabilities | $ 2,656 | $ — | $ 2,656 | $ — |

**ADOBE SYSTEMS INCORPORATED**

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

The fair value of our financial assets and liabilities at December 2, 2016 was determined using the following inputs (in thousands):

| | | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|
| | | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs |
| | Total | (Level 1) | (Level 2) | (Level 3) |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Corporate bonds and commercial paper | $ 1,249 | $ — | $ 1,249 | $ — |
| Money market mutual funds | 782,210 | 782,210 | — | — |
| Municipal securities | 1,301 | — | 1,301 | — |
| Time deposits | 17,920 | 17,920 | — | — |
| Short-term investments: | | | | |
| Asset-backed securities | 110,914 | — | 110,914 | — |
| Corporate bonds and commercial paper | 2,458,350 | — | 2,458,350 | — |
| Municipal securities | 134,222 | — | 134,222 | — |
| U.S. agency securities | 39,580 | — | 39,580 | — |
| U.S. Treasury securities | 1,006,919 | — | 1,006,919 | — |
| Prepaid expenses and other current assets: | | | | |
| Foreign currency derivatives | 38,112 | — | 38,112 | — |
| Other assets: | | | | |
| Deferred compensation plan assets | 42,180 | 1,831 | 40,349 | — |
| Interest rate swap derivatives | 13,117 | — | 13,117 | — |
| Total assets | $ 4,646,074 | $ 801,961 | $ 3,844,113 | $ — |
| | | | | |
| Liabilities: | | | | |
| Accrued expenses: | | | | |
| Foreign currency derivatives | $ 5,246 | $ — | $ 5,246 | $ — |
| Total liabilities | $ 5,246 | $ — | $ 5,246 | $ — |

*See Note 3 for further information regarding the fair value of our financial instruments.*

Our fixed income available-for-sale debt securities consist of high quality, investment grade securities from diverse issuers with a weighted average credit rating of AA-. We value these securities based on pricing from independent pricing vendors who use matrix pricing valuation techniques including market approach methodologies that model information generated by market transactions involving identical or comparable assets, as well as discounted cash flow methodologies. Inputs include quoted prices in active markets for identical assets or inputs other than quoted prices that are observable either directly or indirectly in determining fair value, including benchmark yields, issuer spreads off benchmark yields, interest rates and U.S. Treasury or swap curves. We therefore classify all of our fixed income available-for-sale securities as Level 2. We perform routine procedures such as comparing prices obtained from multiple independent sources to ensure that appropriate fair values are recorded.

**ADOBE SYSTEMS INCORPORATED**

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

The fair values of our money market mutual funds and time deposits are based on the closing price of these assets as of the reporting date. We classify our money market mutual funds and time deposits as Level 1.

Our Level 2 over-the-counter foreign currency and interest rate swap derivatives are valued using pricing models and discounted cash flow methodologies based on observable foreign exchange and interest rate data at the measurement date.

Our deferred compensation plan assets consist of money market mutual funds and other mutual funds.

*Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis*

We also have direct investments in privately held companies accounted for under the cost and equity method, which are periodically assessed for other-than-temporary impairment. If we determine that an other-than-temporary impairment has occurred, we write down the investment to its fair value. We estimate fair value of our cost and equity method investments considering available information such as pricing in recent rounds of financing, current cash positions, earnings and cash flow forecasts, recent operational performance and any other readily available market data. During fiscal 2017 and 2015, we determined there were no other-than-temporary impairments on our cost and equity method investments. During fiscal 2016, we determined there were immaterial other-than-temporary impairments on certain of our cost method investments and wrote down the investments to fair value.

The fair value of our senior notes was $1.98 billion as of December 1, 2017, based on observable market prices in less active markets and categorized as Level 2. *See Note 15 for further details regarding our debt.*

## NOTE 5. DERIVATIVES AND HEDGING ACTIVITIES

*Hedge Accounting and Hedging Programs*

We recognize derivative instruments and hedging activities as either assets or liabilities in our Consolidated Balance Sheets and measure them at fair value. Gains and losses resulting from changes in fair value are accounted for depending on the use of the derivative and whether it is designated and qualifies for hedge accounting.

We evaluate hedge effectiveness at the inception of the hedge prospectively as well as retrospectively, and record any ineffective portion of the hedging instruments in interest and other income (expense), net on our Consolidated Statements of Income. The net gain (loss) recognized in interest and other income (expense), net for cash flow hedges due to hedge ineffectiveness was insignificant for all fiscal years presented. The time value of purchased contracts is recorded in interest and other income (expense), net in our Consolidated Statements of Income.

The bank counterparties to these contracts expose us to credit-related losses in the event of their nonperformance which are largely mitigated with collateral security agreements that provide for collateral to be received or posted when the net fair value of certain financial instruments fluctuates from contractually established thresholds. In addition, we enter into master netting arrangements which have the ability to further limit credit-related losses with the same counterparty by permitting net settlement of transactions.

*Balance Sheet Hedging—Hedges of Foreign Currency Assets and Liabilities*

We also hedge our net recognized foreign currency denominated assets and liabilities with foreign exchange forward contracts to reduce the risk that the value of these assets and liabilities will be adversely affected by changes in exchange rates. These contracts hedge assets and liabilities that are denominated in foreign currencies and are carried at fair value with changes in the fair value recorded to interest and other income (expense), net in our Consolidated Statements of Income. These contracts do not subject us to material balance sheet risk due to exchange rate movements because gains and losses on these derivatives are intended to offset gains and losses on the assets and liabilities being hedged.

As of December 1, 2017, total notional amounts of outstanding contracts were $333.9 million which included the notional equivalent of $105.0 million in Euros, $34.6 million in British Pounds, $45.4 million in Japanese Yen, $78.0 million in Indian Rupees, and $70.9 million in other foreign currencies. As of December 2, 2016, total notional amounts of outstanding contracts were $313.8 million which included the notional equivalent of $152.8 million in Euros, $33.6 million in British Pounds, $46.5

million in Japanese Yen, $26.4 million in Indian Rupees, and $54.5 million in other foreign currencies. At December 1, 2017 and December 2, 2016, the outstanding balance sheet hedging derivatives had maturities of 180 days or less.

*Cash Flow Hedging—Hedges of Forecasted Foreign Currency Revenue*

In countries outside the United States, we transact business in U.S. Dollars and in various other currencies. We may use foreign exchange option contracts or forward contracts to hedge certain cash flow exposures resulting from changes in these foreign currency exchange rates. These foreign exchange contracts, carried at fair value, have maturities of up to twelve months. We enter into these foreign exchange contracts to hedge a portion of our forecasted foreign currency denominated revenue in the normal course of business and accordingly, they are not speculative in nature.

To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge, and the hedges must be highly effective in offsetting changes to future cash flows on hedged transactions. We record changes in the intrinsic value of these cash flow hedges in accumulated other comprehensive income (loss) in our Consolidated Balance Sheets, until the forecasted transaction occurs. When the forecasted transaction occurs, we reclassify the related gain or loss on the cash flow hedge to revenue. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, we reclassify the gain or loss on the related cash flow hedge from accumulated other comprehensive income (loss) to interest and other income (expense), net in our Consolidated Statements of Income at that time. If we do not elect hedge accounting, or the contract does not qualify for hedge accounting treatment, the changes in fair value from period to period are recorded in interest and other income (expense), net in our Consolidated Statements of Income.

For fiscal 2017 and 2016, there were no net gains or losses recognized in other income relating to hedges of forecasted transactions that did not occur. In fiscal 2015, these net gains or losses were immaterial.

*Fair Value Hedging—Hedges of Interest Rate Risks*

During the third quarter of fiscal 2014, we entered into interest rate swaps designated as a fair value hedge related to our $900 million of 4.75% fixed interest rate senior notes due February 1, 2020 (the “2020 Notes”). In effect, the interest rate swaps convert the fixed interest rate on our 2020 Notes to a floating interest rate based on the LIBOR. Under the terms of the swaps, we will pay monthly interest at the one-month LIBOR rate plus a fixed number of basis points on the $900 million notional amount through February 1, 2020. In exchange, we will receive 4.75% fixed rate interest from the swap counterparties. *See Note 15 for further details regarding our debt.*

The interest rate swaps are accounted for as fair value hedges and substantially offset the changes in fair value of the hedged portion of the underlying debt that are attributable to the changes in market risk. Therefore, the gains and losses related to changes in the fair value of the interest rate swaps are included in interest and other income (expense), net in our Consolidated Statements of Income. The fair value of the interest rate swaps is reflected in other liabilities or other assets in our Consolidated Balance Sheets.

The fair value of derivative instruments on our Consolidated Balance Sheets as of December 1, 2017 and December 2, 2016 were as follows (in thousands):

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | **Fair Value Asset Derivatives** | **Fair Value Liability Derivatives** | **Fair Value Asset Derivatives** | **Fair Value Liability Derivatives** |
| Derivatives designated as hedging instruments: | | | | |
| Foreign exchange option contracts [(1)(2)] | $ 12,918 | $ — | $ 34,355 | $ — |
| Interest rate swap [(3)] | — | 1,058 | 13,117 | — |
| Derivatives not designated as hedging instruments: | | | | |
| Foreign exchange forward contracts [(1)] | 1,280 | 1,598 | 3,757 | 5,246 |

| | | | | |
|---|---|---|---|---|
| Total derivatives | $ 14,198 | $ 2,656 | $ 51,229 | $ 5,246 |

(1) Included in prepaid expenses and other current assets and accrued expenses for asset derivatives and liability derivatives, respectively, on our Consolidated Balance Sheets.

(2) Hedging effectiveness expected to be recognized to income within the next twelve months.

(3) Included in other liabilities and other assets in fiscal 2017 and 2016, respectively, on our Consolidated Balance Sheets.

The effect of foreign currency derivative instruments designated as cash flow hedges and of foreign currency derivative instruments not designated as hedges in our Consolidated Statements of Income for fiscal 2017, 2016 and 2015 were as follows (in thousands):

| | 2017 | | 2016 | | 2015 | |
|---|---|---|---|---|---|---|
| | Foreign Exchange Option Contracts | Foreign Exchange Forward Contracts | Foreign Exchange Option Contracts | Foreign Exchange Forward Contracts | Foreign Exchange Option Contracts | Foreign Exchange Forward Contracts |
| Derivatives in cash flow hedging relationships: | | | | | | |
| Net gain (loss) recognized in other comprehensive income, net of tax[1] | $ 6,917 | $ — | $ 36,511 | $ — | $ 39,825 | $ — |
| Net gain (loss) reclassified from accumulated other comprehensive income into income, net of tax[2] | $ 32,852 | $ — | $ 18,823 | $ — | $ 56,336 | $ — |
| Net gain (loss) recognized in income[3] | $ (30,243) | $ — | $ (29,169) | $ — | $ (17,423) | $ — |
| Derivatives not designated as hedging relationships: | | | | | | |
| Net gain (loss) recognized in income[4] | $ — | $ 6,586 | $ — | $ (1,308) | $ — | $ 4,430 |

(1) Net change in the fair value of the effective portion classified in other comprehensive income ("OCI").

(2) Effective portion classified as revenue.

(3) Ineffective portion and amount excluded from effectiveness testing classified in interest and other income (expense), net.

(4) Classified in interest and other income (expense), net.

Net gains (losses) recognized in interest and other income (expense), net relating to balance sheet hedging for fiscal 2017, 2016 and 2015 were as follows (in thousands):

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Gain (loss) on foreign currency assets and liabilities: | | | |
| Net realized gain (loss) recognized in other income | $ (6,142) | $ 832 | $ (10,952) |
| Net unrealized gain (loss) recognized in other income | (907) | (6,070) | 3,815 |
| | (7,049) | (5,238) | (7,137) |
| Gain (loss) on hedges of foreign currency assets and liabilities: | | | |
| Net realized gain recognized in other income | 5,415 | 174 | 5,490 |
| Net unrealized gain (loss) recognized in other income | 1,171 | (1,482) | (1,060) |
| | 6,586 | (1,308) | 4,430 |

| | | | |
|---|---|---|---|
| Net gain (loss) recognized in interest and other income (expense), net | $ (463) | $ (6,546) | $ (2,707) |

## NOTE 6. PROPERTY AND EQUIPMENT

Property and equipment, net consisted of the following as of December 1, 2017 and December 2, 2016 (in thousands):

| | 2017 | 2016 |
|---|---|---|
| Computers and equipment | $ 1,128,264 | $ 1,051,937 |
| Furniture and fixtures | 115,273 | 94,243 |
| Capital projects in-progress | 5,575 | 7,648 |
| Leasehold improvements | 120,165 | 110,414 |
| Land | 77,723 | 77,340 |
| Buildings | 490,665 | 382,364 |
| Building improvements | 265,829 | 202,266 |
| Total | 2,203,494 | 1,926,212 |
| Less accumulated depreciation and amortization | (1,266,518) | (1,109,948) |
| Property and equipment, net | $ 936,976 | $ 816,264 |

Depreciation and amortization expense of property and equipment for fiscal 2017, 2016 and 2015 was $156.9 million, $157.6 million and $146.3 million, respectively.

In March 2017, we exercised our option to purchase the Almaden Tower for a total purchase price of $103.6 million. We capitalized the Almaden Tower as property and equipment on our Consolidated Balance Sheets at $104.2 million, the lesser of cost or fair value, which represented the total purchase price plus other direct costs associated with the purchase.

*See Note 14 of our Notes to Consolidated Financial Statements for additional information regarding purchase of the Almaden Tower.*

## NOTE 7. GOODWILL AND PURCHASED AND OTHER INTANGIBLES

Goodwill by reportable segment and activity for the years ended December 1, 2017 and December 2, 2016 was as follows (in thousands):

| | 2015 | Acquisitions | Other[(1)] | 2016 | Acquisitions | Other[(1)] | 2017 |
|---|---|---|---|---|---|---|---|
| Digital Media | $ 2,796,302 | $ — | $ 288 | $ 2,796,590 | $ — | $ 4,501 | $ 2,801,091 |
| Digital Marketing | 2,312,158 | 35,802 | 3,502 | 2,351,462 | 348,352 | 62,232 | 2,762,046 |
| Print and Publishing | 258,421 | — | 1 | 258,422 | — | 2 | 258,424 |
| Goodwill | $ 5,366,881 | $ 35,802 | $ 3,791 | $ 5,406,474 | $ 348,352 | $ 66,735 | $ 5,821,561 |

(1) Amounts primarily consist of foreign currency translation adjustments.

Purchased and other intangible assets by reportable segment as of December 1, 2017 and December 2, 2016 were as follows (in thousands):

| | 2017 | 2016 |
|---|---|---|
| Digital Media | $ 128,243 | $ 203,570 |
| Digital Marketing | 257,408 | 210,823 |
| Print and Publishing | 7 | 12 |
| Purchased and other intangible assets, net | $ 385,658 | $ 414,405 |

**ADOBE SYSTEMS INCORPORATED**

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

Purchased and other intangible assets subject to amortization as of December 1, 2017 and December 2, 2016 were as follows (in thousands):

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated Amortization | Net | Cost | Accumulated Amortization | Net |
| Purchased technology | $ 223,252 | $ (110,433) | $ 112,819 | $ 149,253 | $ (82,091) | $ 67,162 |
| Customer contracts and relationships | $ 577,484 | $ (356,613) | $ 220,871 | $ 541,366 | $ (274,380) | $ 266,986 |
| Trademarks | 76,255 | (56,094) | 20,161 | 76,355 | (46,846) | 29,509 |
| Acquired rights to use technology | 71,130 | (54,223) | 16,907 | 87,403 | (60,929) | 26,474 |
| Localization | 603 | (170) | 433 | 631 | (177) | 454 |
| Other intangibles | 38,693 | (24,226) | 14,467 | 38,693 | (14,873) | 23,820 |
| Total other intangible assets | $ 764,165 | $ (491,326) | $ 272,839 | $ 744,448 | $ (397,205) | $ 347,243 |
| Purchased and other intangible assets, net | $ 987,417 | $ (601,759) | $ 385,658 | $ 893,701 | $ (479,296) | $ 414,405 |

In fiscal 2017, certain purchased intangibles associated with our acquisitions in prior years and certain other acquired rights to use technology became fully amortized and were removed from the Consolidated Balance Sheets. In fiscal 2016, purchased intangibles associated with our acquisition of EchoSign and certain other acquired rights to use technology became fully amortized and were removed from the Consolidated Balance Sheets.

Amortization expense related to purchased and other intangible assets was $153.6 million, $152.4 million, and $174.5 million for fiscal 2017, 2016 and 2015 respectively. Of these amounts, $76.1 million, $71.1 million, and $104.4 million were included in cost of sales for fiscal 2017, 2016 and 2015 respectively.

Purchased and other intangible assets are amortized over their estimated useful lives of 1 to 14 years. As of December 1, 2017, we expect amortization expense in future periods to be as follows (in thousands):

| Fiscal Year | Purchased Technology | Other Intangible Assets |
|---|---|---|
| 2018 | $ 37,984 | $ 97,726 |
| 2019 | 34,404 | 69,733 |
| 2020 | 32,111 | 39,658 |
| 2021 | 7,203 | 17,304 |
| 2022 | 1,117 | 14,297 |
| Thereafter | — | 34,121 |
| Total expected amortization expense | $ 112,819 | $ 272,839 |

## NOTE 8. ACCRUED EXPENSES

Accrued expenses as of December 1, 2017 and December 2, 2016 consisted of the following (in thousands):

| | 2017 | 2016 |
|---|---|---|
| Accrued compensation and benefits | $ 417,742 | $ 339,487 |
| Accrued media costs | 134,525 | 5,144 |
| Sales and marketing allowances | 47,389 | 55,681 |
| Accrued corporate marketing | 72,087 | 55,218 |
| Taxes payable | 49,550 | 43,113 |
| Royalties payable | 46,411 | 25,089 |
| Accrued interest expense | 25,594 | 25,805 |
| Other | 200,475 | 190,093 |
| Accrued expenses | $ 993,773 | $ 739,630 |

Accrued media costs primarily relate to our advertising platform offerings from TubeMogul, which are part of the Advertising Cloud. We accrue for media costs related to impressions purchased from third-party ad inventory sources. Other primarily includes general corporate accruals for local and regional expenses. Other is also comprised of deferred rent related to office locations with rent escalations and foreign currency liability derivatives.

## NOTE 9. INCOME TAXES

Income before income taxes for fiscal 2017, 2016 and 2015 consisted of the following (in thousands):

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Domestic | $ 1,056,156 | $ 805,749 | $ 589,371 |
| Foreign | 1,081,485 | 629,389 | 284,410 |
| Income before income taxes | $ 2,137,641 | $ 1,435,138 | $ 873,781 |

The provision for income taxes for fiscal 2017, 2016 and 2015 consisted of the following (in thousands):

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Current: | | | |
| United States federal | $ 298,802 | $ 94,396 | $ 204,834 |
| Foreign | 60,962 | 59,749 | 52,125 |
| State and local | 33,578 | 15,222 | (14,975) |
| Total current | 393,342 | 169,367 | 241,984 |
| Deferred: | | | |
| United States federal | 48,905 | 33,924 | (31,011) |
| Foreign | (4,242) | (2,751) | (9,368) |
| State and local | 5,682 | (9,287) | (25,511) |
| Total deferred | 50,345 | 21,886 | (65,890) |
| Tax expense attributable to employee stock plans | — | 75,103 | 68,136 |
| Provision for income taxes | $ 443,687 | $ 266,356 | $ 244,230 |

*See Note 1 to the Consolidated Financial Statements for further information on our adoption of ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting.*

**ADOBE SYSTEMS INCORPORATED**

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

Total income tax expense differs from the expected tax expense (computed by multiplying the U.S. federal statutory rate of 35% by income before income taxes) as a result of the following (in thousands):

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Computed "expected" tax expense | $ 748,174 | $ 502,298 | $ 305,824 |
| State tax expense, net of federal benefit | 25,131 | 10,636 | (8,316) |
| Tax credits | (38,000) | (48,383) | (25,967) |
| Differences between statutory rate and foreign effective tax rate | (215,490) | (133,778) | (90,063) |
| Stock-based compensation, net of tax deduction | (42,512) | 15,101 | 9,623 |
| Resolution of income tax examinations | (31,358) | (68,003) | (17,595) |
| Domestic manufacturing deduction benefit | (32,200) | (26,990) | (16,800) |
| Tax charge for licensing acquired company technology to foreign subsidiaries | 24,771 | 5,346 | 80,015 |
| Other, net | 5,171 | 10,129 | 7,509 |
| Provision for income taxes | $ 443,687 | $ 266,356 | $ 244,230 |

*Deferred Tax Assets and Liabilities*

The tax effects of the temporary differences that gave rise to significant portions of the deferred tax assets and liabilities as of December 1, 2017 and December 2, 2016 are presented below (in thousands):

| | 2017 | 2016 |
|---|---|---|
| Deferred tax assets: | | |
| Acquired technology | $ 4,846 | $ 7,421 |
| Reserves and accruals | 48,761 | 35,440 |
| Deferred revenue | 23,452 | 21,039 |
| Unrealized losses on investments | 11 | 2,391 |
| Stock-based compensation | 74,942 | 56,353 |
| Net operating loss carryforwards of acquired companies | 44,465 | 31,305 |
| Credit carryforwards | 124,205 | 63,315 |
| Capitalized expenses | 13,428 | 15,571 |
| Benefits relating to tax positions | 33,318 | 39,492 |
| Other | 30,289 | 26,439 |
| Total gross deferred tax assets | 397,717 | 298,766 |
| Deferred tax asset valuation allowance | (93,568) | (24,265) |
| Total deferred tax assets | 304,149 | 274,501 |
| Deferred tax liabilities: | | |
| Depreciation and amortization | 84,064 | 78,619 |
| Undistributed earnings of foreign subsidiaries | 382,744 | 292,844 |
| Acquired intangible assets | 117,282 | 120,698 |
| Total deferred tax liabilities | 584,090 | 492,161 |
| Net deferred tax liabilities: | $ 279,941 | $ 217,660 |

Deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Included in the deferred tax assets and liabilities for fiscal 2017 and 2016 are amounts related to various acquisitions. The deferred tax assets are offset by a valuation allowance to the extent it is more likely than not that they are not expected to be realized.

We provide U.S. income taxes on the earnings of foreign subsidiaries unless the subsidiaries' earnings are considered permanently reinvested outside the United States. To the extent that the foreign earnings previously treated as permanently reinvested are repatriated, the related U.S. tax liability may be reduced by any foreign income taxes paid on these earnings. As of December 1, 2017, the cumulative amount of earnings upon which U.S. income taxes have not been provided is approximately $5.0 billion. The unrecognized deferred tax liability for these earnings is approximately $1.4 billion.

As of December 1, 2017, we have net operating loss carryforwards of approximately $118.4 million for federal and $52.6 million for state. We also have state and foreign tax credit carryforwards of approximately $166.2 million and $16.2 million, respectively. The net operating loss carryforward assets and tax credits will expire in various years from fiscal 2018 through 2036. The state tax credit carryforwards can be carried forward indefinitely. The net operating loss carryforward assets and certain credits are reduced by the valuation allowance and are subject to an annual limitation under Internal Revenue Code Section 382, the carrying amount of which are expected to be fully realized.

As of December 1, 2017, a valuation allowance of $93.6 million has been established for certain deferred tax assets related to the impairment of investments and certain state and foreign assets. For fiscal 2017, the total change in the valuation allowance was $69.3 million, of which $55.3 million was related to the deferred tax attributes recorded due to our early adoption of the new accounting guidance related to stock-based compensation.

*Accounting for Uncertainty in Income Taxes*

During fiscal 2017 and 2016, our aggregate changes in our total gross amount of unrecognized tax benefits are summarized as follows (in thousands):

| | 2017 | 2016 |
|---|---|---|
| Beginning balance | $ 178,413 | $ 258,718 |
| Gross increases in unrecognized tax benefits – prior year tax positions | 3,680 | 6,047 |
| Gross decreases in unrecognized tax benefits – prior year tax positions | (30,166) | (67,870) |
| Gross increases in unrecognized tax benefits – current year tax positions | 24,927 | 23,068 |
| Settlements with taxing authorities | (3,876) | (33,265) |
| Lapse of statute of limitations | (8,819) | (8,456) |
| Foreign exchange gains and losses | 8,786 | 171 |
| Ending balance | $ 172,945 | $ 178,413 |

The combined amount of accrued interest and penalties related to tax positions taken on our tax returns were approximately $23.6 million and $22.4 million for fiscal 2017 and 2016, respectively. These amounts were included in non-current income taxes payable in their respective years.

We file income tax returns in the United States on a federal basis and in many U.S. state and foreign jurisdictions. We are subject to the continual examination of our income tax returns by the IRS and other domestic and foreign tax authorities. Our major tax jurisdictions are Ireland, California and the United States. For Ireland, California and the United States, the earliest fiscal years open for examination are 2008, 2010 and 2013, respectively. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from these examinations. We believe such estimates to be reasonable; however, there can be no assurance that the final determination of any of these examinations will not have an adverse effect on our operating results and financial position.

The timing of the resolution of income tax examinations is highly uncertain as are the amounts and timing of tax payments that are part of any audit settlement process. These events could cause large fluctuations in the balance of current and non-current assets, liabilities and income taxes payable. We believe that within the next 12 months, it is reasonably possible that either certain audits will conclude or statutes of limitations on certain income tax examination periods will expire, or both. Given the uncertainties described above, we can only determine a range of estimated potential decreases in underlying unrecognized tax benefits ranging from $0 to approximately $40 million.

Subsequent to December 1, 2017, the "Tax Cuts and Jobs Act" (the "Act") was enacted and included broad tax reforms that are applicable to Adobe. Under the provisions of the Act, the U.S. corporate tax rate decreased from 35% to 21% effective January 1, 2018, our undistributed foreign earnings are subject to taxation in fiscal 2018 and are available for repatriation, and our future foreign earnings are subject to U.S. taxation. These changes will require us to remeasure our deferred tax assets and liabilities and reclassify deferred tax liabilities related to undistributed foreign earnings to long-term income taxes payable due over eight years.

## NOTE 10. BENEFIT PLANS

*Retirement Savings Plan*

In 1987, we adopted an Employee Investment Plan, qualified under Section 401(k) of the Internal Revenue Code, which is a retirement savings plan covering substantially all of our U.S. employees, now referred to as the Adobe 401(k) Retirement Savings Plan. Under the plan, eligible employees may contribute up to 65% of their pretax or after-tax salary, subject to the Internal Revenue Service annual contribution limits. In fiscal 2017, we matched 50% of the first 6% of the employee's eligible compensation. We contributed $34.3 million, $33.4 million and $25.7 million in fiscal 2017, 2016 and 2015, respectively. We are under no obligation to continue matching future employee contributions and, at our discretion, may change our practices at any time.

*Deferred Compensation Plan*

On September 21, 2006, the Board of Directors approved the Adobe Systems Incorporated Deferred Compensation Plan, effective December 2, 2006 (the "Deferred Compensation Plan"). The Deferred Compensation Plan is an unfunded, non-qualified, deferred compensation arrangement under which certain executives and members of the Board of Directors are able to defer a portion of their annual compensation. Participants may elect to contribute up to 75% of their base salary and 100% of other specified compensation, including commissions, bonuses, performance-based and time-based restricted stock units, and directors' fees. Participants are able to elect the payment of benefits to begin on a specified date at least three years after the end of the plan year in which election is made. For cash benefit elections, distributions are made in cash and in the form of a lump sum or annual installments over five years. For stock benefit elections, distributions are settled in stock and in the form of a lump sum payment only.

As of December 1, 2017 and December 2, 2016, the invested amounts under the Deferred Compensation Plan total $56.7 million and $42.2 million, respectively and were recorded as other assets on our Consolidated Balance Sheets. As of December 1, 2017 and December 2, 2016, $67.2 million and $49.0 million, respectively, was recorded as long-term liabilities to recognize undistributed deferred compensation due to employees.

## NOTE 11. STOCK-BASED COMPENSATION

Our stock-based compensation programs are long-term retention programs that are intended to attract, retain and provide incentives for employees, officers and directors, and to align stockholder and employee interests. We have the following stock-based compensation plans and programs:

*Restricted Stock Unit Plan*

We grant restricted stock units to eligible employees under our 2003 Equity Incentive Plan, as amended ("2003 Plan"). Restricted stock units granted as part of our annual review process or for promotions vest annually over three years. Restricted stock units granted to new hires generally vest over four years. Certain grants have other vesting periods approved by our Board of Directors or an authorized committee.

We grant performance awards to officers and key employees under our 2003 Plan which cliff-vest after three years.

As of December 1, 2017, we had reserved 183.2 million shares of common stock for issuance under our 2003 Plan and had 93.6 million shares available for grant.

**ADOBE SYSTEMS INCORPORATED**

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

*Employee Stock Purchase Plan*

Our 1997 Employee Stock Purchase Plan ("ESPP") allows eligible employee participants to purchase shares of our common stock at a discount through payroll deductions. The ESPP consists of a twenty-four month offering period with four six-month purchase periods in each offering period. Employees purchase shares in each purchase period at 85% of the market value of our common stock at either the beginning of the offering period or the end of the purchase period, whichever price is lower. The ESPP will continue until the earlier of (i) termination by the Board or (ii) the date on which all of the shares available for issuance under the plan have been issued.

As of December 1, 2017, we had reserved 93.0 million shares of our common stock for issuance under the ESPP and approximately 7.0 million shares remain available for future issuance.

*Stock Option Plan*

The 2003 Plan allows us to grant options to all employees, including executive officers, outside consultants and non-employee directors. This plan will continue until the earlier of (i) termination by the Board or (ii) the date on which all of the shares available for issuance under the plan have been issued and restrictions on issued shares have lapsed. Option vesting periods used in the past were generally four years and expire seven years from the effective date of grant.

We eliminated the use of stock option grants for all employees effective fiscal 2012, and for all of the non-employee directors effective fiscal 2014, but may choose to issue stock options in the future.

*Performance Share Programs*

Our 2017, 2016 and 2015 Performance Share Programs aim to help focus key employees on building stockholder value, provide significant award potential for achieving outstanding Company performance and enhance the ability of the Company to attract and retain highly talented and competent individuals. The Executive Compensation Committee of our Board of Directors approves the terms of each of our Performance Share Programs, including the award calculation methodology, under the terms of our 2003 Plan. Shares may be earned based on the achievement of an objective relative total stockholder return measured over a three-year performance period. Performance share awards will be awarded and fully vest upon the later of the Executive Compensation Committee's certification of the level of achievement or the three-year anniversary of each grant. Program participants generally have the ability to receive up to 200% of the target number of shares originally granted.

On January 24, 2017, the Executive Compensation Committee approved the 2017 Performance Share Program, the terms of which are similar to prior year performance share programs as discussed above. As of December 1, 2017, the shares awarded under our 2017, 2016 and 2015 Performance Share Programs are yet to be achieved.

*Issuance of Shares*

Upon exercise of stock options, vesting of restricted stock units and performance shares, and purchases of shares under the ESPP, we will issue treasury stock. If treasury stock is not available, common stock will be issued. In order to minimize the impact of on-going dilution from exercises of stock options and vesting of restricted stock units and performance shares, we instituted a stock repurchase program. *See Note 12 for information regarding our stock repurchase programs.*

*Valuation of Stock-Based Compensation*

Stock-based compensation cost is measured at the grant date based on the fair value of the award.

Our performance share awards are valued using a Monte Carlo Simulation model. The fair value of the awards are fixed at grant date and amortized over the longer of the remaining performance or service period.

We use the Black-Scholes option pricing model to determine the fair value of ESPP shares. The determination of the fair value of stock-based payment awards on the date of grant using an option pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the expected term of the awards, actual and projected employee stock option exercise behaviors, a risk-free interest rate and any expected dividends.

The expected term of ESPP shares is the average of the remaining purchase periods under each offering period. The assumptions used to value employee stock purchase rights were as follows:

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Expected life (in years) | 0.5 - 2.0 | 0.5 - 2.0 | 0.5 - 2.0 |
| Volatility | 22% - 27% | 26% - 29% | 26% - 30% |
| Risk free interest rate | 0.62% - 1.41% | 0.37% - 1.06% | 0.11% - 0.67% |

*Summary of Restricted Stock Units*

Restricted stock unit activity for fiscal 2017, 2016 and 2015 was as follows (in thousands):

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Beginning outstanding balance | 8,316 | 10,069 | 13,564 |
| Awarded | 5,018 | 4,440 | 4,012 |
| Released | (3,859) | (5,471) | (6,561) |
| Forfeited | (766) | (722) | (946) |
| Increase due to acquisition | 595 | — | — |
| Ending outstanding balance | 9,304 | 8,316 | 10,069 |

The weighted average grant date fair values of restricted stock units granted during fiscal 2017, 2016 and 2015 were $120.33, $89.87 and $75.47, respectively. The total fair value of restricted stock units vested during fiscal 2017, 2016 and 2015 was $472.0 million, $499.8 million and $495.1 million, respectively.

Information regarding restricted stock units outstanding at December 1, 2017, December 2, 2016 and November 27, 2015 is summarized below:

| | Number of Shares (thousands) | Weighted Average Remaining Contractual Life (years) | Aggregate Intrinsic Value(*) (millions) |
|---|---|---|---|
| **2017** | | | |
| Restricted stock units outstanding | 9,304 | 1.11 | $ 1,670.2 |
| Restricted stock units vested and expected to vest | 8,608 | 1.05 | $ 1,545.3 |
| **2016** | | | |
| Restricted stock units outstanding | 8,316 | 1.11 | $ 829.4 |
| Restricted stock units vested and expected to vest | 7,613 | 1.04 | $ 759.3 |
| **2015** | | | |
| Restricted stock units outstanding | 10,069 | 0.93 | $ 928.0 |
| Restricted stock units vested and expected to vest | 9,267 | 0.86 | $ 842.9 |

(*) The intrinsic value is calculated as the market value as of the end of the fiscal period. As reported by the NASDAQ Global Select Market, the market values as of December 1, 2017, December 2, 2016 and November 27, 2015 were $179.52, $99.73 and $92.17, respectively.

*Summary of Performance Shares*

In the first quarter of fiscal 2017, the Executive Compensation Committee certified the actual performance achievement of participants in the 2014 Performance Share Program. Actual performance resulted in participants achieving 198% of target or approximately 0.6 million additional shares. The shares granted and achieved under the 2014 Performance Share Program fully vested on the three-year anniversary of the grant on January 24, 2017, if not forfeited.

In the first quarter of fiscal 2016, the Executive Compensation Committee certified the actual performance achievement of participants in the 2013 Performance Share Program. Actual performance resulted in participants achieving 198% of target or approximately 0.7 million additional shares. The shares granted and achieved under the 2013 Performance Share Program fully vested on the three-year anniversary of the grant on January 24, 2016, if not forfeited. As of December 1, 2017, the shares awarded under our 2017, 2016 and 2015 Performance Share Programs are yet to be achieved.

Performance share activity for fiscal 2017, 2016 and 2015 was as follows (in thousands):

| | 2017 | | 2016 | | 2015 | |
|---|---|---|---|---|---|---|
| | Shares Granted | Maximum Shares Eligible to Receive | Shares Granted | Maximum Shares Eligible to Receive | Shares Granted | Maximum Shares Eligible to Receive |
| Beginning outstanding balance | 1,630 | 3,261 | 1,940 | 3,881 | 1,517 | 3,034 |
| Awarded | 1,082 (1) | 1,040 | 1,206 (2) | 1,053 | 671 | 1,342 |
| Achieved | (1,135) (3) | (1,147) | (1,373) (3) | (1,387) | — | — |
| Forfeited | (43) | (86) | (143) | (286) | (248) | (495) |
| Ending outstanding balance | 1,534 | 3,068 | 1,630 | 3,261 | 1,940 | 3,881 |

(1) Included in the 1.1 million shares awarded during fiscal 2017 were 0.6 million additional shares awarded for the final achievement of the 2014 Performance Share program. The remaining awarded shares were for the 2017 Performance Share Program.

(2) Included in the 1.2 million shares awarded during fiscal 2016 were 0.7 million additional shares awarded for the final achievement of the 2013 Performance Share program. The remaining awarded shares were for the 2016 Performance Share Program.

(3) Shares achieved under our 2014 and 2013 Performance Share programs which resulted from 198% achievement of target for both programs.

The total fair value of performance awards vested during fiscal 2017, 2016 and 2015 was $127.4 million, $123.1 million and $26.1 million, respectively.

*Summary of Employee Stock Purchase Plan Shares*

The weighted average subscription date fair value of shares under the ESPP during fiscal 2017, 2016 and 2015 were $29.86, $24.84 and $20.81, respectively. Employees purchased 1.9 million shares at an average price of $77.63, 1.9 million shares at an average price of $66.13, and 2.1 million shares at an average price of $52.37, respectively, for fiscal 2017, 2016 and 2015. The intrinsic value of shares purchased during fiscal 2017, 2016 and 2015 was $97.7 million, $54.3 million and $53.9 million, respectively. The intrinsic value is calculated as the difference between the market value on the date of purchase and the purchase price of the shares.

*Summary of Stock Options*

As of December 1, 2017 and December 2, 2016, we had 0.3 million and 0.6 million stock options outstanding, respectively.

*Grants to Executive Officers*

All equity awards granted to executive officers are made after a review by and with the approval of the Executive Compensation Committee of the Board of Directors.

*Grants to Non-Employee Directors*

Although the 2003 Plan provides for the granting of non-qualified stock options and restricted stock units to non-employee directors, restricted stock units are the primary form of our grants to non-employee directors since fiscal 2014. The initial equity grant to a new non-employee director is a restricted stock unit award having an aggregate value of $0.3 million based on the average stock price over the 30 calendar days ending on the day before the date of grant and vest 100% on the day preceding the next annual meeting. The actual target grant value will be prorated based on the number of days remaining before the next annual meeting or the date of the first anniversary of our last annual meeting if the next annual meeting is not yet scheduled.

Annual equity grants to non-employee directors in the form of restricted stock units shall have an aggregate value of $0.3 million as based on the average stock price over the 30 calendar days ending on the day before the date of grant and vest 100% on the day preceding the next annual meeting.

Restricted stock units granted to directors for fiscal 2017, 2016 and 2015 were as follows (in thousands):

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Restricted stock units granted to existing directors | 18 | 25 | 41 |

*Compensation Costs*

We recognize the estimated compensation cost of restricted stock units, net of estimated forfeitures, on a straight-line basis over the requisite service period of the entire award, which is generally the vesting period. The estimated compensation cost is based on the fair value of our common stock on the date of grant.

We recognize the estimated compensation cost of performance shares, net of estimated forfeitures, on a straight-line basis over the requisite service period of the entire award. The fiscal 2017, 2016 and 2015 awards are earned upon achievement of an objective total stockholder return measure at the end of the three-year performance period, as described above.

We estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate forfeitures and record stock-based compensation expense only for those awards that are expected to vest.

As of December 1, 2017, there was $708.3 million of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock-based awards which will be recognized over a weighted average period of 1.8 years. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

**ADOBE SYSTEMS INCORPORATED**

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

Total stock-based compensation costs that have been included in our Consolidated Statements of Income for fiscal 2017, 2016 and 2015 were as follows (in thousands):

| | Income Statement Classifications | | | | | |
|---|---|---|---|---|---|---|
| | Cost of Revenue–Subscription | Cost of Revenue–Services and Support | Research and Development | Sales and Marketing | General and Administrative | Total[1] |
| **Option Grants and Stock Purchase Rights** | | | | | | |
| 2017 | $ 180 | $ 6,661 | $ 20,126 | $ 18,592 | $ 4,973 | $ 50,532 |
| 2016 | $ 1,474 | $ 5,514 | $ 13,932 | $ 16,534 | $ 4,371 | $ 41,825 |
| 2015 | $ 1,449 | $ 5,185 | $ 14,082 | $ 18,360 | $ 4,790 | $ 43,866 |
| **Restricted Stock Units and Performance Share Awards** | | | | | | |
| 2017 | $ 16,792 | $ 9,602 | $ 161,366 | $ 139,047 | $ 77,133 | $ 403,940 |
| 2016 | $ 6,632 | $ 7,522 | $ 109,249 | $ 113,757 | $ 70,312 | $ 307,472 |
| 2015 | $ 6,481 | $ 6,446 | $ 104,624 | $ 109,908 | $ 66,709 | $ 294,168 |

(1) During fiscal 2017, 2016 and 2015, we recorded tax benefits of $153.2 million, $71.7 million and $68.8 million, respectively.

## NOTE 12. STOCKHOLDERS' EQUITY

*Comprehensive Income (Loss)*

The components of accumulated other comprehensive income (loss) and activity, net of related taxes, for fiscal 2017 were as follows (in thousands):

| | December 2, 2016 | Increase / Decrease | Reclassification Adjustments | | December 1, 2017 |
|---|---|---|---|---|---|
| Net unrealized gains / losses on available-for-sale securities: | | | | | |
| Unrealized gains on available-for-sale securities | $ 3,499 | $ 878 | $ (1,673) | | $ 2,704 |
| Unrealized losses on available-for-sale securities | (11,565) | (3,381) | 726 | | (14,220) |
| Total net unrealized gains / losses on available-for-sale securities | (8,066) | (2,503) | (947) | (1) | (11,516) |
| Net unrealized gains / losses on derivative instruments designated as hedging instruments | 21,689 | 6,917 | (31,973) | (2) | (3,367) |
| Cumulative foreign currency translation adjustments | (187,225) | 90,287 | — | | (96,938) |
| Total accumulated other comprehensive income (loss), net of taxes | $ (173,602) | $ 94,701 | $ (32,920) | | $ (111,821) |

(1) Reclassification adjustments for gains / losses on available-for-sale securities are classified in interest and other income (expense), net.

(2) Reclassification adjustments for gains / losses on other derivative instruments are classified in revenue.

**ADOBE SYSTEMS INCORPORATED**

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

The following table sets forth the taxes related to each component of other comprehensive income for fiscal 2017, 2016 and 2015 (in thousands):

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Available-for-sale securities: | | | |
| Unrealized gains / losses | $ 663 | $ (299) | $ (154) |
| Reclassification adjustments | (491) | 108 | — |
| Subtotal available-for-sale securities | 172 | (191) | (154) |
| Derivatives designated as hedging instruments: | | | |
| Unrealized gains on derivative instruments* | — | — | 6,147 |
| Reclassification adjustments* | (732) | (552) | (550) |
| Subtotal derivatives designated as hedging instruments | (732) | (552) | 5,597 |
| Foreign currency translation adjustments | 3,005 | 24 | (3,378) |
| Total taxes, other comprehensive income (loss) | $ 2,445 | $ (719) | $ 2,065 |

(*) Taxes related to derivative instruments other than the interest rate lock agreement were zero based on the tax jurisdiction where these derivative instruments were executed.

*Stock Repurchase Program*

To facilitate our stock repurchase program, designed to return value to our stockholders and minimize dilution from stock issuances, we may repurchase shares in the open market or enter into structured repurchase agreements with third parties. In January 2017, our Board of Directors approved a new stock repurchase program granting us authority to repurchase up to $2.5 billion in common stock through the end of fiscal 2019. The new stock repurchase program approved by our Board of Directors is similar to our previous stock repurchase programs.

During fiscal 2017, 2016 and 2015, we entered into several structured stock repurchase agreements with large financial institutions, whereupon we provided them with prepayments totaling $1.10 billion, $1.08 billion, and $625 million, respectively. We enter into these agreements in order to take advantage of repurchasing shares at a guaranteed discount to the Volume Weighted Average Price ("VWAP") of our common stock over a specified period of time. We only enter into such transactions when the discount that we receive is higher than our estimate of the expected foregone return on our cash prepayments to the financial institutions. There were no explicit commissions or fees on these structured repurchases. Under the terms of the agreements, there is no requirement for the financial institutions to return any portion of the prepayment to us.

The financial institutions agree to deliver shares to us at monthly intervals during the contract term. The parameters used to calculate the number of shares deliverable are: the total notional amount of the contract, the number of trading days in the contract, the number of trading days in the interval and the average VWAP of our stock during the interval less the agreed upon discount. During fiscal 2017, we repurchased approximately 8.2 million shares at an average price per share of $134.20 through structured repurchase agreements entered into during fiscal 2017 and fiscal 2016. During fiscal 2016, we repurchased approximately 10.4 million shares at an average price per share of $97.16 through structured repurchase agreements entered into during fiscal 2016 and fiscal 2015. During fiscal 2015, we repurchased approximately 8.1 million shares at an average price per share of $77.38 through structured repurchase agreements entered into during fiscal 2015 and fiscal 2014.

For fiscal 2017, 2016 and 2015, the prepayments were classified as treasury stock on our Consolidated Balance Sheets at the payment date, though only shares physically delivered to us by December 1, 2017, December 2, 2016 and November 27, 2015 were excluded from the computation of earnings per share. As of December 1, 2017, $101.5 million of prepayments remained under the agreement.

Subsequent to December 1, 2017, as part of the 2017 stock repurchase authority, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of

$300 million. This amount will be classified as treasury stock on our Consolidated Balance Sheets. Upon completion of the $300 million stock repurchase agreement, $1.6 billion remains under our current authority.

## NOTE 13. NET INCOME PER SHARE

Basic net income per share is computed using the weighted average number of common shares outstanding for the period, excluding unvested restricted stock units and performance awards. Diluted net income per share is based upon the weighted average common shares outstanding for the period plus dilutive potential common shares, including unvested restricted stock units, performance share awards, and stock options using the treasury stock method.

The following table sets forth the computation of basic and diluted net income per share for fiscal 2017, 2016 and 2015 (in thousands, except per share data):

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Net income | $ 1,693,954 | $ 1,168,782 | $ 629,551 |
| Shares used to compute basic net income per share | 493,632 | 498,345 | 498,764 |
| Dilutive potential common shares: | | | |
| Unvested restricted stock units and performance share awards | 7,161 | 5,455 | 7,389 |
| Stock options | 330 | 499 | 1,011 |
| Shares used to compute diluted net income per share | 501,123 | 504,299 | 507,164 |
| Basic net income per share | $ 3.43 | $ 2.35 | $ 1.26 |
| Diluted net income per share | $ 3.38 | $ 2.32 | $ 1.24 |

For fiscal 2017, 2016, and 2015 there were no options to purchase shares of common stock with exercise prices greater than the average fair market value of our stock of $138.71, $96.39, and $79.22, respectively, that would have been anti-dilutive.

## NOTE 14. COMMITMENTS AND CONTINGENCIES

*Lease Commitments*

We lease certain of our facilities and some of our equipment under non-cancellable operating lease arrangements that expire at various dates through 2031. We also have one land lease that expires in 2091. Rent expense includes base contractual rent and variable costs such as building expenses, utilities, taxes, insurance and equipment rental. Rent expense for these leases was approximately $115.4 million in fiscal 2017 and $92.9 million in both fiscal 2016 and 2015. Our sublease income was immaterial for all periods presented.

We occupy three office buildings in San Jose, California where our corporate headquarters are located. We reference these office buildings as the Almaden, East and West Towers.

In March 2017, we exercised our option to purchase the Almaden Tower for a total purchase price of $103.6 million. Upon purchase, our investment in the lease receivable of $80.4 million was credited against the total purchase price. We capitalized the Almaden Tower as property and equipment on our Consolidated Balance Sheets at $104.2 million, the lesser of cost or fair value, which represented the total purchase price plus other direct costs associated with the purchase.

As of December 1, 2017, we own the buildings and the underlying land that make up our corporate headquarters in San Jose, California, including the Almaden Tower.

*Unconditional Purchase Obligations*

Our purchase obligations consist of agreements to purchase goods and services entered into in the ordinary course of business.

The following table summarizes our non-cancellable unconditional purchase obligations and operating leases for each of the next five years and thereafter as of December 1, 2017 (in thousands):

| | | Operating Leases | |
|---|---|---|---|
| **Fiscal Year** | **Purchase Obligations** | **Future Minimum Lease Payments** | **Future Minimum Sublease Income** |
| 2018 | $ 449,823 | $ 60,464 | $ 3,001 |
| 2019 | 245,087 | 62,307 | 2,903 |
| 2020 | 410 | 63,341 | 2,286 |
| 2021 | — | 53,670 | 2,036 |
| 2022 | — | 44,016 | — |
| Thereafter | — | 251,544 | — |
| Total | $ 695,320 | $ 535,342 | $ 10,226 |

*Other*

Subsequent to December 1, 2017, we purchased land near our headquarters in San Jose, California for a total purchase price of $68.0 million.

*Royalties*

We have royalty commitments associated with the licensing of certain offerings and products. Royalty expense is generally based on a dollar amount per unit or a percentage of the underlying revenue. Royalty expense, which was recorded under our cost of revenue on our Consolidated Statements of Income, was approximately $100.9 million, $79.8 million and $62.3 million in fiscal 2017, 2016 and 2015, respectively.

*Indemnifications*

In the ordinary course of business, we provide indemnifications of varying scope to customers against claims of intellectual property infringement made by third parties arising from the use of our products and from time to time, we are subject to claims by our customers under these indemnification provisions. Historically, costs related to these indemnification provisions have not been significant and we are unable to estimate the maximum potential impact of these indemnification provisions on our future results of operations.

To the extent permitted under Delaware law, we have agreements whereby we indemnify our officers and directors for certain events or occurrences while the officer or director is or was serving at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the officer's or director's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that reduces our exposure and enables us to recover a portion of any future amounts paid. We believe the estimated fair value of these indemnification agreements in excess of applicable insurance coverage is minimal.

*Legal Proceedings*

In connection with disputes relating to the validity or alleged infringement of third-party intellectual property rights, including patent rights, we have been, are currently and may in the future be subject to claims, negotiations or complex, protracted litigation. Intellectual property disputes and litigation may be very costly and can be disruptive to our business operations by diverting the attention and energies of management and key technical personnel. Although we have successfully defended or resolved past litigation and disputes, we may not prevail in any ongoing or future litigation and disputes. Third-party intellectual property disputes could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from licensing certain of our products or offering certain of our services, subject us to injunctions restricting our sale of products or services, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers including contractual provisions under various license arrangements and service agreements.

In addition to intellectual property disputes, we are subject to legal proceedings, claims and investigations in the ordinary course of business, including claims relating to commercial, employment and other matters. Some of these disputes and legal proceedings may include speculative claims for substantial or indeterminate amounts of damages. We consider all claims on a quarterly basis in accordance with GAAP and based on known facts assess whether potential losses are considered reasonably possible, probable and estimable. Based upon this assessment, we then evaluate disclosure requirements and whether to accrue for such claims in our financial statements. This determination is then reviewed and discussed with our Audit Committee and our independent registered public accounting firm.

We make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Unless otherwise specifically disclosed in this note, we have determined that no provision for liability nor disclosure is required related to any claim against us because: (a) there is not a reasonable possibility that a loss exceeding amounts already recognized (if any) may be incurred with respect to such claim; (b) a reasonably possible loss or range of loss cannot be estimated; or (c) such estimate is immaterial.

All legal costs associated with litigation are expensed as incurred. Litigation is inherently unpredictable. However, we believe that we have valid defenses with respect to the legal matters pending against us. It is possible, nevertheless, that our consolidated financial position, cash flows or results of operations could be negatively affected by an unfavorable resolution of one or more of such proceedings, claims or investigations.

In connection with our anti-piracy efforts, conducted both internally and through organizations such as the Business Software Alliance, from time to time we undertake litigation against alleged copyright infringers. Such lawsuits may lead to counter-claims alleging improper use of litigation or violation of other laws. We believe we have valid defenses with respect to such counter-claims; however, it is possible that our consolidated financial position, cash flows or results of operations could be negatively affected in any particular period by the resolution of one or more of these counter-claims.

**NOTE 15. DEBT**

Our long-term debt as of December 1, 2017 and December 2, 2016 consisted of the following (in thousands):

| | 2017 | 2016 |
|---|---|---|
| Notes | $ 1,882,479 | $ 1,879,083 |
| Fair value of interest rate swap | (1,058) | 13,117 |
| Adjusted carrying value of Notes | 1,881,421 | 1,892,200 |

*Senior Notes*

In February 2010, we issued $900 million of 4.75% senior notes due February 1, 2020 (the “2020 Notes”). Our proceeds were $900 million and were net of an issuance discount of $5.5 million. In addition, we incurred issuance costs of $6.4 million. Both the discount and issuance costs are being amortized to interest expense over the term of the 2020 Notes using the effective interest method. The 2020 Notes rank equally with our other unsecured and unsubordinated indebtedness. The effective interest rate including the discount and issuance costs was 4.92% . Interest is payable semi-annually, in arrears, on February 1 and August 1, and commenced on August 1, 2010.

In June 2014, we entered into interest rate swaps with a total notional amount of $900 million designated as a fair value hedge related to our 2020 Notes. The interest rate swaps effectively convert the fixed interest rate on our 2020 Notes to a floating interest rate based on LIBOR. Under the terms of the swap, we will pay monthly interest at the one-month LIBOR interest rate plus a fixed number of basis points on the $900 million notional amount. In exchange, we will receive 4.75% fixed rate interest from the swap counterparties. *See Note 5 for further details regarding our interest rate swap derivatives.*

**ADOBE SYSTEMS INCORPORATED**

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

In January 2015, we issued $1 billion of 3.25% senior notes due February 1, 2025 (the "2025 Notes"). Our proceeds were approximately $989.3 million which is net of an issuance discount of $10.7 million. In addition, we incurred issuance costs of $7.9 million. Both the discount and issuance costs are being amortized to interest expense over the term of the 2025 Notes using the effective interest method. The 2025 Notes rank equally with our other unsecured and unsubordinated indebtedness. The effective interest rate including the discount, issuance costs and interest rate agreement is 3.67%. Interest is payable semi-annually, in arrears on February 1 and August 1, and commenced on August 1, 2015. A portion of the proceeds from this offering was used to repay $600 million in aggregate principal amount of previously outstanding senior notes plus accrued and unpaid interest due February 1, 2015. The remaining proceeds were used for general corporate purposes.

As of December 1, 2017, our outstanding notes payable consist of the 2020 Notes and 2025 Notes (the "Notes") with a total carrying value of $1.88 billion, which includes the fair value of the interest rate swaps and is net of debt issuance costs. Based on quoted prices in inactive markets, the fair value of the Notes was $1.98 billion as of December 1, 2017, which excludes the effect of the fair value of the interest rate swaps described above.

We may redeem the Notes at any time, subject to a make-whole premium. In addition, upon the occurrence of certain change of control triggering events, we may be required to repurchase the Notes, at a price equal to 101% of their principal amount, plus accrued and unpaid interest to the date of repurchase. The Notes also include covenants that limit our ability to grant liens on assets and to enter into sale and leaseback transactions, subject to significant allowances. As of December 1, 2017, we were in compliance with all of the covenants.

In February and August 2017, we made semi-annual interest payments on our 2020 and 2025 Notes each totaling $37.6 million.

*Credit Agreement*

On March 2, 2012, we entered into a five-year $1 billion senior unsecured revolving credit agreement (the "Credit Agreement"), providing for loans to us and certain of our subsidiaries. Pursuant to the terms of the Credit Agreement, we may, subject to the agreement of the applicable lenders, request up to an additional $500 million in commitments, for a maximum aggregate commitment of $1.5 billion. Loans under the Credit Agreement will bear interest at either (i) LIBOR plus a margin, based on our public debt ratings, ranging from 0.795% and 1.3% or (ii) the base rate, which is defined as the highest of (a) the agent's prime rate, (b) the federal funds effective rate plus 0.50% or (c) LIBOR plus 1.00% plus a margin, based on our debt ratings, ranging from 0.00% to 0.30%. Commitment fees are payable quarterly at rates between 0.08% and 0.20% per year, also based on our debt ratings. Subject to certain conditions stated in the Credit Agreement, we and any of our subsidiaries designated as additional borrowers may borrow, prepay and re-borrow amounts under the revolving credit facility at any time during the term of the Credit Agreement.

The Credit Agreement contains customary representations, warranties, affirmative and negative covenants, including a financial covenant, events of default and indemnification provisions in favor of the lenders. The negative covenants include restrictions regarding the incurrence of liens and indebtedness, certain merger and acquisition transactions, dispositions and other matters, all subject to certain exceptions. The financial covenant, based on a quarterly financial test, requires us not to exceed a maximum leverage ratio.

On March 1, 2013, we exercised an option under the Credit Agreement to extend the maturity date of the Credit Agreement to March 2, 2018. On July 27, 2015, we entered into an amendment to further extend the maturity date to July 27, 2020 and reallocated the facility among the syndicate of lenders that are parties to the Credit Agreement.

The facility will terminate and all amounts owing thereunder will be due and payable on the maturity date unless (a) the commitments are terminated earlier upon the occurrence of certain events, including an event of default, or (b) the maturity date is further extended upon our request, subject to the agreement of the lenders.

As of December 1, 2017, there were no outstanding borrowings under this Credit Agreement and we were in compliance with all covenants.

ADOBE SYSTEMS INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 16. NON-OPERATING INCOME (EXPENSE)

Non-operating income (expense) for fiscal 2017, 2016 and 2015 included the following (in thousands):

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Interest and other income (expense), net: | | | |
| Interest income | $ 66,069 | $ 47,340 | $ 28,759 |
| Foreign exchange gains (losses) | (30,705) | (35,716) | (20,130) |
| Realized gains on fixed income investment | 1,673 | 2,880 | 3,309 |
| Realized losses on fixed income investment | (725) | (985) | (354) |
| Other | 83 | 29 | 22,325 |
| Interest and other income (expense), net | $ 36,395 | $ 13,548 | $ 33,909 |
| Interest expense | $ (74,402) | $ (70,442) | $ (64,184) |
| Investment gains (losses), net: | | | |
| Realized investment gains | $ 3,279 | $ 4,964 | $ 2,760 |
| Unrealized investment gains | 4,274 | 186 | — |
| Realized investment losses | — | (6,720) | (206) |
| Unrealized investment losses | — | — | (1,593) |
| Investment gains (losses), net | $ 7,553 | $ (1,570) | $ 961 |
| Non-operating income (expense), net | $ (30,454) | $ (58,464) | $ (29,314) |

## NOTE 17. INDUSTRY SEGMENT, GEOGRAPHIC INFORMATION AND SIGNIFICANT CUSTOMERS

We report segment information based on the "management" approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of our reportable segments.

Our CEO, the chief operating decision maker, reviews revenue and gross margin information for each of our reportable segments, but does not review operating expenses on a segment by segment basis. In addition, with the exception of goodwill and intangible assets, we do not identify or allocate our assets by the reportable segments.

For fiscal 2017, we have the following reportable segments:

- *Digital Media*—Our Digital Media segment provides tools and solutions that enable individuals, small and medium businesses and enterprises to create, publish, promote and monetize their digital content anywhere. Our customers include traditional content creators, web application developers and digital media professionals, as well as their management in marketing departments and agencies, companies and publishers. Our customers also include knowledge workers who create, collaborate and distribute documents.

- *Digital Marketing*—Our Digital Marketing segment provides solutions and services for how digital advertising and marketing are created, managed, executed, measured and optimized. Our customers include digital marketers, advertisers, publishers, merchandisers, web analysts, chief marketing officers, chief information officers and chief revenue officers.

- *Print and Publishing*—Our Print and Publishing segment addresses market opportunities ranging from the diverse authoring and publishing needs of technical and business publishing to our legacy type and OEM printing businesses.

**ADOBE SYSTEMS INCORPORATED**

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

Our segment results for fiscal 2017, 2016 and 2015 were as follows (dollars in thousands):

| | Digital Media | Digital Marketing | Print and Publishing | Total |
|---|---|---|---|---|
| **Fiscal 2017** | | | | |
| Revenue | $ 5,010,579 | $ 2,120,032 | $ 170,894 | $ 7,301,505 |
| Cost of revenue | 239,994 | 763,468 | 7,029 | 1,010,491 |
| Gross profit | $ 4,770,585 | $ 1,356,564 | $ 163,865 | $ 6,291,014 |
| Gross profit as a percentage of revenue | 95 % | 64 % | 96 % | 86 % |
| **Fiscal 2016** | | | | |
| Revenue | $ 3,941,011 | $ 1,736,585 | $ 176,834 | $ 5,854,430 |
| Cost of revenue | 231,074 | 581,093 | 7,741 | 819,908 |
| Gross profit | $ 3,709,937 | $ 1,155,492 | $ 169,093 | $ 5,034,522 |
| Gross profit as a percentage of revenue | 94 % | 67 % | 96 % | 86 % |
| **Fiscal 2015** | | | | |
| Revenue | $ 3,095,160 | $ 1,508,858 | $ 191,493 | $ 4,795,511 |
| Cost of revenue | 210,587 | 525,309 | 8,421 | 744,317 |
| Gross profit | $ 2,884,573 | $ 983,549 | $ 183,072 | $ 4,051,194 |
| Gross profit as a percentage of revenue | 93 % | 65 % | 96 % | 84 % |

Effective in the first quarter of fiscal 2018, we plan to move our legacy enterprise offerings—Adobe Connect web conferencing platform and Adobe LiveCycle, an enterprise document and forms platform, from our Digital Marketing segment into Print and Publishing, in order to more closely align our Digital Marketing business with the strategic growth opportunity. We will adjust our reportable segments at the beginning of fiscal 2018 to reflect these changes as we enter into the new fiscal year.

The tables below list our revenue and property and equipment, net, by geographic area for fiscal 2017, 2016 and 2015 (in thousands). With the exception of property and equipment, we do not identify or allocate our assets (including long-lived assets) by geographic area.

| **Revenue** | 2017 | 2016 | 2015 |
|---|---|---|---|
| Americas: | | | |
| United States | $ 3,830,845 | $ 3,087,764 | $ 2,548,024 |
| Other | 385,686 | 312,371 | 240,020 |
| Total Americas | 4,216,531 | 3,400,135 | 2,788,044 |
| EMEA | 1,985,105 | 1,619,153 | 1,336,448 |
| APAC: | | | |
| Japan | 524,254 | 401,205 | 347,740 |
| Other | 575,615 | 433,937 | 323,279 |
| Total APAC | 1,099,869 | 835,142 | 671,019 |
| Revenue | $ 7,301,505 | $ 5,854,430 | $ 4,795,511 |

| **Property and Equipment** | 2017 | 2016 | 2015 |
|---|---|---|---|
| Americas: | | | |
| United States | $ 753,393 | $ 642,823 | $ 621,122 |
| Other | 2,797 | 559 | 427 |
| Total Americas | 756,190 | 643,382 | 621,549 |
| EMEA | 54,181 | 48,662 | 43,943 |
| APAC: | | | |
| India | 109,051 | 106,322 | 111,662 |
| Other | 17,554 | 17,898 | 10,267 |
| Total APAC | 126,605 | 124,220 | 121,929 |
| Property and equipment, net | $ 936,976 | $ 816,264 | $ 787,421 |

*Significant Customers*

For fiscal 2017, 2016 and 2015 there were no customers that represented at least 10% of net revenue. As of fiscal year end 2017 and 2016, no single customer was responsible for over 10% of our trade receivables.

## NOTE 18. SELECTED QUARTERLY FINANCIAL DATA (unaudited)

| (in thousands, except per share data) | 2017 Quarter Ended March 3 | June 2 | September 1 | December 1 |
|---|---|---|---|---|
| Revenue | $ 1,681,646 | $ 1,772,190 | $ 1,841,074 | $ 2,006,595 |
| Gross profit | $ 1,444,309 | $ 1,532,830 | $ 1,578,152 | $ 1,735,723 |
| Income before income taxes | $ 460,632 | $ 492,618 | $ 541,379 | $ 643,012 |
| Net income | $ 398,446 | $ 374,390 | $ 419,569 | $ 501,549 |
| Basic net income per share | $ 0.81 | $ 0.76 | $ 0.85 | $ 1.02 |
| Diluted net income per share | $ 0.80 | $ 0.75 | $ 0.84 | $ 1.00 |

| (in thousands, except per share data) | 2016 Quarter Ended March 4 | June 3 | September 2 | December 2 |
|---|---|---|---|---|
| Revenue | $ 1,383,335 | $ 1,398,709 | $ 1,463,967 | $ 1,608,419 |
| Gross profit | $ 1,184,763 | $ 1,196,630 | $ 1,261,266 | $ 1,391,863 |
| Income before income taxes | $ 292,307 | $ 329,830 | $ 356,301 | $ 456,700 |
| Net income | $ 254,307 | $ 244,074 | $ 270,788 | $ 399,613 |
| Basic net income per share | $ 0.51 | $ 0.49 | $ 0.54 | $ 0.81 |
| Diluted net income per share | $ 0.50 | $ 0.48 | $ 0.54 | $ 0.80 |

Our fiscal year is a 52- or 53-week year that ends on the Friday closest to November 30. Each of the fiscal quarters presented were comprised of 13 weeks with the exception of the first quarter of fiscal 2016 which was comprised of 14 weeks.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Adobe Systems Incorporated:

We have audited the accompanying consolidated balance sheets of Adobe Systems Incorporated and subsidiaries as of December 1, 2017 and December 2, 2016, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 1, 2017. We also have audited Adobe Systems Incorporated's internal control over financial reporting as of December 1, 2017, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Adobe Systems Incorporated's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Adobe Systems Incorporated and subsidiaries as of December 1, 2017 and December 2, 2016, and the results of their operations and their cash flows for each of the years in the three-year period ended December 1, 2017, in conformity with U.S. generally accepted accounting principles. Also in our opinion, Adobe Systems Incorporated maintained, in all material respects, effective internal control over financial reporting as of December 1, 2017, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the COSO.

Adobe Systems Incorporated acquired TubeMogul, Inc. (TubeMogul) on December 19, 2016, as discussed in Note 2 to the consolidated financial statements. As discussed in Management's Annual Report on Internal Control over Financial Reporting appearing under Item 9A, management excluded from its assessment of the effectiveness of Adobe System Incorporated's internal control over financial reporting as of December 1, 2017, TubeMogul's internal control over financial reporting associated with consolidated total assets of approximately 1.8% and consolidated total revenues of approximately 2.5%, included in the consolidated financial statements of Adobe Systems Incorporated and subsidiaries as of and for the year ended December 1, 2017. Our audit of internal control over financial reporting of Adobe Systems Incorporated as of December 1, 2017, also excluded an evaluation of the internal control over financial reporting of TubeMogul.

(signed) KPMG LLP

Santa Clara, California
January 22, 2018

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

## ITEM 9A. CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of December 1, 2017. Based on their evaluation as of December 1, 2017, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective at the reasonable assurance level to ensure that the information required to be disclosed by us in this Annual Report on Form 10-K was (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Adobe have been detected.

### Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Our management assessed the effectiveness of our internal control over financial reporting as of December 1, 2017. In making this assessment, our management used the criteria established in Internal Control - Integrated Framework (2013) issued by the COSO. Our management has concluded that, as of December 1, 2017, our internal control over financial reporting is effective based on these criteria.

We acquired TubeMogul, Inc. ("TubeMogul") on December 19, 2016, as discussed in Note 2 to the Consolidated Financial Statements. As permitted by the SEC staff's Frequently Asked Question 3 on Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports (revised September 24, 2007), our management excluded from our assessment of internal control over financial reporting effectiveness as of December 1, 2017, TubeMogul's internal control over financial reporting associated with consolidated total assets of approximately 1.8% and consolidated total revenues of approximately 2.5%, included in our Consolidated Financial Statements as of and for the year ended December 1, 2017. We will include TubeMogul in our assessment of the effectiveness of internal control over financial reporting starting fiscal 2018.

KPMG LLP, the independent registered public accounting firm that audited our financial statements included in this Annual Report on Form 10-K, has issued an attestation report on our internal control over financial reporting, which is included herein.

### Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended December 1, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## ITEM 9B. OTHER INFORMATION

**Item 5.02. Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers.**

**(b)**

On January 22, 2018, Mark Garrett notified Adobe Systems Incorporated ("Adobe") of his intent to retire as Executive Vice President and Chief Financial Officer of Adobe during 2018. Mike Dillon also notified Adobe of his intent to retire as Executive Vice President and General Counsel of Adobe during 2018. To ensure an orderly transition and continuity of operations, both Garrett and Dillon will remain in their current roles with Adobe until their respective successors are in place.

Adobe is conducting an internal and external search to fill both roles and both Garrett and Dillon will be active participants in the search for and transition to their successors.

**Item 8.01. Other Events.**

On January 22, 2018, we issued a press release announcing updated financial targets for fiscal 2018. A copy of this press release is furnished and attached hereto as Exhibit 99.1.

## PART III

### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item 10 of Form 10-K that is found in our 2018 Proxy Statement to be filed with the SEC in connection with the solicitation of proxies for the Company's 2018 Annual Meeting of Stockholders ("2018 Proxy Statement") is incorporated herein by reference to our 2018 Proxy Statement. The 2018 Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year to which this report relates. For information with respect to our executive officers, see "Executive Officers" at the end of Part I, Item 1 of this report.

### ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item 11 of Form 10-K is incorporated herein by reference to our 2018 Proxy Statement.

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item 12 of Form 10-K is incorporated herein by reference to our 2018 Proxy Statement.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item13 of Form 10-K is incorporated herein by reference to our 2018 Proxy Statement.

### ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item 14 of Form 10-K is incorporated herein by reference to our 2018 Proxy Statement.

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

1. Financial Statements. See Index to Consolidated Financial Statements in Part II, Item 8 of this Form 10-K.

| | | Incorporated by Reference** | | | | |
|---|---|---|---|---|---|---|
| Exhibit Number | Exhibit Description | Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
| 3.1 | Restated Certificate of Incorporation of Adobe Systems Incorporated | 8-K | 4/26/11 | 3.3 | 000-15175 | |
| 3.2 | Amended and Restated Bylaws | 8-K | 9/2/16 | 3.2 | 000-15175 | |
| 4.1 | Specimen Common Stock Certificate | 10-Q | 6/25/14 | 4.1 | 000-15175 | |
| 4.2 | | S-3 | 2/26/16 | 4.1 | 333-209764 | |

| | | | | | |
|---|---|---|---|---|---|
| | Form of Indenture dated as of January 25, 2010 by and between Adobe Systems Incorporated and Wells Fargo Bank, National Association, as trustee | | | | |
| 4.3 | Forms of Global Note for Adobe Systems Incorporated's 4.750% Notes due 2020, together with Form of Officer's Certificate setting forth the terms of the Note | 8-K | 1/26/10 | 4.1 | 000-15175 |

| Exhibit Number | Exhibit Description | Incorporated by Reference** Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
|---|---|---|---|---|---|---|
| 4.4 | Form of Global Note for Adobe Systems Incorporated’s 3.250% Notes due 2025, together with Form of Officer’s Certificate setting forth the terms of the Note | 8-K | 1/26/15 | 4.1 | 000-15175 | |
| 10.1A | Amended 1994 Performance and Restricted Stock Plan* | 10-Q | 4/9/10 | 10.1 | 000-15175 | |
| 10.1B | Form of Restricted Stock Agreement used in connection with the Amended 1994 Performance and Restricted Stock Plan* | 10-K | 1/23/09 | 10.3 | 000-15175 | |
| 10.1C | Form of Restricted Stock Unit Agreement used in connection with the Amended 1994 Performance and Restricted Stock Plan* | 10-K | 1/26/12 | 10.13 | 000-15175 | |
| 10.2 | 1997 Employee Stock Purchase Plan, as amended* | 10-Q | 6/29/16 | 10.3 | 000-15175 | |
| 10.3A | 2003 Equity Incentive Plan, as amended* | 8-K | 4/13/17 | 10.1 | 000-15175 | |
| 10.3B | Form of Stock Option Agreement used in connection with the 2003 Equity Incentive Plan* | 8-K | 12/20/10 | 99.4 | 000-15175 | |
| 10.3C | Form of RSU Grant Notice and Award Agreement pursuant to 2003 Equity Incentive Plan* | 8-K | 1/27/17 | 10.6 | 000-15175 | |
| 10.3D | Form of Restricted Stock Agreement used in connection with the 2003 Equity Incentive Plan* | 10-Q | 10/7/04 | 10.11 | 000-15175 | |
| 10.3E | 2013 Performance Share Program pursuant to the 2003 Equity Incentive Plan* | 8-K | 1/28/13 | 10.2 | 000-15175 | |
| 10.3F | Form of Performance Share Award Grant Notice and Performance Share Award Agreement pursuant to the 2003 Equity Incentive Plan (applicable to the 2013 Performance Share Program)* | 8-K | 1/28/13 | 10.3 | 000-15175 | |
| 10.3G | 2014 Performance Share Program pursuant to the 2003 Equity Incentive Plan* | 8-K | 1/29/14 | 10.2 | 000-15175 | |
| 10.3H | Form of Performance Share Award Grant Notice and Performance Share Award Agreement pursuant to the 2003 Equity Incentive Plan (applicable to the 2014 Performance Share Program)* | 8-K | 1/29/14 | 10.3 | 000-15175 | |
| 10.3I | 2015 Performance Share Program pursuant to the 2003 Equity Incentive Plan* | 8-K | 1/28/15 | 10.2 | 000-15175 | |

| | | | | | |
|---|---|---|---|---|---|
| 10.3J | Form of 2015 Performance Share Award Grant Notice and Award Agreement pursuant to the 2003 Equity Incentive Plan (applicable to the 2015 Performance Share Program)* | 8-K | 1/28/15 | 10.3 | 000-15175 |
| 10.3K | 2016 Performance Share Program pursuant to the 2003 Equity Incentive Plan* | 8-K | 1/29/16 | 10.2 | 000-15175 |

| Exhibit Number | Exhibit Description | Incorporated by Reference** Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
|---|---|---|---|---|---|---|
| 10.3L | Form of 2016 Performance Share Award Grant Notice and Award Agreement pursuant to the 2003 Equity Incentive Plan (applicable to the 2016 Performance Share Program)* | 8-K | 1/29/16 | 10.3 | 000-15175 | |
| 10.3M | Form of Director Initial Grant Restricted Stock Unit Award Agreement used in connection with the 2003 Equity Incentive Plan* | 8-K | 12/20/10 | 99.6 | 000-15175 | |
| 10.3N | Form of Director Annual Grant Restricted Stock Unit Award Agreement used in connection with the 2003 Equity Incentive Plan* | 8-K | 12/20/10 | 99.7 | 000-15175 | |
| 10.3O | Form of Director Annual Grant Stock Option Agreement used in connection with the 2003 Equity Incentive Plan* | 8-K | 12/20/10 | 99.8 | 000-15175 | |
| 10.3P | 2017 Performance Share Program pursuant to the 2003 Equity Incentive Plan* | 8-K | 1/27/17 | 10.2 | 000-15175 | |
| 10.3Q | Form of 2017 Performance Share Award Grant Notice and Award Agreement pursuant to 2017 Performance Share Program and 2003 Equity Incentive Plan* | 8-K | 1/27/17 | 10.3 | 000-15175 | |
| 10.4A | 2005 Equity Incentive Assumption Plan, as amended and restated* | 10-Q | 6/28/13 | 10.17 | 000-15175 | |
| 10.4B | Form of Stock Option Agreement used in connection with the 2005 Equity Incentive Assumption Plan* | 8-K | 12/20/10 | 99.10 | 000-15175 | |
| 10.4C | Form of RSU Grant Notice and Award Agreement pursuant to the 2005 Equity Incentive Assumption Plan* | 8-K | 1/28/13 | 10.7 | 000-15175 | |
| 10.5 | Retention Agreement between Adobe Systems Incorporated and Shantanu Narayen, effective December 5, 2014 | 8-K | 12/11/14 | 10.2 | 000-15175 | |
| 10.6 | Form of Indemnity Agreement* | 10-Q | 6/26/09 | 10.12 | 000-15175 | |
| 10.7 | Adobe Systems Incorporated Deferred Compensation Plan, as Amended and Restated* | 10-K | 1/20/15 | 10.19 | 000-15175 | |
| 10.8A | Credit Agreement, dated as of March 2, 2012, among Adobe Systems Incorporated and certain subsidiaries as Borrowers, The Royal Bank of Scotland PLC and U.S. Bank National Association | 8-K | 3/7/12 | 10.1 | 000-15175 | |

| | | | | | |
|---|---|---|---|---|---|
| | as Co-Documentation Agents, JPMorgan Chase Bank, N.A., as Syndication Agent, Bank of America, N.A. as Administrative Agent and Swing Line Lender, and the Other Lenders Party Thereto | | | | |
| 10.8B | Amendment to Credit Agreement, dated as of July 27, 2015, among Adobe Systems Incorporated and Bank of America, N.A. as Administrative Agent and Swing Line Lender and the Other Lenders Party Thereto | 8-K | 7/30/15 | 10.1 | 000-15175 |

| Exhibit Number | Exhibit Description | Incorporated by Reference** Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
|---|---|---|---|---|---|---|
| 10.9 | Omniture, Inc. 2006 Equity Incentive Plan and related forms* | 10-Q | 8/6/09 | 10.3 | 000-52076 | |
| 10.10 | Omniture, Inc. 2007 Equity Incentive Plan and related forms* | 10-K | 2/27/09 | 10.9 | 000-52076 | |
| 10.11 | Omniture, Inc. 2008 Equity Incentive Plan and related forms* | 10-K | 2/27/09 | 10.10 | 000-52076 | |
| 10.12 | Demdex, Inc. 2008 Stock Plan, as amended* | S-8 | 1/27/11 | 99.1 | 333-171902 | |
| 10.13 | 2014 Executive Annual Incentive Plan* | 8-K | 1/29/14 | 10.5 | 000-15175 | |
| 10.14 | 2015 Executive Annual Incentive Plan* | 8-K | 1/28/15 | 10.5 | 000-15175 | |
| 10.15 | 2016 Executive Annual Incentive Plan* | 8-K | 1/29/16 | 10.5 | 000-15175 | |
| 10.16 | 2016 Executive Cash Performance Bonus Plan* | 8-K | 1/29/16 | 10.4 | 000-15175 | |
| 10.17 | 2017 Executive Annual Incentive Plan* | 8-K | 1/27/17 | 10.5 | 000-15175 | |
| 10.18 | EchoSign, Inc. 2005 Stock Plan, as amended* | S-8 | 7/29/11 | 99.1 | 333-175910 | |
| 10.19 | TypeKit, Inc. 2009 Equity Incentive Plan, as amended* | S-8 | 10/7/11 | 99.1 | 333-177229 | |
| 10.20 | Auditude, Inc. 2009 Equity Incentive Plan, as amended* | S-8 | 11/18/11 | 99.1 | 333-178065 | |
| 10.21 | Auditude, Inc. Employee Stock Option Plan, as amended* | S-8 | 11/18/11 | 99.2 | 333-178065 | |
| 10.22 | Efficient Frontier, Inc. 2003 Stock Option/Stock Issuance Plan, as Amended and Restated* | S-8 | 1/27/12 | 99.1 | 333-179221 | |
| 10.23A | Behance, Inc. 2012 Equity Incentive Plan* | S-8 | 1/23/13 | 99.1 | 333-186143 | |
| 10.23B | Amendment No. 1 to the Behance, Inc. 2012 Equity Incentive Plan* | S-8 | 1/23/13 | 99.2 | 333-186143 | |
| 10.24 | Neolane 2008 Stock Option Plan* | S-8 | 8/27/13 | 99.1 | 333-190846 | |
| 10.25 | 2012 Neolane Stock Option Plan for The United States* | S-8 | 8/27/13 | 99.2 | 333-190846 | |

| | | | | | | |
|---|---|---|---|---|---|---|
| 10.26 | Description of 2015 Director Compensation* | 10-K | 1/20/15 | 10.52 | 000-15175 | |
| 10.27 | Description of 2016 Director Compensation* | 10-K | 1/19/16 | 10.32 | 000-15175 | |
| 10.28 | Description of 2017 Director Compensation* | 10-K | 1/20/17 | 10.32 | 000-15175 | |
| 10.29 | Description of 2018 Director Compensation* | | | | | X |
| 10.30A | Aviary, Inc. 2008 Stock Plan, as amended* | S-8 | 9/26/14 | 99.1 | 333-198973 | |

| Exhibit Number | Exhibit Description | Incorporated by Reference** Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
|---|---|---|---|---|---|---|
| 10.30B | Form of Stock Option Grant Notice and Award Agreement pursuant to the Aviary, Inc. 2008 Stock Plan (Installment Vesting)* | S-8 | 9/26/14 | 99.2 | 333-198973 | |
| 10.30C | Form of Stock Option Grant Notice and Award Agreement pursuant to the Aviary, Inc. 2008 Stock Plan (Installment Vesting, Non- U.S.)* | S-8 | 9/26/14 | 99.3 | 333-198973 | |
| 10.31 | Adobe Systems Incorporated 2014 Executive Severance Plan in the Event of a Change of Control* | 8-K | 12/11/14 | 10.1 | 000-15175 | |
| 10.32 | Picasso Acquisition Holding 1, Inc. 2012 Stock Option and Grant Plan* | S-8 | 3/13/15 | 99.1 | 333-202732 | |
| 10.33 | TubeMogul, Inc. 2007 Equity Compensation Plan, as amended, and forms of agreement thereunder††* | S-1 | 3/26/14 | 10.2 | 333-194817 | |
| 10.34 | TubeMogul, Inc. 2014 Equity Incentive Plan, and forms of agreement thereunder††* | S-1A | 7/7/14 | 10.3 | 333-194817 | |
| 12.1 | Ratio of Earnings to Fixed Charges | | | | | X |
| 21 | Subsidiaries of the Registrant | | | | | X |
| 23.1 | Consent of Independent Registered Public Accounting Firm, KPMG LLP | | | | | X |
| 24.1 | Power of Attorney (set forth on the signature page to this Annual Report on Form 10-K) | | | | | X |
| 31.1 | Certification of Chief Executive Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934 | | | | | X |
| 31.2 | Certification of Chief Financial Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934 | | | | | X |
| 32.1 | Certification of Chief Executive Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934† | | | | | X |
| 32.2 | Certification of Chief Financial Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934† | | | | | X |

| | | |
|---|---|---|
| 99.1 | Press release issued on January 22, 2018 entitled "Adobe Updates Q1 and Fiscal Year 2018 Financial Targets" (furnished) | X |
| 101.INS | XBRL Instance | X |
| 101.SCH | XBRL Taxonomy Extension Schema | X |
| 101.CAL | XBRL Taxonomy Extension Calculation | X |

| Exhibit Number | Exhibit Description | Incorporated by Reference** Form | Filing Date | Exhibit Number | SEC File No. | Filed Herewith |
|---|---|---|---|---|---|---|
| 101.LAB | XBRL Taxonomy Extension Labels | | | | | X |
| 101.PRE | XBRL Taxonomy Extension Presentation | | | | | X |
| 101.DEF | XBRL Taxonomy Extension Definition | | | | | X |

* Compensatory plan or arrangement.

** References to Exhibits 10.9 through 10.11 are to filings made by Omniture, Inc.

† The certifications attached as Exhibits 32.1 and 32.2 that accompany this Annual Report on Form 10-K, are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Adobe Systems Incorporated under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Form 10-K, irrespective of any general incorporation language contained in such filing.

†† References to Exhibits 10.33 through 10.34 are to filings made by TubeMogul, Inc.

**ITEM 16. FORM 10-K SUMMARY**

None.

Table of Contents

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ADOBE SYSTEMS INCORPORATED

By: /s/ MARK GARRETT
Mark Garrett
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: January 22, 2018

## POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Shantanu Narayen and Mark Garrett, and each or any one of them, his or her lawful attorneys-in-fact and agents, for such person in any and all capacities, to sign any and all amendments to this report and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that either of said attorneys-in-fact and agent, or substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ SHANTANU NARAYEN<br>Shantanu Narayen | Chairman of the Board of Directors, President and Chief Executive Officer (Principal Executive Officer) | January 22, 2018 |
| /s/ MARK GARRETT<br>Mark Garrett | Executive Vice President and Chief Financial Officer (Principal Financial Officer) | January 22, 2018 |
| /s/ JOHN MURPHY<br>John Murphy | Senior Vice President, Corporate Controller and Chief Accounting Officer (Principal Accounting Officer) | January 22, 2018 |
| /s/ JAMES DALEY<br>James Daley | Director | January 22, 2018 |
| /s/ AMY BANSE<br>Amy Banse | Director | January 22, 2018 |

| | | |
|---|---|---|
| /s/ EDWARD BARNHOLT | | January 22, 2018 |
| Edward Barnholt | Director | |

| Signature | Title | Date |
|---|---|---|
| /s/ ROBERT BURGESS<br>Robert Burgess | Director | January 22, 2018 |
| /s/ FRANK CALDERONI<br>Frank Calderoni | Director | January 22, 2018 |
| /s/ LAURA DESMOND<br>Laura Desmond | Director | January 22, 2018 |
| /s/ CHARLES GESCHKE<br>Charles Geschke | Director | January 22, 2018 |
| /s/ DANIEL ROSENSWEIG<br>Daniel Rosensweig | Director | January 22, 2018 |
| /s/ JOHN WARNOCK<br>John Warnock | Director | January 22, 2018 |

## SUMMARY OF TRADEMARKS

The following trademarks of Adobe Systems Incorporated or its subsidiaries, which may be registered in the United States and/or other countries, are referenced in this Form 10-K:

Acrobat
Acrobat Reader
Adobe
Adobe Connect
Adobe CreativeSync
Adobe Dimension
Adobe Premiere
Adobe Sensei
After Effects
Behance
Creative Cloud
Fotolia
Illustrator
InDesign
Lightroom
LiveCycle
Photoshop
PostScript
Reader
Tubemogul
Typekit

All other trademarks are the property of their respective owners.