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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

/x/ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 2, 2001
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 (State or other jurisdiction of incorporation or organization)	**77-0019522** (I.R.S. Employer Identification No.)
345 Park Avenue, San Jose, California (Address of principal executive offices)	**95110-2704** (Zip Code)

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

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 /x/ NO / /

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Class	Shares Outstanding March 30, 2001
Common stock, $0.0001 par value	239,147,186

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PART I—FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ADOBE SYSTEMS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

	Quarter Ended	
	March 2 2001	March 3 2000
Revenue	$ 328,969	$ 282,232
Direct Costs	20,016	20,722
Gross Profit	308,953	261,510
Operating expenses:		
Research and development	55,687	57,458
Sales and marketing	103,860	87,760
General and administrative	30,370	26,757
Restructuring and other charges	—	(672)
Amortization of goodwill and purchased intangibles	3,582	1,203
Total operating expenses	193,499	172,506
Operating income	115,454	89,004
Nonoperating income:		
Investment gain (loss)	(17,038)	4,676
Interest and other income	5,697	5,651
Total nonoperating income (loss)	(11,341)	10,327
Income before income taxes	104,113	99,331
Provision for income taxes	34,357	34,766
Net income	$ 69,756	$ 64,565
Basic net income per share	$ .29	$ .27
Shares used in computing basic net income per share	240,078	237,256
Diluted net income per share	$ .28	$ .26
Shares used in computing diluted net ncome per share	253,609	252,978

See accompanying Notes to Condensed Consolidated Financial Statements.

ADOBE SYSTEMS INCORPORATED

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	(Unaudited) March 2 2001	(Audited) December 1 2000
ASSETS		

Current assets:		
Cash and cash equivalents	$ 176,262	$ 236,866
Short-term investments	443,957	442,987
Trade receivables, net of allowances for doubtful accounts of $9,653 and $8,788, respectively	149,288	140,514
Other receivables	25,614	19,599
Deferred income taxes	26,215	23,460
Other current assets	24,039	14,486
Total current assets	845,375	877,912
Property and equipment, net	67,147	64,268
Other assets	122,113	127,236
	$ 1,034,635	$ 1,069,416
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Trade and other payables	$ 38,694	$ 40,280
Accrued expenses	143,811	181,861
Income taxes payable	87,227	74,768
Deferred revenue	18,021	17,696
Total current liabilities	287,753	314,605
Deferred income taxes	4,145	2,267
Stockholders' equity:		
Common stock, $0.0001 par value; and additional paid-in-capital	557,865	530,801
Retained earnings	1,239,240	1,172,504
Accumulated other comprehensive loss	(4,004)	(698)
Treasury stock, at cost, (55,267 and 54,818 shares in 2001 and 2000, respectively), net of reissuances	(1,050,364)	(950,063)
Total stockholders' equity	742,737	752,544
	$ 1,034,635	$ 1,069,416

See accompanying Notes to Condensed Consolidated Financial Statements.

ADOBE SYSTEMS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Quarter Ended	
	March 2 2001	**March 3 2000**
Cash flows from operating activities:		
Net income	$ 69,756	$ 64,565
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14,192	10,923
Stock compensation expense	1,611	2,941
Deferred income taxes	3,272	(5,420)
Provision for losses on receivables	605	1,450
Tax benefit from employee stock option plans	10,333	19,945
Gains (losses) of Adobe Incentive Partners	243	(6,880)
Gains on sale of equity securities	(11,898)	—
Gain on sale of building	—	(1,052)
Loss on write-down of investments	28,117	—
Noncash restructuring charges	—	(672)
Net loss on derivative instruments	1,920	—
Changes in operating assets and liabilities:		
Receivables	(15,395)	(68,590)
Other current assets	(8,273)	(4,931)
Trade and other payables	(1,587)	3,038
Accrued expenses	(37,144)	12,922
Accrued restructuring charges	—	(6,539)
Income taxes payable	12,459	23,962

Deferred revenue	326	3,035
Net cash provided by operating activities	68,537	48,697
Cash flows from investing activities:		
Purchases of short-term investments	(150,938)	(346,216)
Maturities and sales of short-term investments	116,412	341,460
Acquisitions of property and equipment	(10,316)	(3,964)
Purchase of long-term investments	(6,223)	(13,290)
Additions to other assets	(7,534)	(174)
Proceeds from sales of equity securities	17,642	—
Proceeds from sale of building	—	5,420
Net cash used for investing activities	(40,957)	(16,764)

(Continued)

See accompanying Notes to Condensed Consolidated Financial Statements.

	Quarter Ended	
	March 2 2001	**March 3 2000**
Cash flows from financing activities:		
Purchase of treasury stock	(117,087)	(67,366)
Proceeds from reissuance of treasury stock	31,906	28,540
Payment of dividends	(3,026)	(2,978)
Net cash used for financing activities	(88,207)	(41,804)
Effect of foreign currency exchange rates on cash and cash equivalents	23	(887)
Net decrease in cash and cash equivalents	(60,604)	(10,758)
Cash and cash equivalents at beginning of period	236,866	171,145
Cash and cash equivalents at end of period	$ 176,262	$ 160,387
Supplemental disclosures:		
Cash paid during the period for income taxes	$ 4,862	$ 1,742
Noncash investing and financing activities:		
Cash dividends declared but not paid	$ 3,008	$ 2,982
Unrealized gains (losses) on available-for-sale securities, net of taxes	$ (6,530)	$ 79,167

See accompanying Notes to Condensed Consolidated Financial Statements.

ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share data)

Note 1. Significant Accounting Policies

Basis of Presentation

Adobe Systems Incorporated ("Adobe" or the "Company") has prepared the accompanying interim condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, consistent in all material respects with those applied in our Annual Report on Form 10-K for the year ended December 1, 2000. The interim financial information is unaudited but reflects all normal adjustments which are, in the opinion of management, necessary to provide fair condensed consolidated balance sheets and condensed consolidated statements of income and cash flows for the interim periods presented. You should read the interim condensed consolidated financial statements in conjunction with the financial statements in our Annual Report on Form 10-K for the year ended December 1, 2000.

The results of operations for the interim period ended March 2, 2001, are not necessarily indicative of the results to be expected for the full year.

Revenue Recognition

We recognize application products revenue upon shipment, provided that collection is determined to be probable and no significant obligations remain. We provide application products customers free telephone support, for which the expense is accrued, up to a maximum of ninety days beginning upon the customer's first call. We amortize the cost of telephone support as the obligation is fulfilled. Revenue from distributors is subject to agreements allowing limited rights of return, rebates, and price protection. We accrue for estimated future returns, price protection when given, and rebates at the time the related revenue is recorded.

We record OEM licensing revenue, primarily royalties, when OEM partners ship products incorporating Adobe software, provided collection of such revenue is probable. We have no remaining obligations in relation to such licensing revenue.

Deferred revenue includes customer advances under OEM licensing agreements, maintenance revenue for application products, and revenue related to free upgrades. We recognize deferred revenue ratably over the term of the contract, generally twelve months. In cases where we will provide a free upgrade to an existing product, we defer revenue until the future obligation is fulfilled.

Recent Accounting Pronouncements

In September 2000, the EITF reached a consensus on Issue No. 00-10, "Accounting for Shipping and Handling Revenues and Costs." Issue No. 00-10 states that a seller of goods should classify as revenue in the income statement amounts billed to a customer for shipping and handling. We are required to adopt this EITF in the fourth quarter of fiscal 2001. We do not expect the adoption of Issue No. 00-10 to have a material impact on our financial position or results of operations.

Foreign Currency and Equity Hedging Instruments

Effective December 2, 2000, we adopted SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS 133 establishes accounting and reporting standards for derivative instruments and hedging activities and requires us to recognize these as either assets or liabilities on the balance sheet 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. The adoption of SFAS 133 did not have a material impact on our financial position or results of operations.

Economic Hedging—Hedges of Forecasted Transactions

We use option and forward foreign exchange contracts to hedge certain operational ("cash flow") exposures resulting from changes in foreign currency exchange rates. These foreign exchange contracts have a duration between three to twelve months. Such exposures result from portions of our revenues denominated in currencies other than the U.S. dollar ("USD"), primarily the Japanese yen and the euro. We enter into these foreign exchange contracts to hedge anticipated product licensing revenue in the normal course of business, and accordingly, they are not speculative in nature.

We record changes in the fair value of the derivative instruments designated as cash flow hedges of anticipated non-USD revenue from licensing of our products in accumulated other comprehensive income (loss), until we recognize the revenue. Upon revenue recognition, 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 other income on the consolidated statement of income at that time. During the quarter, there were no such net gains or losses recognized in other income relating to hedges of forecasted transactions that did not occur. The critical terms of the hedging instruments are the same as the underlying forecasted transaction. The changes in fair value of the derivatives are intended to offset changes in the expected cash flows from the forecasted transaction. We record any ineffective portion of the hedging instruments in other income on the consolidated statement of income. The following table depicts the activity for the first quarter ending March 2, 2001.

Gain(Loss) on Hedges of Forecasted Transactions:

	Balance Sheet	Income Statement	
	Other Comprehensive Income	Revenue	Other Income (Loss)
Realized - Closed Transactions:			
Realized net gain reclassified from other comprehensive income to revenue	$ —	$ 703	$ —
Realized net loss recognized in other income	—	—	(650)
Recognized but Unrealized - Open Transactions:			
Unrealized gain remaining in other comprehensive income	3,201	—	—
Unrealized loss from ineffective portion of hedges			(1,920)
	$ 3,201	$ 703	$ (2,570)

As of March 2, 2001, $3.2 million in other comprehensive income represents the total anticipated gain to be reclassified to revenue over the next twelve months; $0.7 million represents the total recognized in revenue during the quarter relating to hedged anticipated transactions; and $2.6 million loss consisted of a $0.6 million realized loss relating to closed hedging transactions and a $1.9 million loss that was

recognized, but as yet unrealized, relating to open hedges for anticipated transactions of which the majority relates to the cost of purchased options.

Balance Sheet Hedging—Hedging of Foreign Currency Assets and Liabilities

Furthermore, we continue to hedge our net recognized foreign currency assets and liabilities with forward foreign exchange contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in foreign currency exchange rates. These derivative instruments hedge assets and liabilities that are denominated in foreign currencies and are marked-to-market through other income. These derivative instruments do not subject us to material balance sheet risk due to exchange rate movements because gains and losses on these derivatives offset gains and losses on the assets and liabilities being hedged. At March 2, 2001, forward foreign exchange contracts outstanding had maturities of ninety days or less.

Net Gain (Loss) Recognized in Other Income Relating to Balance Sheet Hedging:

		For the Quarter Ended March 2, 2001
Loss on foreign currency assets and liabilities:		
Realized net loss recognized in other income	$	(1,805)
Unrealized net loss recognized in other income		(503)
		(2,308)
Gain on hedges of foreign currency assets and liabilities:		
Realized net gain recognized in other income		2,197
Unrealized net gain recognized in other income		133
		2,330
Net gain recognized in other income	$	22

Equity Hedging

We also have a policy that allows us to hedge our equity holdings in publicly traded companies. We have entered into forward contracts to sell portions of our equity holdings in future periods. We account for these forward contracts at fair market value, offsetting changes in the fair market value of the equities being hedged. As of March 2, 2001, the value of our forward contracts hedging equity securities was $4.8 million.

The Company uses forward contracts to hedge the fair value of certain equity investments. These are accounted for as "Fair value hedges" in accordance with SFAS 133. At the time such contracts are entered into, the existing difference between the cost basis of the equities and the market value is recorded in other comprehensive income. As of March 2, 2001, an unrealized gain of $5.0 million remains in other comprehensive income and is expected to be reclassified to other income over the next twelve months. Any changes in market value thereafter of the shares being hedged, up to the date of delivery against the forward contracts, are recognized in investment gains (losses). The changes in value of the forward contracts are recognized in other income. This value is separated into two parts: the "intrinsic value" and the "forward premium". The intrinsic value (the market value of the shares at the time the contract was

entered into less the current market value) is recognized in other income. The forward premium is deemed to be the "ineffective" portion and is recognized in other income. The intrinsic value of the forward contract should substantially offset the gain or loss on the underlying equities.

As of March 2, 2001, the Company had one forward contract outstanding relating to equities. The fair value of the forward contract was $4.8 million, which was comprised of the intrinsic value of $4.7 million and the forward premium of $0.1 million. An unrealized loss of $4.7 million on the underlying equities was recorded in investment gains (losses), while a gain of $4.7 million on the forward contract, which hedged the underlying equity, was recorded in other income. The forward premium of $0.1 million was recorded as other income. During the quarter there were no net gains or losses recognized in other income relating to hedges of firm commitments which no longer qualified as fair value hedges.

Reclassification

Certain reclassifications have been made to the fiscal 2000 presentation of other assets on the consolidated balance sheet to conform to the fiscal 2001 presentation. These reclassifications did not impact total assets in fiscal 2000.

Note 2. Other Assets

Other assets consisted of the following:

		March 2 2001		December 1 2000
Goodwill	$	53,679	$	53,679
Purchased technology and licensing agreements		15,505		16,703
Intangibles and other assets		14,307		7,719
		83,491		78,101
Less accumulated amortization		27,966		23,355
	$	55,525	$	54,746
Investments		66,588		72,490
	$	122,113	$	127,236

Note 3. Accrued Expenses

Accrued expenses consisted of the following:

		March 2 2001		December 1 2000
Accrued compensation and benefits	$	56,877	$	96,162
Sales and marketing allowances		4,933		6,435
Minority interest		1,100		1,999
Other		80,901		77,265

	$ 143,811	$ 181,861

Note 4. Stockholders' Equity

Stock Repurchase Program

In March 2001, our Board of Directors authorized, subject to certain business and market conditions, the purchase of up to an additional 5.0 million shares of our common stock over a two-year period. No purchases have been made under this 5.0 million share repurchase program.

Under the previously approved 5.0 million share repurchase program authorized by the Board in April 1999, we entered into contracts to repurchase shares during future quarters by selling put warrants and buying call options. Under this program, 4.9 million put warrants were written and 3.5 million call options were purchased during the quarter at prices ranging from $32.60 to $39.58.

Under our existing plan to repurchase shares to offset issuances under our employee stock plans, we repurchased approximately 2.1 million shares in the first quarter of fiscal 2001 at a cost of $117.1 million.

In fiscal 2000, we repurchased 7.2 million shares at a cost of $255.5 million under our existing plan to repurchase shares to offset issuances under employee stock plans.

Put Warrants and Call Options

To facilitate our stock repurchase program designed to minimize dilution from employee stock plans, we sold put warrants to independent third parties in the first quarter of fiscal 2001. Each put warrant entitles the holder to sell one share of Adobe's common stock to Adobe at a specified price. On March 2, 2001, approximately 4.3 million put warrants were outstanding that expire on various dates through October 2001, with an average exercise price of $51.01 per share.

In addition, we purchased call options from independent third parties that entitle us to buy shares of our common stock on certain dates at specified prices. On March 2, 2001, approximately 2.8 million call options were outstanding that expire on various dates through October 2001, with an average exercise price of $54.81 per share.

As of March 2, 2001, approximately 9.2 million put warrants were outstanding that expire on various dates through October 2001, with an average exercise price of $42.09 per share and approximately 6.3 million call options were outstanding that expire on various dates through October 2001, with an average exercise price of $45.02 per share.

Our put and call option contracts provide that we, at our option, can settle with physical delivery or net shares equal to the difference between the exercise price and the value of the option as determined by the contract.

Note 5. Comprehensive Income

The following table sets forth the components of comprehensive income, net of income tax expense:

	Quarter Ended	
	March 2 2001	**March 3 2000**
Net income	$ 69,756	$ 64,565
Other comprehensive income (loss):		
Net unrealized gain (loss) on investments, net of taxes	(6,530)	79,167
Foreign currency translation adjustments	23	(887)
Net gain in derivative instruments, net of taxes	3,201	—
Other comprehensive income (loss)	(3,306)	78,280
Total comprehensive income, net of taxes	$ 66,450	$ 142,845

Note 6. 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. Diluted net income per share is based upon the weighted average common shares outstanding for the period plus dilutive common equivalent shares, including unvested restricted common stock, stock options using the treasury stock method, and put warrants using the reverse treasury stock method.

	Quarter Ended	
	March 2 2001	**March 3 2000**
	(in thousands except per share data)	
Net income	$ 69,756	$ 64,565
Shares used to compute basic net income per share (weighted average shares outstanding during the period, excluding unvested restricted stock)	240,078	237,256
Dilutive common equivalent shares:		
Unvested restricted stock	945	808

Stock options	12,196	14,914
Put warrants	390	—
Shares used to compute diluted net income per share	253,609	252,978
Basic net income per share	$ .29	$ .27
Diluted net income per share	$ .28	$ .26

Note 7. Industry Segments

We have four reportable segments that offer different product lines. These segments are Web Publishing, Cross-media Publishing, ePaper Solutions, and OEM PostScript and Other. The Web Publishing segment provides software to create Web sites with graphics, images, videos, and animations. The Cross-media Publishing segment provides software for professional page layout, illustration, business publishing, and printing. The ePaper Solutions segment allows users to convert information to Adobe

Portable Document Format ("PDF") with the original appearance preserved and allows for the distribution of documents via the Web, intranets, e-mail, or CD-ROM for viewing and printing on any system. The OEM PostScript and Other segment includes printing technology to create and print simple or visually rich documents with precision.

During and prior to fiscal 2000, we evaluated our business based on the contribution margins of each of our four segments. Recently, our executive management team changed the way it evaluates the performance of our business and now focuses on evaluating the gross margins of each of our segments.

The prior period disclosure has been restated for consistent presentation to the current period disclosure. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies. We do not identify or allocate our assets by operating segments. As such, segment asset information is not disclosed.

The following results are broken out by operating segments for the quarters ended March 2, 2001 and March 3, 2000:

	Web Publishing	Cross-media Publishing	ePaper Solutions	OEM PostScript and Other	Total
Quarter ended March 2, 2001					
Revenue	$ 142,119	$ 98,068	$ 61,759	$ 27,023	$ 328,969
Direct costs	8,580	7,628	2,247	1,561	20,016
Gross profit	$ 133,539	$ 90,440	$ 59,512	$ 25,462	$ 308,953
	94%	92%	96%	94%	94%
Quarter ended March 3, 2000					
Revenue	$ 113,935	$ 93,457	$ 43,422	$ 31,418	$ 282,232
Direct costs	8,193	6,853	3,339	2,337	20,722
Gross profit	$ 105,742	$ 86,604	$ 40,083	$ 29,081	$ 261,510
	93%	93%	92%	93%	93%

A reconciliation of the totals reported for the operating segments to the applicable line items in the consolidated financial statements for the quarters ended March 2, 2001 and March 3, 2000 is as follows:

	Quarter Ended	
	March 2, 2001	March 3, 2000
Total gross profit from operating segment above	$ 308,953	$ 261,510
Total operating expenses (a)	193,499	172,506
Total operating income	115,454	89,004
Other income (loss)	(11,341)	10,327
Income before taxes	$ 104,113	$ 99,331

(a) Total operating expenses include research and development, sales and marketing, general and administrative, restructuring and other charges, and amortization of goodwill and purchased intangibles.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion (presented in millions, except per share amounts) should be read in conjunction with the consolidated financial statements and notes thereto.

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations Factors That May Affect Future Results of Operations." You should carefully review the risks described in other documents we file from time to time with the Securities and Exchange Commission, including future Quarterly Reports on Form 10-Q to be filed in 2001. When used in this report, the words "expects," "anticipates," "intends," "plans," "believes," "seeks," "targets," "estimates," and similar expressions are generally intended to identify forward-looking statements. You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. 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.

RESULTS OF OPERATIONS

Overview

Founded in 1982, Adobe Systems Incorporated ("Adobe") is a provider of graphic design, publishing, and imaging software for Web and print production. We offer a market-leading line of application software products and type products, for creating, managing, and distributing information of all types. We license our technology to major hardware manufacturers, software developers, and service providers, and we offer integrated software solutions to businesses of all sizes. We distribute our products through a network of distributors and dealers, value-added resellers ("VARs"), systems integrators, and original equipment manufacturer ("OEM") partners; direct to end users through Adobe call centers; and through our own Web site at *www.adobe.com*. We have operations in the Americas; Europe, Middle East, and Africa ("EMEA"); and Asia.

The following table sets forth for the quarters ended March 2, 2001 and March 3, 2000, our condensed consolidated statements of income expressed as a percentage of total revenue:

	Quarter Ended	
	March 2 2001	March 3 2000
Revenue	100.0%	100.0%
Direct costs	6.1	7.3
Gross margin	93.9	92.7
Operating expenses:		
Research and development	16.9	20.4
Sales and marketing	31.6	31.1
General and administrative	9.2	9.5
Restructuring and other charges	—	(0.2)
Amortization of goodwill and purchased intangibles	1.1	0.4
Total operating expenses	58.8	61.2
Operating income	35.1	31.5
Nonoperating income, net:		
Investment gain (loss)	(5.2)	1.7
Interest and other income	1.7	2.0
Total nonoperating income (loss)	(3.5)	3.7
Income before income taxes	31.6	35.2
Provision for income taxes	10.4	12.3
Net income	21.2%	22.9%

Revenue

	2001	2000	Change
	(Dollars in millions)		
First quarter			
Revenue	$ 329.0	$ 282.2	17%

Our revenue is categorized into four operating segments: Web Publishing, Cross-media Publishing, ePaper Solutions, and OEM PostScript and Other. The Web Publishing, Cross-media Publishing, and ePaper Solutions segments include application products revenue that is derived predominantly from shipments of application software programs marketed through retail, VAR, and OEM distribution channels, as well as direct through our Web site and call centers. The OEM PostScript and Other segment includes licensing revenue, which is made up of royalties received from OEM customers who ship products containing Adobe PostScript technology.

Total revenue increased $46.7 million, or 17%, compared to the first quarter of fiscal 2000 due to increased licensing of our products in the Web Publishing, ePaper Solutions, and Cross-media Publishing segments. Revenue from our Web Publishing segment grew approximately 25% from $113.9 million in the first quarter of fiscal 2000 to $142.1 million in the first quarter of fiscal 2001. Revenue from this segment increased primarily in EMEA due to the release of Adobe Photoshop 6.0 in the fourth quarter of fiscal 2000. This segment also benefited from new releases of products in the first quarter of fiscal 2001, such as Adobe Premiere 6.0, Adobe Web Collection 3.0 in Japan, and increased licensing of our Photoshop LE and LiveMotion products. The increase in revenue from this segment was partially offset by a decline in revenue from our After Effects and PageMill products, due to product lifecycle timing.

The ePaper Solutions segment increased from $43.4 million in the first quarter of fiscal 2000 to $61.8 million in the first quarter of fiscal 2001, or 42%. The growth was fueled by the continued strength of Acrobat and its related technologies throughout enterprises such as corporations, government agencies, and educational institutions in the US, EMEA, and Asia.

Additional revenue growth was achieved through our Cross-media Publishing segment, which increased 5% compared to the first quarter of fiscal 2000, from $93.5 million to $98.1 million. The increase in revenue from this segment was primarily due to increased licensing of our Adobe Design Collection product across all geographic segments as a result of a price decrease and increased marketing of this product. This segment also benefited from increased licensing of our Illustrator 9.0 product due to its recent release in the third quarter of fiscal 2000 and increased licensing of our FrameMaker product in the Americas and EMEA. This increase was largely offset by a decline in revenue from our InDesign, PageMaker, Adobe Publishing Collection, and Adobe Type products.

The growth in revenue in the above operating segments was partially offset by a decline in revenue from the OEM PostScript and Other segment of $4.4 million, or 14%. We expect our OEM PostScript license business to continue to decline for the remainder of the year relative to fiscal 2000.

We categorize our geographic information into three major market regions: the Americas; EMEA; and Asia. In the first quarter of fiscal 2001, revenue generated in the Americas, EMEA, and Asia represented 46%, 30%, and 24% of total revenue, respectively, compared to 54%, 29%, and 17%, respectively, in the first quarter of fiscal 2000.

Total application platform mix (excluding platform independent and UNIX revenues) for the first quarter of fiscal 2001 was split 66% on Windows and 34% on Macintosh as compared to 59% and 41%, respectively, for the first quarter of fiscal 2000.

Direct costs

	2001	2000	Change
	(Dollars in millions)		
First quarter			
Direct costs	$ 20.0	$ 20.7	(3)%
Percentage of total revenue	6.1%	7.3%	

Direct costs decreased in absolute dollars and as a percentage of revenue in the first quarter of fiscal 2001 compared to the same period last year primarily due to lower localization costs. This decrease in localization was partially offset by an increase in higher material costs as a result of an increase in the number of units licensed and higher excess and obsolete inventory expenses.

We are targeting gross margin for the remainder of fiscal 2001 to be approximately 93% of revenue.

Operating expenses

	2001	2000	Change
	(Dollars in millions)		
First quarter			
Research and development	$ 55.7	$ 57.5	(3)%
Percentage of total revenue	16.9%	20.4%	

Research and development expenses decreased $1.8 million, or 3%, in the first quarter of fiscal 2001 compared to the same period last year, primarily due to lower incentive compensation expenses. This decrease was partially offset by increased salaries expense related to headcount growth to support product development efforts.

We will continue to make significant investments in the development of our application software products, including those targeted for the growing Internet market. We expect that research and development expenditures for the remainder of fiscal 2001 will increase in absolute dollars. We have targeted such expenditures to be between 19-20% of revenue for the remainder of fiscal 2001.

	2001	2000	Change
	(Dollars in millions)		
First quarter			
Sales and marketing	$ 103.9	$ 87.8	18%
Percentage of total revenue	31.6%	31.1%	

Sales and marketing expenses increased $16.1 million, or 18%, in the first quarter of fiscal 2001 compared to the same period last year, due to higher advertising and direct marketing expenses to promote our InDesign, Acrobat, and Web Publishing products. In addition, sales and marketing expenses increased due to increased salaries expense related to headcount growth and increased technical support costs.

We have targeted sales and marketing expenses to be between 33-34% of revenue for the remainder of fiscal 2001.

	2001	2000	Change
	(Dollars in millions)		
First quarter			
General and administrative	$ 30.4	$ 26.8	14%
Percentage of total revenue	9.2%	9.5%	

General and administrative expenses increased $3.6 million, or 14%, in the first quarter of fiscal 2001 compared to the same period last year, primarily due to increased salaries expense as a result of headcount growth and increased legal fees.

We expect that general and administrative spending will increase in absolute dollars for the remainder of fiscal 2001 to support ongoing administrative infrastructure needs. However, as a percentage of revenue such expenditures are targeted to be approximately 9% of revenue for the remainder of fiscal 2001.

	2001	2000	Change
	(Dollars in millions)		
First quarter			
Restructuring and other	—	$ (0.7)	100%
Percentage of total revenue	—	(0.2)%	

During the first quarter of fiscal 2000, we revised our estimates of the total costs associated with the fiscal 1999 and 1998 restructuring programs, resulting in an adjustment of approximately $0.7 million. The adjustment primarily reflected lower than estimated severance and related charges attributable to employees whose positions were eliminated as a result of the restructurings but who were able to find alternative employment within Adobe. The remaining adjustment was due to lower than expected charges related to vacating leased facilities.

	2001	2000	Change
	(Dollars in millions)		
First quarter			
Amortization of goodwill and purchased intangibles	$ 3.6	$ 1.2	198%
Percentage of total revenue	1.1%	0.4%	

Amortization of goodwill and purchased intangibles increased in the first quarter of fiscal 2001 compared to the same period last year due to the additional amortization related to the acquisition of Glassbook, Inc. in September 2000.

Nonoperating income

	2001	2000	Change
	(Dollars in millions)		
First quarter			
Investment gain (loss)	$ (17.0)	$ 4.7	(464)%
Percentage of total revenue	(5.2)%	1.7%	

During the first quarter of fiscal 2001, investment loss included other-than-temporary write-downs related to our investments in ESPS, Inc, Tumbleweed Communications Corp. ("Tumbleweed"), Engage Inc., Salon.com, and other privately-held companies, totaling approximately $28.1 million. We also recorded net investment losses related to Adobe Ventures investment activities totaling $0.5 million. These investment losses were partially offset by gains from the sale of a portion of our investments in Tumbleweed, DigitalThink, Inc. and Digimarc Corporation, totaling approximately $11.6 million.

During the first quarter of fiscal 2000, we recorded net investment gains from mark-to-market adjustments totaling $4.7 million primarily related to investments in Virage, Inc., Impresse Corporation, Digimarc Corporation, and HAHT Software, Inc.

We are uncertain of future investment gains and losses, as they are primarily dependent upon the operations of the underlying investee companies.

	2001	2000	Change
	(Dollars in millions)		
First quarter			
Interest and other income	$ 5.7	$ 5.7	1%
Percentage of total revenue	1.7%	2.0%	

Interest and other income consists principally of interest earned on cash, cash equivalents, and short-term investments, as well as foreign exchange transaction gains and losses and realized gains or losses on the disposal of assets.

Interest income remained fairly constant in the first quarter of fiscal 2001 compared to the same period last year. The slight increase was due to higher average cash balances throughout the quarter as a result of more investments made in taxable securities, resulting in higher interest income. In addition, realized gains from the sales of bonds and corporate assets also contributed to the increase in other income during the first quarter of fiscal 2001. The increase in interest and other income was offset by foreign exchange transaction losses.

We expect interest and other income to be approximately $4.0 million per quarter for the remainder of fiscal 2001.

Provision for income taxes

	2001	2000	Change
	(Dollars in millions)		
First quarter			
Provision for income taxes	$ 34.4	$ 34.8	(1)%
Percentage of total revenue	10.4%	12.3%	
Effective tax rate	33.0%	35.0%	

Our effective tax rate decreased in the first quarter of fiscal 2001 compared to fiscal 2000 due to the benefits associated with a restructuring of our international operations. We expect our effective tax rate for the remainder of fiscal 2001 to be approximately 33%.

Factors That May Affect Future Results of Operations

We believe that in the future our results of operations could be affected by various factors, including:

- adverse changes in general economic conditions in any of the countries in which we do business, including the recent slow-down affecting the U.S. and other geographic areas
- delays in shipment of our new products and major new versions of existing products
- lack of market acceptance of new products and upgrades
- Chapter 11 reorganization filing of our sole U.S. manufacturer
- introduction of new products by major competitors
- weakness in demand for application software and printers
- lack of growth in worldwide personal computer and printer sales and downward sales price adjustments
- renegotiation of royalty arrangements
- consolidation in the OEM printer business
- ongoing weakness in our printing business due to product transitions
- industry transitions to new business and information delivery models
- market risks associated with our equity investments (as discussed later under "Quantitative and Qualitative Disclosures about Market Risk")

We have stated that we are targeting our revenue growth to be approximately 15% in the second quarter of fiscal 2001 over the second quarter of fiscal 2000. Additionally, we have stated the following operating model targets for the remainder of fiscal 2001: gross margin of 93%, operating profit margin of 31%, research and development expenses at 19-20% of revenue, sales and marketing expenses at 33-34% of revenue, and general and administrative expenses at 9% of revenue. We have stated that we expect our share count to be between 254 to 256 million shares in the second and third quarter of fiscal 2001 and between 257 to 259 million shares in the fourth quarter of fiscal 2001, and that we plan to hire 1,000 employees in fiscal 2001. However, our headcount increases will not reach this planned level due to adjustments in light of the recent slow-down in some geographic areas. Based on the projected use of cash to buy back shares under existing contracts, we are targeting other income to be approximately $4.0 million per quarter for the remainder of fiscal 2001. Finally, we have stated an effective tax rate target for the remainder of fiscal 2001 of 33% and trade receivables days sales outstanding ("DSO") target range of 40-45 days.

We use these targets to assist us in making decisions about our allocation of resources and investments, not as predictions of future results. The targets reflect a number of assumptions, including assumptions about:

- product pricing and demand
- manufacturing costs and volumes
- the mix of application products and licensing revenue, full and upgrade products, distribution channels, and geographic distribution
- headcount increases

These and many other factors described in this report affect our financial performance and may cause our future results, including results for the current quarter, to vary materially from these targets. In particular, the recent slow-down in some geographic areas, primarily in the U.S., has affected all of our

product segments and may adversely affect our ability to achieve our revenue target. The slow-down has also affected our hiring plans; we may hire significantly fewer than our original target of 1,000 employees during fiscal 2001 in light of this factor. We attribute this slow-down, which is affecting all of our product segments, to weakening economic conditions. These adverse economic conditions in the U.S. and other geographic markets may continue in the short term, and they may continue to adversely affect our revenue and earnings. Furthermore, if the economic slow-down worsens or spreads to other geographic areas where we do business, it would likely cause our future results, including results for the current quarter, to vary materially from our targets.

We plan to continue to invest in certain areas, which will require us to hire a significant number of additional employees. Competition for high-quality personnel, especially highly skilled engineers, is extremely intense. Our ability to effectively manage this growth will require us to continue to improve our operational and financial controls and information management systems, and to attract, retain, motivate, and manage employees effectively; otherwise our business could be seriously harmed.

We currently rely on three manufacturers of our products, each located in a different region. One of these manufacturers, which is currently our sole U.S. manufacturer, recently filed a petition for a Chapter 11 reorganization. While it has assured us that it intends to continue operating and to meet its obligations to us, and we are exploring possible alternatives, there can be no assurance that it will continue operations at all or sufficient to meet our needs, nor that we can establish alternative arrangements in time to avoid serious harm to our business. Additionally, if any manufacturer does not meet our needs, if any manufacturer terminates its relationship with us, or if our supply from any manufacturer is interrupted or terminated for any other reason, we may not have enough time or be able to replace the supply of products manufactured by that manufacturer to avoid serious harm to our business.

Our ability to develop and market products, including upgrades of current products that successfully adapt to changing customer needs, may also have an impact on our results of operations. Our ability to extend our core technologies into new applications and to anticipate or respond to technological changes could affect our ability to develop these products. A portion of our future revenue will come from these new applications. Delays in product or upgrade introductions could cause a decline in our revenue, earnings, or stock price. We cannot determine the ultimate effect that these new products or upgrades will have on our revenue or results of operations.

The market for our graphics applications, particularly our Web publishing and consumer products, is intensely and increasingly competitive and is significantly affected by product introductions and market activities of industry competitors. Additionally, Microsoft has increased its presence in the digital imaging/graphics market; we believe that, due to Microsoft's market dominance, any new Microsoft digital imaging products will be highly competitive with our products. If competing new products achieve widespread acceptance, our operating results would suffer.

In some markets and for some products, we have adopted a strategy aiming to increase our market share and therefore may receive significantly less revenue from certain licensing arrangements than we otherwise would receive for licensing these products. Therefore, increased market penetration may in fact lead to lower revenue growth in these areas. While we believe that this potential market share increase will ultimately benefit us, this strategy could instead harm our business through reduced revenue growth.

We generally offer our application-based products on Macintosh, Windows, and UNIX platforms, and we generally offer our server-based products on the Linux platform as well as these three platforms. To the extent that there is a slow-down of customer purchases of personal computers on either the Windows or Macintosh platform or in general, our business could be harmed.

We distribute our application products primarily through distributors, resellers, and retailers (collectively referred to as "distributors"). A significant amount of our revenue for application products is from two distributors. We have revised our channel program to reduce the overall number of our distributors

worldwide and focus our channel efforts on larger distributors. This revision of the channel program has resulted in an increase in our dependence on a smaller number of distributors selling through a larger amount of our products. Additionally, our goal is to increase our direct distribution of our products to end users through our online store located on our Web site at *www.adobe.com.* Any such increase in our direct revenue efforts will place us in increased competition with our channel distributors and with newer types of distribution of our products by online, Internet-based resellers of our products. While we anticipate that the restructuring and streamlining of our product distribution channels and the increase in the scope of our direct sales efforts will eventually improve our business by decreasing discounts or rebate programs provided to distributors, decreasing product returns, and shortening inventory cycles, these changes could instead seriously harm our business.

In addition, we continue to expand into third-party distribution channels, including VARs and systems integrators, in our effort to further broaden our customer base. As a result, the financial health of these third parties and our continuing relationships with them are becoming more important to our success. Some of these companies are thinly capitalized and may be unable to withstand changes in business conditions. Our business could be seriously harmed if the financial condition of some of these third parties substantially weakens or if our relationships with them deteriorate. Also, as we seek to further broaden our customer base in the corporate business and consumer markets, we may not successfully adapt our application software distribution channels, which could cause our operating results to suffer. We could experience decreases in average selling prices and some transitions in our distribution channels that could seriously harm our business.

Revenue from our OEM PostScript and Other segment experienced a 14% decline in the first quarter of fiscal 2001 compared to the first quarter of fiscal 2000, primarily as a result of a decline in revenue from the licensing of Adobe PostScript technology. We expect this segment to continue to decline for the remainder of fiscal 2001 relative to fiscal 2000, which may harm our business depending on the magnitude of the decline. The ongoing weakness in the monochrome laser printer market as a result of the decline in average selling prices of monochrome laser printers and the increasing use of inkjet printers was a factor causing the revenue decline. In addition, the loss of royalty revenue from HP's desktop monochrome laser printer division, which has been incorporating a clone version of Adobe PostScript technology in some printers, has resulted in lower licensing revenue to us over the past three years. Even though we continue to work with HP printer operations to incorporate Adobe PostScript and other technologies into other HP products, we expect continued lower revenue in this segment from HP. If other significant partners also decide to incorporate a clone version instead of Adobe PostScript technology, it could seriously harm our business. Further, OEM partners on occasion seek to renegotiate their royalty arrangements. We evaluate these requests on a case-by-case basis. If an agreement is not reached, a customer may decide to pursue other options, which could result in lower licensing revenue for us.

We hold equity investments that have recently experienced significant declines in market value. We also have investments, and may continue to make future investments, in several privately held companies, many of which can still be considered in the start-up or development stages. These investments are inherently risky, as the market for the technologies or products they have under development are typically in the early stages and may never materialize. Our investment activities can impact our net income. In the first quarter of 2001, we recorded a pre-tax loss from marketable securities and other investments in privately held companies of $17.0 million compared to a pre-tax gain of $4.7 million in the first quarter of 2000. These amounts reflect net realized gains and losses on sales of certain marketable securities, unrealized gains and losses due to changes in valuation of securities in the Adobe Venture funds which we account for using the equity method, and charges to reflect other-than-temporary declines in value of our available-for-sale and privately-held equity investments. In the first quarter of 2001, decreases in the market prices of these securities resulted in a significant reduction in our pre-tax income, and future price fluctuations in these securities and any significant long-term declines in value could reduce our net income in future periods. We are uncertain of future investment gains and losses, as they are primarily dependent upon the operations of the underlying investee companies.

The Internet market is rapidly evolving and is characterized by an increasing number of market entrants that have introduced or developed products addressing authoring and communication over the Internet. As is typical in the case of a new and evolving industry, demand and market acceptance for recently introduced products and services are subject to a high level of uncertainty. The software industry addressing authoring and communications over the Internet is still developing. Standards defining Web graphics have not yet been finally adopted. In addition, new models for licensing software will be needed to accommodate new information delivery practices. Moreover, critical issues concerning the commercial use of the Internet (including security, reliability, ease of use and access, cost, and quality of service) remain unresolved and may affect the growth of Internet use, together with the software standards and electronic media employed in such markets.

We have stated that we intend to increase our investment in e-business and enhanced marketing activities in an effort to achieve revenue growth, but we can provide no assurance that increased investment in this new market will result in increased revenue.

We derive a significant portion of our revenue and operating income from our customers located in Europe, Japan, Asia Pacific, and Latin America. We generally experience lower revenue from our European operations in the third quarter because many customers reduce their purchasing activities in the summer months. Additionally, we are uncertain whether the recent weakness experienced in the Asia Pacific and Latin America markets will continue in the foreseeable future due to possible currency devaluation and liquidity problems in these regions. While most of the revenue of our European subsidiaries has in the past been denominated in U.S. dollars, in the first quarter of fiscal 2001 we began to denominate revenue in euros in certain European countries. In addition, the majority of our revenue derived from Japan is denominated in yen, and the majority of all our subsidiaries' operating expenses are denominated in their local currencies. As a result, our operating results are subject to fluctuations in foreign currency exchange rates. To date, the financial impact of such fluctuations has not been significant. Our hedging policy attempts to mitigate some of these risks, based on our best judgment of the appropriate trade-offs among risk, opportunity, and expense. We have established a hedging program to hedge our exposure to foreign currency exchange rate fluctuations, primarily of the Japanese yen and the euro. We regularly review our hedging program and will make adjustments based on our best judgment. Our hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movement in foreign currency exchange rates.

In connection with the enforcement of our own intellectual property rights or in connection with disputes relating to the validity or alleged infringement of third-party rights, we have been, are currently, and may in the future be subject to complex, protracted litigation as part of our policy to vigorously defend our intellectual property rights. Intellectual property litigation is typically 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, we may not prevail in any ongoing or future litigation. Adverse decisions in such litigation could have negative results, including subjecting us to significant liabilities, requiring us to seek licenses from others, preventing us from manufacturing or licensing certain of our products, or causing severe disruptions to our operations or the markets in which we compete, any one of which could seriously harm our business.

We prepare our financial statements in conformity with accounting principles generally accepted in the United States of America. These principles are subject to interpretation by the American Institute of Certified Public Accountants (the "AICPA"), the Securities and Exchange Commission (the "SEC"), and various bodies formed to interpret and create appropriate accounting policies. A change in these policies can have a significant effect on our reported results and may even affect the reporting of transactions

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completed before a change is announced. Accounting policies affecting many other aspects of our business, including:

- rules relating to software revenue recognition
- purchase and pooling-of-interests accounting for business combinations
- the valuation of in-process research and development
- employee stock purchase plans
- stock option grants
- goodwill amortization

have recently been revised or are under review by one or more of these groups. Changes to these rules or the questioning of current practices may have a significant adverse effect on our reported financial results or in the way in which we conduct our business.

New FASB guidelines relating to accounting for goodwill could make our acquisition-related charges less predictable in any given reporting period. On February 14, 2001, the FASB issued a limited revision of its Exposure Draft, "Business Combinations and Intangible Assets" that establishes a new standard for accounting for goodwill acquired in a business combination. It would continue to require recognition of goodwill as an asset but would not permit amortization of goodwill as currently required by APB Opinion No. 17, Intangible Assets. Under the proposed statement, goodwill would be separately tested for impairment using a fair-value-based approach when an event occurs indicating the potential for impairment. Any required goodwill impairment charges would be presented as a separate line item within the operating section of the income statement. The shift from an amortization approach to an impairment approach would apply to previously recorded goodwill as well as goodwill arising from acquisitions completed after the application of the new standard. If the standard is adopted as described above, our goodwill amortization charges would cease. However, it is possible that in the future, we would incur less frequent, but larger, impairment charges related to the goodwill already recorded as well as goodwill arising out of potential future acquisitions.

Due to the factors noted above, our future earnings and stock price may be subject to significant volatility, particularly on a quarterly basis. Any shortfall in revenue or earnings, or any delay in the release of any product or upgrade, compared to analysts' or investors' expectations could cause, and has caused in the past, an immediate and significant decline in the trading price of our common stock. Additionally, we may not learn of such shortfalls or delays until late in the fiscal quarter, which could result in an even more immediate and greater decline in the trading price of our common stock. Finally, we participate in a highly dynamic industry. In addition to factors specific to us, changes in analysts' earnings estimates for us or our industry and factors affecting the corporate environment, our industry, or the securities markets in general will often result in significant volatility of our common stock price.

Recent Accounting Pronouncements

In September 2000, the EITF reached a consensus on Issue No. 00-10, "Accounting for Shipping and Handling Revenues and Costs." Issue No. 00-10 states that a seller of goods should classify as revenue in the income statement, amounts billed to a customer for shipping and handling. We are required to adopt this EITF in the fourth quarter of fiscal 2001. We do not expect the adoption of Issue No. 00-10 to have a material impact on our financial position or results of operations.

LIQUIDITY AND CAPITAL RESOURCES

	March 2 2001	December 1 2000	Change
	(Dollars in millions)		
Cash, cash equivalents and short-term investments	$ 620.2	$ 679.9	(9)%
Working capital	$ 557.6	$ 563.3	(1)%
Stockholders' equity	$ 742.7	$ 752.5	(1)%

Our cash, cash equivalents, and short-term investments consist principally of money market mutual funds, municipal bonds, and marketable equity securities. All of our cash equivalents and short-term investments are classified as available-for-sale under the provisions of SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities." The securities are carried at fair value with the unrealized gains and losses, net of tax, included in accumulated other comprehensive income, which is reflected as a separate component of stockholders' equity.

Our cash, cash equivalents, and short-term investments decreased $59.6 million, or 9%, in the first quarter of fiscal 2001, primarily due to the purchase of treasury stock in the amount of $117.1 million, the purchase of long-term investments and other assets for $13.8 million, capital expenditures of $10.3 million, and the payment of dividends totaling $3.0 million. In addition, our short-term investments decreased as a result of mark-to-market adjustments totaling $10.7 million, the write-down of certain short-term marketable equity investments totaling $17.1 million, and the sale of marketable equity investments with a cost basis of $5.7 million.

These decreases were partially offset by cash generated from operations of $68.5 million and proceeds from the issuance of treasury stock related to the exercise of stock options under our stock option plans and sale of stock under the Employee Stock Purchase Plan of $31.9 million. Other sources of cash include the proceeds from the sale of third parties' equity securities of $17.6 million.

We expect to continue our investing activities, including expenditures for computer systems for research and development, sales and marketing, product support, and administrative staff. Furthermore, cash reserves may be used to purchase treasury stock and acquire software companies, products, or technologies that are complementary to our business.

We have paid cash dividends on our common stock each quarter since the second quarter of 1988. Adobe's Board of Directors declared a cash dividend on our common stock of $0.0125 per common share for the first quarter of fiscal 2001. The declaration of future dividends, whether in cash or in-kind, is within the discretion of Adobe's Board of Directors and will depend on business conditions, our results of operations and financial condition, and other factors.

In March 2001, our Board of Directors authorized, subject to certain business and market conditions, the purchase of up to an additional 5.0 million shares of our common stock over a two-year period. No purchases have been made under this 5.0 million share repurchase program.

Under the previously approved 5.0 million share repurchase program authorized by the Board in April 1999, we entered into contracts to repurchase shares during future quarters by selling put warrants and buying call options. Under this program, 4.9 million put warrants were written and 3.5 million call options were purchased during the quarter at prices ranging from $32.60 to $39.58.

Under our existing plan to repurchase shares to offset issuances under our employee stock plans, we repurchased approximately 2.1 million shares in the first quarter of fiscal 2001 at a cost of $117.1 million.

In fiscal 2000, we repurchased 7.2 million shares at a cost of $255.5 million under our existing plan to repurchase shares to offset issuances under employee stock plans.

To facilitate our stock repurchase program designed to minimize dilution from employee stock plans, we sold put warrants to independent third parties in the first quarter of fiscal 2001. Each put warrant entitles the holder to sell one share of Adobe's common stock to Adobe at a specified price. On March 2, 2001, approximately 4.3 million put warrants were outstanding that expire on various dates through October 2001, with an average exercise price of $51.01 per share.

In addition, we purchased call options from independent third parties that entitle us to buy shares of our common stock on certain dates at specified prices. On March 2, 2001, approximately 2.8 million call options were outstanding that expire on various dates through October 2001, with an average exercise price of $54.81 per share.

As of March 2, 2001, approximately 9.2 million put warrants were outstanding that expire on various dates through October 2001, with an average exercise price of $42.09 per share and approximately 6.3 million call options were outstanding that expire on various dates through October 2001, with an average exercise price of $45.02 per share.

Our put and call option contracts provide that we, at our option, can settle with physical delivery or net shares equal to the difference between the exercise price and the value of the option as determined by the contract.

Commitments

Our principal commitments as of March 2, 2001 consists of obligations under operating leases, line of credit agreements, venture investing activities, and various service agreements.

We believe that if our lines of credit are canceled or amounts are not available under the lines, there would not be a material adverse effect on our financial results, liquidity, or capital resources.

Under the terms of the lines of credit and the lease agreement, we may pay cash dividends unless an event of default has occurred or we do not meet certain financial ratios.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Hedging Instruments

The Company transacts business in various foreign currencies, primarily in certain European countries and Japan. Accordingly, we are subject to exposure from movements in foreign currency exchange rates. This exposure is primarily related to yen and euro revenue from the licensing of our products in Japan and Europe, respectively. Our Japanese operating expenses are in yen and the majority of Europe's operating expenses are in euro. Both serve to mitigate a portion of the exposure related to the above-mentioned revenue in both markets.

The Company hedges firmly committed transactions using primarily forward contracts. The Company also hedges a percentage of forecasted international revenue with purchased options. Our hedging policy is designed to reduce the impact of foreign currency exchange rate movements.

Instruments hedging recognized foreign currency assets and liabilities are marked to market at the end of each reporting period. Gains and losses associated with the mark-to-market of these instruments are recognized in income in the current period. Corresponding gains and losses on the foreign currency denominated assets and liabilities being hedged are recognized in other income in that same period. In this manner, the gains and losses on foreign currency denominated transactions will be offset by the gains and losses on the foreign currency hedges. We do not anticipate any material adverse effect on its consolidated financial position, results of operations, or cash flows as a result of these instruments.

We do not use derivative financial instruments for speculative trading purposes, nor do we hedge foreign currency exposure in a manner that entirely offsets the effects of changes in foreign exchange rates.

We currently do not use financial instruments to hedge local currency operating expenses in Europe and Japan. Instead, the Company believes that a natural hedge exists, in that local currency revenue which substantially offsets the local currency operating expenses. We regularly review our hedging program and may, as part of this review, make changes to the program.

Equity Investments

We are exposed to equity price risk on our portfolio of equity securities. As of March 2, 2001, our total equity holdings in publicly traded companies were valued at $58.9 million compared to $90.2 million at December 1, 2000, a decrease of 35%. We believe that it is reasonably possible that the prices of these securities could experience further adverse changes in the near term. We have a policy in place to review our equity holdings on a regular basis to evaluate the economic viability of these publicly traded companies, which includes, but is not limited to, reviewing each of the companies' cash positions, earnings/revenue outlook, stock price activity over the past six months, liquidity and management/ownership. If we believe that an other-than-temporary impairment exists in one of our equity investments in these publicly traded companies, it is our policy to write down these equity investments to the market value on the last day of our reporting period.

Equity Forward Contracts

We also have a policy to hedge a certain portion of our equity holdings in publicly traded companies. We have entered into forward contracts to sell portions of our equity holdings in future periods. We account for these forward contracts at fair market value, offsetting changes in the fair market value of the equities being hedged. As of March 2, 2001, the value of our forward contracts hedging equity securities was $4.8 million compared to $10.7 million at December 1, 2000.

An increase (decrease) in the market value of the underlying equities will result in a corresponding decrease (increase) in the value of the forward contract.

Fixed Income Investments

At March 2, 2001, we had an investment portfolio of fixed income securities, including those classified as cash equivalents, of $415.6 million compared to $369.7 million at December 1, 2000, an increase of 12%. These securities are subject to interest rate fluctuations. An increase in interest rates could adversely affect the market value of our fixed income securities.

We do not use derivative financial instruments in our investment portfolio to manage interest rate risk. We do, however, limit our exposure to interest rate and credit risk by establishing and strictly monitoring clear policies and guidelines for our fixed income portfolios. At the present time, the maximum duration of all portfolios is limited to 2.3 years. The guidelines also establish credit quality standards, limits on exposure to any one security issue, limits on exposure to any one issuer, and limits on exposure to the type of instrument. Due to the limited duration and credit risk criteria established in our guidelines, we do not expect the exposure to market and credit risk to be material.

Privately Held Investments

We have investments in several privately held companies, many of which can still be considered in the start-up or development stages. These investments are inherently risky, as the market for the technologies or products they have under development are typically in the early stages and may never materialize. We could lose a substantial part of or our entire initial investment in these companies.

Please refer to our market risk disclosures in our 2000 Annual Report filed on Form 10-K for a more detailed discussion of quantitative and qualitative disclosures about market risk.

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On August 10, 2000, Adobe filed suit in the U.S. District Court of Delaware against Macromedia, Inc. ("Macromedia") for infringement of U.S. Patent No. 5,546,528 related to Adobe's tabbed palette patent, which is Adobe's method of displaying and working with multiple sets of information in the same area of the computer screen. On September 18, 2000, Adobe amended its complaint to include an additional claim of infringement of U.S. Patent No. 6,084,597 related to method of rasterizing and rendering complex layered compositions in a movie. The complaint seeks a permanent injunction and unspecified treble damages.

On September 27, 2000, Macromedia filed counterclaims in the U.S. District Court of Delaware for infringement of U.S. Patent No. 5,467,443, which relates to changing blended elements and automatic re-blending of elements, and U.S. Patent Nos. 5,151,998 and 5,204,969, which relate to visually displaying and editing sound waveforms. Macromedia denied it infringes Adobe's patents in its answer to Adobe's amended complaint. The counterclaim seeks (i) a declaration that Adobe's patents are unenforceable, invalid, and not infringed by Macromedia; (ii) a permanent injunction; and (iii) unspecified treble damages. This case is currently in the discovery phase. The court has set a trial date for April 29, 2002.

On February 6, 1996, a securities class action complaint was filed against Adobe, certain of its officers and directors, certain former officers of Adobe and Frame Technology Corporation ("Frame"), Hambrecht & Quist, LLP ("H&Q"), investment banker for Frame, and certain H&Q employees, in connection with the drop in the price of Adobe stock following its announcement of financial results for the quarter ended December 1, 1995. The complaint was filed in the Superior Court of the State of California, County of Santa Clara. The complaint alleges that the defendants misrepresented material adverse information regarding Adobe and Frame and engaged in a scheme to defraud investors. The complaint seeks unspecified damages for alleged violations of California law. The court granted plaintiffs' motion for class certification on September 22, 1999. We believe that the allegations against us and our officers and directors are without merit and intend to vigorously defend the lawsuit. We have filed a motion requesting summary judgment and dismissal of the case. The trial date is currently set for July 9, 2001.

Management believes that the ultimate resolution of these matters will not have a material impact on our financial position or results of operations.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(2)
Index to Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference Form	Date	Number	Filed Herewith
3.1	The Registrant's (as successor in-interest to Adobe Systems (Delaware) Incorporated by virtue of a reincorporation effective 5/30/97) Certificate of Incorporation, as filed with the Secretary of State of the State of Delaware on 5/9/97.	10-Q	05/30/97	3.1	
3.2.10	Amended and Restated Bylaws as currently in effect.	8-K	9/3/98	3.2	
3.3	Certificate of Designation of the Series A Preferred Stock	10-K	11/28/97	2.1	
3.4	Agreement and Plan of Merger effective 5/30/97 (by virtue of a reincorporation), by and between Adobe Systems Incorporated, a California corporation and Adobe Systems (Delaware) Incorporated, a Delaware corporation.	10-Q	05/30/97	2.1	
3.5	Certificate of Amendment to Certificate of Incorporation filed with the Secretary of State of the State of Delaware on May 26, 2000	S-8	6/16/00	4.6	
4.1	Third Amended and Restated Rights Agreement between the Company and Harris Trust Company of California	8-K	12/15/98	1	
4.2	Fourth Amended and Restated Agreement between the Company and Computershare Investor Services, LLC	8-K	7/3/00	1	
10.1.6	1984 Stock Option Plan, as amended*	10-Q	07/02/93	10.1.6	
10.21.3	Revised Bonus Plan*	10-Q	02/28/97	10.21.3	
10.24	Amended 1994 Performance and Restricted Stock Plan*	10-Q	05/29/98	10.24.2	
10.25.0	Form of Indemnity Agreement*	10-K	11/30/90	10.17.2	
10.25.1	Form of Indemnity Agreement*	10-Q	05/30/97	10.25.1	
10.32	Sublease of the Land and Lease of the Improvements By and Between Sumitomo Bank Leasing and Finance Inc. and Adobe Systems Incorporated (Phase 1)	10-K	11/25/94	10.32	
10.36	1996 Outside Directors Stock Option Plan*	10-Q	05/31/96	10.36	
10.38	Sublease of the Land and Lease of the Improvements By and Between Sumitomo Bank Leasing and Finance Inc. and Adobe Systems Incorporated (Phase 2)	10-Q	08/30/96	10.38	

10.39	1997 Employee Stock Purchase Plan, as amended*	S-8	05/30/97	10.39	
10.40	1994 Stock Option Plan, as amended*	S-8	05/30/97	10.40	
10.42	Amended and Restated Limited Partnership Agreement of Adobe Incentive Partners, L.P.*	10-Q	8/28/98	10.42	
10.44	Forms of Retention Agreement*	10-K	11/28/97	10.44	
10.48	Letter of Release and Waiver*	10-K	11/27/98	10.48	
10.49	Confidential Executive Resignation Agreement And	10-Q	3/5/99	10.49	

	General Release of Claims*				
10.50	Confidential Executive Separation Agreement And General Release of Claims*	10-Q	6/4/99	10.50	
10.51	Amended 1997 Employee Stock Purchase Plan*	S-8	6/21/99	10.51	
10.52	Amendment to Limited Partnership Agreement of Adobe Incentive Partners, L.P.*	10-Q	6/4/99	10.52	
10.53	Amended, Restated and Consolidated Master Lease of Land and Improvements By and between Sumitomo Bank Leasing and Finance, Inc. and Adobe Systems Incorporated	10-Q	9/3/99	10.53	
10.54	Credit Agreement among Adobe Systems Incorporated, Lenders named therein and ABN AMRO Bank N.V., as Administrative Agent, with certain related Credit Documents	10-Q	9/3/99	10.54	
10.55	1999 Nonstatutory Stock Option Plan*	S-8	9/15/99	4.6	
10.56	Note Secured by Deed of Trust and Promissory Note*	10-K	12/3/99	10.56	
10.57	Confidential Executive Resignation Agreement And General Release of Claims*	10-K	12/3/99	10.57	
10.58	Technical Support Agreement†	10-K	12/1/00	10.58	
10.59	Turnkey Agreement, Europe†	10-Q	3/3/00	10.59	
10.60	European Logistical Services Agreement†	10-K	12/1/00	10.60	
10.61	North America Logistical Agreement†	10-Q	3/3/00	10.61	
10.62	Turnkey Agreement, Adobe Program Packages†	10-Q	3/3/00	10.62	
10.63	1996 Outside Directors' Stock Option Plan, as amended*	S-8	6/16/00	4.7	

10.64	Forms of Stock Option Agreements used in connection with the 1996 Outside Directors' Stock Option Plan*	S-8	6/16/00	4.8	
10.65	Amendment to the European Logistical Services Agreement †	10-Q	9/1/00	10.65	
10.66	Credit Agreement among Adobe Systems, Incorporated, Lenders Named therein and ABN Amro Bank N.V., as Administrative Agent, with Certain Related Credit Documents	10-Q	9/1/00	10.66	
10.67	Amendment No. 1 to 1999 Credit Agreement among Adobe Systems, Incorporated, Lenders Named Therein and ABN Amro Bank N.V., as Administrative Agent, with Certain Related Credit Documents	10-Q	9/1/00	10.67	
10.68	Amendment No. 2 to Amended, Restated, and Consolidated Master Lease of Land and Improvements between Adobe Systems, Incorporated and Sumitomo Bank Leasing and Finance, Inc.	10-Q	9/1/00	10.68	
10.69	1999 Nonstatutory Stock Option Plan, as amended*	S-8	12/22/00	4.6	
10.70	1997 Employee Stock Purchase Plan, as amended*	10-K	12/1/00	10.70	
10.71	1999 Nonstatutory Stock Option Plan, as amended*	S-8	3/15/01	4.7	
10.72	Extension of European Logistical Services Agreement				X
10.73	Extension of North American Logistical Services Agreement				X
10.74	Amendment No. 1 to Technical Support Agreement ‡				X

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* Compensatory plan or arrangement

† Order obtained granting Confidential Treatment, as requested.

‡ Confidential Treatment Request filed April 13, 2001

SIGNATURE

Pursuant to the requirements 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/ MURRAY J. DEMO

Murray J. Demo,
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: April 13, 2001

SUMMARY OF TRADEMARKS

The following trademarks of Adobe Systems Incorporated, which may be registered in certain jurisdictions, are referenced in this Form 10-Q:

Adobe
Acrobat
Adobe Premiere
After Effects
ePaper
FrameMaker
Illustrator
InDesign
LiveMotion
PageMaker
PageMill
Photoshop
PostScript

All other brand or product names are trademarks or registered trademarks of their respective owners.

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