

ADOBE SYSTEMS INC
Form 10-Q
March 25, 2015

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

FORM 10-Q
(Mark One)

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

For the quarterly period ended February 27, 2015

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 95110-2704
(Address of principal executive offices and zip code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller

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reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No
The number of shares outstanding of the registrant's common stock as of March 20, 2015 was 500,269,100.

ADOBE SYSTEMS INCORPORATED
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PART I—FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ADOBE SYSTEMS INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

	February 27, 2015 (Unaudited)	November 28, 2014 (*)
ASSETS		
Current assets:		
Cash and cash equivalents	\$712,884	\$1,117,400
Short-term investments	2,463,936	2,622,091
Trade receivables, net of allowances for doubtful accounts of \$7,201 and \$7,867, respectively	532,427	591,800
Deferred income taxes	60,470	95,279
Prepaid expenses and other current assets	202,442	175,758
Total current assets	3,972,159	4,602,328
Property and equipment, net	784,314	785,123
Goodwill	5,396,174	4,721,962
Purchased and other intangibles, net	629,317	469,662
Investment in lease receivable	80,439	80,439
Other assets	146,019	126,315
Total assets	\$11,008,422	\$10,785,829
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Trade payables	\$71,670	\$68,377
Accrued expenses	564,211	683,866
Debt and capital lease obligations	64	603,229
Accrued restructuring	2,580	17,120
Income taxes payable	19,934	23,920
Deferred revenue	1,129,701	1,097,923
Total current liabilities	1,788,160	2,494,435
Long-term liabilities:		
Debt	1,901,554	911,086
Deferred revenue	53,568	57,401
Accrued restructuring	4,495	5,194
Income taxes payable	245,063	125,746
Deferred income taxes	348,644	342,315
Other liabilities	77,918	73,747
Total liabilities	4,419,402	4,009,924
Stockholders' equity:		
Preferred stock, \$0.0001 par value; 2,000 shares authorized, none issued	—	—
Common stock, \$0.0001 par value; 900,000 shares authorized; 600,834 shares issued;	61	61
500,048 and 497,484 shares outstanding, respectively		
Additional paid-in-capital	3,897,838	3,778,495

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Retained earnings	6,756,803	6,924,294	
Accumulated other comprehensive income (loss)	(103,810) (8,094)
Treasury stock, at cost (100,786 and 103,350 shares, respectively), net of reissuances	(3,961,872) (3,918,851)
Total stockholders' equity	6,589,020	6,775,905	
Total liabilities and stockholders' equity	\$ 11,008,422	\$ 10,785,829	

The Condensed Consolidated Balance Sheet as of November 28, 2014 has been derived from the audited (*) Consolidated Financial Statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.
See accompanying Notes to Condensed Consolidated Financial Statements.

Table of ContentsADOBE SYSTEMS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

	Three Months Ended	
	February 27, 2015	February 28, 2014
Revenue:		
Subscription	\$713,442	\$423,563
Products	290,774	471,454
Services and support	104,965	105,103
Total revenue	1,109,181	1,000,120
Cost of revenue:		
Subscription	95,527	76,732
Products	19,703	27,498
Services and support	51,568	44,279
Total cost of revenue	166,798	148,509
Gross profit	942,383	851,611
Operating expenses:		
Research and development	215,509	209,525
Sales and marketing	392,741	410,141
General and administrative	145,081	138,984
Restructuring and other charges	1,755	663
Amortization of purchased intangibles	14,272	13,552
Total operating expenses	769,358	772,865
Operating income	173,025	78,746
Non-operating income (expense):		
Interest and other income (expense), net	3,338	3,145
Interest expense	(14,545)	) (16,590
Investment gains (losses), net	1,430	) (409
Total non-operating income (expense), net	(9,777)	) (13,854
Income before income taxes	163,248	64,892
Provision for income taxes	78,360	17,846
Net income	\$84,888	\$47,046
Basic net income per share	\$0.17	\$0.09
Shares used to compute basic net income per share	498,754	496,948
Diluted net income per share	\$0.17	\$0.09
Shares used to compute diluted net income per share	507,526	508,340

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Three Months Ended	
	February 27, 2015	February 28, 2014
	Increase/(Decrease)	
Net income	\$84,888	\$47,046
Other comprehensive income, net of taxes:		
Available-for-sale securities:		
Unrealized gains / losses on available-for-sale securities	(817	) 1,510
Reclassification adjustment for gains / losses on available-for-sale securities recognized	(927	) (637
Net increase (decrease) from available-for-sale securities	(1,744	) 873
Derivatives designated as hedging instruments:		
Unrealized gains / losses on derivative instruments	12,296	(29
Reclassification adjustment for gains / losses on derivative instruments recognized	(23,712	) (2,798
Net increase (decrease) from derivatives designated as hedging instruments	(11,416	) (2,827
Foreign currency translation adjustments	(82,556	) 12,443
Other comprehensive income (loss), net of taxes	(95,716	) 10,489
Total comprehensive income (loss), net of taxes	\$(10,828	) \$57,535

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended	
	February 27, 2015	February 28, 2014
Cash flows from operating activities:		
Net income	\$84,888	\$47,046
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	79,635	77,636
Stock-based compensation	84,208	82,788
Deferred income taxes	4,879	(3,341)
Unrealized (gains) losses on investments	(9,687)	) 975
Tax benefit (shortfall) from employee stock option plans	33,584	(38)
Excess tax benefits from stock-based compensation	(33,599)) —
Other non-cash items	(1,241)	) (681)
Changes in operating assets and liabilities, net of acquired assets and assumed liabilities:		
Trade receivables, net	62,058	90,492
Prepaid expenses and other current assets	(23,912)	) (43,559)
Trade payables	1,368	2,412
Accrued expenses	(125,281)	) (60,140)
Accrued restructuring	(14,539)	) (528)
Income taxes payable	21,610	6,336
Deferred revenue	19,044	52,275
Net cash provided by operating activities	183,015	251,673
Cash flows from investing activities:		
Purchases of short-term investments	(318,938)	) (377,598)
Maturities of short-term investments	88,729	46,120
Proceeds from sales of short-term investments	382,611	269,732
Acquisitions, net of cash acquired	(800,342)) —
Purchases of property and equipment	(35,546)	) (29,393)
Purchases of long-term investments and other assets	(16,031)	) (4,062)
Proceeds from sale of long-term investments	1,146	779
Net cash used for investing activities	(698,371)	) (94,422)
Cash flows from financing activities:		
Purchases of treasury stock	(200,000)	) (200,000)
Proceeds from issuance of treasury stock	56,320	189,804
Cost of issuance of treasury stock	(150,017)	) (243,580)
Excess tax benefits from stock-based compensation	33,599	—
Proceeds from debt	989,280	—
Repayment of debt and capital lease obligations	(602,189)	) (4,433)
Debt issuance costs	(7,718)) —
Net cash provided by (used for) financing activities	119,275	(258,209)
Effect of foreign currency exchange rates on cash and cash equivalents	(8,435)	) 318
Net decrease in cash and cash equivalents	(404,516)	) (100,640)
Cash and cash equivalents at beginning of period	1,117,400	834,556
Cash and cash equivalents at end of period	\$712,884	\$733,916

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Supplemental disclosures:

Cash paid for income taxes, net of refunds	\$5,994	\$16,401
Cash paid for interest	\$16,885	\$31,740

See accompanying Notes to Condensed Consolidated Financial Statements.

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ADOBE SYSTEMS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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

We have prepared the accompanying unaudited Condensed Consolidated Financial Statements pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Pursuant to these rules and regulations, we have condensed or omitted certain information and footnote disclosures we normally include in our annual Consolidated Financial Statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). In management’s opinion, we have made all adjustments (consisting only of normal, recurring adjustments, except as otherwise indicated) necessary to fairly present our financial position, results of operations and cash flows. Our interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These financial statements and accompanying notes should be read in conjunction with the Consolidated Financial Statements and notes thereto in our Annual Report on Form 10-K for the fiscal year ended November 28, 2014 on file with the SEC (our “Annual Report”).

There have been no material changes to our significant accounting policies as compared to the significant accounting policies described in our Annual Report.

Recent Accounting Pronouncements Not Yet Effective

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. Early adoption is not permitted. The updated standard is expected to become effective for us in the first quarter of fiscal 2018. We have not yet selected a transition method and we are currently evaluating the effect that the updated standard will have on our consolidated financial statements and related disclosures.

With the exception of the new revenue standard discussed above, there have been no other recent accounting pronouncements or changes in accounting pronouncements during the three months ended February 27, 2015, as compared to the recent accounting pronouncements described in our Annual Report on Form 10-K for the fiscal year ended November 28, 2014, that are of significance or potential significance to us.

NOTE 2. ACQUISITIONS

On January 27, 2015, we completed our acquisition of privately held Fotolia, a leading marketplace for royalty-free photos, images, graphics and HD videos. During the first quarter of fiscal 2015, we began integrating Fotolia into our Digital Media reportable segment.

Under the acquisition method of accounting, the total preliminary purchase price was allocated to Fotolia's net tangible and intangible assets based upon their estimated fair values as of January 27, 2015. The total preliminary purchase price for Fotolia was \$806.8 million of which \$743.9 million was allocated to goodwill that was non-deductible for tax purposes, \$209.2 million to identifiable intangible assets and \$146.3 million to net liabilities assumed. The fair values assigned to assets acquired and liabilities assumed are based on management’s best estimates and assumptions as of the reporting date and are considered preliminary pending finalization of valuation analyses pertaining to intangible assets assumed, liabilities assumed, equity awards assumed and tax liabilities assumed including calculation of deferred tax assets and liabilities. The impact of this acquisition was not material to our Condensed Consolidated Financial Statements.

NOTE 3. CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

Cash equivalents consist of instruments with remaining maturities of three months or less at the date of purchase. We classify all of our cash equivalents and short-term investments as “available-for-sale.” In general, these investments are free of trading restrictions. We carry these investments at fair value, based on quoted market prices or other readily available market information. Unrealized gains and losses, net of taxes, are included in accumulated other comprehensive income, which is reflected as a separate component of stockholders’ equity in our Condensed Consolidated Balance Sheets. Gains and losses are recognized when realized in our Condensed Consolidated

Statements of Income. When we have determined that an other-than-temporary decline in fair value has occurred, the amount of the decline that is related to a credit loss is recognized in income. Gains and losses are determined using the specific identification method.

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Cash, cash equivalents and short-term investments consisted of the following as of February 27, 2015 (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Current assets:				
Cash	\$ 196,164	\$—	\$—	\$ 196,164
Cash equivalents:				
Money market mutual funds	507,132	—	—	507,132
Time deposits	9,588	—	—	9,588
Total cash equivalents	516,720	—	—	516,720
Total cash and cash equivalents	712,884	—	—	712,884
Short-term fixed income securities:				
Corporate bonds and commercial paper	1,531,568	5,586	(822)	) 1,536,332
Asset-backed securities	42,831	28	(8)	) 42,851
Municipal securities	169,711	345	(11)	) 170,045
U.S. agency securities	355,811	608	(83)	) 356,336
U.S. Treasury securities	358,063	404	(95)	) 358,372
Total short-term investments	2,457,984	6,971	(1,019)	) 2,463,936
Total cash, cash equivalents and short-term investments	\$3,170,868	\$6,971	\$(1,019)) \$3,176,820

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Cash, cash equivalents and short-term investments consisted of the following as of November 28, 2014 (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Current assets:				
Cash	\$348,283	\$—	\$—	\$348,283
Cash equivalents:				
Money market mutual funds	705,978	—	—	705,978
Time deposits	63,139	—	—	63,139
Total cash equivalents	769,117	—	—	769,117
Total cash and cash equivalents	1,117,400	—	—	1,117,400
Short-term fixed income securities:				
Corporate bonds and commercial paper	1,514,632	5,253	(509)	) 1,519,376
Foreign government securities	4,499	12	—	4,511
Municipal securities	174,775	438	(12)	) 175,201
U.S. agency securities	497,154	1,295	(64)	) 498,385
U.S. Treasury securities	423,075	1,080	(28)	) 424,127
Subtotal	2,614,135	8,078	(613)	) 2,621,600
Marketable equity securities	153	338	—	491
Total short-term investments	2,614,288	8,416	(613)	) 2,622,091
Total cash, cash equivalents and short-term investments	\$3,731,688	\$8,416	\$(613)	) \$3,739,491

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

The following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category, that have been in an unrealized loss position for less than twelve months, as of February 27, 2015 and November 28, 2014 (in thousands):

	2015		2014	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds and commercial paper	\$370,130	\$(762)	) \$291,890	\$(443)
Municipal securities	17,313	(11)	) 21,759	(12)
U.S. Treasury and agency securities	185,524	(173)	) 43,507	(64)
Asset-backed securities	12,550	(8)) —	—
Total	\$585,517	\$(954)	) \$357,156	\$(519)

There were 287 securities and 213 securities in an unrealized loss position for less than twelve months at February 27, 2015 and at November 28, 2014, respectively.

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category, that were in a continuous unrealized loss position for more than twelve months, as of February 27, 2015 and November 28, 2014 (in thousands):

	2015		2014	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds and commercial paper	\$6,890	\$(60)	\$8,636	\$(66)
U.S. Treasury and agency securities	648	(5)	5,884	(28)
Total	\$7,538	\$(65)	\$14,520	\$(94)

As of February 27, 2015, there were five securities in an unrealized loss position for more than twelve months. As of November 28, 2014, there were eight securities in an unrealized loss position for more than twelve months.

The following table summarizes the cost and estimated fair value of short-term fixed income securities classified as short-term investments based on stated effective maturities as of February 27, 2015 (in thousands):

	Amortized Cost	Estimated Fair Value
Due within one year	\$604,410	\$605,226
Due between one and two years	915,217	917,464
Due between two and three years	705,725	707,533
Due after three years	232,632	233,713
Total	\$2,457,984	\$2,463,936

We review our debt and marketable equity securities classified as short-term investments on a regular basis to evaluate whether or not any security has experienced an other-than-temporary decline in fair value. We consider factors such as the length of time and extent to which the market value has been less than the cost, the financial condition and near-term prospects of the issuer and our intent to sell, or whether it is more likely than not we will be required to sell the investment before recovery of the investment's amortized cost basis. If we believe that an other-than-temporary decline exists in one of these securities, we write down these investments to fair value. For debt securities, the portion of the write-down related to credit loss would be recorded to interest and other income, net in our Condensed Consolidated Statements of Income. Any portion not related to credit loss would be recorded to accumulated other comprehensive income, which is reflected as a separate component of stockholders' equity in our Condensed Consolidated Balance Sheets. For equity securities, the write-down would be recorded to investment gains (losses), net in our Condensed Consolidated Statements of Income. During the three months ended February 27, 2015, we did not consider any of our investments to be other-than-temporarily impaired.

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 4. FAIR VALUE MEASUREMENTS

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

We measure certain financial assets and liabilities at fair value on a recurring basis. There have been no transfers between fair value measurement levels during the three months ended February 27, 2015.

The fair value of our financial assets and liabilities at February 27, 2015 was determined using the following inputs (in thousands):

	Fair Value Measurements at Reporting Date Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents:				
Money market mutual funds	\$507,132	\$507,132	\$—	\$—
Time deposits	9,588	9,588	—	—
Short-term investments:				
Corporate bonds and commercial paper	1,536,332	—	1,536,332	—
Asset-backed securities	42,851	—	42,851	—
Municipal securities	170,045	—	170,045	—
U.S. agency securities	356,336	—	356,336	—
U.S. Treasury securities	358,372	—	358,372	—
Prepaid expenses and other current assets:				
Foreign currency derivatives	30,418	—	30,418	—
Other assets:				
Deferred compensation plan assets	29,840	558	29,282	—
Interest rate swap derivatives	15,244	—	15,244	—
Total assets	\$3,056,158	\$517,278	\$2,538,880	\$—
Liabilities:				
Accrued expenses:				
Foreign currency derivatives	\$2,118	\$—	\$2,118	\$—
Total liabilities	\$2,118	\$—	\$2,118	\$—

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The fair value of our financial assets and liabilities at November 28, 2014 was determined using the following inputs (in thousands):

	Fair Value Measurements at Reporting Date Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents:				
Money market mutual funds	\$705,978	\$705,978	\$—	\$—
Time deposits	63,139	63,139	—	—
Short-term investments:				
Corporate bonds and commercial paper	1,519,376	—	1,519,376	—
Foreign government securities	4,511	—	4,511	—
Marketable equity securities	491	491	—	—
Municipal securities	175,201	—	175,201	—
U.S. agency securities	498,385	—	498,385	—
U.S. Treasury securities	424,127	—	424,127	—
Prepaid expenses and other current assets:				
Foreign currency derivatives	32,991	—	32,991	—
Other assets:				
Deferred compensation plan assets	25,745	549	25,196	—
Interest rate swap derivatives	14,268	—	14,268	—
Total assets	\$3,464,212	\$770,157	\$2,694,055	\$—
Liabilities:				
Accrued expenses:				
Foreign currency derivatives	\$663	\$—	\$663	\$—
Total liabilities	\$663	\$—	\$663	\$—

See Note 3 for further information regarding the fair value of our financial instruments.

Our fixed income available-for-sale securities consist of high quality, investment grade securities from diverse issuers with a minimum credit rating of BBB and a weighted average credit rating of AA-. We value these securities based on pricing from pricing vendors who may use quoted prices in active markets for identical assets (Level 1 inputs) or inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs) in determining fair value. However, we classify all of our fixed income available-for-sale securities as having Level 2 inputs. The valuation techniques used to measure the fair value of our financial instruments and derivatives having Level 2 inputs were derived from non-binding market consensus prices that are corroborated by observable market data, quoted market prices for similar instruments, or pricing models such as discounted cash flow techniques. Our procedures include controls to ensure that appropriate fair values are recorded such as comparing prices obtained from multiple independent sources.

Our deferred compensation plan assets consist of prime money market funds and mutual funds.

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

We also have direct investments in privately held companies accounted for under the cost method, which are periodically assessed for other-than-temporary impairment. If we determine that an other-than-temporary impairment has occurred, we write down the investment to its fair value. We estimate fair value of our cost method investments considering available information such as pricing in recent rounds of financing, current cash positions, earnings and cash flow forecasts, recent operational performance and any other readily available market data. For the three months ended February 27, 2015 and February 28, 2014, we determined there were no other-than-temporary impairments on our cost method investments.

As of February 27, 2015, the carrying value of our lease receivables approximated fair value, based on Level 2 valuation inputs which include Treasury rates, LIBOR rates and applicable credit spreads. See Note 12 for further details regarding our investment in lease receivable.

The fair value of our senior notes was \$2.0 billion as of February 27, 2015, based on observable market prices in less active markets and categorized as Level 2. See Note 13 for further details regarding our debt.

NOTE 5. DERIVATIVES

Hedge accounting and hedging programs

We recognize all derivative instruments as either assets or liabilities in our Condensed Consolidated Balance Sheets and measure them at fair value. Gains and losses resulting from changes in fair value are accounted for depending on the use of the derivative and whether it is designated and qualifies for hedge accounting.

We evaluate hedge effectiveness on our hedges that are designated and qualify for hedge accounting at the inception of the hedge prospectively as well as retrospectively, and record any ineffective portion of the hedging instruments in interest and other income (expense), net on our Condensed Consolidated Statements of Income. The time value of purchased contracts is recorded in interest and other income (expense), net in our Condensed Consolidated Statements of Income.

The bank counterparties to these contracts expose us to credit-related losses in the event of their nonperformance which are largely mitigated with collateral security agreements that provide for collateral to be received or posted when the net fair value of certain financial instruments fluctuates from contractually established thresholds. In addition, the Company enters into master netting arrangements which have the ability to further limit credit related losses with the same counterparty by permitting net settlement of transactions. Our hedging policy also establishes maximum limits for each counterparty to mitigate any concentration of risk.

Balance Sheet Hedging - Hedges of Foreign Currency Assets and Liabilities

We hedge our net recognized foreign currency denominated assets and liabilities with foreign exchange forward contracts to reduce the risk that the value of these assets and liabilities will be adversely affected by changes in exchange rates. These contracts hedge assets and liabilities that are denominated in foreign currencies and are carried at fair value as either assets or liabilities on the Condensed Consolidated Balance Sheet with changes in the fair value recorded to interest and other income (expense), net in our Condensed Consolidated Statements of Income. These contracts do not subject us to material balance sheet risk due to exchange rate movements because gains and losses on these derivatives are intended to offset gains and losses on the assets and liabilities being hedged.

Cash Flow Hedging—Hedges of Forecasted Foreign Currency Revenue and Interest Rate Risk

In countries outside the U.S., we transact business in U.S. Dollars and in various other currencies. We may use foreign exchange option contracts or forward contracts to hedge certain cash flow exposures resulting from changes in these foreign currency exchange rates. These foreign exchange contracts, carried at fair value, have maturities of up to twelve months. We enter into these foreign exchange contracts to hedge a portion of our forecasted foreign currency denominated revenue in the normal course of business and accordingly, they are not speculative in nature.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

We recognize these contracts as derivative instruments and they are classified as either assets or liabilities on the Condensed Consolidated Balance Sheets and measured on a recurring basis at fair value. Gains and losses resulting from changes in fair value are accounted for depending on the use of the contract and whether it is designated and qualifies for hedge accounting. To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge, and the hedges must be highly effective in offsetting changes to future cash flows on hedged transactions. We record changes in the intrinsic value of these cash flow hedges in accumulated other comprehensive income in our Condensed Consolidated Balance Sheets, until the forecasted transaction occurs. When the forecasted transaction occurs, we reclassify the related gain or loss on the cash flow hedge to revenue. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, we reclassify the gain or loss on the related cash flow hedge from accumulated other comprehensive income to interest and other income (expense), net in our Condensed Consolidated Statements of Income at that time. If we do not elect hedge accounting, or the contract does not qualify for hedge accounting treatment, the changes in fair market value from period to period are recorded in interest and other income (expense), net in our Condensed Consolidated Statements of Income.

In December 2014, in anticipation of issuing new long-term fixed rate debt, we entered into an interest rate lock agreement on a notional amount of \$600.0 million to hedge against the variability of future interest payments due to changes in the benchmark interest rate. This instrument was designated as a cash flow hedge. Upon issuance of our \$1.0 billion of 3.25% senior notes due February 1, 2025 (the “2025 Notes”) in January 2015, we terminated the instrument and incurred a loss of \$16.2 million. This loss is recorded in the stockholders’ equity section in our Condensed Consolidated Balance Sheets in accumulated other comprehensive income and will be reclassified to interest expense over a ten-year term consistent with the impact of the hedged item. See Note 13 for further details regarding our debt.

Fair Value Hedging - Hedges of Interest Rate Risk

During the third quarter of fiscal 2014, we entered into interest rate swaps designated as a fair value hedges related to our \$900.0 million of 4.75% fixed interest rate senior notes due February 1, 2020 (the “2020 Notes”). In effect, the interest rate swaps convert the fixed interest rate on our 2020 Notes to a floating interest rate based on the London Interbank Offered Rate (“LIBOR”). Under the terms of the swaps, we will pay monthly interest at the one-month LIBOR rate plus a fixed number of basis points on the \$900.0 million notional amount through February 1, 2020. In exchange, we will receive 4.75% fixed rate interest from the swap counterparties. See Note 13 for further details regarding our debt.

The interest rate swaps are accounted for as fair value hedges and substantially offset the changes in fair value of the hedged portion of the underlying debt that are attributable to the changes in market risk. Therefore, the gains and losses related to changes in the fair value of the interest rate swaps are included in interest and other income (expense), net in our Condensed Consolidated Statement of Income. The fair value of the interest rate swaps is reflected as either assets or liabilities in our Condensed Consolidated Balance Sheets.

The fair value of derivative instruments on our Condensed Consolidated Balance Sheets as of February 27, 2015 and November 28, 2014 were as follows (in thousands):

2015		2014	
Fair Value	Fair Value	Fair Value	Fair Value

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	Asset Derivatives	Liability Derivatives	Asset Derivatives	Liability Derivatives
Derivatives designated as hedging instruments:				
Foreign exchange option contracts ^{(1) (3)}	\$29,546	\$—	\$31,275	\$—
Interest rate swap ⁽²⁾	15,244	—	14,268	—
Derivatives not designated as hedging instruments:				
Foreign exchange forward contracts ⁽¹⁾	872	2,118	1,716	663
Total derivatives	\$45,662	\$2,118	\$47,259	\$663

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

- (1) Included in prepaid expenses and other current assets and accrued expenses for asset derivatives and liability derivatives, respectively, on our Condensed Consolidated Balance Sheets.
- (2) Included in other assets or other liabilities on our Condensed Consolidated Balance Sheets.
- (3) Hedging effectiveness expected to be recognized into income within the next twelve months.

The effect of foreign currency derivative instruments designated as cash flow hedges and of foreign currency derivative instruments not designated as hedges in our Condensed Consolidated Statements of Income for the three months ended February 27, 2015 and February 28, 2014 were as follows (in thousands):

	2015		2014	
	Foreign	Foreign	Foreign	Foreign
	Exchange	Exchange	Exchange	Exchange
	Option	Forward	Option	Forward
	Contracts	Contracts	Contracts	Contracts
Derivatives in cash flow hedging relationships:				
Net gain (loss) recognized in OCI, net of tax ⁽¹⁾	\$22,239	\$—	\$(29) \$—
Net gain (loss) reclassified from accumulated OCI into income, net of tax ⁽²⁾	\$23,712	\$—	\$2,798	\$—
Net gain (loss) recognized in income ⁽³⁾	\$(2,935	) \$—	\$(3,543) \$—
Derivatives not designated as hedging relationships:				
Net gain (loss) recognized in income ⁽⁴⁾	\$—	\$2,070	\$—	\$1,235

(1) Net change in the fair value of the effective portion classified in other comprehensive income (“OCI”).

(2) Effective portion classified as revenue.

(3) Ineffective portion and amount excluded from effectiveness testing classified in interest and other income (expense), net.

(4) Classified in interest and other income (expense), net.

NOTE 6. GOODWILL AND PURCHASED AND OTHER INTANGIBLES

Goodwill as of February 27, 2015 and November 28, 2014 was \$5.396 billion and \$4.722 billion, respectively. The increase was due to our acquisition of Fotolia and offset by foreign currency translation adjustments.

Purchased and other intangible assets subject to amortization as of February 27, 2015 and November 28, 2014 were as follows (in thousands):

	2015			2014		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Purchased technology	\$409,114	\$(279,237	) \$129,877	\$405,208	\$(264,697	) \$140,511
Customer contracts and relationships	\$513,836	\$(153,062	) \$360,774	\$376,994	\$(143,330	) \$233,664
Trademarks	90,067	(38,637	) 51,430	67,268	(36,516	) 30,752
Acquired rights to use technology	149,825	(91,573	) 58,252	148,836	(86,258	) 62,578
Localization	614	(197	) 417	549	(382	) 167
Other intangibles	30,535	(1,968	) 28,567	3,163	(1,173	) 1,990
Total other intangible assets	\$784,877	\$(285,437	) \$499,440	\$596,810	\$(267,659	) \$329,151

Purchased and other intangible assets, net	\$1,193,991	\$ (564,674)	\$629,317	\$1,002,018	\$ (532,356)	\$469,662
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Amortization expense related to purchased and other intangible assets was \$39.5 million and \$38.4 million for the three months ended February 27, 2015 and February 28, 2014, respectively. Of these amounts, \$24.9 million were included in cost of sales for both the three months ended February 27, 2015 and February 28, 2014.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

As of February 27, 2015, we expect amortization expense in future periods to be as follows (in thousands):

Fiscal Year	Purchased Technology	Other Intangible Assets
Remainder of 2015	\$48,034	\$85,315
2016	28,789	107,765
2017	21,384	98,011
2018	14,345	87,345
2019	7,364	60,515
Thereafter	9,961	60,489
Total expected amortization expense	\$129,877	\$499,440

NOTE 7. ACCRUED EXPENSES

Accrued expenses as of February 27, 2015 and November 28, 2014 consisted of the following (in thousands):

	2015	2014
Accrued compensation and benefits	\$221,137	\$320,679
Sales and marketing allowances	64,348	75,627
Accrued corporate marketing	30,061	28,369
Taxes payable	22,157	24,658
Royalties payable	15,094	15,073
Accrued interest expense	8,163	22,621
Other	203,251	196,839
Accrued expenses	\$564,211	\$683,866

Other primarily includes general corporate accruals for technical support and local and regional expenses, including our accrual for a loss contingency. Other is also comprised of deferred rent related to office locations with rent escalations and foreign currency liability derivatives. See Note 12 for further information regarding the loss contingency.

NOTE 8. STOCK-BASED COMPENSATION

Summary of Restricted Stock Units

Restricted stock unit activity for the three months ended February 27, 2015 and the fiscal year ended November 28, 2014 was as follows (in thousands):

	2015	2014
Beginning outstanding balance	13,564	17,948
Awarded	2,915	4,413
Released	(5,226)	(7,502)
Forfeited	(251)	(1,295)
Ending outstanding balance	11,002	13,564

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Information regarding restricted stock units outstanding at February 27, 2015 and February 28, 2014 is summarized below:

	Number of Shares (thousands)	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value ^(*) (millions)
2015			
Restricted stock units outstanding	11,002	1.39	\$870.2
Restricted stock units vested and expected to vest	9,557	1.33	\$746.7
2014			
Restricted stock units outstanding	15,044	1.45	\$1,032.5
Restricted stock units vested and expected to vest	13,177	1.39	\$899.0

The intrinsic value is calculated as the market value as of the end of the fiscal period. As reported by the NASDAQ^(*) Global Select Market, the market values as of February 27, 2015 and February 28, 2014 were \$79.10 and \$68.63, respectively.

Summary of Performance Shares

On January 26, 2015, our Executive Compensation Committee approved the 2015 Performance Share Program, including the award calculation methodology, under the terms of our 2003 Equity Incentive Plan. Under our 2015 Performance Share Program (“2015 Program”), shares may be earned based on the achievement of an objective relative total stockholder return measured over a three-year performance period. The purpose of the 2015 Program is to help focus key employees on building stockholder value, provide significant award potential for achieving outstanding Company performance and enhance the ability of the Company to attract and retain highly talented and competent individuals. Performance share awards will be awarded and fully vest upon the Executive Compensation Committee’s certification of the level of achievement following the three-year anniversary of the grant date on January 24, 2018. Participants in the 2015 Program generally have the ability to receive up to 200% of the target number of shares originally granted.

On January 24, 2014, our Executive Compensation Committee approved the 2014 Performance Share Program, including the award calculation methodology, under the terms of our 2003 Equity Incentive Plan. Under our 2014 Performance Share Program (“2014 Program”), shares may be earned based on the achievement of an objective relative total stockholder return measured over a three-year performance period. The purpose of the 2014 Program is to help focus key employees on building stockholder value, provide significant award potential for achieving outstanding company performance and enhance the ability of the Company to attract and retain highly talented and competent individuals. Performance share awards will be awarded and fully vest upon the Executive Compensation Committee’s certification of the level of achievement following the three-year anniversary of the grant date on January 24, 2017. Participants in the 2014 Program generally have the ability to receive up to 200% of the target number of shares originally granted.

Effective January 24, 2013, our Executive Compensation Committee modified our Performance Share Program by eliminating the use of qualitative performance objectives, with 100% of shares to be earned based on the achievement of an objective relative total stockholder return measured over a three-year performance period. Performance awards were granted under the 2013 Performance Share Program (“2013 Program”) pursuant to the terms of our 2003 Equity

Incentive Plan. The purpose of the 2013 Program is to align key management and senior leadership with stockholders' interests over the long term and to retain key employees. Performance share awards will be awarded and fully vest upon the Executive Compensation Committee's certification of the level of achievement following the three-year anniversary of the grant date on January 24, 2016. Participants in the 2013 Program generally have the ability to receive up to 200% of the target number of shares originally granted.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

As of February 27, 2015, the shares awarded under our 2013, 2014, and 2015 Performance Share Programs are yet to be achieved. The following table sets forth the summary of performance share activity under our 2013, 2014, and 2015 Performance Share Programs for the three months ended February 27, 2015 and the fiscal year ended November 28, 2014 (in thousands):

	2015		2014	
	Shares Granted	Maximum Shares Eligible to Receive	Shares Granted	Maximum Shares Eligible to Receive
Beginning outstanding balance	1,517	3,034	854	1,707
Awarded	671	1,342	709	1,417
Forfeited	(37	) (74	) (46	) (90
Ending outstanding balance	2,151	4,302	1,517	3,034

The following table sets forth the summary of performance share activity under our performance share programs prior to fiscal 2013, based upon share awards actually achieved, for the three months ended February 27, 2015 and the fiscal year ended November 28, 2014 (in thousands):

	2015	2014
Beginning outstanding balance	354	861
Released	(354	) (486
Forfeited	—	(21
Ending outstanding balance	—	354

Information regarding performance shares outstanding at February 28, 2014 is summarized below:

	Number of Shares (thousands)	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value ^(*) (millions)
Performance shares outstanding	365	0.90	\$25.1
Performance shares vested and expected to vest	336	0.90	\$22.9

(*) The intrinsic value is calculated as the market value as of the end of the fiscal period. As reported by the NASDAQ Global Select Market, the market value as of February 28, 2014 was \$68.63.

Summary of Stock Options

There were no option grants during the three months ended February 27, 2015 and the three months ended February 28, 2014. Option activity for the three months ended February 27, 2015 and the fiscal year ended November 28, 2014 was as follows (in thousands):

	2015	2014
Beginning outstanding balance	3,173	7,359
Exercised	(701	) (4,055
Cancelled	(17) (153
Increase due to acquisition	—	22
Ending outstanding balance	2,455	3,173

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Information regarding stock options outstanding at February 27, 2015 and February 28, 2014 is summarized below:

	Number of Shares (thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value ^(*) (millions)
2015				
Options outstanding	2,455	\$28.87	3.03	\$123.3
Options vested and expected to vest	2,443	\$28.95	3.01	\$122.5
Options exercisable	2,301	\$29.90	2.78	\$113.2
2014				
Options outstanding	5,807	\$29.46	3.21	\$227.5
Options vested and expected to vest	5,730	\$29.57	3.18	\$223.8
Options exercisable	4,681	\$30.64	2.73	\$177.9

The intrinsic value is calculated as the difference between the market value as of the end of the fiscal period and ^(*) the exercise price of the shares. As reported by the NASDAQ Global Select Market, the market values as of February 27, 2015 and February 28, 2014 were \$79.10 and \$68.63, respectively.

Summary of Employee Stock Purchase Plan Shares

The expected life of the employee stock purchase plan ("ESPP") shares is the average of the remaining purchase periods under each offering period. The assumptions used to value employee stock purchase rights during the three months ended February 27, 2015 and February 28, 2014 were as follows:

	Three Months	
	2015	2014
Expected life (in years)	0.5 - 2.0	0.5 - 2.0
Volatility	27% - 30%	27% - 28%
Risk free interest rate	0.12% - 0.67%	0.09% - 0.39%

Employees purchased 0.7 million shares at an average price of \$50.31 and 1.2 million shares at an average price of \$27.84 for the three months ended February 27, 2015 and February 28, 2014, respectively. The intrinsic value of shares purchased during the three months ended February 27, 2015 and February 28, 2014 was \$16.0 million and \$39.0 million, respectively. The intrinsic value is calculated as the difference between the market value on the date of purchase and the purchase price of the shares.

Compensation Costs

As of February 27, 2015, there was \$552.3 million of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock-based awards which will be recognized over a weighted average period of 2.0 years. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Total stock-based compensation costs that have been included in our Condensed Consolidated Statements of Income for the three months ended February 27, 2015 and February 28, 2014 were as follows (in thousands):

Income Statement Classifications	2015		2014	
	Option Grants and Stock Purchase Rights	Restricted Stock and Performance Share Awards	Option Grants and Stock Purchase Rights	Restricted Stock and Performance Share Awards
Cost of revenue—subscription	\$441	\$1,529	\$461	\$1,369
Cost of revenue—services and support	1,216	1,857	731	1,538
Research and development	4,056	26,705	4,257	26,557
Sales and marketing	4,598	27,285	4,763	25,731
General and administrative	1,463	16,761	1,786	15,595
Total	\$11,774	\$74,137	\$11,998	\$70,790

NOTE 9. RESTRUCTURING CHARGES

Fiscal 2014 Restructuring Plan

In the fourth quarter of fiscal 2014, in order to better align our global resources for Digital Media and Digital Marketing, we initiated a restructuring plan to vacate our Research and Development facility in China and our Sales and Marketing facility in Russia. This plan consisted of reductions of approximately 350 full-time positions and we recorded restructuring charges of approximately \$19.2 million through the first quarter of fiscal 2015 related to ongoing termination benefits for the positions eliminated. The amount accrued for the fair value of future contractual obligations under these operating leases was insignificant. During the first quarter of fiscal 2015 we vacated both of these facilities and as of February 27, 2015 we consider the Fiscal 2014 Restructuring Plan to be substantially complete.

Other Restructuring Plans

During the past several years, we have implemented Other Restructuring Plans consisting of reductions in workforce and the consolidation of facilities to better align our resources around our business strategies. As of February 27, 2015, we considered our Other Restructuring Plans to be substantially complete. We continue to make cash outlays to settle obligations under these plans, however the current impact to our Condensed Consolidated Financial Statements is not significant.

Summary of Restructuring Plans

The following table sets forth a summary of restructuring activities related to all of our restructuring plans during the three months ended February 27, 2015 (in thousands):

	November 28, 2014	Costs Incurred	Cash Payments	Other Adjustments	February 27, 2015
Fiscal 2014 Restructuring Plan:					
Termination benefits	\$14,461	\$420	\$(15,731)	) \$994	\$144
Cost of closing redundant facilities	472	—	(227)	) 133	378
Other Restructuring Plans:					
Termination benefits	537	—	(4)) (54)) 479
Cost of closing redundant facilities	6,844	—	(332)) (438)) 6,074

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Total restructuring plans \$22,314 \$420 \$(16,294) \$635 \$7,075

Accrued restructuring charges of \$7.1 million as of February 27, 2015 includes \$2.6 million recorded in accrued restructuring, current and \$4.5 million related to long-term facilities obligations recorded in accrued restructuring, non-current on our Condensed

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Consolidated Balance Sheets. We expect to pay accrued termination benefits through fiscal 2015 and facilities-related liabilities under contract through fiscal 2021 of which approximately 41% will be paid through fiscal 2016.

NOTE 10. STOCKHOLDERS' EQUITY

Retained Earnings

The changes in retained earnings for the three months ended February 27, 2015 were as follows (in thousands):

Balance as of November 28, 2014	\$6,924,294
Net income	84,888
Re-issuance of treasury stock	(252,379)
Balance as of February 27, 2015	\$6,756,803

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

The components of accumulated other comprehensive income (loss) and activity, net of related taxes, as of February 27, 2015 were as follows (in thousands):

	November 28, 2014	Increase / Decrease	Reclassification Adjustments	February 27, 2015
Net unrealized gains on available-for-sale securities:				
Unrealized gains on available-for-sale securities	\$ 8,237	\$(370)	\$ (967)	\$ 6,900
Unrealized losses on available-for-sale securities	(609)	(447)	40	(1,016)
Total net unrealized gains on available-for-sale securities	7,628	(817)	(927)	(1) 5,884
Net unrealized gains / losses on derivative instruments designated as hedging instruments	28,655	12,296	(23,712)	(2) 17,239
Cumulative foreign currency translation adjustments	(44,377)	(82,556)	—	(126,933)
Total accumulated other comprehensive income (loss), net of taxes	\$ (8,094)	\$(71,077)	\$ (24,639)	\$(103,810)

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

(2) Reclassification adjustments for loss on the interest rate lock agreement and gains / losses on other derivative instruments are classified in interest and other income (expense), net and revenue, respectively.

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table sets forth the taxes related to each component of other comprehensive income (loss) for the three months ended February 27, 2015 and February 28, 2014 (in thousands):

	Three Months	
	2015	2014
Available-for-sale securities:		
Unrealized gains / losses	\$(107	) \$(20
Reclassification adjustments	—	(1
Subtotal available-for-sale securities	(107	) (21
Derivatives designated as hedging instruments:		
Unrealized gains / losses on derivative instruments*	6,147	—
Reclassification adjustments*	(53) —
Subtotal derivatives designated as hedging instruments	6,094	—
Foreign currency translation adjustments	(2,095	) 1
Total taxes, other comprehensive income (loss)	\$3,892	\$(20

(*) Taxes related to derivative instruments other than the interest rate lock agreement were zero based on the tax jurisdiction where these derivative instruments were executed.

Stock Repurchase Program

To facilitate our stock repurchase program, designed to return value to our stockholders and minimize dilution from stock issuances, we may repurchase shares in the open market or enter into structured repurchase agreements with third parties. During the three months ended February 27, 2015 and February 28, 2014, we entered into several structured stock repurchase agreements with large financial institutions, whereupon we provided them with prepayments totaling \$200.0 million in each period. Upon completion of the agreement entered into during the three months ended February 27, 2015, there was no remaining balance under the previous \$2.0 billion authority granted by the Board of Directors in April 2012. In the first quarter of fiscal 2015, the Board of Directors approved a new stock repurchase program granting the company authority to repurchase up to \$2.0 billion in common stock through the end of fiscal 2017. The new stock repurchase program approved by our Board of Directors is similar to our previous \$2.0 billion stock repurchase program.

We enter into these agreements in order to take advantage of repurchasing shares at a guaranteed discount to the Volume Weighted Average Price (“VWAP”) of our common stock over a specified period of time. We only enter into such transactions when the discount that we receive is higher than the foregone return on our cash prepayments to the financial institutions. There were no explicit commissions or fees on these structured repurchases. Under the terms of the agreements, there is no requirement for the financial institutions to return any portion of the prepayment to us.

The financial institutions agree to deliver shares to us at monthly intervals during the contract term. The parameters used to calculate the number of shares deliverable are: the total notional amount of the contract, the number of trading days in the contract, the number of trading days in the interval and the average VWAP of our stock during the interval less the agreed upon discount. During the three months ended February 27, 2015, we repurchased approximately 2.4 million shares at an average price of \$72.39 through structured repurchase agreements entered into during fiscal 2014 and the three months ended February 27, 2015. During the three months ended February 28, 2014, we repurchased approximately 4.5 million shares at an average price of \$58.27 through structured repurchase agreements entered into during fiscal 2013 and the three months ended February 28, 2014.

For the three months ended February 27, 2015, the prepayments were classified as treasury stock on our Condensed Consolidated Balance Sheets at the payment date, though only shares physically delivered to us by February 27, 2015

were excluded from the computation of earnings per share. As of February 27, 2015, \$66.7 million of prepayment remained under this agreement.

Subsequent to February 27, 2015, as part of our \$2.0 billion stock repurchase program, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of \$200.0 million. This

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

amount will be classified as treasury stock on our Condensed Consolidated Balance Sheets. Upon completion of the \$200.0 million stock repurchase agreement, \$1.8 billion remains under our current authority.

NOTE 11. NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted net income per share for the three months ended February 27, 2015 and February 28, 2014 (in thousands, except per share data):

	Three Months	
	2015	2014
Net income	\$84,888	\$47,046
Shares used to compute basic net income per share	498,754	496,948
Dilutive potential common shares:		
Unvested restricted stock and performance share awards	7,479	8,897
Stock options	1,293	2,495
Shares used to compute diluted net income per share	507,526	508,340
Basic net income per share	\$0.17	\$0.09
Diluted net income per share	\$0.17	\$0.09

For the three months ended February 27, 2015 and February 28, 2014, there were no options to purchase shares of common stock with exercise prices greater than the average fair market value of our stock of \$73.38 and \$60.85, respectively, that would have been anti-dilutive.

NOTE 12. COMMITMENTS AND CONTINGENCIES

Lease Commitments

We occupy three office buildings in San Jose, California where our corporate headquarters are located. We reference these office buildings as the Almaden Tower and the East and West Towers. We own the land and the East and West Tower buildings, and lease the Almaden Tower building.

The lease agreement for the Almaden Tower is effective through March 2017. We are the investors in the lease receivable related to the Almaden Tower lease in the amount of \$80.4 million, which is recorded as investment in lease receivable on our Condensed Consolidated Balance Sheets. As of February 27, 2015, the carrying value of the lease receivable related to the Almaden Tower approximated fair value. Under the agreement for the Almaden Tower, we have the option to purchase the building at any time during the lease term for \$103.6 million. If we purchase the building, the investment in the lease receivables may be credited against the purchase price. The residual value guarantee under the Almaden Tower obligation is \$89.4 million.

The Almaden Tower lease is subject to standard covenants including certain financial ratios that are reported to the lessor quarterly. As of February 27, 2015, we were in compliance with all of the covenants. In the case of a default, the lessor may demand we purchase the building for an amount equal to the lease balance, or require that we remarket or relinquish the building. If we choose to remarket or are required to do so upon relinquishing the building, we are bound to arrange the sale of the building to an unrelated party and will be required to pay the lessor any shortfall between the net remarketing proceeds and the lease balance, up to the residual value guarantee amount less our investment in lease receivable. The Almaden Tower lease qualifies for operating lease accounting treatment and, as such, the building and the related obligation are not included in our Condensed Consolidated Balance Sheets.

Royalties

We have royalty commitments associated with the shipment and licensing of certain products. Royalty expense is generally based on a dollar amount per unit sold or a percentage of the underlying revenue.

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Indemnifications

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

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

Legal Proceedings

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

Between May 4, 2011 and July 14, 2011, five putative class action lawsuits were filed in Santa Clara Superior Court and Alameda Superior Court in California. On September 12, 2011, the cases were consolidated into In Re High-Tech Employee Antitrust Litigation ("HTEAL") pending in the United States District Court for the Northern District of California, San Jose Division. In the consolidated complaint, Plaintiffs alleged that Adobe, along with Apple, Google, Intel, Intuit, Lucasfilm and Pixar, agreed not to recruit each other's employees in violation of Federal and state antitrust laws. Plaintiffs claim the alleged agreements suppressed employee compensation and deprived employees of career opportunities. Plaintiffs seek injunctive relief, monetary damages, treble damages, costs and attorneys fees.

All defendants deny the allegations and that they engaged in any wrongdoing of any kind. On October 24, 2013, the court certified a class of all persons who worked in the technical, creative, and/or research and development fields on a salaried basis in the United States for one or more of the following: (a) Apple from March 2005 through December 2009; (b) Adobe from May 2005 through December 2009; (c) Google from March 2005 through December 2009; (d) Intel from March 2005 through December 2009; (e) Intuit from June 2007 through December 2009; (f) Lucasfilm from January 2005 through December 2009; or (g) Pixar from January 2005 through December 2009, excluding retail employees, corporate officers, members of the boards of directors, and senior executives of all defendants. During the first quarter of fiscal 2015, the parties reached another agreement to settle the litigation. On March 2015, the court granted preliminary approval of the settlement. The hearing for final approval is set for July 2015. We accrued a loss contingency of \$10.0 million associated with this matter during the first quarter of fiscal 2014. If the settlement is approved, we expect to incur no additional losses associated with this matter.

In addition to intellectual property disputes, we are subject to legal proceedings, claims and investigations in the ordinary course of business, including claims relating to commercial, employment and other matters. Some of these disputes and legal proceedings may include speculative claims for substantial or indeterminate amounts of damages. We consider all claims on a quarterly basis in accordance with GAAP and based on known facts assess whether potential losses are considered reasonably possible, probable and estimable. Based upon this assessment, we then evaluate disclosure requirements and whether to accrue for such claims in our financial statements. This determination is then reviewed and discussed with our Audit Committee and our independent registered public accounting firm. We make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. Unless otherwise

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

specifically disclosed in this note, we have determined that no provision for liability nor disclosure is required related to any claim against us because: (a) there is not a reasonable possibility that a loss exceeding amounts already recognized (if any) may be incurred with respect to such claim; (b) a reasonably possible loss or range of loss cannot be estimated; or (c) such estimate is immaterial.

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

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

NOTE 13. DEBT

Notes

In February 2010, we issued \$600.0 million of 3.25% senior notes due February 1, 2015 (the “2015 Notes”) and \$900.0 million of 4.75% senior notes due February 1, 2020 (the “2020 Notes”). Our proceeds were \$1.5 billion and were net of an issuance discount of \$6.6 million. In addition, we incurred issuance costs of \$10.7 million. Both the discount and issuance costs are being amortized to interest expense over the respective terms of the 2015 and 2020 Notes using the effective interest method. The 2015 and 2020 Notes rank equally with our other unsecured and unsubordinated indebtedness. The effective interest rate including the discount, issuance costs and interest rate agreement is 3.45% for the 2015 Notes and 4.92% for the 2020 Notes. Interest is payable semi-annually, in arrears, on February 1 and August 1, and commenced on August 1, 2010. During the three months ended February 27, 2015, we made semi-annual interest payments on our 2015 and 2020 Notes totaling \$31.1 million.

In June 2014, we entered into interest rate swaps with a total notional amount \$900.0 million designated as a fair value hedge related to our 2020 Notes. The effect of such interest rate swaps is to effectively convert the fixed interest rate on our 2020 Notes to a floating interest rate based on the LIBOR plus a fixed number of basis points. Under the terms of the swap, we will pay monthly interest at the one-month LIBOR floating interest plus a spread of a fixed number of basis points on the \$900.0 million notional amount. In exchange, we will receive 4.75% fixed rate interest from the swap counterparties. See Note 5 for further details regarding our interest rate swap derivatives.

In January 2015, we issued \$1.0 billion of 3.25% senior notes due February 1, 2025 (the “2025 Notes”). Our proceeds were approximately \$989.3 million which is net of an issuance discount of \$10.7 million. In addition, we incurred issuance cost of \$7.9 million. Both the discount and issuance costs are being amortized to interest expense over the respective terms of the 2025 Notes using the effective interest method. The 2025 Notes rank equally with our other unsecured and unsubordinated indebtedness. The effective interest rate including the discount, issuance costs and interest rate agreement is 3.67% for the 2025 Notes. Interest is payable semi-annually, in arrears on February 1 and August 1, commencing on August 1, 2015. A portion of the proceeds from this offering was used to repay \$600.0 million in aggregate principal amount of the 2015 Notes plus accrued and unpaid interest due February 1, 2015. The remaining proceeds will be used for general corporate purposes.

In December 2014, in anticipation of issuing new long-term fixed rate debt, we entered into an interest rate lock agreement on a notional amount of \$600.0 million to hedge against the variability of future interest payments due to changes in the benchmark interest rate. This instrument was designated as a cash flow hedge. See Note 5 for further details regarding our interest rate lock agreement.

As of February 27, 2015, our outstanding notes payable consists of the 2020 Notes and 2025 Notes (the “Notes”) with a total carrying value of \$1.9 billion. Based on quoted prices in inactive markets, the fair value of the Notes was \$2.0 billion as of February 27, 2015. The total fair value of \$2.0 billion excludes the effect of fair value hedge of the 2020 Notes for which we entered into interest rate swaps as described above.

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

We may redeem the Notes at any time, subject to a make-whole premium. In addition, upon the occurrence of certain change of control triggering events, we may be required to repurchase the Notes, at a price equal to 101% of their principal amount, plus accrued and unpaid interest to the date of repurchase. The Notes also include covenants that limit our ability to grant liens on assets and to enter into sale and leaseback transactions, subject to significant allowances. As of February 27, 2015, we were in compliance with all of the covenants.

Credit Agreement

On March 2, 2012, we entered into a five-year \$1.0 billion senior unsecured revolving credit agreement (the "Credit Agreement"), providing for loans to us and certain of our subsidiaries. Pursuant to the terms of the Credit Agreement, we may, subject to the agreement of the applicable lenders, request up to an additional \$500.0 million in commitments, for a maximum aggregate commitment of \$1.5 billion. Loans under the Credit Agreement will bear interest at either (i) LIBOR plus a margin, based on our debt ratings, ranging from 0.795% and 1.30% or (ii) the base rate, which is defined as the highest of (a) the agent's prime rate, (b) the federal funds effective rate plus 0.50% or (c) LIBOR plus 1.00% plus a margin, based on our debt ratings, ranging from 0.00% to 0.30%. Commitment fees are payable quarterly at rates between 0.08% and 0.20% per year also based on our public debt ratings. Subject to certain conditions stated in the Credit Agreement, we and any of our subsidiaries designated as additional borrowers may borrow, prepay and re-borrow amounts under the revolving credit facility at any time during the term of the Credit Agreement.

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

On March 1, 2013, we exercised an option under the Credit Agreement to extend the maturity date of the Credit Agreement by one year to March 2, 2018. The facility will terminate and all amounts owing thereunder will be due and payable on the maturity date unless (a) the commitments are terminated earlier upon the occurrence of certain events, including an event of default, or (b) the maturity date is further extended upon our request, subject to the agreement of the lenders.

As of February 27, 2015, there were no outstanding borrowings under this Credit Agreement and we were in compliance with all covenants.

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 14. NON-OPERATING INCOME (EXPENSE)

Non-operating income (expense) for the three months ended February 27, 2015 and February 28, 2014 included the following (in thousands):

	Three Months	
	2015	2014
Interest and other income (expense), net:		
Interest income	\$6,288	\$5,134
Foreign exchange gains (losses)	(4,247)	) (2,803)
Realized gains on fixed income investment	967	670
Realized losses on fixed income investment	(40)	) (33)
Other	370	177
Interest and other income (expense), net	\$3,338	\$3,145
Interest expense	\$(14,545)	) \$(16,590)
Investment gains (losses), net:		
Realized investment gains	\$1,695	\$550
Unrealized investment gains	—	95
Realized investment losses	—	(1,054)
Unrealized investment losses	(265)) —
Investment gains (losses), net	\$1,430	\$(409)
Non-operating income (expense), net	\$(9,777)) \$(13,854)

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 15. SEGMENTS

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

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

Digital Media—Our Digital Media segment provides tools and solutions that enable individuals, small and medium businesses and enterprises to create, publish, promote and monetize their digital content anywhere. Our customers include traditional content creators, web application developers and digital media professionals, as well as their management in marketing departments and agencies, companies and publishers. Our customers also include knowledge workers who create, collaborate and distribute documents.

Digital Marketing—Our Digital Marketing segment provides solutions and services for how digital advertising and marketing are created, managed, executed, measured and optimized. Our customers include digital marketers, advertisers, publishers, merchandisers, web analysts, chief marketing officers, chief information officers and chief revenue officers.

Print and Publishing—Our Print and Publishing segment addresses market opportunities ranging from the diverse authoring and publishing needs of technical and business publishing to our legacy type and OEM printing businesses. Our segment results for the three months ended February 27, 2015 and February 28, 2014 were as follows (dollars in thousands):

	Digital Media	Digital Marketing	Print and Publishing	Total		
Three months ended February 27, 2015						
Revenue	\$702,773	\$357,167	\$49,241	\$1,109,181		
Cost of revenue	44,345	120,375	2,078	166,798		
Gross profit	\$658,428	\$236,792	\$47,163	\$942,383		
Gross profit as a percentage of revenue	94	% 66	% 96	% 85	%	%
Three months ended February 28, 2014						
Revenue	\$641,103	\$314,431	\$44,586	\$1,000,120		
Cost of revenue	38,087	108,017	2,405	148,509		
Gross profit	\$603,016	\$206,414	\$42,181	\$851,611		
Gross profit as a percentage of revenue	94	% 66	% 95	% 85	%	%

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

The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements and Notes thereto.

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements, including statements regarding product plans, future growth, market opportunities, strategic initiatives, industry positioning, revenue growth, customer acquisition, the amount of recurring revenue and revenue growth, each of which involve risks and uncertainties that could cause actual results to differ materially from these forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Risk Factors" in Part II, Item 1A of this report. You should carefully review the risks described herein and in other documents we file from time to time with the U.S. Securities and Exchange Commission ("the SEC"), including our Annual Report on Form 10-K for fiscal 2014. When used in this report, the words "will," "expects," "could," "would," "may," "anticipates," "intends," "plans," "believes," "seeks," "targets," "estimates," "looks for," "looks to," similar expressions, as well as statements regarding our focus for the future, 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, except as required by law.

BUSINESS OVERVIEW

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

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

OPERATIONS OVERVIEW

For our first quarter of fiscal 2015, we reported financial results consistent with the continued execution of our long-term plans for our two strategic growth areas, Digital Media and Digital Marketing, while continuing to market and license a broad portfolio of products and solutions.

In our Digital Media segment, we are a market leader with Creative Cloud, our subscription-based offering for creating and publishing content and applications. Creative Cloud, first delivered in May 2012, is our next-generation offering that supersedes our historical model of licensing our creative products with perpetual licenses. Creative Cloud delivers value through more frequent product updates, storage and access to user files stored in the cloud with syncing of files across users' machines, social and community-based features with our Behance service, app creation capabilities and lower entry point pricing for cost-sensitive customers.

We offer Creative Cloud for individuals and for teams, and we enable larger enterprise customers to acquire Creative Cloud capabilities through Enterprise Term License Agreements (“ETLAs”). The three Creative Cloud offerings address the multiple routes to market we use to license our creative software to targeted customers. Adoption of Creative Cloud has transformed our business model, and we continue to expect this to drive higher long-term revenue growth through an expansion of our customer base by acquiring new users through a lower cost of entry and delivery of additional features and value, as well as keeping existing

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customers current on our latest release. This model drives our revenue to be more recurring and predictable as revenue is recognized ratably.

We are also a market leader with our Document Services offerings built around our Acrobat family of products, the Adobe Reader and a set of integrated cloud-based document services. Adobe Acrobat provides for the reliable creation and exchange of electronic documents, regardless of platform or application source type. In March 2015, we announced the next generation of this offering called Adobe Document Cloud, which we believe will enhance the way people manage critical documents at home, in the office and across devices. Adobe Document Cloud, scheduled to be available in the second quarter of fiscal 2015, includes an all-new Adobe Acrobat DC, a set of integrated services which will enable users to create, review, approve, sign and track documents whether on a desktop or mobile device. Acrobat DC, with a touch-enabled user interface, will be licensed both via subscription and perpetual pricing.

We continue to implement strategies that will accelerate awareness, consideration and purchase of subscriptions to our Creative Cloud offering. These strategies include increasing the value Creative Cloud users receive such as offering new mobile applications, as well as targeted promotions and offers that attract past customers and potential users to try out and ultimately subscribe to Creative Cloud. Because of the shift towards Creative Cloud subscriptions and ETLAs, perpetual revenue for older Creative products has continued to decline, and revenue from perpetual licensing of these products was immaterial for the first quarter of fiscal 2015.

We are using certain performance metrics to assess the health and trajectory of our overall Digital Media segment. These metrics include the total number of current paid subscriptions and Annualized Recurring Revenue (“ARR”). ARR should be viewed independently of revenue, deferred revenue and unbilled deferred revenue as ARR is a performance metric and is not intended to be combined with any of these items. We plan to adjust our reported ARR on an annual basis to reflect any material exchange rates changes. We calculate ARR as follows:

	(# of Creative Cloud Subscriptions)
	x (Average Revenue Per Subscription Per Month) x 12
Creative ARR	+ Annual Digital Publishing Suite Contract Value
	+ Annual Creative ETLA Contract Value
	Annual Acrobat ETLA Contract Value
Document Services ARR	+ Annual Value of Acrobat Cloud, Subscriptions and EchoSign Services
Digital Media ARR	+ Creative ARR Document Services ARR

We exited the first quarter of fiscal 2015 with 3.971 million paid Creative Cloud subscriptions, up 15% from 3.454 million at the end of fiscal 2014. In addition, net new subscriptions added in Q1 fiscal 2015 grew 28% year-over-year when compared to net new subscriptions added in Q1 fiscal 2014. Total Creative ARR exiting the first quarter of fiscal 2015 was \$1.79 billion, up from \$1.61 billion at the end of fiscal 2014. Our Digital Media segment also includes our Document Services products and solutions, including Acrobat, Acrobat cloud services and EchoSign e-signing solution. In the first quarter of fiscal 2015, we drove adoption of subscription-based services including our Acrobat cloud services which helped grow Document Services ARR to \$297 million exiting the first quarter fiscal 2015, up from \$265 million at the end of fiscal 2014.

Total Digital Media ARR, which we define as the sum of Creative ARR and Document Services ARR, grew to \$2.09 billion at the end of the first quarter of fiscal 2015, up from \$1.88 billion at the end of fiscal 2014, demonstrating the progress we have made with the transformation of our business to a more recurring, ratable and predictable revenue model. Our reported ARR results in the first quarter of fiscal 2015 are based on currency rates set at the start of fiscal

2015 and held constant throughout the year.

We are a market leader in the fast-growing category addressed by our Digital Marketing segment. Our Adobe Marketing Cloud now includes eight solutions which address the expanding needs of marketers, the newest of which are Adobe Primetime

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—a multiscreen TV platform that helps broadcasters, cable networks and service providers create and monetize engaging and personalized TV and film experiences; and Adobe Audience Manager—a data management platform that helps marketers build unique audience profiles so they can identify their most valuable segments and use them across digital channels.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

There have been no significant changes in our critical accounting policies and estimates during the three months ended February 27, 2015, as compared to the critical accounting policies and estimates disclosed in Management’s Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended November 28, 2014.

Recent Accounting Pronouncements Not Yet Effective

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. Early adoption is not permitted. The updated standard is expected to become effective for us in the first quarter of fiscal 2018. We have not yet selected a transition method and we are currently evaluating the effect that the updated standard will have on our consolidated financial statements and related disclosures.

With the exception of the new revenue standard discussed above, there have been no other recent accounting pronouncements or changes in accounting pronouncements during the three months ended February 27, 2015, as compared to the recent accounting pronouncements described in our Annual Report on Form 10-K for the fiscal year ended November 28, 2014, that are of significance or potential significance to us.

RESULTS OF OPERATIONS

Financial Performance Summary for the First Quarter of Fiscal 2015

During the three months ended February 27, 2015, our subscription revenue as a percentage of total revenue increased to 64% compared to 42% in the year-ago period as we transitioned more of our business to a subscription-based model.

We exited the first quarter of fiscal 2015 with 3.971 million paid Creative Cloud subscriptions, up 15% from 3.454 million at the end of fiscal 2014.

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Total Digital Media ARR of approximately \$2.09 billion as of February 27, 2015 increased by \$214 million, or 11%, from \$1.88 billion as of November 28, 2014. The change in our Digital Media ARR is primarily due to increases in the number of paid Creative Cloud individual and team subscriptions.

Adobe Marketing Cloud revenue of \$311.5 million during the three months ended February 27, 2015 increased by \$44.5 million, or 17% compared with the year-ago period. The increase was primarily due to continued adoption of our AEM offering and increases in Adobe Analytics revenue.

Our total deferred revenue of \$1.18 billion as of February 27, 2015 increased by \$27.9 million, or 2%, from \$1.16 billion as of November 28, 2014.

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Cost of revenue of \$166.8 million during the three months ended February 27, 2015 increased by \$18.3 million, or 12% compared with the year-ago period, primarily due to increased hosting and server costs associated with our subscription and SaaS offerings, royalty costs and costs associated with compensation and related benefits driven by additional headcount.

Operating expenses of \$769.4 million during the three months ended February 27, 2015 remained relatively stable compared with the year-ago period.

Net income of \$84.8 million during the three months ended February 27, 2015 increased by \$37.8 million, or 80% compared with the year-ago period primarily due to revenue increases.

Net cash flow from operations of \$183.0 million during the three months ended February 27, 2015 decreased by \$68.7 million, or 27%, compared to the three months ended February 28, 2014 primarily due to greater decreases in accrued expenses coupled with lower increases in deferred revenue compared with the year ago period. These decreases were partially offset by higher net income compared with the year-ago period.

Revenue for the Three Months Ended February 27, 2015 and February 28, 2014 (dollars in millions)

	Three Months			
	2015	2014	% Change	
Subscription	\$713.4	\$423.6	68	%
Percentage of total revenue	64	% 42	%	
Product	290.8	471.5	(38)%
Percentage of total revenue	26	% 47	%	
Services and support	105.0	105.1	—	%
Percentage of total revenue	9	% 11	%	
Total revenue	\$1,109.2	\$1,000.1	11	%

Our subscription revenue is comprised primarily of fees we charge for our subscription and hosted service offerings including Creative Cloud and certain of our Adobe Marketing Cloud services. We recognize subscription revenue ratably over the term of agreements with our customers, beginning on the commencement of the service. We expect our subscription revenue will continue to increase as a result of our investments in new SaaS and subscription models. We also expect this to continue to increase the amount of our recurring revenue.

As described in Note 15 of our Notes to Condensed Consolidated Financial Statements, we have the following segments: Digital Media, Digital Marketing and Print and Publishing. Subscription revenue by reportable segment for the three months ended February 27, 2015 and February 28, 2014 are as follows (dollars in millions):

	Three Months			
	2015	2014	% Change	
Digital Media	\$483.8	\$238.0	103	%
Digital Marketing	224.9	183.8	22	%
Print and Publishing	4.7	1.8	*	
Total subscription revenue	\$713.4	\$423.6	68	%

(*) Percentage is not meaningful.

Our services and support revenue is comprised of consulting, training and maintenance and support, primarily related to the licensing of our enterprise, developer and platform products and the sale of our hosted Adobe Marketing Cloud services. Our support revenue also includes technical support and developer support to partners and developer organizations related to our desktop products. Our maintenance and support offerings, which entitle customers to receive desktop product upgrades and enhancements or technical support, depending on the offering, are generally

recognized ratably over the term of the arrangement.

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Segment Information (dollars in millions)

	Three Months				
	2015	2014		% Change	
Digital Media	\$702.8	\$641.1		10	%
Percentage of total revenue	63	% 64		%	
Digital Marketing	357.2	314.4		14	%
Percentage of total revenue	32	% 31		%	
Print and Publishing	49.2	44.6		10	%
Percentage of total revenue	4	% 5		%	
Total revenue	\$1,109.2	\$1,000.1		11	%

Digital Media

Revenue from Digital Media increased \$61.7 million during the three months ended February 27, 2015, as compared to the three months ended February 28, 2014 primarily driven by increases in revenue associated with our Creative Cloud while Document Services revenue remained relatively stable. The increases associated with our creative products were offset in part by declines in revenue associated with distribution of third party software downloads. Document Services revenue, which includes our Acrobat product family, remained stable during the three months ended February 27, 2015 as compared to the year ago period, as increases in revenue associated with Acrobat subscription and ETLA offerings were offset by decreases in revenue associated with our Acrobat perpetual license offerings.

Digital Marketing

Revenue from Digital Marketing increased \$42.7 million during the three months ended February 27, 2015, as compared to the three months ended February 28, 2014 primarily due to continued revenue growth associated with our Adobe Marketing Cloud, which increased 17% during the three months ended February 27, 2015, as compared to the year-ago period. Contributing to this increase was the continued adoption of our AEM term-based offering and increases in Adobe Analytics revenue.

Print and Publishing

Revenue from Print and Publishing increased during the three months ended February 27, 2015 as compared to the three months ended February 28, 2014 primarily due to increases in legacy product revenue.

Geographical Information (dollars in millions)

	Three Months				
	2015	2014		% Change	
Americas	\$644.6	\$536.6		20	%
Percentage of total revenue	58	% 54		%	
EMEA	307.1	299.8		2	%
Percentage of total revenue	28	% 29		%	
APAC	157.5	163.7		(4)%
Percentage of total revenue	14	% 16		%	
Total revenue	\$1,109.2	\$1,000.1		11	%

Overall revenue during the three months ended February 27, 2015 as compared to the three months ended February 28, 2014 increased in the Americas and EMEA while overall revenue in APAC slightly declined. Revenue in the Americas increased across all reportable segments during the three months ended February 27, 2015 as compared to the year-ago period. Revenue in EMEA increased during the three months ended February 27, 2015 as compared to the year-ago period due to increases in Digital Media and Print and Publishing revenue, offset by slight declines in

Digital Marketing revenue. Within the Americas and EMEA, the fluctuations in revenue by reportable segment were attributable to the factors noted in the segment information above.

Revenue in APAC slightly declined during the three months ended February 27, 2015 as compared to the year-ago period due to decreases in Digital Media partially offset by increases in Digital Marketing and Print and Publishing revenue. The decline in Digital Media revenue was primarily due to expected decreases in perpetual license revenue and was partially offset by increases in subscription revenue during the three months ended February 27, 2015 as compared to the year-ago period.

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Included in the overall increase in revenue for the three months ended February 27, 2015 as compared to the three months ended February 28, 2014 were impacts associated with foreign currency as shown below.

(in millions)	2015	
Revenue impact:	Increase/(Decrease)	
EMEA:		
Euro	\$ (13.9)
British Pound	(1.4)
Other currencies	(2)
Total EMEA	(17.3)
Japanese Yen	(6.2)
Other currencies	(2.4)
Total revenue impact	(25.9)
Hedging impact:		
Euro	12.1	
British Pound	3.2	
Japanese Yen	8.4	
Total hedging impact	23.7	
Total impact	\$ (2.2)

During the three months ended February 27, 2015, the U.S. Dollar strengthened against the Euro, British Pound, Japanese Yen and other Asian currencies causing revenue in EMEA and APAC measured in U.S. Dollar equivalents to decrease as compared to the three months ended February 28, 2014. These decreases were offset by hedging gains from our Euro, British Pound and Japanese Yen hedging programs during the three months ended February 27, 2015.

Cost of Revenue for the Three Months Ended February 27, 2015 and February 28, 2014 (dollars in millions)

	Three Months			% Change	%
	2015	2014			
Subscription	\$95.5	\$76.7	25		%
Percentage of total revenue	9	% 8	%		
Product	19.7	27.5	(28)%
Percentage of total revenue	2	% 3	%		
Services and support	51.6	44.3	16		%
Percentage of total revenue	5	% 4	%		
Total cost of revenue	\$166.8	\$148.5	12		%
Subscription					

Cost of subscription revenue consists of third-party royalties and expenses related to operating our network infrastructure, including depreciation expenses and operating lease payments associated with computer equipment, data center costs, salaries and related expenses of network operations, implementation, account management and technical support personnel, amortization of intangible assets and allocated overhead. We enter into contracts with third parties for the use of their data center facilities and our data center costs largely consist of the amounts we pay to these third parties for rack space, power and similar items.

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Cost of subscription revenue increased due to the following:

	% Change 2015-2014 QTD	
Data center cost	5	%
Compensation cost and related benefits associated with headcount	5	
Depreciation expense	4	
Royalty cost	5	
Amortization of purchased intangibles	2	
Various individually insignificant items	4	
Total change	25	%

Data center costs increased during the three months ended February 27, 2015 as compared to the year-ago period primarily due to higher transaction volumes in our Adobe Marketing Cloud and Creative Cloud services. Depreciation expense increased as compared to the year-ago period primarily due to higher capital expenditures in recent periods as we continue to invest in our network and data center infrastructure to support the growth of our subscription and hosted services business. Royalty costs increased compared to the year-ago period primarily due to increases in subscriptions and downloads of our SaaS offerings, and royalty payments related to our stock photography offering from the acquisition of Fotolia in the first quarter of fiscal 2015.

Product

Cost of product revenue includes product packaging, third-party royalties, excess and obsolete inventory, amortization related to localization costs, purchased intangibles and acquired rights to use technology and the costs associated with the manufacturing of our products.

Cost of product revenue decreased due to the following:

	% Change 2015-2014 QTD	
Excess and obsolete inventory	(12)%
Royalty cost	(9)
Cost of sales	(3)
Various individually insignificant items	(4)
Total change	(28)%

Cost of product revenue decreased during the three months ended February 27, 2015 as compared to the three months ended February 28, 2014 primarily due to decreases in excess and obsolete inventory, royalty costs, and cost of sales. Excess and obsolete inventory decreased as compared to the year-ago period primarily due to expected returns for CS6 shrink boxes and point-of-sale activation keycards as we had discontinued the general availability of these products on a perpetual licensing basis in the first quarter of fiscal 2014. Royalty costs and cost of sales decreased as compared to the year-ago period primarily due to the decreases in revenue from our perpetual offerings.

Services and Support

Cost of services and support revenue is primarily comprised of employee-related costs and associated costs incurred to provide consulting services, training and product support.

Cost of services and support revenue increased during the three months ended February 27, 2015 as compared to the three months ended February 28, 2014 primarily due to increases in compensation and related benefits driven by additional headcount.

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Operating Expenses for the Three Months Ended February 27, 2015 and February 28, 2014 (dollars in millions)

	Three Months		% Change	
	2015	2014		
Research and development	\$215.5	\$209.5	3	%
Percentage of total revenue	19	% 21	%	
Sales and marketing	392.7	410.1	(4)%
Percentage of total revenue	35	% 41	%	
General and administrative	145.1	139.0	4	%
Percentage of total revenue	13	% 14	%	
Restructuring and other charges	1.8	0.7	**	
Percentage of total revenue	*	*		
Amortization of purchased intangibles	14.3	13.6	5	%
Percentage of total revenue	1	% 1	%	
Total operating expenses	\$769.4	\$772.9	**	

(*) Percentage is less than 1%.

(**) Percentage is not meaningful.

Research and Development

Research and development expenses consist primarily of salary and benefit expenses for software developers, contracted development efforts, related facilities costs and expenses associated with computer equipment used in software development.

Research and development expenses increased during the three months ended February 27, 2015 as compared to the three months ended February 28, 2014 primarily due to a technical event for our engineers which was held during the first quarter of fiscal 2015 that did not occur during the first quarter of fiscal 2014.

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

Sales and Marketing

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

Sales and marketing expenses decreased during the three months ended February 27, 2015 as compared to the three months ended February 28, 2014 due to the following:

	% Change 2015-2014 QTD	
Compensation associated with cash incentives	(5)%
Compensation and related benefits associated with headcount	2	
Various individually insignificant items	(1)
Total change	(4)%

General and Administrative

General and administrative expenses consist primarily of compensation and benefit expenses, travel expenses and related facilities costs for our finance, facilities, human resources, legal, information services and executive personnel.
General and

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administrative expenses also include outside legal and accounting fees, provision for bad debts, expenses associated with computer equipment and software used in the administration of the business, charitable contributions and various forms of insurance.

General and administrative expenses increased during the three months ended February 27, 2015 as compared to the three months ended February 28, 2014 due to the following:

	% Change 2015-2014 QTD	
Compensation associated with cash incentives	(4)%
Compensation and related benefits associated with headcount	1	
Charitable contributions	12	
Loss contingency	(7)
Various individually insignificant items	2	
Total change	4)%

The increase in charitable contributions during the three months ended February 27, 2015 as compared to the three months ended February 28, 2014 is primarily due to the timing of planned contributions to the Adobe Foundation. The decrease in loss contingency during the three months ended February 27, 2015 as compared to the three months ended February 28, 2014 is primarily due to the loss incurred in the year-ago period that did not recur. See Note 12 of our Notes to the Condensed Consolidated Financial Statements for further information regarding the loss contingency.

Restructuring and Other Charges

Charges and credits related to our restructuring plans for the three months ended February 27, 2015 and February 28, 2014 were immaterial.

Amortization of Purchased Intangibles

Amortization expense increased 5% during the three months ended February 27, 2015 as compared to the three months ended February 28, 2014. The increase is primarily due to amortization expense associated with intangible assets purchased through our acquisition of Fotolia in the first quarter of fiscal 2015.

Non-Operating Income (Expense), Net for the Three Months Ended February 27, 2015 and February 28, 2014 (dollars in millions)

	Three Months		
	2015	2014	% Change
Interest and other income (expense), net	\$3.3	\$3.1	6 %
Percentage of total revenue	*	*	
Interest expense	(14.5	) (16.6	) (13
Percentage of total revenue	(1	)% (2)%
Investment gains (losses), net	1.4	(0.4) **
Percentage of total revenue	*	*	
Total non-operating income (expense), net	\$(9.8	) \$(13.9	) (29
)%

(*) Percentage is less than 1%.

(**) Percentage is not meaningful.

Interest and Other Income (Expense), Net

Interest and other income (expense), net consists primarily of interest earned on cash, cash equivalents and short-term fixed income investments. Interest and other income (expense), net also includes gains and losses on fixed income investments and foreign exchange gains and losses other than any gains recorded to revenue from hedging Euros, British Pounds and Yen currencies.

Interest and other income (expense), net increased during the three months ended February 27, 2015 as compared to the three months ended February 28, 2014 primarily due to increased interest income on fixed income investments due to higher average invested balances and interest rates, partially offset by increased foreign currency losses.

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Interest Expense

Interest expense primarily represents interest associated with our senior notes and interest rate swaps. Interest on our senior notes is payable semi-annually, in arrears, on February 1 and August 1. Floating interest payments on the interest rate swaps are paid monthly. The fixed-rate interest receivable on the swaps is received semi-annually concurrent with the senior notes interest payments.

Interest expense decreased during the three months ended February 27, 2015 as compared to the three months ended February 28, 2014 due to the favorable impact of the interest rate swaps. Interest payments on our 2025 Notes will commence on August 1, 2015. See Notes 5 and 13 of our Notes to Condensed Consolidated Financial Statements for further details regarding our senior notes and interest rate swaps.

Investment Gains (Losses), Net

Investment gains (losses), net consists principally of realized gains and losses from the sale of marketable equity investments, other-than-temporary declines in the value of marketable and non-marketable equity securities and unrealized holding gains and losses associated with our deferred compensation plan assets (classified as trading securities) and gains and losses associated with our direct and indirect investments in privately held companies. Total investment gains (losses), net increased to net gains during the three months ended February 27, 2015 as compared to the three months ended February 28, 2014 primarily due to an increase in net realized gains from the sale of our direct investments in privately-held companies and marketable equity securities.

Provision for Income Taxes for the Three Months Ended February 27, 2015 and February 28, 2014 (dollars in millions)

	Three Months		
	2015	2014	% Change
Provision	\$78.4	\$17.8	340 %
Percentage of total revenue	7	% 2	%
Effective tax rate	48	% 28	%

Our effective tax rate increased by twenty percentage points for the three months ended February 27, 2015 as compared to the three months ended February 28, 2014. The increase was primarily due to the one-time tax costs associated with licensing acquired company assets to Adobe's trading companies. The increase was partially offset by tax benefits related to the reinstatement of the U.S. Research and Development credit in December 2014. The reinstatement of the credit was retroactive to January 1, 2014. A tax benefit for the credit relating to fiscal 2014 was reflected in its entirety in the first quarter of fiscal 2015.

We are a United States-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. A significant portion of our foreign earnings for the current fiscal year were earned by our Irish subsidiaries. In addition to providing for U.S. income taxes on earnings from the U.S., we provide for U.S. income taxes on the earnings of foreign subsidiaries unless the subsidiaries' earnings are considered permanently reinvested outside the U.S. While we do not anticipate changing our intention regarding permanently reinvested earnings, if certain foreign earnings previously treated as permanently reinvested are repatriated, the related U.S. tax liability may be reduced by any foreign income taxes paid on these earnings. Currently, there are a significant amount of foreign earnings upon which U.S. income taxes have not been provided.

Accounting for Uncertainty in Income Taxes

The gross liability for unrecognized tax benefits at February 27, 2015 was \$259.5 million, exclusive of interest and penalties. If the total unrecognized tax benefits at February 27, 2015 were recognized in the future, \$213.8 million of unrecognized tax benefits would decrease the effective tax rate, which is net of an estimated \$45.7 million federal benefit related to deducting certain payments on future state tax returns.

As of February 27, 2015, the combined amount of accrued interest and penalties related to tax positions taken on our tax returns was \$23.6 million. This amount is included in non-current income taxes payable.

The timing of the resolution of income tax examinations is highly uncertain as are the amounts and timing of tax payments that are part of any audit settlement process. These events could cause large fluctuations in the balance sheet classification of current and non-current assets and liabilities. We believe that within the next 12 months, it is

reasonably possible that either certain audits will conclude or statutes of limitations on certain income tax examination periods will expire, or both. Given the uncertainties

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described above, we can only determine a range of estimated potential decreases in underlying unrecognized tax benefits ranging from \$0 to approximately \$10 million.

LIQUIDITY AND CAPITAL RESOURCES

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

(in millions)	As of	
	February 27, 2015	November 28, 2014
Cash and cash equivalents	\$712.9	\$1,117.4
Short-term investments	\$2,463.9	\$2,622.1
Working capital	\$2,184.0	\$2,107.9
Stockholders' equity	\$6,589.0	\$6,775.9

A summary of our cash flows is as follows:

(in millions)	Three Months Ended	
	February 27, 2015	February 28, 2014
Net cash provided by operating activities	\$183.0	\$251.7
Net cash used for investing activities	(698.4	) (94.4
Net cash provided by (used for) financing activities	119.3	(258.2
Effect of foreign currency exchange rates on cash and cash equivalents	(8.4	) 0.3
Net decrease in cash and cash equivalents	\$(404.5	) \$(100.6

Our primary source of cash is receipts from revenue. The primary uses of cash are payroll related expenses, general operating expenses including marketing, travel and office rent, and cost of revenue. Other sources of cash are proceeds from the exercise of employee stock options and participation in the employee stock purchase plan. Other uses of cash include our stock repurchase program, which is described below, business acquisitions and purchases of property and equipment.

Cash Flows from Operating Activities

Net cash provided by operating activities of \$183.0 million for the three months ended February 27, 2015 was primarily comprised of net income plus the net effect of non-cash items. The primary working capital sources of cash were net income coupled with decreases in trade receivables, and increases in income taxes payable and deferred revenue. Trade receivables declined primarily due to improved collections as we were able to collect a substantial portion of our revenues earned during the three months ended February 27, 2015 within the same quarter. The increase in deferred revenue is primarily due to increased subscriptions for our individual and team Creative Cloud offerings, and increases in Digital Marketing and Digital Publishing hosted services. Additionally, the increase in income taxes payable is primarily due to the increase in our tax provision during the three months ended February 27, 2015.

The primary working capital uses of cash were decreases in accrued expenses and increases in prepaid expenses and other current assets. Accrued expenses decreased primarily due to payment of fiscal 2014 bonuses, commissions, and other incentive plans in the first quarter of fiscal 2015. We also made our semi-annual interest payments associated with our senior notes during the first quarter of fiscal 2015. These reductions were partially offset by additional accruals made during the period. Prepaid expenses and other current assets increased primarily due to higher prepaid employee benefit expenses largely associated with recognition of yearly fringe benefit expense, which are estimated and recorded at the beginning of the fiscal year and expensed throughout the fiscal year. Also contributing to the increase in prepaid expenses and other current assets were payments for our annual customer and partner events expenses which are scheduled to occur later in the fiscal year, and payments of annual maintenance agreements and annual insurance contracts which are billed on a calendar year basis and paid in beginning of the fiscal year.

Cash Flows from Investing Activities

Net cash used for investing activities of \$698.4 million for the three months ended February 27, 2015 was primarily due to our acquisition of Fotolia. Other uses of cash during the three months ended February 27, 2015 represented

purchases of short-term investments, property and equipment, and long-term investments and other assets. These cash outflows were offset in part by sales and maturities of short-term investments. See Note 2 of our Condensed Consolidated Financial Statements for more detailed information regarding our acquisition of Fotolia.

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Cash Flows from Financing Activities

In January 2015, we issued \$1 billion of 3.25% senior notes due February 1, 2025 (the “2025 Notes”). Our proceeds were approximately \$989.3 million which is net of an issuance discount of \$10.7 million. The 2025 Notes rank equally with our other unsecured and unsubordinated indebtedness. In addition, we incurred issuance costs of \$7.9 million. Both the discount and issuance costs are being amortized to interest expense over the term of the 2025 Notes using the effective interest method.

We used \$600 million of the proceeds from the 2025 Notes offering to repay the outstanding balance plus accrued and unpaid interest of the \$600.0 million 3.25% senior notes due February 1, 2015 (“2015 Notes”). The remaining proceeds will be used for general corporate purposes. See Note 13 of our Condensed Consolidated Financial Statements for more detailed information.

In addition to the 2025 Notes issuance and 2015 Notes repayment, other financing activities during the three months ended February 27, 2015 include the purchases and issuances of treasury stock. Payments for our treasury stock repurchases and costs associated with the issuance of treasury stock were offset in part by proceeds from issuance of treasury stock during the three months ended February 27, 2015. See the section titled “Stock Repurchase Program” discussed below.

We expect to continue our investing activities, including short-term and long-term investments, venture capital, facilities expansion and purchases of computer systems for research and development, sales and marketing, product support and administrative staff. Furthermore, cash reserves may be used to repurchase stock under our stock repurchase program and to strategically acquire companies, products or technologies that are complementary to our business.

Restructuring

During the past several years, we have initiated various restructuring plans. Currently, we consider our restructuring plans to be substantially complete.

As of February 27, 2015, we have accrued total restructuring charges of \$7.1 million. Of this amount, \$6.5 million relates to the cost of closing redundant facilities and are expected to be paid under contract through fiscal 2021 of which approximately 41% will be paid through fiscal 2016.

We believe that our existing cash and cash equivalents, short-term investments and cash generated from operations will be sufficient to meet the cash outlays for the restructuring actions described above.

See Note 9 of our Notes to Condensed Consolidated Financial Statements for more detailed information regarding our restructuring plans.

Other Liquidity and Capital Resources Considerations

Our existing cash, cash equivalents and investment balances may fluctuate during fiscal 2015 due to changes in our planned cash outlay, including changes in incremental costs such as direct and integration costs related to our acquisitions. Our intent is to permanently reinvest a significant portion of our earnings from foreign operations, and current plans do not anticipate that we will need funds generated from foreign operations to fund our domestic operations. In the event funds from foreign operations are needed to fund operations in the United States and if U.S. tax has not already been previously provided, we would provide for and pay additional U.S. taxes in connection with repatriating these funds.

Cash from operations could also be affected by various risks and uncertainties, including, but not limited to the risks detailed in Part II, Item 1A titled “Risk Factors”. However, based on our current business plan and revenue prospects, we believe that our existing balances, our anticipated cash flows from operations and the available balance under our credit facility will be sufficient to meet our working capital and operating resource expenditure requirements for the next twelve months.

As of February 27, 2015, the amount outstanding under our senior notes was \$1.9 billion, consisting of \$900 million of 4.75% senior notes due February 1, 2020 (the “2020 Notes”) and \$1.0 billion of 3.25% senior notes due February 1, 2025 (the “2025 Notes”).

On March 2, 2012, we entered into a five-year \$1.0 billion senior unsecured revolving credit agreement (the “Credit Agreement”), providing for loans to us and certain of our subsidiaries. On March 1, 2013, we exercised an option under the Credit Agreement to extend the maturity date of the Credit Agreement by one year to March 2, 2018. As of February 27, 2015, there were no outstanding borrowings under this Credit Agreement and the entire \$1.0 billion credit line remains available for borrowing.

We use professional investment management firms to manage a large portion of our invested cash. External investment firms managed, on average, 53% of our consolidated invested balances during the first quarter of fiscal 2015. The fixed income

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portfolio is primarily invested in corporate bonds and commercial paper, money market mutual funds, municipal securities, asset-backed securities, U.S. agency securities and U.S. Treasury securities.

Stock Repurchase Program

To facilitate our stock repurchase program, designed to return value to our stockholders and minimize dilution from stock issuances, we may repurchase shares in the open market or enter into structured repurchase agreements with third parties.

During the three months ended February 27, 2015 and February 28, 2014, we entered into structured stock repurchase agreements with large financial institutions, whereupon we provided them with prepayments of \$200.0 million in each period. Upon completion of the agreement entered into during the three months ended February 27, 2015, there was no remaining balance under the previous \$2.0 billion authority granted by the Board of Directors in April 2012. In the first quarter of fiscal 2015, the Board of Directors approved a new stock repurchase program granting the company authority to repurchase up to \$2.0 billion in common stock through the end of fiscal 2017. The new stock repurchase program approved by our Board of Directors is similar to our previous \$2.0 billion stock repurchase program.

We enter into these agreements in order to take advantage of repurchasing shares at a guaranteed discount to the Volume Weighted Average Price ("VWAP") of our common stock over a specified period of time. We only enter into such transactions when the discount we receive is higher than the foregone return on our cash prepayments to the financial institutions. There were no explicit commissions or fees on these structured repurchases. Under the terms of the agreements, there is no requirement for the financial institutions to return any portion of the prepayment to us.

The financial institutions agree to deliver shares to us at monthly intervals during the contract term. The parameters used to calculate the number of shares deliverable are: the total notional amount of the contract, the number of trading days in the contract, the number of trading days in the interval and the average VWAP of our stock during the interval less the agreed upon discount. During the three months ended February 27, 2015, we repurchased approximately 2.4 million shares at an average price of \$72.39 through structured repurchase agreements entered into during fiscal 2014 and the three months ended February 27, 2015. During the three months ended February 28, 2014, we repurchased approximately 4.5 million shares at an average price of \$58.27 through structured repurchase agreements entered into during 2013 and the three months ended February 28, 2014.

For the three months ended February 27, 2015, the prepayments were classified as treasury stock on our Condensed Consolidated Balance Sheets at the payment date, though only shares physically delivered to us by February 27, 2015 were excluded from the computation of earnings per share. As of February 27, 2015, \$66.7 million of prepayments remained under the agreement.

Subsequent to February 27, 2015, as part of our \$2.0 billion stock repurchase program, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of \$200.0 million. This amount will be classified as treasury stock on our Condensed Consolidated Balance Sheets. Upon completion of the \$200.0 million stock repurchase agreement, \$1.8 billion remains under our current authority.

Refer to Part II, Item 2 in this report for share repurchases during the quarter ended February 27, 2015.

Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

We presented our contractual obligations in our Annual Report on Form 10-K for the fiscal year ended November 28, 2014. Our principal commitments as of February 27, 2015 consist of obligations under operating leases, capital leases, royalty agreements and various service agreements. Except as discussed below, there have been no significant changes in those obligations during the three months ended February 27, 2015. See Notes 12 and 13 of our Notes to Condensed Consolidated Financial Statements for more detailed information.

Senior Notes

In January 2015, we issued the 2025 Notes and settled the 2015 Notes. The following table updates our senior notes obligations as of February 27, 2015 (in millions):

	Payment Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Notes	\$2,439.2	\$75.7	\$150.5	\$1,050.5	\$1,162.5

Interest on our senior notes is payable semi-annually, in arrears on February 1 and August 1. At February 27, 2015, our maximum commitment for interest payments was \$539.2 million for the remaining duration of our senior notes.

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In June of fiscal 2014, we entered into interest rate swaps that effectively converted the fixed interest rate on our 2020 Notes to a floating interest rate based on the London Interbank Offered Rate plus a fixed number of basis points through February 1, 2020.

Covenants

Our credit facility contains a financial covenant requiring us not to exceed a maximum leverage ratio. Our Almaden Tower lease includes certain financial ratios as defined in the lease agreements that are reported to the lessor quarterly. As of February 27, 2015, we were in compliance with all of our covenants. We believe these covenants will not impact our credit or cash in the coming fiscal year or restrict our ability to execute our business plan. Our senior notes do not contain any financial covenants.

Under the terms of our credit agreement and lease agreements, we are not prohibited from paying cash dividends unless payment would trigger an event of default or one currently exists. We do not anticipate paying any cash dividends in the foreseeable future.

Royalties

We have certain royalty commitments associated with the shipment and licensing of certain products. Royalty expense is generally based on a dollar amount per unit sold or a percentage of the underlying revenue.

Indemnifications

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

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We believe that there have been no significant changes in our market risk exposures for the three months ended February 27, 2015, as compared with those discussed in our Annual Report on Form 10-K for the fiscal year ended November 28, 2014.

ITEM 4. CONTROLS AND PROCEDURES

Based on their evaluation as of February 27, 2015, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective at the reasonable assurance level to ensure that the information required to be disclosed by us in this Quarterly Report on Form 10-Q was (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

There were no changes in our internal control over financial reporting during the quarter ended February 27, 2015 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

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

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PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note 12 “Commitments and Contingencies” of our Notes to Condensed Consolidated Financial Statements regarding our legal proceedings.

ITEM 1A. RISK FACTORS

As previously discussed, our actual results could differ materially from our forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed below. These and many other factors described in this report could adversely affect our operations, performance and financial condition. If we cannot continue to develop, market and offer new products and services or enhancements to existing products and services that meet customer requirements, our operating results could suffer.

The process of developing new high technology products and services and enhancing existing products and services is complex, costly and uncertain. If we fail to anticipate customers’ changing needs and emerging technological trends, our market share and results of operations could suffer. We must make long-term investments, develop or obtain appropriate intellectual property and commit significant resources before knowing whether our predictions will accurately reflect customer demand for our products and services. If we are unable to extend our core technologies into new applications and new platforms and to anticipate or respond to technological changes, the market’s acceptance of our products and services could decline and our results would suffer. Additionally, any delay in the development, production, marketing or offering of a new product or service or enhancement to an existing product or service could result in customer attrition or impede our ability to attract new customers, causing a decline in our revenues, earnings or stock price and weakening our competitive position. We maintain strategic relationships with third parties to market certain of our products and support certain product functionality. If we are unsuccessful in establishing or maintaining our strategic relationships with these third parties, our ability to compete in the marketplace, to reach new customers and geographies or to grow our revenues would be impaired and our operating results would suffer.

We offer our products on a variety of PC, tablet and mobile devices. Recent trends have shown a technological shift from personal computers to tablet and mobile devices. If we cannot continue to adapt our products to tablet and mobile devices our business could be harmed. To the extent that consumer purchases of these devices slow down, or to the extent that significant demand arises for our products or competitive products on other platforms before we offer our products on those platforms, our business could be harmed. Releases of new devices or operating systems may make it more difficult for our products to perform or may require significant costs in order for us to adapt our solutions to such devices or operating systems. These potential costs and delays could harm our business.

Introduction of new products, services and business models by existing and new competitors could harm our competitive position and results of operations.

The markets for our products and services are characterized by intense competition, evolving industry standards, emerging business and distribution models, disruptive technology developments, short product and service life cycles, price sensitivity on the part of customers, and frequent new product introductions, including alternatives with limited functionality available at lower costs or free of charge. Any of these factors could create downward pressure on pricing and gross margins and could adversely affect our renewal and upgrade rates, as well as our ability to attract new customers. Our future success will depend on our ability to enhance our existing products and services, introduce new products and services on a timely and cost-effective basis, meet changing customer needs, extend our core technology into new applications, and anticipate and respond to emerging standards, business models, software delivery methods and other technological developments, such as the evolution and emergence of digital application marketplaces as a direct sales and software delivery environment. These digital application marketplaces often have exclusive distribution for certain platforms, which may make it more difficult for us to compete in these markets. If any competing products, services or operating systems (that don’t support our solutions) achieve widespread acceptance, our operating results could suffer. In addition, consolidation has occurred among some of the competitors in the markets in which we compete. Further consolidations in these markets may subject us to increased competitive pressures and may therefore harm our results of operations. For additional information regarding our competition and the risks arising out of the competitive environment in which we operate, see the section entitled “Competition” contained in Item 1 of our Annual Report on Form 10-K for the fiscal year ended November 28, 2014.

If we fail to successfully manage transitions to new business models and markets, our results of operations could suffer.

We often release new offerings and employ new software and services delivery methods in connection with our diversification into new business models and markets. It is uncertain whether these strategies will prove successful or whether we will be able

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to develop the necessary infrastructure and business models more quickly than our competitors. Market acceptance of new product and service offerings will be dependent on our ability (1) to include functionality and usability that address customer requirements, and (2) to optimally price our products in light of marketplace conditions, our costs and customer demand. New product and service offerings could subject us to increased risk of liability related to the provision of services as well as cause us to incur significant technical, legal or other costs. For example, with our cloud-based services and subscription-based licensing models, such as Creative Cloud, we have entered markets that may not be fully accustomed to cloud-based subscription offerings. Market acceptance of such services is affected by a variety of factors, including information security, reliability, performance, social/community engagement, local government regulations regarding online services and user-generated content, the sufficiency of technological infrastructure to support our products in certain geographies, customer concerns with entrusting a third party to store and manage their data, public concerns regarding data privacy and the enactment of laws or regulations that restrict our ability to provide such services to customers in the U.S. or internationally. If we are unable to respond to these threats, our business could be harmed.

From time to time we open-source certain of our technology initiatives, provide broader open access to our technology, license certain of our technology on a royalty-free basis, or release selected technology for industry standardization. Additionally, customer requirements for open standards or open-source products could impact adoption or use of some of our products or services. To the extent we incorrectly predict customer requirements for such products or services, or if there is a delay in market acceptance of such products or services, our business could be harmed.

We also devote significant resources to the development of technologies and service offerings in markets where our operating history is less extensive, such as the marketplace for stock imagery. These new offerings and markets may require a considerable investment of technical, financial, compliance and sales resources, and a scalable organization. Some of our competitors may have advantages over us due to their larger presence, larger developer network, deeper market experience and larger sales, consulting and marketing resources. If we are unable to successfully establish new offerings in light of the competitive environment, our results of operations could suffer.

The increased emphasis on a cloud strategy may give rise to risks that could harm our business.

Over the past several years, our business has shifted away from pre-packaged creative software to focus on a subscription model that prices and delivers our products in a way that differs from the historical pricing and delivery methods of our creative tools. These changes reflect a significant shift from perpetual license sales and distribution of our software in favor of providing our customers the right to access certain of our software in a hosted environment or use downloaded software for a specified subscription period. This cloud strategy requires continued investment in product development and cloud operations, and may give rise to a number of risks, including the following:

- if customers desire only perpetual licenses or to purchase or renew only point product subscriptions rather than acquire the entire Creative Cloud offering, our subscription sales may lag behind our expectations;
- our cloud strategy may raise concerns among our customer base, including concerns regarding changes to pricing over time, service availability, information security of a cloud solution and access to files while offline or once a subscription has expired;

- small businesses and hobbyists may turn to competitive or open-source offerings;

- we may be unsuccessful in maintaining our target pricing, new seat adoption and projected renewal rates; we may select a target price that is not optimal and could negatively affect our sales or earnings; or we may have to rely heavily on promotional rates to achieve target seat adoption, which could reduce average revenue per user; and
- we may incur costs at a higher than forecasted rate as we expand our cloud operations.

Subscription offerings and ETLAs create risks related to the timing of revenue recognition.

Although the subscription model is designed to increase the number of customers who purchase our products and services and create a recurring revenue stream that is more predictable, it creates certain risks related to the timing of revenue recognition and potential reductions in cash flows.

A portion of the subscription-based revenue we report each quarter results from the recognition of deferred revenue relating to subscription agreements entered into during previous quarters. A decline in new or renewed subscriptions in any period may not be immediately reflected in our reported financial results for that period, but may result in a decline in our revenue in future quarters. If we were to experience significant downturns in subscription sales and renewal rates, our reported financial results might not reflect such downturns until future periods. Our subscription model could also make it difficult for us to rapidly increase

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our revenues from subscription-based or hosted services through additional sales in any period, as revenue from new customers will be recognized over the applicable subscription term. Further, any increases in sales under our subscription sales model could result in decreased revenues over the short term if they are offset by a decline in sales from perpetual license customers.

Additionally, in connection with our sales efforts to enterprise customers and our use of ETLAs, a number of factors could affect our revenues, including longer than expected sales and implementation cycles, potential deferral of revenue due to multiple-element revenue arrangements and alternate licensing arrangements. If any of our assumptions about revenue from our new businesses or our addition of a subscription-based model prove incorrect, our actual results may vary materially from those anticipated, estimated or projected.

We may be unable to predict subscription renewal rates and the impact these rates may have on our future revenue and operating results.

The hosted business model we utilize in our Adobe Marketing Cloud offerings typically involves selling services on a subscription basis pursuant to service agreements that are generally one to three years in length. Our individual Creative Cloud subscription agreements are generally month-to-month or one year in length, ETLAs for our Digital Media products and services are generally three years in length, and subscription agreements for other products and services may provide for shorter or longer terms. Although many of our service and subscription agreements contain automatic renewal terms, our customers have no obligation to renew their subscriptions for our services after the expiration of their initial subscription period, and some customers elect not to renew. We cannot provide assurance that these subscriptions will be renewed at the same or higher level of service, for the same number of seats/licenses or for the same duration of time, if at all. Moreover, under certain circumstances, some of our customers have the right to cancel their service agreements prior to the expiration of the terms of their agreements. We cannot be assured that we will be able to accurately predict future customer renewal rates. Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their level of satisfaction with our services, the reliability (including uptime) of our subscription services, the prices of our services, the perceived information security of our systems and services, the prices of services offered by our competitors, mergers and acquisitions affecting our customer base, reductions in our customers' spending levels, or declines in customer activity as a result of economic downturns or uncertainty in financial markets. If our customers do not renew their subscriptions for our services or if they renew on less favorable terms to us, our revenues may decline.

Our future growth is also affected by our ability to sell additional features and services to our current customers, which depends on a number of factors, including customers' satisfaction with our products and services, the prices of our offerings and general economic conditions. If our efforts to cross-sell and upsell to our customers are unsuccessful, the rate at which our business grows might decline.

Security vulnerabilities in our products and systems could lead to reduced revenues or to liability claims.

Maintaining the security of our products, computers and networks is a critical issue for us and our customers. Security researchers, criminal hackers and other third parties regularly develop new techniques to penetrate computer and network security measures and, as we have previously disclosed, certain parties have in the past managed to breach certain of our data-security systems and misused certain of our systems and software in order to access our end users' authentication and payment information. In addition, cyber-attackers also develop and deploy viruses, worms and other malicious software programs, some of which may be specifically designed to attack our products, systems, computers or networks. Sophisticated hardware and operating system applications that we produce or procure from third parties may contain defects in design or manufacture, including bugs and other problems that could unexpectedly compromise the security of the system. The costs to eliminate or alleviate cyber or other security problems, bugs, viruses, worms, malicious software programs and security vulnerabilities are significant, and our efforts to address these problems may not be successful and could result in interruptions, delays, cessation of service and loss of existing or potential customers that may impede our sales, manufacturing, distribution or other critical functions, as well as potential liability to the company.

Outside parties have in the past and may in the future attempt to fraudulently induce our employees or users of our services to disclose sensitive information via illegal electronic spamming, phishing or other tactics. Unauthorized parties may also attempt to gain physical access to one of our facilities in order to infiltrate our information systems.

These actual and potential breaches of our security measures and the accidental loss, inadvertent disclosure or unauthorized dissemination of proprietary information or sensitive, personal or confidential data about us, our employees or our customers, including the potential loss or disclosure of such information or data as a result of hacking, fraud, trickery or other forms of deception, could expose us, our employees, our customers or the individuals affected to a risk of loss or misuse of this information. This may result in litigation and potential liability or fines for us, or governmental inquiry and oversight, any of which could damage our brand and reputation, possibly impeding our present and future success in retaining and attracting new customers and thereby requiring time and resources to repair our brand image.

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These problems affect our products and services in particular because cyber-attackers tend to focus their efforts on the most popular offerings (such as those with large bases of users), and we expect them to continue to do so. Critical vulnerabilities may be identified in certain of our applications. These vulnerabilities could cause such applications to crash and could allow an attacker to take control of the affected system, which could result in liability to us or limit our ability to conduct our business and deliver our products and services to customers. We devote significant resources to address security vulnerabilities through engineering more secure products, enhancing security and reliability features in our products and systems, code hardening, conducting rigorous penetration tests, deploying security updates to address security vulnerabilities and improving our incident response time, but these security vulnerabilities cannot be totally eliminated. The cost of these steps could reduce our operating margins, and we may be unable to implement these measures quickly enough to prevent cyber-attackers from gaining unauthorized access into our systems and products. Despite our preventative efforts, actual or perceived security vulnerabilities in our products and systems may harm our reputation or lead to claims against us (and have in the past lead to such claims), and could lead some customers to seek to return products, to stop using certain services, to reduce or delay future purchases of products or services, or to use competing products or services. If we do not make the appropriate level of investment in our technology systems or if our systems become out-of-date or obsolete and we are not able to deliver the quality of data security customers require, our business could be adversely affected. Customers may also increase their expenditures on security measures designed to protect their existing computer systems from attack, which could delay adoption of new technologies. Further, if we or our customers are subject to a future attack, or our technology is utilized in a third-party attack, it may be necessary for us to take additional extraordinary measures and make additional expenditures to take appropriate responsive and preventative steps. Any of these events could adversely affect our revenues or margins. Moreover, delayed sales, lower margins or lost customers resulting from the disruptions of cyber-attacks or preventative measures could adversely affect our financial results, stock price and reputation.

Some of our lines of business rely on us or our third-party service providers to host and deliver services and data, and any interruptions or delays in these hosted services, security or privacy breaches, or failures in data collection could expose us to liability and harm our business and reputation.

Some of our lines of business and services, including our online store at adobe.com, Creative Cloud, other hosted Digital Media offerings and our Adobe Marketing Cloud solutions, rely on hardware and services hosted and controlled directly by us or by our third-party service providers. We do not have redundancy for all of our systems, many of our critical applications reside in only one of our data centers, and our disaster recovery planning may not account for all eventualities. If our business relationship with a third-party provider of hosting or content delivery services is negatively affected, or if one of our content delivery suppliers were to terminate their agreement with us, we might not be able to deliver the corresponding hosted offerings to our customers, which could subject us to reputational harm and cause us to lose customers and future business, reducing our revenues.

We hold large amounts of customer data, some of which is hosted in third-party facilities. A security incident at those facilities or ours may compromise the confidentiality, integrity or availability of customer data. Unauthorized access to customer data stored on our computers or networks may be obtained through break-ins, breach of our secure network by an unauthorized party, employee theft or misuse, or other misconduct. It is also possible that unauthorized access to customer data may be obtained through inadequate use of security controls by customers. While our products and services provide and support strong password controls, IP restriction and account controls, their use is controlled by the customer. Accounts created with weak passwords could allow cyber-attackers to gain access to customer data. Additionally, failure by customers to remove accounts of their own employees, or granting of accounts by the customer in an uncontrolled manner, may allow for access by former or unauthorized customer representatives. If there were an inadvertent disclosure of personal information, or if a third party were to gain unauthorized access to the personal information we possess on behalf of our customers, our operations could be disrupted, our reputation could be damaged and we could be subject to claims or other liabilities. In addition, such perceived or actual unauthorized disclosure of the information we collect or breach of our security could damage our reputation, result in the loss of customers and harm our business.

Because of the large amount of data that we collect and manage on behalf of our customers, it is possible that hardware or software failures or errors in our systems (or those of our third-party service providers) could result in data loss or corruption or cause the information that we collect to be incomplete or contain inaccuracies that our customers regard as significant. Furthermore, our ability to collect and report data may be delayed or interrupted by a number of factors, including access to the internet, the failure of our network or software systems, security breaches or significant variability in visitor traffic on customer websites. In addition, computer viruses may harm our systems causing us to lose data, and the transmission of computer viruses could expose us to litigation. We may also find, on occasion, that we cannot deliver data and reports to our customers in near real time because of a number of factors, including significant spikes in customer activity on their websites or failures of our network or software. If we supply inaccurate information or experience interruptions in our ability to capture, store and supply information in near real time or at all, our reputation could be harmed and we could lose customers, or we could be found liable for damages or incur other losses.

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

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in economic and political conditions, both domestically and globally. Uncertainty about current and future economic and political conditions on us, our customers, suppliers and partners, makes it difficult for us to forecast operating results and to make decisions about future investments. If economic growth in countries where we do business slows, customers may delay or reduce technology purchases, advertising spending or marketing spending. This could result in reductions in sales of our products and services, longer sales cycles, slower adoption of new technologies and increased price competition. Our customers include government entities, including the U.S. federal government, and if spending cuts impede the government's ability to purchase our products and solutions, our revenues could decline.

Deterioration in economic conditions in any of the countries in which we do business could also cause slower or impaired collections on accounts receivable, which may adversely impact our liquidity and financial condition.

A financial institution credit crisis could impair credit availability and financial stability of our customers, including our distribution partners and channels. A disruption in the financial markets may also have an effect on our derivative counterparties and could also impair our banking partners on which we rely for operating cash management. Any of these events would likely harm our business, results of operations and financial condition.

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

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

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

- difficulty in integrating the operations and personnel of the acquired company;
- difficulty in effectively integrating the acquired technologies, products or services with our current technologies, products or services;
- difficulty in maintaining controls, procedures and policies during the transition and integration;
- entry into markets in which we have minimal prior experience and where competitors in such markets have stronger market positions;
- disruption of our ongoing business and distraction of our management and other employees from other opportunities and challenges;
- inability to retain personnel of the acquired business;
- inability to retain key customers, distributors, vendors and other business partners of the acquired business;
- inability to achieve the financial and strategic goals for the acquired and combined businesses;
- inability to take advantage of anticipated tax benefits as a result of unforeseen difficulties in our integration activities;
- incurring acquisition-related costs or amortization costs for acquired intangible assets that could impact our operating results;
 - potential additional exposure to fluctuations in currency exchange rates;
- potential additional costs of bringing acquired companies into compliance with laws and regulations applicable to us as a multi-national corporation;
- potential impairment of our relationships with employees, customers, partners, distributors or third-party providers of our technologies, products or services;
- potential failure of the due diligence processes to identify significant problems, liabilities or other challenges of an acquired company or technology, including but not limited to, issues with the acquired company's intellectual property, product quality or product architecture, data back-up and security (including security from cyber-attacks), privacy

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practices, revenue recognition or other accounting practices, employee, customer or partner issues or legal and financial contingencies;

exposure to litigation or other claims in connection with, or inheritance of claims or litigation risk as a result of, an acquisition, including but not limited to claims from terminated employees, customers, former stockholders or other third parties;

incurring significant exit charges if products or services acquired in business combinations are unsuccessful;

potential inability to assert that internal controls over financial reporting are effective;

potential inability to obtain, or obtain in a timely manner, approvals from governmental authorities, which could delay or prevent such acquisitions;

potential delay in customer and distributor purchasing decisions due to uncertainty about the direction of our product and service offerings; and

potential incompatibility of business cultures.

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

We may incur substantial costs enforcing or acquiring intellectual property rights and defending against third-party claims as a result of litigation or other proceedings.

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

We may not be able to protect our intellectual property rights, including our source code, from third-party infringers or unauthorized copying, use or disclosure.

Although we vigorously defend our intellectual property rights and attempt to combat unlicensed copying, access and use of software and intellectual property through a variety of techniques, preventing unauthorized use or infringement of our rights is inherently difficult. We actively combat software piracy as we enforce our intellectual property rights, but we nonetheless lose significant revenue due to illegal use of our software. If piracy activities continue at historical levels or increase, they may further harm our business.

Additionally, we take significant measures to protect the secrecy of our confidential information and trade secrets, including our source code. Despite these measures, as we have previously disclosed, hackers have managed to access certain of our source code and may obtain access in the future. If unauthorized disclosure of our source code occurs through security breach, cyber-attack or otherwise, we could potentially lose future trade secret protection for that source code. The loss of future trade secret protection could make it easier for third parties to compete with our products by copying functionality, which could cause us to lose customers and could adversely affect our revenue and operating margins. We also seek to protect our confidential information and trade secrets through the use of non-disclosure agreements with our customers, contractors, vendors and partners. However, there is a risk that our confidential information and trade secrets may be disclosed or published without our authorization, and in these situations enforcing our rights may be difficult or costly.

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

Our industry is highly regulated, including for privacy and data security. We are also expanding our business in countries that have more stringent data protection laws than those in the U.S. Privacy laws globally are changing and evolving. Governments, privacy advocates and class action attorneys are increasingly scrutinizing how companies collect, process, use, store, share or transmit personal data. New laws and industry self-regulatory codes have been enacted and more are being considered that may affect our ability to reach current and prospective customers, to understand how our products and services are being used, to respond to customer requests allowed under the laws, and to implement our new business models effectively. These new laws and regulations would similarly affect our competitors as well as our customers. Any perception of our practices or products as an invasion of privacy, whether or not consistent with current regulations and industry practices, may subject us to public criticism, class action lawsuits, reputational harm or claims by regulators, industry groups or other third parties, all of which could disrupt our business and expose us to increased liability. Additionally, both laws regulating privacy, as well as third-party products addressing perceived privacy concerns, could affect the functionality of and demand for our products, thereby harming our revenues.

On behalf of certain customers, we collect and store anonymous and personal information derived from the activities of end users with various channels, including traditional websites, mobile websites and applications, email interactions, direct mail, point of sale, text messaging and call centers (collectively, “channels”). This enables us to provide such customers with reports on aggregated anonymous or personal information from and about end-user interactions with various channels in the manner specifically directed by each such individual customer. Federal, state and foreign governments and agencies have adopted or are considering adopting laws regarding the collection, use and disclosure of this information. Our compliance with privacy laws and regulations and our reputation among the public body of end users depend in part on such customers’ adherence to privacy laws and regulations and their use of our services in ways consistent with such end users’ expectations. We also rely on representations made to us by customers that their own use of our services and the information they provide to us via our services do not violate any applicable privacy laws, rules and regulations or their own privacy policies. We ask customers to represent to us that they provide their end users the opportunity to “opt-out” of the information collection associated with our services, as applicable. We do not formally audit such customers to confirm compliance with these representations. If these representations are false or if such customers do not otherwise comply with applicable privacy laws, we could face adverse publicity and possible legal or other regulatory action. In addition, some countries are considering enacting laws that would expand the scope of privacy-related obligations required of service providers, such as Adobe, that would require additional compliance expense and increased liability.

If we fail to process transactions effectively our revenue and earnings may be harmed.

We process a significant volume of transactions on a daily basis in both our Digital Marketing and Digital Media businesses. Due to the size and volume of transactions that we handle, effective processing systems and controls are essential; but even the most sophisticated systems and processes may not be effective in preventing all errors. The systems supporting our business are comprised of multiple technology platforms that may be difficult to scale. If we are unable to effectively manage these systems and processes, we may be unable to process customer data in an accurate, reliable and timely manner, which may harm our customer relationships or results of operations.

Failure to manage our sales and distribution channels and third-party customer service and technical support providers effectively could result in a loss of revenue and harm to our business.

We contract with a number of software distributors, none of which is individually responsible for a material amount of our total net revenue for any recent period. If any single agreement with one of our distributors were terminated, we believe we could make arrangements with new or existing distributors to distribute our products without a substantial disruption to our business; however, any prolonged delay in securing a replacement distributor could have a negative short-term impact on our results of operations.

Successfully managing our indirect channel efforts to reach various customer segments for our products and services is a complex process across the broad range of geographies where we do business or plan to do business. Our

distributors and other channel partners are independent businesses that we do not control. Notwithstanding the independence of our channel partners, we face potential legal risk and reputational harm from the activities of these third parties including, but not limited to, export control violations, workplace conditions, corruption and anti-competitive behavior. Although we have undertaken efforts to reduce these third-party risks, they remain present. We cannot be certain that our distribution channel will continue to market or sell our products effectively. If our distribution channel is not successful, we may lose sales opportunities, customers and revenues. Our distributors also sell our competitors' products, and if they favor our competitors' products for any reason, they may fail to market our products as effectively or to devote resources necessary to provide effective sales, which would cause our results

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to suffer. We also distribute some products through our OEM channel, and if our OEMs decide not to bundle our applications on their devices, our results could suffer.

In addition, the financial health of our distributors and our continuing relationships with them are important to our success. Some of these distributors may be adversely impacted by changes to our business model or unable to withstand adverse changes in economic conditions, which could result in insolvency and/or the inability of such distributors to obtain credit to finance purchases of our products. In addition, weakness in the end-user market could negatively affect the cash flows of our distributors who could, in turn, delay paying their obligations to us, which would increase our credit risk exposure. Our business could be harmed if the financial condition of some of these distributors substantially weakened and we were unable to timely secure replacement distributors.

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

We also provide products and services, directly and indirectly, to a variety of governmental entities, both domestically and internationally. Risks associated with licensing and selling products and services to governmental entities include longer sales cycles, varying governmental budgeting processes and adherence to complex procurement regulations and other government-specific contractual requirements. Ineffectively managing these risks could result in various civil and criminal penalties and administrative sanctions, including termination of contracts, payment of fines, and suspension or debarment from future government business, as well as harm to our reputation.

We outsource a substantial portion of our customer service and technical support activities to third-party service providers. We rely heavily on these third-party customer service and technical support representatives working on our behalf, and we expect to continue to rely heavily on third parties in the future. This strategy provides us with lower operating costs and greater flexibility, but also presents risks to our business due to the fact that we may not be able to influence the quality of support as directly as we would be able to do if our own employees performed these activities. Our customers may react negatively to providing information to, and receiving support from, third-party organizations, especially if based overseas. If we encounter problems with our third-party customer service and technical support providers, our reputation may be harmed and we could lose customers and associated revenues.

Certain of our enterprise offerings have long and complex sales cycles.

Sales cycles for some of our enterprise offerings, including our Adobe Marketing Cloud Solutions and ETLAs in our Digital Media business, are long and complex. The complexity in these sales cycles is due to a number of factors, including:

- the need for our sales representatives to educate customers about the use and benefit of our large-scale deployments of our products and services, including technical capabilities, security features, potential cost savings and return on investment;
- the desire of large and medium size organizations to undertake significant evaluation processes to determine their technology requirements prior to making information technology expenditures;
- the need for our representatives to spend a significant amount of time assisting potential customers in their testing and evaluation of our products and services;
- the negotiation of large, complex, enterprise-wide contracts, as often required by our and our customers' business and legal representatives;
- the need for our customers to obtain requisition approvals from various decision makers within their organizations;
- and
- customer budget constraints, economic conditions and unplanned administrative delays.

We spend substantial time and expense on our sales efforts without any assurance that potential customers will ultimately purchase our solutions. As we target our sales efforts at larger enterprise customers, these trends are expected to continue. Additionally, our enterprise sales pattern has historically been uneven, where a higher percentage of a quarter's total sales occur

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during the final weeks of each quarter, which is common in our industry. Our long sales cycle for these products makes it difficult to predict when a given sales cycle will close.

Catastrophic events may disrupt our business.

We are a highly automated business and rely on our network infrastructure and enterprise applications, internal technology systems and our website for our development, marketing, operational, support, hosted services and sales activities. In addition, some of our businesses rely on third-party hosted services, and we do not control the operation of third-party data center facilities serving our customers from around the world, which increases our vulnerability. A disruption, infiltration or failure of these systems or third-party hosted services in the event of a major earthquake, fire, flood, power loss, telecommunications failure, software or hardware malfunctions, cyber-attack, war, terrorist attack or other catastrophic event could cause system interruptions, reputational harm, loss of intellectual property, delays in our product development, lengthy interruptions in our services, breaches of data security and loss of critical data. Any of these events could prevent us from fulfilling our customers' orders. Our corporate headquarters, a significant portion of our research and development activities, certain of our data centers and certain other critical business operations are located in the San Francisco Bay Area, and additional facilities where we conduct significant operations are located in the Salt Lake Valley Area, both of which are near major earthquake faults. We have developed certain disaster recovery plans and backup systems to reduce the potentially adverse effect of such events, but a catastrophic event that results in the destruction or disruption of any of our data centers or our critical business or information technology systems could severely affect our ability to conduct normal business operations and, as a result, our future operating results could be adversely affected.

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

The market price for our common stock has in the past experienced significant fluctuations and may fluctuate significantly in the future. A number of factors may affect the market price for our common stock, including: shortfalls in our revenue, margins, earnings, the number of paid Creative Cloud subscribers, ARR, bookings within our Adobe Marketing Cloud business or other key performance metrics; changes in estimates or recommendations by securities analysts; the announcement of new products, product enhancements or service introductions by us or our competitors; the loss of a large customer or our inability to increase sales to existing customers or attract new customers; variations in our or our competitors' results of operations, changes in the competitive landscape generally and developments in our industry; and unusual events such as significant acquisitions, divestitures, litigation, general socio-economic, regulatory, political or market conditions and other factors, including factors unrelated to our operating performance.

We are subject to risks associated with compliance with laws and regulations globally which may harm our business. We are a global company subject to varied and complex laws, regulations and customs domestically and internationally. These laws and regulations relate to a number of aspects of our business, including trade protection, import and export control, data and transaction processing security, payment card industry data security standards, records management, user-generated content hosted on websites we operate, privacy practices, corporate governance, employee and third-party complaints, gift policies, conflicts of interest, employment and labor relations laws, securities regulations and other regulatory requirements affecting trade and investment. The application of these laws and regulations to our business is often unclear and may at times conflict. Compliance with these laws and regulations may involve significant costs or require changes in our business practices that result in reduced revenue and profitability. Non-compliance could also result in fines, damages, criminal sanctions against us, our officers or our employees, prohibitions on the conduct of our business, and damage to our reputation. We incur additional legal compliance costs associated with our global operations and could become subject to legal penalties if we fail to comply with local laws and regulations in U.S. jurisdictions or in foreign countries, which laws and regulations may be substantially different from those in the U.S. In many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by U.S. regulations applicable to us, including the Foreign Corrupt Practices Act. Although we implement policies and procedures designed to ensure compliance with these laws, there can be no assurance that all of our employees, contractors and agents, as well as

those companies to which we outsource certain of our business operations, including those based in or from countries where practices that violate such U.S. laws may be customary, will not take actions in violation of our internal policies. Any such violation, even if prohibited by our internal policies, could have an adverse effect on our business.

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We face various risks associated with our operating as a multi-national corporation.

As a global business that generates approximately 42% of our total revenue from sales to customers outside of the Americas, we are subject to a number of risks, including:

- foreign currency fluctuations;
- changes in government preferences for software procurement;
- international economic, political and labor conditions;
- tax laws (including U.S. taxes on foreign subsidiaries);
- increased financial accounting and reporting burdens and complexities;
- unexpected changes in, or impositions of, legislative or regulatory requirements;
- changes in laws governing the free flow of data across international borders;
- failure of laws to protect our intellectual property rights adequately;
- inadequate local infrastructure and difficulties in managing and staffing international operations;
- delays resulting from difficulty in obtaining export licenses for certain technology, tariffs, quotas and other trade barriers;
- the imposition of governmental economic sanctions on countries in which we do business or where we plan to expand our business;
- transportation delays;
- operating in locations with a higher incidence of corruption and fraudulent business practices; and
- other factors beyond our control, including terrorism, war, natural disasters and pandemics.

If sales to any of our customers outside of the Americas are delayed or canceled because of any of the above factors, our revenues may decline.

In addition, approximately 52% of our employees are located outside the U.S. Accordingly, we are exposed to changes in laws governing our employee relationships in various U.S. and foreign jurisdictions, including laws and regulations regarding wage and hour requirements, fair labor standards, employee data privacy, unemployment tax rates, workers' compensation rates, citizenship requirements and payroll and other taxes, which likely would have a direct impact on our operating costs. We may continue to expand our international operations and international sales and marketing activities. Expansion in international markets has required, and will continue to require, significant management attention and resources. We may be unable to scale our infrastructure effectively or as quickly as our competitors in these markets, and our revenues may not increase to offset these expected increases in costs and operating expenses, which would cause our results to suffer.

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

Our operating results are subject to fluctuations in foreign currency exchange rates. We attempt to mitigate a portion of these risks through foreign currency hedging, based on our judgment of the appropriate trade-offs among risk, opportunity and expense. We have established a hedging program to partially hedge our exposure to foreign currency exchange rate fluctuations for various currencies. We regularly review our hedging program and make adjustments as necessary based on the factors discussed above. Our hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movement in foreign currency exchange rates, which could adversely affect our financial condition or results of operations.

We have issued \$1.9 billion of notes in a debt offering and may incur other debt in the future, which may adversely affect our financial condition and future financial results.

We have \$1.9 billion in senior unsecured notes outstanding. We also have a \$1.0 billion revolving credit facility, which is currently undrawn. This debt may adversely affect our financial condition and future financial results by, among other things:

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requiring the dedication of a portion of our expected cash from operations to service our indebtedness, thereby reducing the amount of expected cash flow available for other purposes, including capital expenditures and acquisitions; and

limiting our flexibility in planning for, or reacting to, changes in our business and our industry.

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

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

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

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

For example, the U.S.-based Financial Accounting Standards Board ("FASB") is currently working together with the International Accounting Standards Board ("IASB") on several projects to further align accounting principles and facilitate more comparable financial reporting between companies who are required to follow GAAP under SEC regulations and those who are required to follow International Financial Reporting Standards outside of the U.S. These efforts by the FASB and IASB may result in different accounting principles under GAAP that may result in materially different financial results for us in areas including, but not limited to, principles for recognizing revenue and lease accounting. Additionally, significant changes to GAAP resulting from the FASB's and IASB's efforts may require that we change how we process, analyze and report financial information and that we change financial reporting controls.

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

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

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

We are a United States-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. A significant portion of our foreign earnings for the current fiscal year were earned by our Irish subsidiaries. In addition to providing for U.S. income taxes on earnings from the United States, we provide for U.S. income taxes on the earnings of foreign subsidiaries unless the subsidiaries' earnings are considered permanently reinvested outside the United States. While we do not anticipate changing our intention regarding permanently reinvested earnings, if certain foreign earnings previously treated as permanently reinvested are repatriated, the related U.S. tax liability may be reduced by any foreign income taxes paid on these earnings.

Our income tax expense has differed from the tax computed at the U.S. federal statutory income tax rate due primarily to discrete items and to earnings considered as permanently reinvested in foreign operations. Unanticipated changes in

our tax rates could affect our future results of operations. Our future effective tax rates could be unfavorably affected by changes in the tax rates in jurisdictions where our income is earned, by changes in, or our interpretation of, tax rules and regulations in the jurisdictions in which we do business, by unanticipated decreases in the amount of earnings in countries with low statutory tax rates, by lapses of the availability of the U.S. research and development tax credit, or by changes in the valuation of our deferred tax assets and liabilities. The United States, countries in the European Union and other countries where we do business have been considering changes in relevant tax, accounting and other laws, regulations and interpretations, including changes to tax laws applicable to

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corporate multinationals such as Adobe. These potential changes could adversely affect our effective tax rates or result in other costs to us.

In addition, we are subject to the continual examination of our income tax returns by the U.S. Internal Revenue Service (“IRS”) and other domestic and foreign tax authorities, including a current examination by the IRS of our fiscal 2010, 2011 and 2012 tax returns. These tax examinations are expected to focus on our intercompany transfer pricing practices as well as other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from the current examinations. There can be no assurance that the final determination of any of these examinations will not have an adverse effect on our operating results and financial position.

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

Much of our future success depends on the continued service and availability of our senior management. These individuals have acquired specialized knowledge and skills with respect to Adobe. The loss of any of these individuals could harm our business, especially in the event that we have not been successful in developing adequate succession plans. Our business is also dependent on our ability to retain, hire and motivate talented, highly skilled personnel across all levels of our organization. Experienced personnel in the information technology industry are in high demand and competition for their talents is intense in many areas where our employees are located. If we are unable to continue to successfully attract and retain key personnel, our business may be harmed. Effective succession planning is also a key factor for our long-term success. Our failure to enable the effective transfer of knowledge and facilitate smooth transitions of our key employees could adversely affect our long-term strategic planning and execution.

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

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

Our cash equivalent and short-term investment portfolio as of February 27, 2015 consisted of corporate bonds and commercial paper, U.S. agency securities and U.S. Treasury securities, money market mutual funds, municipal securities, time deposits and asset-backed securities. We follow an established investment policy and set of guidelines to monitor and help mitigate our exposure to interest rate and credit risk. The policy sets forth credit quality standards and limits our exposure to any one issuer, as well as our maximum exposure to various asset classes.

Should financial market conditions worsen in the future, investments in some financial instruments may pose risks arising from market liquidity and credit concerns. In addition, any deterioration of the capital markets could cause our other income and expense to vary from expectations. As of February 27, 2015, we had no material impairment charges associated with our short-term investment portfolio, and although we believe our current investment portfolio has little risk of material impairment, we cannot predict future market conditions or market liquidity, or credit availability, and can provide no assurance that our investment portfolio will remain materially unimpaired.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Below is a summary of stock repurchases for the three months ended February 27, 2015. See Note 10 of our Notes to Condensed Consolidated Financial Statements for information regarding our stock repurchase program.

Period	Shares Repurchased	Average Price Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Approximate Dollar Value that May Yet be Purchased Under the Plans
	(in thousands, except average price per share)			
Beginning repurchase authority ⁽¹⁾				\$240,309
November 29—December 26, 2014				
Shares repurchased	557	\$72.38	557	\$(40,309)
December 27, 2014—January 23, 2015				
Shares repurchased	918	\$72.60	918	\$(66,667) ⁽²⁾
January 24—February 27, 2015				
Shares repurchased	924	\$72.18	924	\$(66,665) ⁽²⁾
Additional repurchase authority granted ⁽³⁾				\$2,000,000
Total	2,399		2,399	\$2,066,668

⁽¹⁾ In April 2012, the Board of Directors granted authority to repurchase up to \$2.0 billion in common stock through the the end of fiscal 2015. As of February 27, 2015, we have exhausted our \$2.0 billion authority granted by our Board of Directors in fiscal 2012.

⁽²⁾ In December 2014, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of \$200.0 million. As of February 27, 2015, \$66.7 million of the prepayment remained under this agreement.

⁽³⁾ In January 2015, the Board of Directors approved a new stock repurchase program granting authority to repurchase up to \$2.0 billion in common stock through the end of fiscal 2017. The new stock repurchase program approved by our Board of Directors is similar to our previous \$2.0 billion stock repurchase program. As of February 27, 2015, we have not entered into any stock repurchase agreements under the new authority.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

The exhibits listed in the accompanying "Index to Exhibits" are filed or incorporated by reference as part of this Form 10-Q.

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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/ MARK GARRETT
Mark Garrett
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: March 25, 2015

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SUMMARY OF TRADEMARKS

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

Adobe
Acrobat
Behance
Creative Cloud
EchoSign
Reader

All other trademarks are the property of their respective owners.

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INDEX TO EXHIBITS

Exhibit Number	Exhibit Description	Incorporated by Reference**			SEC File No.	Filed Herewith
		Form	Filing Date	Exhibit Number		
3.1	Restated Certificate of Incorporation of Adobe Systems Incorporated	8-K	4/26/11	3.3	000-15175	
3.2	Amended and Restated Bylaws	8-K	10/30/12	3.1	000-15175	
4.1	Specimen Common Stock Certificate	10-Q	6/25/14	4.1	000-15175	
4.2	Form of Indenture	S-3	1/15/10	4.1	333-164378	
4.3	Forms of Global Note for Adobe Systems Incorporated's 4.750% Notes due 2020, together with Form of Officer's Certificate setting forth the terms of the Note	8-K	1/26/10	4.1	000-15175	
4.4	Form of Global Note for Adobe Systems Incorporated's 3.250% Notes due 2025, together with Form of Officer's Certificate setting forth the terms of the Note	8-K	1/26/15	4.1	000-15175	
10.1A	Amended 1994 Performance and Restricted Stock Plan*	10-Q	4/9/10	10.1	000-15175	
10.1B	Form of Restricted Stock Agreement used in connection with the Amended 1994 Performance and Restricted Stock Plan*	10-K	1/23/09	10.3	000-15175	
10.1C	Form of Restricted Stock Unit Agreement used in connection with the Amended 1994 Performance and Restricted Stock Plan*	10-K	1/26/12	10.13	000-15175	
10.2A	1996 Outside Directors Stock Option Plan, as amended*	10-Q	4/12/06	10.6	000-15175	
10.2B	Forms of Stock Option Agreements used in connection with the 1996 Outside Directors Stock Option Plan*	S-8	6/16/00	4.8	333-39524	
10.3	1997 Employee Stock Purchase Plan, as amended*	8-K	4/26/11	10.1	000-15175	
10.4A	2003 Equity Incentive Plan, as amended*	8-K	4/14/14	10.1	000-15175	
10.4B	Form of Stock Option Agreement used in connection with the 2003 Equity Incentive	8-K	12/20/10	99.4	000-15175	

Plan*

10.4C	Form of RSU Grant Notice and Award Agreement pursuant to the 2003 Equity Incentive Plan*	8-K	1/28/15	10.6	000-15175
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Exhibit Number	Exhibit Description	Incorporated by Reference**			SEC File No.	Filed Herewith
		Form	Filing Date	Exhibit Number		
10.4D	Form of Restricted Stock Agreement used in connection with the 2003 Equity Incentive Plan*	10-Q	10/7/04	10.11	000-15175	
10.4E	Form of Performance Share Program pursuant to the 2003 Equity Incentive Plan (applicable to the 2011 Performance Share Program)*	8-K	1/29/10	10.1	000-15175	
10.4F	Award Calculation Methodology to the 2011 Performance Share Program pursuant to the 2003 Equity Incentive Plan*	8-K	1/28/11	10.3	000-15175	
10.4G	Form of Award Grant Notice and Performance Share Award Agreement pursuant to the 2003 Equity Incentive Plan (applicable to the 2011 Performance Share Program)*	8-K	12/20/10	99.5	000-15175	
10.4H	Form of Performance Share Program pursuant to the 2003 Equity Incentive Plan (applicable to the 2012 Performance Share Program)*	8-K	1/26/12	10.2	000-15175	
10.4I	Award Calculation Methodology to the 2012 Performance Share Program pursuant to the 2003 Equity Incentive Plan*	8-K	1/26/12	10.3	000-15175	
10.4J	Form of Performance Share Award Grant Notice and Performance Share Award Agreement pursuant to the 2003 Equity Incentive Plan (applicable to the 2012 Performance Share Program)*	10-K	1/26/12	10.61	000-15175	
10.4K	2013 Performance Share Program pursuant to the 2003 Equity Incentive Plan*	8-K	1/28/13	10.2	000-15175	
10.4L	Form of Performance Share Award Grant Notice and Performance Share Award Agreement pursuant to the 2003 Equity Incentive Plan (applicable to the 2013 Performance Share Program)*	8-K	1/28/13	10.3	000-15175	
10.4M	2014 Performance Share Program pursuant to the 2003 Equity Incentive Plan*	8-K	1/29/14	10.2	000-15175	
10.4N	Form of Performance Share Award Grant Notice and Performance Share Award	8-K	1/29/14	10.3	000-15175	

Agreement pursuant to the 2003 Equity
Incentive Plan (applicable to the 2014
Performance Share Program)*

10.40	2015 Performance Share Program pursuant to the 2003 Equity Incentive Plan*	8-K	1/28/2015	10.2	000-15175
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Exhibit Number	Exhibit Description	Incorporated by Reference**			SEC File No.	Filed Herewith
		Form	Filing Date	Exhibit Number		
10.4P	Form of 2015 Performance Share Award Grant Notice and Award Agreement pursuant to the 2015 Performance Share Program	8-K	1/28/2015	10.3	000-15175	
10.4Q	Form of Director Initial Grant Restricted Stock Unit Award Agreement used in connection with the 2003 Equity Incentive Plan*	8-K	12/20/10	99.6	000-15175	
10.4R	Form of Director Annual Grant Restricted Stock Unit Award Agreement used in connection with the 2003 Equity Incentive Plan*	8-K	12/20/10	99.7	000-15175	
10.4S	Form of Director Annual Grant Stock Option Agreement used in connection with the 2003 Equity Incentive Plan*	8-K	12/20/10	99.8	000-15175	
10.5A	2005 Equity Incentive Assumption Plan, as amended and restated*	10-Q	6/28/13	10.17	000-15175	
10.5B	Form of Stock Option Agreement used in connection with the 2005 Equity Incentive Assumption Plan*	8-K	12/20/10	99.10	000-15175	
10.5C	Form of RSU Grant Notice and Award Agreement pursuant to the 2005 Equity Incentive Assumption Plan*	8-K	1/28/13	10.7	000-15175	
10.6	Allaire Corp. 1997 Stock Incentive Plan*	S-8	3/27/01	4.06	333-57708	
10.7	Allaire Corporation 1998 Stock Incentive Plan, as amended*	S-8	3/27/01	4.07	333-57708	
10.8	Allaire Corporation 2000 Stock Incentive Plan*	S-8	3/27/01	4.08	333-57708	
10.9	Andromedia, Inc. 1999 Stock Plan*	S-8	12/7/99	4.09	333-92233	
10.10	Macromedia, Inc. 1999 Stock Option Plan*	S-8	8/17/00	4.07	333-44016	
10.11	Macromedia, Inc. 2002 Equity Incentive Plan, as amended*	S-8	8/10/05	4.08	333-127392	
10.12	Form of Macromedia, Inc. Stock Option Agreement*	S-8	8/10/05	4.09	333-127392	
10.13		S-8	11/23/04	4.10	333-120712	

Form of Macromedia, Inc. Revised Non-Plan
Stock Option Agreement*

10.14	Form of Macromedia, Inc. Restricted Stock Purchase Agreement*	10-Q	2/8/05	10.01	000-22688
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Exhibit Number	Exhibit Description	Incorporated by Reference**			SEC File No.	Filed Herewith
		Form	Filing Date	Exhibit Number		
10.15A	Forms of Retention Agreement*	10-K	2/17/98	10.44	000-15175	
10.15B	Second Amendment to Retention Agreement between Adobe Systems Incorporated and Shantanu Narayen, effective as of December 17, 2010*	10-K	1/27/11	10.40	000-15175	
10.15C	Retention Agreement between Adobe Systems Incorporated and Shantanu Narayen, effective December 5, 2014	8-K	12/11/14	10.20	000-15175	
10.16	Form of Indemnity Agreement*	10-Q	6/26/09	10.12	000-15175	
10.17	Second Amended and Restated Master Lease of Land and Improvements by and between SMBC Leasing and Finance, Inc. and Adobe Systems Incorporated	10-Q	10/7/04	10.14	000-15175	
10.18A	Lease between Adobe Systems Incorporated and Selco Service Corporation, dated March 26, 2007	8-K	3/28/07	10.1	000-15175	
10.18B	Participation Agreement among Adobe Systems Incorporated, Selco Service Corporation, et al. dated March 26, 2007	8-K	3/28/07	10.2	000-15175	
10.18C	Master Amendment No. 2 among Adobe Systems Incorporated, Selco Service Corporation and KeyBank National Association dated October 31, 2011	10-K	1/22/13	10.13	000-15175	
10.19	Adobe Systems Incorporated Deferred Compensation Plan, as Amended and Restated*	10-K	1/20/15	10.19	000-15175	
10.20	Employment offer letter between Adobe Systems Incorporated and Richard Rowley, dated October 30, 2006*	8-K	11/16/06	10.1	000-15175	
10.21	Employment offer letter between Adobe Systems Incorporated and Mark Garrett dated January 5, 2007*	8-K	1/26/07	10.1	000-15175	
10.22	Credit Agreement, dated as of March 2, 2012, among Adobe Systems Incorporated and certain subsidiaries as Borrowers, The Royal Bank of	8-K	3/7/12	10.1	000-15175	

Scotland PLC and U.S. Bank National
Association as Co-Documentation Agents,
JPMorgan Chase Bank, N.A., as Syndication
Agent, Bank of America, N.A. as
Administrative Agent and Swing Line Lender,
and the Other Lenders Party Thereto

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Exhibit Number	Exhibit Description	Incorporated by Reference**			SEC File No.	Filed Herewith
		Form	Filing Date	Exhibit Number		
10.23	Purchase and Sale Agreement, by and between NP Normandy Overlook, LLC, as Seller and Adobe Systems Incorporated as Buyer, effective as of May 12, 2008	8-K	5/15/08	10.1	000-15175	
10.24A	Omniture, Inc. 1999 Equity Incentive Plan, as amended (the "Omniture 1999 Plan")*	S-1	4/4/06	10.2A	333-132987	
10.24B	Forms of Stock Option Agreement under the Omniture 1999 Plan*	S-1	4/4/06	10.2B	333-132987	
10.24C	Form of Stock Option Agreement under the Omniture 1999 Plan used for Named Executive Officers and Non-Employee Directors*	S-1	6/9/06	10.2C	333-132987	
10.25	Omniture, Inc. 2006 Equity Incentive Plan and related forms*	10-Q	8/6/09	10.3	000-52076	
10.26	Omniture, Inc. 2007 Equity Incentive Plan and related forms*	10-K	2/27/09	10.9	000-52076	
10.27	Omniture, Inc. 2008 Equity Incentive Plan and related forms*	10-K	2/27/09	10.10	000-52076	
10.28A	Visual Sciences, Inc. (formerly, WebSideStory, Inc.) 2004 Equity Incentive Award Plan (the "VS 2004 Plan") and Form of Option Grant Agreement*	10-K	2/29/08	10.6	000-52076	
10.28B	Form of Restricted Stock Award Grant Notice and Restricted Stock Award Agreement under the VS 2004 Plan*	10-K	2/29/08	10.6A	000-52076	
10.29	Visual Sciences, Inc. (formerly, WebSideStory, Inc.) 2006 Employment Commencement Equity Incentive Award Plan and Form of Option Grant Agreement*	10-K	2/29/08	10.8	000-52076	
10.30	Day Software Holding AG International Stock Option/Stock Issuance Plan*	S-8	11/1/10	99.1	333-170254	
10.31	Day Interactive Holding AG U.S. Stock Option/Stock Issuance Plan*	S-8	11/1/10	99.2	333-170254	
10.32	Demdex, Inc. 2008 Stock Plan, as amended*	S-8	1/27/11	99.1	333-171902	

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10.33	2011 Executive Cash Performance Bonus Plan*	8-K	1/28/11	10.4	000-15175
10.34	2011 Executive Annual Incentive Plan*	8-K	1/28/11	10.5	000-15175
10.35	2012 Executive Annual Incentive Plan*	8-K	1/26/12	10.4	000-15175

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Exhibit Number	Exhibit Description	Incorporated by Reference**			SEC File No.	Filed Herewith
		Form	Filing Date	Exhibit Number		
10.36	2013 Executive Annual Incentive Plan*	8-K	1/28/13	10.5	000-15175	
10.37	2014 Executive Annual Incentive Plan*	8-K	1/29/14	10.5	000-15175	
10.38	2015 Executive Annual Incentive Plan	8-K	1/28/2015	10.5	000-15175	
10.39	EchoSign, Inc. 2005 Stock Plan, as amended*	S-8	7/29/11	99.1	333-175910	
10.40	TypeKit, Inc. 2009 Equity Incentive Plan, as amended*	S-8	10/7/11	99.1	333-177229	
10.41	Auditude, Inc. 2009 Equity Incentive Plan, as amended*	S-8	11/18/11	99.1	333-178065	
10.42	Auditude, Inc. Employee Stock Option Plan, as amended*	S-8	11/18/11	99.2	333-178065	
10.43	Adobe Systems Incorporated 2011 Executive Severance Plan in the Event of a Change of Control for Prior Participants *	8-K	12/15/11	10.1	000-15175	
10.44	Adobe Systems Incorporated 2011 Executive Severance Plan in the Event of a Change of Control*	8-K	12/15/11	10.2	000-15175	
10.45	Efficient Frontier, Inc. 2003 Stock Option/Stock Issuance Plan, as Amended and Restated*	S-8	1/27/12	99.1	333-179221	
10.46	Efficient Frontier, Inc. Form of Non-Plan Stock Option Agreement*	S-8	1/27/12	99.2	333-179221	
10.47	Nomination and Standstill Agreement between the Company and the ValueAct Group dated December 4, 2012	8-K	12/5/12	99.1	000-15175	
10.48A	Behance, Inc. 2012 Equity Incentive Plan*	S-8	1/23/13	99.1	333-186143	
10.48B	Amendment No. 1 to the Behance, Inc. 2012 Equity Incentive Plan*	S-8	1/23/13	99.2	333-186143	
10.49	Neolane 2008 Stock Option Plan*	S-8	8/27/13	99.1	333-190846	
10.50	2012 Neolane Stock Option Plan for The United States*	S-8	8/27/13	99.2	333-190846	

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10.51	Description of 2012 Director Compensation*	10-K	1/26/12	10.76	000-15175
10.52	Description of 2013 Director Compensation*	10-K	1/21/14	10.80	000-15175

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Exhibit Number	Exhibit Description	Incorporated by Reference**			SEC File No.	Filed Herewith
		Form	Filing Date	Exhibit Number		
10.53	Description of 2014 Director Compensation*	10-K	1/21/14	10.81	000-15175	
10.54	Description of 2015 Director Compensation*	10-K	1/20/15	10.52	000-15175	
10.55A	Aviary, Inc. 2008 Stock Plan, as amended	S-8	9/26/14	99.1	333-198973	
10.55B	Form of Stock Option Grant Notice and Award Agreement pursuant to the Aviary, Inc. 2008 Stock Plan (Installment Vesting)	S-8	9/26/14	99.2	333-198973	
10.55C	Form of Stock Option Grant Notice and Award Agreement pursuant to the Aviary, Inc. 2008 Stock Plan (Installment Vesting, Non-U.S.)	S-8	9/26/14	99.3	333-198973	
10.56	Adobe Systems Incorporated 2014 Executive Severance Plan in the Event of a Change of Control	8-K	12/11/14	10.1	000-15175	
31.1	Certification of Chief Executive Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934					X
31.2	Certification of Chief Financial Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934					X
32.1	Certification of Chief Executive Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934†					X
32.2	Certification of Chief Financial Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934†					X
101.INS	XBRL Instance					X
101.SCH	XBRL Taxonomy Extension Schema					X
101.CAL	XBRL Taxonomy Extension Calculation					X
101.LAB	XBRL Taxonomy Extension Labels					X
101.PRE	XBRL Taxonomy Extension Presentation					X

101.DEF XBRL Taxonomy Extension Definition

X

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* Compensatory plan or arrangement.

** References to Exhibits 10.6 through 10.14 are to filings made by Macromedia, Inc. References to Exhibits 10.24A through 10.29 are to filings made by Omniture, Inc.

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