



Adobe Inc

Valuations remain expensive

UNITED STATES | SOFTWARE | 4Q23 RESULTS

19 December 2023

- 4Q23 results met our expectations. FY23 revenue/PATMI were at 100%/101% of our FY23e forecasts. 4Q23 PATMI increased 26% YoY to US\$1.5bn driven by higher operating leverage, lower taxes, and higher interest income.
- For FY24e, Adobe expects adj. EPS to grow by 11% YoY to US\$17.80 on total revenues of US\$21.4bn, up 10% YoY. Management signaled that the AI-related boost and recent price hike for its Creative Cloud offerings would take longer to materialize.
- We maintain a **REDUCE** recommendation with a higher DCF target price of US\$465 (WACC 7.3%, g 4%), up from US\$441. We cut our FY24e revenue by 1% to account for lower-than-expected pricing impact, while increasing FY24e PATMI by 3% to reflect lower expenses. However, we believe ADBE valuations remain expensive as its market cap is up about 60% or US\$100bn over the last six months on an annual incremental profit opportunity of US\$4bn assuming Creative Cloud revenue doubles with its generative AI functionality Firefly.

Results at a glance

US\$ bn	4Q23	4Q22	YoY	Comments
Revenue	5.0	4.5	11.6%	13% YoY growth in constant currency
- Digital Media	3.7	3.3	12.6%	Driven by Creative Cloud (12% YoY) and Document Cloud (16%)
- Digital Experience	1.3	1.2	10.1%	
Gross profit	4.4	4.0	11.5%	Gross margin of 87% driven by recurring subscription revenue model
Operating Expenses	2.7	2.5	8.9%	
Operating Income	1.7	1.5	15.8%	
PATMI	1.5	1.2	26.1%	
EPS (\$)	3.23	2.53	27.7%	Ahead of company guidance range of US\$3.10 - US\$3.15
Adj. PATMI	2.0	1.7	17.0%	Excludes stock-based compensation, acquisition-related, and amortization of intangibles expenses
Adj. EPS (\$)	4.27	3.60	18.6%	Ahead of company guidance range of US\$4.10 - US\$4.15

Source: Company, PSR

The Positives

+ Revenue growth driven by Digital Media vertical. 4Q23 revenue grew 12% YoY to US\$5.0bn, in line with the company guidance. Digital Media segment revenue rose 13% YoY to US\$3.7bn led by higher subscription sales for its creative software applications. Adobe's Creative Cloud unit, which makes up 80% of Digital Media segment revenues, reported revenue growth of 12% YoY to US\$3.0bn. The growth was mainly led by strong demand for its photography and video editing applications (Photoshop and Illustrator). Management highlighted that users have generated over 4.5bn images so far using its generative AI functionality Firefly compared with 3bn in October. Document Cloud revenue grew by 16% YoY to US\$721mn (20% of Digital Media revenues) driven by continued demand for PDF and e-signature solutions. Management highlighted that Acrobat Web's monthly active users, or MAUs, spiked 70% YoY while Acrobat Mobile surpassed 100mn MAUs in the quarter.

+ Improvements in margins. Adobe reported an impressive gross margin of 87% as the company reports the bulk of its sales from recurring revenue. Operating margins expanded 120bps YoY driven by continued focus on operational discipline, including careful investments in research and development as well as sales and marketing. Net margins expanded 340bps YoY driven by higher operating leverage, lower tax expense, and a 2.5x increase in interest income. PATMI rose 26% YoY to US\$1.5bn.

REDUCE (Maintained)

CLOSING PRICE	USD 599.13
FORECAST DIV	USD 0.00
TARGET PRICE	USD 465.00
TOTAL RETURN	-22.4%

COMPANY DATA

Bloomberg CODE:	ADBE US
O/S SHARES (MN):	455
MARKET CAP (SGD bn / USD bn):	363 / 273
52 - WK HI/LO (USD):	633.89 / 318.6
3M Average Daily T/O (mn):	2.91

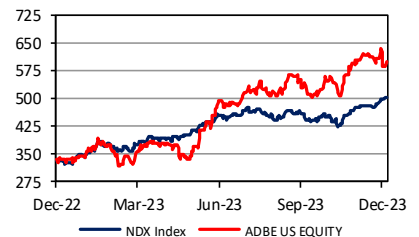
MAJOR SHAREHOLDERS

Vanguard Group Inc/The	8.7%
BlackRock Inc	8.0%
State Street Corp	4.1%

PRICE PERFORMANCE (%)

	1MTH	3MTH	YTD
COMPANY	(1.8)	10.5	73.7
NASDAQ RETURN	5.2	9.6	53.2

PRICE VS. NASDAQ



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Nov, USD (bn)	FY22	FY23	FY24e	FY25e
Revenue	17.6	19.4	21.5	24.1
EBITDA	7.0	7.5	8.5	9.6
PATMI	4.8	5.4	6.3	7.1
PATMI, Adjusted	6.5	7.4	8.1	9.1
EPS	10.1	11.8	13.8	15.7
P/E (X) - Adjusted	43.7	37.3	33.5	29.6
ROE	33.8%	32.9%	29.2%	25.3%
ROA	17.5%	18.2%	17.8%	16.7%

Source: Company, PSR

VALUATION METHOD

Discounted Cash-Flow, WACC 7.3%, g 4.0%

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The Negative

- **Soft FY24e revenue guidance.** For FY24e, Adobe expects total revenue to grow 10% YoY to US\$21.4bn at the midpoint, which was below our estimate of US\$21.8bn. The soft guidance was primarily due to a lower-than-expected impact from the pricing changes. Management highlighted that the price increase in November would impact less than half of the Creative Cloud base and expects a material impact in 2H24e and beyond.

Outlook

For 1Q24e, Adobe is guiding for revenue of US\$5.1bn, up 10% YoY, and adj. EPS of US\$4.38, both at the midpoint of its guidance (Figure 1). The Digital Media segment's revenue is expected to grow by 11% YoY to US\$3.8bn driven by subscriber gains and new product innovations. Net new annualised recurring revenue in the Digital Media segment is forecasted to be US\$410mn due to rising digital content creation and a shift to electronic document processes.

For FY24e, Adobe expects adj. EPS of US\$17.80 on total revenue of US\$21.4bn at the midpoint (10% YoY growth). The growth would be again driven by its Digital Media segment with net new annualised recurring revenue of US\$1.9bn. Management noted that the outlook takes into consideration FX headwinds and macroeconomic uncertainty as it still faces cautious enterprise buying behaviour. Adobe is witnessing strong early adoption for its generative AI functionality Firefly as about 4.5bn images have been generated on the platform so far. We believe that Firefly should enhance Adobe's competitive position but is not expected to meaningfully contribute to its top-line growth in the near term.

On Dec. 18, Adobe and Figma announced that both companies are mutually terminating their proposed US\$20bn merger deal following increasing pressure from regulatory authorities in the U.K. and European Union. Adobe will pay Figma a US\$1bn termination fee. In addition, Adobe is facing an investigation from the Federal Trade Commission regarding its subscriber cancellation practices. Management said its past behaviour was lawful but cautioned that the matter might have a material impact on its financial results.

Figure 1: Adobe forecasts 10% YoY revenue growth for FY24e

US\$ bn	Adobe		PSR
	1Q24e	FY24e	FY24e
Revenue	5.10 - 5.15	21.30 - 21.50	21.5
- Digital Media	3.77 - 3.80	15.75 - 15.85	15.9
- Digital Experience	1.27 - 1.29	5.28 - 5.38	5.3
GAAP EPS (\$)	3.35 - 3.40	13.45 - 13.85	13.81
Adj. EPS (\$)*	4.35 - 4.40	17.60 - 18.00	17.87

Source: Company, PSR

Note - Adj. EPS excludes stock based compensation expense and amortization of intangibles

RULE OF 40

The "Rule of 40" was first introduced as a benchmark to measure the balance between growth and profitability of SaaS companies, taking into account both revenue growth, as well as profitability (Revenue Growth + EBITDA Margins), with the addition of both metrics needing to exceed the 40% threshold. We have modified this slightly by averaging revenue growth over a 3-year period compared with just a single-period growth rate. Adding together Adobe's 3-year average revenue growth of 15% and its EBITDA margin of 39%, the total of 54% is more than our required threshold of 40% (Figure 2).

Maintain REDUCE with higher TP of US\$465.00 (prev. US\$441.00)

We maintain a REDUCE recommendation with a higher DCF target price of US\$465 (WACC 7.3%, g 4%), up from US\$441. We cut our FY24e revenue by 1% to account for lower-than-expected pricing impact, while increasing FY24e PATMI by 3% to reflect lower expenses. However, we believe ADBE valuations remain expensive as its market cap is up about 60% or US\$100bn over the last six months on an annual incremental profit opportunity of US\$4bn assuming Creative Cloud revenue doubles with its generative AI functionality Firefly.

Figure 2: Rule of 40 calculation meets 40% threshold

Rule of 40

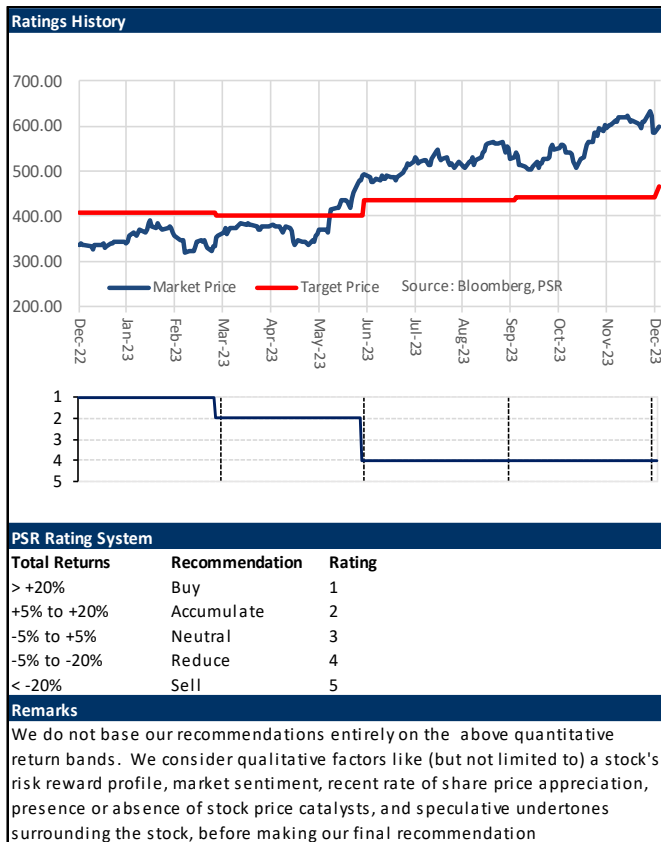
3 Year Average Revenue Growth	Adj. EBITDA Margin	Total
15%	39%	54%

Source: Company, PSR

Asian Hours Trading

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Financials

Income Statement

Y/E Nov, USD mn	FY21	FY22	FY23	FY24e	FY25e
Revenue	15,785	17,606	19,409	21,544	24,101
Gross Profit	13,920	15,441	17,055	18,942	21,175
EBITDA	6,590	6,954	7,522	8,550	9,583
Depreciation & Amortization	(788)	(856)	(872)	(913)	(974)
EBIT	5,802	6,098	6,650	7,637	8,609
Interest Expense	(113)	(112)	(113)	(113)	(113)
Other Income (expense), net	16	22	262	191	191
Profit before tax	5,705	6,008	6,799	7,715	8,687
Taxation	(883)	(1,252)	(1,371)	(1,434)	(1,613)
PATMI	4,822	4,756	5,428	6,281	7,074
PATMI, Adjusted	6,003	6,457	7,377	8,125	9,103

Per share data (USD)

Y/E Nov	FY21	FY22	FY23	FY24e	FY25e
Diluted EPS	10.02	10.10	11.83	13.81	15.74
Diluted EPS, Adjusted	12.48	13.71	16.07	17.87	20.25
DPS	-	-	-	-	-
BVPS	30.76	29.83	35.99	47.28	62.28

Cash Flow

Y/E Nov, USD mn	FY21	FY22	FY23	FY24e	FY25e
CFO					
Profit after tax (GAAP)	4,822	4,756	5,428	6,281	7,074
Adjustments	2,116	2,746	2,229	3,160	3,448
WC Changes	292	336	(355)	(250)	(200)
Cash Flow from Operations	7,230	7,838	7,302	9,190	10,322
CFI					
CAPEX, net	(348)	(442)	(360)	(457)	(500)
Others	(3,189)	(128)	1,136	(100)	(100)
Cash Flow from Investing	(3,537)	(570)	776	(557)	(600)
CFF					
Debt, net of repayments	-	-	(500)	-	-
Others	(4,301)	(6,825)	(4,682)	(3,200)	(2,700)
Cash Flow from Financing	(4,301)	(6,825)	(5,182)	(3,200)	(2,700)
Net Change in Cash	(634)	392	2,905	5,434	7,022
CCE, end	3,844	4,236	7,141	12,575	19,597

Balance Sheet

Y/E Nov, USD mn	FY21	FY22	FY23	FY24e	FY25e
ASSETS					
Cash & Cash Equivalents	3,844	4,236	7,141	12,575	19,597
Others	4,825	4,760	3,943	4,793	5,643
Total current assets	8,669	8,996	11,084	17,368	25,240
PPE & IA	16,161	16,144	15,923	15,467	14,992
Deferred income taxes	1,085	777	1,191	941	691
Others	1,326	1,248	1,581	1,481	1,381
Total non-current assets	18,572	18,169	18,695	17,889	17,064
Total Assets	27,241	27,165	29,779	35,257	42,304

LIABILITIES

Account Payables	312	379	314	339	364
Accrued Expenses	1,736	1,790	1,942	1,842	1,742
ST Debt	-	500	-	-	-
Others	4,884	5,459	5,995	6,570	7,195
Total current liabilities	6,932	8,128	8,251	8,751	9,301
LT Debt	4,123	3,629	3,634	3,634	3,634
Income Tax Payable	534	530	514	514	514
Others	855	827	862	862	862
Total non-current liabilities	5,512	4,986	5,010	5,010	5,010
Total liabilities	12,444	13,114	13,261	13,761	14,311

Equity

Share Capital & APIC	8,428	9,868	11,586	12,993	14,626
Shareholder Equity	14,797	14,051	16,518	21,496	27,993

Valuation Ratios

Y/E Nov	FY21	FY22	FY23	FY24e	FY25e
P/E (X) - Adjusted	48.0	43.7	37.3	33.5	29.6
P/B (X)	19.5	20.1	16.6	12.7	9.6
EV/EBITDA (X)	43.8	40.6	36.1	30.8	26.4
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%

Growth & Margins

Growth					
Revenue	22.7%	11.5%	10.2%	11.0%	11.9%
EBITDA	32.0%	5.5%	8.2%	13.7%	12.1%
EBIT	36.9%	5.1%	9.1%	14.8%	12.7%
Net profit, reported	-8.3%	-1.4%	14.1%	15.7%	12.6%
Margins					
Gross margin	88.2%	87.7%	87.9%	87.9%	87.9%
EBITDA margin	41.7%	39.5%	38.8%	39.7%	39.8%
EBIT margin	36.8%	34.6%	34.3%	35.4%	35.7%
Net profit margin, reported	30.5%	27.0%	28.0%	29.2%	29.4%

Key Ratios

ROE	32.6%	33.8%	32.9%	29.2%	25.3%
ROA	17.7%	17.5%	18.2%	17.8%	16.7%
Net Gearing	1.9%	nm	nm	nm	nm
Net Debt/EBITDA (X)	0.0	nm	nm	nm	nm

Source: Company, Phillip Securities Research (Singapore) Estimates

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