

Adobe Inc.

No More Figma Dilution, Upside to Numbers, Still Beginning on Firefly; Upgrading to OW

We are upgrading Adobe to OW from EW following the news that the two companies will no longer pursue the deal. Implied dilution has kept us on the sideline since deal announcement - now that this overhang is lifted, we think upside to estimates and more optionality in Firefly could support this multiple. More below...

Following the news this morning that Adobe will no longer pursue the acquisition of Figma, we are upgrading to OW from EW. Three key points: (1) key catalyst for the upgrade is the Figma acquisition is no longer happening, which means that dilution that was implied in the deal will not occur, and that was our main sticking point on the sidelines; (2) we think it is still early innings on Gen AI, with optionality around Adobe Express, improving retention rates as Gen AI drives more engagement, and we have not seen Gen AI impact Document Cloud yet where there could be more opportunity to monetize; and (3) while this name has out-performed and is not cheap, Adobe is a best-in-class software franchise and we think upside to estimates (now that this Figma overhang is lifted) could support continued out-performance.

- **Figma deal no longer happening, which means no dilution as we feared - this was our biggest reason for being EW previously.** Adobe and Figma announced this morning that the two companies would no longer pursue the \$20B acquisition. While we did believe that the deal was positive for Adobe in the longer term, the 50/50 mix of cash and stock as well as the further dilution to EPS from combining the businesses has had us on the sidelines since the deal was initially announced in September 2022. Now, the dilution that we previously feared from the deal will not occur, and we believe that the company can consistently grow top and bottom line 10-15% through its leadership in DM and DX with Gen AI tailwinds, which we discuss below.
- **GenAI story is well known - but we think its just the beginning with optionality around Adobe Express, improving retention rates, and Document Cloud.** While Adobe did have some AI capabilities, like Adobe Sensei, when the Figma acquisition was originally announced, consensus did not believe this would be as large of a revenue driver as Firefly and its Gen AI products and features would be today. Clearly, this is different now with Gen AI driving price increases in FY24 that will add ~\$300M in net new ARR, by our estimates, but we think there could be more to go than what currently is modelled in to Street

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CORE Rating Change

ADBE	OVERWEIGHT from Equal Weight
U.S. Software	POSITIVE Unchanged
Price Target	USD 700.00 raised 3% from USD 680.00
Price (15-Dec-23)	USD 584.68
Potential Upside/Downside	+19.7%

Market Cap (USD mn)	266204
Shares Outstanding (mn)	455.30
Free Float (%)	99.76
52 Wk Avg Daily Volume (mn)	3.1
Dividend Yield (%)	N/A
Return on Equity TTM (%)	35.51
Current BVPS (USD)	36.28
Source: Bloomberg	

Price Performance	Exchange-Nasdaq
52 Week range	USD 633.89-318.60



Source: IDC
[Link to Barclays Live for interactive charting](#)

U.S. Software

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numbers. First, Firefly capabilities embedded in Adobe Express is a clear competitive advantage to others that may need to partner with open source AI vendors as well as the general advantage of owning the workflow. Second, we believe Adobe has strong retention rates, but we could see them increasing moderately as Gen AI drives more engagement. Third, while document cloud posted a strong 4Q, we think trends like Mobile and high growth in MAU on the web provide a strong and growing base to monetize through Gen AI capabilities, which we have not seen yet.

- **Stock has outperformed - but we would not be surprised to see FY24 and FY25 estimates march up, so with this overhang behind us, we upgrade to OW and tweak our PT up to \$700.** At low-30s/high-20s PE ratio on FY24 and 25, the stock is arguably not cheap vs other design and large cap software names, but we think, based on where FY24 guide was set, there will be room for multiple quarters of beats and raises throughout the year given the momentum and trends aforementioned. Thus, we think results will be able to support the premium valuation for this best-in-class software franchise and raise our rating to OW from EW, and while the stock has outperformed, the termination lifts an overhang prompting us to tweak our multiple higher, arriving at a PT of \$700 based on 35x our FY25 EPS of 19.79.

ADBE: Quarterly and Annual EPS (USD)

	2023	2024			2025			Change y/y	
FY Nov	Actual	Old	New	Cons	Old	New	Cons	2024	2025
Q1	3.80A	4.38E	4.38E	4.38E	4.76E	4.76E	4.86E	15%	9%
Q2	3.91A	4.40E	4.40E	4.39E	4.89E	4.89E	5.00E	13%	11%
Q3	4.09A	4.46E	4.46E	4.52E	5.01E	5.01E	5.13E	9%	12%
Q4	4.27A	4.57E	4.57E	4.68E	5.13E	5.13E	5.33E	7%	12%
Year	16.06A	17.80E	17.80E	17.95E	19.79E	19.79E	20.39E	11%	11%
P/E	36.4		32.8			29.6			

Consensus numbers are from Bloomberg received on 18-Dec-2023; 13:50 GMT
Source: Barclays Research

U.S. Software

POSITIVE

Adobe Inc. (ADBE)

OVERWEIGHT

Income statement (\$mn)	2023A	2024E	2025E	2026E	CAGR
Revenue	19,409	21,400	23,585	N/A	N/A
EBITDA (adj)	9,417	10,239	11,340	N/A	N/A
Operating profit (adj)	8,918	9,737	10,801	N/A	N/A
Pre-tax income (adj)	9,051	9,920	10,909	N/A	N/A
Net income (adj)	7,377	8,085	8,891	N/A	N/A
EPS (adj) (\$)	16.06	17.80	19.79	N/A	N/A
Diluted shares (mn)	459.3	454.1	449.4	N/A	N/A
DPS (\$)	0.00	0.00	0.00	N/A	N/A
Margin and return data	2023A	2024E	2025E	2026E	Average
EBITDA (adj) margin (%)	48.5	47.8	48.1	N/A	48.1
Operating margin (adj) (%)	45.9	45.5	45.8	N/A	45.7
Pre-tax (adj) margin (%)	46.6	46.4	46.3	N/A	46.4
Net (adj) margin (%)	38.0	37.8	37.7	N/A	37.8
ROIC (%)	21.3	20.9	20.2	N/A	20.8
ROA (%)	24.8	23.4	22.1	N/A	23.4
ROE (%)	24.8	23.4	22.1	N/A	23.4
Balance sheet and cash flow (\$mn)	2023A	2024E	2025E	2026E	CAGR
Net PP&E	2,030	1,928	1,790	N/A	N/A
Goodwill	12,805	12,805	12,805	N/A	N/A
Cash and equivalents	7,842	12,361	17,840	N/A	N/A
Total assets	29,779	34,606	40,297	N/A	N/A
Short and long-term debt	3,634	3,634	3,634	N/A	N/A
Other long-term liabilities	376	376	376	N/A	N/A
Total liabilities	13,261	13,945	14,643	N/A	N/A
Net debt/(funds)	-4,208	-8,727	-14,206	N/A	N/A
Shareholders' equity	16,518	20,660	25,654	N/A	N/A
Change in working capital	-345	-136	-64	N/A	N/A
Cash flow from operations	7,302	8,919	9,879	N/A	N/A
Capital expenditure	-360	-400	-400	N/A	N/A
Free cash flow	6,942	8,519	9,479	N/A	N/A
Valuation and leverage metrics	2023A	2024E	2025E	2026E	Average
P/E (adj) (x)	36.4	32.8	29.6	N/A	32.9
EV/sales (x)	13.6	12.3	11.2	N/A	12.4
EV/EBITDA (adj) (x)	28.1	25.8	23.3	N/A	25.7
Equity FCF yield (%)	2.6	3.2	3.6	N/A	3.1
Dividend yield (%)	0.0	0.0	0.0	N/A	0.0
Net debt/EBITDA (adj) (x)	-0.4	-0.9	-1.3	N/A	-0.9
Total debt/capital (%)	18.0	15.0	12.4	N/A	15.1
Selected operating metrics (\$mn)	2023A	2024E	2025E	2026E	CAGR
License revenue	460	487	475	N/A	N/A
Maintenance revenue	18,284	20,321	22,534	N/A	N/A
Services revenue	665	592	577	N/A	N/A
Deferred revenue	5,950	6,490	7,083	N/A	N/A

Note: FY End Nov

Source: Company data, Bloomberg, Barclays Research

Price (15-Dec-2023) **USD 584.68**
 Price Target **USD 700.00**

Why OVERWEIGHT?

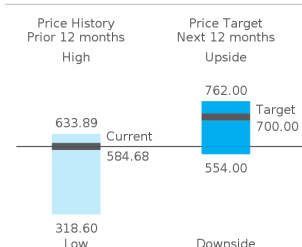
We think the business can organically grow at a LDD CAGR through FY25 with the potential to grow EPS faster given ADBE's leadership position in Creative Cloud, Document Cloud, and Experience Cloud. We think this name is a clear beneficiary of Gen AI, which we think drives better engagement, retention, and new business.

Upside case **USD 762.00**

Our upside case of \$762 assumes FY25E EPS comes in 10% higher than our estimates, and we apply a ~35x multiple.

Downside case **USD 554.00**

Our downside case of \$554 is based on 28x our FY25E EPS of \$19.79.

Upside/Downside scenarios

Valuation

Our new price target of \$700 is based on 35x our FY25E EPS of \$19.79. Our prior price target of \$680 was based on ~34x our FY25E EPS of \$19.79.

FIGURE 1. ADBE Non-GAAP Income Statement (\$ in millions)

	FY 2020	FY 2021	Feb-22	May-22	Aug-22	Nov-22	FY 2022	Feb-23	May-23	Aug-23	Nov-23	FY 2023	Feb-24E	May-24E	Aug-24E	Nov-24E	FY 2024E	FY 2025E
Products	507.0	555.0	145.0	146.0	126.0	115.0	532.0	120.0	130.0	96.0	114.0	460.0	131.3	131.0	107.9	116.8	487.1	474.6
y/y Change	-21.7%	9.5%	-6.5%	-4.6%	5.9%	-10.2%	-4.1%	-17.2%	-11.0%	-23.8%	-0.9%	-13.5%	9.4%	0.8%	12.4%	2.5%	5.9%	-2.6%
Subscription	11,814.0	14,573.0	3,958.0	4,070.0	4,128.0	4,232.0	16,388.0	4,373.0	4,517.0	4,631.0	4,763.0	18,284.0	4,872.5	5,014.7	5,151.7	5,282.3	20,321.2	22,533.8
y/y Change	18.2%	23.4%	10.4%	15.6%	12.9%	11.0%	12.5%	10.5%	11.0%	12.2%	12.5%	11.6%	11.4%	11.0%	11.2%	10.9%	11.1%	10.9%
Services and Other	547.0	657.0	159.0	170.0	179.0	178.0	686.0	162.0	169.0	163.0	171.0	665.0	121.2	160.2	149.0	161.3	591.7	576.5
y/y Change	3.4%	20.1%	-4.2%	4.9%	12.6%	4.7%	4.4%	1.9%	-0.6%	-8.9%	-3.9%	-3.1%	-25.2%	-5.2%	-8.6%	-5.7%	-11.0%	-2.6%
Total Revenue	12,868.0	15,785.0	4,262.0	4,386.0	4,433.0	4,525.0	17,606.0	4,655.0	4,816.0	4,890.0	5,048.0	19,409.0	5,125.0	5,305.9	5,408.6	5,560.5	21,400.0	23,584.9
y/y Change	15.2%	22.7%	9.1%	14.4%	12.7%	10.1%	11.5%	9.2%	9.8%	10.3%	11.6%	10.2%	10.1%	10.2%	10.6%	10.2%	10.3%	10.2%
Cost of Products	36.0	41.0	10.0	9.0	8.0	8.0	35.0	8.0	8.0	7.0	6.0	29.0	9.2	9.4	7.8	8.4	34.8	34.2
% of Revenue	0.3%	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.1%	0.1%	0.1%	0.2%	0.2%	0.1%	0.2%	0.2%	0.1%
Cost of Subscription	1,077.5	1,188.5	332.1	350.1	354.1	370.1	1,406.5	379.1	381.1	395.1	410.1	1,565.5	419.0	431.3	443.0	454.3	1,747.6	1,937.9
% of Revenue	8.4%	7.5%	7.8%	8.0%	8.0%	8.2%	8.0%	8.1%	7.9%	8.1%	8.1%	8.1%	8.2%	8.1%	8.2%	8.2%	8.2%	8.2%
Cost of Services and Other	349.5	385.5	90.9	97.9	100.9	106.9	396.5	97.9	100.9	97.9	97.9	394.5	71.5	94.5	87.9	95.2	349.1	334.4
% of Revenue	2.7%	2.4%	2.1%	2.2%	2.3%	2.4%	2.3%	2.1%	2.1%	2.0%	1.9%	2.0%	1.4%	1.8%	1.6%	1.7%	1.6%	1.4%
Total Cost of Goods Sold	1,463.0	1,615.0	433.0	457.0	463.0	485.0	1,838.0	485.0	490.0	500.0	514.0	1,989.0	499.7	535.2	538.7	557.9	2,131.5	2,306.5
Gross Profit	11,405.0	14,170.0	3,829.0	3,929.0	3,970.0	4,040.0	15,768.0	4,170.0	4,326.0	4,390.0	4,534.0	17,420.0	4,625.2	4,770.7	4,869.9	5,002.6	19,268.5	21,278.5
Gross Margin %	88.6%	89.8%	89.8%	89.6%	89.6%	89.3%	89.6%	89.6%	89.8%	89.8%	89.8%	89.8%	90.2%	89.9%	90.0%	90.0%	90.0%	90.2%
Operating Expenses																		
Sales & Marketing	3,326.0	4,008.0	1,068.0	1,150.0	1,156.0	1,183.0	4,557.0	1,179.0	1,220.0	1,205.0	1,247.0	4,851.0	1,255.6	1,347.7	1,390.0	1,429.0	5,422.4	6,037.5
% of Revenue	25.8%	25.4%	25.1%	26.2%	26.1%	26.1%	25.9%	25.3%	25.3%	24.6%	24.7%	25.0%	24.5%	25.4%	25.7%	25.7%	25.3%	25.6%
Research & Development	1,712.0	1,984.0	545.0	564.0	589.0	572.0	2,270.0	618.0	649.0	654.0	670.0	2,591.0	691.9	705.7	724.8	745.1	2,867.4	3,071.7
% of Revenue	13.3%	12.6%	12.8%	12.9%	13.3%	12.6%	12.9%	13.3%	13.5%	13.4%	13.3%	13.3%	13.5%	13.3%	13.4%	13.4%	13.4%	13.0%
General & Administrative	846.0	919.0	223.0	241.0	270.0	262.0	996.0	242.0	277.0	267.0	274.0	1,060.0	287.0	307.7	319.1	328.1	1,241.9	1,367.9
% of Revenue	6.6%	5.8%	5.2%	5.5%	6.1%	5.8%	5.7%	5.2%	5.8%	5.5%	5.4%	5.5%	5.6%	5.8%	5.9%	5.9%	5.8%	5.8%
Total Operating Expenses	5,884.0	6,911.0	1,836.0	1,955.0	2,015.0	2,017.0	7,823.0	2,039.0	2,146.0	2,126.0	2,191.0	8,502.0	2,234.5	2,361.1	2,433.9	2,502.2	9,531.7	10,477.1
Operating Income	5,521.0	7,259.0	1,993.0	1,974.0	1,955.0	2,023.0	7,945.0	2,131.0	2,180.0	2,264.0	2,343.0	8,918.0	2,390.8	2,409.6	2,436.0	2,500.4	9,736.7	10,801.3
Operating Margin %	42.9%	46.0%	46.8%	45.0%	44.1%	44.7%	45.1%	45.8%	45.3%	46.3%	46.4%	45.9%	46.6%	45.4%	45.0%	45.0%	45.5%	45.8%
Total Other Income/(Expense)	(74.0)	(113.0)	(28.0)	(29.0)	(22.0)	8.0	(71.0)	11.0	21.0	40.0	61.0	133.0	57.1	46.1	43.7	36.4	183.3	108.1
Pretax Income	5,447.0	7,146.0	1,965.0	1,945.0	1,933.0	2,031.0	7,874.0	2,142.0	2,201.0	2,304.0	2,404.0	9,051.0	2,447.9	2,455.7	2,479.7	2,536.8	9,920.1	10,909.4
Pretax Margin %	42.3%	45.3%	46.1%	44.3%	43.6%	44.9%	44.7%	46.0%	45.7%	47.1%	47.6%	46.6%	47.8%	46.3%	45.8%	45.6%	46.4%	46.3%
Non-GAAP Net Income	4,903.0	6,003.0	1,602.0	1,585.0	1,595.0	1,675.0	6,457.0	1,746.0	1,794.0	1,878.0	1,959.0	7,377.0	1,995.0	2,001.4	2,021.0	2,067.5	8,084.9	8,891.2
Net Margin	38.1%	38.0%	37.6%	36.1%	36.0%	37.0%	36.7%	37.5%	37.3%	38.4%	38.8%	38.0%	38.9%	37.7%	37.4%	37.2%	37.8%	37.7%
EPS-Diluted	\$10.10	\$12.47	\$3.37	\$3.35	\$3.40	\$3.59	\$13.72	\$3.80	\$3.91	\$4.09	\$4.27	\$16.06	\$4.38	\$4.40	\$4.46	\$4.57	\$17.80	\$19.79
Diluted Shares Outstanding (in MM)	485.6	481.3	475.0	473.0	469.0	466.0	470.8	460.0	459.0	459.0	459.0	459.3	456.0	454.9	453.5	452.1	454.1	449.4
y/y Change	28.3%	23.5%	7.5%	10.7%	9.3%	12.3%	10.0%	12.5%	16.6%	20.3%	18.7%	17.1%	15.3%	12.6%	8.9%	7.1%	10.8%	11.1%

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Primary Stocks (Ticker, Date, Price)

Adobe Inc. (ADBE, 15-Dec-2023, USD 584.68), Overweight/Positive, CD/CE/J

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In addition to the stock rating, we provide industry views which rate the outlook for the industry coverage universe as Positive, Neutral or Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

Stock Rating

Overweight - The stock is expected to outperform the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

Equal Weight - The stock is expected to perform in line with the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

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Neutral - industry coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.

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U.S. Software

8x8 Inc. (EGHT)	Adobe Inc. (ADBE)	Alarm.com Holdings, Inc. (ALRM)
Alkami Technology, Inc. (ALKT)	Ansys, Inc. (ANSS)	Appian Corporation (APPN)
Atlassian (TEAM)	AudioCodes Ltd. (AUDC)	Autodesk Inc. (ADSK)
Bandwidth Inc. (BAND)	BigCommerce (BIGC)	Braze Inc. (BRZE)
CCC Intelligent Solutions (CCCS)	Ceridian HCM Holding Inc. (CDAY)	Check Point Software Technologies Ltd. (CHKP)

Confluent, Inc. (CFLT)	Couchbase (BASE)	CrowdStrike Holdings, Inc (CRWD)
CyberArk Software (CYBR)	Datadog, Inc. (DDOG)	Definitive Healthcare Corp (DH)
Descartes Systems Group (DSGX)	DigitalOcean (DOCN)	DoubleVerify Holdings, Inc. (DV)
Dynatrace, Inc. (DT)	Elastic N.V. (ESTC)	Everbridge, Inc. (EVBG)
EverCommerce Inc. (EVCN)	Five9, Inc. (FIVN)	Fortinet, Inc. (FTNT)
Freshworks Inc. (FRSH)	Gen Digital Inc. (GEN)	GitLab Inc. (GTLB)
HubSpot, Inc. (HUBS)	Intapp, Inc. (INTA)	Integral Ad Science Holding Corp. (IAS)
Intuit Inc. (INTU)	Jamf Holding Corp. (JAMF)	Klaviyo, Inc. (KVYO)
Lightspeed Commerce Inc. (LSPD)	LivePerson, Inc. (LPSN)	MeridianLink, Inc. (MLNK)
Microsoft Corp. (MSFT)	MongoDB, Inc. (MDB)	nCino, Inc. (NCNO)
OpenText Corp. (OTEX)	Oracle Corp. (ORCL)	Palo Alto Networks (PANW)
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Sprinklr, Inc. (CXM)	Sprout Social, Inc. (SPT)	Tenable Holdings Inc (TENB)
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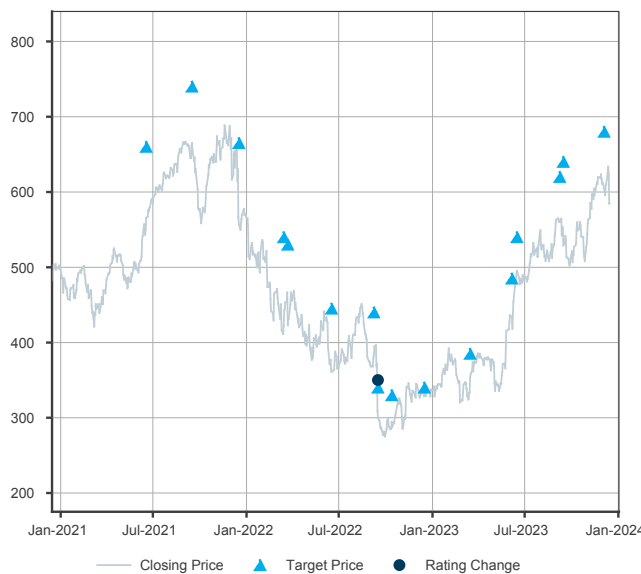
Stock Rating: **OVERWEIGHT**

Industry View: **POSITIVE**

Closing Price: **USD 584.68** (15-Dec-2023)

Rating and Price Target Chart - USD (as of 15-Dec-2023)

Currency=USD



Source: IDC, Barclays Research

[Link to Barclays Live for interactive charting](#)

Publication Date	Closing Price*	Rating	Adjusted Price Target
04-Dec-2023	612.47		680.00
15-Sep-2023	552.16		640.00
08-Sep-2023	560.46		620.00
16-Jun-2023	478.99		540.00
06-Jun-2023	434.18		485.00
16-Mar-2023	333.61		385.00
16-Dec-2022	328.71		340.00
13-Oct-2022	286.15		330.00
16-Sep-2022	309.13	Equal Weight	340.00
08-Sep-2022	368.30		440.00
17-Jun-2022	365.08		445.00
23-Mar-2022	466.45		530.00
15-Mar-2022	411.50		540.00
17-Dec-2021	614.86		665.00
16-Sep-2021	661.08		740.00
18-Jun-2021	565.59		660.00

On 18-Dec-2020, prior to any intra-day change that may have been published, the rating for this security was Overweight, and the adjusted price target was 605.00.

Source: Bloomberg, Barclays Research

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Valuation Methodology: Our price target of \$700 is based on ~35x our FY25E EPS of \$19.79.

Risks which May Impede the Achievement of the Barclays Research Valuation and Price Target: We see three risks to our OW rating: 1) albeit unlikely, if development slows in Adobe's core creative franchise, we could see new entrants to the market that could challenge Adobe's leadership in this segment; 2) If digital marketing competitors such as Salesforce or Google improve the competitiveness of their solutions, Adobe's growth in that segment will slow; 3) If a macro recession were to hit, customers might spend less on Adobe's Creative and Marketing tools.

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