Putting it all together

Adobe Systems Incorporated
1994 Annual Report

Adobe

To our shareholders

Our acquisition of Aldus Corporation, completed in August, brings together the two software companies that launched the desktop publishing revolution—and begins an exciting new era in Adobe's history.

IN 1994, ADOBE GENERATED FAVORABLE MARKET AND FINANCIAL RESULTS during a period of extraordinary change. Our acquisition of Aldus Corporation, completed in August, brings together the two software companies that launched the desktop publishing revolution—and begins an exciting new era in Adobe's history. This report summarizes the activities and financial results of the joined organization.

On a combined basis, revenue reached $597,772,000 in 1994, a 15 percent increase over 1993 revenue of $520,237,000. Net income for 1994 totaled $6,309,000, compared with $66,545,000 in 1993, while earnings per share were $.10, compared with $1.11 in 1993. These results were affected by a $72,183,000 restructuring charge taken in conjunction with the acquisition of Aldus, and from a $15,469,000 write-off of in-process research and development in conjunction with our acquisition of both Compumation, Inc., and LaserTools Corporation. Excluding these one-time events, our business and financial results for 1994 were excellent, showing positive revenue and earnings trends from the past year. During 1994, the company declared cash dividends on its common stock totaling $.20 per share. Our financial position remains strong, with cash, cash equivalents and short-term investments balances exceeding $400 million.

From a product perspective, joining forces with Aldus fills in strategic pieces of our business. It enables the Application Products Division, for example, to offer a complete line of tools for information authoring. Throughout the acquisition, the division continued to release award-winning, best-of-class retail products while improving operating income and increasing revenue 18 percent, from $374,061,000 in 1993 to $441,120,000 in 1994. The group issued major upgrades of flagship applications such as Adobe Photoshop, Adobe Illustrator, Adobe Premiere and PageMaker, led the industry in providing widespread Power Macintosh support, and shipped key international versions of many products.

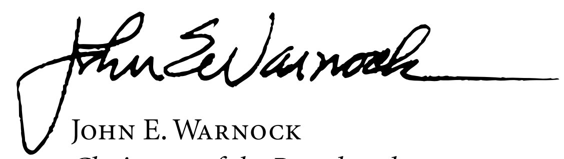
For the System Products Division, 1994 was a year of renewed growth. Licensing revenue for Adobe PostScript software reached $156,652,000, an increase of 7 percent from $146,176,000 in 1993. By offering a set of world-class development tools, the division has enabled its OEM customers to double their rate of Adobe PostScript product introductions, which include everything from popular network and color printers to specialty devices such as large-format plotters. On average, the group releases a new PostScript product to an OEM customer at least every other working day. And it has freed more resources for long-term technology development. The addition of Aldus prepress tools ensures that Adobe will be instrumental in the continuing shift of the print production process to the desktop. Meanwhile, our October acquisition of LaserTools positions us to enter the market of personal printing and solidifies our commitment to being a broad-based provider of printing systems software.

While still an area of investment for the company, Adobe Acrobat technology is gaining acceptance as a universal, standard platform for distributing information by any electronic medium, from networks to on-line services to compact discs. We released a second version of our Acrobat product family, which contains many new features in response to market feedback. Strong and increasing relationships with systems integrators and third-party developers, positive trade-press reviews, and sales penetration into markets, such as publishing, government and financial services, make us optimistic about the future of Acrobat, both as a product line and as a development platform.

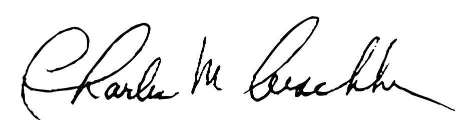
Not surprisingly, the acquisition of Aldus necessitated significant operational changes for Adobe, and we moved quickly to eliminate redundancies and reshape the organization to our best advantage. Scores of Adobe and Aldus people worked together to assure a smooth transition, while continuing to meet their respective business commitments. Adobe's headquarters remain in Mountain View, California, with customer support, North American sales, and some key application product marketing and engineering activities now based in Seattle, Washington. The addition of Aldus has substantially expanded our international infrastructure, and we experienced particularly rapid growth in the Pacific Rim.

In light of these changes, 1995 will be a year for adapting and moving forward. We will focus on integrating Adobe and Aldus technologies, rationalizing product lines, strengthening our information systems, and smoothly divesting the Aldus FreeHand illustration program under our agreement with the Federal Trade Commission.

While other major software companies deal in raw words, data and numbers, Adobe thrives on enabling visual forms of communication. We can now offer computer users everything they need to create, manage and share content-rich information on printed and electronic media. We look forward with great excitement to bringing the Adobe and Aldus pieces together for greater product integration, larger presence in more markets worldwide, ever higher levels of customer satisfaction, and a technological impact that exceeds what either company could have achieved on its own.



John E. Warnock
Chairman of the Board and
Chief Executive Officer



Charles M. Geschke
President

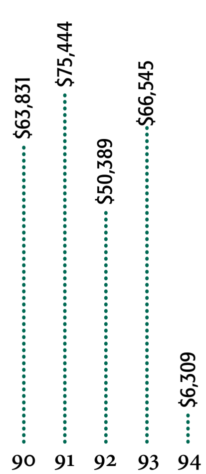
Financial highlights

See Note 2 in the Notes to Consolidated Financial Statements regarding the merger with Aldus Corporation.

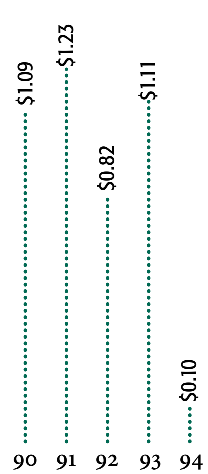
(In thousands, except per share data)

	Years Ended				
	November 25 1994	November 26 1993	November 27 1992	November 29 1991	November 30 1990
OPERATIONS:					
Revenue	$597,772	$520,237	$440,063	$397,183	$303,713
Merger transaction and restructuring costs	72,183	–	–	–	–
Income before income taxes	39,997	105,060	79,448	118,279	101,556
Net income[1]	6,309	66,545	50,389	75,444	63,831
Net income per share[1,2]	0.10	1.11	0.82	1.23	1.09
Dividends declared per common share[2,3]	.20	.20	.16	.16	.12
FINANCIAL POSITION:					
Cash and short-term investments	400,360	308,985	230,980	222,551	145,832
Working capital	363,631	318,215	247,878	251,721	163,676
Total assets	625,503	529,840	437,623	399,764	286,882
Shareholders' equity	456,771	414,102	351,743	338,079	223,590
ADDITIONAL DATA:					
Worldwide employees	1,584	2,051	1,894	1,653	1,317

REVENUE
(in millions)



NET INCOME[1]
(in millions)



NET INCOME PER SHARE[1,2]

[1] *Reflects incremental costs incurred during 1994 in connection with the acquisition of Aldus and the write-off of acquired in-process research and development, totaling $72.2 million and $15.5 million, respectively. (For additional information, see Note 2 and Note 6 in the Notes to Consolidated Financial Statements.)*

[2] *Adjusted for a two-for-one stock split, effective July 1993.*

[3] *Amounts prior to the merger with Aldus on August 31, 1994 have not been restated to reflect the effects of the pooling of interest.*

A L'ATTENTION DE NOS ACTIONNAIRES

LES BOULEVERSEMENTS SURVENUS EN 1994 n'ont pas empêché Adobe d'obtenir des résultats très satisfaisants. Le rachat d'Aldus Corporation, en août dernier, réunit les deux pionniers de la PAO et marque le début d'une nouvelle ère pour Adobe. Ce rapport présente les activités et les résultats financiers de la nouvelle société.

Le chiffre d'affaires cumulé des deux sociétés a atteint 597 772 000 $ en 1994, soit une augmentation de 15% par rapport à 1993 (520 237 000 $). Le bénéfice net s'élève à 6 309 000 $ en 1994 (66 545 000 $ en 1993). Le bénéfice par action est passé de 1,11 $ en 1993 à 0,10 $ en 1994. Des charges de restructuration de 72 183 000 $ entraînées par le rachat d'Aldus et des engagements à hauteur de 15 469 000 $ pour des travaux de recherche et développement engagés avec nos sociétés Compumation, Inc. et LaserTools Corporation expliquent cette situation. Abstraction faite de ces dépenses exceptionnelles, nos résultats commerciaux et financiers sont excellents, avec un chiffre d'affaires et des bénéfices en progression par rapport à l'an dernier. En 1994, la Société a annoncé un dividende en numéraire de 0,20 $ par action. Notre position financière reste forte, la trésorerie dépassant 400 000 000 $.

L'union avec Aldus offre des avantages stratégiques. Elle permet à la division Applications (Application Products Division) de proposer une gamme complète d'outils. En dépit du rachat d'Aldus, la division a continué de lancer des produits d'exception tout en améliorant le résultat d'exploitation et en faisant passer le chiffre d'affaires à 441 120 000 $ en 1994, soit une progression de 18% par rapport à 1993 (374 061 000 $). Le groupe a lancé des mises à jour de produits-phares tels qu'Adobe Photoshop, Adobe Illustrator, Adobe Premiere et PageMaker. Il a en outre été le premier à apporter un large soutien au Power Macintosh et a diffusé des versions internationales de nombreux produits.

Pour la division Systèmes (System Products Division), 1994 a été une année de croissance renouvelée. Le chiffre d'affaire généré par Adobe PostScript a atteint 156 652 000 $, soit 7% de plus qu'en 1993 (146 176 000 $). En proposant des outils de développement de renommée internationale, la division a permis à ses clients OEM de doubler le rythme de lancement de leurs produits Adobe PostScript (qui vont de l'imprimante de réseau aux imprimantes couleur en passant par les traceurs grand format). Un nouveau produit PostScript destiné aux OEM est lancé au moins tous les deux jours. Davantage de ressources sont allouées aux projets à long terme. Les outils de prépresse d'Aldus assurent désormais à Adobe une présence active dans les activités de production. L'acquisition en octobre de LaserTools Corporation permet au groupe d'investir le marché de l'impression personnelle et renforce sa présence dans le domaine des logiciels pour systèmes d'impression.

Restant un domaine d'investissement, la technologie Acrobat est en train de devenir une plate-forme universelle de diffusion de données sur tout support électronique (réseaux, services télématiques, CD-ROM, etc). La nouvelle version d'Acrobat présente des fonctions répondant aux suggestions des utilisateurs. La multiplication et le renforcement des relations avec les intégrateurs de systèmes et d'autres éditeurs, des échos positifs dans la presse spécialisée et la pénétration de marchés tels que l'édition, l'administration et les établissements financiers prédisent un bel avenir à Acrobat.

Le rachat d'Aldus a bien entendu entraîné des changements significatifs. Nous avons restructuré la société au mieux de nos intérêts. Adobe et Aldus ont conjointement assuré une transition douce, tout en continuant à faire face à leurs engagements respectifs. Le siège d'Adobe demeure à Mountain View (Californie). Le service clients, celui des ventes pour l'Amérique du Nord et certaines activités-clés de marketing et d'ingénierie sont désormais implantés à Seattle (Washington). L'arrivée d'Aldus a étendu notre infrastructure internationale et permis une croissance très rapide dans la région du Pacifique.

1995 sera l'année de l'adaptation et de la marche en avant. Nos efforts porteront sur l'intégration des technologies, la rationalisation des lignes de produits, le renforcement de nos systèmes d'information et le retrait progressif du programme de dessin Aldus FreeHand conformément à notre accord avec la Federal Trade Commission.

Alors que d'autres grands éditeurs de logiciels parient sur les données et les chiffres bruts, Adobe doit son succès aux formes visuelles de communication. Aujourd'hui, nous offrons à l'utilisateur tout ce dont il a besoin pour créer, gérer et partager des informations sur support imprimé ou électronique. L'union d'Adobe et d'Aldus doit déboucher sur une meilleure intégration des produits, une présence plus importante sur les marchés, une meilleure satisfaction du client et un impact technologique plus fort.

AN UNSERE AKTIONÄRE

IN 1994 – EINEM ZEITRAUM außergewöhnlicher Änderungen – erzielte Adobe positive Markterfolge und finanziellen Zuwachs. Durch den Zusammenschluß mit der Aldus Corporation, der im August abgeschlossen wurde, wurden zwei Software-Unternehmen zusammengebracht, die die Revolution des Desktop Publishing eingeleitet haben – gleichzeitig beginnt eine neue, aufregende Ära in der Geschichte von Adobe. Der folgende Bericht faßt die Aktivitäten und finanziellen Ergebnisse des Gemeinschaftsunternehmens zusammen.

Für das Geschäftsjahr 1994 belief sich der Gesamtertrag auf $597.772.000, was einer Steigerung von 15 Prozent im Vergleich zu $520.237.000 in 1993 entspricht. Der Reingewinn für 1994 betrug $6.309.000 gegenüber $66.545.000, während sich der Gewinn pro Aktie auf $0,10 im Vergleich zu $1,11 in 1993 belief. Umstrukturierungskosten in Höhe von $72.183.000 in Verbindung mit dem Zusammenschluß mit Aldus sowie Vollabschreibungen in Höhe von $15.469.000 für laufende Forschungs-arbeiten und Entwicklungen in Verbindung mit der Übernahme von Compumation, Inc. und der LaserTools Corporation haben sich auf diese Ergebnisse ausgewirkt. Ausgenommen dieser einmaligen Ereignisse haben wir 1994 hervorragende geschäftliche und finanzielle Ergebnisse erzielt, mit positiven Tendenzen gegenüber dem letzten Jahr in bezug auf Einnahmen und Gewinnen. Im Laufe dieses Jahres erklärte das Unternehmen, daß sich die Bardividende auf seine Stammaktien auf $0,20 pro Aktie beläuft. Unsere finanzielle Lage bleibt stark, mit einem Kassenbestand, der $400 Millionen übersteigt.

Durch den Zusammenschluß mit Aldus wurde die Produktpalette um strategisch wichtige Produkte erweitert. Auf diese Weise ist es der „Application Products Division“ z. B. möglich, alle für das Umsetzen von Information wichtigen Hilfsmittel anzubieten. Trotz des

Zusammenschlusses wurden neue Versionen preisgekrönter und erstklassiger Verkaufsprodukte herausgegeben, während gleichzeitig das Betriebseinkommen von $374.061.000 in 1993 um 18 Prozent auf $441.120.000 in 1994 verbessert werden konnte. Man stellte umfangreiche Upgrades der Aushängeschilder Adobe Photoshop, Adobe Illustrator, Adobe Premiere und PageMaker vor, war innerhalb der Branche führend in bezug auf eine breite Power Macintosh Unterstützung und lieferte internationale Versionen in den wichtigsten Sprachen für viele Produkte aus.

In der „System Products Division“ waren 1994 neue Zuwachsraten zu verzeichnen. Die Einnahmen aus Lizenzen für Adobe PostScript-Software erreichten $156.652.000, was einem Anstieg von 7 Prozent gegenüber $146.176.000 in 1993 entspricht. Durch das Angebot erstklassiger Entwicklungswerkzeuge war es OEM-Kunden möglich, die Rate an Adobe PostScript-Neuerscheinungen zu verdoppeln, die alles – von weitverbreiteten Netzwerk- und Farbdruckern bis hin zu Spezialgeräten wie großformatigen Plottern – einschließen. Das bedeutet, daß an mindestens jedem zweiten Arbeitstag ein neues PostScript-Produkt an einen OEM-Kunden herausgegeben wird. Somit stehen mehr Ressourcen für Langzeitprojekte zur Verfügung. Die zusätzlichen Aldus Prepress-Produkte gewährleisten, daß Adobe für die fortwährende Umstellung der Herstellung gedruckter Medien auf den Schreibtisch gerüstet ist. Inzwischen ermöglicht uns die Übernahme der LaserTools Corporation im Oktober den Einstieg in den Markt des „Personal Printing“ und verstärkt unser Engagement, ein weit verbreiteter Software-Anbieter für Drucksysteme zu werden.

Obwohl die Adobe Acrobat Technologie noch immer einen Investitionsbereich für das Unternehmen darstellt, gewinnt sie eine immer größer werdende Akzeptanz als universeller Standard für die Verteilung von Informationen mit Hilfe elektronischer Medien, von Netzwerken über Online-Dienste zu CDs. Wir haben eine zweite Version unserer Acrobat Produktreihe vorgestellt, die viele neue Funktionen basierend auf dem Feedback der Anwender bietet. Enge und immer zahlreicher werdende Geschäftsverbindungen zu Systemintegratoren und Drittanbieter-Entwicklern, positive Berichte der Fachpresse sowie das Vordringen in Märkte wie Verlagswesen, Behörden und Finanzdienste lassen uns optimistisch in die Zukunft von Acrobat sowohl als Produktreihe als auch als Entwicklungsplattform sehen.

Erwartungsgemäß hat der Zusammenschluß mit Aldus zu bedeutenden, strukturellen Änderungen für Adobe geführt, auf die wir schnell reagiert haben, um Redundanzen zu vermeiden und das Unternehmen bestmöglich zu organisieren. Hunderte von Adobe und Aldus Mitarbeitern haben gemeinsam daran gearbeitet, den Übergang so reibungslos wie möglich zu gestalten, während sie weiterhin ihren jeweiligen geschäftlichen Verpflichtungen nachkamen. Der Hauptsitz von Adobe bleibt in Mountain View, Kalifornien.

Die Bereiche „Customer Support“, „North American Sales“, Produkt-Marketing für einige Hauptanwendungsprodukte und einige Entwicklungsbereiche befinden sich nun in Seattle, Washington.

Die Ergänzung durch Aldus hat unsere internationale Infrastruktur wesentlich erweitert, so daß wir bereits besonders hohe Zuwachsraten im pazifischen Raum verzeichnen konnten.

In Anbetracht dieser Änderungen wird 1995 ein Jahr der Konsolidierung und Weiterentwicklung sein. Wir werden uns auf die Integration der Adobe und Aldus Technologien, Straffung der Produktreihen, Stärkung unserer Informationssysteme und auf die reibungslose Abwicklung der im Abkommen mit der Federal Trade Commision vereinbarten Rückgabe des Illustrationsprogramms Aldus FreeHand konzentrieren.

Während die Produkte anderer bedeutender Software-Unternehmen nur mit reinen Wörtern, Daten und Zahlen arbeiten, richtet sich Adobes Augenmerk darauf, visuelle Formen der Kommunikation zu ermöglichen. Wir können Computer-Anwendern heute alles bieten, was sie zur Erstellung, Verwaltung und Distribution anspruchsvoller Informationen auf gedruckten und elektronischen Medien brauchen. Wir freuen uns darauf, die Teile beider Unternehmen zusammen zubringen, um eine bessere Produktintegration, größere Präsenz auf zusätzlichen Märkten weltweit, noch zufriedenere Kunden und eine technologische Bedeutung zu erreichen, die das übersteigt, was jedes Unternehmen alleine hätte verwirklichen können.

お客様へ

1994年は弊社にとって大きな変化の年でありました。8月にアルダス社との合併を終え、出版と印刷にDTP (Desktop Publishing) の革命をもたらしたアドビとアルダスが一つになったことは、弊社の歴史に新しい一時代を拓くものとなりました。この変化の年にあって、良好な業績を収めることができました。このレポートは合併した弊社の1994年度の業績を要約したものです。

両社の合併決算による1994年度の売り上げは597億7,720万円（換算率：1ドル＝100円）で、昨年度の実績の520億2,370万円から15％増加しています。昨年の66億5,450万円に対し純利益は6億3,090万円で、1株あたりの純利益は昨年度の111円に対し10円となりました。これは、アルダスとの合併に伴って実施した72億1,830万円のリストラ対策、およびコンピュメーション社 (Compumation, Inc.) とレーザーツールス社 (LaserTools Corporation) の買収によって中止された研究開発費15億4,690万円を償却したことによるものです。これらの特別な要因を除くと、1994年度の弊社のビジネスおよび財務実績は良好で、売り上げおよび利益の両方が前年度比で上昇傾向を示しています。1994年中の弊社の普通株式に対する現金配当は、1株当り合計20円に達しました。さらに、現金残高も400億円を超えており、良好な財務状況が継続していると言えます。

製品面においても、アルダス製品が加わったことで戦略的に重要な製品ラインが整いました。アプリケーション プロダクト ディビジョンは情報の創作活動（オーサリング）に必要なさまざまなツール類をすべてカバーする製品ラインを提供することができるようになりました。また、合併後もそれぞれの製品分野で各種業界賞受賞に輝くトップクラスの製品を提供し続けました。その結果、昨年度の374億610万円から18％増の441億1,200万円の売り上げを達成すると同時に、営業収益もさらに向上させています。また、主力製品であるAdobe PhotoshopとAdobe Illustrator、Adobe Premiere、PageMakerの大幅なアップグレードをおこない、さらにPower Macintoshへの対応を拡大しています。また、多くの製品について、主要各国語に対応するバージョンを発売しました。

システム プロダクト ディビジョンにとって、1994年度は新たな飛躍の年となりました。Adobe PostScript（ポストスクリプト）ソフトウェアのライセンス収入は156億6,520万円に達し、昨年度の146億1,760万円から7％の増収を達成しています。システム プロダクト ディビジョンが提供しているトップクラスの開発ツール群によって、OEMは従来の倍のペースでポストスクリプト関連製品を開発することが可能になりました。OEMからリリースされているポストスクリプト関連製品には、一般的なネットワークプリンタやカラープリンタをはじめ、用紙サイズの大きいプロッタなどの特殊な用途の出力装置まで、あらゆる種類の製品が含まれています。システム プロダクト ディビジョンは実質的に営業日換算で一日おきに一つの新製品をOEMに提供していることになります。さらに、長期的なプロジェクトのために、より多くの資産を割り当てることに成功しています。また、アルダスの種々のプリプレス向けツールが製品ラインに加わりました。これによって印刷工程のデスクトップへのシフトという時代の流れのなかで、アドビが果たす役割はさらに大きなものとなります。

また、1994年のレーザーツールス社買収によって、パーソナルプリンティング市場へ進出する道が開けたばかりでなく、幅広い印刷関連システムソフトウェアを提供するというアドビ システムズ社の立場がこれまで以上に強化されました。

Adobe Acrobat関連の技術は、弊社が今後も引き続き投資を行わなければならない分野です。オンライン通信サービスからコンパクトディスクにいたる、あらゆる種類の電子メディアを通じて情報を配布するための標準プラットフォームとして急速に認められつつあります。昨年出荷したAcrobatバージョン2には、初期の製品に対する市場からのフィードバックに呼応した新しい機能が盛り込まれています。システムインテグレータやサードパーティデベロッパーとの強力な提携が広がりつつあること、業界誌における高い評価、および出版や行政・金融サービスなどの市場への浸透が進んでいることから、弊社は製品ラインと開発プラットフォームとしてのAcrobatの将来について明るい展望をもっています。

当初から予想されたことですが、アルダス社との合併によって組織と運営方法に大きな変更が必要となりました。これに関しては、迅速に対処し、重複する機能を整理するとともに、もっとも望ましい形での組織の再編成を実施しました。アドビとアルダスの多くの社員の努力によって、通常業務にいささかの支障もなくスムーズに新体制に移行することができました。

新体制のもとでは、アドビ システムズの本社をこれまで通り、カリフォルニア州マウンテンビュー市に置き、カスタマーサポートと北米地域のセールス、および一部の主要アプリケーション製品のマーケティングとエンジニアリング活動の拠点をワシントン州シアトルに置いています。また、アルダス社との合併によって弊社の世界各国における拠点が大きく拡大し、特に環太平洋地域において急速な成長を遂げました。弊社にとって1995年は変化に適応し、さらに前進する年であります。アドビとアルダスの技術の統合、製品ラインの合理化、社内情報システムの強化、そして連邦通商委員会 (Federal Trade Commission) との合意に基づくAldus FreeHandプログラムの権利関係の整理という課題に全力を集中する所存です。

他の主要ソフトウェア会社が、生のテキストやデータ、数値を扱っているのにくらべ、弊社はさまざまな形式の視覚的コミュニケーションを可能にする、ということで発展を遂げています。紙の上にでも電子メディアでも、内容のある情報を作成、管理、共有するのに必要なあらゆるものを、今、アドビはコンピュータのユーザに提供することができます。より統一した製品ラインの構築、世界各国の市場でのより大きな影響力、顧客の皆様方のより深い満足、そして、アドビもアルダスも単独ではなしえなかった大きな技術的影響力の獲得。このような諸課題の達成に向けて、アドビとアルダスの力を一つとすることに、弊社は大きな期待と自負を抱くものであります。


Alliances
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A LOOK AT THE BIG PICTURE. Ten years ago, Adobe and Aldus developed the software that launched the desktop publishing revolution and literally changed the way the world works. Today, as one company, we are uniquely positioned to make a further dramatic impact not only on how society creates information, but also on how it delivers and manages that information in the Digital Age.

The new digital world is one rich with color, movement, sound, images, text and other elements of human expression. People receive information in printed forms such as books, periodicals, brochures and reports; in projected forms such as overheads and slides; and in broadcast forms such as film and video. And because it can all be delivered electronically, the information reaches a vast, global audience in real time.

Moreover, the recipients are far from passive. They increasingly control not only what they experience, but also how, when and where they experience it. And they have access to software that enables them to create information with a level of visual sophistication once provided only by graphics professionals.

Over time, individuals and organizations will accumulate entire libraries of electronic documents and presentations, using and reusing them continuously. To satisfy this growing need to access and exchange information at will, electronic content must transcend and outlive the constraints of specific computer hardware, software, networks and operating systems now and in the future.

This communications picture is quickly coming together. And Adobe provides essential pieces for defining and shaping it. More than any other developer of personal software, we offer products that enable people to use the computer to express and share their ideas in imaginative and meaningful new ways, whether the choice of media is static, dynamic or a combination of the two.

Authoring

With flagship products Adobe Photoshop, Adobe Illustrator, Adobe Premiere and PageMaker, our family of software makes the creative potential of the computer as limitless as the human mind.

THE ADOBE SUITE OF APPLICATION PRODUCTS

TAKES PROFESSIONAL tools once available only in massive, dedicated systems—or not available at all—and puts them on the desktop. It gives art directors, graphic designers and others all the software they need to create and manipulate the elements of visual communication, from photographs to illustrations to typefaces to video footage, and combine them into complete documents for viewing on the screen or printed page.

Our flagship applications not only established entirely new categories of software, but also continue to lead those categories by offering the most useful, sophisticated capabilities of their kind. While gaining market share, these programs have spawned mini-industries of third-party accelerator boards, image libraries, special-effects filters, color and calibration tools, and other plug-ins that increase customer value and productivity.

And as powerful as they are individually, the applications are even more potent when used together. This synergy will grow with time, as we work to offer comparable feature sets to users in Macintosh, PC and UNIX environments, and to build technologies that increase cross-product compatibility and extensibility.

GRAPHICS. Used for everything from commercial packaging to fine art, Adobe Illustrator software gives graphic artists, technical illustrators and desktop publishers a powerful, professional design tool. New versions in 1994 for Macintosh and UNIX users continue the program's category leadership. Adding to the toolkit are complementary programs such as Adobe Dimensions for three-dimensional design, Adobe Streamline for line-art conversion and IntelliDraw for quick refinement of business graphics.

IMAGES. Adobe Photoshop software takes photographers, artists and prepress professionals beyond the lens and the darkroom into a whole new world of visual possibilities. It has become as essential as the camera itself for anyone creating, retouching or processing still images on the computer—and a staple in design studios, advertising agencies and publishing offices everywhere. Version 2.5 of the program is now available for UNIX users, while version 3.0 for Macintosh and Windows environments adds to an already rich feature set. Accessory products such as Gallery Effects special-effects filters and TextureMaker texture-design software increase users' creative choices. Fetch cataloging software makes it easy to store, find and retrieve artwork files for reuse.

TYPE. Adobe's Type 1 font format is the only truly cross-platform type solution. More than 20,000 Type 1 typefaces are now available from foundries worldwide. Over 2,000 of those come from the Adobe Type Library, the most honored digital type collection in the industry.

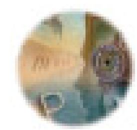
Adobe markets the library directly and through resellers. In 1994, we repriced, repackaged and revised licensing policies for the library to meet market needs. Meanwhile, an increasing percentage of Adobe's type revenue now comes from direct purchases through the Type On Call CD-ROM, a locked, buy-as-you-go version of the library—and one of the best-selling CD products of its kind.

The *Image Club* catalog gives Adobe the opportunity to offer a wide variety of typefaces, as well as clip art, stock images and other digital content, directly to desktop publishers.

PAGE LAYOUT. The international leader in desktop publishing, PageMaker software incorporates a great variety of features and functionality that are vital to professional users. It enables them to combine text and graphics from many sources to create high-quality printed materials. Along with other Adobe products, PageMaker was among the first programs this year to offer a version native to Apple's new Power Macintosh platform. It also is a market leader in the Windows environment. As popular around the world as it is in the United States, PageMaker 5.0 is now available in 26 languages, including Chinese, Japanese and Korean.

PRESENTATIONS. Available for Macintosh and Windows environments, Persuasion 3.0 software is a program for producing and managing slide, overhead and on-screen presentations. It enables business users to build presentations of any complexity from information they gather and create on a personal computer.

Our flagship application products:



Adobe Photoshop

Adobe Illustrator

Adobe Premiere

PageMaker

MOTION AND SOUND. Just as it enabled desktop publishing, Adobe software is now fueling the shift toward "desktop broadcasting." For film and video editors, multimedia producers and graphics professionals, Adobe offers high-quality alternatives to using expensive, specialized production equipment.

Adobe Premiere software, for example, has become the de facto standard for editing film, video and multimedia productions on the Macintosh and, with the release of version 4.0, now delivers nearly identical capabilities to Windows users. After Effects software gives television and motion-picture professionals a set of post-production editing and 2D animation tools.

CONSUMER. Not all Adobe software is geared toward professional communicators. As more and more people become information authors, we also are leveraging our technology and worldwide reseller channels to create and market high-value applications for small businesses and families. Titles encompass everything from children's art to publishing to home improvement. With offerings for Macintosh and Windows users, Adobe's consumer group released ten new titles in 1994, including CD versions of several products.

In the world of

Printing & Publishing

information travels from author to consumer on a road paved with Adobe PostScript page-description software. It enables computer users to image everything that they imagine.

For output devices from printers to slide recorders, from imagesetters to screen displays, Adobe's PostScript language describes and renders documents of any visual complexity with total precision. Since we introduced it in 1985, PostScript has become the printing and imaging technology of choice for many multinational corporations, the vast majority of professional publishers and the U.S. federal government. It forms the basis for the International Standards Organization page-description standard and remains the only completely platform-independent page-description language—a characteristic that grows in importance as networks and mixed computing environments flourish.

Right now, more than 60 manufacturers produce over 300 Adobe PostScript output devices, offering them at prices ranging from less than $700 to $100,000 and higher. All major software applications and operating systems support the PostScript language standard. This prevalence gives computer users tremendous breadth of choice in hardware and software.

Over the years, Adobe PostScript products have become increasingly affordable and functional, opening up new markets for the company while solidifying our presence in established areas. We continue to find new ways to enhance and deliver Adobe PostScript technology, and to pursue new opportunities in printing systems software.

WORKSTATION-BASED SOFTWARE. Adobe PostScript software typically resides on a controller embedded in an output device. But today our original equipment manufacturer (OEM) customers increasingly offer those same capabilities in the form of software that users can install directly onto their personal computers and workstations. Because it can drive everything from a $50,000 imagesetter to a $1,000 office printer, this Configurable PostScript Interpreter (CPSI) gives manufacturers greater flexibility in developing new products quickly without sacrificing printing quality.

PROFESSIONAL PRINTING. Adobe PostScript continues to be the software of choice for driving imagesetters and other professional printing devices. The availability of CPSI has extended the reach of Adobe PostScript technology into specialty equipment such as large-format plotters, multifunction printer/copiers, high-speed digital presses, gravure presses and color proofers. In the Japanese market, our presence grows as traditional reliance on proprietary technologies gives way to open, standard solutions. Currently available for inclusion in high-end and other color output devices, new Adobe Brilliant Screens, FM screening technology, provides rich color detail at full printing speed.

PREPRESS TOOLS. Between creation and printing come specific steps that make a document ready for press. Adobe now offers prepress professionals a set of software tools for preparing electronic document files. Sold through graphic arts distributors, these products streamline tasks such as color trapping, color separation, image replacement and page imposition, plus they address the workflow and batch processing needs of high-volume printing operations. They not only enable us to help a loyal customer base move a labor-intensive process to the desktop, but also complete the picture of Adobe software at every stage in the life of a printed document.

OFFICE AND PERSONAL PRINTING. The benefits of Adobe PostScript software also have become widely available in corporate offices worldwide. Here, where mixed computing environments predominate, Adobe PostScript printers uniquely provide cross-platform operation and network support. And they deliver outstanding color quality, an important feature as more and more manufacturers offer affordable color models. Helping OEMs price laser printers competitively and buyers receive maximum value, new Adobe Memory Booster technology reduces the amount of memory that Adobe PostScript printers require to produce visually complex documents. Newly acquired LaserTools technologies will enable us to address the market for personal printers costing less than $1,000, particularly those destined for the Windows environment.

MULTIFUNCTION PRINTING. Adobe PostScript technology itself continues to grow, giving printers additional capabilities. PostScript Fax software, for example, enables laser printers to receive high-quality fax documents on plain paper and send documents directly from a desktop computer. It provides every user on a network with a printer and plain-paper fax machine combined—an economical solution. Approximately 12 Adobe PostScript Fax models have reached North American markets, with some becoming available in Europe.

HARDWARE SOLUTIONS. Adobe continues to invest in hardware technologies that address specific printer cost and performance issues. Through coprocessors, utility software and network support, we can help our OEMs develop products that best meet their customer needs. The Adobe PixelBurst coprocessor for imagesetters and high-volume printers, for instance, renders PostScript language images up to ten times faster than software-based rendering.

DISPLAYS. Adobe's Display PostScript system is the standard imaging model for UNIX platforms, a mainstay of corporate computing. This advanced graphics software enables users to view pages on-screen that match the output they receive from Adobe PostScript printers. Now available in high-performance products from most major workstation vendors, Display PostScript software also lets UNIX application developers work in one broadly supported imaging environment.

As computer-based publishing moves beyond the desktop and beyond paper, Adobe Acrobat software provides a universal standard for information

Delivery

one that redefines the boundaries of corporate communication.

THE INFORMATION THAT PEOPLE CREATE and store on their computers now—thanks to desktop publishing—includes documents of tremendous visual impact. These documents have become true corporate assets, much the same as equipment or real estate. Clearly, businesses that learn how to harness and effectively use these information assets today will hold the strategic advantage tomorrow. That's why they need Adobe Acrobat software.

With our Portable Document Format (PDF) at its heart, Acrobat software has all the ingredients to succeed as a universal standard for information exchange. It makes information from any source easy to access and reuse, preserves document form and content, and adapts to a variety of needs. Most important, PDF is the only open format of its kind, the only approach to electronic document delivery that is independent of computer hardware, application software, operating system and networking environment. And that makes Acrobat technology a solution that works with what businesses have now, and will have in the future.

TOOLS OF THE INFORMATION TRADE. From the simplest memos to the richest color brochures, the Adobe Acrobat product family gives users instant access to documents in their original form, independent of computer platform. It also enables users to distribute and manage those documents electronically, without losing their investment in existing computer systems. In late 1994, we issued a major revision of the product line in response to market feedback. The new Adobe Acrobat, Adobe Acrobat Pro and Adobe Acrobat for Workgroups products are designed to meet the needs of a range of individual and corporate users in mixed computing environments.

To promote acceptance of PDF as a standard, the Acrobat Reader viewing tool is now freely distributable. Acrobat Reader also is widely available over on-line services and as a bundled product with leading software applications and soon in selected Macintosh computers.

MORE DIRECT ACCESS TO INFORMATION. With Acrobat, users can produce a document and then distribute it to anyone instantly, via any electronic media. This flexibility and immediacy greatly expand the audience that businesses can reach, and increase the quality of service that they can provide.

Advertising agencies, for example, use Acrobat software for review and distribution of ads via networks and electronic mail, speeding approval cycles, delivering print-ready materials directly to publishers and giving agency clients a competitive edge. To serve more citizens in budget-conscious times, U.S. government agencies have turned to Acrobat software to distribute tax forms, budget proposals, legislation and other documents via CD-ROM and on-line services. Financial institutions produce and distribute newsletters and research reports as PDF files over on-line services, not only saving substantial printing and mailing costs, but also giving decision-makers real-time, searchable information complete with the formatting and graphics that clarify complex material.

BETTER WAYS TO MANAGE INFORMATION. Acrobat software helps make electronic documents more valuable than their paper counterparts. Businesses can reuse information by electronically copying and pasting formatted text and graphics into other applications, and by recombining pages to create new documents. Network administrators can index documents for full-text search, without changing the way they are organized or stored. Security controls let users password-protect PDF files or limit who can modify or print them. And, with their compressed size and platform independence, PDF files can be archived on a central file server or distributed on a multiplatform CD-ROM.

At major universities, faculty and students use Acrobat software to access course descriptions, class schedules, computer documentation and other materials on local area networks and on the Internet, sharing ideas and information across campus and around the world. Insurance companies create document management systems that deliver reams of correspondence to thousands of agents nationwide over corporate networks and let them quickly locate mission-critical information.

MORE WAYS TO CUSTOMIZE AND INTEGRATE INFORMATION. Like the PostScript language it is based on, Adobe's PDF specification has been published for use by software developers as an open standard. To promote development, Acrobat 2.0 software contains more than 500 application programming interfaces for adapting it to specific needs. It also supports industry-standard interfaces, so developers can seamlessly integrate Acrobat with other information management solutions and with popular applications such as Lotus Notes.

While building a base of marketing materials or other information from scratch would be prohibitively expensive and time-consuming, Acrobat software enables corporations to reuse and recombine information as needed. Its open architecture gives systems integrators a way to efficiently customize solutions that are compatible with existing hardware and software. As a result, worldwide sales organizations, for example, increase productivity because they have instant access to the information they need on CD-ROM or network servers. Their customers receive the latest product literature immediately. And everyone saves the cost of printing, shipping, storing and retrieving paper documents.

While highly competitive, the software industry also is highly collaborative. At Adobe, we foster

Alliances

with individuals and organizations who can help bring leading technology and solutions to our customers, the most valued partners of all.

ADOBE ALONE COULD NEVER PROVIDE ALL of the goods and services required to satisfy the growing demand for computer-based information authoring and distribution tools and technologies. Therefore, we plan, staff and manage a select number of activities internally, and then leverage our own resources by forming strategic alliances in all areas of our business. These relationships play a critical role in our ability to create products that make a valuable difference to our customers, to expand market opportunities and to sustain an environment in which we can thrive.

TECHNOLOGY DEVELOPMENT. Because we have set open, extensible information standards, a vast community of software and hardware developers works with PostScript, Acrobat and other Adobe technologies every day. We now offer software development kits and other tools to help them create customized solutions and plug-ins. The Adobe Developers Association provides a range of resources, including telephone and on-line support, training programs and consulting services.

Flourishing in its third year, our large-scale cooperative development program enables OEM customers to perform key PostScript software engineering activities in-house, so they can bring more products to market efficiently while differentiating them with their own proprietary technologies. About half of our OEMS now participate in the program. We also have enlisted a number of third parties to provide some of the custom engineering services once provided exclusively by us. Such team efforts help our OEMS respond to greater demand for Adobe PostScript printers and to shorter product life cycles.

MARKETING AND DISTRIBUTION. Cooperative relationships have always formed the backbone of our marketing and distribution strategies. An international network of authorized distributors and resellers, plus hardware bundle customers, make our application products widely available on retail shelves and in consumer catalogs. OEM customers collaborate regularly with us on promotional and dealer training efforts that reinforce the advantages of Adobe PostScript products and build brand recognition around the world. And helping to proliferate a new information standard, value-added resellers and systems integrators combine Acrobat software with other technologies and products, and offer it as part of enterprise-wide solutions.

END USER SUPPORT AND EDUCATION. For Adobe's application software, our technical support and services staff provides the information users need by phone and on-line. We also inform customers through our bimonthly *Adobe Magazine* and an expanding series of how-to books published by Adobe Press, a joint venture with Macmillan Computer Publishing. In addition, we prepare and authorize independent trainers to teach Adobe software classes, and sponsor workshops led by our own graphics staff.

All of these activities, plus interaction with independent user groups, and regular seeding and testing programs, keep us in continuous contact with customers, whose feedback provides the richest source of ideas for new products and product enhancements.

INVESTMENT IN EMERGING MARKETS. Adobe's core technologies and flagship applications have consistently helped generate product and service opportunities for other companies. Continuing in this tradition, we invested in a venture capital limited partnership in 1994 that is chartered to invest in innovative companies strategic to our software business. Adobe Ventures L.P. makes a broader set of products and services available to computer users, and enables us to join other investors in building new market opportunities.

Management's discussion and analysis

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

RESULTS OF OPERATIONS

Overview

Adobe develops, markets and supports computer software products and technologies that enable users to create, display, print and communicate electronic documents. The Company licenses its technology to major computer and publishing suppliers, and markets application software products and typeface products for authoring and editing visually rich documents, including digital and video output. The Company distributes its products through a network of original equipment manufacturer (OEM) customers, distributors and dealers, and value-added resellers (VARS) and system integrators. The Company has operations in the Americas, Europe and the Pacific Rim.

In August 1994, the Company acquired Aldus Corporation ("Aldus"). Aldus began operations in 1984 and created computer software solutions that help people throughout the world effectively communicate information and ideas. Aldus focused on three lines of business: applications for the professional print publishing, graphics and prepress markets; applications for the general consumer market; and applications for the interactive publishing market. To effect the combination, approximately 14.2 million shares of Adobe's common stock were issued in exchange for all of the outstanding common stock of Aldus. The merger was accounted for by the pooling of interests method, and accordingly, all annual and interim financial information prior to the merger has been restated to combine the results of the Company and Aldus. In connection with the merger, the Company recorded $14.6 million of merger transaction costs and $57.6 million of restructuring costs in the fourth quarter of 1994. In addition, the Company incurred one-time expenses that are not included in the restructuring charge but were related to the Aldus acquisition. These charges included writing off certain capitalized software development costs, transition personnel bonuses, and relocation expenses among others, and totaled approximately $10.1 million.

Revenue

	1994	Change	1993	Change	1992
Total revenue	$597.8	15%	$520.2	18%	$440.1

In 1994, the Company's worldwide revenue grew 15 percent over the prior year, compared with revenue growth of 18 percent in 1993 over 1992.

Revenue growth in 1994 and 1993 is attributable to an increase in application products revenue resulting from the release of new and enhanced products, as well as growth in the Company's royalty revenue from licensing its PostScript interpreter to OEM customers. Product unit volume (as opposed to price) growth was the principal factor in the Company's revenue growth in application products revenue. The continued decline in laser printer prices was offset by increases in shipments of the Configurable PostScript Interpreter (CPSI), resulting in an increase in 1994 licensing revenues.

	1994	Change	1993	Change	1992
Product group revenue— Licensing	$156.7	7%	$146.2	–4%	$152.7
Percentage of total revenue	26.2%		28.1%		34.7%

Licensing revenue is derived from shipments by OEM customers of products containing the PostScript interpreter and the Display PostScript system. Such products include printers in both Roman and Japanese languages, imagesetters and workstations. Licensing revenue is also derived from shipments of products containing CPSI by OEM customers. CPSI is a fully functional PostScript interpreter that resides on the host computer system rather than in a dedicated controller integrated into an output device. The configuration flexibility of CPSI allows OEMs and software developers to create and market a variety of PostScript products independently of controller hardware development.

The number of units shipped by OEMs continued to grow on an annual basis in 1994 and 1993. Royalty per unit is generally calculated as a percentage of the end user list price of a printer. During 1993, several of the Company's OEMs introduced lower end printers, resulting in a shift in product mix to a lower average list price, and accordingly a decline in licensing revenue compared to 1992. While the product mix shift continued in 1994, shipments of products containing the PostScript interpreter were supplemented by increased shipments of several new products containing CPSI, producing increased licensing revenue in 1994 over 1993.

The Company has seen year-to-year increases in the number of OEM customers from which it is receiving licensing revenue, demonstrating continued acceptance of PostScript software, as well as reflecting a diversification of the Company's customer base across Macintosh, IBM PC and compatibles, and multiple platform markets. No OEM customer accounted for more than 10 percent of the Company's total revenue in 1994.

	1994	Change	1993	Change	1992
Product group revenue— Application products	$441.1	18%	$374.0	30%	$287.4
Percentage of total revenue	73.8%		71.9%		65.3%

Application products revenue is derived from shipments of application software programs marketed through retail and distribution channels; however, the information products are becoming more widely distributed through VARs and systems integrators.

Application products revenue grew in 1994 and 1993 due to increased demand for Adobe Illustrator, Adobe Photoshop and PageMaker for both the Macintosh and Windows platforms. In addition, the release of new versions of Adobe Illustrator, for the Macintosh, and Adobe Photoshop and PageMaker, for the Macintosh and Windows platforms, contributed to the revenue growth in 1994 and 1993. The Macintosh versions include new features and native support for the Power Macintosh computers. The release of Aldus FreeHand 4.0 (divested by the Company in January 1995) for Windows and the Power Macintosh platforms also contributed to 1994 revenue growth. Localized versions for the Japanese market of Adobe Photoshop, Adobe Illustrator and PageMaker for the Macintosh platform also contributed to revenue growth from application products, while reduced sales for individual typeface packages offset a portion of the revenue growth in 1994. In addition, increasing sales for Adobe Premiere, a video editing and sequencing tool; After Effects, a video post-production special effects tool; and Fetch, a digital media cataloging and retrieval tool, contributed to the increase in application products revenue growth. Adobe Illustrator and Adobe Photoshop were also shipped for selected UNIX platforms in 1994, contributing to product revenue increases.

Direct costs

	1994	Change	1993	Change	1992
Direct costs	$111.8	16%	$96.7	10%	$87.9
Percentage of total revenue	18.7%		18.6%		20.0%

Direct costs include royalties; amortization of typeface production costs; amortization of acquired technologies; and direct product, packaging and shipping costs. Typeface production costs were fully amortized in 1994.

Licensing revenue typically has higher gross margins than application products revenue; therefore, revenue mix will affect overall gross margins. During 1994, the revenue mix of application products as a percentage of total revenue increased to 73.8 percent, compared to 71.9 percent during 1993, while direct costs as a percentage of total revenue were 18.7 percent, compared to 18.6 percent in 1993. The increase in direct costs, in absolute dollars, has been mitigated by actions taken by the Company to reduce direct costs. In 1993, the Company achieved lower per unit manufacturing costs for certain products, reduced royalty agreement rates, and reduced typeface production costs amortization, all of which contributed to minimal growth of 1994 direct costs as a percentage of total revenue.

The Company also delivers its type library on its Type On Call CD-ROM media, and end users wishing to license typeface designs call the Company with a credit card number to receive the unlocking code for the desired typeface. This method of delivery also contributes to reduced direct costs. Other applications are also available through the Company's distributors on CD-ROM.

Operating expenses

	1994	Change	1993	Change	1992
Software development costs— Research and development	$99.0	14%	$86.7	33%	$65.2
Percentage of total revenue	16.6%		16.7%		14.8%

Research and development expenses consist principally of salaries and benefits for software developers, contracted development efforts, related facilities costs, and expenses associated with computer equipment used in software development.

Research and development expense has increased significantly over the last three years as the Company invested in new technologies, new product development, and the infrastructure to support such activities. The increase reflects the expansion of the Company's engineering staff and related costs required to support its continued emphasis on developing new products and enhancing existing products. Many of these engineers are working with OEM customers to design and implement PostScript Level 2 devices. The Company has begun working with many of its OEM customers in a co-development program. This allows customers to be more self-sufficient in new device development by taking on more of the implementation task themselves rather than relying so heavily on the Company's engineers. While this mitigates certain costs, the Company continues to make significant investments in development of its PostScript and application software products.

The Company believes that continued investments in research and development are necessary to remain competitive in the marketplace, and are directly related to continued, timely development of new and enhanced products. The Company intends to continue recruiting and hiring experienced software developers but expects that research and development expenditures in 1995 will approximate current spending levels as a percentage of revenue.

	1994	Change	1993	Change	1992
Software development costs— Amortization of capitalized software development costs	$13.3	30%	$10.2	1%	$10.1
Percentage of total revenue	2.2%		2.0%		2.3%

In the implementation of Statement of Financial Accounting Standards (SFAS) No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed," software development expenditures on Adobe products, after achieving technological feasibility, were deemed to be immaterial. Certain software development expenditures on Aldus products have been capitalized and are being amortized over the lives of the respective products. In the fourth quarter of 1994, software development expenditures on Aldus products, after reaching technological feasibility, were immaterial and the Company anticipates this trend to continue in the future. Accordingly, the fourth quarter of 1994 did, and all of 1995 will, reflect the additional expense of amortizing capitalized software development costs acquired with Aldus, in addition to the actual development expenditures (classified as research and development) made prior to achieving technological feasibility.

Amortization of capitalized software development costs increased in 1994 due to the amortization of PageMaker 5.0 released in the second half of 1993, and the release of other new application products.

	1994	Change	1993	Change	1992
Sales, marketing and customer support	$201.0	18%	$170.9	17%	$145.7
Percentage of total revenue	33.6%		32.9%		33.1%

Sales, marketing and customer support expenses generally include salaries and benefits, sales commissions, travel expenses and related facility costs for the Company's sales, marketing, customer support and distribution personnel. Sales, marketing and customer support expense also includes the costs of programs aimed at increasing revenue, such as advertising, trade shows and other market development programs.

Increases in sales, marketing and customer support expenses are due to increased advertising and promotional expenditures for upgrades of existing products and further development of customer and technical support services to support a growing installed base of customers.

Continuing efforts to expand markets and increase penetration into targeted software markets, and increasing competition in the software industry, are expected to cause 1995 sales, marketing and customer support expenditures to approximate the same spending levels as a percentage of revenue.

	1994	Change	1993	Change	1992
General and administrative	$54.0	–9%	$59.2	17%	$50.4
Percentage of total revenue	9.0%		11.4%		11.5%

General and administrative expenses consist principally of salaries and benefits, travel expenses, and related facility costs for the finance, human resources, legal, information services and administrative personnel of the Company. General and administrative expenses also include outside legal and accounting fees, bad debts, and expenses associated with computer equipment and software used in the administration of the business.

During 1993, the growth in spending on general and administrative expenses was attributable to the growth in the systems, processes and people necessary to support overall increases in the scope of the Company's operations, as well as additional costs incurred for legal defenses and settlement of an Aldus class-action securities lawsuit. General and administrative spending decreased as a percentage of revenue in 1994 from 1993 due to a reduction of salary and depreciation expense resulting from restructuring activities, as well as reduced legal expenditures.

The Company expects general and administrative spending to be a lower percentage of revenue in 1995 than was achieved in 1994.

	1994	Change	1993	Change	1992
Write-off of acquired in-process research and development	$15.5	260%	$4.3	–32%	$6.3
Percentage of total revenue	2.6%		0.8%		1.4%

During 1994, the Company acquired LaserTools Corporation and Compumation, Incorporated for an aggregate purchase price of $17.0 million, of which $15.5 million was allocated to in-process research and development, and was expensed at the time of these acquisitions.

During 1993, the Company acquired two software developers—AH Software, Inc. (doing business as After Hours Software) and The Company of Science & Art. Approximately $4.3 million of the total purchase price for these two companies was allocated to in-process research and development, and was expensed at the time of acquisition.

During 1992, the Company acquired OCR Systems Incorporated and Nonlinear Technologies, Incorporated for an aggregate purchase price of $6.8 million, of which $6.3 million was allocated to in-process research and development, and was expensed at the time of these acquisitions.

	1994	Change	1993	Change	1992
Merger transaction and restructuring costs	$72.2	–	–	–	–
Percentage of total revenue	12.1%		–		–

During the fourth quarter of 1994, the Company recorded merger transaction and restructuring costs associated with the acquisition of Aldus of $14.6 million and $57.6 million, respectively. The restructuring costs included $46.5 million related to cash expenditures and noncash items of $25.7 million, consisting primarily of write-offs of redundant information systems and equipment, and duplicate product lines. As of November 25, 1994, the balance of $28.4 million in accrued restructuring costs represents expected future cash expenditures, most of which will be spent in 1995.

To execute the merger, the Company incurred transaction costs consisting principally of transaction fees for investment bankers, attorneys, accountants, financial printing and other related charges to negotiate the merger, conduct financial and technical due diligence, file appropriate regulatory documents and solicit shareholder votes.

As a result of the merger, certain technical support, customer service, distribution and administration functions have been or will be combined and/or reduced. Such restructuring costs include severance and outplacement charges of $20.8 million related to approximately 500 terminated employees. Affected employees received notification of their termination by September 9, 1994, and final assignments are expected to be completed by the first quarter of 1995.

As a condition to the merger, effective January 1995, the Company will no longer sell and distribute FreeHand, the illustration program previously sold and distributed by Aldus. In addition, PhotoStyler, an image and video editing software tool, was discontinued in the fourth quarter of 1994, as the product competed with certain existing products of the Company. The respective inventories and capitalized software development costs and technologies of these duplicate product lines were written off in the fourth quarter of 1994, resulting in a $15.0 million charge to restructuring costs.

To facilitate the operations of the Company, the combined organization migrated to common management information systems, which resulted in a write-off of the book value of the abandoned systems and equipment. The write-off of abandoned systems included in restructuring costs was $10.8 million. In addition, redundant offices in Europe, Japan, Canada and the United States will be consolidated. Lease and third-party contract termination payments totaling $11.0 million, resulting from the planned closure of 10 facilities, are accrued as part of the restructuring costs.

The Company is unable to determine the effects that the merger and restructuring actions will have on future operating results and the financial condition of the organization. In addition to the acquisition-related expenses recognized in the restructuring charge, the Company incurred approximately $10.1 million of certain one-time charges that were recognized in operating expenses. These charges included writing off certain capitalized software development costs, transition personnel bonuses, relocation expenses and expenses incurred for integrating the two companies' benefit plans.

Nonoperating income

	1994	Change	1993	Change	1992
Interest, investment and other income	$9.0	–30%	$12.8	16%	$11.0
Percentage of total revenue	1.5%		2.5%		2.5%

Interest, investment and other income decreased by $3.8 million in 1994 from 1993 and increased by $1.8 million in 1993 over 1992. Interest and other income was adversely impacted by $1.5 million in 1994, as the Company sold several securities (acquired in the Aldus acquisition) for losses in principal created by increases in interest rates during 1994, and for the write-off of an investment in a privately held enterprise. Interest, investment and other income in 1993 included a gain of $3.9 million on the sale of common stock held as an investment and a $1.0 million write-off of an investment in a privately held enterprise. While the Company's cash balances and short-term investments have increased each year due to profitable operations and modest expenditures for capital outlays and other investments, 1994 interest, investment and other income would have increased approximately $0.6 million absent the 1993 net gain on the sales of common stock and the losses experienced in 1994. Such increase is attributable to increased levels of cash invested and a slight increase in interest earned on the Company's investments as driven by slight increases in prevailing interest rates.

	1994	Change	1993	Change	1992
Loss on real estate partnership	–	–	–	–	$6.0
Percentage of total revenue	–		–		1.4%

The Company incurred a $6.0 million loss on a real estate partnership in 1992, as it withdrew from this partnership, due to complications that affected the developer's ability to finance the project and to meet specific development timetables.

Provision for income taxes

	1994	Change	1993	Change	1992
Provision for income taxes	$33.7	–12%	$38.5	32%	$29.1
Percentage of total revenue	5.6%		7.4%		6.6%
Effective tax rate	84.2%		36.6%		36.5%

The Company's effective tax rate in 1994 increased significantly over the effective tax rates of 1993 and 1992, due primarily to one-time, nondeductible merger transaction and restructuring costs. An analysis of the differences between the statutory and effective income tax rates is provided in Note 9 to the accompanying Consolidated Financial Statements. In 1995, the Company expects its effective tax rate to approximate that of 1993 and 1992.

Net income and net income per share

	1994	Change	1993	Change	1992
Net income	$6.3	–91%	$66.5	32%	$50.4
Percentage of total revenue	1.1%		12.8%		11.5%
Net income per share	$0.10	–91%	$1.11	35%	$0.82
Weighted shares *(in thousands)*	61,620	2%	60,144	–2%	61,193

Net income for 1994 represents a 91 percent decrease from 1993 net income of $66.5 million. Results of operations in 1994 included several one-time charges that would not normally be included in the Company's operating results. A reconciliation of the reported results of operations, to the results of operations excluding these one-time charges for 1994, follows.

	Income Before Income Taxes	Income Tax Provision	Net Income	Net Income Per Share
Reported results of operations	$39,997	$33,688	$6,309	$.10
Write-off of acquired in-process research and development:				
Compumation, Incorporated	3,045	–	3,045	.05
LaserTools Corporation	12,424	–	12,424	.20
Acquisition of Aldus:				
Merger transaction costs	14,618	–	14,618	.23
Restructuring costs	57,565	19,922	37,643	.61
Other one-time expenses resulting from the acquisition	10,092	3,734	6,358	.10
Results of operations excluding one-time charges	$137,741	$57,344	$80,397	$1.29

Furthermore, the future effective tax rate is expected to be approximately 37 percent. Had this been in effect in 1994, the net income per share, excluding the above one-time charges, would have been $1.39 per share.

Net income for 1993 increased 32 percent, including a $3.9 million gain on the sale of an investment. Earnings per share were $1.11, a 35 percent increase from 1992. The one-time gain on the sale of an investment resulted in an increase in earnings per share of $.04.

Factors that may affect future results of operations

The Company believes that in the future its results of operations could be impacted by factors such as the ability of the Company to integrate Adobe and Aldus product lines, renegotiation of royalty arrangements, delays in shipment of the Company's new products and major new versions of existing products, market acceptance of new products and upgrades, growth in worldwide personal computer and printer sales and sales price adjustments, consolidation in the OEM printer business, and adverse changes in general economic conditions in any of the countries in which the Company does business.

In connection with the merger with Aldus, the Company has sought to reduce combined expenses by the elimination of duplicate or unnecessary facilities, employees, marketing programs and other expenses. The Company believes that the major impact of such reductions occurred in the fourth quarter of 1994 but expects some additional impact in the first quarter of 1995. The Company expects that these reductions will benefit future operating results, but the reductions could adversely impact the earnings of the combined company. In addition, there can be no assurance that the integration of the product lines of the two companies will not have a material adverse effect on the results of operations.

As previously stated, the Company will no longer market FreeHand after January 1, 1995 and has made the decision to discontinue the marketing of PhotoStyler. These two products aggregated $53.2 million of revenue and $35.4 million of gross profit in 1994. There can be no assurance that the Company will be able to replace this lost revenue or that it will be able to do so as profitably.

The Company's OEM customers on occasion seek to renegotiate their royalty arrangements. The Company evaluates these requests on a case-by-case basis. If an agreement is not reached, a customer may decide to pursue other options, including licensing a PostScript language compatible interpreter from a third party, which could result in lower licensing revenue for the Company.

With the acquisition of Aldus, the Company will derive a larger portion of its revenues from its subsidiaries located in Europe and the Pacific Rim. Certain transactions by these subsidiaries are denominated in foreign currencies. As a result, the Company's operating results are subject to fluctuations in foreign currency exchange rates.

The Company's ability to develop and market products, including upgrades of currently shipping products, that successfully adapt to current market needs may also have an impact on the results of operations. A portion of the Company's future revenue will come from these products. Delays in such introductions could have an adverse effect on the Company's revenue, earnings or stock price. The Company cannot determine the ultimate effect that these new products or upgrades will have on its sales or results of operations.

Due to the factors noted above, the Company's future earnings and stock price may be subject to significant volatility, particularly on a quarterly basis. Any shortfall in revenue or earnings from levels expected by securities analysts could have an immediate and significant adverse effect on the trading price of the Company's common stock in any given period. Additionally, the Company may not learn of such shortfalls until late in the fiscal quarter, which could result in an even more immediate and adverse effect on the trading price of the Company's common stock.

Finally, the Company participates in a highly dynamic industry, which often results in significant volatility of the Company's common stock price.

FINANCIAL CONDITION

Cash, cash equivalents and short-term investments

	1994	Change	1993	Change	1992
Cash, cash equivalents and short-term investments	$400.4	30%	$309.0	34%	$231.0

Cash, cash equivalents and short-term investments totaled $400.4 million as of November 25, 1994, compared to $309.0 million as of November 26, 1993, representing 64 percent and 58 percent of total assets, respectively. Cash equivalents consist of highly liquid money market instruments. In 1994, the Company adopted SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." In accordance with SFAS No. 115, prior period financial statements have not been restated to reflect the change in accounting principle. The cumulative effect of adopting SFAS No. 115 was not material to the Company's financial position and results of operations. Certain cash equivalents and all of the Company's short-term investments, consisting principally of municipal bonds, commercial paper, auction rate securities, United States government and government agency securities, and asset-backed securities, are classified as available-for-sale under the provisions of SFAS No. 115. The securities are carried at fair value with the unrealized gains and losses, net of tax, reported as a separate component of shareholders' equity.

The Company's cash balances and short-term investments have increased each year due to profitable operations, but have been offset partially by modest expenditures for capital outlays and other investments. In 1994, growth in cash balances and short-term investments was reduced by increased corporate merger and acquisition activity.

Noncurrent liabilities and shareholders' equity

	1994	Change	1993	Change	1992
Noncurrent liabilities and shareholders' equity	$456.8	9%	$421.0	20%	$351.7

Included above are put warrants and shareholders' equity. The Company has no long-term debt. Shareholders' equity as of November 25, 1994 was $456.8 million, compared to $414.1 million as of November 26, 1993.

The Company has paid cash dividends on its common stock each quarter since the second quarter of 1988. During 1994, the Company paid cash dividends of $.20 per common share. The Board of Directors of the Company approved a two-for-one stock split on July 9, 1993, payable in the form of a stock dividend for shareholders of record as of July 27, 1993, with a distribution date of August 10, 1993. All share and per share data has been restated to reflect this stock split. The declaration of future dividends is within the discretion of the Board of Directors of the Company and will depend upon business conditions, results of operations, the financial condition of the Company and other factors.

Under its stock repurchase program, the Company expects to continue to repurchase shares from time to time in 1995. These share repurchases are intended to fund the employee stock purchase and stock option plans. Until the merger with Aldus, the Company had engaged in a regular share repurchase program. In 1995, the Company plans to continue that regular repurchase program.

Working capital

	1994	Change	1993	Change	1992
Working capital	$363.6	14%	$318.2	28%	$247.9

Net working capital grew to $363.6 million as of November 25, 1994, compared to $318.2 million as of November 26, 1993. Cash flows provided by operations during 1994 was $142.5 million. Cash generated from operations has been sufficient to fund the Company's investment in research and development, and sales and marketing activities.

Expenditures for property and equipment totaled $28.5 million. Such expenditures are expected to continue, including computer systems for development, sales and marketing, product support, and administrative staff. In addition, in 1994 the Company paid approximately $14.8 million to acquire LaserTools Corporation, Compumation, Incorporated, Image Club Graphics, Incorporated, and the remaining 20 percent interest in Aldus K.K. In the future, additional cash may be used to acquire software products or technologies complementary to the Company's business. Net cash provided by financing activities during 1994 was $25.0 million, primarily resulting from the issuance of common stock under employee stock plans.

The Company's principal commitments as of November 25, 1994 consisted of obligations under operating leases, a real estate development agreement, and various service and lease guarantee agreements with a related party. In 1994, the Company entered into a real estate development agreement for the construction of an office facility and in 1996 will enter into an operating lease agreement for this facility. The Company will have the option to purchase the facility at the end of the lease term. In the event the Company chooses not to exercise this option, the Company is obligated to arrange the sale of the facility to an unrelated party and is required to pay the lessor any difference between the net sales proceeds and the lessor's net investment in the facility, in an amount not to exceed that which would preclude classification of the lease as an operating lease, approximately $52.0 million. The Company also is required, periodically during the construction period, to deposit funds with the lessor to secure the performance of its obligations under the lease and as of November 25, 1994, the Company had deposited approximately $2.3 million in securities. Also during 1994, the Company entered into various agreements with McQueen Holdings Limited ("McQueen") whereby the Company has agreed to guarantee obligations under operating leases for certain facilities utilized by McQueen, and to guarantee certain levels of business between Adobe and McQueen. The Company currently owns 10 percent of the outstanding stock in McQueen as a result of the merger with Aldus.

The Company believes that existing cash, cash equivalents and short-term investments, together with cash generated from operations, will provide sufficient funds for the Company to meet its operating cash requirements in the foreseeable future.

Consolidated balance sheets

(In thousands, except share data)

	November 25 1994	November 26 1993
ASSETS		
Current assets:		
Cash and cash equivalents	$190,091	$134,039
Short-term investments	210,269	174,946
Receivables	96,585	84,864
Inventories	9,619	10,779
Other current assets	7,837	9,821
Deferred income taxes	17,962	12,598
Total current assets	532,363	427,047
Property and equipment	39,104	49,135
Other assets	45,561	53,124
Deferred income taxes	8,475	534
	$625,503	$529,840
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Trade and other payables	$30,840	$20,925
Accrued expenses	79,000	59,114
Accrued restructuring costs	28,457	–
Income taxes payable	23,083	21,189
Deferred revenue	7,352	7,604
Total current liabilities	168,732	108,832
Put warrants	–	6,906
Shareholders' equity:		
Preferred stock, no par value; 2,000,000 shares authorized; none issued	–	–
Common stock, no par value; 200,000,000 shares authorized; 61,150,049 and 58,651,027 shares issued and outstanding as of November 25, 1994 and November 26, 1993, respectively	142,207	90,199
Unrealized losses on investments	(1,088)	–
Retained earnings	319,704	328,207
Cumulative foreign currency translation adjustments	(4,052)	(4,304)
Total shareholders' equity	456,771	414,102
	$625,503	$529,840

See accompanying Notes to Consolidated Financial Statements.

Consolidated statements of income

(In thousands, except per share data)

	Years Ended		
	November 25 1994	November 26 1993	November 27 1992
REVENUE:			
Licensing	$156,652	$146,176	$152,701
Application products	441,120	374,061	287,362
Total revenue	597,772	520,237	440,063
Direct costs	111,810	96,638	87,871
Gross margin	485,962	423,599	352,192
OPERATING EXPENSES:			
Software development costs:			
Research and development	98,995	86,727	65,181
Amortization of capitalized software development costs	13,316	10,208	10,128
Sales, marketing and customer support	200,993	170,945	145,748
General and administrative	54,021	59,203	50,344
Write-off of acquired in-process research and development	15,469	4,285	6,325
Merger transaction and restructuring costs	72,183	–	–
Total operating expenses	454,977	331,368	277,726
Operating income	30,985	92,231	74,466
NONOPERATING INCOME (EXPENSE):			
Interest, investment and other income	9,012	12,829	10,982
Loss on real estate partnership	–	–	(6,000)
Income before income taxes	39,997	105,060	79,448
Income tax provision	33,688	38,515	29,059
Net income	$6,309	$66,545	$50,389
Net income per share	$0.10	$1.11	$0.82
Shares used in computing net income per share	61,620	60,144	61,193

See accompanying Notes to Consolidated Financial Statements.

Consolidated statements of shareholders' equity

(In thousands, except share data)

	Common Stock Shares	Common Stock Amount	Unrealized Losses on Investments	Retained Earnings	Cumulative Foreign Currency Translation Adjustments	Total
BALANCES AS OF NOVEMBER 29, 1991	59,049,328	$108,713	$ –	$227,486	$1,880	$338,079
Issuance of common stock under Stock Option Plans	977,271	9,406	–	–	–	9,406
Issuance of common stock under Employee Stock Purchase Plan	420,154	5,721	–	–	–	5,721
Issuance of common stock under Restricted Stock Plans	68,360	–	–	–	–	–
Tax benefit from employee stock plans	–	6,545	–	–	–	6,545
Restricted stock compensation expense	–	2,278	–	–	–	2,278
Dividends declared	–	–	–	(7,208)	–	(7,208)
Repurchase of common stock	(2,776,670)	(47,744)	–	–	–	(47,744)
Foreign currency translation adjustment	–	–	–	–	(5,723)	(5,723)
Net income	–	–	–	50,389	–	50,389
BALANCES AS OF NOVEMBER 27, 1992	57,738,443	84,919	–	270,667	(3,843)	351,743
Issuance of common stock under Stock Option Plans	1,371,387	15,715	–	–	–	15,715
Issuance of common stock under Employee Stock Purchase Plan	510,461	6,980	–	–	–	6,980
Issuance of common stock under Restricted Stock Plans	50,300	–	–	–	–	–
Tax benefit from employee stock plans	–	10,134	–	–	–	10,134
Restricted stock compensation expense	–	1,651	–	–	–	1,651
Dividends declared	–	–	–	(9,005)	–	(9,005)
Acquisition of The Company of Science & Art	105,049	2,545	–	–	–	2,545
Repurchase of common stock	(1,124,613)	(25,533)	–	–	–	(25,533)
Proceeds from sales of put warrants	–	694	–	–	–	694
Reclassification of put warrant obligations	–	(6,906)	–	–	–	(6,906)
Foreign currency translation adjustment	–	–	–	–	(461)	(461)
Net income	–	–	–	66,545	–	66,545
BALANCES AS OF NOVEMBER 26, 1993	58,651,027	90,199	–	328,207	(4,304)	414,102

	Common Stock Shares	Common Stock Amount	Unrealized Losses on Investments	Retained Earnings	Cumulative Foreign Currency Translation Adjustments	Total
BALANCES AS OF NOVEMBER 26, 1993	58,651,027	$90,199	$ –	$328,207	$(4,304)	$414,102
Issuance of common stock under Stock Option Plans	2,331,438	34,962	–	–	–	34,962
Issuance of common stock under Employee Stock Purchase Plan	629,992	9,487	–	–	–	9,487
Issuance of common stock under Restricted Stock Plans	53,500	–	–	–	–	–
Tax benefit from employee stock plans	–	12,418	–	–	–	12,418
Restricted stock compensation expense	–	1,064	–	–	–	1,064
Adjustment for change in Aldus Corporation fiscal year-end	(130,534)	(3,265)	–	(4,394)	487	(7,172)
Dividends declared	–	–	–	(10,418)	–	(10,418)
Repurchase of common stock	(385,374)	(10,283)	–	–	–	(10,283)
Proceeds from sales of put warrants	–	719	–	–	–	719
Reclassification of put warrant obligations	–	6,906	–	–	–	6,906
Unrealized losses on investments	–	–	(1,088)	–	–	(1,088)
Foreign currency translation adjustment	–	–	–	–	(235)	(235)
Net income	–	–	–	6,309	–	6,309
BALANCES AS OF NOVEMBER 25, 1994	61,150,049	$142,207	$(1,088)	$319,704	$(4,052)	$456,771

See accompanying Notes to Consolidated Financial Statements.

Consolidated statements of cash flows

(In thousands)

	Years Ended November 25 1994	Years Ended November 26 1993	Years Ended November 27 1992
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$6,309	$66,545	$50,389
Adjustments to reconcile net income to net cash provided by operating activities:			
Restricted stock compensation expense	1,064	1,651	2,278
Depreciation and amortization	53,207	45,566	37,130
Deferred income taxes	(12,505)	(1,178)	(11,539)
Unrealized loss on investments	–	(113)	(509)
Provision for losses on accounts receivable	1,518	1,842	862
Tax benefit from employee stock plans	12,418	10,134	6,545
Write-off of acquired in-process research and development	15,469	4,285	6,325
Loss on real estate partnership	–	–	6,000
Noncash restructuring costs	25,735	–	–
Changes in operating assets and liabilities:			
Receivables	(14,965)	(15,631)	(10,134)
Inventories	1,004	(85)	(190)
Other current assets	669	(1,143)	(132)
Trade and other payables	11,720	7,866	6,397
Accrued expenses	10,915	10,277	6,698
Accrued restructuring costs	28,457	–	–
Income taxes payable	1,495	11,134	16,821
Deferred revenue	–	590	2,896
Net cash provided by operating activities	142,510	141,740	119,837
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of short-term investments	(1,734,357)	(698,334)	(739,082)
Maturities and sales of short-term investments	1,697,993	671,064	723,277
Acquisitions of property and equipment	(28,526)	(22,984)	(29,022)
Capitalization of software development costs	(9,133)	(11,573)	(9,821)
Additions to other assets	(17,813)	(4,904)	(11,340)
Acquisitions, net of cash acquired	(14,750)	(4,554)	(12,271)
Net cash used for investing activities	(106,586)	(71,285)	(78,259)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of common stock	$44,449	$14,045	$9,516
Proceeds from sales of put warrants	719	694	–
Repurchase of common stock	(10,283)	(25,533)	(47,744)
Payment of dividends	(9,906)	(8,523)	(7,212)
Net cash provided by (used for) financing activities	24,979	(19,317)	(45,440)
Effect of foreign currency exchange rates on cash and cash equivalents	(1,297)	(516)	(4,023)
Net increase (decrease) in cash and cash equivalents	59,606	50,622	(7,885)
Adjustment for change in Aldus Corporation fiscal year-end	(3,554)	–	–
Cash and cash equivalents at beginning of year	134,039	83,417	91,302
Cash and cash equivalents at end of year	$190,091	$134,039	$83,417
SUPPLEMENTAL DISCLOSURES:			
Cash paid during the year for income taxes	$25,945	$21,999	$16,525
Noncash investing and financing activities:			
Dividends declared but not paid	$2,778	$2,262	$1,780
Reclassification of put warrants	$(6,906)	$6,906	$ –

See accompanying Notes to Consolidated Financial Statements.

Notes to consolidated financial statements

(In thousands, except share and per share data)

Note 1.
significant accounting policies

Operations
Founded in 1982, Adobe Systems Incorporated ("Adobe" or the "Company") develops, markets and supports computer software products and technologies that enable users to create, display, print and communicate electronic documents. The Company licenses its technology to major computer and publishing suppliers, and markets application software products and typeface products for authoring and editing visually rich documents, including digital and video output. The Company distributes its products through a network of original equipment manufacturer (OEM) customers, distributors and dealers, and value-added resellers (VARS) and system integrators. The Company has operations in the Americas, Europe and Pacific Rim regions.

In August 1994, Adobe acquired Aldus Corporation ("Aldus"), a developer of software applications for the professional publishing, graphics and prepress markets; interactive publishing; and the general consumer market through a pooling of interests. Accordingly, the Company's financial statements have been restated, for all periods prior to the merger, to include the results of operations, financial position and cash flows of Aldus.

Fiscal year
The Company's fiscal year is a 52-/53-week year ending on the last Friday of November.

Basis of consolidation
The accompanying consolidated financial statements include those of Adobe and its wholly owned subsidiaries, after elimination of all significant intercompany accounts and transactions.

Cash equivalents and short-term investments
Cash equivalents consist of instruments with maturities of three months or less at the time of purchase.

In 1994, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities." In accordance with SFAS No. 115, prior period financial statements have not been restated to reflect the change in accounting principle. The cumulative effect of adopting SFAS No. 115 was not material to the Company's financial position and results of operations. Certain cash equivalents and all of the Company's short-term and noncurrent investments, consisting principally of United States government and government agency securities, municipal bonds, commercial paper, auction rate preferred stocks, and asset-backed securities, are classified as available-for-sale under the provisions of SFAS No. 115. The securities are carried at fair value, with the unrealized gains and losses, net of taxes, reported as a separate component of shareholders' equity.

The amortized cost of available-for-sale debt securities are adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in investment income. Realized gains and losses, and declines in value judged to be other than temporary on available-for-sale securities are included in investment income. The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in interest, investment and other income.

The Company owns a minority interest in certain technology companies and a majority interest in a limited partnership, established to invest in technology companies, and accounts for such investments under the cost method.

Foreign currency translation
Assets and liabilities of certain foreign subsidiaries whose functional currency is the local currency are translated from their respective functional currencies to United States dollars at year-end exchange rates. Income and expense items are translated at the average rates of exchange prevailing during the year. The adjustment resulting from translating the financial statements of such foreign subsidiaries is reflected as a separate component of shareholders' equity. Certain other transaction gains or losses, which have not been material, are reported in results of operations.

Inventories
Inventories are stated at the lower of cost (first-in, first-out basis) or market (net realizable value).

Property and equipment
Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation of a building in Edinburgh, Scotland is calculated using the straight-line method over 35 years. Depreciation of equipment, and furniture and fixtures, is calculated using the straight-line method over the estimated useful lives of the respective assets, generally three to seven years. Leasehold improvements are amortized over the lesser of the lease term or the estimated useful lives of the related assets, generally five to nine years.

Other assets
Acquired technology, goodwill and licensing agreements are stated at cost less accumulated amortization. Amortization is provided on the straight-line method over the estimated useful lives of the respective assets, generally three years for technology, five to ten years for goodwill, and three to six years for licensing agreements. The Company periodically reviews the net realizable value of its intangible assets and adjusts the carrying amount accordingly.

Research and development costs are charged to expense when incurred. Costs incurred in the research and development of new software products and enhancements to existing software products are also expensed as incurred until the technological feasibility of the product has been established. After technological feasibility has been established, any additional costs are capitalized in accordance with SFAS No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise

Marketed," and are included in other assets on the accompanying consolidated balance sheets. Such costs are amortized using the greater of the ratio of current product revenue to the total current and anticipated product revenue or the straight-line method of the software's estimated economic life, generally 9 to 24 months.

Typeface production costs comprise direct and indirect costs associated with the production of typefaces to be used with the PostScript interpreter, or to be distributed in shrink-wrapped packages to end users through the retail channel or directly from the Company. Amortization is provided on the straight-line method over the estimated useful lives of the respective assets, which is generally three years.

Revenue recognition

Licensing revenue is recognized when the Company's OEM customers ship their products incorporating Adobe's software to their end user customers. The Company also enters into contracts with OEMs to provide research and development to adapt the Company's software products to the OEMs' hardware products. Revenue on such contracts is recognized based on the percentage-of-completion method and is included in licensing revenue. Deferred revenue comprises payments received in advance of revenue recognized on the aforementioned contracts. Revenue relating to OEM licenses stipulating fixed future payment streams in excess of 12 months is recognized as income on a straight-line basis over the term of the licenses.

Application products revenue is recognized upon shipment. Revenue from distributors is subject to agreements allowing limited rights of return and price protection. The Company provides reserves for estimated future returns, exchanges and price protection. The costs associated with other obligations, consisting principally of the customer's right to use the Company's technical hotline, have been immaterial during all periods presented.

Direct costs

Direct costs include royalties, amortization of typeface production costs, amortization of acquired technologies, and direct product, packaging and shipping costs.

Income taxes

The Company accounts for its income taxes under SFAS No. 109, "Accounting for Income Taxes." Under the asset and liability method of SFAS No. 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities measured using enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or settled. Under SFAS No. 109, the effect on deferred tax assets and liabilities due to a change in tax rates is recognized in income in the period that includes the enactment date.

The Company does not provide deferred income taxes for unremitted earnings of foreign subsidiaries, as it is management's intent to reinvest these earnings indefinitely.

Concentration of credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk are primarily cash, cash equivalents, short-term investments and accounts receivable. The Company's investment portfolio consists of investment-grade securities diversified among security types, industries and issuers. The Company's investments are managed by recognized financial institutions that follow the Company's investment policy. The Company's policy limits the amount of credit exposure in any one issue and believes no significant concentration of credit risk exists with respect to these investments.

Credit risk in receivables is limited to OEMs, and to dealers and distributors of hardware and software products to the retail market. The Company adopts credit policies and standards to keep pace with the evolving software industry. Management believes that any risk of accounting loss is significantly reduced due to the diversity of its products, end users and geographic sales areas. The Company performs on-going credit evaluations of its customers' financial condition and requires letters of credit or other guarantees, whenever deemed necessary.

Net income per share

Net income per share is based upon weighted average common and dilutive equivalent shares outstanding using the treasury stock method. Dilutive common equivalent shares include stock options and restricted stock. Fully diluted earnings per share for 1994, 1993 and 1992 were not materially different from primary earnings per share.

Reclassifications

Certain reclassifications were made to the 1993 and 1992 consolidated financial statements to conform to the 1994 presentation.

Note 2.

MERGER WITH ALDUS CORPORATION

On August 31, 1994, the Company issued approximately 14.2 million shares of its common stock in exchange for all of the common stock of Aldus. This business combination has been accounted for as a pooling of interests, and accordingly, the consolidated financial statements for periods prior to the combination have been restated to include the results of operations, financial position and cash flows of Aldus.

The results of operations for the separate enterprises and the combined amounts presented in the accompanying consolidated financial statements are summarized below.

	Nine Months Ended August 26 1994	Year Ended November 26 1993	Year Ended November 27 1992
REVENUE:			
Adobe Systems Incorporated	$260,112	$313,457	$265,931
Aldus Corporation	172,210	206,780	174,132
Combined	$432,322	$520,237	$440,063
NET INCOME:			
Adobe Systems Incorporated	$49,329	$57,030	$43,610
Aldus Corporation	5,131	9,515	6,779
Combined	$54,460	$66,545	$50,389

Prior to the combination, Aldus' fiscal year ended on December 31. In recording the business combination, Aldus' financial statements for the 12 months ended November 25, 1994 were combined with the Company's financial statements for the same period. Aldus' financial statements for the years ended December 31, 1993 and 1992 were combined with the Company's financial statements for the years ended November 26, 1993 and November 27, 1992, respectively. Revenue and net income of Aldus for the month ended December 31, 1993 were $26.1 million and $4.4 million, respectively. Net income, the foreign currency translation adjustment, the issuance of common stock, and the net increase in cash and cash equivalents were adjusted to eliminate the effect of including Aldus' results of operations, financial position and cash flows for the month ended December 31, 1993 in the years ended November 25, 1994 and November 26, 1993.

There were no significant transactions between the Company and Aldus prior to the combination, which required elimination, and no adjustments were required to conform accounting policies. However, certain reclassifications were made to the 1993 and 1992 financial statements to conform to the 1994 presentation.

Note 3.

CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

As discussed in "Note 1—Significant Accounting Policies," in 1994 the Company adopted the provisions of SFAS No. 115.

Certain cash equivalents and all investments have been classified as available-for-sale securities, and as of November 25, 1994 consisted of the following:

	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Tax-exempt commercial paper and agency discount notes	$152,326	$4	$(4)	$152,326
United States government treasury notes	30,647	–	(629)	30,018
State and municipal bonds and notes	92,931	–	(927)	92,004
Corporate notes	511	–	(6)	505
Auction-rate securities	80,865	–	–	80,865
Asset-backed securities	7,199	–	(322)	6,877
	$364,479	$4	$(1,888)	$362,595

Unrealized losses are reported as a separate component of shareholders' equity net of taxes of $0.8 million. Net realized gains for the year ended November 25, 1994 of $0.2 million are included in interest, investment and other income.

The Company's investments are classified as follows:

	November 25 1994
Cash equivalents	$152,326
Short-term investments	210,269
	$ 362,595

The cost and estimated fair value of available-for-sale securities as of November 25, 1994, by contractual maturity, consisted of the following:

	Cost	Estimated Fair Value
Due in one year or less	$229,435	$228,725
Due in one to three years	46,981	46,128
Auction-rate securities	80,865	80,865
	357,281	355,718
Asset-backed securities	7,199	6,877
	$364,480	$362,595

Included in auction-rate securities are Select Auction Variable Rate Securities (SAVRS) whose stated maturities exceed ten years; however, the Company had the option of adjusting the respective interest rates or liquidating these investments at auction on stated auction dates every 35 days.

Note 4.

RECEIVABLES

Receivables consisted of the following:

	November 25 1994	November 26 1993
Trade receivables	$69,628	$58,555
Royalty receivables	26,800	22,532
Interest and other receivables	3,410	6,098
	99,838	87,185
Less allowance for doubtful accounts	3,253	2,321
	$96,585	$84,864

Note 5.

PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

	November 25 1994	November 26 1993
Land	$782	$740
Building	4,615	4,370
Equipment	88,285	82,079
Furniture and fixtures	15,487	29,522
Leasehold improvements	4,146	3,822
	113,315	120,533
Less accumulated depreciation and amortization	74,211	71,398
	$39,104	$49,135

Note 6.
OTHER ASSETS

Other assets consisted of the following:

	November 25 1994	November 26 1993
Licensing agreements	$15,565	$16,057
Goodwill	22,359	21,806
Software development costs	27,199	35,427
Typeface production costs	–	4,841
Miscellaneous other assets	16,123	7,437
	81,246	85,568
Less accumulated amortization	35,685	32,444
	$45,561	$53,124

The following significant transactions and activities are included in other assets:

Acquisitions and goodwill

During 1994, the Company acquired LaserTools Corporation and Compumation, Incorporated for an aggregate purchase price of $17.0 million. Approximately $15.5 million was allocated to in-process research and development, and was expensed at the time of these acquisitions. The Company plans to integrate the acquired technologies into future products. In addition, Image Club Graphics, Incorporated ("Image Club"), a mail-order catalog marketer, was acquired for an aggregate purchase price of $3.4 million in cash, which was primarily allocated to goodwill. Also during 1994, the Company acquired the remaining 20 percent interest of Aldus Kabushiki Kaisha ("Aldus K.K."), a Tokyo-based company, from Something Good, Inc., a Japanese software company for an aggregate purchase price of $2.0 million, which was primarily allocated to goodwill. Aldus K.K. develops and markets Japanese-language versions of the Company's products. Operating results of Aldus K.K. have been included in the consolidated statements from the date of acquisition.

During 1993, the Company acquired AH Software, Inc. (doing business as After Hours Software) and The Company of Science & Art, for an aggregate purchase price of $4.6 million in cash and $2.5 million in restricted stock. Of the purchase price, $4.3 million was allocated to in-process research and development, and was expensed at the time of these acquisitions.

During 1992, the Company acquired OCR Systems Incorporated, Nonlinear Technologies, Incorporated, and 80 percent of Aldus K.K. for an aggregate purchase price of $13.8 million, of which $6.3 million was allocated to in-process research and development, and was expensed at the time of these acquisitions.

Software development costs

Unamortized software development costs were $9.1 million and $17.1 million as of November 25, 1994 and November 26, 1993, respectively. Amortization of software development costs was $8.7 million, $10.2 million and $10.1 million for the years ended November 25, 1994, November 26, 1993, and November 27, 1992, respectively.

Typeface production costs

Amortization of typeface production costs charged to direct costs was $4.8 million, $4.6 million and $4.1 million for the years ended November 25, 1994, November 26, 1993, and November 27, 1992, respectively.

Miscellaneous other assets

Included in miscellaneous other assets are investments in a venture capital limited partnership, minority interests held in other technology companies and other intangible assets.

During 1991, the Company invested $6.0 million in a real estate partnership to acquire land and develop office space for its own use. During 1992, the Company chose to abandon its efforts to pursue the development of land and buildings under this partnership. The Company entered into an agreement with the general partner that dissolved the partnership without recourse to the Company. Accordingly, the investment was written off in 1992.

Note 7.
ACCRUED EXPENSES

Accrued expenses consisted of the following:

	November 25 1994	November 26 1993
Royalties	$10,824	$10,388
Accrued compensation and benefits	17,039	17,005
Sales and marketing allowances	19,445	12,466
Miscellaneous accrued expenses	31,692	19,255
	$79,000	$59,114

Note 8.
ACCRUED RESTRUCTURING COSTS

On August 31, 1994, the Company merged with Aldus, described in "Note 2—Merger with Aldus Corporation," and initiated a plan to combine the operations of the two companies. On this date, the Company recorded a $72.2 million charge to operating expenses related to the merger transaction and restructuring costs.

Merger transaction costs consist principally of transaction fees for investment bankers, attorneys, accountants, financial printing and other related charges. Restructuring costs include the elimination of redundant information systems and equipment, severance and outplacement of terminated employees, the write-off of certain assets related to product lines to be divested or eliminated, and cancellation of certain contractual agreements.

The merger transaction and restructuring costs are summarized below:

	Provision Recorded at Acquisition Date	Period from Acquisition to November 25, 1994		Accrued as of November 25 1994
		Write-offs	Cash Payments	
Merger transaction costs	$14,618	$ –	$8,755	$5,863
RESTRUCTURING COSTS:				
Severance and outplacement	20,784	–	9,236	11,548
Redundant information systems and equipment	10,778	10,778	–	–
Assets associated with duplicate product lines	14,957	14,957	–	–
Cancellation of facility leases and other contracts	11,046	–	–	11,046
	$72,183	$25,735	$17,991	$28,457

The nature, timing and extent of restructuring costs follow:

Severance and outplacement
As a result of the merger, certain technical support, customer service, distribution and administrative functions were combined and reduced. Restructuring included severance and outplacement charges related to approximately 500 terminated employees. Affected employees had received notification of their termination by September 9, 1994 and final assignments are expected to be completed during the first quarter of 1995.

Redundant information systems and equipment
To facilitate the operations of the Company, the combined organization migrated to a common management information system, which resulted in the write-off of the book value of the abandoned systems. The sale or disposal of duplicate information systems and equipment was completed in the fourth quarter of 1994.

Assets associated with duplicate product lines
As a condition of the merger, the Company will no longer (after January 1995) sell and distribute FreeHand, the illustration program previously sold and distributed by Aldus. In addition, PhotoStyler, an image and video editing software tool, was discontinued in the fourth quarter of 1994, as the product competed with certain existing products of the Company. The respective inventories and capitalized software development costs and technologies of these duplicate product lines were written off in the fourth quarter of 1994.

Cancellation of facility leases and other contracts
The Company plans to consolidate duplicate offices in Europe, Japan, Canada and the United States. Lease and third-party contract termination payments, resulting from the planned closure of these facilities, are expected to continue through the lease term or negotiated early termination date, if applicable.

Note 9.
INCOME TAXES

Income before income taxes includes net income (loss) from foreign operations of approximately $(10.5) million, $13.5 million and $3.5 million for the years ended November 25, 1994, November 26, 1993, and November 27, 1992, respectively.

The provision for income taxes consisted of the following:

	Years Ended November 25 1994	November 26 1993	November 27 1992
CURRENT:			
United States federal	$21,776	$14,400	$18,667
Foreign	7,579	8,714	7,248
State and local	7,120	6,445	6,138
Total current	36,475	29,559	32,053
DEFERRED:			
United States federal	(11,525)	(1,926)	(7,954)
Foreign	(1,785)	964	18
State and local	(1,895)	(216)	(1,603)
Total deferred	(15,205)	(1,178)	(9,539)
Charge in lieu of taxes attributable to employee stock plans	12,418	10,134	6,545
	$33,688	$38,515	$29,059

Total income tax expense differs from the expected tax expense (computed by multiplying the United States federal statutory rate of approximately 35 percent for 1994 and 1993, and 34 percent for 1992, to income before income taxes) as a result of the following:

	Years Ended November 25 1994	November 26 1993	November 27 1992
Computed "expected" tax expense	$13,999	$36,804	$27,012
State tax expense, net of federal benefit	3,396	5,154	3,826
Nondeductible merger costs	5,209	–	–
Nondeductible write-off of acquired in-process research and development	7,216	489	245
Tax credits	(1,755)	(3,433)	(3,344)
Foreign losses, not benefited	3,550	676	462
Foreign tax rate differential	2,018	–	–
Other, net	55	(1,175)	858
	$33,688	$38,515	$29,059

The tax effects of the temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of 1994 and 1993 are presented below:

	November 25 1994	November 26 1993
DEFERRED TAX ASSETS:		
Acquired technology	$3,306	$1,428
Reserves and deferred revenue	17,515	10,599
Depreciation	2,438	1,982
Foreign operating loss carryforwards	5,130	2,678
Tax credits and other carryforwards	4,088	3,777
Other	1,285	3,657
Total gross deferred tax assets	33,762	24,121
Deferred tax asset valuation allowance	(5,130)	(2,678)
Total deferred tax assets	28,632	21,443
DEFERRED TAX LIABILITIES:		
Basis difference of acquired assets	(694)	(35)
Capitalized costs	(1,297)	(7,270)
Other	(204)	(1,006)
Total deferred tax liabilities	(2,195)	(8,311)
Net deferred tax assets	$26,437	$13,132

As of November 25, 1994, the Company had United States tax credit carryforwards of approximately $4 million, which expire in years 1997 through 2008. The carryforwards are attributable to the premerger years of Aldus and are subject to certain limitations on usage. The Company also has foreign operating loss carryovers in various jurisdictions of approximately $13.5 million with various expiration dates. For financial reporting purposes, a valuation allowance has been established to fully offset the deferred tax assets related to foreign operating losses due to uncertainties in utilizing these losses. The increase in the valuation allowance in 1994 resulted from foreign losses for which no tax benefit has been recognized.

Note 10.
EMPLOYEE BENEFIT PLANS

Stock option plan

As of November 25, 1994, the Company had reserved 20,000,000 shares of common stock for issuance under its Stock Option Plan.

Each option assumed by Adobe under the Merger Agreement will continue to have, and be subject to, the same terms and conditions set forth in the relevant Stock Option Plan. The Aldus plan provided for the granting of stock options to employees and officers at the fair market value at the grant date. Options vest at 20 percent after the first year and ratably each month for the next four years.

The Adobe plan provides for the granting of stock options to employees and officers at the fair market value of the Company's common stock at the grant date. Options generally vest over three years: 25 percent after the first year, and the remainder ratably each month for the next two years so that the options are 50 percent vested after the second year and fully vested after the third year. All options have a five-, seven-, or ten-year term. Stock option activity for 1992, 1993 and 1994 is presented below.

		Options Outstanding	
	Options Available for Grant	Number of Shares	Price per Share
BALANCES AS OF NOVEMBER 29, 1991	5,093,694	8,396,826	$0.02–49.00
Options granted	(4,813,516)	4,813,516	10.25–33.88
Options exercised	–	(972,271)	0.02–24.75
Options cancelled	3,117,067	(3,117,067)	0.58–49.00
BALANCES AS OF NOVEMBER 27, 1992	3,397,245	9,121,004	0.02–47.25
Additional shares reserved	4,500,000	–	–
Options granted	(3,278,018)	3,278,018	2.17–33.75
Options exercised	–	(1,366,387)	0.02–27.25
Options cancelled	741,861	(741,861)	0.58–37.87
BALANCES AS OF NOVEMBER 26, 1993	5,361,088	10,290,774	0.06–47.25
Options granted	(2,246,430)	2,246,430	17.25–36.38
Options exercised	–	(2,331,438)	0.06–33.75
Options cancelled	788,482	(788,482)	0.58–33.75
Adjustment for change in Aldus Corporation fiscal year-end	142,314	(51,421)	–
Aldus options retired	(968,713)	–	–
BALANCES AS OF NOVEMBER 25, 1994	3,076,741	9,365,863	$0.25–47.25

Of the options outstanding, 5,570,349 were exercisable as of November 25, 1994.

Restricted stock option plan

The Company's Restricted Stock Option Plan provides for the granting of non-qualified stock options to nonemployee directors and consultants. Option grants are limited to 7,500 shares per person in each fiscal year and are immediately exercisable within a ten-year term. Options generally vest over three years: 25 percent in each of the first two years and 50 percent in the third year. Stock option activity for 1992, 1993 and 1994 is as follows:

	Options Available for Grant	Options Outstanding: Number of Shares	Options Outstanding: Price per Share
BALANCES AS OF NOVEMBER 29, 1991	82,500	95,000	$4.13–27.00
Options granted	(50,000)	50,000	14.06–21.56
Options exercised	–	(5,000)	11.13
BALANCES AS OF NOVEMBER 27, 1992	32,500	140,000	4.13–27.00
Options granted	(40,000)	40,000	23.94
Options exercised	–	(5,000)	11.13
Options cancelled	20,000	(20,000)	21.56–27.00
BALANCES AS OF NOVEMBER 26, 1993	12,500	155,000	4.13–27.00
Additional shares reserved	50,000	–	–
Options granted	(45,000)	45,000	21.88–31.75
BALANCES AS OF NOVEMBER 25, 1994	17,500	200,000	$4.13–31.75

All options outstanding were exercisable as of November 25, 1994 under the Restricted Stock Option Plan. In addition, 95,375 outstanding options under the Aldus Restricted Stock Option Plan were assumed by Adobe, of which all shares are outstanding and exercisable as of November 25, 1994, at prices ranging from $13.75 to $47.25 per share.

Performance and restricted stock plan

The Company's Performance and Restricted Stock Plan is an amendment and restatement of the Restricted Stock Plan. In August 1994, shareholders approved an amendment to increase the number of shares authorized for issuance from 1,000,000 to 1,500,000. The Performance and Restricted Stock Plan provides for the granting of restricted stock and/or performance units to officers and key employees. Shares issued under this plan vest annually over three years but are considered outstanding at the time of grant, as the shareholders are entitled to dividends and voting rights. Performance units issued under this plan would entitle the recipient to receive shares upon completion of the performance period subject to attaining identified performance goals. As of November 25, 1994, 702,192 shares were outstanding under this plan, of which 101,787 were not yet vested. As of November 25, 1994, no performance units had been issued.

Employee stock purchase plan

Under the terms of the Company's Employee Stock Purchase Plan, eligible employee participants may purchase shares of the Company's common stock semiannually at 85 percent of the market price, on either the purchase date or the offering date, whichever price is lower. In April 1994, shareholders approved an amendment to increase the number of shares authorized for issuance under the plan from 2,000,000 to 4,000,000.

Pretax savings plan

In 1987, the Company adopted an Employee Investment Plan, qualified under Section 401(k) of the Internal Revenue Code, which is a pretax savings plan covering substantially all of the Company's United States employees. Under the plan, eligible employees may contribute up to 18 percent of their pretax salary, subject to certain limitations. There were 841 employees under the plan in 1994 and 720 employees under the plan in 1993. Commencing in 1992, the Company matched a portion of employee contributions. Company matching contributions, which can be terminated at the Company's discretion, were $0.7 million and $0.6 million in 1994 and 1993, respectively. No matching contributions were made to the plan in 1992.

Note 11.
CAPITAL STOCK

Shareholder rights plan

The Company's Shareholder Rights Plan is intended to protect shareholders from unfair or coercive takeover practices. In accordance with this plan, the Board of Directors declared a dividend distribution of one common stock purchase right on each outstanding share of its common stock held as of July 24, 1990. Each right entitles the registered holder to purchase from the Company a share of common stock at $230. The rights become exercisable in the following circumstances:

- The rights become exercisable ten days after of a public announcement by another entity that it has acquired beneficial ownership of 20 percent or more of the shares (and that is without the approval of the Board of Directors) or, if earlier, a public announcement of another entity's intention to commence a tender offer to acquire beneficial ownership of 20 percent or more of the shares.
- The rights become exercisable if another entity engages in certain self-dealing transactions with the Company or becomes the beneficial owner of 20 percent or more of the shares.
- The rights become exercisable if the Company is acquired by any person in a merger or business combination transaction, or if 50 percent or more of the Company's assets or earnings powers are being sold to another entity.

The rights are redeemable by the Company prior to exercise at $0.01 per right and expire on July 24, 2000.

Put warrants

In a series of private placements in 1994 and 1993, the Company sold put warrants entitling the holder of each warrant to sell one share of common stock to the Company at a specified price. The Company received $719,000 and $694,000 for the sale of put warrants in 1994 and 1993, respectively.

The Company's $6.9 million potential buyback obligation, as of November 26, 1993, was removed from shareholders' equity and recorded as put warrants. At the prevailing market prices for the Company's common stock, there was no dilutive effect on earnings per share in 1993. No put warrants were outstanding as of November 25, 1994.

Stock split

On July 9, 1993, the Board of Directors of the Company approved a two-for-one split of the Company's common stock, payable in the form of a stock dividend. The shares were distributed on August 10, 1993, to shareholders of record on July 27, 1993. The share and per share amounts in the consolidated financial statements and notes thereto have been retroactively adjusted to reflect the effects of this split for all periods presented.

Note 12.
COMMITMENTS AND CONTINGENCIES

Lease commitments

The Company has operating leases for its corporate headquarters, field sales offices and certain office equipment that expire at various dates through 2001. Rent expense for these leases aggregated $14.8 million, $17.0 million and $13.1 million during 1994, 1993 and 1992, respectively. As of November 25, 1994, future minimum lease payments under noncancellable operating leases are as follows: 1995–$15.0 million; 1996–$11.5 million; 1997–$3.7 million; 1998–$1.3 million; 1999–$0.9 million; and $4.8 million thereafter.

Real estate development agreement

In 1994, the Company entered into a real estate development agreement for the construction of an office facility and in 1996 will enter into an operating lease agreement for this facility. The Company will have the option to purchase the facility at the end of the lease term. In the event the Company chooses not to exercise this option, the Company is obligated to arrange the sale of the facility to an unrelated party and is required to pay the lessor any difference between the net sales proceeds and the lessor's net investment in the facility, in an amount not to exceed that which would preclude classification of the lease as an operating lease, which is approximately $52.0 million. The Company also is required, periodically during the construction period, to deposit funds with the lessor to secure the performance of its obligations under the lease, and as of November 25, 1994, the Company had deposited approximately $2.3 million in securities.

Royalties

The Company has certain royalty commitments associated with the shipment and licensing of certain products. While royalty expense is generally based on a dollar amount per unit shipped, ranging from $0.25 to $63.00, certain royalties are based on a percentage, ranging from 0.2 percent to 20 percent, of the underlying revenue. Royalty expense was approximately $34.8 million, $32.4 million and $32.5 million for the years ended November 25, 1994, November 26, 1993, and November 27, 1992, respectively.

Legal actions

The Company is engaged in certain legal actions arising in the ordinary course of business. The Company believes it has adequate legal defenses and believes that the ultimate outcome of these actions will not have a material effect on the Company's financial position and results of operations.

Note 13.
TRANSACTIONS WITH AFFILIATES

The Company holds a 10 percent equity interest in McQueen Holdings Limited ("McQueen") and accounts for the investment at cost. During 1994, the Company entered into various agreements with McQueen, whereby the Company has contracted with McQueen to perform printing, assembly and warehousing services, and has agreed to guarantee obligations under operating leases for certain facilities utilized by McQueen and to guarantee a certain level of business between the Company and McQueen. The remaining aggregate contingent liability for nonpayment of rent, through September 1999, for facilities occupied by McQueen was approximately $2.3 million, and minimum monthly payments Adobe will make to McQueen for certain services, over the next three years, are approximately $15.8 million. Purchases from McQueen amounted to $13.0 million, $12.6 million and $11.0 million during 1994, 1993 and 1992, respectively.

Note 14.
FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company's cash equivalents and short-term investments are carried at fair value, based on quoted market prices for these or similar investments. For other investments, included in miscellaneous other assets, the estimated fair value is determined using available market information or other appropriate valuation methodologies, and the carrying amount of these investments approximates fair value.

Put warrants outstanding as of November 26, 1993 are carried at the maximum amount required to settle the potential obligations under the terms of the put warrants. The fair value of the put warrants is not practically determinable, because it fluctuates based on the Company's stock price and at any point in time could be less than the carrying amount.

Note 15.

INDUSTRY SEGMENT REPORTING AND FOREIGN OPERATIONS

Adobe and its subsidiaries operate in one dominant industry segment. The Company is engaged principally in the design, development, manufacture and licensing of computer software. No customer accounted for more than 10 percent of the Company's total revenue in 1994, 1993 or 1992.

The Americas operations include revenue and results of operations in North America, South America, Mexico and Latin America, as well as licensing revenue recognized on a worldwide basis. Licensing revenue is not available on a geographic basis, because the source of licensing revenue is known only by the OEMs' headquarters, and not necessarily by the geographic region providing the revenue stream to the OEMs. Accordingly, all licensing revenue is included in The Americas. European operations primarily include subsidiaries in the Netherlands, the United Kingdom, France, Germany and Sweden, while Pacific Rim operations include subsidiaries in Japan and Australia. Transfers between subsidiaries are accounted for at amounts that are generally above cost and consistent with rules and regulations of governing tax authorities. Such transfers are eliminated in the consolidated financial statements. Identifiable assets are those assets that can be directly associated with a particular geographic area and subsidiary. Geographic information for each of the years in the three-year period ended November 25, 1994 is presented below.

	Years Ended		
	November 25 1994	November 26 1993	November 27 1992
REVENUE:			
The Americas	$430,770	$386,156	$350,486
Europe	108,903	107,582	92,147
Pacific Rim	72,036	51,495	30,557
Eliminations	(13,937)	(24,996)	(33,127)
	$597,772	$520,237	$440,063
OPERATING INCOME:			
The Americas	$(1,847)	$64,719	$70,345
Europe	53	22,361	16,539
Pacific Rim	32,745	21,645	11,010
Eliminations	34	(16,494)	(23,428)
	$30,985	$92,231	$74,466
IDENTIFIABLE ASSETS:			
The Americas	$591,625	$608,636	$417,800
Europe	53,944	46,205	51,885
Pacific Rim	18,633	9,885	8,067
Eliminations	(38,699)	(134,886)	(40,129)
	$625,503	$529,840	$437,623

Independent auditors' report

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF ADOBE SYSTEMS INCORPORATED:

We have audited the accompanying consolidated balance sheets of Adobe Systems Incorporated and subsidiaries as of November 25, 1994 and November 26, 1993, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the years in the three-year period ended November 25, 1994. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Aldus Corporation, a company acquired by the Company in a business combination accounted for as a pooling of interests, as described in Note 2 to the consolidated financial statements, which statements reflect total assets constituting 33 percent as of November 26, 1993, and total revenues constituting 40 percent in both fiscal 1993 and 1992, of the related consolidated totals. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Aldus Corporation, is based solely upon the report of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Adobe Systems Incorporated and subsidiaries as of November 25, 1994, and November 26, 1993, and the results of their operations and their cash flows for each of the years in the three-year period ended November 25, 1994, in conformity with generally accepted accounting principles.

KPMG Peat Marwick LLP

KPMG Peat Marwick LLP
San Jose, California
December 20, 1994

Management's report

Management is responsible for all the information and representations contained in the consolidated financial statements and other sections of this Form 10-K. Management believes that the consolidated financial statements have been prepared in conformity with generally accepted accounting principles appropriate in the circumstances to reflect in all material respects the substance of events and transactions that should be included, and that the other information in this Form 10-K is consistent with those statements. In preparing the consolidated financial statements, management makes informed judgments and estimates of the expected effects of events and transactions that are currently being accounted for.

In meeting its responsibility for the reliability of the consolidated financial statements, management depends on the Company's system of internal accounting control. This system is designed to provide reasonable assurance that assets are safeguarded and transactions are executed in accordance with management's authorization, and are recorded properly to permit the preparation of consolidated financial statements in accordance with generally accepted accounting principles. In designing control procedures, management recognizes that errors or irregularities may nevertheless occur. Also, estimates and judgments are required to assess and balance the relative cost and expected benefits of the controls. Management believes that the Company's accounting controls provide reasonable assurance that errors or irregularities that could be material to the consolidated financial statements are prevented or would be detected within a timely period by employees in the normal course of performing their assigned functions.

The Board of Directors pursues its oversight role for these consolidated financial statements through the Audit Committee, which is comprised solely of Directors who are not officers or employees of the Company. The Audit Committee meets with management periodically to review their work and to monitor the discharge of each of their responsibilities. The Audit Committee also meets periodically with KPMG Peat Marwick LLP, the independent auditors who have free access to the Audit Committee or the Board of Directors, without management present, to discuss internal accounting control, auditing and financial reporting matters.

KPMG Peat Marwick LLP is engaged to express an opinion on our consolidated financial statements. Their opinion is based on procedures believed by them to be sufficient to provide reasonable assurance that the consolidated financial statements are not materially misleading and do not contain material errors.

M. Bruce Nakao
Senior Vice President,
Finance and Administration,
Chief Financial Officer,
Treasurer and Assistant Secretary
December 20, 1994

Quarterly results of operations

(In thousands, except per share data)

1994	Unaudited Quarter Ended February 25 1994	May 27 1994	August 26 1994	November 25 1994	Audited Year Ended November 25
Revenue	$135,892	$149,793	$146,637	$165,450	$597,772
Gross margin	109,887	121,899	120,475	133,701	485,962
Merger transaction and restructuring costs	–	–	–	72,183	72,183
Income (loss) before income taxes	29,941	27,453	28,752	(46,149)	39,997
Net income (loss)	19,093	17,306	18,061	(48,151)	6,309
Net income (loss) per share	.31	.28	.29	(.79)	.10
Shares used in computing net income (loss) per share	61,289	61,768	62,566	60,856	61,620
COMMON STOCK PRICE PER SHARE:					
High	$32.00	$34.50	$34.50	$38.50	$38.50
Low	19.75	21.50	24.50	29.75	19.75

1993	Unaudited Quarter Ended February 26 1993	May 28 1993	August 27 1993	November 26 1993	Audited Year Ended November 26
Revenue	$110,113	$125,254	$140,942	$143,928	$520,237
Gross margin	89,760	102,463	115,547	115,829	423,599
Income before income taxes	25,633	23,983	24,941	30,503	105,060
Net income	15,824	14,672	15,623	20,426	66,545
Net income per share	.27	.24	.26	.34	1.11
Shares used in computing net income per share	59,530	60,003	60,758	60,231	60,144
COMMON STOCK PRICE PER SHARE:					
High	$22.88	$35.75	$37.00	$24.63	$37.00
Low	14.50	18.50	19.25	16.25	14.50

Share and per share amounts have been adjusted for a two-for-one stock split, effective July 1993. The Company's common stock is traded on the Nasdaq National Market under the symbol ADBE. On December 30, 1994, there were 2,211 shareholders of record of the Company's common stock.

See accompanying Notes to Consolidated Financial Statements.

Corporate directory

Board of Directors

John E. Warnock
Chairman of the Board & Chief Executive Officer

Charles M. Geschke
President

William R. Hambrecht
Director

William J. Spencer
Director

Robert Sedgewick
Director

Delbert W. Yocam
Director

Gene P. Carter
Director

Paul Brainerd
Director

Executive Officers

Charles M. Geschke
President

John E. Warnock
Chairman of the Board & Chief Executive Officer

Derek J. Gray
Senior Vice President & General Manager, Adobe Systems Europe

Stephen A. MacDonald
Senior Vice President & General Manager, System Products Division

David B. Pratt
Senior Vice President & General Manager, Application Products Division

M. Bruce Nakao
Senior Vice President, Finance & Administration, Chief Financial Officer, Treasurer & Assistant Secretary

Colleen M. Pouliot
Vice President, General Counsel & Secretary

Form 10-K: A copy of the Company's Annual Report to the Securities and Exchange Commission (Form 10-K) is available free of charge by writing or calling: Investor Relations Department, Adobe Systems Incorporated, 1585 Charleston Road, P.O. Box 7900, Mountain View, California 94039-7900 USA, Tel.: 415-961-4400

Transfer Agent/Registrar: Harris Trust Company of California, Chicago, Illinois

Stock Exchange Listing: Nasdaq National Market, ticker symbol ADBE

Independent Auditors: KPMG Peat Marwick LLP, San Jose, California

Colophon

This annual report was electronically produced with Adobe PostScript software, including Adobe Illustrator, Adobe Photoshop and PageMaker. Text is set in the Minion multiple master typeface, with headlines in Diotima, Ellington, Ex Ponto, Adobe Jenson and Nofret—all from the Adobe Type Library.

Copy: Molly Detwiler
Design: Lori Barnett, Gail Blumberg, Jan Seals, James Young
Portrait Photography: Howard Schatz, San Francisco, California (inside cover); Peter Fox, Palo Alto, California (page 68); Douglas McBride, Edinburgh, Scotland (Derek Gray portrait, page 68)
Prepress: Metagraphics, Palo Alto, California
Printing: George Rice & Sons, Los Angeles, California
Paper: Lustro Dull Recycled, S.D. Warren Company

Illustrations:
Kevin Irby, San Francisco, California (page 17). Part traditionalist, part high-tech aficionado, photographer Irby used the camera and gelled lights to capture his montage of cut paper. He scanned this and other images into his computer, layering them and adding realistic effects with Adobe Photoshop.

Martin Venezky, San Francisco, California (page 21). Venezky is a graphic designer who loves to create collages from photographs he collects and takes himself. He experimented with dozens of images for this report, combining his choices using Adobe Illustrator on the Macintosh. "It was exciting to fit it all together, to make the elements intersect and resonate," he says.

J. otto Seibold, San Francisco, California (page 25). "I use Adobe Illustrator for every piece I do," says Seibold, whose whimsical illustrations grace everything from corporate logos to children's books such as *Mr. Lunch Borrows a Canoe.* For this report, he scanned a pencil sketch into his Macintosh and then recreated and colored the basic drawing with Adobe Illustrator.

Nancy Stahl, New York, New York (page 29). To create this composite image, illustrator Stahl began by drawing the foreground images on her Macintosh with Adobe Illustrator and building the background from a scan in Adobe Photoshop. "I'm such an enthusiastic convert to working on the computer that my paints have dried up," she says.