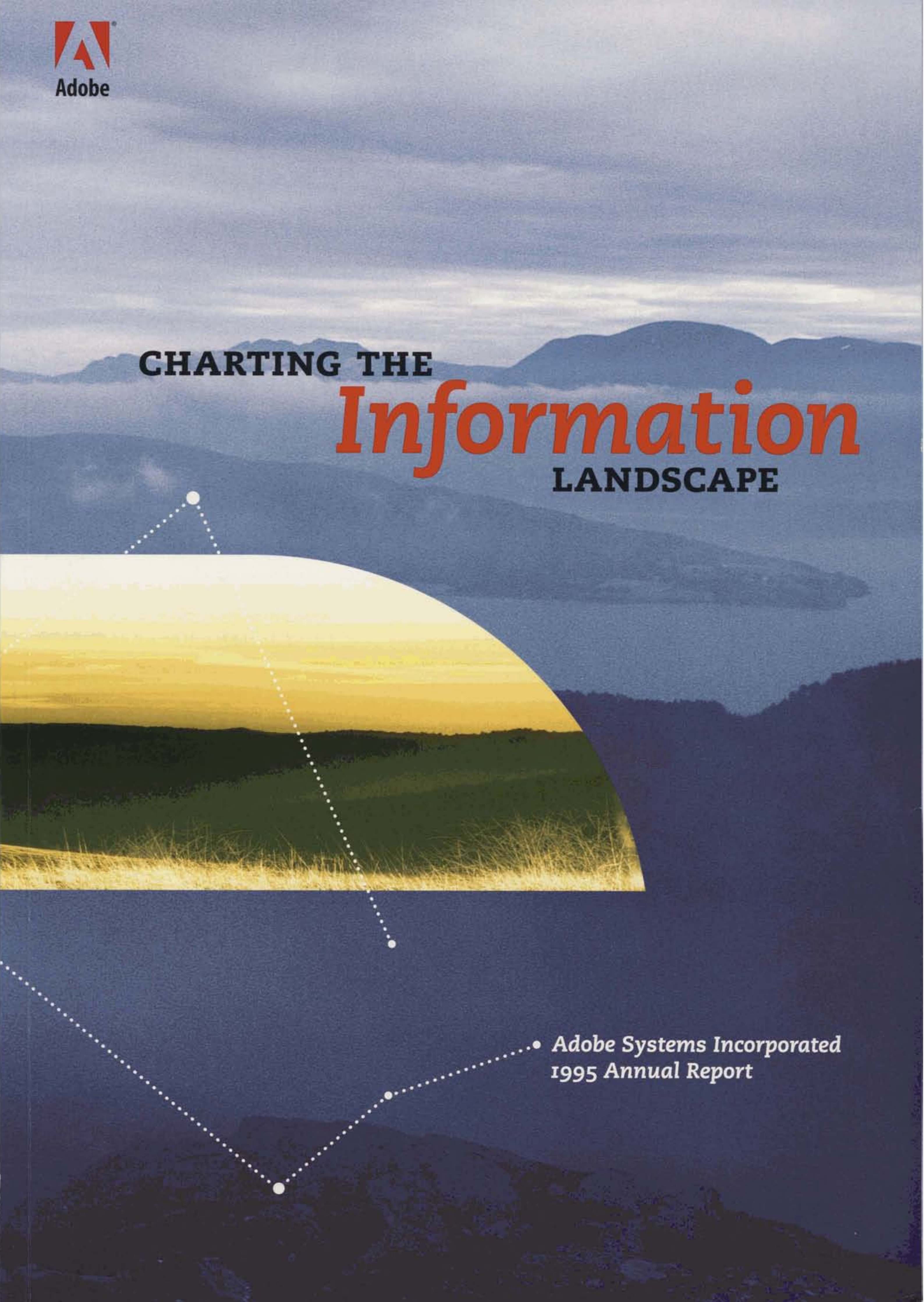
Adobe

CHARTING THE *Information* LANDSCAPE



Adobe Systems Incorporated
1995 Annual Report

Based in Mountain View, California, Adobe Systems Incorporated is the world's third largest personal computer software company. We develop and support products to help people express and use information in more imaginative and meaningful ways, across all print and electronic media. Founded in 1982, Adobe helped launch the desktop publishing revolution. Today, we offer a market-leading line of application software and type products for creating and distributing visually rich communications materials; license our industry-standard technologies to major hardware manufacturers, software developers, and service providers; and offer integrated software solutions to businesses of all sizes.

FINANCIAL ***Highlights***

	Fiscal Year				
(In thousands, except per share amounts)	1995	1994	1993	1992	1991
Operating data:					
Total revenue	\$762,339	\$675,617	\$580,103	\$520,031	\$452,144
Net income	93,485	15,337	42,007	57,664	78,725
Net income per share	1.26	0.22	0.62	0.84	1.17
Dividends declared per common share	0.20	0.20	0.20	0.16	0.16
Balance sheet data:					
Cash and short-term investments	516,040	444,768	344,714	275,522	234,063
Total assets	884,732	710,000	597,696	525,849	437,803
Shareholders' equity	698,417	514,315	457,216	418,771	358,755

REVENUE
(in thousands)

NET INCOME
(in thousands)

NET INCOME PER SHARE

See Note 2 of Consolidated Financial Statements regarding mergers with Aldus Corporation and Frame Technology Corporation.

In fiscal 1995, we at Adobe experienced our most challenging year ever. On a normalized basis, we achieved revenue growth of 22 percent and net income growth of 79 percent, while integrating Aldus Corporation, acquired in August 1994, and preparing to integrate Frame Technology Corporation, acquired in October 1995. We combined Adobe and Aldus operations quickly, and in a way that was nondilutive to shareholders. The Frame acquisition proved to be more complex than anticipated and affected our fourth quarter results. However, the integration is now well underway, and we expect to realize cost savings from this activity over the first two quarters of fiscal 1996.

TO OUR *Shareholders*

This report summarizes the activities and financial results of the joined Adobe and Frame organization. On a combined basis, revenue reached $762.3 million in 1995, a 13 percent increase over 1994 revenue of $675.6 million. On a normalized basis, excluding divested or discontinued businesses, revenue increased 22 percent from 1994 revenue of $622.4 million.

Reported net income for 1995 totaled $93.5 million, compared with $15.3 million in 1994, while earnings per share were $1.26, compared with $0.22 in 1994. On a normalized basis, excluding nonrecurring expenses and divested or discontinued businesses, net income increased from $75.9 million to $135.6 million, a gain of 79 percent, and earnings per share rose from $1.07 to $1.80, a gain of 68 percent. The fourth quarter included a restructuring charge of $31.5 million associated with the Frame acquisition, and a write-off of $15.0 million for in-process research and development related to the purchase of Ceneca Communications, Inc. These charges affected both the fourth quarter and fiscal year results.

During 1995, the company declared cash dividends on its common stock totaling $0.20 per share. Our financial position remains strong, with cash, cash equivalents, and short-term investment balances of $516.0 million.

Overall application products revenue, which includes graphics, type, Adobe Acrobat, and Frame product sales, grew 12 percent to $578.9 million, compared with $519.0 million in 1994. Factoring out Aldus FreeHand and Aldus PhotoStyler results for 1994, application products revenue increased from $465.8 million, generating a gain of 24 percent in 1995.

This year, key application releases included Adobe PageMaker 6.0 page-layout software—the first major release of the combined Adobe and Aldus team—as well as Adobe After Effects 3.0 software for video post-production and special effects, and newly acquired Adobe FrameMaker 5.0 software for long-document creation. We also announced Adobe Illustrator 6.0 for Macintosh, the most advanced version yet of this top-selling illustration program. During 1996, we expect to continue our flow of product releases worldwide, including versions optimized for the Windows 95 operating system.

The investment that Adobe has made in developing Acrobat technology over the past three years is starting to provide returns. Sales of the Acrobat retail products increased significantly in 1995. We released Acrobat 2.1 software, which supports multimedia and World Wide Web publishing—and contributes to the proliferation of Portable Document Format (PDF) content on the Internet. In addition, many of Adobe's graphics applications now support Acrobat technology, which instantly makes these authoring tools suitable for both electronic and print-based publishing. Particularly useful in corporate and government environments, new Acrobat Capture software works with scanners to convert printed "legacy" documents to electronic PDF files. New Acrobat Player technology, licensed by third parties, is designed for embedding into projection devices and other computer-based equipment to read and process PDF files directly. We also have announced an enhanced version of Acrobat technology that will enable companies such as AT&T, Microsoft, Netscape, and Oracle to incorporate it into their software and services for Internet users. Meanwhile, thanks to third-party bundling agreements and free Internet availability, six to ten million people are now using the Acrobat Reader viewing tool.

Revenue from the licensing of PostScript printing technology, at $183.4 million, rose 17 percent over the $156.7 million posted in 1994. Fueling this growth is the increased corporate demand for printers that provide cross-platform operation, network support, and color capabilities—three areas in which PostScript software excels. Substantial royalties from the Japanese market also contributed to these positive results. Looking forward, we are poised to meet the emerging need for everyone with a computer to have a fast, high-quality printer on their desktop, so that they can accurately reproduce the information they find on the Internet, compact discs, corporate servers, and other electronic media. To save costs, corporations can store large documents electronically and print them wherever and whenever needed. This "distribute and print" model is

quickly becoming a reality, and will build demand for the color and multifunction capabilities so well suited to the PostScript language standard. Our first non-PostScript printing technology, stemming from our 1994 acquisition of LaserTools Corporation, the new Adobe PrintGear architecture dramatically improves the quality and performance of low-cost, black-and-white laser printers. The first products containing PrintGear software are scheduled to enter the market in spring 1996.

Collectively, Adobe retains a decisiveness and an agility that belie our 13 years—and our position as the world's third largest personal computer software company. For example, in October, we not only acquired Frame, but also a much smaller company, Ceneca Communications, which had developed several products that complement our current authoring tools. Recognizing a rare opportunity, we moved from negotiations to having an Adobe-branded product on store shelves in less than two months. New Adobe PageMill software makes creating home pages on the World Wide Web as easy as producing a word-processed document. Adobe SiteMill software, shipping in early 1996, dramatically simplifies management of Web sites.

This year's acquisition activity also provided an opportunity to reassess our organizational structure. Adobe's business is now aligned primarily by functions, rather than by product lines. Most notably, as our product family broadens, becomes fully integrated, and gains prevalence in corporate settings, we have adopted a solution sales approach. Our goal is to help customers combine Adobe software with the tools they already have for maximum productivity, creativity, and quality in all of their communications, across all media.

Adobe's first decade centered around software to simplify the authoring and printing of visually rich documents. In Adobe's second decade, our vision has expanded to include the distribution and access of that information. We now offer the broadest, most integrated set of tools for print-based and electronic communications, built on a technological foundation that will continue to shape the new information landscape. In this most eventful of years, we are particularly proud of what we have accomplished here at Adobe—and of the people who have made it happen. Everyone contributed above regular commitments and beyond expectations. Because of their passion, talent, and commitment, we can't wait to see what's over the horizon.

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

Charles M. Geschke
President

Lettre à nos actionnaires

En 1995, Adobe a vécu l'année la plus stimulante et la plus remarquable de son existence. Nous avons en effet atteint un croissance de 22 pour cent pour le chiffre d'affaires normalisé, et de 79 pour cent pour le bénéfice net, tout en procédant à l'intégration d'Aldus Corporation, achetée en août 1994, et en préparant celle de Frame Technology Corporation, achetée en octobre dernier. Non seulement la fusion Adobe/Aldus a été plus rapide que prévue, mais elle a aussi été effectuée de manière transparente pour les actionnaires. L'intégration de Frame s'est avérée plus complexe que prévue et cela s'est répercuté sur les résultats du quatrième trimestre. Mais elle est aujourd'hui en bonne voie et nous espérons que cette activité nous permettra de faire des économies au cours du premier semestre 1996. Le présent rapport résume les activités et les résultats financiers de la société Adobe, opérations Frame incluses. Le chiffre d'affaires global a atteint 762 300 000 dollars en 1995, soit une augmentation de 13 pour cent par rapport à 1994 (675 600 000 dollars). Si l'on compare les chiffres d'affaires normalisés de 1995 et 1994 en excluant les rentrées liées à des produits rétrocédés ou arrêtés, on constate une augmentation de 22 pour cent par rapport aux 622 400 000 dollars de 1994.

Le bénéfice net réalisé en 1995 se monte à 93 500 000 dollars (15 300 000 dollars en 1994), tandis que le bénéfice par action représente 1,26 dollars (0,22 dollar en 1994). Déduction faite des dépenses non-récurrentes et du chiffre d'affaires issu des produits rétrocédés ou arrêtés, le bénéfice net est passé de 75 900 000 dollars l'année dernière à 135 600 000 dollars, soit une augmentation de 79 pour cent. Quant au bénéfice par action, il est passé de 1,07 à 1,80 dollars et a donc augmenté de 68 pour cent. Les résultats du quatrième trimestre tiennent compte des 31 500 000 dollars de frais de restructuration qu'a entraînés l'acquisition de Frame, ainsi que d'une déduction de 15 000 000 dollars pour les Recherches et Développements en cours acquis lors du rachat de Ceneca Communications, Inc. Toutes ces dépenses se sont répercutées sur les résultats du quatrième trimestre et ceux de l'exercice 1995.

Au cours de l'année 1995, la société a procédé à un paiement de dividende de 0,20 dollar par action ordinaire. Notre situation financière demeure très saine : les disponibilités et investissements à court terme se soldent par un bilan positif d'environ 516 000 000 dollars.

Le chiffre d'affaires provenant des logiciels (produits graphiques, polices de caractères, Adobe Acrobat, prépresse et produits Frame) représente 578 900 000 dollars, soit une croissance de 12 pour cent par rapport aux 519 000 000 dollars de 1994. Si l'on exclut des résultats 1994 les sommes générées par FreeHand et PhotoStyler, la croissance par rapport à 1994 est de 24 pour cent sur un chiffre d'affaires de 465 800 000 dollars.

Cette année, les lancements les plus importants ont concerné Adobe PageMaker 6.0, première version du logiciel de mise en page développée par une équipe Adobe/Aldus, Adobe After Effects 3.0 pour la post-production et les effets spéciaux, ainsi qu'Adobe FrameMaker 5.0, nouveau venu destiné à la création de gros documents. Nous avons également annoncé l'arrivée prochaine d'Adobe Illustrator 6.0 pour Macintosh, la version la plus sophistiquée de ce best-seller des logiciels de dessin. En 1996, nous continuerons à lancer sur les marchés du monde entier de nouvelles versions majeures, y compris des versions optimisées pour Windows 95.

Nous commençons à récolter les fruits des sommes investies ces trois dernières années dans le développement de la technologie Acrobat. En 1995, les ventes de produits Acrobat ont considérablement augmenté. Nous avons lancé Acrobat 2.1 pour la publication World Wide Web et le multimédia et ce logiciel contribue largement à la diffusion du format PDF (Portable Document Format) sur Internet. Ajoutons qu'aujourd'hui de nombreuses applications graphiques Adobe supportent la technologie Acrobat, ce qui permet de faire appel à ces produits aussi bien pour la publication électronique que pour la publication papier. Le nouveau logiciel Adobe Capture fonctionne avec les scanners pour convertir des documents «juridiques» imprimés en fichiers électroniques PDF. Il est de ce fait tout particulièrement utile aux grosses entreprises et administrations. La nouvelle technologie Acrobat Player, sous licence de sociétés tierces, permet de lire et traiter directement des fichiers PDF sur matériel de projection ou autres équipements informatiques. Nous avons également annoncé une version améliorée de la technologie Acrobat qui pourra être intégrée dans les logiciels et services d'entreprises telles qu'AT&T, Microsoft, Netscape et Oracle, pour les utilisateurs Internet. Dans le même temps, grâce à des accords de partenariat et une diffusion gratuite sur réseau Internet, six à dix millions de personnes peuvent désormais utiliser le programme de visualisation Acrobat Reader.

Le chiffre d'affaires généré par les licences de la technologie d'impression PostScript s'élève à 183 400 000 dollars, soit une augmentation de 17 pour cent par rapport aux 156 700 000 dollars de 1994. Cette croissance s'explique par une demande plus importante pour des imprimantes fonctionnant sur multiples plates-formes, en réseau et assurant l'impression couleur : trois domaines dans lesquels excelle le langage PostScript. Les nombreuses devises provenant du marché japonais ont largement contribué à ces résultats. Si l'on se tourne vers l'avenir, on constate que chaque utilisateur de système informatique devra bientôt disposer sur son bureau d'une imprimante rapide et de haute qualité pour reproduire fidèlement les documents obtenus sur Internet, CD, serveurs d'entreprises ou autres supports électroniques. Afin de réduire leurs frais, les entreprises peuvent stocker électroniquement leurs gros documents et les imprimer quand et où cela leur est nécessaire. Ce procédé «diffusion puis impression» se répand rapidement et générera une demande accrue en imprimantes couleur et multifonctions si bien adaptées au langage PostScript. Quant à la qualité de l'impression laser noir et blanc pour petits budgets, elle s'est considérablement améliorée depuis l'apparition d'Adobe PrintGear, notre première technologie d'impression non PostScript, dont les origines remontent à l'acquisition de LaserTools en 1994. Les premiers produits contenant le logiciel PrintGear seront mis en vente au printemps 1996.

Dans son ensemble, Adobe fait preuve d'un esprit de décision et d'une souplesse rares pour une société de treize ans et qui se place en tant que troisième éditeur informatique mondial. Pour ne citer qu'un exemple, en octobre, nous avons racheté Frame ainsi que Ceneca Communications, une société beaucoup plus petite, certes, mais qui a su développer toute une gamme de produits complémentaires à nos actuels outils de création. Décelant une véritable opportunité, nous sommes parvenus à conclure les négociations et livrer les premiers produits Adobe en moins de deux mois. Avec Adobe PageMill, la création de pages World Wide Web devient aussi simple que le traitement de texte. La gestion des sites Web avec Adobe SiteMill, qui sera lancé début 1996, sera elle aussi d'une remarquable simplicité.

Les acquisitions de cette année ont également permis de revoir notre structure. Adobe est aujourd'hui organisée principalement par fonctions plutôt que par lignes de produits. Et surtout, nous avons adopté une approche commerciale différente basée sur la vente de solutions. En effet, la gamme de produits s'élargit, ces produits sont intégrés et ils sont de plus en plus utilisés dans des configurations d'entreprises. Tous ces changements ont pour but d'aider nos clients à associer les logiciels Adobe aux outils dont ils disposent afin d'optimiser leur productivité, leur créativité et la qualité des documents qu'ils utilisent, quel que soit le support utilisé pour leur communication.

Pendant 10 ans, Adobe s'est concentrée sur le développement de logiciels simplifiant la création et l'impression des documents haute qualité. A l'aube de sa deuxième décennie, Adobe élargit son horizon et se penche sur les moyens de diffusion et d'accès à ces documents. Aujourd'hui, nous offrons la gamme de produits la plus complète et la mieux intégrée pour la communication papier ou électronique. Cette gamme est construite sur des bases technologiques capables de faire évoluer le monde de l'information. Chez Adobe, nous sommes particulièrement fiers de cette année 1995, une année riche en événements s'il en est, et fiers aussi des personnes qui ont oeuvré pour ce succès. Tous se sont surpassés au-delà de nos espérances. Etant donné la passion, le talent et le sérieux dont ils ont fait preuve, nous sommes impatients d'aller voir ce qui se passe de l'autre côté de l'horizon.

An unsere Aktionäre

Im Steuerjahr 1995 blicken wir bei Adobe auf ein Jahr, das uns vor die bisher größten Herausforderungen gestellt hat. Von Sonderfaktoren bereinigt, haben wir einen Umsatzzuwachs von 22% und einen Anstieg des Reingewinns von 79% erzielt, während wir die im August 1994 erworbene Aldus Corporation integriert und gleichzeitig die Integration der im Oktober 1995 erworbenen Frame Technology Corporation vorbereitet haben. Wir haben die Adobe und Aldus Unternehmen sehr schnell so zusammengeführt, daß keine Nachteile für die Aktionäre entstanden sind. Der Erwerb des Frame Unternehmens hat sich als komplexer herausgestellt als erhofft, was sich auf die Ergebnisse des vierten Quartals ausgewirkt hat. Die Integration von Frame ist jedoch in vollem Gange, und wir erwarten, Kosteneinsparungen aus dieser Aktivität innerhalb der ersten beiden Quartale des Steuerjahres 1996 zu realisieren.

Dieser Bericht faßt die Aktivitäten und finanziellen Ergebnisse des zusammengeführten Unternehmens Adobe und Frame zusammen. Auf dieser kombinierten Grundlage wurde in 1995 ein Umsatz von $762,3 Millionen erzielt, was einem Anstieg von 13% gegenüber dem Umsatz von $675,6 Millionen in 1994 entspricht. Von Sonderfaktoren bereinigt, ohne einmalige Posten und abgegebene oder eingestellte Geschäftsbereiche, stieg der Umsatz gegenüber $622,4 Millionen in 1994 um 22%.

Der Reingewinn beläuft sich in 1995 auf $93,5 Millionen, im Vergleich zu $15,3 Millionen in 1994, wobei der Gewinn pro Aktie $1,26 beträgt, im Vergleich zu $0,22 in 1994. Von Sonderfaktoren bereinigt, ohne einmalige Posten und abgegebene oder eingestellte Geschäftsbereiche, ist der Reingewinn von $75,9 Millionen auf $135,6 Millionen gestiegen, was einem Zuwachs von 79% entspricht, während der Gewinn pro Aktie von $1,07 auf $1,80 gestiegen ist, was einem Zuwachs von 68% entspricht. In Verbindung mit der Übernahme von Frame sind Umstrukturierungskosten in Höhe von $31,5 Millionen innerhalb des vierten Quartals entstanden sowie Abschreibungen von $15,0 Millionen für laufende Forschung und Entwicklung in Zusammenhang mit dem Erwerb von Ceneca Communications, Inc. Diese Kosten haben sowohl das Ergebnis für das vierte Quartal als auch des gesamten Steuerjahres beeinflußt.

1995 verkündete das Unternehmen Bardividenden auf seine Stammaktien von insgesamt $0,20 pro Aktie. Unsere Finanzposition ist gefestigt, mit Bilanzen über Bargeld, Gegenwerte und kurzfristige Anlagen von nahezu $516 Millionen.

Die Gesamtumsätze im Bereich der Softwareprodukte, die die Verkäufe aus Grafik- und Schriftenprodukten sowie Adobe Acrobat und Frame Produkte einschließen, stiegen um 12% auf $578,9 Millionen, im Vergleich zu $519,0 Millionen in 1994. Werden die Ergebnisse von FreeHand und PhotoStyler für 1994 ausgenommen, stieg der Ertrag für Softwareprodukte auf $465,8 Millionen, was einem Anstieg von 24% in 1995 entspricht.

In diesem Jahr zählten das Seitenlayoutprogramm Adobe PageMaker 6.0 – das erste große Release des kombinierten Adobe- und Aldus-Teams – sowie Adobe After Effects 3.0 für die Videobearbeitung und Spezialeffekte sowie der von Adobe neu erworbene Adobe FrameMaker 5.0 zum Erstellen von umfangreichen Dokumenten zu den wichtigsten Upgrades einiger unserer bedeutendsten Programme. Darüber hinaus kündigten wir Adobe Illustrator 6.0 für Macintosh an, die bis jetzt ausgereifteste Version dieses gefragten Illustrationsprogramms. Auch für 1996 planen wir, weltweit weitere, neue Produktversionen herauszubringen, einschließlich für das Betriebssystem Windows 95 optimierter.

Adobes Investitionen in die Entwicklung der Acrobat Technologie in den letzten drei Jahren beginnen sich auszuzahlen, denn die Verkaufszahlen der Acrobat Einzelhandelsversionen sind 1995 kräftig gestiegen. Wir brachten Acrobat 2.1 heraus, das Multimedia und das Publizieren im World Wide Web unterstützt, und den Anstieg des Portable Document Format (PDF) im Internet fördert. Darüber hinaus unterstützen viele Adobe Grafikprodukte jetzt die Acrobat-Technologie, wodurch dieses führende Werkzeug sowohl für die Verbreitung von elektronischen als auch gedruckten Dokumenten geeignet ist. Da das neue Acrobat Capture Programm mit Scannern arbeitet, um gedruckte, „antiquarische“ Dokumente in elektronische PDF-Dateien umzuwandeln, eignet es sich besonders für Firmen und

Behörden. Die neue Technologie Acrobat Player, die von Drittherstellern lizenziert wird, kann in Präsentations- und anderen, auf Computern basierenden Geräten integriert werden, damit PDF-Dokumente direkt gelesen und bearbeitet werden können. Weiterhin haben wir auch eine verbesserte Version der Acrobat Technologie herausgebracht, die Unternehmen wie AT&T, Microsoft, Netscape und Oracle in ihre Programme und Dienste für Internet-Anwender integrieren können. Inzwischen nutzen dank der Vereinbarungen mit Drittanbietern und dem freien Internet Zugang sechs bis zehn Millionen Anwender den Acrobat Reader.

Der Umsatz aus den Lizenzen der PostScript-Drucktechnologie beträt $183,4 Millionen, was einem 17%igen Anstieg gegenüber $156,7 Millionen in 1994 entspricht. Dieser Zuwachs ist auf den wachsenden Bedarf von Firmen nach Druckern, die systemübergreifend arbeiten, sowie Netzwerkunterstützung und Möglichkeiten der Farbwiedergabe bieten – drei Eigenschaften, durch die sich die PostScript-Software auszeichnet, zurückzuführen. Ebenso trugen beträchtliche Tantiemen des japanischen Markts zu diesem positiven Ergebnis bei. Wenn wir in die Zukunft blicken, sind wir zuversichtlich, daß wir die große Nachfrage decken und allen Computeranwendern einen schnellen, qualitativ hochwertigen Drucker auf ihren Schreibtisch stellen können, damit sie die Informationen aus dem Internet, von CDs, firmeninternen Servern und anderen elektronischen Medien genau reproduzieren können. Um Kosten zu sparen, können Firmen umfangreiche Dokumente elektronisch speichern und sie immer und überall ausdrucken. Dieses „Verteilen und Drucken“ Modell, das mehr und mehr Realität wird, steigert die Nachfrage nach Möglichkeiten der Farbwiedergabe und Multifunktionalität, die die PostScript-Seitenbeschreibungsprache, der Industriestandard, bereits bietet. Die Adobe PrintGear Architektur, unsere erste nicht-PostScript-fähige Drucktechnologie, die aus dem Erwerb von LaserTools in 1994 hervorging, hat die Qualität und Geschwindigkeit von preiswerten Schwarzweißdruckern erheblich verbessert. Die ersten Produkte mit PrintGear werden voraussichtlich im Frühjahr 1996 auf den Markt kommen.

Gemeinsam legen wir bei Adobe eine Entscheidungsfreude und Beweglichkeit an den Tag, die für ein Unternehmen mit 13jähriger Tradition und weltweit drittgrößter Anbieter für Computerprogramme nicht unbedingt selbstverständlich ist. So haben wir z. B. im Oktober nicht nur Frame sondern auch das kleinere Unternehmen Ceneca Communications gekauft, das einige Produkte hervorgebracht hat, die unsere führenden Werkzeuge ergänzen. Da wir diese seltene Gelegenheit erkannten, vergingen von den Verhandlungen bis zur Fertigstellung eines neuen Adobe Markenprodukts nicht einmal zwei Monate. Mit dem neuen Adobe PageMill ist das Erzeugen von Home Pages im World Wide Web so einfach wie das Erstellen von Dokumenten mit Textverarbeitungsprogrammen. Adobe SiteMill, das Anfang 1996 herauskommen wird, vereinfacht die Verwaltung von Web-Servern.

Die diesjährigen Übernahmeaktivitäten boten gleichzeitig die Möglichkeit, unsere Unternehmensstruktur zu überdenken. Adobes Geschäftsbereiche sind jetzt in erster Linie nach Funktionen und nicht nach Produktlinien ausgerichtet. Das zeigt sich insbesondere daran, daß wir dazu übergegangen sind, Produktlösungen anzubieten, als unsere Produktfamilie größer, voll integriert und in Firmen immer gefragter wurde. Unser Ziel ist es, Kunden zu helfen, Adobe Programme mit ihren bereits vorhandenen Werkzeugen nutzen zu können, um ein Maximum an Produktivität, Kreativität und Qualität zur Kommunikation zu erzielen, egal mit welchen Mitteln.

In Adobes erster Dekade haben wir uns auf Software konzentriert, um das Handhaben und die Ausgabe von visuell ansprechenden Dokumenten zu vereinfachen. In Adobes zweiter Dekade haben wir unser Augenmerk auch auf die Verteilung und den Zugriff auf diese Informationen gelegt. Wir bieten einen umfangreichen und gut integrierten Satz an Werkzeugen für gedruckte und elektronische Materialien auf einer Technologiebasis an, die auch in Zukunft die neue Informationslandschaft prägen wird. In dem bisher ereignisreichsten Jahr sind wir auf das, was bei Adobe geleistet wurde, besonders stolz – und auf die Menschen, die es ermöglicht haben. Sie haben einen Einsatz gezeigt, der alle unsere Erwartungen übertroffen hat. Bei soviel Begeisterung, Talent und Engagement unserer Mitarbeiter können wir die Zukunft kaum erwarten.

お客様へ

情報をとりまく環境がめまぐるしく変貌する時代にあって、1995年は弊社にとって特筆すべき、かつてなく内容の充実した年でした。1994年に買収したアルダス社（Aldus Corporation）の業務の統合に加えて、1995年10月に買収したフレーム テクノロジー社（Frame Technology Corporation）との統合の準備を進めながらも、常態ベースでは22%の売り上げの伸びと79%の純利益の増加を達成することができました。アドビとアルダスの業務の統合は、株主の利益を損なわない形で、予定よりも短い期間で完了しましたが、フレーム社に関しては当初予想したよりも複雑で第4四半期の業績に影響が出ています。しかし、業務統合作業は現在順調に進捗しており、1996年度の第1第2四半期にはコスト削減の効果が表われると予想しています。

このレポートは、統合したアドビとフレームの1995年度の業績を要約したものです。両社の合併決算による1995年度の売り上げは838億5,300万円（換算率：1ドル＝110円）で、昨年度の実績の743億1,600万円から13%の増加を示しています。臨時支出や分離あるいは中止した業務に関連した費用を除いた常態ベースでは、1995年度の売り上げは昨年度の684億6,400万円から22%増加したことになります。

純利益は昨年度の16億8,300万円に対して102億8,500万円、1株あたりの純利益は昨年度の24.2円に対して138.6円となりました。臨時支出や分離あるいは中止された業務に関連した費用を除いた常態ベースでは、純利益は、昨年度の83億4,900万円から149億1,600万円と79%の伸び率を達成し、1株あたりの純利益は117.7円から68%増の198円へ上昇したことになります。第4四半期には、フレーム社の買収に伴って発生した34億6,500万円の組織再編費用およびセネカ社（Ceneca Communications, Inc.）の買収によって発生した16億5,000万円の研究開発費の償却が行われました。こうした特別な要因が、第4四半期および1995年度全体の実績に影響を及ぼしています。

1995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22円に達しています。現金残高も567億7,600万円を超えており、良好な財務状況が継続していると言えます。

グラフィック関連製品や書体、Adobe Acrobat、旧フレーム社製品を含むアプリケーション製品全体の売り上げは、昨年度の約570億9,000万円から12%増加して636億7,900万円に達しました。1994年度中のFreeHandとPhotoStylerの売り上げを除いた場合、1995年度のアプリケーション製品の売り上げは、512億3,800万円から24%の成長を達成したことになります。

1995年度には、旧アルダス社との合同チームによる初の本格的なリリースとなったページレイアウトソフトウェアのAdobe PageMaker 6.0をはじめ、ビデオ ポストプロダクション・特殊効果用ソフトウェアAdobe After Effects 3.0、長文のドキュメント制作に適した旧フレーム社のAdobe FrameMaker 5.0などのアプリケーションがリリースされています。さらに、ベストセラーとして定評のMacintosh版Adobe Illustratorについても最新バージョン6.0を発表いたしました。1996年度においてもWindows 95用に最適化したバージョン等、重要な製品のリリースを世界各国で継続していく予定です。

過去3年間のAcrobat関連技術に対する投資は実を結び始め、1995年度のAcrobat製品の販売が飛躍的に伸びました。マルチメディアとWWW（World Wide Web）制作をサポートしたAcrobat 2.1のリリースは、インターネット上でのPortable Document Format（PDF）の普及に大きく貢献しました。さらに、弊社のグラフィック関連パッケージ製品の多くにAcrobat技術をサポートする機能を持たせました。これによって、これらの創作ツール（Authoring tools）を電子メディアと印刷の両方の用途で活用できるようになりました。また、特に注目すべき新製品として、Acrobat Captureがあります。これは、スキャナを用いて既存の印刷物を読み取り、電子文書であるPDFファイルに変換するためのソフトウェアで、企業や行政機関での利用に効果的です。サードパーティにライセンス供給している新技術Acrobat Playerは、プロジェクタ装置等に組み込んで、それらの装置が直接PDFファイルを読み込み、処理すること

を可能にします。また、弊社は、Acrobat技術をさらに強化したバージョンも発表しました。これは、さまざまな企業、たとえばAT&TやMicrosoft、Netscape、Oracleといった企業が自社のインターネット ユーザ向けソフトウェアやサービスに組み込むことができる技術です。サードパーティによるバンドルとインターネット上での無償提供の効果によって、Acrobat Readerのユーザ数は現在600万人から1,000万人に達しています。

Adobe PostScript（ポストスクリプト）プリント技術のライセンス収入は201億7,400万円に達し、昨年度の172億3,700万円から17%の増収を達成しています。この成長の大きな原因は、クロスプラットフォームな利用形態、ネットワークのサポート、カラー印刷機能という、まさにポストスクリプト ソフトウェアが得意とする分野で企業ユーザのプリンタ需要が増加したことです。日本市場からの収入もこの好調な業績に大きく貢献しています。誰もがデスクトップ上のコンピュータで素早く、良質の印刷結果を得られること。それを実現するための態勢を、常に弊社は整えています。インターネットやコンパクトディスク、企業内のファイルサーバー等の電子メディアから得た情報を正しく再現するために、ますますその必要性が増しているからです。電子メディアに書類を保存しておき、必要なときに必要な場所で出力することができれば、企業にとって大きなコストダウンへの道が開けます。こうした書類の“電子的な配布と出力”は急速に現実となりつつあり、ポストスクリプト言語が得意とする、カラー印刷と多機能性に対する需要を生むものと予測できます。昨年度のレーザーツールス社の買収がもたらした、弊社にとっては初めての非ポストスクリプトのプリント技術であるAdobe PrintGearアーキテクチャは、低価格の白黒レーザープリンタの性能及び印字品質を劇的に向上する技術です。PrintGearソフトウェア内蔵の最初の製品は、1996年春に発売予定となっています。

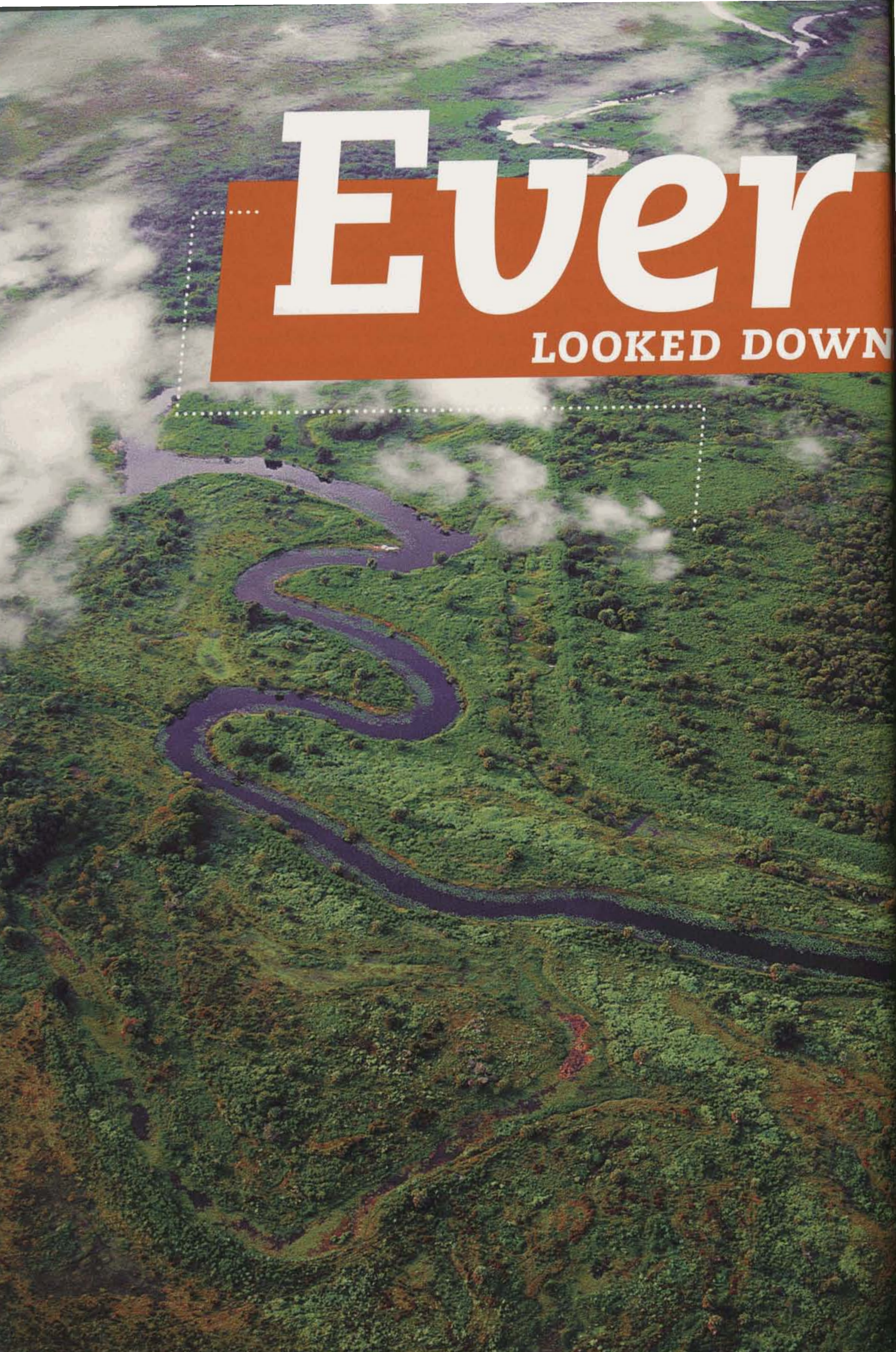
弊社は、13年間という創立以来の歴史、そしてパーソナルコンピュータの分野で世界第3位の規模のソフトウェア会社としての地位を有しながら、優れた決断力と機動性を常に維持しつづけてきました。例をあげれば、10月にはフレーム社を買収したのみならず、現行の弊社の創作ツール類（Authoring tools）の働きを補完する製品を開発してきた、セネカコミュニケーションズ（Ceneca Communications, Inc.）という非常に小さな会社も買収しています。セネカ社との交渉開始から同社のPageMillソフトウェアが弊社ブランドの製品として店頭に並ぶまでに要した時間はわずか2ヵ月でした。このAdobe PageMillは、ワードプロセッサで文書を作成するのと同様の手軽さで、WWW上のホームページを作成することができるソフトウェアです。さらに、ウェブサイトの管理作業を簡素化する画期的なソフトウェアAdobe SiteMillの発売を1996年始めに予定しています。

今年度に実施した買収が弊社の組織編成を見直す機会ともなり、製品構成に基づく従来の編成から、機能別の編成に生まれ変わりました。もっとも大きな変化は、個々の製品ではなくソリューションを販売するというアプローチを採用したことです。これは、製品ファミリーの拡大と統合化、企業への浸透に向けた戦略であり、ユーザが既に持っているツールと弊社のソフトウェアとを組み合わせること。それによって、あらゆるメディアを通じたコミュニケーションの生産性、創造性、そして品質を最大限に高めることを目指しています。

弊社創立から最初の10年間は、視覚的に高品質の文書を容易に制作・印刷できるソフトウェアの開発が中心課題でした。今日、「情報の配布とアクセス」を含むより広い範囲にまで、アドビの視野は広がっています。印刷及び電子的なコミュニケーションのために、今日、弊社はもっとも広範かつ統合されたツール類を提供しています。それらは、情報をとりまく新しい環境を次々と作りだしてゆくことのできる技術基盤に立脚したものです。激動する時代の中で弊社が達成してきた業績は、従業員各自のたゆまない努力の結果であり、それぞれの才能と情熱、そして献身を考える時、これからの新しい地平に何が見えてくるのか、大きな期待を禁じ得ません。

Ever

LOOKED DOWN



FROM A JET and been mildly surprised that black lines don't divide state from state, province from province, or country from country? That bold letters don't announce that you've just passed over Colorado, China, or the Red Sea? That the world we live in is really a place without borders, spread endlessly out, crisscrossed by paths that join metropolitan hubs?

The face of information today is much like that landscape. Unmarked by boundaries. Stretched from horizon to horizon. Cross-hatched by wires that pulse data through Internet sites.

It's a place where ideas travel freely—without passport, without visa, across borders to all nations. Where a concept that belongs to one can now belong to all.

Never has the individual had so much power to broadcast a message across the land. Never have so many others had the chance to respond to its call.

The Internet is, perhaps, the closest the world will get to the transference of thought to a multitude of minds.

For Adobe,

THE FUTURE HAS BEGUN ANEW.

Blazing NEW TRAILS *So That Others May*

A new information landscape is before us, characterized by dramatic changes in the way people create, present, and respond to information. Today, individuals and businesses can combine text, images, colors, sounds, and movement into rich displays of human expression. At the same time, recipients of that information have unprecedented freedom to access it, change it, move it, and reuse it, based on individual needs. Much of this new scenery has sprung up around trails blazed by Adobe more than a decade ago.

We founded Adobe on the simple premise that a computer should enable people to express and use information in more imaginative and meaningful ways. We developed software that put desktop publishing on the map. We created tools that made computer-based design as limitless as the human mind. We have continued to grow, adapt, and innovate to meet—head-on—the challenges and opportunities that are taking computer publishing to regions beyond the desktop, and beyond even paper itself.

The Internet and its World Wide Web mark the greatest advance in communication and commerce that this century has yet seen. In a very real sense, the Web is touching every market, every corporation, every industry. The Internet is an ideal electronic publishing and information exchange forum. It can grow to meet demand, has a low cost of entry and operation, and in the future, will be able to accept all imaginable kinds of information.

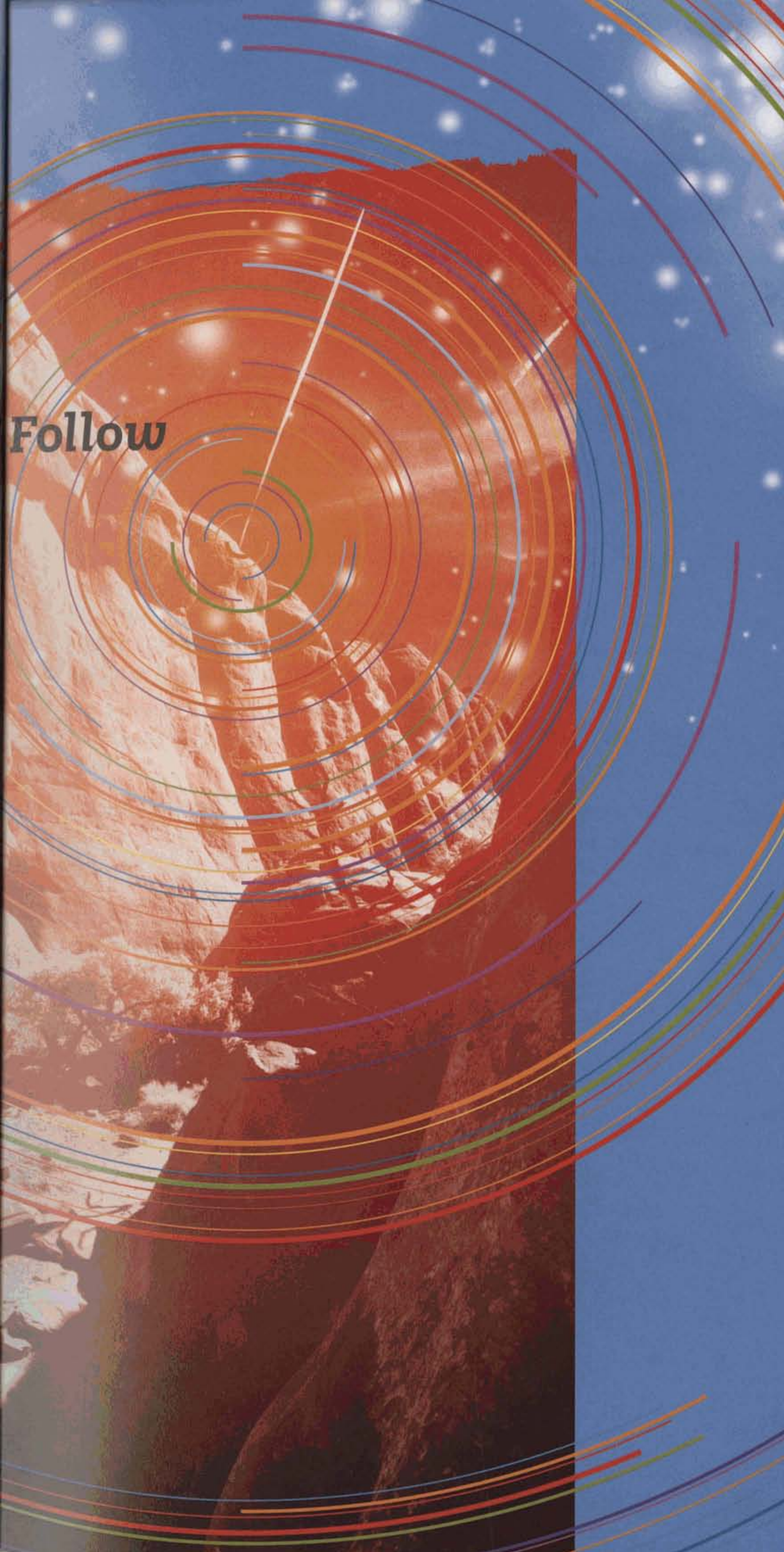
Adobe occupies a special place in this ever-expanding realm. Few other companies have the breadth and depth of experience to be in all the places that we are. We develop the software standards that let information flow freely around the world. We provide authoring applications so that people can create and assemble all the messages they dream up. And we produce distribution tools to let them disperse that information in any way that suits them. Thanks to all of that, you can now have an idea in the morning, execute it during the day, and distribute it worldwide that evening.

We think that's pretty exciting.

Today, we're as full of fresh ideas as when we started. And we're even better equipped to guide the many markets we're in: Corporate. Government. Commercial publishing. Entertainment and multimedia. Education.

We invite you to sit back for a tour of these markets. It's a mere skim over the surface, a bird's-eye view of where we are and what lies ahead in this changing information landscape. With the Internet taking off in a thousand new directions, it seems that no matter which way you turn, you'll be crossing a path that Adobe has cleared.

Follow



In April 1995, Volpe, Welty & Co. predicted that the Internet economy would reach $5.8 billion in the year 2000. Recent analyses now project ten times that number, from $45.8 billion to $73 billion annually by the year 2000.

According to a survey released by market research firm FIND/SVP in January 1996, 9.5 million Americans use the Internet, with some 4 million getting started in 1995 alone.

Building Corporate

Every corporation today must curb the meteoric costs of marketing products and disseminating information. Take advertising, for example. To deliver a one-page, four-color ad in a national magazine (circulation of one million) runs a hefty $97,000. Yet for a third of that price, a company could finance a dynamically linked World Wide Web address for nearly a year. The business could send thousands of messages to millions of people on a continuous basis—all with little or no cost for packaging, printing, and distribution.

Few companies can resist the lure of such savings, which is why all counts show that corporate use of the Internet is ballooning. A November 1995 Goldman Sachs report, for example, noted that external commercial Web sites quadrupled to roughly 120,000 in the past year, and it estimated that internal commercial Web sites have jumped to 160,000, up 350 percent from 1994.

With more than 80 percent of a company's information captured in written format, and the volume doubling every three to four years, it's no wonder that corporations are running headlong toward centralized, electronic distribution of information on the Web or server networks. Many reach this goal thanks to bridges anchored by Adobe software standards and applications.

Electronic distribution of information. Corporations large and small are improving information access and protecting their corporate identity by choosing Adobe Acrobat and the Adobe Portable Document Format (PDF) as their electronic document standard. PDF is a unique, open file format that preserves the high-quality look and feel of printed documents, no matter which computer platform, operating system, or fonts a recipient uses to view or print the files. With PDF, a page's visual integrity stays intact anywhere the information goes.

An October 1995 survey showed that 77 percent of U.S. companies were either already in cyberspace or will be within the next two years.

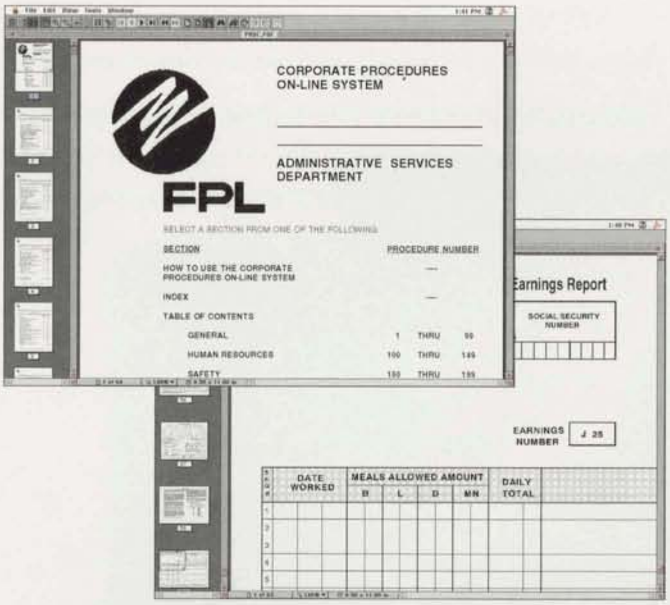
Bridges TO THE INTERNET

First Call Corporation, for instance, a Thomson Financial Services Company, delivers market research reports from brokerage firms to institutions and money managers solely as PDF files through its RESEARCH DIRECT service. What used to take inches of paper-based reports is now sent to First Call's servers as viewable, searchable, linked PDF files. Every document looks exactly like its original printed counterpart, which puts brokers and clients at ease with electronic delivery, gives them instant access to clear, vital information, and preserves the professional image of First Call.

Adobe, too, is a microcosm of this trend. Employees worldwide attach PDF files to e-mail, drop them onto servers, or post them to our internal Web site. More than 10,000 PDF documents are available, such as up-to-date organization charts, job openings, and training schedules. Everyone can view and print them, with design and text intact, from any computer in the company. An independent study showed that PDF distribution has shaved an average of a week and a half off Adobe project schedules because PDF sidesteps the delays of printing, collating, binding, and mailing review copies.

Web publishing with Adobe tools. Just as with print, authoring for the Web means producing graphics, images, text, and layouts. Adobe's content-creation tools fit here as naturally as in print production, enabling corporations to make the most of their existing software to produce messages for on-line use.

Using Adobe Acrobat software, Tandem Computers saved $1 million in 1995 by distributing company marketing materials to its worldwide sales force on CD-ROM.

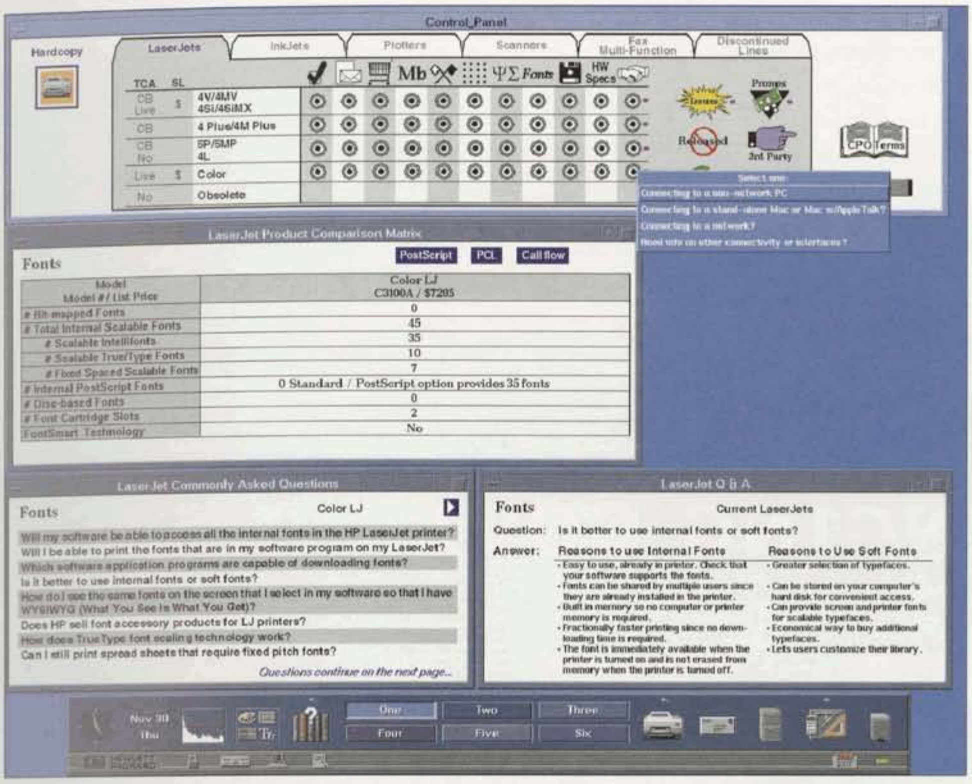


In 1991, Florida Power & Light Company (FPL) had a staff of 15 people maintaining 8,000 procedures (30,000 pages) in 52 books with 101 volumes. They spent $50,000 a year on printing and distribution. Since moving to electronic delivery with Adobe Acrobat software, FPL has reduced its printing costs by 94 percent, to only $3,000 a year.

Adobe Photoshop image editing software is the favored tool among Web developers to get artwork ready for the Internet. The folks at Clement Mok designs in California, for example, use it daily for all their on-line work. The software's high-quality GIF and JPEG output enable this premier design firm to create complex sites for customers such as Sony, 20th Century Fox, and Michael Crichton.

Thousands of in-house Webmasters are also finding a simple way to author pages using new Adobe PageMill software. This product's completely visual approach makes it easy to create, edit, and update Web pages without the complexities of the Hypertext Markup Language (HTML). A companion application, Adobe SiteMill, automatically maintains links for a Web site as pages get moved around, renamed, and updated.

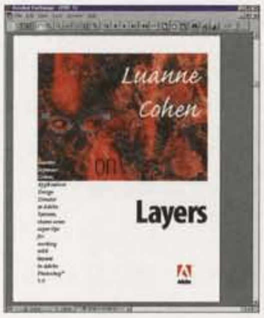
More information on demand. Electronic distribution encourages businesses to publish more documents, because funds once allocated to printing and delivery can go to producing more messages. In 1995, for example, Tandem Computers, Inc. switched its sales-support literature from paper to PDF distribution on CD-ROM, and in one year saved more than $1 million in hard costs. That same year, its collateral increased five-fold, from 250 documents in paper form to 1,500 documents in PDF electronic form.



The customer service division of Hewlett-Packard Company relies on Adobe FrameMaker to publish and maintain its enormous collection of on-line documentation. Phone technicians retrieve the documents with Adobe FrameViewer and then use hypertext links as they navigate files and open related documents to get immediate answers to customer queries.

Perhaps paradoxically, people also are printing more in the new information landscape. The primary difference is that the recipient, not the sender, controls what ends up on paper. Many people, for instance, print only specific PDF pages, instead of leafing through an entire printout for parts that interest them. This "distribute and print" model inverts the traditional "print and distribute" pattern that many corporations grew up with. It also spurs the popularity of Adobe PostScript printers, which reliably reproduce files in PDF and other standard formats, even when they're printed directly from a company's Web site.

Crossing the technological rapids. There's a saying in science that one cannot study a system without also becoming part of that system. The Internet is no exception. As they adjust their tactics to the changing economics of distribution, corporate publishers themselves are forever altering the look of the information landscape. With Adobe software, businesses can deliver the information they want, when they want it, in a way that they can use it best.

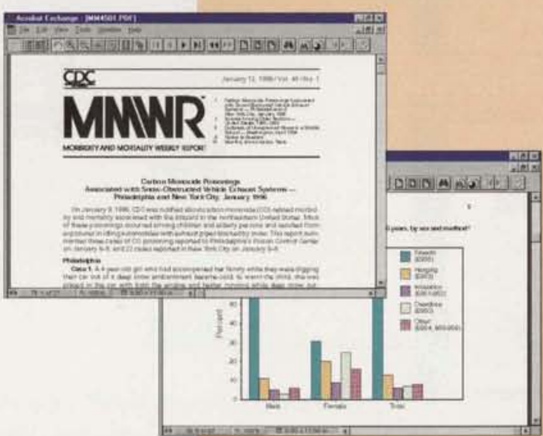


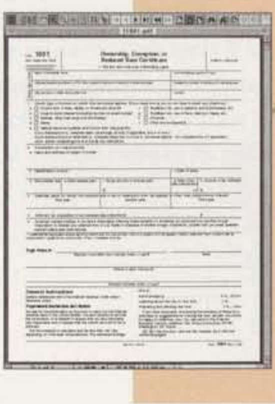
Adobe saves nearly $1 million a year in printing and mailing costs by using PDF for electronic document distribution.

BRINGING GOVERNMENT *Over*

The surge in federal Web sites proves that the U.S. government is shucking the image of a paper-clotted bureaucracy in favor of being at the forefront of the electronic era.

The Internal Revenue Service and the Centers for Disease Control and Prevention are just two of the government agencies that are saving money by using Adobe Acrobat software to distribute information electronically.



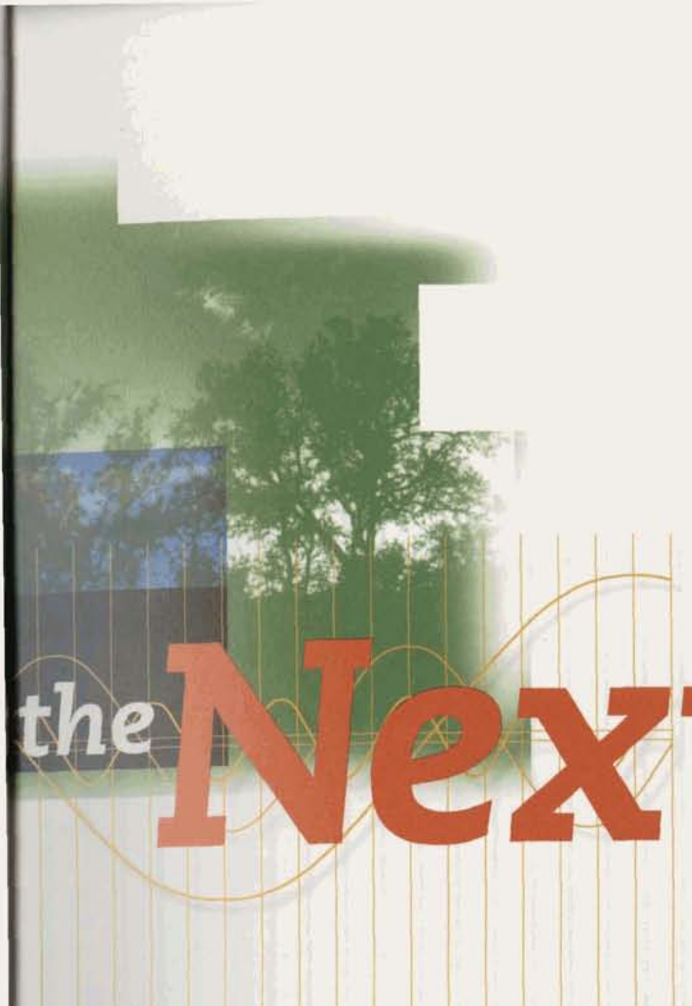


Together, federal, state, and local governments constitute about 20 percent of the U.S. market for information technology. The federal government alone processes millions of pages annually and presides over trillions more in cold storage. Its perpetual mandate: get the right information to the right places and manage an ever-growing mountain of information. Several Adobe products are helping government do just that.

Going digital from the basement up. Across the nation, government agencies are emptying filing cabinets and filling networked servers with scanned, electronic versions of once-fallow pages. Information long buried is now accessible at an instant's notice. The Department of Defense, for example, is scanning 20 million pages from thousands of weapons, training, and maintenance manuals with Adobe Acrobat Capture software. The resulting PDF files look exactly like the printed pages, but are fully searchable and selectable so that employees can find and adapt the data to a variety of needs. The PDF conversion process is expected to save the

The Paperwork Reduction Act of 1995 requires all government agencies to reduce paperwork for the public by 10 percent in 1996 and 1997, and by 5 percent annually until 2001.

In a 1995 SIMBA Information study, 46 percent of the people surveyed said they use the Web to find government information.



the Next Rise

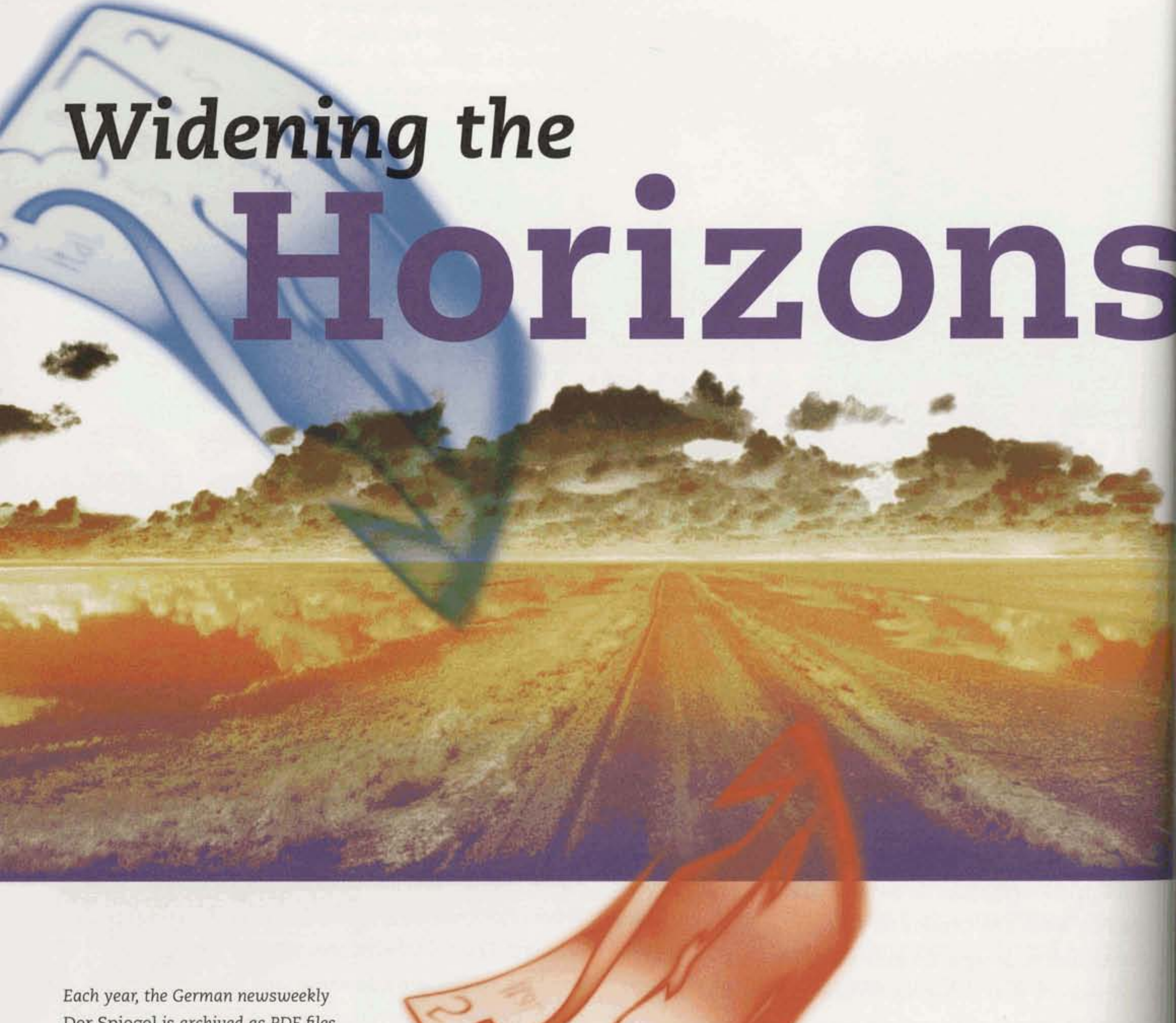
government at least $5 a page over traditional methods of tagging the document structure and then storing the coded text in ASCII format.

Getting on-line with PDF. Many government agencies publish electronic files on the Web to cut printing and mailing costs. The Centers for Disease Control and Prevention in Georgia, for example, uses Adobe Acrobat to distribute vital public health information worldwide in PDF. The Internal Revenue Service keeps PDF versions of its hundreds of tax forms on the Internet so that any of the nation's 208 million taxpayers can print and use them as if they were originals. Meanwhile, United Nations members receive up-to-the-minute reports about environmental negotiations, thanks to the International Institute for Sustainable Development in Winnipeg, Canada. This group sends relevant U.N. minutes as PDF files over the Internet so that government ministries around the world can receive news in the same format as the version that hits the tables at the next day's meeting. All files can be easily accessed using the Adobe Acrobat Reader, the freely distributed application that enables people to read and print any PDF file.

Publishing with Adobe FrameMaker. "Technical," "long," and "standardized" are catchwords for the hundreds of thousands of documents the federal government publishes annually. To handle the rigor, dozens of government agencies have chosen Adobe FrameMaker as their primary publishing application. At the Department of the Navy, for example, multiple collaborators use Adobe FrameMaker software to produce thousands of pages of maintenance manuals and engineering specifications. The documents abound with procedures, graphics, engineering drawings, and tables, as well as highly detailed cross-references and indexing. The files are often output as PDF or Adobe FrameViewer files for on-line retrieval and use.

Moving on with a lighter load. The government's renowned need for thorough documentation (applications for new drugs, for instance, can require 200,000 pages of supporting material) rightfully prompted the Paperwork Reduction Act of 1995. To meet that challenge, more and more agencies are relying on Adobe software to electronically manage and shrink their mountains of paper.

Widening the Horizons



Each year, the German newsweekly Der Spiegel is archived as PDF files on CD-ROM for instant access to past issues. The magazine's graphics and images are mainly produced using Adobe Photoshop and Adobe Illustrator.

According to a late 1995 survey by research firm Frost & Sullivan, advances in color, printer, computer, and imaging technology will cause the desktop publishing equipment market to grow to $27 billion by the year 2001, nearly four times its 1994 size.

# of Professional Publishing

Despite the undeniable influence of the Internet, print-based publishing is alive and well. The definition of "graphics communication" within commercial publishing, however, is broadening daily.

As the economics of distribution shift to favor electronic output, graphic artists are just as likely to design for on-line consumption as for paper. Their illustrations, images, and layouts can now go on CD-ROMs, servers, video, the Web—in short, just about anywhere people need the information to be. As always, their projects begin and end with Adobe software.

CONTENT STILL AT THE CORE OF PUBLISHING. Our flagship authoring tools—Adobe PageMaker for page layout, Adobe Illustrator for design and illustration, and Adobe Photoshop for image editing—remain the workhorse applications for people who create content on Apple Macintosh or Microsoft Windows computers. Commercial publishers and graphic artists worldwide put this powerhouse trio to work every day, and they select their fonts from the Adobe Type Library. For high-quality output from laser printers, imagesetters, and other devices, they rely on Adobe PostScript software as the de facto standard. (Today, there's hardly a piece of visual communication that hasn't, in some way, been touched by Adobe PostScript technology—whether in fonts, graphics, layout, image manipulation, or means of delivery.)

Bennett Peji Design in California uses Adobe software to produce award-winning packaging, brochures, annual reports, catalogs, and exhibit graphics for clients such as GTE, Proxima, and the Internet Advertising Corporation. Its Adobe PageMaker layouts typically contain scores of images from Adobe Photoshop and graphics from Adobe Illustrator.

Bosch & Keuning, one of The Netherlands' foremost printing and publishing groups, uses the same trio to create up to 800 new titles a year and 80 magazines a month. Improved integration among the applications helps speed design and production.

In France, Jean-Pascal Grevet has been producing his international *Icônes* magazine with Adobe PageMaker for a decade. Originally 32 pages in black and white, the publication has become a full-color, 100-page monthly that's produced almost exclusively with Adobe software and type.

Nations in the Pacific Rim are riding the same desktop publishing wave that swept over America a few years ago. Electronic projects are popping up everywhere using Japanese versions of Adobe's creation tools and Adobe fonts, and the latest in Japanese PostScript language printers. Japanese graphic artist Susumu Endo, for instance, abandoned traditional darkroom techniques in favor of digital imaging for his complex, layered artwork. Now all of his pieces are designed in Adobe Photoshop and are seen in exhibitions in Japan and around the world. Our recent Chinese and Korean versions of Adobe PageMaker, Adobe Illustrator, and Adobe Photoshop are also accelerating the growth of desktop publishing in Asian markets, where designers are adapting Adobe software to their unique styles and needs.

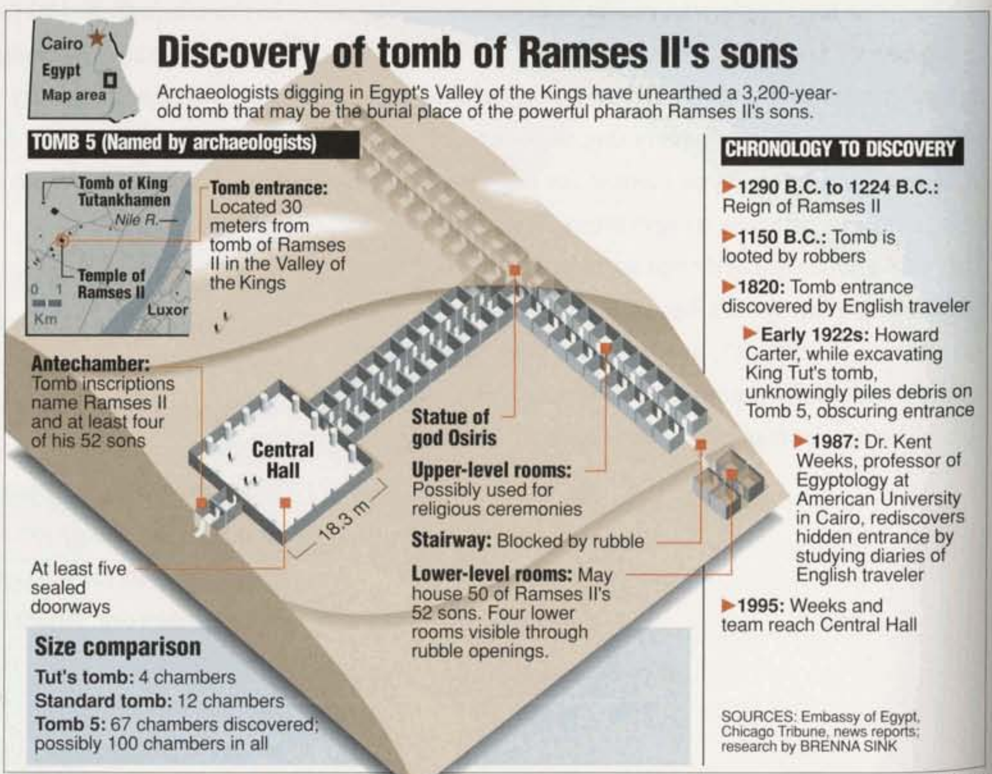
Double-duty publishing. Designers are often being asked to "repurpose" printed materials for electronic use, or to create pieces with both electronic and print distribution in mind. Most continue to work in the software they already know, because many Adobe products can output in PDF, and Adobe Acrobat can produce PDF files from any Windows or Macintosh application.

Medical Economics Company, for instance, a leading provider of health care information, published the third edition of *The PDR Family Guide to Prescription Drugs* to include a PDF version on CD-ROM. The electronic book mirrors the look and feel of its printed counterpart, but links, threading, bookmarks, and searching within Adobe Acrobat software add functionality beyond anything possible in the printed edition.

Book publishers, too, are slowly embracing both electronic and printed output. HarperCollins Publishers, Penguin USA, and Simon & Schuster all have interactive electronic publishing divisions, and nearly 300 CD-ROM publishers pour out reference works, educational materials, "edutainment" titles, and other products in electronic format. As in other visually rich media, the text, images, video, and graphics often originate with Adobe software and type.

Moving to the Web and on-line. The Internet brings still more options to Adobe software–based publishers. Designers and service bureaus use PDF and HTML output from Adobe FrameMaker or Adobe PageMaker to prepare print-based work for the Web. Adobe Photoshop has a new GIF filter to automatically convert any image for on-line viewing. And Web-page designers are flocking to Adobe PageMill software for its visual, click-and-drag way of producing HTML pages for Web sites.

With the help of Adobe Acrobat, Dial-A-Book, Inc. and IEEE Press (a subsidiary of the Institute of Electrical and Electronics Engineers) sell both print and electronic titles on the Internet. Rather than wait for delivery or incur the cost of overnight mail, the Institute's 300,000 members worldwide can buy a title from the Dial-A-Book Web site, immediately download a searchable Adobe PDF version of the book, and receive shipment of the



In 1995, Knight-Ridder Tribune (KRT) Graphics Network standardized exclusively on Adobe Illustrator software for its artwork. KRT supplies more than 500 graphics a month to 400-plus newspapers in the U.S., Canada, Europe, and Latin America.

Studio Matchbox of Sweden calls on a full complement of Adobe products to produce highly designed materials for corporations and to publish its Mac Art&Design *magazine. In addition to Adobe PageMaker, Adobe Illustrator, and Adobe Photoshop, the firm uses Adobe Dimensions software for 3D illustrations and Adobe Streamline software for converting scanned images to editable line drawings.*

paper edition for the cost of the paper copy alone. The downloaded work is protected against digital redistribution by Keychain, a proprietary software program developed by Magnetic Press, Inc.

Electronic publishing also appeals to magazines and newspapers that want to avoid the expense of postage and paper. As of fall 1995, more than 500 newspapers worldwide had cyberspace editions—four times as many as a year before. Many use Adobe PDF in whole or in part, such as *La Stampa* (Italy), *El Norte* (Mexico), and The New York Times *TimesFax* service of daily news reports. Top stories in *PC Week* appear entirely in PDF on the Web, with graphics, charts, and photos intact. Other on-line magazines, many designed with the help of Adobe's creation tools and fonts, include *U.S. News & World Report, Air & Space* (from the Smithsonian), and *The New Yorker.*

PDF ARCHIVING AND AD DISTRIBUTION. The open standard of PDF frequently solves special needs for commercial publishers, such as how to turn years of back issues into living archives. PrePress-Consulting in Switzerland, for example, set up the publishers at *Facts,* a Swiss newsweekly, to distill and index issues in PDF, so journalists can instantly search and peruse articles. Similarly, SRZ-Berlin produces an annual CD-ROM of issues for *Der Spiegel,* Germany's best-selling newsweekly; a special Acrobat Search plug-in provides access to the publisher's own library of established keywords.

Complex layouts and images are also zipping their way electronically to service bureaus and ad houses. The Associated Press' digital advertising delivery service, AP AdSEND, has integrated Adobe Acrobat software to electronically transmit thousands of ads a month to nearly 900 of the 1,555 daily newspapers in the United States. The PDF ads keep their visual integrity despite the broad range of computer systems and typesetting equipment used to design and print them.

CREATIVE HORIZONS BROADER THAN EVER. Adobe's success in commercial publishing has stood the test of time, thanks to our PostScript technology and the breadth of creative options our tools bring to graphic artists. As they stake out new territory within the information landscape, these professionals can still rely on Adobe products to realize their vision.

Taking ENTERTAINMENT and New

If the analysts are correct, the multimedia creation and delivery market is close to launching into orbit very soon. In-Sat Inc. projects that worldwide shipment of multimedia-capable desktop personal computers will soar from just 12,000 in 1995 to 32 million worldwide in 1998. In America, multimedia software and hardware sales are expected to double from nearly $10 billion in 1995 to $22 billion in 1999.

These runaway projections reflect the computer industry's race toward lightning-fast processors and low-cost multimedia delivery systems. They also reflect the astounding advances that tools such as Adobe After Effects and Adobe Premiere software have brought to professional multimedia and video authoring.

Cutting costs, not quality. Adobe's dynamic media products enable video and multimedia designers to produce broadcast-quality videos and special effects from their desktops. More often than not, the results rival or exceed what high-end systems produce at many times the price.

For instance, Adobe After Effects, our special-effects software, gives post-production houses such as Dream Quest Images in California the tools to produce superior motion effects and 2D animation for television, CD-ROMs, movies, and commercials. Proof of their skill with this versatile product can be seen in special effects for films such as *The Three Musketeers* and *The Mask*.

Adobe After Effects enables the special-effects firm Dream Quest Images to deliver as many as 55 special-effects shots per week. These images are from the television series JAG *(top) and the movie* The Three Musketeers *(bottom).*

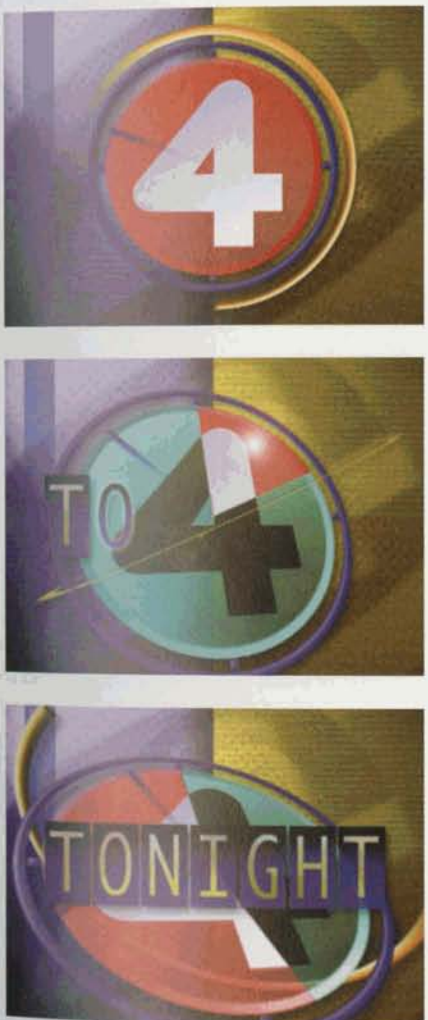
Adobe Premiere video editing software is vital for designers who compile video, audio, photos, titles, and other visual elements for entertainment and commercial use. Daizaburo Harada, a 3D graphics artist/animator and director at Shadow Entertainment Inc. of Tokyo and Los Angeles, uses it to create music videos for Ryuichi Sakamoto, an Oscar-winning composer–musician. Harada's digital films were projected on screens and monitors at Sakamoto's 1995 concert tour in Japan. Harada's work in Adobe Premiere also includes commercial films for companies such as Mitsubishi Electronics.

Multiple Adobe products work together at studios, as well. At the regional BBC station in Leeds, England, artwork from Adobe Illustrator and Adobe Photoshop software migrates to Adobe After Effects and Adobe Premiere for compositing, editing, and special effects. Sequences that were once far beyond the studio's budget—such as zooms, overlays, and animated titles—are now made totally in-house using Adobe's multimedia products.

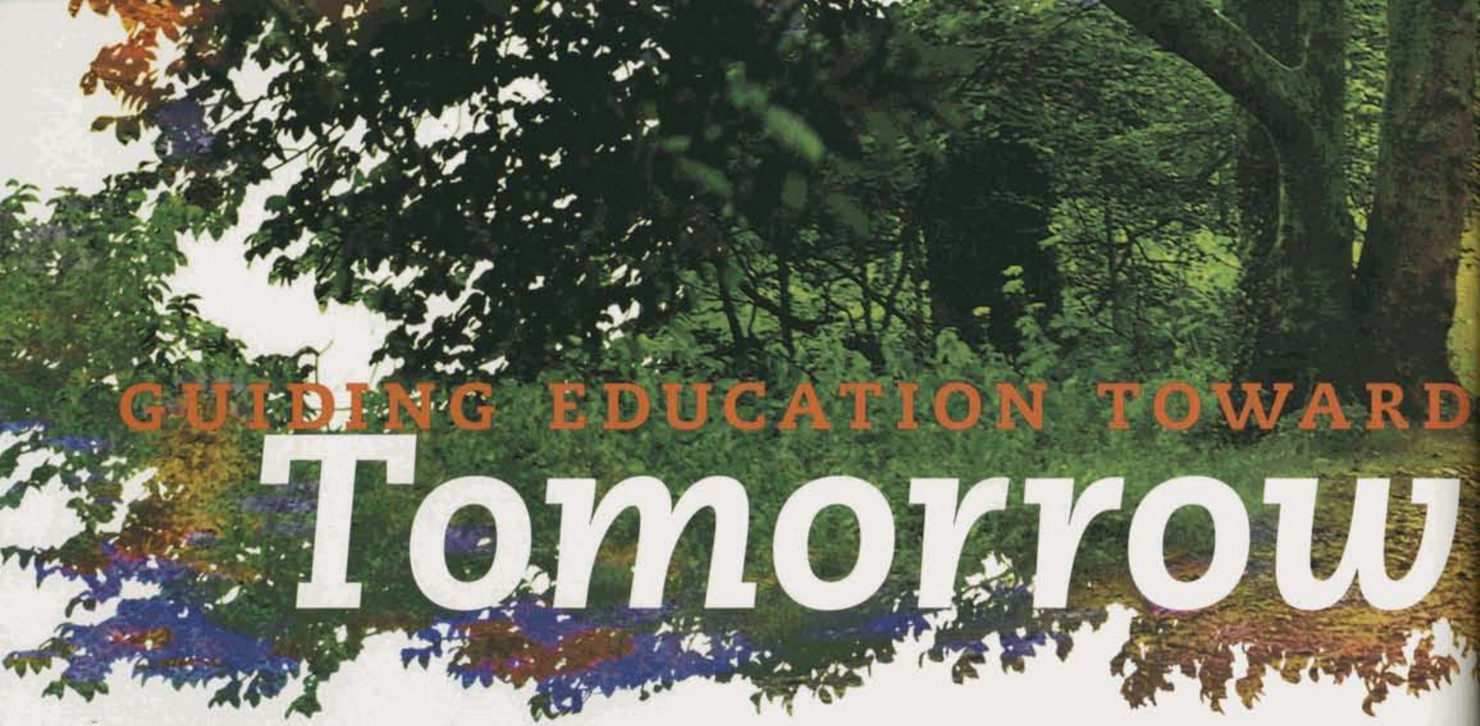
That's entertainment on-line. Entertainment and multimedia are naturals for the Internet and electronic distribution. Schock Entertainment of New York, a longtime promoter for performers such as Billy Joel, uses Adobe products and PDF to package information about its clients. Schock builds electronic press kits and promotions that combine images, video, interviews, and other information, and distributes them in PDF to publications and record companies. The PDF files often end up on a Web site to promote clients' recordings.

Creativity foremost. The public's insatiable appetite for high-tech films, computer graphics, and music videos continually raises the bar on what motion-based media should be like. Adobe software gives multimedia and video specialists the top-notch tools they need to pursue—and deliver—endless creative possibilities.

MULTIMEDIA to Heights



The news opener for WIVB TV in New York combines nearly 140 elements of video, text, and images in 150 layers in Adobe After Effects software. It would have cost $40,000 to $50,000 for a production house to create—which is much more than the station could afford.

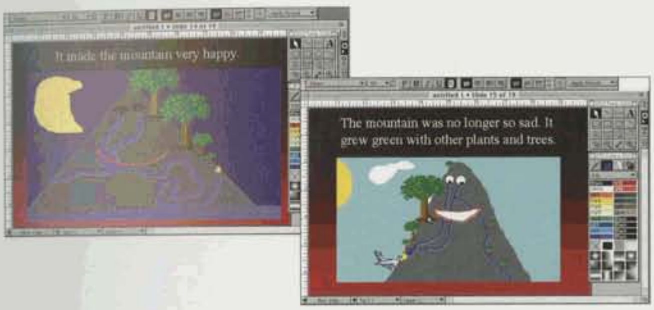


GUIDING EDUCATION TOWARD *Tomorrow*

The Wharton School of the University of Pennsylvania has developed a customized suite of Internet software for its students that includes the Adobe Acrobat Reader for viewing electronic versions of handbooks, faculty guides, and other publications. In some instances, the PDF files are available on-line several weeks before distribution of printed versions.

From kindergarten to post-graduate, all schools and universities face the same two-pronged challenge: how to offer more educational resources on increasingly smaller budgets, and how to prepare students for a future that relies increasingly on computer technology. Using Adobe software, many schools are reducing the cost of course materials, promoting on-line learning, and adding computer courses as fast as budgets will allow.

High-tech teaching tactics. The high cost of textbooks, manuals, and lecture notes has prompted many instructors to use Adobe PDF to electronically distribute syllabi and lecture materials to students. Virginia Tech's Department of Chemical Engineering, for example, provides process-controls course and laboratory materials only in PDF, and students must submit all laboratory reports as PDF files. Compression capabilities in Acrobat software keep the PDF files small enough for modem-less students to transfer them to floppy disks. One professor saves his students about five cents per page by distributing his documents (50 to 200 pages each) electronically instead of on paper.



Fourth and fifth graders at the Andrew A. Robinson Elementary School in Florida use Adobe Persuasion presentation software to prepare and present book reports, social studies projects, and similar assignments. The approach teaches them writing, problem solving, logical thinking, and public speaking.

Campus-wide communications. The universal format of Adobe PDF also presides over many campuses and education Web sites as the fastest, cheapest, most visually rich way to exchange information across campus or around the world. The Wharton School of the University of Pennsylvania, for instance, publishes PDF versions of course information, annual reports, alumni news, and research. Younger students will soon be in touch with the Web, thanks to AT&T's recent plan to fund $150 million in Internet access for every K–12 school in America. Adobe is providing Acrobat software as the natural path by which these youngsters will exchange information on the worldwide campus.

Software skills with Adobe class. Helping students prepare for the future has always been a high priority at Adobe. Our discount education pricing program and our internationally acclaimed Classroom in a Box curricula help all grade levels learn to create, assemble, and distribute content with our software. At Cornwall High School in New York, for instance, art students explore their creativity through the world of Adobe Photoshop, Adobe Illustrator, and Adobe Dimensions. Ideadisc, a CD-ROM housing their best digital projects and produced by teacher Laurie Greenly, has been recognized as a model for computer-based art education throughout the state.

At the post-graduate level, Adobe's collection of creation, assembly, and delivery software is widely used in student work at the Royal College of Art in London. Its new Master of Arts in Interactive Multimedia (MA IMM) degree is instilling vital computer skills in a new generation of multimedia designers across Europe.

Learning at the brink of change. A 1995 educator survey reported that 85 percent of 1,000 respondents use computers in the classroom, and that 29 percent of them use the Internet or another on-line service for instructional purposes. At the K–12 level, an estimated 5.5 million computers are installed in the United States and Canada. Clearly, schools recognize the urgency for computer-based training and the value of on-line learning. The education market is evolving daily to help students meet the future, and Adobe software is there to point the way.

U.S. NEWS ONLINE
http://www2.USNews.com/usnews

HARPERCOLLINS INTERACTIVE
http://www.harpercollins.com/hci

ADOBE ILLUSTRATOR

AT&T WORLDNET SERVICES
http://www.att.com/worldnet

SCHOCK ENTERTAINMENT
http://www.bway.net/~schock

ADOBE PAGEMAKER

AIR & SPACE
http://airspacemag.com

ADOBE PAGEMILL

TIMESFAX INTERNET EDITION
http://nytimesfax.com

La Stampa
http://www.lastamp

ADOBE SYSTEMS
http://www.adobe.com

ASSOCIATED PRESS
http://www.trib.com/NEWS/APwire.html

MEDICAL ECONOMICS
http://www.medec.com

ADOBE FRAMEMAKER

ADOBE ACROBAT CAPTURE

INTERNAL REVENUE SERVICE
http://www.irs.ustreas.gov

FIRST CALL CORPORATION
http://www.firstcall.com

U.S. DEPT. OF THE NAV
http://www.navy.co

ADOBE PHOTOSHOP

PENGUIN USA
http://www.penguin.com/usa

CLEMENT MOK DESIGNS
http://www.cmdesigns.com

ADOBE TYPE LIBRARY

WHARTON INFORMATION NETWORK
http://www.wharton.upenn.edu

SUSUMU ENDO
http://www.Bekkoame.or.jp/~endos

ADOBE PERSUASION

DER SPIEGEL
http://www.spiegel.de

ADOBE PREMIERE

ADOBE AFTER EFFECTS

TANDEM
http://www.tandem.co

MAGNETIC PRESS
http://www.acropolis.com/acropolis

IDEADISC
http://ny.frontiercomm.net/~lngpost/ideadisc.html

ADOBE POSTSCRIPT

THE ECONOMIST
http://www.economist.com

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 Systems Incorporated ("Adobe" or the "Company") develops, markets, and supports computer software products and technologies that enable users to create, display, manage, communicate, and print electronic documents. The Company licenses its technology to major computer, printing, and publishing suppliers and markets a line of application software products and type products for authoring and editing visually rich documents. 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 October 1995, the Company acquired Frame Technology Corporation ("Frame"). Frame, established in 1986, developed, marketed, and supported writing and publishing software for the creation and distribution of critical business and technical documents. To effect the combination, approximately 8.5 million shares of Adobe's common stock were issued in exchange for all of the outstanding common stock of Frame. 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 Frame. In connection with the merger, the Company recorded $11.4 million of merger transaction costs and $21.1 million of restructuring costs in the fourth quarter of 1995.

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 the write-off of certain capitalized software development costs, transition personnel bonuses, and relocation expenses among others, and totaled approximately $10.1 million.

In January 1996, the Company spun off its prepress applications product business to a newly established company, Luminous Corporation ("Luminous"). Under the terms of the agreement, Luminous has acquired or licensed and will continue to develop, market, and distribute Adobe's prepress application products. Adobe will retain a minority equity interest in Luminous and will maintain ownership of certain core technologies for Adobe prepress products. Luminous will pay royalties to Adobe based on a percentage of revenue from certain products for the next two years. Revenue from prepress application products was approximately $10.4 million in fiscal 1995.

Revenue	1995	Change	1994	Change	1993
Total revenue	$762.3	13%	$675.6	16%	$580.1

Revenue growth in 1995 and 1994 is attributable to increases in both licensing activity related to the Company's PostScript interpreter and application products shipments resulting from the release of new and enhanced products. In 1995, the increase in application products revenue was partially offset by the divestiture of Aldus FreeHand in January 1995 and the discontinuance of Aldus PhotoStyler in late 1994, as further discussed below. Product unit volume (as opposed to price) growth was the principal factor in the Company's revenue growth in application products revenue. No customer accounted for more than 10 percent of the Company's total revenue in 1995, 1994, or 1993.

	1995	Change	1994	Change	1993
Product group revenue—Licensing	$183.4	17%	$156.7	7%	$146.2
Percentage of total revenue	24.1%		23.2%		25.2%

Licensing revenue is derived from shipments by OEM customers of products containing the Adobe 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 the Configurable PostScript Interpreter ("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 1995 and 1994. Royalty per unit is generally calculated as a percentage of the end user list price of a printer, although there are some components of licensing revenue based on a flat dollar amount per unit that typically do not change with list prices. During this period, some OEMs introduced lower end printers or reduced their list prices on lower end printers, which resulted in lower royalties per unit on such printers. However, in 1995 and 1994, this trend was offset by increased demand for CPSI and, in 1995, by increased demand for color capability as well as greater penetration into the Japanese market, all of which have higher royalties per unit.

The Company has seen year-to-year increases in the number of OEM customers from which it is receiving licensing revenue and believes that such increases are attributable to the continued acceptance of PostScript software, as well as to the diversification of the Company's customer base across multiple platforms.

	1995	Change	1994	Change	1993
Product group revenue—Application products	$578.9	12%	$519.0	20%	$433.9
Percentage of total revenue	75.9%		76.8%		74.8%

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 1995 primarily due to increased demand for Adobe Photoshop, Adobe PageMaker, Adobe FrameMaker, and the Adobe Acrobat family of products. The Company released Adobe PageMaker 6.0 for the Macintosh platform late in the third quarter, and for the Windows and Windows 95 platforms in the fourth quarter. In addition, the Company released Adobe Photoshop 3.0 for the Windows platform in the first quarter and released new Adobe Acrobat products or new versions of existing products throughout the year. The 1995 revenue growth was partially offset by the divestiture of Aldus FreeHand in January 1995 and the discontinuance of Aldus PhotoStyler late in 1994. These two products aggregated $53.2 million of revenue in 1994.

In 1994, application products revenue increased as a result of higher sales of Adobe Illustrator, Adobe Photoshop, and Adobe PageMaker, all of which benefited from the release of new versions in 1994. Adobe

FrameMaker also showed strong revenue growth. The release of Aldus FreeHand 4.0 (divested by the Company in January 1995) for Windows and the Power Macintosh platforms also contributed to the 1994 revenue increase. Other factors affecting 1994 revenue growth include the release of localized versions for the Japanese market of Adobe Photoshop, Adobe Illustrator, and Adobe PageMaker for the Macintosh platform; increased sales of Adobe Premiere, a video editing and sequencing tool; and the release of Adobe Illustrator and Adobe Photoshop for selected UNIX platforms. Reduced sales for individual typeface packages offset a portion of the revenue growth in 1994.

Direct costs	1995	Change	1994	Change	1993
Direct costs	$130.3	7%	$122.0	13%	$107.8
Percentage of total revenue	17.1%		18.1%		18.6%

Direct costs include royalties; amortization of acquired technologies; and direct product, packaging, and shipping costs. During 1994 and 1993, direct costs also included amortization of typeface production costs, which totaled $4.8 million and $4.6 million, respectively.

Gross margins are affected by the mix of licensing revenue versus application products revenue, as well as the product mix within application products. 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. These actions also benefited 1995 and 1994. In addition, the 1995 purchase relating to Adobe Photoshop, as further discussed below, resulted in lower direct costs for that product as a percentage of its revenue.

On March 31, 1995, the Company entered into an agreement with the developers of the technology underlying its Adobe Photoshop product under which the Company made a lump-sum payment to the developers of $34.5 million in lieu of all royalty obligations incurred in connection with the technology after the beginning of the fourth quarter of 1994. Accordingly, $8.5 million of the amount paid to the developers was applied to accrued royalties related to the fourth quarter of 1994 and the 1995 period prior to the execution of the agreement. The balance of $26.0 million is being amortized over 30 months. This transaction has been recorded on the Consolidated Balance Sheets in "Other assets" as part of purchased technology. Prior to this agreement, the Company paid the developers a royalty for each copy of Adobe Photoshop sold by the Company. To date, the amortization expense related to the purchase has been less than the per-copy royalty expense that would otherwise have been incurred.

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	1995	Change	1994	Change	1993
Software development costs—Research and development	$138.6	22%	$113.8	14%	$100.2
Percentage of total revenue	18.2%		16.8%		17.3%

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 continued 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. Accordingly, the Company intends to continue recruiting and hiring experienced software developers.

While the Company expects that research and development expenditures in 1996 will increase in absolute dollars, such expenditures are expected to decline as a percentage of revenue.

	1995	Change	1994	Change	1993
Software development costs—Amortization of capitalized software development costs	$11.1	−23%	$14.3	36%	$10.5
Percentage of total revenue	1.5%		2.1%		1.8%

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 Frame and Aldus products have been capitalized and are being amortized over the lives of the respective products. In the fourth quarters of 1995 and 1994, software development expenditures on Frame and Aldus products, respectively, after reaching technological feasibility, were immaterial and the Company anticipates this trend to continue in the future. Accordingly, the fourth quarter of 1994 and all of 1995 reflect the additional expense of amortizing capitalized software development costs acquired with Aldus. All such capitalized software development costs acquired with Aldus were fully amortized at the end of 1995. Likewise, the fourth quarter of 1995 did, and all of 1996 will, reflect the additional cost of amortizing capitalized software costs acquired with Frame in addition to the actual development expenditures (classified as research and development) made prior to achieving technological feasibility.

Amortization of capitalized software development costs decreased in 1995 as a result of achieving full amortization of all Aldus products by the end of 1995. The increase in 1994 was due to the amortization of Adobe PageMaker 5.0, released in the second half of 1993, and the release of other new application products. It is expected that amortization of software development costs will decrease both in absolute dollars and as a percentage of revenue during 1996 as the software products acquired with Frame become fully amortized.

	1995	Change	1994	Change	1993
Sales, marketing, and customer support	$242.7	3%	$234.8	13%	$206.9
Percentage of total revenue	31.8%		34.7%		35.7%

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 expenses also include 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. In 1995, reduced costs resulting from the restructuring of the combined company after the acquisition of Aldus in 1994 resulted in a decrease in costs as a percentage of revenue. This decrease was partially offset by the effect of the acquisition of Frame as well as increased advertising relating to the release of Adobe PageMaker 6.0 and expenses from several major trade shows.

Decreased costs expected to result from the restructuring of the combined company after the acquisition of Frame will be partially offset by continuing efforts to expand markets and increase penetration into targeted software markets, as well as to respond to increased competition in the software industry. As a result, 1996 sales, marketing, and customer support expenditures are expected to decrease from 1995 spending levels as a percentage of revenue.

	1995	Change	1994	Change	1993
General and administrative	$58.5	–3%	$60.5	–8%	$66.0
Percentage of total revenue	7.7%		9.0%		11.4%

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.

General and administrative expenses have decreased each year since 1993, both in absolute dollars and as a percentage of revenue. The 1993 expense reflects a higher spending level attributable to the growth of systems, processes, and people necessary to support overall increases in the scope of the Company's operations, as well as additional costs incurred for the legal defense 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 1995 decrease reflects savings related to the restructuring of the combined company after the acquisition of Aldus, partially offset by costs related to the acquisition of Frame and write-downs related to certain intangible assets.

The Company expects general and administrative spending in 1996 to be slightly lower than 1995 levels as a percentage of revenue.

	1995	Change	1994	Change	1993
Write-off of acquired in-process research and development	$15.0	–3%	$15.5	261%	$4.3
Percentage of total revenue	2.0%		2.3%		0.7%

During 1995, 1994, and 1993, the Company acquired in purchase transactions one or more software developers. In each of these transactions, a portion of the purchase price was allocated to in-process research and development and was expensed at the time of the acquisitions. In 1995, this expense relates to Ceneca Communications, Inc.; in 1994, to LaserTools Corporation and Compumation, Incorporated; and in 1993, to AH Software, Inc. (doing business as After Hours Software) and The Company of Science & Art.

	1995	Change	1994	Change	1993
Merger transaction and restructuring costs	$31.5	–56%	$72.2	180%	$25.8
Percentage of total revenue	4.1%		10.7%		4.4%

Merger transaction and restructuring costs for 1995 were $31.5 million. This represents charges of $32.5 million in connection with the acquisition of Frame less the reversal of $1.0 million of excess reserves related to restructuring costs recorded in prior years.

During the fourth quarter of 1995, the Company recorded merger transaction and restructuring costs associated with the acquisition of Frame of $11.4 million and $21.1 million, respectively. The restructuring costs included $16.4 million related to cash expenditures and noncash items of $4.7 million, consisting primarily of write-offs of redundant equipment and intangible assets. As of December 1, 1995, $20.1 million of the balance in accrued restructuring costs represented expected future cash expenditures related to the Frame acquisition, most of which will be spent in 1996.

To execute the acquisition of Frame, 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 acquisition of Frame, certain sales, 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 $11.0 million related to approximately 200 terminated employees. Affected employees received notification of their termination by November 8, 1995, and final assignments are expected to be completed by mid-1996.

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, as well as of other redundant equipment. In addition, certain intangible assets that will have no benefit to the combined company were written off. The write-off of abandoned equipment and intangible assets included in restructuring costs was $4.7 million. In addition, redundant offices in Europe, Japan, Canada, and the United States will be eliminated. Lease and third-party contract termination payments totaling $5.4 million, resulting from the planned closure of 14 facilities, are accrued as part of the restructuring costs.

The Company is unable to determine what effects the merger and restructuring actions will have on future operating results and the financial condition of the organization.

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. These costs included $46.5 million of current and future cash expenditures related to merger transaction fees and expenses, severance and outplacement for approximately 500 terminated employees, and lease and third-party contract termination payments resulting from the planned closure of 10 facilities. Noncash items of $25.7 million consisted primarily of write-offs of redundant information systems and equipment and of duplicate product lines. As a condition to the acquisition of Aldus, effective January 1995, the Company no longer sells and distributes FreeHand, the illustration program previously sold and distributed by Aldus. Also, PhotoStyler, an image editing software tool, was discontinued in the fourth quarter of 1994, as the product competed with certain existing products of the Company. 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.

In the fourth quarter of 1995, the Company analyzed the remaining accrued restructuring costs related to the acquisition of Aldus. As a result of this review, it was determined that approximately $0.7 million represented excess reserves and, therefore, this amount was reversed and credited to "Merger transaction and restructuring costs" in the Consolidated Statements of Income. As of December 1, 1995, $7.0 million of the balance in accrued restructuring costs represented expected future cash expenditures related to the Aldus acquisition, primarily related to payments under leases on redundant offices that will be incurred in future periods.

Due to lower than anticipated revenues experienced in the first three quarters of 1993, Frame undertook certain restructuring measures to reduce the size and scope of its operations and re-evaluated and redirected its product and distribution strategies. These actions resulted in restructuring charges totaling $16.0 million. In addition, Frame incurred other charges relating to the restructuring of approximately $9.8 million, which consisted primarily of write-offs of capitalized software, obsolete inventory and equipment, and the settlement of certain contingencies. Of the total restructuring and other charges, $12.8 million resulted from the write-off of assets, which occurred in 1993, and $13.0 million involved cash outflows, of which $4.7 million were incurred in 1993.

During 1994, the results of the settlement of certain contingencies and changes in Frame's foreign distribution in Japan were more favorable than expected by approximately $2.2 million. However, these amounts were offset by increased estimates of costs related to facilities previously vacated and Frame's decision to curtail significantly its Irish operations resulting in a charge for termination costs, vacated facilities, and fixed asset write-offs. In 1994, Frame paid approximately $1.6 million in salary costs and approximately $3.3 million related to the settlement of certain contingencies, changing its foreign distribution in Japan, the relocation of its European headquarters, lease payments for vacated facilities, and other charges.

During 1995, Frame made cash payments of $1.6 million and $0.2 million related to the curtailment of its Irish operations and vacated leased facilities, respectively. In addition, an analysis of its remaining accrued restructuring costs in the fourth quarter of 1995 indicated that approximately $0.3 million represented excess reserves. This amount was reversed and credited to "Merger transaction and restructuring costs" in the Consolidated Statements of Income. As of December 1, 1995, $1.1 million remained accrued and represented anticipated future cash outflows related to lease payments on vacated facilities.

Nonoperating income	1995	Change	1994	Change	1993
Interest, investment, and other income	$29.3	181%	$10.4	−25%	$13.8
Percentage of total revenue	3.8%		1.5%		2.4%

Interest, investment, and other income increased by $18.9 million in 1995 from 1994 and decreased by $3.4 million in 1994 from 1993. The increase in 1995 from 1994 is primarily due to a larger investment base and generally higher interest rates in 1995 compared to 1994. In addition, the Company increased the weighted average days-to-maturity of its investments in 1995, which generated higher rates of return. 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. Interest, investment, and other income in 1994 would have increased approximately $1.0 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 from small increases in prevailing interest rates.

Income tax provision	1995	Change	1994	Change	1993
Income tax provision	$70.4	87%	$37.6	24%	$30.4
Percentage of total revenue	9.2%		5.6%		5.2%
Effective tax rate	42.9%		71.0%		41.9%

The Company's effective tax rate in 1995 decreased significantly over the effective tax rate of 1994, due primarily to smaller one-time, nondeductible merger transaction and restructuring costs and increased tax-exempt income. The Company's effective tax rate in 1994 increased significantly over the effective tax rate of 1993, 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 of Notes to Consolidated Financial Statements.

Net income and net income per share	1995	Change	1994	Change	1993
Net income	$93.5	510%	$15.3	−63%	$42.0
Percentage of total revenue	12.3%		2.3%		7.2%
Net income per share	$ 1.26	473%	$ 0.22	−65%	$ 0.62
Weighted shares (in thousands)	74,253	6%	70,169	3%	68,252

Net income for 1995 represents a 510 percent increase over 1994, while 1994 net income decreased 63 percent from that of 1993. Results of operations in each of the three years 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 each of the years follows.

(In thousands, except per share data)	Income Before Income Taxes	Income Tax Provision	Net Income	1995 Net Income Per Share
Reported results of operations	$163,853	$70,368	$ 93,485	$1.26
Write-off of acquired in-process research and development:				
Ceneca Communications, Inc.	14,983	—	14,983	0.20
Acquisition of Frame:				
Merger transaction costs	11,399	—	11,399	0.15
Restructuring costs	20,135	6,086	14,049	0.19
Other one-time charges	3,160	1,484	1,676	0.02
Effect of fourth quarter antidilutive common stock equivalents	—	—	—	(0.02)
Results of operations excluding one-time charges	$213,530	$77,938	$135,592	$1.80

(In thousands, except per share data)	Income Before Income Taxes	Income Tax Provision	Net Income	1994 Net Income Per Share
Reported results of operations	$ 52,946	$37,609	$15,337	$0.22
Write-off of acquired in-process research and development:				
Compumation, Incorporated	3,045	—	3,045	0.04
LaserTools Corporation	12,424	—	12,424	0.17
Acquisition of Aldus:				
Merger transaction costs	14,618	—	14,618	0.21
Restructuring costs	57,565	19,922	37,643	0.53
Other one-time expenses resulting from the acquisition	10,092	3,734	6,358	0.09
Results of operations excluding one-time charges	$150,690	$61,265	$89,425	$1.26

(In thousands, except per share data)	Income Before Income Taxes	Income Tax Provision	Net Income	1993 Net Income Per Share
Reported results of operations	$ 72,358	$30,351	$42,007	$0.62
Write-off of acquired in-process research and development:				
AH Software, Inc. and The Company of Science & Art	4,285	—	4,285	0.06
Restructuring of Frame's operations	25,800	9,030	16,770	0.24
Results of operations excluding one-time charges	$102,443	$39,381	$63,062	$0.92

Furthermore, the future effective tax rate is expected to be approximately 36 percent. Had this rate been in effect in 1995, 1994, and 1993, the net income per share, excluding the above one-time charges, would have been $1.82, $1.36, and $0.96 per share, respectively.

Factors that may affect future results of operations

The Company believes that in the future its results of operations could be affected by various factors such as the ability of the Company to integrate Adobe, Aldus, and Frame 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 Frame, 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 will occur in the first and second quarters of 1996 but expects some additional impact in later quarters of 1996. 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, the integration of the product lines of the two companies could have a material adverse effect on the results of operations, including the potential for charges for certain discontinued business components.

As previously stated, effective January 1, 1995, the Company no longer markets FreeHand and discontinued marketing of PhotoStyler in late 1994. 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 continue 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.

The Company derives a significant portion of its revenue and operating income from its subsidiaries located in Europe and the Pacific Rim. While most of the revenue of these subsidiaries is denominated in U.S. dollars, the majority of their expense transactions are denominated in foreign currencies, including the Japanese yen and most major European currencies. As a result, the Company's operating results are subject to fluctuations in foreign currency exchange rates. To date the impact of such fluctuations has been insignificant, and the Company has not engaged in any significant activities to hedge its exposure to foreign currency exchange rate fluctuations.

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 product 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.

Although the Company generally offers its application products on Macintosh, Windows, and UNIX platforms, a majority of the overall sales of these products to date has been for the Macintosh platform, particularly for the higher end Macintosh computers. To the extent that there is a slowdown of customer purchases in the higher end Macintosh market, or if other operating systems, such as Windows 95, become more prevalent among the Company's customers, the Company's operating results could be materially adversely affected.

During 1995, the Company entered the Internet market, which has only recently begun to develop. The Internet market is rapidly evolving and is characterized by an increasing number of market entrants who have introduced or developed products addressing authoring and communication over the Internet. As is typical in the case of a new and evolving industry, demand and market acceptance for recently introduced products and services are subject to a high level of uncertainty. The software industry addressing the authoring and electronic publishing requirements of the Internet is young and has few proven products. Moreover, critical issues concerning the commercial use of the Internet (including security, reliability, cost, ease of use and access, and quality of service) remain unresolved and may impact the growth of Internet use, together with the software standards and electronic media employed in such markets.

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. In addition to factors specific to the Company, changes in analysts' earnings estimates for the Company or its industry, and factors affecting the corporate environment or the securities markets in general, will often result in significant volatility of the Company's common stock price.

Recent accounting pronouncements

In March 1995, the Financial Accounting Standards Board issued SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS No. 121 will be effective for fiscal years beginning after December 15, 1995, and requires long-lived assets to be evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company will adopt SFAS No. 121 in fiscal 1997 and does not expect its provisions to have a material effect on the Company's consolidated results of operations in the year of adoption.

In October 1995, the Financial Accounting Standards Board issued SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123 will be effective for fiscal years beginning after December 15, 1995, and will require that the Company either recognize in its consolidated financial statements costs related to its employee stock-based compensation plans, such as stock option and stock purchase plans, using a prescribed methodology, or make pro forma disclosure of such costs in a footnote to the consolidated financial statements.

The Company expects to continue to use the intrinsic value based method of Accounting Principles Board Opinion No. 25, as allowed under SFAS No. 123, to account for all of its employee stock-based compensation plans. Therefore, in its consolidated financial statements for fiscal 1997, the Company will make the required pro forma disclosures in a footnote to the consolidated financial statements. SFAS No. 123 is not expected to have a material effect on the Company's consolidated results of operations or financial position.

Financial Condition

Cash, cash equivalents, and short-term investments

	1995	Change	1994	Change	1993
Cash, cash equivalents, and short-term investments	$516.0	16%	$444.8	29%	$344.7

The Company's cash balances and short-term investments have increased each year due to profitable operations, partially offset by expenditures for capital outlays and other investments. In 1995 and 1994, growth in cash balances and short-term investments was reduced by increased merger and acquisition activity.

Cash equivalents consist of highly liquid money market instruments. All of the Company's cash equivalents and 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.

Noncurrent liabilities and shareholders' equity

	1995	Change	1994	Change	1993
Noncurrent liabilities and shareholders' equity	$698.4	36%	$514.3	11%	$464.1

Included above are shareholders' equity and, in 1993, put warrants. As of December 1, 1995, the Company had no noncurrent liabilities. Shareholders' equity as of December 1, 1995 was $698.4 million, compared to $514.3 million as of November 25, 1994 and $457.2 million as of November 26, 1993. A significant portion of the year-to-year increases in shareholders' equity is attributable to issuance of common stock under the Company's stock option and employee stock purchase plans.

The Company has paid cash dividends on its common stock each quarter since the second quarter of 1988. During 1995, the Company paid cash dividends of $0.20 per common share. The Company's Board of Directors 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 Company's Board of Directors and will depend upon business conditions, results of operations, the financial condition of the Company, and other factors.

Working capital	1995	Change	1994	Change	1993
Working capital	$506.5	26%	$402.8	16%	$347.7

Net working capital grew to $506.5 million as of December 1, 1995, compared to $402.8 million as of November 25, 1994. Cash flow provided by operations during 1995 was $177.0 million.

Expenditures for property and equipment totaled $34.1 million. Such expenditures are expected to continue, including expenditures for computer systems for development, sales and marketing, product support, and administrative staff. In addition, in 1995 the Company paid approximately $67.4 million to acquire Ceneca Communications, Inc., to buy out its future royalty obligation with respect to its Adobe Photoshop product, and to invest in various companies, either directly or through a limited partnership arrangement. 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 1995 was $36.9 million, primarily resulting from the issuance of common stock under employee stock plans, partially offset by repurchases of common stock and payment of dividends.

The Company's principal commitments as of December 1, 1995 consisted of obligations under operating leases, a real estate development agreement, and various service and lease guarantee agreements with a related party.

The Company has 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 for 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. During 1995, the Company increased its deposits by approximately $33.4 million, and as of December 1, 1995, the Company's deposits under this agreement totaled approximately $35.6 million in United States government treasury notes and money market mutual funds. These deposits are included in "Other assets" in the Consolidated Balance Sheets.

The Company has also entered into various agreements with McQueen Holdings Limited ("McQueen"), a European operating entity, whereby the Company has agreed to guarantee obligations under operating leases for certain European facilities utilized by McQueen, and to guarantee certain levels of business between Adobe and McQueen. The Company currently owns 16 percent of the outstanding stock in McQueen. The Company's ownership percentage has increased over that of 1994 because McQueen repurchased some of its previously outstanding shares.

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.

Except for the historical information contained herein, the matters discussed in this Annual Report contain forward-looking statements that involve risks and uncertainties. Adobe's actual results could differ materially. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Factors that may affect future results of operations" above, as well as those discussed elsewhere in Adobe's SEC reports (including without limitation its Report on Form 10-K for the fiscal year ended December 1, 1995).

CONSOLIDATED **Balance Sheets**

(In thousands, except share data)	December 1 1995	November 25 1994
Assets		
Current assets:		
Cash and cash equivalents	$ 58,493	$204,120
Short-term investments	457,547	240,648
Receivables	133,208	111,290
Inventories	7,277	10,113
Other current assets	11,924	11,302
Deferred income taxes	24,338	21,049
Total current assets	692,787	598,522
Property and equipment	51,708	46,568
Other assets	135,735	51,426
Deferred income taxes	4,502	13,484
	$884,732	$710,000
Liabilities and Shareholders' Equity		
Current liabilities:		
Trade and other payables	$ 25,639	$ 34,354
Accrued expenses	94,848	88,954
Accrued restructuring costs	28,151	31,688
Income taxes payable	19,420	24,982
Deferred revenue	18,257	15,707
Total current liabilities	186,315	195,685
Shareholders' equity:		
Preferred stock, no par value; 2,000,000 shares authorized; none issued	—	—
Common stock, no par value; 200,000,000 shares authorized; 72,834,444 and 69,389,591 shares issued and outstanding as of December 1, 1995 and November 25, 1994, respectively	293,258	204,033
Unrealized gains (losses) on investments	18,831	(1,277)
Retained earnings	390,793	315,611
Cumulative foreign currency translation adjustments	(4,465)	(4,052)
Total shareholders' equity	698,417	514,315
	$884,732	$710,000

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF **Income**

(In thousands, except per share data)	Years Ended December 1 1995	November 25 1994	November 26 1993
Revenue:			
Licensing	$183,437	$156,652	$146,176
Application products	578,902	518,965	433,927
Total revenue	762,339	675,617	580,103
Direct costs	130,301	122,023	107,792
Gross margin	632,038	553,594	472,311
Operating expenses:			
Software development costs:			
Research and development	138,616	113,797	100,200
Amortization of capitalized software development costs	11,095	14,329	10,498
Sales, marketing, and customer support	242,713	234,771	206,946
General and administrative	58,526	60,531	66,048
Write-off of acquired in-process research and development	14,983	15,469	4,285
Merger transaction and restructuring costs	31,534	72,183	25,800
Total operating expenses	497,467	511,080	413,777
Operating income	134,571	42,514	58,534
Nonoperating income:			
Interest, investment, and other income	29,282	10,432	13,824
Income before income taxes	163,853	52,946	72,358
Income tax provision	70,368	37,609	30,351
Net income	$ 93,485	$ 15,337	$ 42,007
Net income per share	$ 1.26	$ 0.22	$ 0.62
Shares used in computing net income per share	74,253	70,169	68,252

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF *Shareholders' Equity*

(In thousands, except share data)	Common Stock Shares	Common Stock Amount	Unrealized Gains (Losses) on Investments	Retained Earnings	Cumulative Foreign Currency Translation Adjustments	Total
Balances as of November 27, 1992	65,233,723	$137,478	$ —	$285,136	$(3,843)	$418,771
Issuance of common stock under Stock Option Plans	1,597,587	16,285	—	—	—	16,285
Issuance of common stock under Employee Stock Purchase Plan	558,301	7,741	—	—	—	7,741
Issuance of common stock under Restricted Stock Plans	50,300	—	—	—	—	—
Tax benefit from employee stock plans	—	11,234	—	—	—	11,234
Stock compensation expense	—	1,651	—	—	—	1,651
Dividends declared	—	—	—	(9,005)	—	(9,005)
Subchapter S distributions of Mastersoft	—	—	—	(1,807)	—	(1,807)
Shares issued in connection with acquisition	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	—	—	—	42,007	—	42,007
Balances as of November 26, 1993	66,420,347	145,189	—	316,331	(4,304)	457,216
Issuance of common stock under Stock Option Plans	2,647,740	37,103	—	—	—	37,103
Issuance of common stock under Employee Stock Purchase Plan	679,392	10,077	—	—	—	10,077
Issuance of common stock under Restricted Stock Plans	53,500	—	—	—	—	—
Tax benefit from employee stock plans	—	14,418	—	—	—	14,418
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)
Subchapter S distributions of Mastersoft	—	—	—	(1,245)	—	(1,245)
Shares issued in connection with acquisition	104,520	2,105	—	—	—	2,105
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	—	—	(1,277)	—	—	(1,277)
Foreign currency translation adjustment	—	—	—	—	(235)	(235)
Net income	—	—	—	15,337	—	15,337
Balances as of November 25, 1994	69,389,591	204,033	(1,277)	315,611	(4,052)	514,315

(In thousands, except share data)	Common Stock Shares	Common Stock Amount	Unrealized Gains (Losses) on Investments	Retained Earnings	Cumulative Foreign Currency Translation Adjustments	Total
Balances as of November 25, 1994	69,389,591	$204,033	$ (1,277)	$315,611	$(4,052)	$514,315
Issuance of common stock under Stock Option Plans	3,179,073	58,417	—	—	—	58,417
Issuance of common stock under Employee Stock Purchase Plan	594,129	11,950	—	—	—	11,950
Issuance of common stock under Restricted Stock Plans	141,000	—	—	—	—	—
Tax benefit from employee stock plans	—	32,445	—	—	—	32,445
Stock compensation expense	—	4,433	—	—	—	4,433
Adjustment for change in Frame Technology Corporation fiscal year-end	(9,516)	(171)	—	(1,784)	—	(1,955)
Dividends declared	—	—	—	(13,177)	—	(13,177)
Subchapter S distributions of Mastersoft	—	—	—	(3,342)	—	(3,342)
Repurchase of common stock	(459,833)	(17,849)	—	—	—	(17,849)
Unrealized gains on investments	—	—	20,108	—	—	20,108
Foreign currency translation adjustment	—	—	—	—	(413)	(413)
Net income	—	—	—	93,485	—	93,485
Balances as of December 1, 1995	72,834,444	$293,258	$18,831	$390,793	$(4,465)	$698,417

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF *Cash Flows*

(In thousands)	Years Ended December 1 1995	November 25 1994	November 26 1993
Cash flows from operating activities:			
Net income	$ 93,485	$ 15,337	$ 42,007
Adjustments to reconcile net income to net cash provided by operating activities:			
Stock compensation expense	4,433	1,064	1,651
Depreciation and amortization	60,435	57,794	49,841
Deferred income taxes	(6,828)	(11,663)	(10,993)
Unrealized loss on investments	—	—	(113)
Provision for losses on accounts receivable	2,038	1,963	1,842
Tax benefit from employee stock plans	32,445	14,418	11,234
Write-off of acquired in-process research and development	14,983	15,469	4,285
Noncash restructuring costs	4,714	25,735	10,936
Changes in operating assets and liabilities:			
Receivables	(26,586)	(17,648)	(3,239)
Inventories	2,496	962	1,028
Other current assets	(1,868)	(1,274)	(304)
Trade and other payables	(7,032)	11,979	5,473
Accrued expenses	3,161	14,505	8,878
Accrued restructuring costs	1,835	23,384	8,304
Income taxes payable	(5,184)	2,452	11,544
Deferred revenue	4,474	1,259	710
Net cash provided by operating activities	177,001	155,736	143,084
Cash flows from investing activities:			
Purchases of short-term investments	(2,614,349)	(1,766,916)	(754,767)
Maturities and sales of short-term investments	2,403,631	1,724,612	722,759
Acquisitions of property and equipment	(34,071)	(32,700)	(25,508)
Capitalization of software development costs	(2,175)	(10,953)	(14,129)
Additions to other assets	(93,791)	(17,663)	(4,755)
Acquisitions, net of cash acquired	(15,158)	(14,750)	(9,304)
Net cash used for investing activities	(355,913)	(118,370)	(85,704)

(In thousands)	December 1 1995	November 25 1994	Years Ended November 26 1993
Cash flows from financing activities:			
Proceeds from issuance of common stock	$ 70,367	$ 47,180	$ 15,376
Proceeds from sales of put warrants	—	719	694
Repurchase of common stock	(17,849)	(10,283)	(25,533)
Payment of dividends	(12,310)	(9,906)	(8,523)
Payment of Subchapter S distributions of Mastersoft	(3,342)	(1,245)	(1,807)
Net cash provided by (used for) financing activities	36,866	26,465	(19,793)
Effect of foreign currency exchange rates on cash and cash equivalents	10	(1,297)	(516)
Net increase (decrease) in cash and cash equivalents	(142,036)	62,534	37,071
Adjustment for change in acquired companies' fiscal year-ends	(3,591)	(3,554)	—
Cash and cash equivalents at beginning of year	204,120	145,140	108,069
Cash and cash equivalents at end of year	$ 58,493	$204,120	$145,140
Supplemental disclosures:			
Cash paid during the year for income taxes	$ 44,470	$ 26,121	$ 22,362
Noncash investing and financing activities:			
Dividends declared but not paid	$ 3,645	$ 2,778	$ 2,262
Reclassification of put warrants	$ —	$ (6,906)	$ 6,906

See accompanying 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, manage, communicate, and print electronic documents. The Company licenses its technology to major computer, printing, and publishing suppliers, and markets a line of application software products and type products for authoring and editing visually rich documents. Additionally, the Company markets a line of powerful, easy-to-use products for home and small business users. 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 October 1995, Adobe acquired Frame Technology Corporation ("Frame"), a developer of software applications for the creation, management, and distribution of documents for individuals and workgroups. In July 1995, Frame acquired Mastersoft, Inc. ("Mastersoft"), a developer of file conversion, viewing, and document comparison software. 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. Each of these acquisitions was made through a pooling of interests. Accordingly, the Company's consolidated financial statements have been restated, for all periods prior to the acquisitions, to include the results of operations, financial position, and cash flows of Frame, Mastersoft, and Aldus.

Fiscal year

The Company's current fiscal year is a 52/53-week year ending on the Friday closest to November 30.

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.

All of the Company's cash equivalents, short-term investments, and certain 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 Statement of Financial Accounting Standards ("SFAS") No. 115. The Company's investments in equity securities that are free of trading restrictions or that will become free of trading restrictions during the next 12 months are also classified as available-for-sale. 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 is 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.

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 U.S. 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 two 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

Purchased 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 seven 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" in the 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 36 months.

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 and equity methods, respectively.

Revenue recognition

The Company recognizes revenue in accordance with Statement of Position 91-1, "Software Revenue Recognition," and SFAS No. 48, "Revenue Recognition When Right of Return Exists." 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 for estimated future returns and price protection.

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 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 consists of customer advances under OEM licensing agreements and maintenance contracts for application products, which are deferred and recognized ratably over the term of the contract, generally 12 months.

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 and the tax basis of existing assets and liabilities measured using existing tax rates. 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.

Net income per share

Net income per share is based upon weighted average common and dilutive common equivalent shares outstanding using the treasury stock method. Dilutive common equivalent shares include stock options and restricted stock.

Recent accounting pronouncements

In March 1995, the Financial Accounting Standards Board issued SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS No. 121 will be effective for fiscal years beginning after December 15, 1995, and requires long-lived assets to be evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company will adopt SFAS No. 121 in fiscal 1997 and does not expect its provisions to have a material effect on the Company's consolidated results of operations in the year of adoption.

In October 1995, the Financial Accounting Standards Board issued SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123 will be effective for fiscal years beginning after December 15, 1995, and will require that the Company either recognize in its consolidated financial statements costs related to its employee stock-based compensation plans, such as stock option and stock purchase plans, or make pro forma disclosures of such costs in a footnote to the consolidated financial statements.

The Company expects to continue to use the intrinsic value based method of Accounting Principles Board Opinion No. 25, as allowed under SFAS No. 123, to account for all of its employee stock-based compensation plans. Therefore, in its consolidated financial statements for fiscal 1997, the Company will make the required pro forma disclosures in a footnote to the consolidated financial statements. SFAS No. 123 is not expected to have a material effect on the Company's consolidated results of operations or financial position.

Reclassifications

Certain reclassifications were made to the 1994 and 1993 consolidated financial statements to conform to the 1995 presentation.

Note 2.

ACQUISITIONS

Poolings of interests

On October 28, 1995, the Company issued approximately 8.5 million shares of its common stock in exchange for all of the common stock of Frame. Prior to its acquisition by the Company, on July 28, 1995, Frame acquired all of the common stock of Mastersoft in exchange for approximately 0.6 million equivalent shares of Adobe common stock. 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. These business combinations have been accounted for as poolings of interests, and, accordingly, the consolidated financial statements for periods prior to the combinations have been restated to include the results of operations, financial position, and cash flows of Frame, Mastersoft, and Aldus.

Prior to the combinations, Frame's and Aldus' fiscal years ended on December 31. In recording the business combination, Frame's financial statements for the 12 months ended December 1, 1995 were combined with the Company's consolidated financial statements for the same period. Frame's financial statements for the years ended December 31, 1994 and 1993 were combined with the Company's consolidated financial statements for the years ended November 25, 1994 and November 26, 1993, respectively. Revenue and net income of Frame for the month ended December 31, 1994 were $8.6 million and $2.3 million, respectively. Net income, Subchapter S distributions of Mastersoft, the issuance of common stock, and the net decrease in cash and cash equivalents were adjusted to eliminate the effect of including Frame's results of operations, financial position, and cash flows for the month ended December 31, 1994 in the years ended December 1, 1995 and November 25, 1994.

Similarly, Aldus' financial statements for the 12 months ended November 25, 1994 were combined with the Company's for the same period. Aldus' financial statements for the year ended December 31, 1993 were combined with the Company's consolidated financial statements for the year ended November 26, 1993. 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.

Combined results of operations

There were no significant transactions among the Company, Frame, and Aldus prior to the combinations which required elimination, and no adjustments were required to conform Aldus' accounting policies to those of the Company. Certain adjustments were made to Frame's tax provision and deferred tax accounts to reflect tax benefits available to the combined company. In addition, certain reclassifications were made to Frame's 1994 and 1993 financial statements to conform to the 1995 presentation.

The table below provides information for periods prior to the combinations regarding the results of operations for the separate enterprises.

	Nine Months Ended		Years Ended	
	September 1 1995	August 26 1994	November 25 1994	November 26 1993
Revenue:				
Adobe	$493,238	$260,112	$597,772	$313,457
Frame	68,225	55,646	77,845	59,866
Aldus	—	172,210	—	206,780
Combined	$561,463	$487,968	$675,617	$580,103
Net Income:				
Adobe	$ 97,705	$ 49,329	$ 6,309	$ 57,030
Frame	10,476	7,950	11,870	(32,392)
Aldus	—	5,131	—	9,515
Adjustment to Frame's tax provision	(2,906)	(1,916)	(2,842)	7,854
Combined	$105,275	$ 60,494	$ 15,337	$ 42,007

Purchases

In October 1995, the Company acquired Ceneca Communications, Inc. for approximately $15.2 million in cash and assumed liabilities. Of this amount, $15.0 million was allocated to in-process research and development and expensed at the time of acquisition. The remainder of the purchase price was allocated primarily to 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 operating results of the acquired companies have been included in the accompanying consolidated financial statements from their dates of acquisition.

Note 3.

Cash Equivalents and Short-term Investments

All cash equivalents, short-term investments, noncurrent investments, and certain investments in equity securities have been classified as available-for-sale securities and consisted of the following:

	As of December 1, 1995			
	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Classified as current assets:				
Money market mutual funds	$ 23,387	$ —	$ —	$ 23,387
United States government treasury notes and agency discount notes	129,350	2,356	—	131,706
State and municipal bonds and notes	245,758	1,911	(80)	247,589
Corporate and bank notes	54,493	710	(26)	55,177
Auction-rate securities	13,700	—	—	13,700
Asset-backed securities	15,131	122	(182)	15,071
Total current	481,819	5,099	(288)	486,630
Classified as noncurrent assets:				
Money market mutual funds	353	—	—	353
United States government treasury notes	35,237	44	—	35,281
Equity securities	2,000	26,835	—	28,835
Total noncurrent	37,590	26,879	—	64,469
Total securities	$519,409	$31,978	$(288)	$551,099

	As of November 25, 1994			
	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Classified as current assets:				
Money market mutual funds and time deposits	$ 11,050	$—	$ (7)	$ 11,043
United States government treasury notes and agency discount notes	134,209	—	(702)	133,507
State and municipal bonds and notes	147,882	—	(958)	146,924
Corporate and bank notes	16,094	—	(42)	16,052
Auction-rate securities	80,865	—	—	80,865
Asset-backed securities	7,199	—	(322)	6,877
Other securities	5,504	—	(46)	5,458
Total current	402,803	—	(2,077)	400,726
Classified as noncurrent assets:				
Money market mutual funds and time deposits	2,245	4	—	2,249
Total securities	$405,048	$ 4	$(2,077)	$402,975

Unrealized gains (losses) are reported as a separate component of shareholders' equity, net of taxes of $12.9 million and $0.8 million as of December 1, 1995 and November 25, 1994, respectively. Net realized gains for the years ended December 1, 1995 and November 25, 1994 of $1.4 million and $0.2 million, respectively, are included in interest, investment, and other income.

The Company's investments are classified as follows:

	December 1 1995	November 25 1994
Cash equivalents	$ 29,083	$160,078
Short-term investments	457,547	240,648
Other assets—equity investments	28,835	—
Other assets—restricted funds	35,634	2,249
	$551,099	$402,975

The cost and estimated fair value of available-for-sale securities by contractual maturity consisted of the following:

	December 1, 1995		November 25, 1994	
	Cost	Estimated Fair Value	Cost	Estimated Fair Value
Debt securities:				
One year or less	$ 89,895	$ 89,940	$267,511	$266,654
One to three years	363,167	367,196	49,473	48,579
Three to five years	35,516	36,357	—	—
Auction-rate securities	13,700	13,700	80,865	80,865
	502,278	507,193	397,849	396,098
Asset-backed securities	15,131	15,071	7,199	6,877
Total debt securities	517,409	522,264	405,048	402,975
Equity securities	2,000	28,835	—	—
Total securities	$519,409	$551,099	$405,048	$402,975

Included in auction-rate securities in 1994 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:

	December 1 1995	November 25 1994
Trade receivables	$ 91,296	$ 84,568
Royalty receivables	34,017	26,800
Interest and other receivables	11,593	3,815
	136,906	115,183
Less allowance for doubtful accounts	3,698	3,893
	$133,208	$111,290

Note 5.
Property and Equipment

Property and equipment consisted of the following:

	December 1 1995	November 25 1994
Land	$ 782	$ 782
Building	4,615	4,615
Equipment	122,794	107,078
Furniture and fixtures	18,962	20,042
Leasehold improvements	8,790	4,146
	155,943	136,663
Less accumulated depreciation and amortization	104,235	90,095
	$ 51,708	$ 46,568

Note 6.
Other Assets

Other assets consisted of the following:

	December 1 1995	November 25 1994
Licensing agreements	$ 16,319	$15,565
Goodwill	13,753	25,262
Purchased technology	35,626	355
Software development costs	36,988	33,260
Equity investments	53,091	5,927
Restricted funds	35,634	2,249
Miscellaneous other assets	11,363	8,202
	202,774	90,820
Less accumulated amortization	67,039	39,394
	$135,735	$51,426

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

Purchased technology
During 1995, the Company entered into an agreement with the developers of the technology underlying its Adobe Photoshop product under which the Company made a lump-sum payment of $34.5 million in lieu of all royalty obligations incurred in connection with the technology after the beginning of the fourth quarter of 1994. Accordingly, $8.5 million of the amount paid to the developers was applied to accrued royalties related to the fourth quarter of 1994 and the 1995 period prior to the execution of the agreement. The balance of $26.0 million is being amortized over 30 months, and as of December 1, 1995, the remaining unamortized cost was $18.2 million. Prior to this agreement, the Company paid the developers a royalty for each copy of Adobe Photoshop sold by the Company.

Software development costs
Unamortized software development costs were $2.5 million and $11.6 million as of December 1, 1995 and November 25, 1994, respectively. Amortization of software development costs was $11.1 million, $14.3 million, and $10.5 million for the years ended December 1, 1995, November 25, 1994, and November 26, 1993, respectively.

Note 7.
Accrued Expenses

Accrued expenses consisted of the following:

	December 1 1995	November 25 1994
Royalties	$ 7,194	$10,824
Accrued compensation and benefits	26,730	22,748
Sales and marketing allowances	24,586	20,697
Other	36,338	34,685
	$94,848	$88,954

Note 8.
Accrued Restructuring Costs

Associated with the acquisition of Frame

On October 28, 1995, the Company acquired Frame, described in "Note 2 - Acquisitions," and initiated a plan to combine the operations of the two companies. On this date, the Company recorded a $32.5 million charge to operating expenses related to 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 equipment, the write-off of certain intangible assets, severance and outplacement of terminated employees, and cancellation of certain contractual agreements.

Merger transaction and restructuring costs are summarized below:

	Provision Recorded at Acquisition Date	Period from Acquisition to December 1, 1995		Accrued as of December 1 1995
		Write-offs	Cash Payments	
Merger transaction costs	$11,399	$ —	$6,341	$ 5,058
Restructuring costs:				
Severance and outplacement	10,958	—	1,346	9,612
Redundant equipment and intangibles	4,452	4,452	—	—
Cancellation of facility leases and other contracts	5,664	262	—	5,402
	$32,473	$4,714	$7,687	$20,072

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 200 terminated employees. Affected employees had received notification of their termination by November 8, 1995, and final assignments are expected to be completed by mid-1996.

Note 5.
Property and Equipment

Property and equipment consisted of the following:

	December 1 1995	November 25 1994
Land	$ 782	$ 782
Building	4,615	4,615
Equipment	122,794	107,078
Furniture and fixtures	18,962	20,042
Leasehold improvements	8,790	4,146
	155,943	136,663
Less accumulated depreciation and amortization	104,235	90,095
	$ 51,708	$ 46,568

Note 6.
Other Assets

Other assets consisted of the following:

	December 1 1995	November 25 1994
Licensing agreements	$ 16,319	$15,565
Goodwill	13,753	25,262
Purchased technology	35,626	355
Software development costs	36,988	33,260
Equity investments	53,091	5,927
Restricted funds	35,634	2,249
Miscellaneous other assets	11,363	8,202
	202,774	90,820
Less accumulated amortization	67,039	39,394
	$135,735	$51,426

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

Purchased technology

During 1995, the Company entered into an agreement with the developers of the technology underlying its Adobe Photoshop product under which the Company made a lump-sum payment of $34.5 million in lieu of all royalty obligations incurred in connection with the technology after the beginning of the fourth quarter of 1994. Accordingly, $8.5 million of the amount paid to the developers was applied to accrued royalties related to the fourth quarter of 1994 and the 1995 period prior to the execution of the agreement. The balance of $26.0 million is being amortized over 30 months, and as of December 1, 1995, the remaining unamortized cost was $18.2 million. Prior to this agreement, the Company paid the developers a royalty for each copy of Adobe Photoshop sold by the Company.

Software development costs

Unamortized software development costs were $2.5 million and $11.6 million as of December 1, 1995 and November 25, 1994, respectively. Amortization of software development costs was $11.1 million, $14.3 million, and $10.5 million for the years ended December 1, 1995, November 25, 1994, and November 26, 1993, respectively.

Note 7.
Accrued Expenses

Accrued expenses consisted of the following:

	December 1 1995	November 25 1994
Royalties	$ 7,194	$10,824
Accrued compensation and benefits	26,730	22,748
Sales and marketing allowances	24,586	20,697
Other	36,338	34,685
	$94,848	$88,954

Note 8.
Accrued Restructuring Costs

Associated with the acquisition of Frame

On October 28, 1995, the Company acquired Frame, described in "Note 2 - Acquisitions," and initiated a plan to combine the operations of the two companies. On this date, the Company recorded a $32.5 million charge to operating expenses related to 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 equipment, the write-off of certain intangible assets, severance and outplacement of terminated employees, and cancellation of certain contractual agreements.

Merger transaction and restructuring costs are summarized below:

	Provision Recorded at Acquisition Date	Period from Acquisition to December 1, 1995		Accrued as of December 1 1995
		Write-offs	Cash Payments	
Merger transaction costs	$11,399	$ —	$6,341	$ 5,058
Restructuring costs:				
Severance and outplacement	10,958	—	1,346	9,612
Redundant equipment and intangibles	4,452	4,452	—	—
Cancellation of facility leases and other contracts	5,664	262	—	5,402
	$32,473	$4,714	$7,687	$20,072

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 200 terminated employees. Affected employees had received notification of their termination by November 8, 1995, and final assignments are expected to be completed by mid-1996.

Redundant equipment and intangibles
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 as well as other redundant equipment. In addition, certain intangible assets that will have no benefit to the combined company were written off. Redundant equipment was either disposed of during the fourth quarter or written down to its estimated net realizable value.

Cancellation of facility leases and other contracts
The Company has consolidated 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.

Associated with the acquisition of Aldus

On August 31, 1994, the Company merged with Aldus, described in "Note 2 - Acquisitions," 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 merger transaction and restructuring costs.

Merger transaction costs consisted principally of transaction fees for investment bankers, attorneys, accountants, financial printing, and other related charges. Restructuring costs included 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.

Merger transaction and restructuring costs are summarized below:

	Provision Recorded at Acquisition Date	Period from Acquisition to November 25, 1994: Write-offs	Period from Acquisition to November 25, 1994: Cash Payments	Accrued as of November 25 1994
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

	Accrued as of November 25 1994	Year Ended December 1, 1995: Write-offs	Year Ended December 1, 1995: Cash Payments	Year Ended December 1, 1995: Change in Estimate	Accrued as of December 1 1995
Merger transaction costs	$ 5,863	$ —	$ 5,863	$ —	$ —
Restructuring costs:					
Severance and outplacement	11,548	—	8,116	3,432	—
Cancellation of facility leases and other contracts	11,046	3,226	3,580	(2,743)	6,983
	$28,457	$3,226	$17,559	$ 689	$6,983

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 received notification of their termination by September 9, 1994, and final assignments were completed during 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 approximately $10.8 million of the abandoned systems. The sale or disposal of duplicate information systems and equipment was completed in the fourth quarter of 1994.

Duplicate product lines
As a condition of the merger, the Company no longer (after January 1995) sells and distributes FreeHand, the illustration program previously sold and distributed by Aldus. In addition, PhotoStyler, an image 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, totaling approximately $15.0 million, were written off in the fourth quarter of 1994.

Cancellation of facility leases and other contracts
The Company has consolidated 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.

Restructuring of Frame's operations in 1993
Due to lower than anticipated revenues experienced in the first three quarters of 1993, Frame undertook certain restructuring measures primarily related to reducing the size and scope of its operations and re-evaluating and redirecting its product and distribution strategies. These actions resulted in restructuring charges totaling $16.0 million. In addition, Frame incurred other charges relating to the restructuring of approximately $9.8 million, which consisted primarily of write-offs of capitalized software, obsolete inventory and equipment, and the settlement of certain contingencies. Of the total restructuring and other charges, $12.8 million resulted from the write-off of assets, which occurred in 1993, and $13.0 million involved cash outflows, of which $4.7 million were incurred in 1993.

During 1994, the results of the settlement of certain contingencies and changes in Frame's foreign distribution in Japan were more favorable than expected by approximately $2.2 million. However, these amounts were offset by increased estimates of costs related to facilities previously vacated and Frame's decision to curtail significantly its Irish operations, resulting in a charge for termination costs, vacated facilities, and fixed asset write-offs. In 1994, Frame paid approximately $1.6 million in salary costs and approximately $3.3 million related to the settlement of certain contingencies, changing its foreign distribution in Japan, the relocation of its European headquarters, lease payments for vacated facilities, and other charges.

During 1995, Frame made cash payments of $1.6 million and $0.2 million related to the curtailment of its Irish operations and vacated leased facilities, respectively. In addition, an analysis of its remaining accrued restructuring expenses in the fourth quarter of 1995 indicated that approximately $0.3 million represented excess reserves. This amount was reversed and credited to "Merger transaction and restructuring costs" in the Consolidated Statements of Income. As of December 1, 1995, $1.1 million remained accrued and represented anticipated future cash outflows related to lease payments on vacated facilities.

Note 9.

Income taxes

Income before income taxes includes net income (loss) from foreign operations of approximately $19.2 million, $(8.7) million, and $12.7 million for the years ended December 1, 1995, November 25, 1994, and November 26, 1993, respectively.

The provision for income taxes consisted of the following:

	Years Ended December 1 1995	November 25 1994	November 26 1993
Current:			
United States federal	$21,466	$22,048	$13,413
Foreign	18,418	8,336	8,849
State and local	5,206	7,170	6,470
Total current	45,090	37,554	28,732
Deferred:			
United States federal	(6,305)	(10,683)	(10,379)
Foreign	(986)	(1,785)	964
State and local	124	(1,895)	(200)
Total deferred	(7,167)	(14,363)	(9,615)
Charge in lieu of taxes attributable to employee stock plans	32,445	14,418	11,234
	$70,368	$37,609	$30,351

Total income tax expense differs from the expected tax expense (computed by multiplying the United States federal statutory rate of approximately 35 percent for 1995, 1994, and 1993 to income before income taxes) as a result of the following:

	Years Ended December 1 1995	November 25 1994	November 26 1993
Computed "expected" tax expense	$57,349	$18,531	$25,325
State tax expense, net of federal benefit	6,442	3,429	5,171
Nondeductible merger costs	4,078	5,209	—
Nondeductible write-off of acquired in-process research and development	5,244	5,475	489
Nondeductible goodwill	3,689	1,741	—
Tax-exempt income	(3,532)	—	—
Tax credits	(3,904)	(1,755)	(3,433)
Foreign losses, not benefited	2,706	3,550	2,038
Foreign tax rate differential	1,130	2,027	—
Other, net	(2,834)	(598)	761
	$70,368	$37,609	$30,351

The tax effects of the temporary differences that give rise to significant portions of the deferred tax assets and liabilities as of 1995 and 1994 are presented below:

	December 1 1995	November 25 1994
Deferred tax assets:		
Acquired technology	$ 4,750	$ 3,306
Reserves and deferred revenue	25,025	24,501
Depreciation	3,544	2,438
Net operating loss carryforwards	10,625	5,130
Tax credits and other carryforwards	5,702	12,486
Other	3,468	2,278
Total gross deferred tax assets	53,114	50,139
Deferred tax asset valuation allowance	(10,204)	(11,611)
Total deferred tax assets	42,910	38,528
Deferred tax liabilities:		
Basis difference of acquired assets	(113)	(694)
Capitalized costs	(29)	(2,315)
Investments	(12,860)	—
Other	(1,068)	(986)
Total deferred tax liabilities	(14,070)	(3,995)
Net deferred tax assets	$28,840	$34,533

As of December 1, 1995, the Company had United States federal net operating loss carryforwards of approximately $17.0 million, which expire in 2008, and tax credit carryforwards of approximately $5.0 million, which expire in years 1997 through 2009. The carryforwards are attributable to the premerger years of Aldus and Frame and are subject to certain limitations on usage. The Company also has foreign operating loss carryovers in various jurisdictions of approximately $16.0 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. Management believes that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the net deferred tax assets.

Note 10.

Employee Benefit Plans

Stock Option Plan

As of December 1, 1995, 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 agreements with Frame and Aldus will continue to have, and be subject to, the same terms and conditions set forth in the relevant Stock Option Plan after, in the case of Frame, application of the exchange ratio to the number of shares and the exercise price of each option. The Frame plan provided for the granting of stock options to employees, consultants, and officers under terms and conditions determined by Frame's Board of Directors at the time of the grant. The Aldus plan provided for the granting of stock options to employees and officers at the fair market value at the grant date. Options under the Aldus plan 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 vesting 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 1995, 1994, and 1993 is presented below.

	Options Available for Grant	Options Outstanding: Number of Shares	Options Outstanding: Price per Share
Balances as of November 27, 1992	3,419,085	10,361,204	$ 0.02–47.25
Additional shares reserved	5,224,880	—	—
Options granted	(4,858,298)	4,858,298	2.17–33.75
Options exercised	—	(1,592,587)	0.02–27.40
Options repriced	437,320	(437,320)	12.98–43.27
Options canceled	1,255,101	(1,255,101)	0.58–43.27
Balances as of November 26, 1993	5,478,088	11,934,494	0.06–47.25
Additional shares reserved	299,000	—	—
Options granted	(2,678,550)	2,678,550	3.44–36.38
Options exercised	—	(2,627,318)	0.06–33.75
Options canceled	979,842	(979,842)	0.58–43.27
Adjustment for change in Aldus' fiscal year-end	142,314	(51,421)	—
Aldus options retired	(968,713)	—	—
Balances as of November 25, 1994	3,251,981	10,954,463	0.25–47.25
Additional shares reserved	338,000	—	—
Options granted	(2,351,568)	2,351,568	3.45–67.00
Options exercised	—	(2,967,042)	0.25–50.75
Options canceled	430,195	(430,195)	0.57–58.25
Adjustment for change in Frame's fiscal year-end	(5,688)	18,873	—
Frame options retired	(228,903)	—	—
Aldus options retired	(65,451)	—	—
Balances as of December 1, 1995	1,368,566	9,927,667	$ 2.60–67.00

Of the options outstanding, 5,573,788 were exercisable as of December 1, 1995.

Restricted Stock Option Plan

As of December 1, 1995, the Company had reserved 500,000 shares of common stock for issuance under its Restricted Stock Option Plan, which provides for the granting of nonqualified stock options to nonemployee directors and consultants. Option grants are limited to 10,000 shares per person in each fiscal year except for a new nonemployee director who may be granted 15,000 shares upon joining the Board. All options 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 1995, 1994, and 1993 is as follows:

	Options Available for Grant	Options Outstanding: Number of Shares	Options Outstanding: Price per Share
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 canceled	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
Additional shares reserved	250,000	—	—
Options granted	(40,000)	40,000	48.25
Options exercised	—	(41,875)	11.13–27.00
Balances as of December 1, 1995	227,500	198,125	$ 4.13–48.25

All options outstanding were exercisable as of December 1, 1995 under the Restricted Stock Option Plan. In addition, Adobe assumed 65,000 outstanding options under the Frame Director's Stock Option Plan and 95,375 outstanding options under the Aldus Restricted Stock Option Plan. All such assumed options had been exercised as of December 1, 1995 for an aggregate exercise price of $6.1 million.

Performance and Restricted Stock Plan

The Performance and Restricted Stock Plan provides for the granting of restricted stock and/or performance units to officers and key employees. As of December 1, 1995, the Company had reserved 1,500,000 shares of its common stock for issuance under this plan. Restricted 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. As of December 1, 1995, 836,090 shares were outstanding under this plan, of which 167,002 were not yet vested.

Performance units issued under this plan entitle the recipient to receive shares upon completion of the performance period subject to attaining identified performance goals. Performance units are generally earned over a three-year period, and shares earned are issued at the end of the three-year period. The ultimate value of the performance units is dependent upon the Company's revenue and operating margin growth (as defined by the Plan) during the three-year performance period adjusted by a factor determined by comparing the growth in the Company's stock price to an index of comparable stocks. The projected value of these units is accrued by the Company and charged to expense over the three-year performance period. As of December 1, 1995, performance units for 75,420 shares were outstanding and $2.5 million was charged to expense for this plan in 1995. There were no performance units outstanding during the years ended November 25, 1994 and November 26, 1993.

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. As of December 1, 1995, the Company had reserved 4,000,000 shares of its common stock for issuance under this plan and 1,490,448 shares remain available for future issuance.

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 2,382 employees under the plan in 1995 and 841 employees under the plan in 1994. Commencing in 1992, the Company matched a portion of employee contributions. Company matching contributions, which can be terminated at the Company's discretion, were $1.2 million, $0.7 million, and $0.6 million in 1995, 1994, and 1993, respectively.

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, and on each share of common stock issued thereafter. Each right entitles the registered holder to purchase from the Company a share of common stock at $115. The rights become exercisable in the following circumstances:

- The rights become exercisable ten days after 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 December 1, 1995 and November 25, 1994.

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 2015. Rent expense for these leases aggregated $21.0 million, $16.9 million, and $18.7 million during 1995, 1994, and 1993, respectively. As of December 1, 1995, future minimum lease payments under noncancelable operating leases were as follows: 1996—$16.7 million; 1997—$9.0 million; 1998—$7.4 million; 1999—$4.7 million; 2000—$2.8 million; and $18.0 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 for 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 December 1, 1995, the Company had deposited approximately $35.6 million in United States government treasury notes and money market mutual funds.

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 $0.05 to $40.83, certain royalties are based on a percentage, ranging from 0.05 percent to 50 percent, of the underlying revenue. Royalty expense was approximately $23.1 million, $35.2 million, and $32.8 million for the years ended December 1, 1995, November 25, 1994, and November 26, 1993, 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 Affiliate

The Company holds a 16 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 contracted with McQueen to perform product localization and technical support functions and to provide 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 $1.8 million, and minimum annual payments Adobe will make to McQueen for certain services are approximately $4.6 million and $4.8 million in 1996 and 1997, respectively. Purchases from McQueen amounted to $23.6 million, $13.0 million, and $12.6 million during 1995, 1994, and 1993, respectively.

Note 14.

Financial Instruments

Fair value of financial instruments

The Company's cash equivalents, short-term investments, restricted funds, and investments in equity securities that are free of trading restrictions or that will become free of trading restrictions during the next 12 months are carried at fair value, based on quoted market prices for these or similar investments. (See Note 3.)

The Company's investment in equity securities that are subject to trading restrictions are carried at cost, which aggregates $4.4 million. The fair value of these securities as of December 1, 1995, based on quoted market prices, was $125.9 million. These investments are recorded as equity securities in other assets.

The Company's majority interest in a limited partnership, accounted for using the equity method, is carried at $18.5 million as part of equity securities in other assets. Most of the technology companies in which the limited partnership invests are not publicly traded, and therefore there is no established market for these investments. One investment of the limited partnership is publicly traded, and the fair value of this investment is based on quoted market price.

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 the Company 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 ongoing credit evaluations of its customers' financial condition and requires letters of credit or other guarantees, whenever deemed necessary.

Industry segment

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 1995, 1994, or 1993.

Note 15.

Industry Segment Reporting and Foreign Operations

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. Substantially all of the merger transaction and restructuring costs and write-off of in-process research and development costs were incurred in the Americas and therefore have been charged against the Americas operating income.

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 December 1, 1995 is presented below.

	Years Ended		
	December 1 1995	November 25 1994	November 26 1993
Revenue:			
The Americas	$533,332	$494,525	$434,111
Europe	133,982	124,283	118,859
Pacific Rim	107,357	72,036	51,495
Eliminations	(12,332)	(15,227)	(24,362)
	$762,339	$675,617	$580,103
Operating income:			
The Americas	$ 26,446	$ 7,991	$ 31,084
Europe	37,319	1,818	21,685
Pacific Rim	70,416	32,745	21,645
Eliminations	390	(40)	(15,880)
	$134,571	$ 42,514	$ 58,534
Identifiable assets:			
The Americas	$944,484	$670,650	$672,961
Europe	64,807	60,375	50,662
Pacific Rim	14,258	18,633	9,885
Eliminations	(138,817)	(39,658)	(135,812)
	$884,732	$710,000	$597,696

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 December 1, 1995 and November 25, 1994, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the years in the three-year period ended December 1, 1995. 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 consolidated financial statements of Frame Technology 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 12 percent as of November 25, 1994, and total revenues constituting 12 and 10 percent in fiscal 1994 and 1993, respectively, of the related consolidated totals. We also did not audit the consolidated 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 revenues constituting 36 percent of consolidated fiscal 1993 revenues. The statements of Frame Technology Corporation and Aldus Corporation were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for Frame Technology Corporation and Aldus Corporation, is based solely upon the reports 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 and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports 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 December 1, 1995 and November 25, 1994, and the results of their operations and their cash flows for each of the years in the three-year period ended December 1, 1995, in conformity with generally accepted accounting principles.

KPMG Peat Marwick LLP

KPMG Peat Marwick LLP
San Jose, California
December 19, 1995

MANAGEMENT'S *Report*

Management is responsible for all the information and representations contained in the consolidated financial statements and other sections of this Annual Report. 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 Annual Report 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

M. Bruce Nakao
Senior Vice President, Finance and Administration,
Chief Financial Officer,
Treasurer, and Assistant Secretary
December 19, 1995

QUARTERLY RESULTS OF *Operations*

(In thousands, except per share amounts)	Unaudited Quarter Ended March 3 1995	June 2 1995	September 1 1995	December 1 1995	Audited Year Ended December 1 1995
Revenue	$188,845	$189,498	$183,120	$200,876	$762,339
Gross margin	154,991	157,188	155,637	164,222	632,038
Merger transaction and restructuring costs	—	—	—	31,534	31,534
Income (loss) before income taxes	57,246	55,913	52,354	(1,660)	163,853
Net income (loss)	36,144	35,245	33,886	(11,790)	93,485
Net income (loss) per share	0.50	0.47	0.44	(0.16)	1.26
Shares used in computing net income (loss) per share	72,888	75,321	76,325	72,477	74,253
Common stock price per share:					
High	$ 36.25	$ 58.75	$ 66.50	$ 70.25	$ 70.25
Low	27.25	34.25	49.50	45.00	27.25

1994	Unaudited Quarter Ended February 25 1994	May 27 1994	August 26 1994	November 25 1994	Audited Year Ended November 25 1994
Revenue	$153,128	$168,228	$166,612	$187,649	$675,617
Gross margin	124,654	137,781	138,010	153,149	553,594
Merger transaction and restructuring costs	—	—	—	72,183	72,183
Income (loss) before income taxes	32,139	30,260	32,401	(41,854)	52,946
Net income (loss)	20,626	19,263	20,605	(45,157)	15,337
Net income (loss) per share	0.30	0.27	0.29	(0.65)	0.22
Shares used in computing net income (loss) per share	69,698	70,353	71,548	69,076	70,169
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

The Company's common stock is traded on The Nasdaq Stock Market under the symbol "ADBE."
On December 29, 1995, there were 2,073 holders of record of the Company's common stock.

CORPORATE **Directory**

Executive Officers

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President

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

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

Stephen A. MacDonald
Senior Vice President & Chief Operating Officer

David B. Pratt
Senior Vice President & Chief Operating Officer

Colleen M. Pouliot
Vice President, General Counsel & Secretary

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

Board of Directors

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

Charles M. Geschke
President

William R. Hambrecht
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Director

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Director

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Director

Paul Brainerd
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Design
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Cameron Davidson, Arlington, Virginia (page 10)
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Jonathan Caponi, San Francisco, California
(page 28, synthetic nebula)
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(page 66, portrait of Derek Gray)

Prepress
Metagraphics, Palo Alto, California

Printing
George Rice & Sons, Los Angeles, California

Paper
Lustro Dull Recycled, S. D. Warren Company;
Benefit Soft White, Champion Paper Company

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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:

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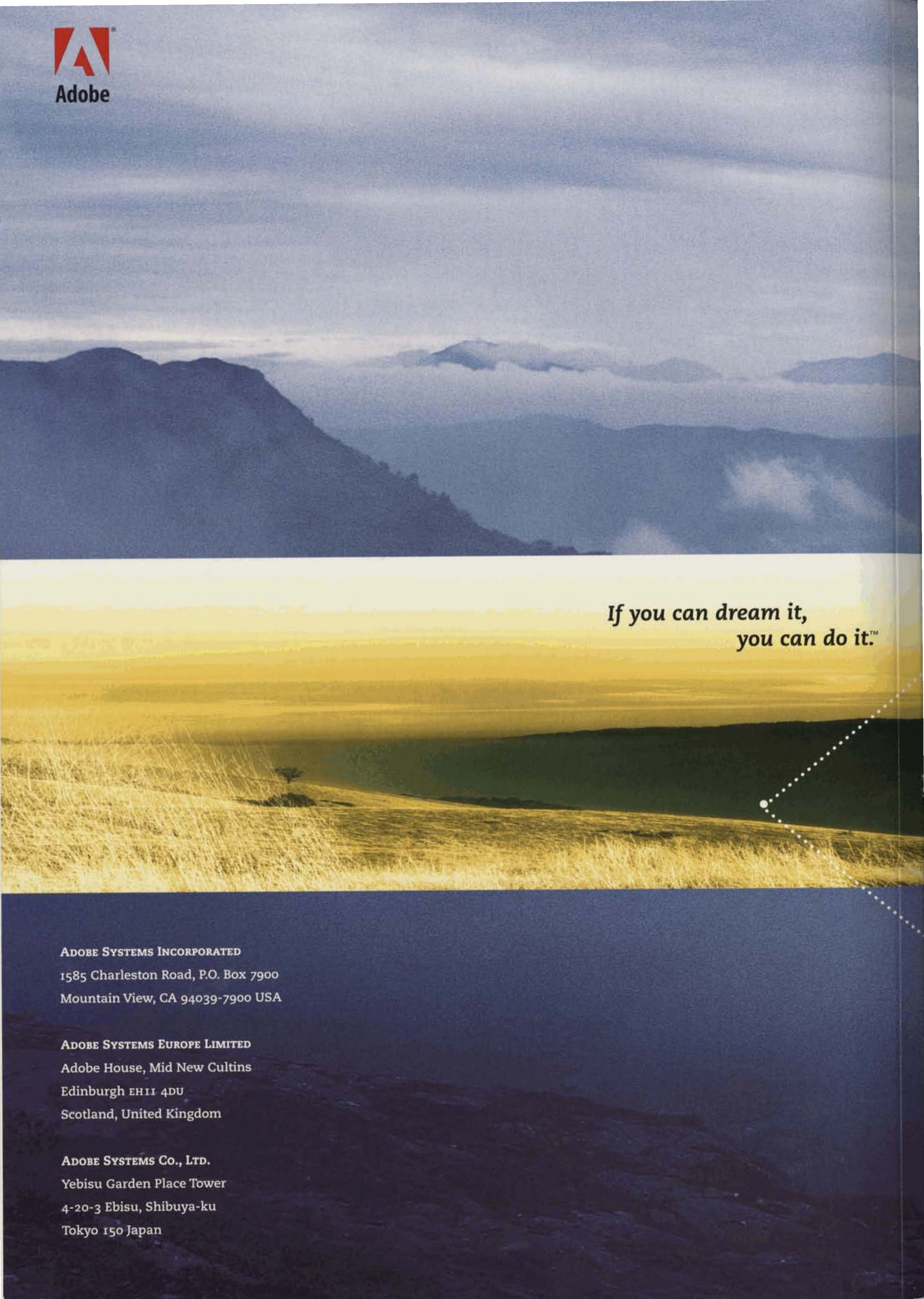
Harris Trust Company of California, Chicago, Illinois

Stock Exchange Listing
The Nasdaq Stock Market, ticker symbol "ADBE"

Independent Auditors
KPMG Peat Marwick LLP, San Jose, California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