

Adobe Systems Incorporated 1988 Annual Report

*Adobe Systems creates, markets and supports computer systems software and application software. The company's PostScript® page description language is an industry standard for device-independent communication among software, computers and laser printers. Adobe's retail software products have made precision graphics possible in personal computing. Technology developed at Adobe has effectively brought five-hundred years of graphic communication techniques to the computer industry.*

FINANCIAL HIGHLIGHTS

<i>Fiscal year ended</i> <i>(in thousands except per share data)</i>	<i>Nov 30, 1988</i>	<i>Nov 30, 1987</i>	<i>Nov 30, 1986</i>	<i>Nov 30, 1985</i>	<i>Nov 30, 1984</i>
Revenue	\$ 83,483	\$ 39,324	\$ 16,055	\$ 4,604	\$ 2,209
Income (loss) before income taxes	35,750	16,892	7,220	838	(27)
Net income	21,080	8,982	3,586	496	58
Net income per share	.98	.43	.19	.03	—
Working capital	32,525	17,543	11,151	3,148	3,263
Total assets	65,460	32,302	20,016	6,074	4,543
Shareholders' equity	44,297	23,525	13,719	4,646	4,150
Dividends per common share	.12	—	—	—	—

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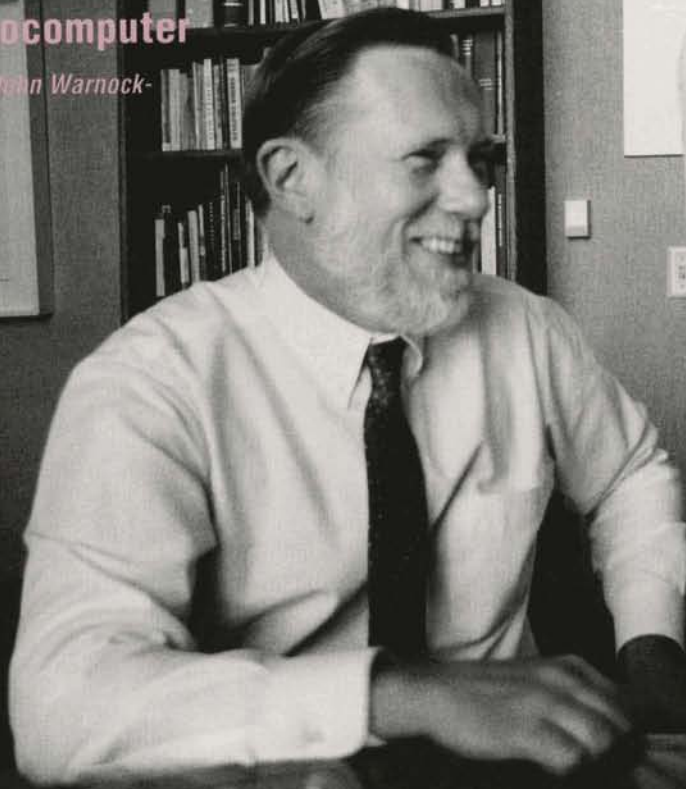
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**P**ostScript is  
bringing a

five-hundred-year  
tradition of visual  
communication  
techniques to  
the microcomputer  
world. —John Warnock—



*Charles Geschke  
Executive Vice President  
and Chief Operating Officer*



*John Warnock  
President and  
Chief Executive Officer*

**January 31, 1989**

When we started Adobe six years ago, none of us imagined the far-reaching effect our products would have throughout the computer, printing and publishing industries.

PostScript software now pervades electronic communications. Nearly every major computer system, printer and typesetter manufacturer offers printing solutions from Adobe.

This success is reflected in the growth of our revenue, which more than doubled in 1988—to \$83.5 million, from \$39.3 million in 1987. Our net income increased to \$21.1 million from \$9.0 million last year.

The gains in revenue were mostly due to an increase in the number of royalty-paying customers from eight to thirteen and the strong performance of Apple Computer on the systems side of our business. Overall revenue also increased from our application software business and from Adobe's European subsidiary.

We attribute many of the company's accomplishments to our 291 talented and hard-working people. In 1988, Adobe earned an outstanding \$360,000 in revenue per employee.

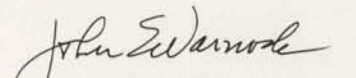
Adobe paid its first dividend beginning in the second quarter of 1988. Dividends paid were \$.04 per share per quarter for the final three quarters.

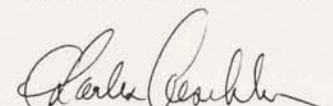
We've expanded our PostScript software technology into new domains—including color printing, support of non-roman alphabets for the Japanese market, and the Display PostScript™ system. The Adobe® Type Library more than doubled, to include software for over three-hundred typefaces.

We also announced two new versions of Adobe Illustrator®, our award-winning application program. Adobe Illustrator 88™ began shipping last May with new capabilities for Macintosh users. Adobe Illustrator®-Windows Version, for IBM users, began shipping this month. The second volume of Adobe Collector's Edition also shipped this month.

The company acquired Spectrum Digital Systems and its TrueForm™ product last October. We're eager to enter this new field of forms management.

All of these developments influenced Adobe's exceptional profitability in 1988. Not only did we exceed our own projections for growth, but we also hired more talent and laid the groundwork for exciting future achievements.

  
John E. Warnock  
*President and Chief Executive Officer*

  
Charles M. Geschke  
*Executive Vice President  
and Chief Operating Officer*





*Adobe engineers work with their clients to design the PostScript interpreter, the heart of PostScript technology. Over 350,000 PostScript printers have been shipped to date.*

**PostScript: The Technology that Continues to Revolutionize Computer Printing and Publishing**

Adobe's Systems Division develops PostScript interpreter software, the Display PostScript system, and typeface software for computer, printer and typesetter manufacturers, who distribute these products to their customers. In fiscal 1988, royalties from these customers provided nearly 74 percent of Adobe's \$83.5 million revenue.

The PostScript language gives manufacturers, software developers and computer users access to an industry-standard imaging model for both printers and computer displays.

PostScript software interpreters have enabled a growing array of laser printers, typesetting equipment and other output devices to produce pages of integrated text and graphics. In fact, since 1985, when Apple Computer introduced the Apple LaserWriter,<sup>®</sup> Adobe's customers have shipped over 350,000 printers and typesetters containing PostScript software from Adobe.

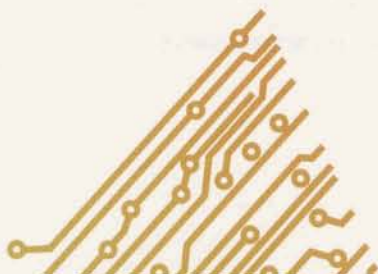
Adobe adapts its PostScript software to meet the requirements of each manufacturer's product. In most cases, Adobe provides its proprietary designs for the printer's digital controller. In addition, each printer product contains a collection of typefaces which is licensed to the manufacturer. PostScript-generated pages can include multiple typefaces, precision line art, charts, tables and photographic images. This versatility is vital to the computer printing and publishing industry.

**A UNIQUE MARKETING STRATEGY**

To encourage the development of application programs that are compatible with its PostScript interpreter, Adobe makes its PostScript language available to all software developers. The company also provides training, telephone support and technical information to help software developers produce PostScript language drivers for their application packages.

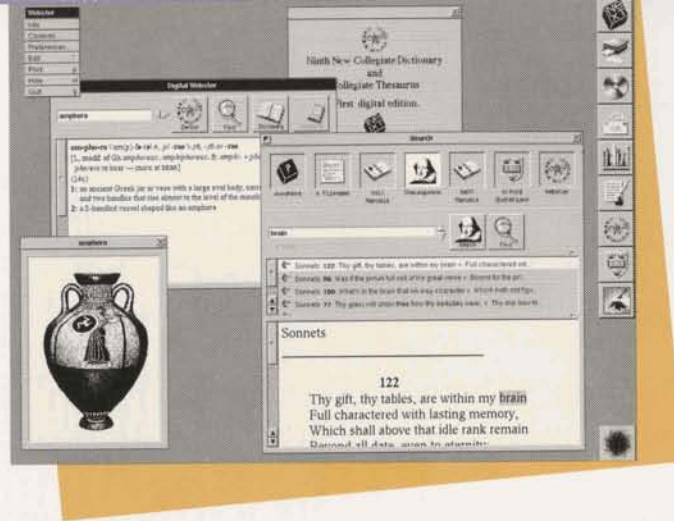
As a result, more than 3000 application programs support the PostScript page description language, stimulating the demand for printers containing the PostScript interpreter. Software applications that can print on PostScript printers now include best-selling word processing, page layout, spreadsheet and graphics programs such as Microsoft Word,<sup>®</sup> Word Perfect,<sup>®</sup> Aldus PageMaker,<sup>®</sup> Excel,<sup>™</sup> Lotus<sup>®</sup> 1-2-3, and Adobe Illustrator 88.

Manufacturers pay royalties to Adobe for the right to distribute products containing the PostScript interpreter. In return, Adobe gives manufacturers the assistance they need to design and develop their PostScript-based products. This strategy has been financially successful, and has promoted a new union between software developers and hardware manufacturers that continues to benefit Adobe Systems.





A new level of excellence in screen fidelity is revealed on the NeXT computer using the Display PostScript system.



## THE INDUSTRY STANDARD

PostScript software technology is an industry standard for electronic printing and publishing. The PostScript language pervades every aspect of visual communications: books, maps, reports, correspondence, manuals, charts, forms, brochures, newsletters, posters, ads, packaging, slides, overhead transparencies, flip charts, spreadsheets, diagrams, illustrations and countless other forms of visual communications.

Twenty-seven companies have announced licensing agreements with Adobe to distribute the PostScript interpreter in printers and other output devices they are developing. Seventeen of these companies have already introduced printers that utilize the PostScript interpreter. Today nearly every major computer, printer and typesetter manufacturer offers Adobe PostScript printing solutions.

## NEW MARKETS FOR POSTSCRIPT PRINTERS

During 1988, Adobe not only expanded the existing PostScript printer market, but also extended PostScript software technology into new domains—color printing and non-roman alphabets.

The first color PostScript printer was introduced by QMS in 1988. Now artists, designers and publishers can use graphics software like Adobe Illustrator 88 to produce color compositions on a personal computer, then proof color prints and make color separations on a high-resolution PostScript typesetter.

The first PostScript products were announced for the Japanese market in 1988 by Apple, Digital and NEC. Adobe's proprietary technology is especially important for products serving the Japanese market, where Kanji character sets consist of thousands of ideographs. This breakthrough will allow the PostScript language to become the first truly international standard for electronic printing—spanning language, character symbols and typographic conventions.

- 89 ● Schlumberger
- Hewlett-Packard
- NeXT
- Monotype
- Matsushita
- Ricoh
- 88 ● Scitex
- Fujitsu
- General Computer
- Mass Micro Systems
- Quadram
- AST Research
- IBM
- 87 ● Varsity
- Qume
- Agfa-Gevaert
- Wang
- 86 ● NEC
- NBI
- Digital
- Diconix
- Dataproducts
- Apollo
- Texas Instruments
- Linotype
- Apple
- 85 ● QMS

### ADOBE'S CUSTOMERS



PostScript solves complex production problems for direct marketers. They can now create their entire catalog electronically and ship the files directly to the printer for plating.



#### DISPLAY POSTSCRIPT INTRODUCED FOR COMPUTER SYSTEMS

The most exciting expansion of the PostScript technology in 1988 was the introduction of the Display PostScript system, bringing the benefits of the PostScript language to computer workstations.

The Display PostScript system is an exceptionally powerful graphics model that supports images, graphics and text of any size. Graphic elements can be scaled, rotated, skewed, clipped or otherwise transformed on screen, for maximum flexibility. The system provides an ideal base for developing exciting new text and graphics applications.

Display PostScript produces true WYSIWYG, or "what you see is what you get." For the first time, the image that appears on the computer display is an accurate rendition of the image that is output on the printer.

The functionality and device independence of the Display PostScript system are important features for workstation manufacturers. These features help Adobe's customers sell hardware. Digital, IBM, NeXT and Scitex have already licensed the Display PostScript system for products which will begin to ship in 1989.

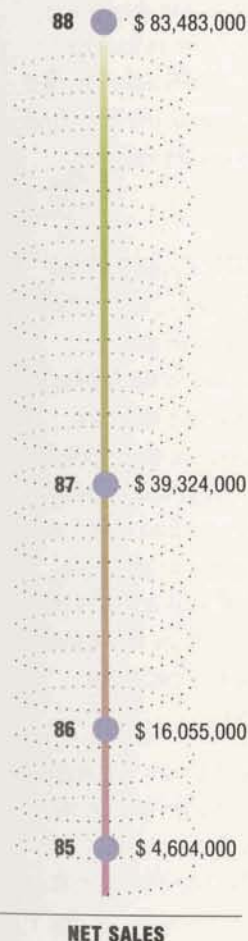
#### COMMERCIAL PRINTING AND PUBLISHING MARKETS EXPAND

From the very beginning, Adobe's PostScript software technology was developed for the full spectrum of printing and publishing—from convenient, low-cost printers for office and personal use to the most sophisticated and demanding color prepress publishing systems. Two new PostScript customers in 1988, R.R. Donnelley and Scitex, exemplify this expansion of Adobe technology into mainstream commercial printing and publishing.

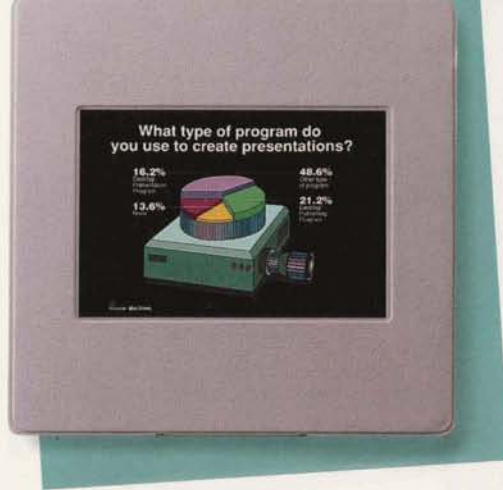
In 1988, R.R. Donnelley & Sons Company, the largest printer in North America, standardized on the PostScript language for its catalog publishing system, Pulsar™. Now Sears and other Donnelley clients prepare their catalog materials in PostScript format, then transmit these files to the Donnelley plant for direct output to printing plates.

Scitex has announced its intention to use the Display PostScript system to merge text and graphics into its color prepress composition systems, and to drive high-resolution output recorders.

Also in 1988, major commercial typesetter manufacturers, including Agfa Compugraphic, Linotype, Monotype and Varityper, announced new PostScript typesetter products.



The same type of electronic PostScript output used to command printer pages can now generate 35mm slides, a boon to business presentations.



### TYPEFACE DEVELOPMENT AND DISTRIBUTION

Adobe distributes typeface software through three channels—manufacturers, retailers and directly to customers. The Adobe Type Library now consists of over 300 roman typefaces, as well as two Japanese Kanji fonts. Adobe is recognized as a leading supplier of high-quality typefaces for electronic printing and publishing.

Adobe licenses typefaces from some of the world's most prestigious typeface libraries—including Linotype, ITC, Morisawa, Letraset, Fundicion Typographica Neufville and Bigelow & Holmes. In addition, Adobe's team of type designers develops original typefaces internally. Using proprietary software, the company refines licensed fonts to achieve high quality on laser printers.

Revenue from typefaces bundled with hardware systems continues

to grow along with the sales of PostScript printers and typesetters. Each PostScript interpreter includes a minimum of thirteen Adobe fonts. However, most printer manufacturers are bundling additional fonts with their products. As the installed base of PostScript printers grows, typefaces should continue to provide a steady, important source of revenue.

### BARRIERS TO EFFECTIVE COMPETITION

Although a number of companies may be trying to "clone" the PostScript interpreter, very few can hope to compete in product and support with the assets and resources Adobe already has in place. Competitive products face many obstacles, including technical, marketing, legal, and quality barriers.

Adobe's PostScript interpreter is a de facto standard. Nearly every major computer system, printer and typesetter manu-

facturer offers PostScript printing solutions from Adobe. The company has formed strong, long-term relationships with its manufacturing customers, resulting in a wide choice of printing solutions for the marketplace. With only limited solutions, competitors may find it difficult to locate volume markets.

In 1988, Adobe developed its PostScript logotype to reinforce brand awareness in the marketplace. Many of Adobe's customers now use the new PostScript logo on their products, packaging, advertising, brochures and other marketing materials. The symbol also appears on the first page that prints on most PostScript printers.

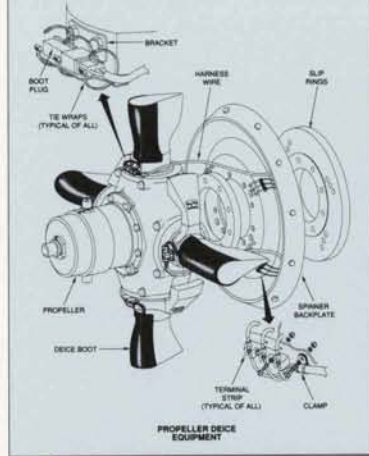
Retailers use the new logotype to promote PostScript products from Adobe. Some Adobe dealers display the PostScript



**POSTSCRIPT**  
Software From Adobe



Engineers at Fairchild Aircraft prefer PostScript for producing, storing, and transmitting huge data files of technical illustrations.



PostScript software has become increasingly important in business publications. Paste-up has been eliminated in this four-color newsletter. It was all created electronically—from design to color separations.



logo in a prominent position in front of their stores. They know that, for their customers, that logo symbolizes high-quality electronic publishing.

#### THE FUTURE OF POSTSCRIPT

Adobe expects continued growth as new licensed products enter the market, and as the company intensifies its marketing efforts in Europe, North America and Japan.

The company will continue to work with its current clients to expand their product lines, upgrade their products and increase their market penetration. At the same time, Adobe will seek new relationships with manufacturers of both workstation and printer products.

Adobe's controller technology continues to advance as the company works with hardware manufacturers to evaluate new

designs. A range of controller designs, from high-performance to low-price, will provide a broad spectrum of PostScript printing solutions.

As Display PostScript products enter the market, Adobe will continue to provide training, support and technical information to help software developers produce high-quality PostScript language application products.

Adobe continues to enhance its PostScript software. The company's advanced development team is working to improve quality, performance, and language capabilities—and to provide PostScript software solutions for increasingly sophisticated workstations and printing systems.

88 ● \$ 21,080,000

87 ● \$ 8,982,000

86 ● \$ 3,586,000

85 ● \$ 496,000

NET INCOME

- 88 ● Color PostScript
- Kanji Interpreter
- Display PostScript
- 87 ● Non-roman Fonts
- 86 ● Proprietary Fonts
- Licensed Fonts
- Printer Fonts
- 85 ● PostScript Interpreter
- 84 ● PostScript Language

#### SYSTEMS PRODUCTS



*Adobe's own graphic designers are the perfect testing ground for our application products. They routinely use Adobe Illustrator 88 to create artwork for everything from annual reports to packaging.*



**Adobe Application  
Products: Type  
Font and Graphics  
Software for  
Personal  
Computers**

The Application Products Division markets the Adobe Type Library and graphics software to users throughout the world. Revenue from Adobe application products increased 88% in 1988, to over \$19 million—approximately twenty percent of company revenues.

Introduced in 1986, the Adobe Type Library was the company's first application software product line. The following year, the company introduced Adobe Illustrator, one of the first high-quality illustration programs for personal computers.

Growing demand for the Adobe Type Library and Adobe Illustrator has added to the company's revenue. The increased popularity of these products reflects the status of the PostScript language as an industry standard.

In 1988, Adobe opened new sales offices in Atlanta, New York, and Washington, D.C., established distribution in Japan, and furthered operations in Europe and Canada.

Adobe's application software helps to expand the market for PostScript printers. The division's goals are to develop a strong application software business that builds upon the advantages of the PostScript language, to bring Adobe typeface software to a broad range of customers, and to play a leading role in developing the electronic publishing market.

**A YEAR OF NEW  
PRODUCTS**

The Adobe Type Library more than doubled in 1988, to include software for over 300 typefaces. Publications professionals, large corporations and other computer users need a broad selection of typefaces in order to

communicate effectively. Font software packages from the Adobe Type Library are now available in Apple Macintosh<sup>®</sup>, IBM PC and DEC VAX/VMS formats.

In September, the company announced an exciting new version of the library—the Adobe Font Folio™. The Font Folio product includes the entire Adobe Type Library on a hard disk that connects directly to several popular PostScript printers. This product, which is expected to ship in early 1989, enables users to install all the typefaces in a few minutes.

The company also introduced three Adobe Publishing Packs in 1988. Each package contains a selection of type families chosen for a particular market segment



PostScript software is a valuable ally at Esprit in California. Designers rely on its speed and flexibility in creating fashions, from textiles to T-shirts.



by an expert in the field. The Publishing Packs—for Newsletters, Forms and Schedules, and Presentations—offer excellent value for customers, and they are also convenient for dealers who carry the Adobe Type Library.

#### ADOBE ILLUSTRATOR EARNS INDUSTRY ACCLAIM

Adobe Illustrator has had a significant impact on the growth of the Application Products Division. Since its release in March 1987, the program has established a growing base of enthusiasts from the graphic design community and large corporations, where it is revolutionizing technical illustration and other graphics tasks.

Adobe continued to provide new illustration tools for personal computers with its January 1988 announcement of Adobe Illustrator 88. This version of the original product, which began

shipping in May, adds important features for both graphic artists and business people. For example, with the program's color capabilities, users can now create color illustrations and four-color separations. An auto-trace tool speeds production by automatically tracing scanned pictures and bit-mapped clip art into PostScript format.

Adobe announced the Adobe Illustrator-Windows Version for IBM users in the Fall of 1988. This new product will bring many of the benefits of Adobe Illustrator 88 to the IBM PC compatibles market. Shipments are expected to begin in early 1989.

Adobe Illustrator has received widespread industry acclaim. The Software Publishers Association voted Adobe Illustrator *Best Graphics Tool*, *Best Business Productivity Tool*, and *Best of the Best*. The package also won two of the most prestigious software awards in Great Britain. Recognition of Information Technology

Achievement (RITA) named Adobe Illustrator *Software Product of the Year*, and the product won the British Micro-computing Award for *Business Software of the Year*.

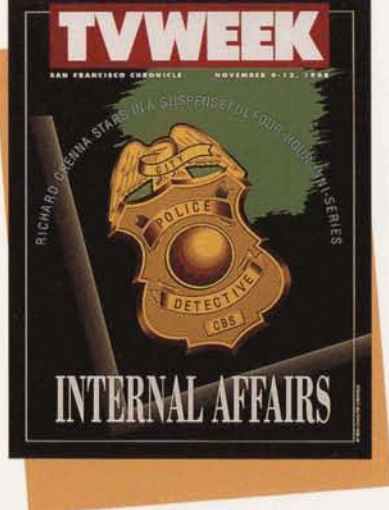
#### COLLECTOR'S EDITIONS OFFER NEW SHAPES AND PATTERNS

A related new product line, Adobe Collector's Edition, provides graphic artists with a useful assortment of pre-drawn shapes. The first software package in the series is Adobe Collector's Edition: Symbols, Borders and Letterforms. These designs were all created with the Adobe Illustrator program, so artists can easily modify them.

Adobe Collector's Edition: Patterns and Textures, announced in September 1988, is expected to ship in early 1989.



Adobe Illustrator 88 has become the drawing tool of choice for several major US newspapers. It's been used here to design a cover for the weekly TV listing.



PostScript software is effecting big changes in the packaging industry. It speeds consumer goods from concept to the store shelves.

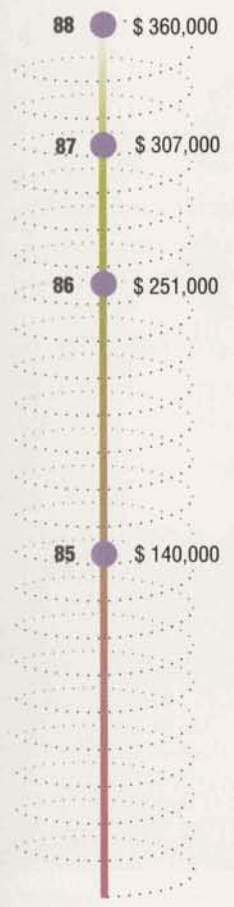


This software package enables architects, engineers and graphic artists to create illustrations with the Adobe Illustrator program, then fill shapes with precise, industry-standard patterns that are the exact size and color they need.

Adobe acquired Spectrum Digital Systems and its TrueForm product in October 1988. Forms generation and management is an important new software product category. The TrueForm package lets users print a variety of forms on plain paper. Combined with a data base program, the product enables fast, efficient data entry and form completion. The first Adobe version of TrueForm is expected during 1989.

FUTURE GROWTH PROJECTED FOR APPLICATIONS

Adobe expects growth to continue during 1989, as the company develops additional application products that expand the market for its software. Growth is also planned for the Adobe Type Library, with new original designs and licensed type-faces. Adobe's objective is to continue to develop tools that will enhance the effectiveness of customers' printed communications.



REVENUE PER EMPLOYEE

- Illustrator-Windows
- Collector's Edition 2
- Illustrator 88
- 88 Publishing Packs
- Collector's Edition 1
- 87 Illustrator
- 85 Downloadable Fonts
- 84 PostScript Language

APPLICATION PRODUCTS

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*Adobe added Kanji printer products to its line in 1988, making PostScript the first truly international standard for computer printing.*



**Adobe's  
International Business  
Opportunities**

The growing acceptance of PostScript software technology in international markets presents exciting opportunities for marketing Adobe's systems and application products.

The company first gained international distribution of its PostScript software through the marketing efforts of major American hardware manufacturers such as Apple, Dataproducts, Digital, QMS, Texas Instruments and Wang, who licensed PostScript interpreters from Adobe for their printer products.

Today, major European manufacturers, including Agfa-Gevaert, Linotype and Monotype, distribute PostScript products worldwide. Several European computer companies, like Nixdorf, Olivetti and Wenger, market PostScript printers which they purchase from other Adobe licensees.

Adobe's application products are distributed in 21 countries on four continents throughout the world. The company opened its first international subsidiary,

Adobe Systems Europe B.V., in the World Trade Center in Amsterdam, Netherlands at the end of 1987.

EUROPEAN  
DISTRIBUTION

In 1988, approximately 25 percent of all PostScript printers were shipped to Europe. With the new Amsterdam office, Adobe will be able to give its customers in Europe the same kind of sales and marketing support that it provides in the United States. Adobe Systems Europe B.V. also offers technical support to local software developers and customers who use PostScript products.

Adobe's European presence helps the company establish local retail and distributor channels for application software. By the end of 1988, the Adobe Type Library, Adobe Illustrator 88, Adobe Collector's

Edition and the Adobe Publishing Packs were available in sixteen European countries, through nineteen distributors.

Adobe's European business has grown considerably during the past year. The company's European subsidiary will help sustain Adobe's success in this important market.

THE POSTSCRIPT  
MARKET IN JAPAN

Although more than ninety percent of all laser printers sold throughout the world are manufactured in Japan, only a small percentage are sold in the Japanese market.

The Japanese language has presented a significant barrier to printing automation. Since there are over 7,000 Kanji

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HBO cable television uses Illustrator 88 for creative flexibility on their title graphics.



characters, and they are much more complex than the letters of the roman alphabet, it has been difficult to produce letter-quality output with inexpensive laser printers.

The first PostScript products for printing Kanji were introduced in Japan in 1988. Both Apple and NEC, one of Japan's leading personal computer makers, showed PostScript printers that print Kanji at the Tokyo Data Show last September. At the same show, a Kanji version of Adobe Illustrator for the Apple Macintosh was demonstrated for the first time.

In 1988, Adobe announced licensing agreements for the PostScript interpreter with Ricoh, the second-largest printer engine manufacturer in the world, as well as Matsushita, one of the world's largest electronics companies.

Adobe's proprietary technology is important for products serving the Japanese market, where Kanji character sets consist of thousands of ideographs. The introduction of Adobe software in this new world market will allow the PostScript language to become the first truly international standard for electronic printing—spanning language, character symbols and typographic conventions.

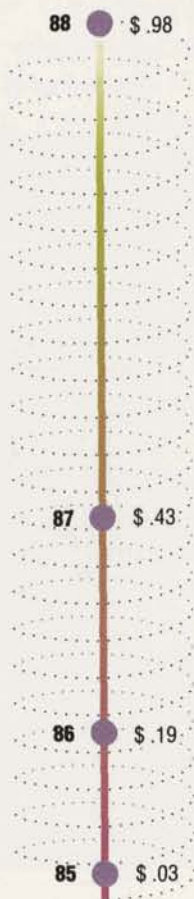
#### ADOBE'S INTERNATIONAL FUTURE

The market opportunities for PostScript products from European and Japanese manufacturers will continue to be substantial. Adobe is also optimistic about the success of American manufacturers who sell PostScript products in the international market.

The company will form a new subsidiary with an office in Tokyo in early 1989. This

office will enable Adobe to be near its customers in Japan, and will help them market and support PostScript products. The Japanese office will also support software developers working on applications that take advantage of the new Kanji PostScript printers.

International activities are becoming an increasingly important part of Adobe's overall business strategy. As the company's customers bring their products to new markets, PostScript software will become an integral factor for electronic printing and publishing throughout the world.



EARNINGS PER SHARE



		Percentage of Revenue Year Ended November 30			% Change	% Change
		1988	1987	1986	1987 to 1988	1986 to 1987
<b>Revenue</b>	Royalties	73.8%	69.4%	84.3%	125.8%	101.6%
	Product sales	23.1	26.1	8.4	87.9	663.6
	Contract revenue	3.1	4.5	7.3	45.9	50.7
	Total revenue	100.0	100.0	100.0	112.3	144.9
<b>Costs and Expenses</b>	Direct costs	17.6	14.3	10.0	162.4	247.6
	Research, development and contract costs	8.8	10.5	17.6	76.2	46.7
	Sales, marketing and customer support	25.9	27.3	22.2	101.6	201.3
	General and administrative	6.8	6.9	7.4	108.5	128.1
	Total costs and expenses	59.1	59.0	57.2	112.6	152.5
	Operating income	40.9	41.0	42.8	111.8	134.8
	Interest income	1.9	1.9	2.2	107.0	116.7
	Income before taxes	42.8	42.9	45.0	111.6	134.0
	Income tax expense	17.6	20.1	22.6	85.5	117.7
	Net income	25.2%	22.8%	22.4%	134.7%	150.5%

### Results of Operations

Total revenue grew rapidly during the three fiscal years ended November 30, 1988. The printer products of the Company's original equipment manufacturer (OEM) customers continued to meet with strong customer acceptance producing significant growth in royalty revenue. In fiscal 1986 two customers were paying the Company royalties. This grew to eight customers by the end of fiscal 1987 and increased to thirteen customers by the end of fiscal 1988.

Revenue from product sales increased in fiscal 1988 over 1987. In fiscal 1988 the Company shipped Adobe Illustrator 88, its updated version of Adobe Illustrator, which is a graphics arts and illustration package for the Apple Macintosh computer, and

increased the number of downloadable typeface software packages available for both the Macintosh and the IBM personal computer. In addition, the Company shipped Adobe Collector's Edition: Symbols, Borders and Letterforms, a software package of designs and forms used frequently by graphic artists. Revenue from product sales increased in fiscal 1987 over fiscal 1986 due to the introduction of Adobe Illustrator. Also additional downloadable typeface software for the Macintosh and the initial downloadable typeface software for IBM personal computers were shipped in 1987.



During 1987 the Company also opened an office in Amsterdam, the Netherlands, to manage its European distribution of software products. In fiscal 1988 this office was in operation for the full year and helped to increase the revenue from product sales through its distributors in Europe.

Contract revenue grew during the three fiscal years, reflecting the continued engineering effort on new projects for new OEM customers, as well as work completed on new projects for existing OEM customers.

Apple Computer continues to be the Company's largest customer accounting for nearly 33% of total revenue. This is a significant percentage decrease from Apple's 49% share of the Company's revenue in fiscal 1987 and 84% in fiscal 1986. This decrease is due to the growth in royalty revenue from new royalty paying customers as well as increased revenue from other existing OEM customers. A second OEM customer provided 10% of the Company's total revenue in fiscal 1988.

A significant component of direct costs is royalties paid to third parties for their typeface styles which are distributed with the PostScript interpreter or as downloadable software packages to end users. Royalty expense is generally paid on a per unit basis whereas royalty revenue can reflect volume discounts. Therefore direct costs as a percentage of revenue can increase as an OEM customer ships higher volumes of printers. Other direct costs beginning in fiscal 1986 consist of packaging and shipping costs associated with the downloadable typeface software products. Beginning in fiscal 1987 packaging and shipping costs have been incurred for Adobe Illustrator and in fiscal year 1988, for Adobe Illustrator 88 and Adobe Collector's Edition. Consistent with the Company's accounting policies, amortization of capitalized

typeface production costs commences and is included in direct costs when the related typeface software is released for distribution. The increase in total direct costs during the three years reflects these facts and is consistent with the increase in revenue generated from royalties and product sales.

Research, development and contract costs have increased during the three years ended in fiscal 1988 as a result of increases in staff and facilities. New hardware and software engineers have been added to the Company's staff to meet the technical demands of existing customer product development as well as the needs of the Company's new customers and new products such as PostScript interpreters for the Japanese market and the Display PostScript system. Engineering staff has also been added to develop and enhance the Company's application products such as Adobe Illustrator 88 and the other software packages distributed by the Company. Research, development and contract costs have decreased as a percentage of revenue due to the very rapid growth in sales. These costs consist almost entirely of personnel costs which are more difficult to expand than expenses for such items as advertising or sales materials in the sales and marketing area. The Company expects research, development and contract costs to increase as a percentage of revenue in fiscal 1989 as a result of planned increases in the development staff to handle new products and advanced development for potential future products.

Sales, marketing and customer support expenses increased over 100% in 1988 and over 200% in 1987, reflecting increases in the sales and marketing staffs. In addition, sales and marketing staff has been added to service the Company's European and Japanese business relationships. During 1987, the Company created a direct sales force



located in various parts of the United States to call on dealers and distributors of the Company's packaged software. Marketing expenses increased because of staff added in product marketing and marketing communication areas. Other additions to marketing communication expenses were for higher levels of advertising, sales materials and brochures to support the Company's added products and new editions of existing products. The Company expects sales, marketing and customer support expenses to continue to grow in fiscal 1989 in line with the increased level of business from a growing number of customers and products.

General and administrative expenses increased during the three years from 1986 to 1988, due to growth in the size of the Company in overall revenue and personnel. The Company moved into a new facility in fiscal 1987 and added a new building in the same complex in fiscal 1988. Also during 1988, the Company acquired a new administrative computer hardware system and attendant software to accommodate the growth in business and the increase in overall complexity in managing and controlling the business. The Company

expects general and administrative expenses to grow in line with the growth in the rest of the Company.

Interest income of \$1,588,000, \$767,000 and \$354,000 for the years ended November 30, 1988, 1987 and 1986, was earned on the Company's cash balances and short-term investments. The Company's cash balances have increased over the last three years as its operations have been profitable and generated positive cash flow.

The Company's 1988, 1987 and 1986 effective income tax rates were 41.0%, 46.8% and 50.3%, respectively. For an analysis of the differences between the statutory and effective income tax rates see Note 7 to the Consolidated Financial Statements. In general, overall tax rates have declined during the three years due to statutory changes in rates. The Company adopted Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes," in fiscal 1988. Adopting this standard did not result in a material adjustment to the Company's financial statements.

Inflation has not had a significant impact on the Company's operations.

#### **Financial Condition**

Total assets of the Company were \$65,460,000 at the end of fiscal 1988 compared to \$32,302,000 in fiscal 1987 and \$20,016,000 in fiscal 1986. Working capital for the years ended November 30, 1988, 1987 and 1986 totaled \$32,525,000, \$17,543,000, and \$11,151,000, respectively. At the end of fiscal 1988, deferred revenue was \$6,082,000 compared to \$629,000 at the end of fiscal 1987. A large part of this increase was accounted for by an advance against future royalties by a large OEM customer for the Company's Display PostScript system. It is anticipated that this deferred revenue will be recognized as the customer ships products incorporating the Display PostScript system.

The Company's cash and short-term investments have grown to \$35,176,000 in fiscal 1988 from \$17,444,000 in fiscal 1987. The Company has been profitable and its capital spending needs have been relatively modest in relation to its profitability, allowing the Company to generate significant positive cash flow. In light of its positive cash generation, the Company's Board of Directors elected to pay a cash dividend of \$.04 per common share for the Company's second fiscal quarter of 1988 and has done so for the third and fourth fiscal quarters. The Company has a \$5,000,000 unsecured line of credit available.

CONSOLIDATED BALANCE SHEETS  
NOVEMBER 30, 1988 AND 1987

		1988	1987	
<b>Assets</b>	Current assets:			
	Cash and cash equivalents	\$ 13,361,000	\$ 6,173,000	
	Short-term investments	21,815,000	11,271,000	
	Receivables (Notes 2 and 10)	14,612,000	7,501,000	
	Inventory (Note 3)	1,108,000	530,000	
	Deferred income taxes (Note 7)	606,000	—	
	Total current assets	51,502,000	25,475,000	
	Property and equipment (Notes 4 and 12)	8,091,000	3,712,000	
	Typeface production costs	3,830,000	2,916,000	
	Other assets	2,037,000	199,000	
		\$ 65,460,000	\$ 32,302,000	
	<b>Liabilities and Shareholders' Equity</b>	Current liabilities:		
		Accrued expenses (Note 6)	\$ 8,162,000	\$ 2,884,000
		Income taxes payable (Note 7)	3,130,000	2,760,000
Other payables		1,603,000	1,659,000	
Deferred revenue		6,082,000	629,000	
Total current liabilities		18,977,000	7,932,000	
Capital lease obligations, less current portion (Note 12)		863,000	—	
Deferred income taxes (Note 7)		1,323,000	845,000	
Shareholders' equity (Notes 8 and 9):				
Common stock, no par value. 50,000,000 shares authorized; 20,672,452 and 20,401,590 shares issued and outstanding at November 30, 1988 and 1987, respectively		12,379,000	10,226,000	
Retained earnings		31,943,000	13,333,000	
		44,322,000	23,559,000	
Less shareholder notes receivable		25,000	34,000	
Total shareholders' equity		44,297,000	23,525,000	
Commitments (Note 12)				
	\$ 65,460,000	\$ 32,302,000		

*See accompanying notes to consolidated financial statements.*



CONSOLIDATED STATEMENTS OF INCOME  
YEARS ENDED NOVEMBER 30, 1988, 1987 AND 1986

		<u>1988</u>	<u>1987</u>	<u>1986</u>
<b>Revenue</b>	Royalties	\$ 61,617,000	\$ 27,293,000	\$ 13,538,000
<b>(Note 10)</b>	Product sales	19,286,000	10,263,000	1,344,000
	Contract revenue	2,580,000	1,768,000	1,173,000
	Total revenue	<u>83,483,000</u>	<u>39,324,000</u>	<u>16,055,000</u>
<b>Costs and</b>	Direct costs	14,719,000	5,610,000	1,614,000
<b>Expenses</b>	Research, development and contract costs	7,295,000	4,139,000	2,821,000
<b>(Note 11)</b>	Sales, marketing and customer support	21,634,000	10,729,000	3,561,000
	General and administrative	5,673,000	2,721,000	1,193,000
	Total costs and expenses	<u>49,321,000</u>	<u>23,199,000</u>	<u>9,189,000</u>
	Operating income	34,162,000	16,125,000	6,866,000
	Interest income	1,588,000	767,000	354,000
	Income before income taxes	35,750,000	16,892,000	7,220,000
	Income tax expense (Note 7)	14,670,000	7,910,000	3,634,000
	Net income	<u>\$ 21,080,000</u>	<u>\$ 8,982,000</u>	<u>\$ 3,586,000</u>
	Net income per share	<u>\$ .98</u>	<u>\$ .43</u>	<u>\$ .19</u>
	Shares used in computing net income per share	<u>21,496,000</u>	<u>21,034,000</u>	<u>18,912,000</u>

*See accompanying notes to consolidated financial statements.*

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
YEARS ENDED NOVEMBER 30, 1988, 1987 AND 1986

(In thousands, except share data)

	Convertible Preferred Stock	Common Stock		Shareholder Notes Receivable	Retained Earnings	Total Shareholders' Equity
		Shares	Amount			
Balances as of November 30, 1985	\$ 3,781	6,327,816	\$ 121	\$ (21)	\$ 765	\$ 4,646
Issuance of 52,466 shares of Series C						
Preferred Stock upon exercise of warrant	153	—	—	—	—	153
Conversion of Preferred Stock	(3,934)	10,937,688	3,934	—	—	—
Issuance of Common Stock under Employee Stock						
Purchase Plan	—	36,000	5	(3)	—	2
Repurchase of Common Stock from employees under stock purchase plan	—	(122,104)	(3)	1	—	(2)
Issuance of Common Stock under stock option plan	—	927,640	78	(36)	—	42
Initial public Common Stock offering, net of expenses	—	2,200,000	5,239	—	—	5,239
Collections on shareholder notes receivable	—	—	—	9	—	9
Stock option compensation expense	—	—	44	—	—	44
Net income	—	—	—	—	3,586	3,586
Balances as of November 30, 1986	—	20,307,040	9,418	(50)	4,351	13,719
Issuance of Common Stock under stock option plan	—	86,550	48	—	—	48
Issuance of Common Stock to employee	—	8,000	53	—	—	53
Tax benefit from exercise of stock options	—	—	618	—	—	618
Collections on shareholder notes receivable	—	—	—	16	—	16
Stock option compensation expense	—	—	89	—	—	89
Net income	—	—	—	—	8,982	8,982
Balances as of November 30, 1987	—	20,401,590	10,226	(34)	13,333	23,525
Issuance of Common Stock under stock option plan	—	252,832	955	—	—	955
Issuance of Common Stock under Employee Stock						
Purchase Plan	—	18,030	228	—	—	228
Tax benefit from exercise of stock options	—	—	837	—	—	837
Collections on shareholder notes receivable	—	—	—	9	—	9
Stock option compensation expense	—	—	133	—	—	133
Dividends (\$.12 per share)	—	—	—	—	(2,470)	(2,470)
Net income	—	—	—	—	21,080	21,080
Balances as of November 30, 1988	\$ —	20,672,452	\$ 12,379	\$ (25)	\$ 31,943	\$ 44,297

See accompanying notes to consolidated financial statements.



CONSOLIDATED STATEMENTS OF CASH FLOWS  
YEARS ENDED NOVEMBER 30, 1988, 1987 AND 1986

		1988	1987	1986
<b>Cash Flows from Operating Activities</b>	Net income	\$ 21,080,000	\$ 8,982,000	\$ 3,586,000
	Adjustments to reconcile net income to net cash provided by operating activities:			
	Stock option compensation expense	133,000	89,000	44,000
	Depreciation and amortization	3,311,000	1,621,000	705,000
	Deferred income taxes	8,000	6,000	507,000
	Changes in operating assets and liabilities:			
	Receivables	(7,111,000)	(3,879,000)	(2,219,000)
	Inventory	(578,000)	(484,000)	(46,000)
	Other current assets	—	—	68,000
	Accrued expenses	5,278,000	1,926,000	657,000
	Income taxes payable	1,207,000	253,000	3,103,000
	Other payables	(1,213,000)	924,000	547,000
	Deferred revenue	5,453,000	(11,000)	55,000
	Net cash provided by operating activities	27,568,000	9,427,000	7,007,000
<b>Cash Flows from Investing Activities</b>	Short-term investments	(10,544,000)	(11,271,000)	—
	Purchases of property and equipment	(4,952,000)	(3,027,000)	(1,226,000)
	Capitalized typeface production costs	(2,138,000)	(1,821,000)	(1,090,000)
	Other assets	(1,974,000)	(193,000)	3,000
	Net cash used in investing activities	(19,608,000)	(16,312,000)	(2,313,000)
<b>Cash Flows from Financing Activities</b>	Principal payments under capital lease obligations	(321,000)	—	—
	Proceeds from issuance of Preferred Stock	—	—	153,000
	Proceeds from issuance of Common Stock, net	1,183,000	101,000	5,283,000
	Collections on shareholder notes receivable	9,000	16,000	9,000
	Repurchase of Common Stock, net	—	—	(2,000)
	Dividends paid	(1,643,000)	—	—
	Net cash (used) provided by financing activities	(772,000)	117,000	5,443,000
	Net increase (decrease) in cash and cash equivalents	7,188,000	(6,768,000)	10,137,000
	Cash and cash equivalents at beginning of year	6,173,000	12,941,000	2,804,000
	Cash and cash equivalents at end of year	\$ 13,361,000	\$ 6,173,000	\$ 12,941,000
<b>Supplemental Disclosures</b>	Cash paid during the year:			
	Interest	\$ 90,000	\$ —	\$ —
	Income taxes	13,304,000	7,638,000	3,125,000
	Non-cash investing and financing activities:			
	Acquisition of new equipment under capital leases	\$ 1,514,000	\$ —	\$ —
	Conversion of Preferred Stock to Common Stock	—	—	3,934,000
	Tax benefit from exercise of stock options	837,000	618,000	—
	Dividends declared but not paid	827,000	—	—

See accompanying notes to consolidated financial statements.



**Note 1. Significant Accounting Policies**

*Basis of Presentation.* Adobe Systems Incorporated (Adobe or the Company), formed in 1983, designs, develops and markets systems and application software used to print integrated text and graphics for high quality electronic printing and publishing applications. The accompanying consolidated financial statements include those of Adobe and its wholly owned subsidiary, Adobe Systems Europe, B.V., after elimination of all significant intercompany accounts and transactions.

*Statements of Cash Flows.* During 1988 the Company adopted Statement of Financial Accounting Standards (SFAS) No. 95, "Statement of Cash Flows." The accompanying consolidated financial statements present statements of cash flows for the years ended November 30, 1987 and 1986 in place of the previously reported Statements of Changes in Financial Position.

Cash equivalents consist of highly liquid money market instruments purchased with a maturity of three months or less and are carried at cost, which approximated market at November 30, 1988 and 1987.

*Short-term Investments.* Short-term investments are carried at cost, which approximated market at November 30, 1988 and 1987. Short-term investments at November 30, 1988 consisted principally of municipal bonds, commercial paper, bankers' acceptances, money market preferreds and treasury notes.

*Inventory.* Inventory is 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 is provided on the straight-line method over the estimated useful lives of the respective assets, generally three to eight years. Leasehold improvements are amortized using the straight-line method over the lesser of the lease term or the estimated useful lives of the related assets, generally five to nine years.

*Typeface Production Costs.* Typeface production costs, less \$1,963,000 and \$739,000 accumulated amortization in 1988 and 1987, respectively, comprise direct and indirect costs associated with the production of typefaces to be used with the PostScript® interpreter. Costs incurred prior to the November 1984 market introduction of the PostScript interpreter were expensed as incurred. Subsequent to the market introduction of the PostScript interpreter, Adobe capitalized the costs related to the production of several product lines of individual new typeface software programs that are marketed to PostScript software users. These costs are amortized on a straight-line basis over the expected product life cycle, generally three to five years, commencing with the market release of each new typeface software program.

*Revenue Recognition.* Royalties earned from original equipment manufacturers (OEM) relating to licensing agreements whereby the OEM licenses Adobe's proprietary software for redistribution to the OEM's end user customers are recognized when the OEM ships its products incorporating Adobe's software.



Product sales comprise revenue from licensing new typeface software, Adobe Illustrator, Adobe Illustrator 88, Collector's Edition, TranScript and PostScript language instruction manuals. Revenue from product sales is recognized upon shipment.

Contract revenue relates to Adobe's performance under contracts entered into with the Company's OEM licensees which normally stipulate that Adobe will provide the research and development required to adapt the Company's software products to the OEM's hardware products. Revenue on such contracts is recognized based on a modified percentage-of-completion method. The costs incurred in performing under the contracts are included in research, development and contract costs in the accompanying consolidated statements of income.

Deferred revenue comprises payments received in advance of revenue recognized on the aforementioned contracts and payments received representing royalty advances.

*Direct Costs.* Direct costs comprise royalty fees payable by Adobe, which are accrued concurrent with the Company's recognition of royalty revenue, amortization of typeface production costs, direct product costs and the costs of packaging and shipping.

*Income Taxes.* On December 1, 1987 the Company adopted SFAS No. 96, "Accounting for Income Taxes." Deferred tax liabilities or assets at the end of each period are determined using the tax rate expected to be in effect when taxes are actually paid or recovered. The cumulative effect of this change in method of accounting for income taxes

as of December 1, 1987 was immaterial. Prior years' financial statements have not been restated to apply the provisions of SFAS No. 96. The application of SFAS No. 96 for the year ended November 30, 1988 did not have a material effect on net income.

Investment tax credits and research and experimental tax credits are accounted for on the flow-through method.

*Net Income Per Share.* Net income per share is computed based upon the weighted average number of shares of Common Stock and Common Stock Equivalents outstanding during each year. The determination of Common Stock Equivalents assumes exercise of those outstanding stock options which have a dilutive effect on earnings per share. Fully diluted earnings per share for the years ended November 30, 1988, 1987 and 1986 were not materially different than primary earnings per share.

*Foreign Operations and Currency Translation.* The functional currency of the Company's foreign operations is the U.S. dollar. Accordingly, gains and losses arising from the translation of foreign currency statements and transactions are included in determining net income. Net gains or losses from currency translation were not significant.

*Reclassifications.* Certain amounts in the 1987 and 1986 consolidated financial statements have been reclassified to conform with the 1988 presentation.

<b>Note 2. Receivables</b>	A summary of receivables follows:		
		1988	1987
	Royalties	\$ 11,549,000	\$ 5,755,000
	Product sales	2,795,000	1,831,000
	Interest	312,000	69,000
	Other receivables	162,000	15,000
		<u>14,818,000</u>	<u>7,670,000</u>
	Less allowance for doubtful accounts	206,000	169,000
		<u>\$ 14,612,000</u>	<u>\$ 7,501,000</u>

<b>Note 3. Inventory</b>	A summary of inventory follows:		
		1988	1987
	Purchased components	\$ 933,000	\$ 424,000
	Finished goods	175,000	106,000
		<u>\$ 1,108,000</u>	<u>\$ 530,000</u>

<b>Note 4. Property and Equipment</b>	A summary of property and equipment follows:		
		1988	1987
	Computers and peripherals	\$ 6,866,000	\$ 2,955,000
	Production and development equipment	1,322,000	1,187,000
	Furniture and fixtures	3,363,000	1,486,000
	Leasehold improvements	603,000	60,000
		<u>12,154,000</u>	<u>5,688,000</u>
	Less accumulated depreciation and amortization	4,063,000	1,976,000
		<u>\$ 8,091,000</u>	<u>\$ 3,712,000</u>

**Note 5. Line of Credit** The Company has available a \$5,000,000 unsecured bank line of credit which expires on March 30, 1990. Interest on borrowings is at the bank's reference rate (prime rate).

<b>Note 6. Accrued Expenses</b>	A summary of accrued expenses follows:		
		1988	1987
	Rent	\$ 1,367,000	\$ 563,000
	Royalties	3,116,000	929,000
	Officers' and employees' bonuses and commissions	895,000	665,000
	Vacation and benefit plans	858,000	130,000
	Other	1,926,000	597,000
		<u>\$ 8,162,000</u>	<u>\$ 2,884,000</u>



**Note 7.** The components of income tax expense are as follows:  
**Income Taxes** Current:

	1988	1987	1986
U.S. Federal	\$ 11,312,000	\$ 6,370,000	\$ 2,680,000
Foreign	95,000	—	—
U.S. state and local	3,255,000	1,534,000	603,000
Total current	<u>14,662,000</u>	<u>7,904,000</u>	<u>3,283,000</u>
Deferred:			
U.S. Federal	(44,000)	(79,000)	256,000
U.S. state and local	52,000	85,000	95,000
Total deferred	<u>8,000</u>	<u>6,000</u>	<u>351,000</u>
	<u>\$ 14,670,000</u>	<u>\$ 7,910,000</u>	<u>\$ 3,634,000</u>

Total income tax expense differs from the expected tax expense ( computed by applying the U.S. Federal income statutory tax rates of 34% in 1988, 41% weighted average in 1987 and 46% in 1986 to income before income taxes ) as follows:

	1988	1987	1986
Tax at Federal statutory rate	\$ 12,155,000	\$ 6,926,000	\$ 3,322,000
State income taxes, net of Federal benefit	2,183,000	955,000	377,000
Other	332,000	29,000	(65,000)
	<u>\$ 14,670,000</u>	<u>\$ 7,910,000</u>	<u>\$ 3,634,000</u>

In 1988, deferred income tax represents the effect of changes in the amounts of temporary differences from December 1, 1987 to November 30, 1988. For 1987 and 1986, deferred income tax resulted from timing differences in the recognition of income and expense for tax and financial reporting purposes. The sources and tax effects of the temporary differences for 1988 and timing differences for 1987 and 1986 are presented below:

	1988	1987	1986
Typeface production costs	\$ 298,000	\$ 642,000	\$ 550,000
Excess tax depreciation	25,000	(20,000)	(169,000)
State income tax deduction	(520,000)	(421,000)	(316,000)
Accruals, allowances and reserves	238,000	(226,000)	—
Investment and research tax credits	—	—	281,000
Tax net operating loss carryforward	—	—	41,000
Other	(33,000)	31,000	(36,000)
	<u>\$ 8,000</u>	<u>\$ 6,000</u>	<u>\$ 351,000</u>

**Note 8. Convertible Preferred Stock** The Company has authorized 2,000,000 shares of Preferred Stock. In August 1986 the outstanding 190,356 shares, 722,648 shares and 480,440 shares of Series A, B and C Preferred Stock, respectively, were converted into Common Stock.

**Note 9. Common Stock** The Company has authorized 50,000,000 shares of Common Stock. The Company effected two-for-one stock splits on November 15, 1988, February 27, 1987 and July 3, 1986. All references to common shares and per share amounts in the accompanying consolidated financial statements have been retroactively adjusted to reflect these stock splits.

The Company adopted an Employee Stock Purchase Plan on January 1, 1988. Under the terms of the plan, eligible employee participants purchase shares of Common Stock semiannually at the lower of 85% of the market price on either the purchase date or the offering date. During 1988, 18,030 shares were issued under the plan at an average price of \$12.65 per share.

At November 30, 1988 the Company had reserved 4,000,000 shares (200,000 of which are subject to shareholder approval) of Common Stock for issuance under its 1984 Stock Option Plan. This plan, which was amended in 1987 to exclude non-

employee directors, 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 granted prior to January 1, 1988 generally vest over three years: 25% of the granted options at the end of each of the first two years and 50% at the end of the third year. Options granted to employees hired subsequent to December 31, 1987 generally vest over three years: 25% at the end of the first year, 25% pro rata during the second year and 50% pro rata during the third year. Options granted to existing employees subsequent to December 31, 1987 also vest over three years: 25% pro rata during each of the first two years and 50% pro rata during the third year. On June 16, 1986 the Company accelerated to that date the exercisability of 996,640 outstanding options. Unvested shares remain subject to certain Company repurchase rights. All options have a five or ten year term.

The following table summarizes option activity under this plan:

	Shares Available for Grant	Options Outstanding	
		Shares	Average Price per Share
Balances at November 30, 1986	1,404,560	467,800	\$ .08-5.72
Increase in shares reserved	1,000,000	—	—
Options granted	(1,790,048)	1,790,048	5.88-24.38
Options exercised	—	(86,550)	.08-5.72
Options canceled	366,600	(366,600)	.08-24.38
Balances at November 30, 1987	981,112	1,804,698	\$ .08-11.25
Increase in shares reserved	200,000	—	—
Options granted	(1,069,000)	1,069,000	12.13-22.38
Options exercised	—	(252,832)	.08-17.00
Options canceled	75,250	(75,250)	.08-18.81
Balances at November 30, 1988	187,362	2,545,616	\$ .08-22.38
(458,293 shares exercisable)			



During 1987 the Company adopted the Restricted Stock Option Plan which provides for the granting of nonqualified stock options to nonemployee directors and outside consultants. Option grants are limited to 5,000 shares per person in each fiscal year and are immediately exercisable within a ten year term. The restricted options vest over three years; 25% of the granted options at the end of the first two years and 50% at the end of the third year. At November 30, 1988 10,000 options were outstanding under this plan, of which 2,500 are exercisable.

**Note 10. Major Customers** One customer accounted for 33%, 49% and 84% of Adobe's total revenue for 1988, 1987 and 1986, respectively. Receivables from this customer aggregated approximately \$5,308,000 at November 30, 1988. At November 30, 1988 this customer was also a major shareholder, owning approximately 17% of the Company's common shares. A second customer accounted for 10% of the Company's total revenue in 1988, with receivables from this customer aggregating \$1,115,000 at November 30, 1988.

**Note 11. Supplementary Income Statement Information** The following items are included in costs and expenses in the accompanying consolidated statements of income:

	1988	1987	1986
Maintenance and repairs	\$ 459,000	\$ 297,000	\$ 165,000
Depreciation	2,087,000	1,051,000	536,000
Amortization of typeface production costs	1,224,000	570,000	169,000
Royalties	9,634,000	3,484,000	1,272,000
Advertising	2,046,000	1,647,000	580,000

**Note 12. Commitments** The Company has operating leases for the corporate headquarters, field sales offices and certain office equipment that expire at various dates through 1996. Rental expense for these operating leases was \$2,123,000, \$1,064,000 and \$590,000 during the years ended November 30, 1988, 1987 and 1986, respectively.

At November 30, 1988 future minimum lease payments under noncancelable operating leases were:

1989	\$ 3,121,000
1990	4,396,000
1991	4,527,000
1992	4,404,000
1993	4,295,000
1994 and thereafter	11,689,000
Total minimum lease payments	<u>\$ 32,432,000</u>

During 1988 the Company entered into capital lease agreements for computer software, furniture and equipment aggregating \$1,514,000. At November 30, 1988 future minimum lease payments under these agreements aggregated \$1,193,000 and are payable over a four-year period.

**To the Board  
of Directors  
and Shareholders  
Adobe Systems  
Incorporated**

We have audited the accompanying consolidated balance sheets of Adobe Systems Incorporated and subsidiary as of November 30, 1988 and 1987, and the related consolidated statements of income, shareholders' equity and cash flows for each of the years in the three-year period ended November 30, 1988. 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 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, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Adobe Systems Incorporated and subsidiary, at November 30, 1988 and 1987, and the results of their operations and their cash flows for each of the years in the three-year period ended November 30, 1988, in conformity with generally accepted accounting principles.

PEAT MARWICK MAIN & CO.

San Jose, California  
December 30, 1988



QUARTERLY RESULTS OF OPERATIONS  
(UNAUDITED)

<i>(In thousands, except per share data)</i>		1988, Quarter Ended				Year Ended
		Feb 29	May 31	Aug 31	Nov 30	Nov 30
<b>1988</b>	Revenue	\$ 14,229	\$ 18,757	\$ 25,232	\$ 25,265	\$ 83,483
	Income before income taxes	5,962	7,640	10,876	11,272	35,750
	Net income	3,575	4,474	6,372	6,659	21,080
	Net income per share	\$ .17	\$ .21	\$ .29	\$ .31	\$ .98
	Shares used in per share calculation	21,268	21,428	21,606	21,741	21,496
	Common Stock price per share:					
	High	15 <sup>3</sup> / <sub>4</sub>	18 <sup>1</sup> / <sub>2</sub>	20 <sup>1</sup> / <sub>8</sub>	24 <sup>3</sup> / <sub>4</sub>	24 <sup>3</sup> / <sub>4</sub>
	Low	11 <sup>1</sup> / <sub>2</sub>	14 <sup>1</sup> / <sub>2</sub>	17 <sup>3</sup> / <sub>8</sub>	18 <sup>3</sup> / <sub>8</sub>	11 <sup>1</sup> / <sub>2</sub>
		1987, Quarter Ended				Year Ended
		Feb 28	May 31	Aug 31	Nov 30	Nov 30
<b>1987</b>	Revenue	\$ 6,901	\$ 9,563	\$ 10,552	\$ 12,308	\$ 39,324
	Income before income taxes	2,994	4,318	4,628	4,952	16,892
	Net income	1,584	2,313	2,370	2,715	8,982
	Net income per share	\$ .08	\$ .11	\$ .11	\$ .13	\$ .43
	Shares used in per share calculation	20,652	21,088	21,054	21,176	21,034
	Common Stock price per share:					
	High	11 <sup>1</sup> / <sub>2</sub>	27	23 <sup>3</sup> / <sub>4</sub>	22 <sup>1</sup> / <sub>2</sub>	27
	Low	5 <sup>7</sup> / <sub>8</sub>	11 <sup>3</sup> / <sub>8</sub>	15 <sup>1</sup> / <sub>8</sub>	7 <sup>3</sup> / <sub>8</sub>	5 <sup>7</sup> / <sub>8</sub>
		1986, Quarter Ended				Year Ended
		Feb 28	May 31	Aug 31	Nov 30	Nov 30
<b>1986</b>	Revenue	\$ 2,392	\$ 3,498	\$ 4,932	\$ 5,233	\$ 16,055
	Income before income taxes	1,109	1,751	2,358	2,002	7,220
	Net income	550	868	1,168	1,000	3,586
	Net income per share	\$ .03	\$ .05	\$ .06	\$ .05	\$ .19
	Shares used in per share calculation	18,128	18,048	18,580	20,648	18,912
	Common Stock price per share:					
	High	—	—	3 <sup>7</sup> / <sub>8</sub>	6 <sup>1</sup> / <sub>4</sub>	6 <sup>1</sup> / <sub>4</sub>
	Low	—	—	2 <sup>7</sup> / <sub>8</sub>	3 <sup>3</sup> / <sub>8</sub>	2 <sup>7</sup> / <sub>8</sub>

The Company paid its initial cash dividend of \$.04 per share on its Common Stock at the end of its second fiscal quarter of 1988 and has paid a \$.04 per share quarterly dividend since then. The Company's stock has been traded on the NASDAQ National Market System since February 3, 1987. Prior to that the stock was traded on the NASDAQ bid and ask market since its initial public offering in August 1986. On January 31, 1989 there were 795 holders of record of the Company's Common Stock. All share and per share amounts have been retroactively adjusted to reflect two-for-one stock splits effective November 15, 1988, February 27, 1987 and July 3, 1986.

**Board of Directors**

Q.T. WILES  
Chairman of the Board  
Adobe Systems Incorporated  
Silicon General, Inc.

Chairman of the Board  
and Chief Executive Officer  
MiniScribe Corporation

Vice-Chairman of the Board  
Hambrecht & Quist Group

JOHN E. WARNOCK  
Director  
President and Chief Executive Officer  
Adobe Systems Incorporated

CHARLES M. GESCHKE  
Director  
Executive Vice President  
and Chief Operating Officer  
Adobe Systems Incorporated

DAVID EVANS  
Director  
Adobe Systems Incorporated  
Alps Systems  
VLSI Technology, Inc.  
Hambrecht & Quist Group

Chairman of the Board, President  
and Chief Executive Officer  
Evans & Sutherland Computer Corporation

WILLIAM R. HAMBRECHT  
Director  
Adobe Systems Incorporated  
ADAC Laboratories, Inc.  
Auto-Trol Technology Corporation  
Concurrent Computer Corporation  
Chalone Incorporated  
Executone Information Systems, Inc.  
MiniScribe Corporation  
Rexon Incorporated  
Silicon General, Inc.  
Visual Technology, Inc.

President and Director  
Hambrecht & Quist Incorporated

**Executive Officers**

JOHN E. WARNOCK  
President and Chief Executive Officer

CHARLES M. GESCHKE  
Executive Vice President  
and Chief Operating Officer

STEPHEN A. MACDONALD  
Vice President Marketing and Sales

M. BRUCE NAKAO  
Vice President Finance,  
Chief Financial Officer,  
Treasurer and Assistant Secretary

R. DANIEL PUTMAN  
Vice President Engineering

DIANE W. SAVAGE  
General Counsel and Secretary

**Legal Counsel**

Ware & Freidenrich,  
A Professional Corporation  
Palo Alto, California

**Transfer Agent/  
Registrar**

Manufacturers Hanover Trust Company  
San Francisco, California

**Common Stock**

NASDAQ National Market System  
Ticker Symbol ADBE

**Independent  
Accountants**

Peat Marwick Main & Co.  
San Jose, California

**Form 10-K**

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

**Annual Meeting**

The Company's Annual Meeting of Shareholders will be held at 1:00 p.m. on Thursday, March 30, 1989 at the Stanford Park Hotel, in Menlo Park, California.



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