

Equity Research

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Company Update — December 18, 2023

U.S. Software

Adobe Inc. (ADBE)

ADBE: Figma Deal Broken, but Thesis Remains Intact

Our Call

While we were encouraged about the synergies/potential of ADBE + Figma, & expect competitive discourse to tick up post Figma deal termination news this AM, we believe ADBE remains in position of strength with Firefly product cycle. Reiterate OW.

Announcement Details: ADBE + Figma mutually agreed to break the deal as they no longer viewed a road forward to closing of the deal (lack approval from regulators in both the UK and EU on anti-competitive grounds). As part of the termination agreement, ADBE is to pay Figma \$1Bn fee (ADBE has ~\$7Bn in cash and cash equivalents on its BS). Notably, ADBE has ~\$3.15Bn in share repo authorized outstanding and we est each \$1Bn of repo equates to ~\$0.07 of EPS accretion (at ~\$600/share).

Potential NT Impacts: In the NT, we expect ADBE shares will see a positive reaction, as the price paid for Figma had approached ~\$26.5Bn. While we don't know Figma's exact scale/growth, taking the \$400M ARR (and 100% y/y growth) exiting 2022 & assuming 75% y/y growth in 2023 (& ~50% in 2024), that would imply >25x NTM ARR, well above any multiple for public software cos today. With ADBE having found a next DM product cycle since the deal (Firefly/GenAI), we don't expect many NT growth concerns.

Thoughts on LT Impacts: Longer term, we believe Figma is a credible competitive threat to the ADBE's DM growth profile. To be clear, we do not expect Figma to compete with the core CC offerings ADBE has today (or Firefly), but we do view Figma's products as natural areas of tangency to CC. Notably, we expect ADBE will likely need to expand into some of these areas LT to maintain its DM growth profile (low teens rev growth), which we now view as incrementally challenged post the deal breaking.

No Change to Our Thesis: While the deal breaking may introduce some elevated NT volatility as investors digest the puts and takes, we do not believe this meaningfully changes our thesis on ADBE. Notably, we continue to believe that ADBE is one of the few software cos that has a tangible GenAI product (Firefly) & is positioned to monetize in the NT. When paired with a best in class operating profile and large TAM opportunity, we view the co as one of the more attractive large cap software cos.

Valuation: ADBE shares are currently trading at 12.5x NTM EV/S, 32.5x P/E, and 30x EV/FCF on our revised estimates (in after-hours trading). Our \$690 PT (no change), is derived using a combination of 13.5x EV/S, 32.5x P/E, and 30x EV/FCF on our Fwd NTM estimates (those in 5-8 quarters)—reasonable, in our view, given improving competitive positioning, new product cycles, and a best-in-class margin profile

Equity Analyst(s)

Michael Turrin, CFA

Equity Analyst | Wells Fargo Securities, LLC
Michael.Turrin@wellsfargo.com | 628-629-7565

Michael Berg, CFA

Equity Analyst | Wells Fargo Securities, LLC
Michael.Berg3@wellsfargo.com | 925-899-7406

Austin Williams

Associate Equity Analyst | Wells Fargo Securities, LLC
Austin.R.Williams@wellsfargo.com | 628-629-7572

David Unger, CFA

Associate Equity Analyst | Wells Fargo Securities, LLC
David.Unger@wellsfargo.com | 212-214-5317

Rating	Overweight
Ticker	ADBE
Price Target/Prior:	\$690.00/NC
Upside/(Downside) to Target	18.0%
Price (12/15/2023)	\$584.68
52 Week Range	\$318.60 - 633.89
Shares Outstanding	455,300,000
Market Cap (MM)	\$266,205
Enterprise Value (MM)	\$261,949
Average Daily Volume	8,664,363
Average Daily Value (MM)	\$5,066
Dividend (NTM)	\$0.00
Dividend Yield	0.0%
Net Debt (MM) - last reported	\$(4,256)
ROIC - Current year est.	31%
3 Yr EPS CAGR from current year (unless otherwise noted)	20%

\$	2023A	2024E	2024E	2025E	2025E
EPS		Curr.	Prior	Curr.	Prior
Q1 (Feb)	3.80 A	4.39 E	NC	4.84 E	NC
Q2 (May)	3.91 A	4.40 E	NC	5.02 E	NC
Q3 (Aug)	4.09 A	4.46 E	NC	5.19 E	NC
Q4 (Nov)	4.27 A	4.74 E	NC	5.42 E	NC
FY	16.06 A	17.99 E	NC	20.47 E	NC
P/E	36.4x	32.5x		28.6x	

Source: Company Data, Wells Fargo Securities estimates, and Refinitiv.
NA = Not Available, Volatility = Historical trading volatility

Wells Fargo Express Takeaways

Adobe Inc. (ADBE) | Rating: Overweight | Price Target: \$690.00

Analyst: Michael Turrin

Financials

FY (Nov)	2023A	2024E	2025E
\$			
ESTIMATES			
EPS			
Q1	3.80 A	4.39 E	4.84 E
Q2	3.91 A	4.40 E	5.02 E
Q3	4.09 A	4.46 E	5.19 E
Q4	4.27 A	4.74 E	5.42 E
AN	16.06 A	17.99 E	20.47 E
Rev. (MM)	19,409.0 A	21,471.6 E	24,013.3 E
EBIT (MM)	8,918.0 A	9,866.2 E	11,109.6 E
EBITDA (MM)	9,798 A	10,668 E	11,778 E
FCF (MM)	6,942.0 A	9,063.7 E	10,208.9 E

WELLS FARGO vs. CONSENSUS

Consensus Estimate	15.92 A	17.99 E	20.64 E
Difference from Consensus		0.0%	(0.8)%

VALUATION

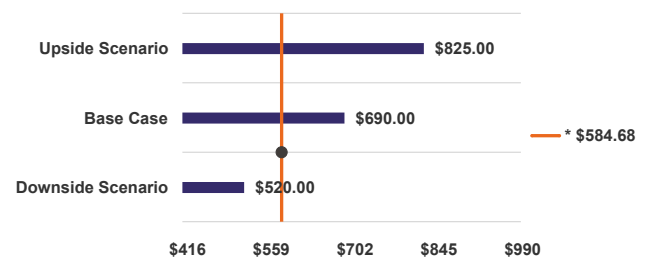
P/E	36.4x	32.5x	28.6x
EV/Revenue	13.5x	12.2x	10.9x
EV/EBIT	29.4x	26.6x	23.6x
EV/EBITDA	26.8x	24.6x	22.3x
EV/FCF	37.7x	28.9x	25.7x
FCF Yield	4.0%	5.3%	5.9%

Source: Company Data, Wells Fargo Securities estimates, and Refinitiv.
NA = Not Available, NE = No Estimate

Investment Thesis

We view Adobe as one of a few trusted platforms in software, given the company's solid core positioning as the de-facto toolkit for creatives, TAM-expansive digital tailwinds tied to experience, and best-in-class financial profile. Despite the breaking of the Figma deal (~\$20Bn), we believe Adobe has an organic answer around 'what's next for growth,' with the potential opportunity related to its generative AI platform, "Firefly." We rate ADBE Overweight.

Risk vs. Reward – Upside/Downside Price Target Scenarios



*As of 12/15/23

Source: Wells Fargo Securities, LLC estimates and Refinitiv.

Base Case | \$690.00

Our \$690 PT is derived using a combination of 13.5x EV/S, 30x EV/FCF, and 32.5x P/E on our Fwd NTM estimates (those in 5-8 quarters)—reasonable, in our view, given improved competitive positioning, new product cycles, and a best-in-class margin profile.

Upside Scenario | \$825.00

Our upside scenario inc accelerating CC growth from GenAI + Figma, while adopting multiple apps at a higher rate, coupled with an uptick in DX growth from favorable secular tailwinds, inc GenAI. In our upside scenario, ADBE is able to grow FY23-FY25 revenue at ~15% 3-year CAGR, yielding \$26.8B of FY25 rev and FCFm of 45% (\$12.1Bn). We expect this scenario would justify multiples of ~13.5x EV/S and 32.5x EV/FCF, which suggests \$825 for ADBE share, derived using FY25 ests.

Downside Scenario | \$520.00

Our downside scenario suggests growth metrics stagnate, while comp concerns increase, and the CC market doesn't expand the way we anticipate, particularly around GenAI. In our downside scenario, ADBE FY23-FY25 rev growth of ~10% 3-year CAGR, yielding \$23.4B of FY25 revenue, and margin stagnation (\$9.4B or 40% margin). These downside ests suggest ADBE could warrant multiples around ~10x EV/S, or 25x EV/FCF, which suggests \$520 for ADBE shares, derived using FY25 estimates.

Upcoming Catalysts

Upcoming potential catalysts include: 1) The company's FQ1 earnings call in March. We expect investors will focus on net new ARR, Experience Cloud demand environment, and any updated FY24 outlook (particularly color on GenAI contribution); 2) any changes in competitive dynamics for DM (now that Figma is broken) or DX, and 3) Any change in the IT spend/ demand environment, in particular related to changes in the macro environment.

Company Description

Adobe Systems offers a line of software and services focused on content creation and content management. Key products in areas such as digital imaging and video are focused at creative professionals, while other products such as Acrobat and the PDF format are aimed at enterprise customers. The company distributes its products primarily through the indirect channel augmented by a focused direct sales effort. Adobe was founded in 1982 and is headquartered in San Jose, California.

Investment Thesis, Valuation and Risks

Adobe Inc. (ADBE)

Investment Thesis

We view Adobe as one of a few trusted platforms in software, given the company's solid core positioning as the de-facto toolkit for creatives, TAM-expansive digital tailwinds tied to experience, and best-in-class financial profile. Despite the breaking of the Figma deal (~\$20Bn), we believe Adobe has an organic answer around 'what's next for growth,' with the potential opportunity related to its generative AI platform, "Firefly." We rate ADBE Overweight.

Target Price Valuation for ADBE: \$690.00 from NC

Our \$690 PT is derived using a combination of 13.5x EV/S, 30x EV/FCF, and 32.5x P/E on our Fwd NTM estimates (those in 5-8 quarters)—reasonable, in our view, given improved competitive positioning, new product cycles, and a best-in-class margin profile.

Risks to Our Price Target and Rating for ADBE

Downside risks include: 1) The spending environment meaningfully slows, due to worsening macroeconomic conditions. 2) generative AI is actually a net negative to business instead of what we see as a net positive. 3) Competitive intensity in the markets in which ADBE participates (primarily for Experience and Document Clouds) continues to increase, with the potential for new entrants to gain share via more modern technology.

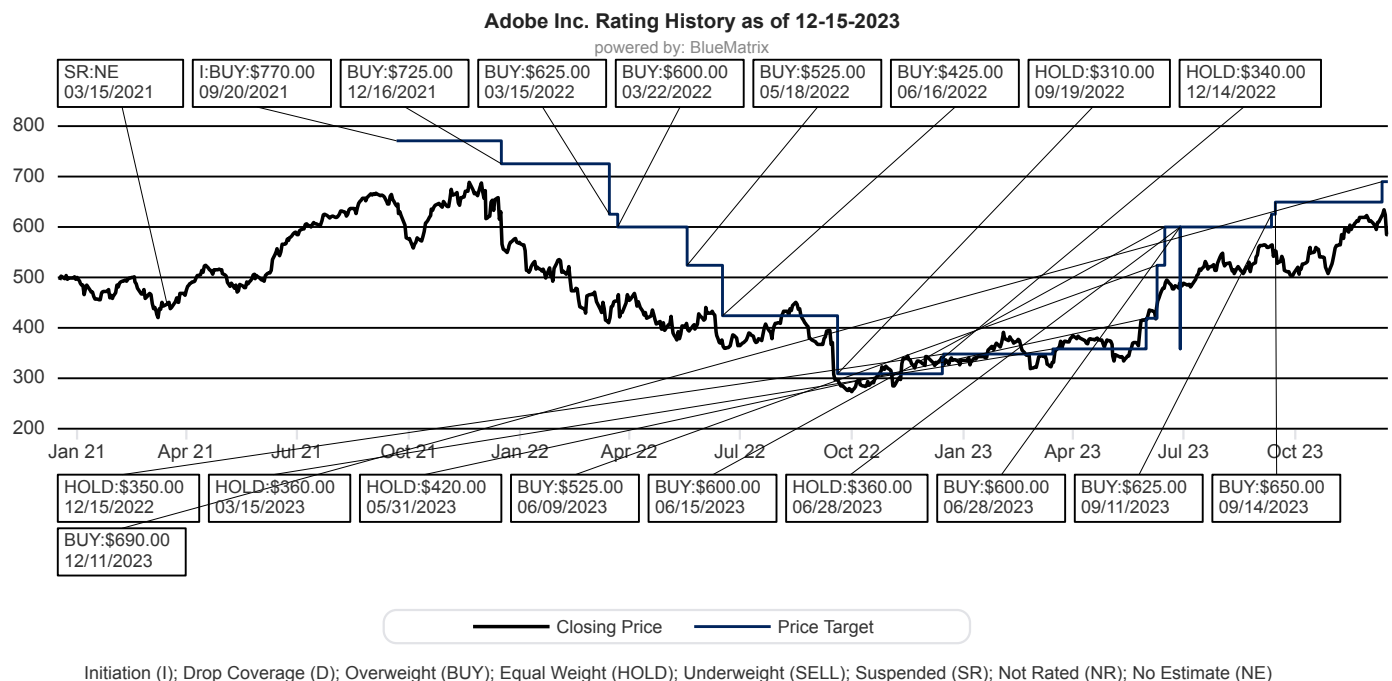
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NR=Not Rated: The rating and price target has been removed due to lack of fundamental basis to support the recommendation or due to legal, regulatory or company policy considerations.

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