

ADOBE SYSTEMS INC
Form 10-Q
June 29, 2011

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

FORM 10-Q
(Mark One)

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

For the quarterly period ended June 3, 2011

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

For the transition period from _____ to _____

Commission File Number: 0-15175

ADOBE SYSTEMS INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

77-0019522
(I.R.S. Employer
Identification No.)

345 Park Avenue, San Jose, California 95110-2704
(Address of principal executive offices and zip code)

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

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

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

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

Edgar Filing: ADOBE SYSTEMS INC - Form 10-Q

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No
The number of shares outstanding of the registrant's common stock as of June 24, 2011 was 493,866,593.

ADOBE SYSTEMS INCORPORATED
FORM 10-Q

TABLE OF CONTENTS

	Page No.
PART I—FINANCIAL INFORMATION	
Item 1. <u>Condensed Consolidated Financial Statements:</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets</u> <u>June 3, 2011 and December 3, 2010</u>	<u>3</u>
<u>Condensed Consolidated Statements of Income</u> <u>Three and Six Months Ended June 3, 2011 and June 4, 2010</u>	<u>4</u>
<u>Condensed Consolidated Statements of Cash Flows</u> <u>Six Months Ended June 3, 2011 and June 4, 2010</u>	<u>5</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>6</u>
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>30</u>
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>42</u>
Item 4. <u>Controls and Procedures</u>	<u>42</u>
PART II—OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	<u>43</u>
Item 1A. <u>Risk Factors</u>	<u>43</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>52</u>
Item 6. <u>Exhibits</u>	<u>52</u>
<u>Signature</u>	<u>53</u>
<u>Summary of Trademarks</u>	<u>54</u>
<u>Index to Exhibits</u>	<u>55</u>

Table of Contents

PART I—FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ADOBE SYSTEMS INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

	June 3, 2011 (Unaudited)	December 3, 2010 (*)
ASSETS		
Current assets:		
Cash and cash equivalents	\$827,475	\$749,891
Short-term investments	1,798,045	1,718,124
Trade receivables, net of allowances for doubtful accounts of \$14,603 and \$15,233, respectively	568,570	554,328
Deferred income taxes	68,017	83,247
Prepaid expenses and other current assets	127,211	110,460
Total current assets	3,389,318	3,216,050
Property and equipment, net	463,415	448,881
Goodwill	3,693,505	3,641,844
Purchased and other intangibles, net	424,199	457,263
Investment in lease receivable	207,239	207,239
Other assets	162,040	169,871
Total assets	\$8,339,716	\$8,141,148
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Trade payables	\$60,533	\$52,432
Accrued expenses	496,535	564,275
Capital lease obligations	9,003	8,799
Accrued restructuring	5,260	8,119
Income taxes payable	40,970	53,715
Deferred revenue	438,078	380,748
Total current liabilities	1,050,379	1,068,088
Long-term liabilities:		
Debt and capital lease obligations	1,509,428	1,513,662
Deferred revenue	43,949	48,929
Accrued restructuring	7,203	8,254
Income taxes payable	173,023	164,713
Deferred income taxes	121,996	103,098
Other liabilities	44,323	42,017
Total liabilities	2,950,301	2,948,761
Stockholders' equity:		
Common stock, \$0.0001 par value; 900,000 shares authorized; 600,834 shares issued;		
493,763 and 501,897 shares outstanding, respectively	61	61
Additional paid-in-capital	2,611,997	2,458,278
Retained earnings	6,228,574	5,980,914

Edgar Filing: ADOBE SYSTEMS INC - Form 10-Q

Accumulated other comprehensive income	54,342	17,428
Treasury stock, at cost (107,071 and 98,937 shares, respectively), net of reissuances	(3,505,559)	(3,264,294)
Total stockholders' equity	5,389,415	5,192,387
Total liabilities and stockholders' equity	\$8,339,716	\$8,141,148

The Condensed Consolidated Balance Sheet at December 3, 2010 has been derived from the audited consolidated (*) financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of ContentsADOBE SYSTEMS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

	Three Months Ended		Six Month Ended	
	June 3, 2011	June 4, 2010	June 3, 2011	June 4, 2010
Revenue:				
Products	\$830,281	\$795,260	\$1,672,970	\$1,499,198
Subscription	109,169	92,279	215,340	187,786
Services and support	83,729	55,496	162,575	114,751
Total revenue	1,023,179	943,035	2,050,885	1,801,735
Cost of revenue:				
Products	34,666	39,645	65,383	63,155
Subscription	47,329	50,190	95,207	95,925
Services and support	27,206	17,998	56,250	38,121
Total cost of revenue	109,201	107,833	216,840	197,201
Gross profit	913,978	835,202	1,834,045	1,604,534
Operating expenses:				
Research and development	183,211	167,318	361,611	341,658
Sales and marketing	348,690	320,976	676,768	618,270
General and administrative	95,547	89,953	196,526	180,999
Restructuring charges	(586	) 11,541	(545	) 23,163
Amortization of purchased intangibles	10,392	18,129	20,627	36,326
Total operating expenses	637,254	607,917	1,254,987	1,200,416
Operating income	276,724	227,285	579,058	404,118
Non-operating income (expense):				
Interest and other income (expense), net	(839	) (6,313	) (1,656	) (5,702
Interest expense	(16,727	) (16,076	) (33,747	) (23,771
Investment gains (losses), net	86	(10,723	) 1,676	(14,257
Total non-operating income (expense), net	(17,480	) (33,112	) (33,727	) (43,730
Income before income taxes	259,244	194,173	545,331	360,388
Provision for income taxes	29,808	45,562	81,304	84,623
Net income	\$229,436	\$148,611	\$464,027	\$275,765
Basic net income per share	\$0.46	\$0.28	\$0.92	\$0.53
Shares used to compute basic net income per share	499,686	526,148	501,910	525,124
Diluted net income per share	\$0.45	\$0.28	\$0.91	\$0.52
Shares used to compute diluted net income per share	506,280	533,259	509,572	533,305

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of ContentsADOBE SYSTEMS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended	
	June 3, 2011	June 4, 2010
Cash flows from operating activities:		
Net income	\$464,027	\$275,765
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	132,906	143,487
Stock-based compensation	145,851	124,577
Deferred income taxes	28,796	(178,038)
Unrealized (gains) losses on investments	(567)	) 12,222
Tax benefit from employee stock option plans	7,322	38,743
Other non-cash items	3,392	1,182
Excess tax benefits from stock-based compensation	(8,778)	) (8,485)
Changes in operating assets and liabilities, net of acquired assets and assumed liabilities:		
Trade receivables, net	(16,032)	) (27,999)
Prepaid expenses and other current assets	(15,580)	) (8,808)
Trade payables	8,101	(8,631)
Accrued expenses	(72,145)	) 53,132
Accrued restructuring	(4,206)	) (18,962)
Income taxes payable	(4,004)	) 25,580
Deferred revenue	52,350	87,186
Net cash provided by operating activities	721,433	510,951
Cash flows from investing activities:		
Purchases of short-term investments	(1,137,730)	) (1,202,326)
Maturities of short-term investments	254,706	285,889
Proceeds from sales of short-term investments	798,484	318,092
Acquisitions, net of cash acquired	(36,572)) —
Purchases of property and equipment	(69,922)	) (75,175)
Purchases of long-term investments and other assets	(10,672)	) (18,998)
Proceeds from sale of long-term investments	4,230	719
Other	(124)	) 2,177
Net cash used for investing activities	(197,600)	) (689,622)
Cash flows from financing activities:		
Purchases of treasury stock	(545,015)	) (250,020)
Proceeds from issuance of treasury stock	87,383	84,060
Excess tax benefits from stock-based compensation	8,778	8,485
Proceeds from debt	—	1,493,439
Repayment of debt and capital lease obligations	(3,624)	) (1,000,058)
Debt issuance costs	—	) (10,662)
Net cash (used for) provided by financing activities	(452,478)	) 325,244
Effect of foreign currency exchange rates on cash and cash equivalents	6,229	(8,454)
Net increase in cash and cash equivalents	77,584	138,119
Cash and cash equivalents at beginning of period	749,891	999,487
Cash and cash equivalents at end of period	\$827,475	\$1,137,606

Edgar Filing: ADOBE SYSTEMS INC - Form 10-Q

Supplemental disclosures:

Cash paid for income taxes, net of refunds	\$54,381	\$198,512
Cash paid for interest	\$31,972	\$2,742

See accompanying Notes to Condensed Consolidated Financial Statements.

5

Table of Contents

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

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

We have prepared the accompanying unaudited Condensed Consolidated Financial Statements pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Pursuant to these rules and regulations, we have condensed or omitted certain information and footnote disclosures we normally include in our annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). In management’s opinion, we have made all adjustments (consisting only of normal, recurring adjustments, except as otherwise indicated) necessary to fairly present our financial position, results of operations and cash flows. Our interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. Certain immaterial prior year amounts have been reclassified to conform to the current year presentation in the Condensed Consolidated Statements of Cash Flows. These financial statements and accompanying notes should be read in conjunction with the consolidated financial statements and notes thereto in our Annual Report on Form 10-K for the fiscal year ended December 3, 2010 on file with the SEC. The six months ended June 4, 2010 financial results benefited from an extra week in the first quarter of fiscal 2010 due to our 52/53 week financial calendar whereby fiscal 2010 was a 53-week year compared with fiscal 2011 which is a 52-week year.

There have been no material changes to our significant accounting policies as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 3, 2010.

Recent Accounting Pronouncements

There have been no new accounting pronouncements during the six months ended June 3, 2011, as compared to the recent accounting pronouncements described in our Annual Report on Form 10-K for the fiscal year ended December 3, 2010, that are of significance, or potential significance, to us.

NOTE 2. ACQUISITIONS

Demdex

On January 18, 2011, we completed our acquisition of privately held Demdex, a data management platform company. The impact of this acquisition was not material to our consolidated balance sheets or results of operations.

Day Software Holding AG

On October 28, 2010, we completed our acquisition of Day Software Holding AG (“Day”), a provider of Web content management solutions that many leading global enterprises rely on for Web 2.0 content application and content infrastructure. Day is based in Basel, Switzerland and Boston, Massachusetts. We believe that our acquisition of Day has enabled us to provide comprehensive solutions to create, manage, deliver and optimize Web content. Following the closing, we integrated Day as a product line within our Enterprise segment for financial reporting purposes. We have included the financial results of Day in our Condensed Consolidated Financial Statements beginning on the acquisition date.

Under the acquisition method of accounting, the total preliminary purchase price was allocated to Day’s net tangible and intangible assets based upon their estimated fair values as of October 28, 2010. During the first six months of fiscal 2011, we finalized our purchase accounting after adjustments were made to the preliminary purchase price allocation. The total final purchase price for Day was approximately \$248.3 million of which approximately \$157.0 million was allocated to goodwill, \$79.2 million to substantially all of the identifiable intangible assets and \$9.0 million to net tangible assets. The impact of this acquisition was not material to our condensed consolidated balance sheets or results of operations.

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

Cash equivalents consist of instruments with remaining maturities of three months or less at the date of purchase. We classify all of our cash equivalents and short-term investments as “available-for-sale.” In general, these investments are free of trading restrictions. We carry these investments at fair value, based on quoted market prices or other readily available market information. Unrealized gains and losses, net of taxes, are included in accumulated other

comprehensive income, which is reflected as a separate component of stockholders' equity in our Condensed Consolidated Balance Sheets. Gains and losses are recognized when realized in our Condensed Consolidated Statements of Income. When we have determined that an other-than-temporary decline in fair value has occurred, the amount of the decline that is related to a credit loss is recognized in income. Gains and losses are determined using the specific identification method.

6

Table of Contents

ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Cash, cash equivalents and short-term investments consisted of the following as of June 3, 2011 (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Current assets:				
Cash	\$ 181,036	\$—	\$—	\$ 181,036
Cash equivalents:				
Commercial paper	28,044	—	—	28,044
Money market mutual funds and repurchase agreements	576,878	—	—	576,878
Municipal securities	601	—	—	601
Time deposits	40,916	—	—	40,916
Total cash equivalents	646,439	—	—	646,439
Total cash and cash equivalents	827,475	—	—	827,475
Short-term fixed income securities:				
Corporate bonds and commercial paper	1,038,924	9,263	(269)	) 1,047,918
Foreign government securities	16,443	137	—	16,580
Municipal securities	118,453	198	(18)	) 118,633
U.S. agency securities	214,279	1,424	—	215,703
U.S. Treasury securities	383,913	2,189	(1)	) 386,101
Subtotal	1,772,012	13,211	(288)	) 1,784,935
Marketable equity securities	10,778	2,332	—	13,110
Total short-term investments	1,782,790	15,543	(288)	) 1,798,045
Total cash, cash equivalents and short-term investments	\$2,610,265	\$ 15,543	\$(288)	) \$2,625,520

Table of Contents

ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Cash, cash equivalents and short-term investments consisted of the following as of December 3, 2010 (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Current assets:				
Cash	\$98,691	\$—	\$—	\$98,691
Cash equivalents:				
Commercial paper	41,389	—	—	41,389
Money market mutual funds and repurchase agreements	477,259	—	—	477,259
Municipal securities	350	—	—	350
Time deposits	64,006	—	—	64,006
U.S. Treasury securities	68,195	1	—	68,196
Total cash equivalents	651,199	1	—	651,200
Total cash and cash equivalents	749,890	1	—	749,891
Short-term fixed income securities:				
Corporate bonds and commercial paper	977,889	8,079	(1,450)	) 984,518
Foreign government securities	33,079	309	(2)	) 33,386
Municipal securities	119,608	29	(32)	) 119,605
U.S. agency securities	229,772	778	(179)	) 230,371
U.S. Treasury securities	336,441	2,828	(209)	) 339,060
Subtotal	1,696,789	12,023	(1,872)	) 1,706,940
Marketable equity securities	11,196	1,122	(1,134)	) 11,184
Total short-term investments	1,707,985	13,145	(3,006)	) 1,718,124
Total cash, cash equivalents and short-term investments	\$2,457,875	\$13,146	\$(3,006)	) \$2,468,015

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

The following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category, that have been in a continuous unrealized loss position for less than twelve months, as of June 3, 2011 and December 3, 2010 (in thousands):

	2011		2010	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds and commercial paper	\$96,582	\$(269	) \$257,615	\$(1,450
Foreign government securities	—	—	4,531	(2
Marketable equity securities	—	—	9,380)