Adobe

idea

reality

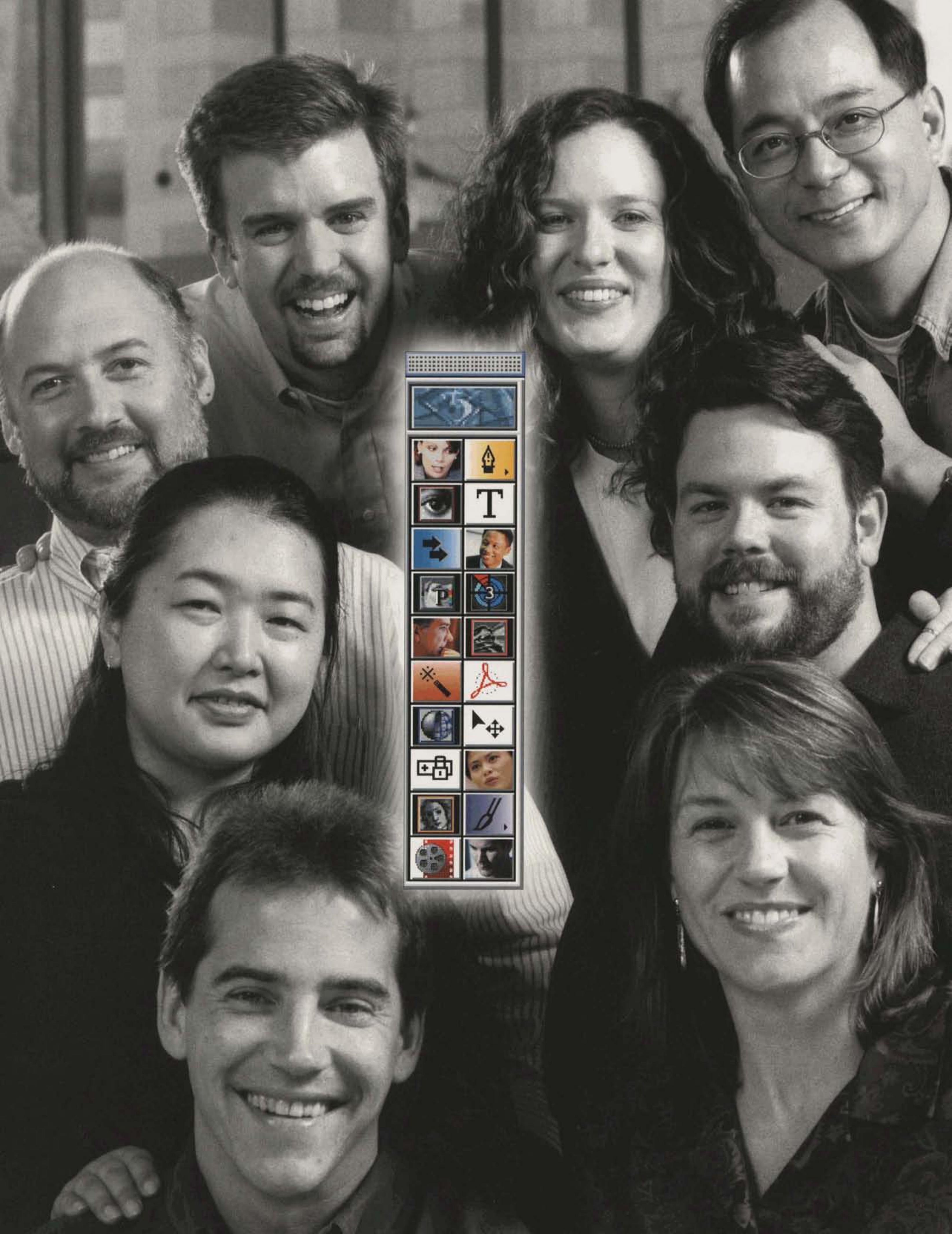
Adobe Systems Incorporated Annual Report 1997

Adobe

"What a good idea!"

It's a comment that's heard every day, thousands of times, throughout the world. The idea that stands out, however, is the idea that's remembered. And that's where Adobe comes in. Adobe software and technologies enable people to express their ideas exactly as they envision them, in any media, with power and precision. Adobe software is the tool people use to transform ideas into reality.

In 1997, Adobe Systems helped more people and businesses than ever make their ideas stand out—from stone carvers and storytellers to software companies and space scientists. The stories in this report are about good ideas made real.



To Our Stockholders

An invasion of armies can be resisted, but not an idea whose time has come.

— Victor Hugo

Ideas can be powerful things.

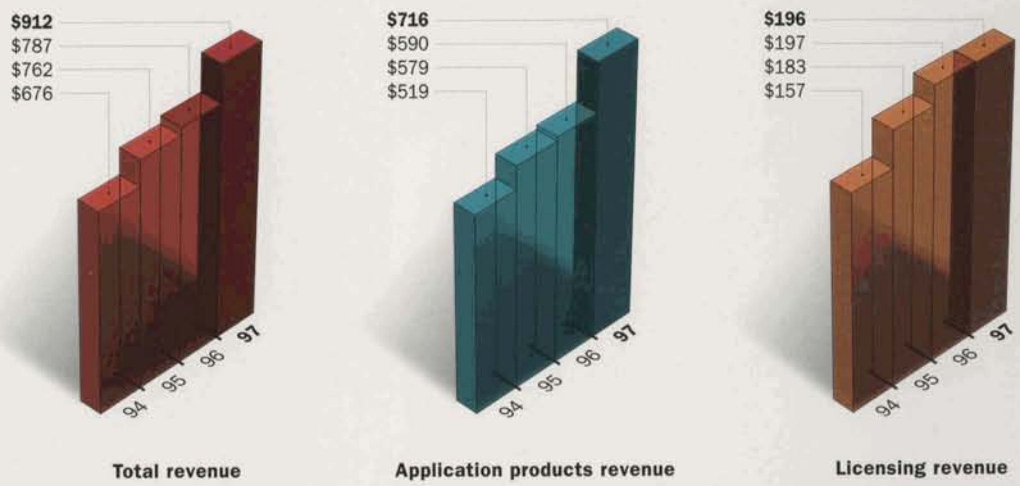
But only if you can make them compelling, express them clearly, and communicate them directly to those you want to affect. As technology transforms the way the world experiences information, people in businesses and homes everywhere face the same challenges in creating and distributing their ideas.

"How can I make my message stand out?"
"How can I get it to look just the way I want?"
"Can I deliver it faster and more easily?"

Adobe provides solutions to these challenges: solutions that let everyone turn ideas into reality—exactly as envisioned.

In 1997, Adobe's objective was to deliver solutions and expand its customer base. We accomplished this goal by attracting new users and meeting their needs with integrated solutions and standards. We leveraged our core technologies to create new products. And we invested in strengthening a foundation on which to build in 1998.

Dollars in millions



1997 was a record year for Adobe.

As we extended our reach to new markets, we maintained solid financial performance. In fiscal year 1997, Adobe achieved revenue growth of 16 percent and reported net income growth of 22 percent. Revenue reached a record $912 million, with reported net income also a record at $187 million. Revenue from application products was a record $716 million, compared with $590 million in fiscal 1996, while our licensing revenue was level with 1996 figures.

Extending our reach to new markets

During 1997, Adobe declared cash dividends on its common stock totaling $0.20 per share, and repurchased more than 6 million shares of common stock, offsetting dilution from issuances under our employee stock option and stock purchase plans and reducing the actual number of shares outstanding. Adobe's overall financial position is strong, with cash, cash equivalents, and short-term investment balances of $503 million and no long-term debt, as of our fiscal year-end on November 28,1997.

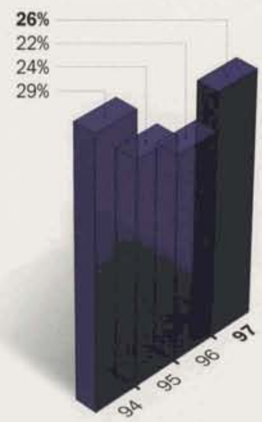
Leveraging our core technologies

Adobe extends its leadership in graphics software solutions.

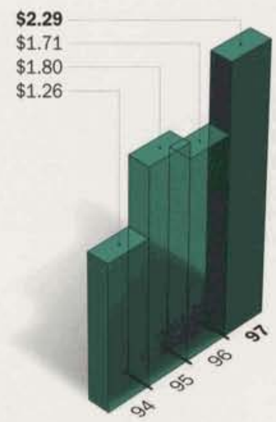
In 1997, Adobe's relationship with our key customer base, professional designers, remained strong, while a new class of users increasingly turned to our applications for the power to make ideas compelling. Customer research indicates that the number of corporate users of Adobe graphics applications is increasing impressively. The result was outstanding sales. Application products revenue climbed 21 percent in 1997.

The growth of the Web fueled revenue from Adobe graphics applications. Indeed, as Adobe continues to integrate and expand the Web capabilities of our product line, customers increasingly use our tools to create graphics and deliver documents for the Internet.

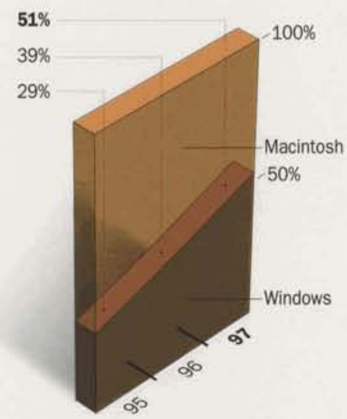
Adobe has continued to attract customers by tightly integrating its graphics products into a virtual suite. For example, we've added consistent features, user interfaces, and functionality to Adobe® Photoshop,® Adobe Illustrator,® and Adobe PageMaker® to form an online and print publishing solution that competitors with only a single product offering simply cannot match.



Operating margin
(excluding nonrecurring gains and charges)



Earnings per share
(excluding nonrecurring gains and charges)



Application products revenue
(Macintosh/Windows)

We're making our mark in the Windows® world.

Particularly notable was Adobe's growth on the Windows platform. In 1996, Adobe made simultaneous cross-platform product releases a priority. In 1997, for the first time, revenue from Windows platform products exceeded that from the Macintosh platform. Windows products accounted for 51 percent of application products revenue (excluding platform-independent and UNIX® products), with 49 percent going to Macintosh products. On a year-over-year basis, application products revenue on the Windows platform grew 64 percent.

Shipments of Adobe Illustrator 7.0 in 1997 demonstrate the company's success in making graphics a priority for Windows users. Adobe Illustrator 7.0 became the best-selling cross-platform desktop illustration application in the U.S. Sales of Adobe Illustrator for Windows pushed Adobe's cross-platform retail unit sales beyond 50 percent of the entire U.S. desktop illustration software market for the rest of fiscal 1997.

Our printing business faces challenges and opportunities.

The past year was challenging for our printing technologies, the primary source of our licensing revenue. We launched Adobe PostScript® 3,™ the next generation of the world-standard printing technology primed to meet the needs of Internet-based, distributed printing environments. With IBM, we announced the first on-demand digital printing system based on Adobe PostScript Extreme,™ the IBM® InfoPrint 4000, which prints at speeds exceeding 1,000 pages per minute. And products based on Adobe PrintGear™—the architecture that dramatically improves the quality and performance of low-cost printers for small offices, home offices, and workgroups—continue to garner awards and acclaim.

Adobe software is used worldwide by individuals, small businesses, and large organizations who want to turn ideas into reality.

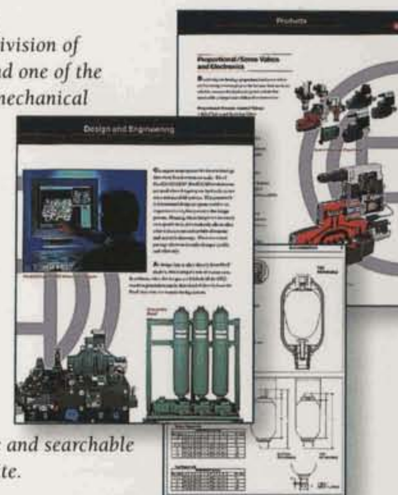
Despite these accomplishments, revenue from the licensing of Adobe PostScript and other printing technologies reached $196 million, effectively level with $197 million in 1996. The year-to-year flatness is the result of a number of factors affecting our original equipment manufacturer (OEM) customers, primarily in the Japanese and Macintosh markets. We continue to evaluate ways to better communicate the value of Adobe PostScript and serve our customers' needs in a distribute-then-print world.

NASA's Mars Pathfinder

The information-rich Mars Pathfinder Web site attracted millions of earthbound visitors daily during the summer 1997 mission. NASA's Jet Propulsion Laboratory (JPL) used Adobe PageMill,® Adobe Photoshop, and Adobe Acrobat® software to rapidly provide images and other data to those following the expedition online. "With Adobe Acrobat, we didn't have to reauthor materials to get them ready for the Web," says Rich Pavlovsky, JPL Webmaster.

Bosch Automation Technology

Bosch Automation Technology, a division of Robert Bosch GmbH, Germany and one of the world's leading manufacturers of mechanical components, uses Adobe Acrobat software for electronic document distribution. Bosch chose Adobe Enterprise Publishing Services (formerly Digidox Document Solutions), a subsidiary of Adobe, to convert thousands of pages of printed technical and marketing materials to Portable Document Format (PDF) files. Bosch customers, sales personnel, and distributors benefit from having voluminous information accessible and searchable on CD-ROM and the Bosch Web site.



Adobe makes digital workflows a reality for enterprises.

In 1997, Adobe led the industry in enabling digital workflows, a revolutionary trend that we expect to accelerate in the coming year. Digital workflow—a streamlined publishing process, independent of hardware, computing platforms, and applications—lets businesses create compelling content once and then easily publish both in print and on the Web, instead of duplicating efforts and reauthoring using separate, expensive systems for different media, thus saving time and money.

Making cross-platform product releases a priority

Adobe solutions are the foundation for an efficient digital workflow. Adobe Portable Document Format (PDF), for example, is increasingly being adopted worldwide as a de facto standard format for Internet document publishing. The number of copies of free Adobe Acrobat Reader software Adobe has distributed shot past the 20 million mark in 1997. PDF generation is integrated into many Adobe authoring applications such as Adobe Illustrator 7.0, Adobe Photoshop 4.0, and Adobe PageMaker 6.5.

Adobe FrameMaker® 5.5, the new version of our publishing solution for complex, mission-critical documents, enables digital workflows by allowing users to output to PDF, HTML, SGML, or Adobe PostScript formats—all from a single source file.

In addition, with Adobe Acrobat 3.0 software for converting virtually any computer-generated file to PDF, the newly released Acrobat Capture® 2.0 software for bringing legacy paper documents into PDF, and PDF-based Adobe PostScript 3 printing systems, enterprises can go from creation to output using PDF as a media-independent digital master, dramatically reducing the chances for errors and delays.

Serving customers' needs in a distribute-then-print world

Adobe brings publishing power to homes and small businesses.

It's not only designers and users in enterprises who need power to make their ideas stand out. We have created flexible, easy-to-use products tailored especially for the needs of new customers in homes and offices. Adobe PhotoDeluxe,® our photo-editing software that applies Adobe Photoshop technology for home use, has been one of 1997's major successes. Version 2.0, released this year, lets users customize the product and enhance their skills by downloading free "Guided Activities" from Adobe's Web site.

Glyphica

Glyphica, a digital publishing company, is restoring rare documents from the Olympic games using Adobe Acrobat Capture and Adobe Photoshop software. The texts and photographs, many dating back to the 1890s, are then converted to Adobe PDF with Adobe Acrobat software and published on the Web site of the Amateur Athletic Foundation as part of an extensive virtual library. The publication of the historic documents coincides with the 1998 Olympic Winter Games in Nagano, Japan.

Bobbie Coughlin, M.D.

Bobbie Coughlin, a pediatrician and mother, uses Adobe PhotoDeluxe software for a variety of family projects. Whether helping her children incorporate pictures in their school reports or cleaning up cluttered backgrounds in photos, Coughlin enjoys "altering, improving, playing with, and combining photographs in new ways." Often she'll give old family photos renewed vitality by adjusting the image size and adding color. "Adobe PhotoDeluxe is wonderful!" Coughlin says.

In 1997, Adobe PhotoDeluxe reached and quickly surpassed the milestone of 5 million units shipped worldwide since its introduction last year. Our strategy links Adobe PhotoDeluxe with the cameras, printers, and scanners that generate digital images by bundling it with devices from leading OEM customers such as Kodak, Epson, Hewlett-Packard, Olympus, UMAX, and many more.

The success of Adobe PhotoDeluxe offers Adobe a blueprint for leveraging our technology investment by adapting high-end imaging, layout, dynamic media, printing, and content management software for a wider variety of customers in homes and businesses. Our strategy of adding customized user interfaces and application programming interfaces to powerful engines gives us a competitive advantage in developing products and bringing them to market quickly.

We're structured for success.

In late 1997, we adapted our organization to reflect our commitment to new markets. To streamline planning and decision making, we now share the new Office of the Chairman of the Board. We restructured Adobe's business units to focus on growing market opportunities. In addition to our Printing and Systems Division and our Graphics Products Division, we established an Enterprise Solutions Division. We also created a Home and Office Products Division to address the needs of homes and small businesses. Finally, we created an Engineering Technology Group, which will carry on Adobe's tradition of developing innovative technologies and driving standards. All divisions are dedicated to delivering new, high-quality solutions as well as new versions of key products in 1998.

Executive Committee

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

Charles M. Geschke
Chairman of the Board and President

Frederick A. Schwedner
Senior Vice President and General Manager, Printing and Systems Division

P. Jackson Bell
Executive Vice President, Chief Financial Officer, Chief Administrative Officer, and Assistant Secretary

Adapting our organization to focus on new opportunities

Other important objectives for Adobe in 1998 include strengthening our worldwide sales organization, developing an integrated channel strategy dedicated to penetrating new markets, and coordinating marketing efforts to make Adobe one of the world's best-recognized brands. And we will continue to foster the unique corporate culture that has made us, according to *FORTUNE Magazine*'s January 12, 1998 issue, one of the "100 Best Companies to Work for in America."

Adobe enables everyone to create and deliver ideas with impact, just as intended, across all media. We've been gratified to see this message reach a wide array of new customers, who are increasingly discovering the power of Adobe solutions. In 1998, we look forward to seeing our commitment deliver even more exciting results.

Robert A. Roblin
Executive Vice President, Marketing

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

Colleen M. Pouliot
Senior Vice President, General Counsel, and Secretary

Ross A. Bott
Executive Vice President, Product Divisions

John E. Warnock
Chairman of the Board
Chief Executive Officer

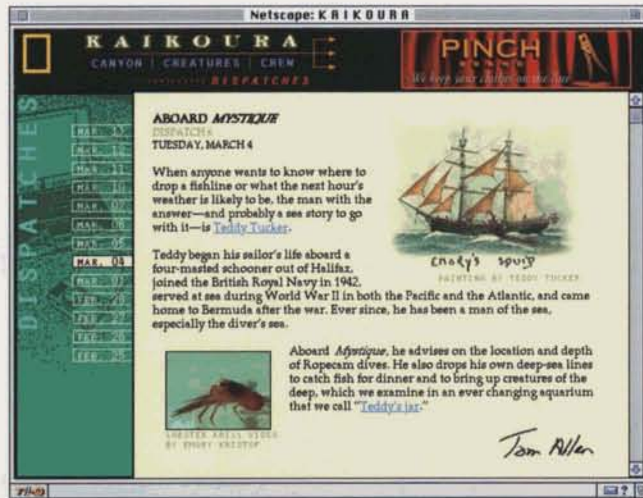
Charles M. Geschke
Chairman of the Board
President

January 1998

Adobe

Creative professionals communicate with other people by shaping landscapes made of information. Artists, designers, and innovators rely on powerful tools that free them to use their own vigorous imaginations to create and connect in new ways, moving from vision to reality without compromise. Adobe tools enable creative professionals to express themselves with precision.

The following stories recognize professionals who use Adobe tools to make new creative connections.



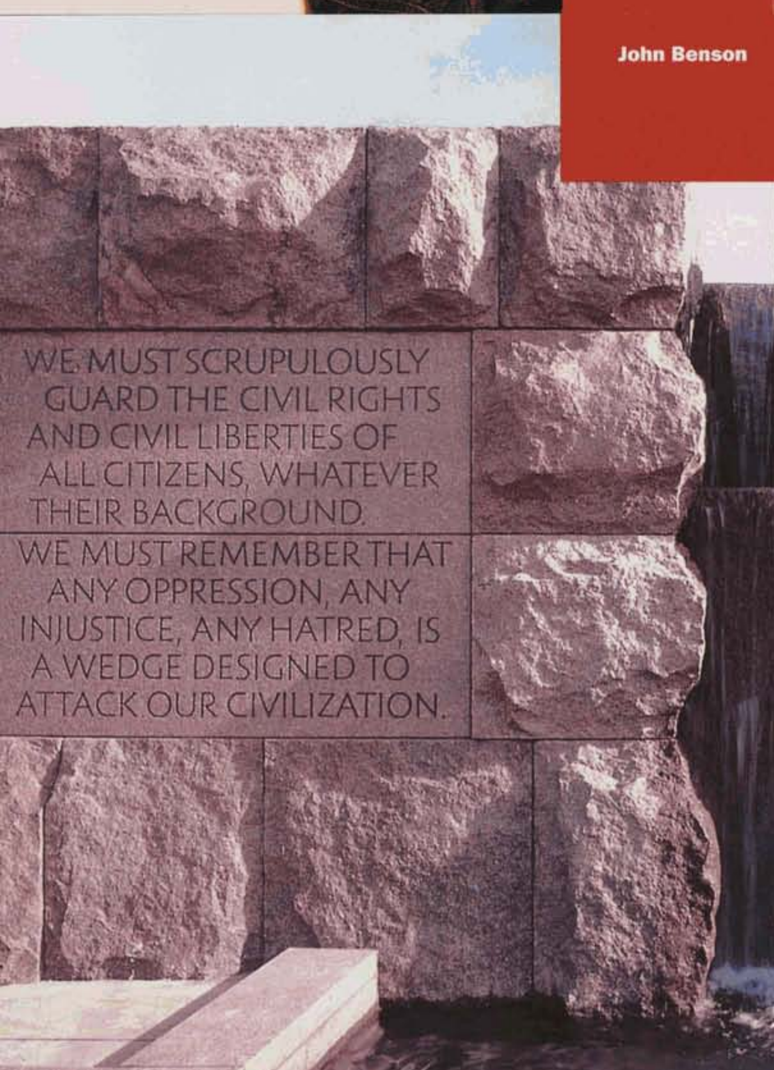
A daily dispatch and other pages from the "Kaikoura" Web site.
Design: Brad Johnson, Julie Beeler.
Client: National Geographic Online.

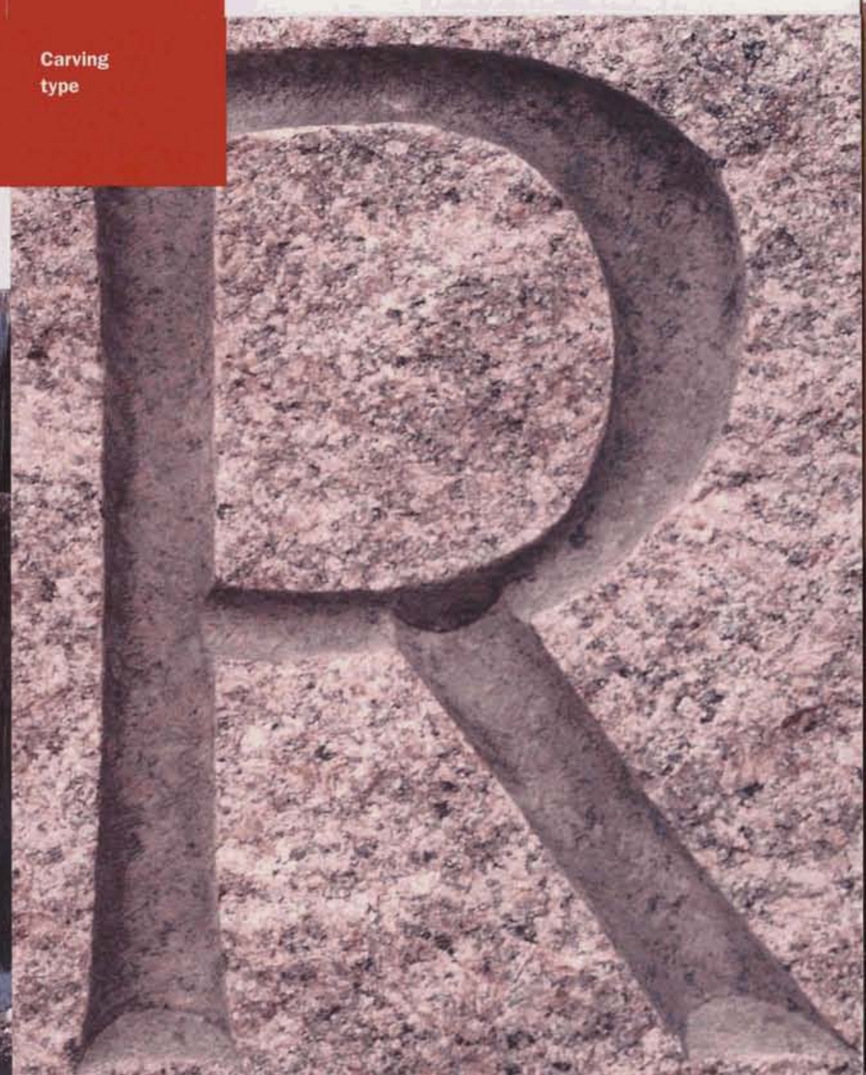
Digital Clubhouse Network

Second Story

John Benson

Carving type





Adobe

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John Benson

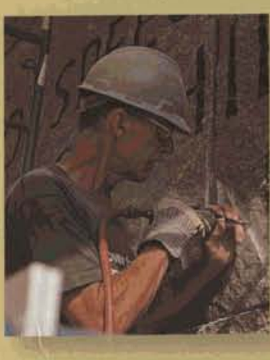
What could be more challenging than designing type? Doing it in granite.

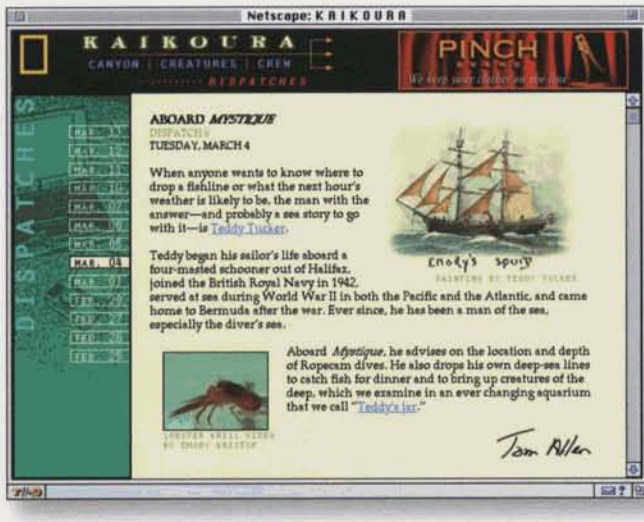
To meet such a challenge, John Benson, the renowned stonecarver and lettering artist of Newport, Rhode Island, relies on Adobe Illustrator software. Benson's meticulous lettering is seen on some of the United States' most prominent monuments and buildings–from the John F. Kennedy Memorial at Arlington National Cemetery to the National Gallery of Art. In recognition of his work, he has received many awards, including the American Institute of Architects Craftsmanship Medal, the Rhode Island Governor's Award for the Arts, and an honorary doctorate degree from the Rhode Island School of Design.

The Franklin D. Roosevelt Memorial in West Potomac Park, Washington, D.C. called for Benson to develop numerous lengthy inscriptions on panels of granite. In preparation, he says, he wanted to "vigorously explore the typeface design to make the stone come alive."

However, carrying out his experiments by hand-carving granite would be too costly and time-consuming. "So I sketched the inscriptions in pencil at reduced size, scanned them, and then–using a digital font I designed specifically for the purpose–produced a rough composition. I used Adobe Illustrator to create several alternate inscriptions, each of which was submitted for approval." Benson then employed Adobe Illustrator to further refine the type before the layouts were transferred to stone. "Adobe Illustrator saved me a tremendous amount of time, and I was able to do a great deal more exploration than if I were working by hand," he says. "It was wonderful."

Above: Preliminary type design for the Franklin D. Roosevelt Memorial.





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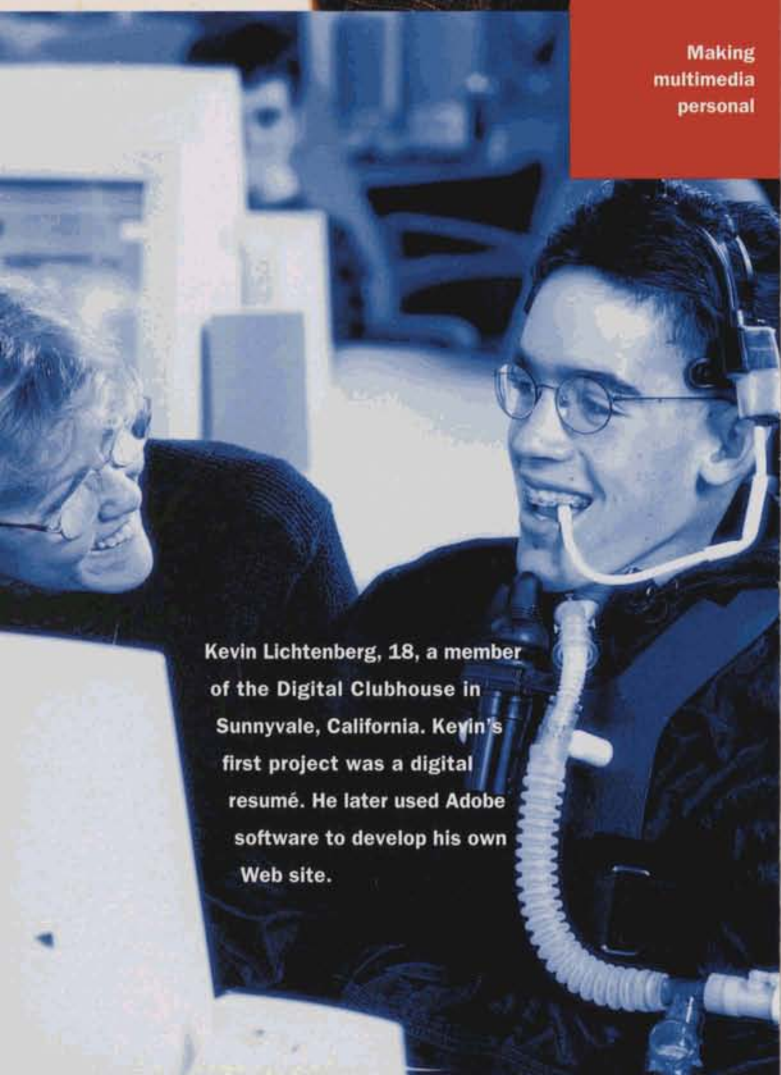
Digital Clubhouse Network

Making multimedia personal

Second Story

Creating the interactive experience

Web pages from "Explore the Fantastic Forest," an interactive, online module for children.
Design: Brad Johnson, Julie Beeler.
Client: National Geographic Online.



Kevin Lichtenberg, 18, a member of the Digital Clubhouse in Sunnyvale, California. Kevin's first project was a digital resumé. He later used Adobe software to develop his own Web site.

Ado

Creative professi
with other people
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to use their own

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Digital Clubhouse Network

What's the story with Digital Clubhouse Network?
It's digital storytelling—bringing people together through the power of networked multimedia.

Warren Hegg, a former director of planning and coordination for SRI International, is the co-founder of Digital Clubhouse Network, a nonprofit organization that introduces people of all ages and backgrounds to the technologies that are transforming our world.

"When we started," says Hegg, "we were interested in discovering a multimedia application that would, for instance, get a 92-year-old man, a teenager with disabilities, and a 10-year-old girl to reach out and use technology—on their own terms." What common denominator, Hegg wondered, would unite the greatest variety of people around what he calls "the bonfire of networked multimedia"?

> **"By sharing personal stories in this exciting new medium, people discover how much they have in common."**
> **—Joe Lambert**
> *Co-founder*
> *Digital Clubhouse Network*

"The answer was digital storytelling," Hegg says. "At a Digital Clubhouse, we bring together all types of people and teach them to create three- to five-minute movies, drawing from their own life experiences. Adobe Premiere and Adobe Photoshop are our key tools. The results are extraordinary and extremely compelling," Hegg continues. "We also find that digital storytelling helps build a sense of community among those who participate in the life of the Clubhouse."

> **"Because they care deeply about the story they're telling, people are motivated to master the tools. Adobe Premiere® and Photoshop software give their creations a professional look and feel."**
> **—Mary Ellen Locke**
> *Director*
> *Digital Clubhouse Network*

Adobe Systems has supported Digital Clubhouse Network from its earliest days, providing software and sponsoring workshops at both the Silicon Valley and New York's Silicon Alley Clubhouses. Since the Network began operations less than two years ago, more than 3,000 people have participated in its programs and projects.

"We're proud of our partnership with Adobe," says Hegg. "Together we're helping to ensure that as many people as possible understand and have access to the communication tools that will enable them to have more productive and fulfilling lives. We've found that it's very exciting and invigorating when people use Adobe software for digital storytelling. We believe everybody has something significant to say, and working in a collaborative, nonthreatening environment using networked multimedia is a powerful way to say it."

www.digiclub.org

Second Story

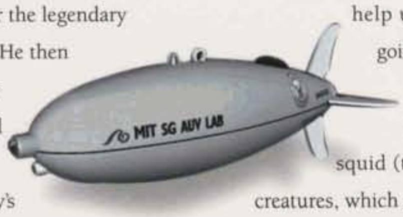
Is it possible to build a Web site via e-mail while searching for giant squid?

Is the ocean wet?

A less adventurous soul might have balked at such an assignment, but Brad Johnson didn't think twice. "When *National Geographic* called, it was a dream come true," Johnson says. "All the work we do is interesting, but the Kaikoura Canyon project was one of the most exhilarating and challenging."

Johnson established Second Story, his multimedia design firm in 1994. Today, he and partner Julie Beeler use Adobe Photoshop, Adobe Illustrator, Adobe Premiere, and Adobe After Effects® software to create interactive experiences delivered on the Web and CD-ROM for clients such as *National Geographic*, DreamWorks Records, and Pacific Bell.

To develop "Kaikoura" for the *National Geographic* Web site, Johnson produced daily content "dispatches," including graphics and animated images, while on an expedition exploring a maze of deep sea trenches near New Zealand, searching for the legendary giant squid. He then e-mailed the new material to Beeler at Second Story's studio in the United States. Beeler integrated it into the "Kaikoura" feature and transmitted the new content to *National Geographic* headquarters in Washington, D.C. for posting on the organization's Web site.



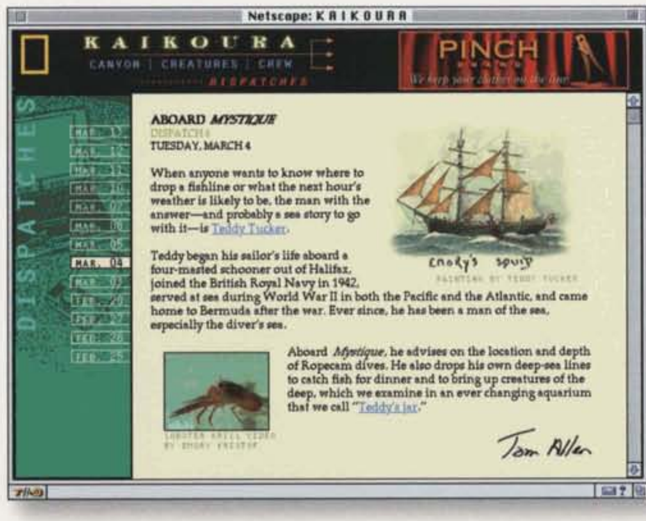
"In New Zealand," Johnson says, "the expedition photographers shot digital video under water. I'd use Adobe Premiere to grab stills and sequences. Sometimes I'd use Adobe Premiere to transform them into animations. At other times, I'd create QuickTime movies for downloading, which Adobe Premiere is extremely good at optimizing for the Web."

The Kaikoura expedition cameras were often shooting as much as 3,000 feet beneath the surface. The minimal lighting at that depth can produce dark, murky images. "Adobe After Effects is superb for cleaning up such images," Johnson says. "I used it extensively. In one

situation, the photographer took a picture of a small arrow squid racing past. Using Adobe Premiere and After Effects software, I enhanced the image to reveal that the little squid was actually escaping from another one. It was exciting to have the Adobe tools on hand to help us see what was going on down below."

They never found the giant squid (though the creatures, which can reach 60 feet in length, do exist), but the "Kaikoura" Web feature was a giant success for *National Geographic* and Second Story. Such a success that Johnson and Beeler's "Kaikoura" is featured as a case study in two recent books: *Secrets of Successful Web Sites* and Graphis's *Web Design Now.*

www.bradjohnson.com



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Second Story

Creating the interactive experience

Web pages from "Explore the Fantastic Forest," an interactive, online module for children.
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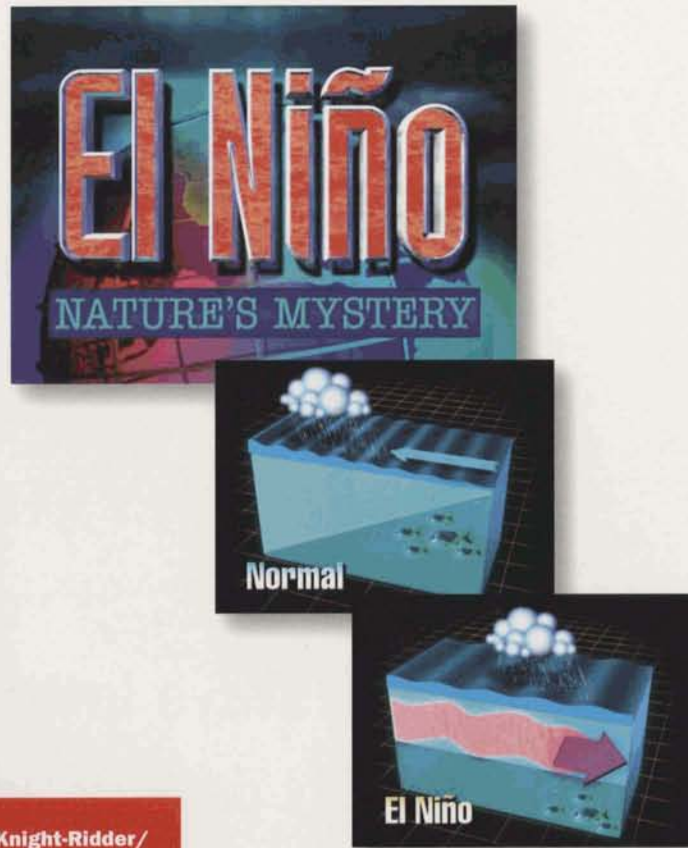
Adobe

The enterprise is group effort, intensely focused. Today, it extends far beyond the limitations of the past. The enterprise operates wherever there is need, interest, and relevance—24 hours a day. Compelling, economical communication is essential. Conveying messages with impact and immediacy is crucial. Working across all platforms is integral to success. Adobe makes the tools that enterprises everywhere use to succeed in a rapidly changing world.

The following stories tell how enterprises using Adobe solutions are getting their messages across in new, more effective ways.



Graphics content is repurposed for television, the Web, and newspapers.

Cisco Systems, Inc.

Knight-Ridder/ Tribune Information Services

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MadhavrayTextileIndsPL(Textile Processing)
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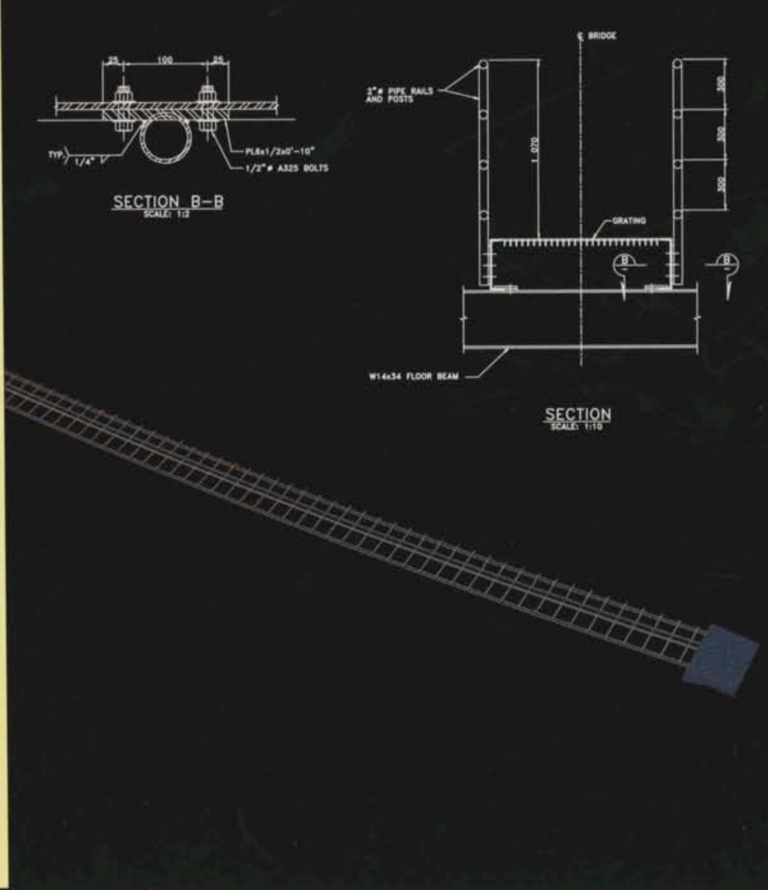
Maham Synthetic Textiles L(Textile Processing)
137bKewalIndlEstSBRdLowerParel-13 4949381
Maharani Prints(Textile Processing)
10CavesRdSubhashRdJogeshwariEB-60 6372164
Makalsa Synfab International L(TextileProcessg)
26\8bSamhitaCplxAndhKurlaRd-72 5131895
Marco Silk Mills Pvt Ltd(Textile Processing)
B/7VeeraIndlEstVrDesaiRdAndheriW-58 6267502
Matushree Textiles Ltd(Textile Processing)
5CCourtChmbs35NewMarineLinesBom-20 2036076
Monalisa Traders(Textile Processing)
7,CamaIndEstSunMlCompdLParel(W)-13 4929872
Narayan Dyeing(Textile Processing)
D128MIDC,TTC,ShiravaneNMum-613 7681608
Nedungadi Radhakrishna(Textl.ProcsngMfgBleach)
1Srinagar11thRdChemburBom-71 5283169
Neha Printing And Brushing(Textile Processing)
BldgNo25thSankilStOppJunaMsjd-8 3090533
New Mahalaxmi Silk Mills P Ltd(Textile Procsng)
MathurdasMillCmpdNMJoshiMrgLParel13 4938238
New Shakti Dye Works P.L(Textile Processing)
DrAmbedkarRdThana-602 5245318

Tata Donnelley Limited
Doing ten weeks of work in an hour

OPAC Consulting Engineers



Adobe

The enterprise is group effort, intensely focused. Today, it extends far beyond the limitations of the past. The enterprise operates wherever there is need, interest, and relevance—24 hours a day. Compelling, economical communication i
Conveying messa
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Tata Donnelley, Ltd.

A 1,000-page directory for a city of 10 million in one hour?

Mumbai (formerly known as Bombay), the financial and industrial capital of India, is home to nearly 10 million people and thousands of businesses. The commercial directory for the thriving metropolis is produced by Tata Donnelley Ltd., India's largest publisher of Yellow Pages®

"We rely on Adobe software to produce the 1,000-page directory," says Tata Donnelley's K.V. Rao. "We use Adobe PageMaker, Adobe Photoshop, Adobe PostScript technology, and Adobe Illustrator extensively."

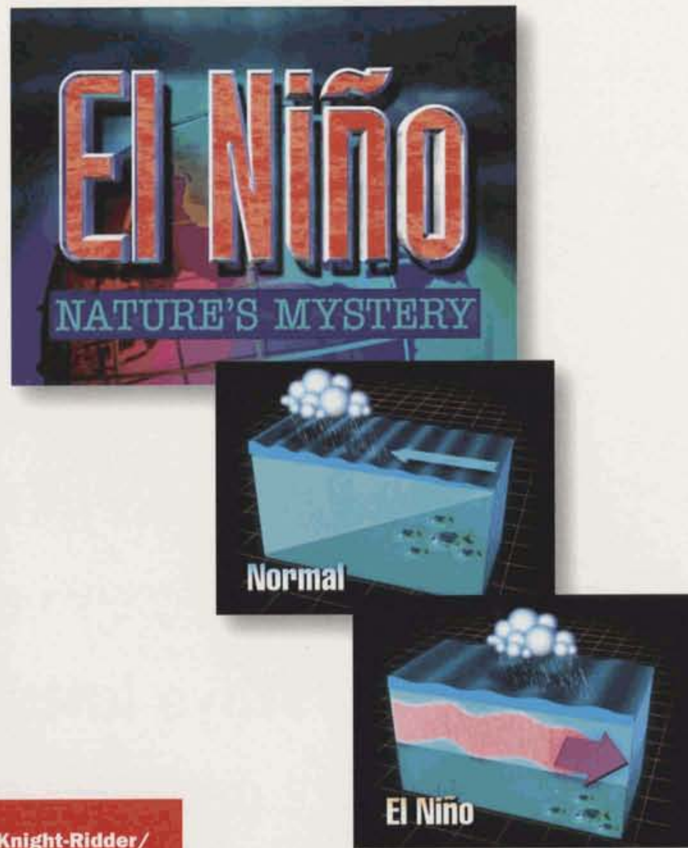
"We selected PageMaker for publishing the commercial directory," Rao explains, "because it enables us to automate the entire pagination process–including page creation and image placement–while producing a precise result. This also cuts down significantly on proofreading and corrections. It would take 10 to 12 weeks to do this work manually. With PageMaker, the task is accomplished in less than one hour."

www.tatadonnelley.com

Mumbai, India

Cisco Systems, Inc.

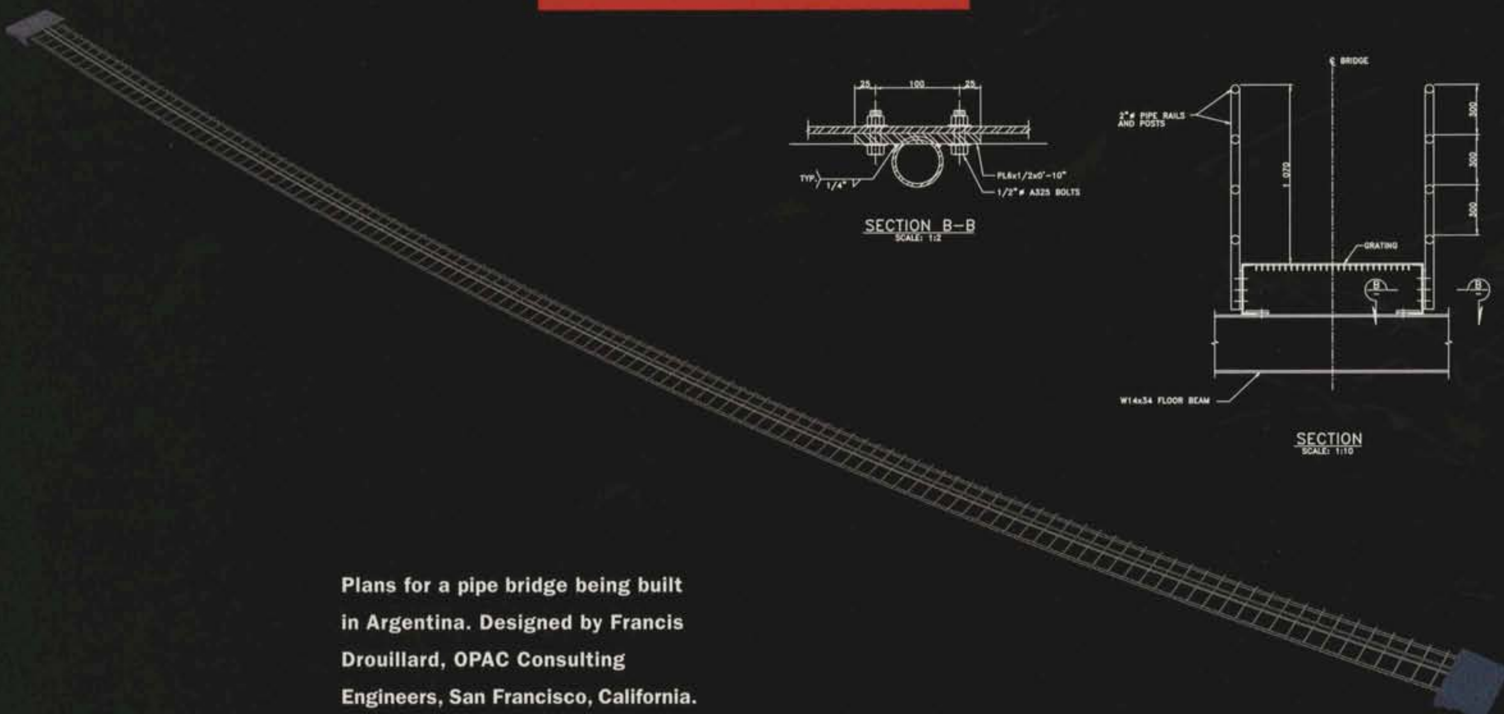
Knight-Ridder/Tribune Information Services



Graphics content is repurposed for television, the Web, and newspapers.

Designing a bridge from afar

OPAC Consulting Engineers



Plans for a pipe bridge being built in Argentina. Designed by Francis Drouillard, OPAC Consulting Engineers, San Francisco, California.

Adobe

The enterprise is group effort, intensely focused. Today, it extends far beyond the limitations of the past. The enterprise operates wherever there is need, interest, and relevance—24 hours a day. Compelling, economical communication is essential

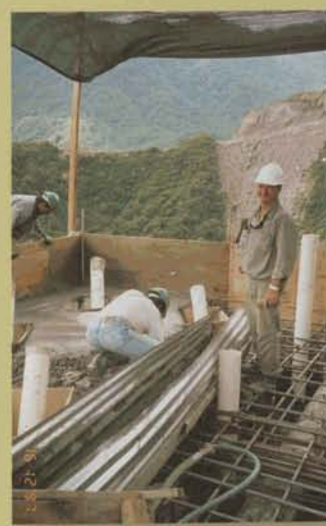
OPAC
Consulting Engineers

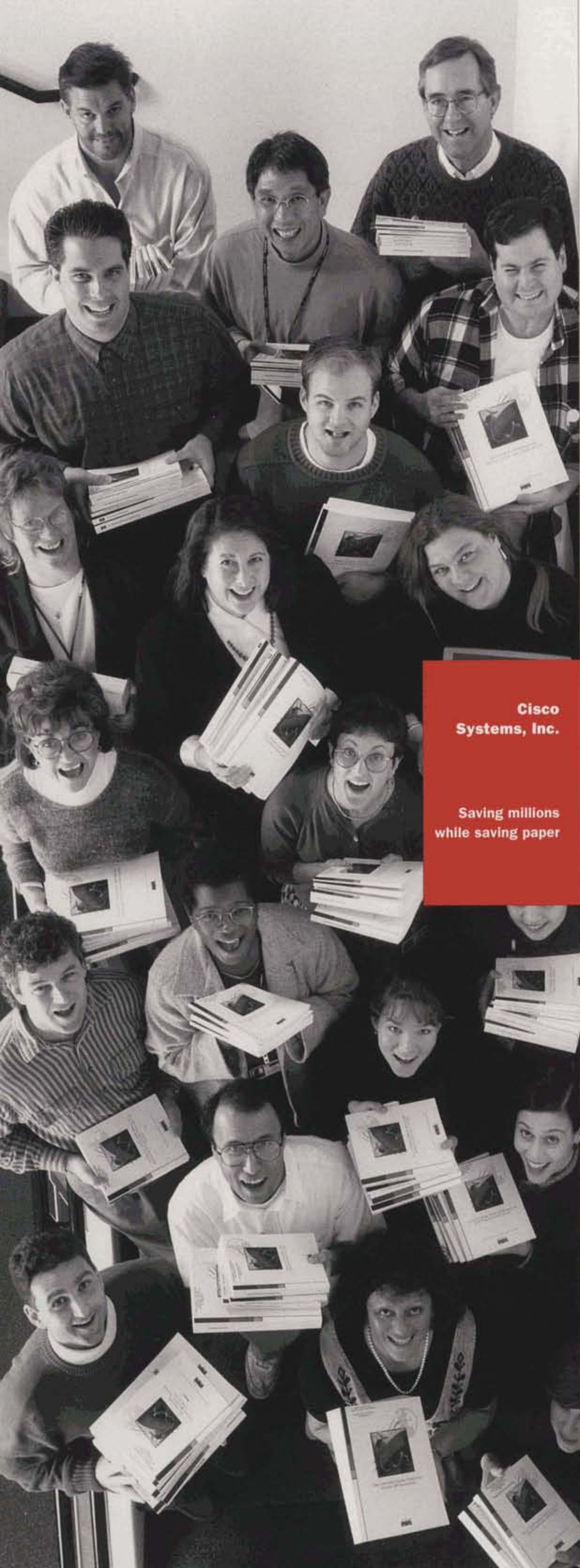
If you're designing a bridge in the wilds of Argentina and a mountain gets in the way, what do you do? Redesign the whole thing—only faster the second time.

Designing a bridge is complicated enough, but for OPAC Consulting Engineers of San Francisco, California, it was just the beginning. "We designed a special cable-supported span for a mining project in a remote part of Argentina," explains OPAC's Francis Drouillard. "They literally had to build a road to get to the site. Then, while we were doing the design, the location was changed due to a big mountain of rock that they could not blast through—suddenly it was a new project. There were many, many changes, and we were on a very fast track to meet the construction schedule."

To move critical documents rapidly between California and Argentina, Drouillard chose Adobe Acrobat software to convert highly detailed plans to Portable Document Format (PDF). "As the bridge's designer, I'm concerned about the danger of unauthorized modifications to my drawing," Drouillard explains. "With Acrobat, I'm able to add a password, and it can't be changed. I put my signature and engineering stamp directly on the drawing, and I'm confident that my work won't be misused in the field. The accuracy and security of using PDF over the Internet is very reassuring."

And the bridge? Going up right now, thanks.



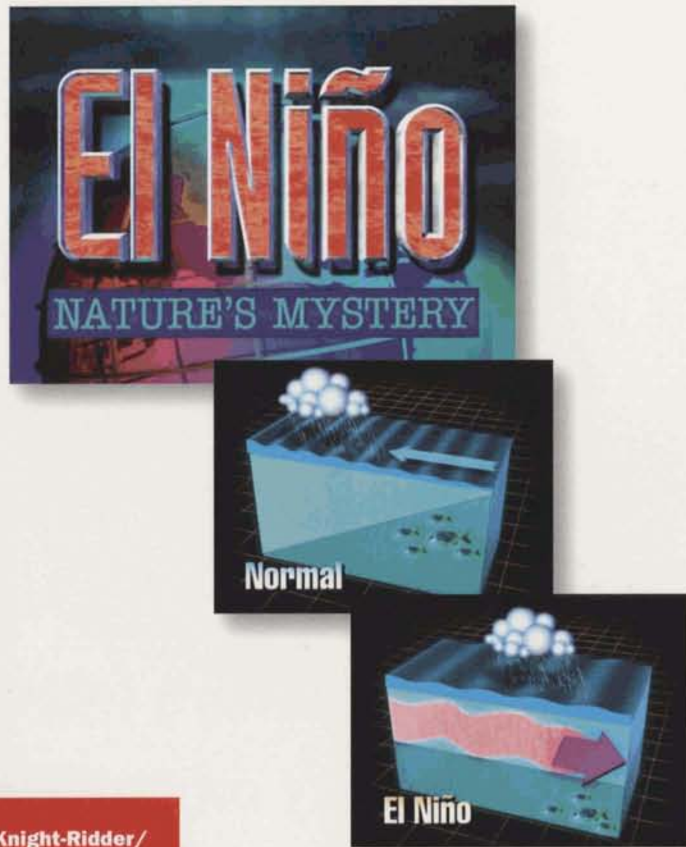


Cisco Systems, Inc.

Saving millions while saving paper

Knight-Ridder/ Tribune Information Services

Publishing the news in parallel



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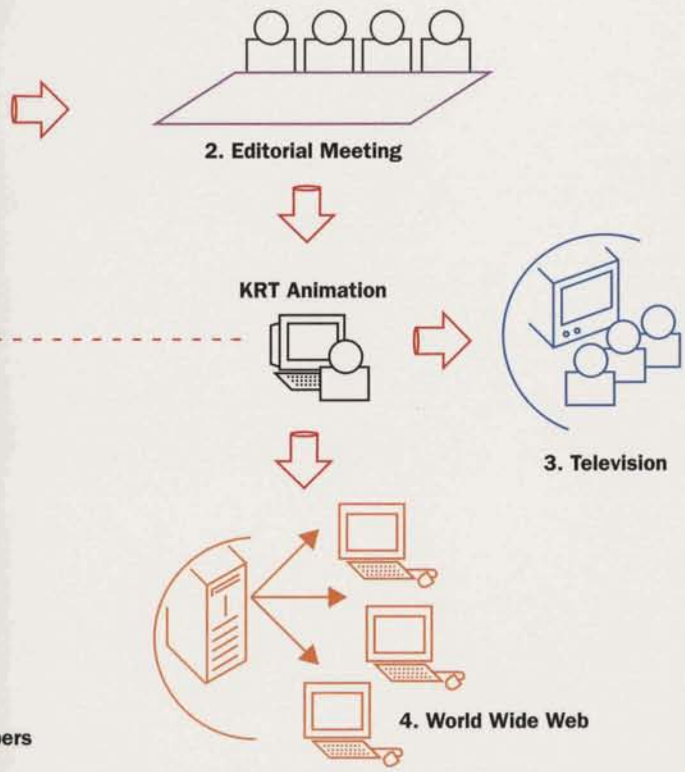

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Cisco Systems, Inc.

What do you call a company that saves $50 million while producing 11,000-page publications? The Leader.

It's no surprise that Cisco Systems is a global, networked business and one of the most effective and efficient users of the network doing business over the Internet. Cisco employs Adobe FrameMaker and Adobe Acrobat, along with its own innovative technology, to ensure that the wealth of electronic publications it produces is comprehensive, up-to-date, and easy to access.

"At Cisco, we see the Internet as a strategic communications investment," remarks Jan Johnston-Tyler, the company's senior manager of central documentation services. "We save $50 million annually in printing and reproduction costs by publishing our technical documentation and marketing collateral on the Web and CD-ROM."

Fast, ready access to accurate, timely information is a fundamental part of the Cisco vision. "For example," says Johnston-Tyler, "documentation for Cisco IOS™ software is 11,000 pages long. People don't want something like that delivered on paper. But at the same time, they need to have access to such mission-critical content. Delivering it online is the clear solution."

Cisco publications are developed in Adobe FrameMaker.

"We see the Internet as a strategic communications investment."

—Jan Johnston-Tyler
Senior Manager
Central Documentation Services
Cisco Systems, Inc.

The company's electronic publishing system then automatically creates Portable Document Format (PDF), HTML, and PostScript files, enabling the "single source" text to be printed on paper and used in Web and CD-ROM versions. "We couldn't do it without Adobe FrameMaker and Adobe Acrobat," Johnston-Tyler says. "Together they create an easy, attractive, economical solution that saves Cisco millions and millions of dollars a year."

www.cisco.com

Knight-Ridder/Tribune Information Services

How does one company stay ahead of the rapid changes in news presentation? Vision, hard work, and parallel publishing.

Knight-Ridder/Tribune Information Services (KRT) develops and distributes news and information features that appear in more than 500 newspapers worldwide. KRT is also a major content provider to online services and television throughout North America. In addition to being a leading media resource, KRT is at the forefront of parallel publishing—the repurposing of content for use in a variety of media.

George Rorick is head of KRT's News in Motion and Graphics departments. "We do everything as one large multimedia effort, not as separate operations," says Rorick. The tools of choice at KRT are Adobe Photoshop, Adobe After Effects, and Adobe Illustrator.

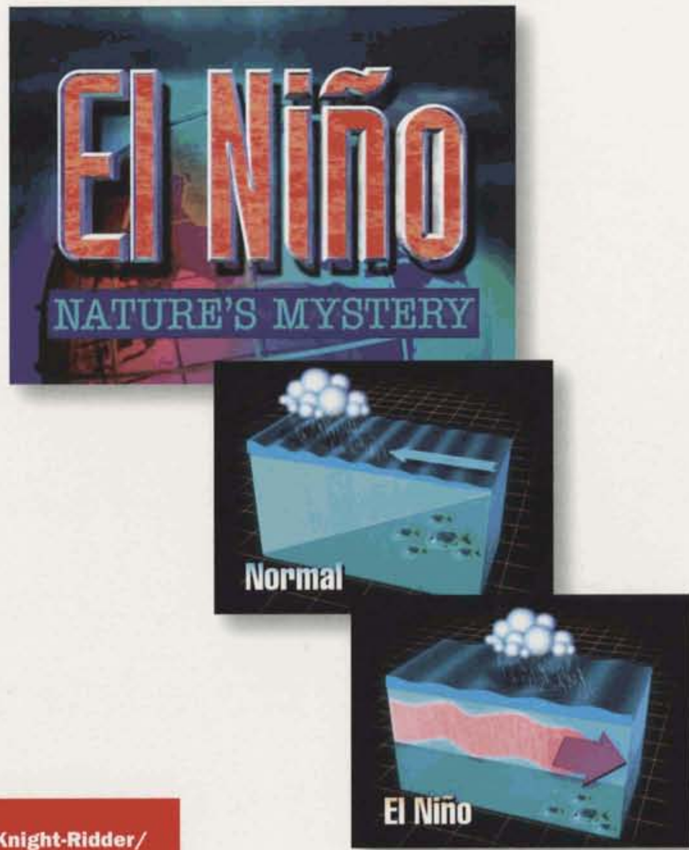
The news industry operates at two speeds—fast and faster—and KRT is no exception. "We use Adobe Photoshop and Adobe After Effects to turn out a minimum of four animations a day. Often it's five or six," Rorick says. "And we use Adobe Illustrator extensively to produce about 350 graphics a month. You might say that Adobe After Effects brought us into adulthood. It's a very powerful digital editing tool. It enables us to employ effects that we just couldn't use before. Adobe Photoshop and Adobe After Effects help us bring life and reality to our animations."

"The presentation of news has become increasingly visual," says Rorick, who helped develop *USA Today*'s distinctive format. "That's where everything is going in this fast-paced society. It's difficult to visually explain news and information, and to do it accurately." But the graphics, animations, and interactive Web packages that KRT produces using Adobe software make a big contribution toward achieving that goal. "It's a great way to deliver information," Rorick says.

www.tmstv.com/krt/info.htm

Knight-Ridder/ Tribune Information Services

Publishing the news in parallel



Graphics content is repurposed for television, the Web, and newspapers.

Parallel Publishing Workflow

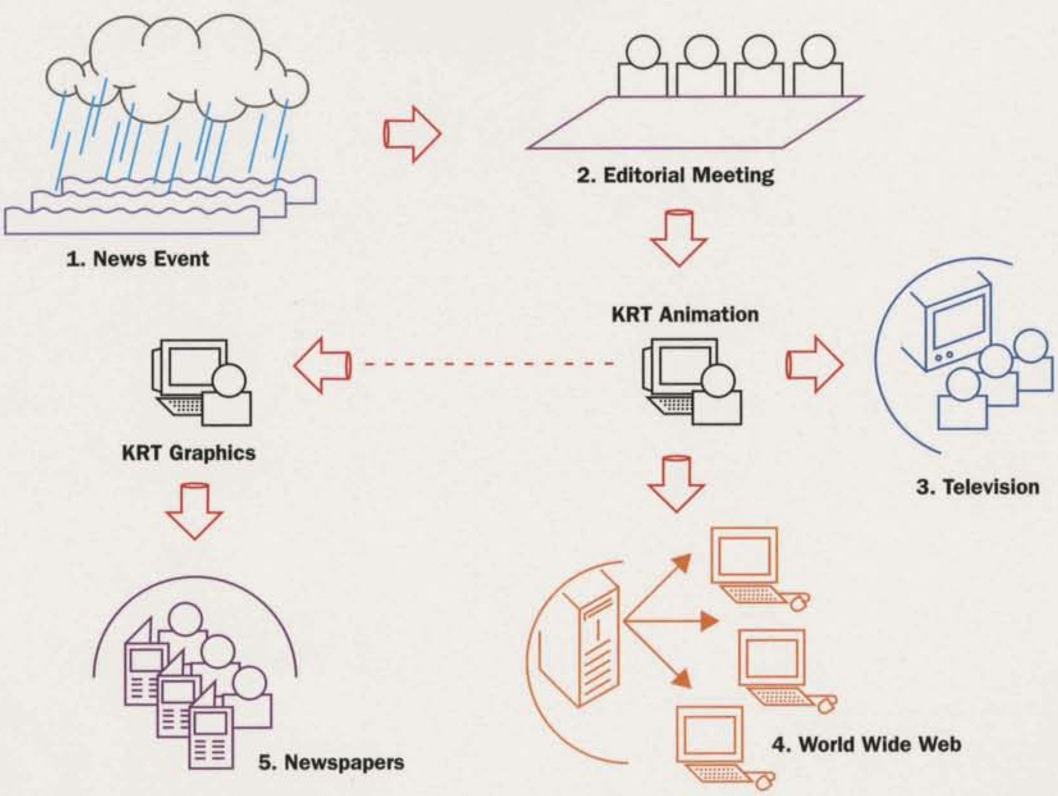
1. *A news event occurs, such as the El Niño weather phenomenon.*

2. *At a morning editorial meeting, an animator is assigned to produce a 15-second animation explaining El Niño. A writer is assigned to create the narration.*

3. *The animation is developed for television newscasts using Adobe Photoshop and Adobe After Effects software.*

4. *Adobe Premiere software is used to convert the animation for use on online news services.*

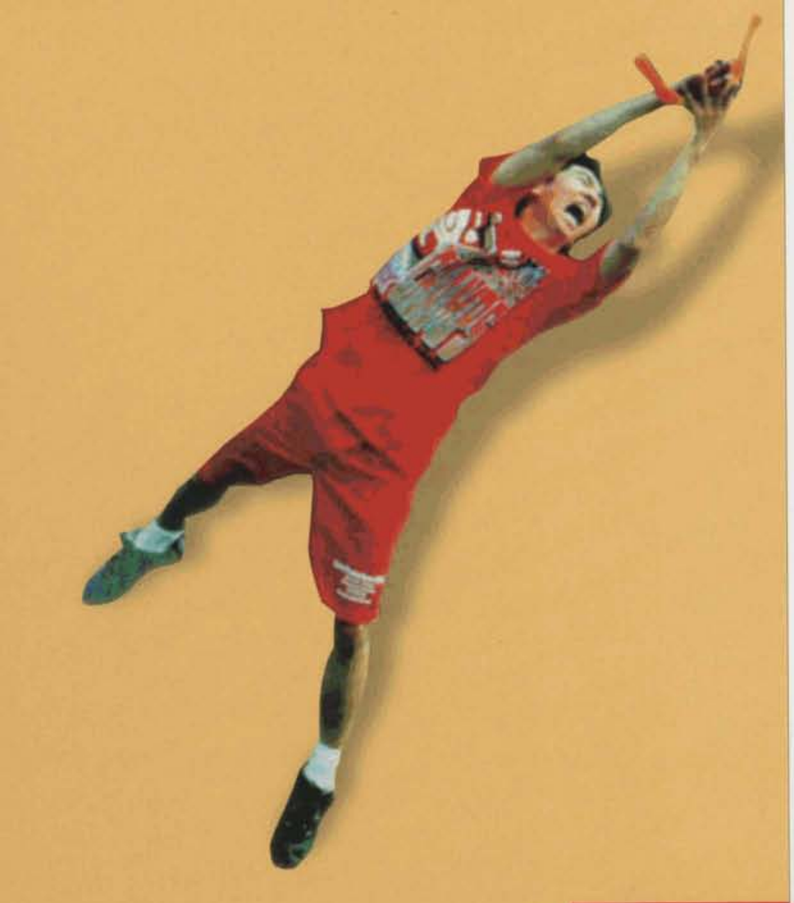
5. *Using Adobe Photoshop and Illustrator software, a single frame from the animation is converted to a news graphic for print. The text is adapted from the original narration.*



Adobe

In homes and offices around the world, the challenge is there. Always. It arrives every morning and stays late into the night. Every project begins with questions. How can I make information memorable? How can I give impact to my concept? How can I be more creative and innovative? Adobe provides solutions to those who ask such questions, but people provide the answers.

The following stories tell of new ways in which Adobe customers are answering (and asking) the most challenging questions.

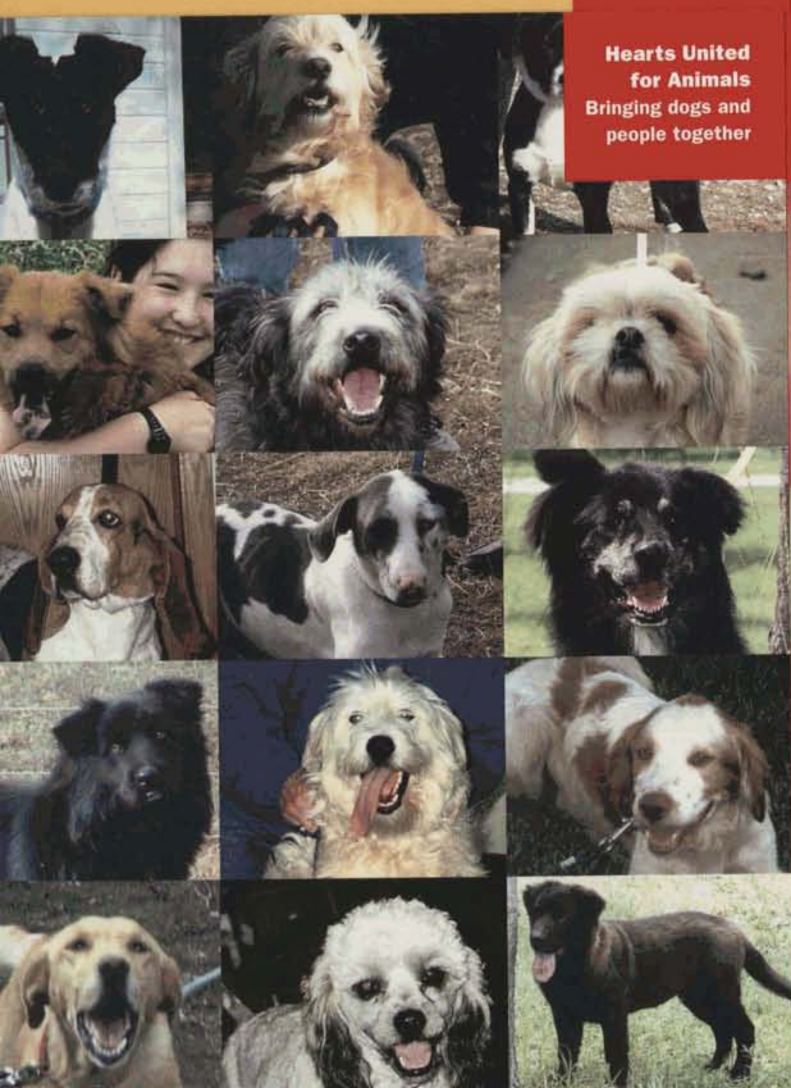


Thingz
OZ

Schroeder's
Bakery

Hearts United
for Animals
Bringing dogs and
people together

Paul Geller,
D.D.S.



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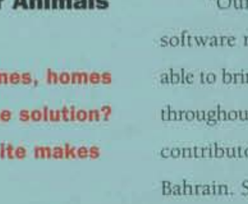
Hearts United for Animals

Dogs looking for homes, homes looking for dogs—the solution? An innovative Web site makes the connection.

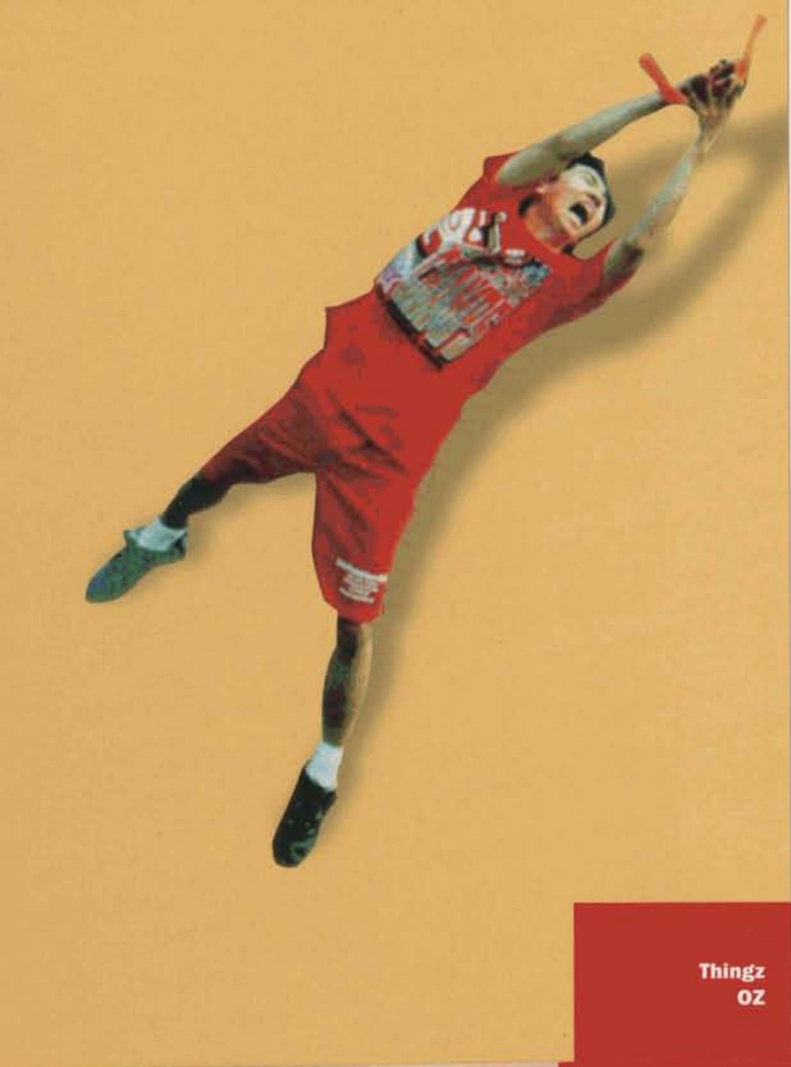
Hearts United for Animals (HUA) is a national animal rescue organization headquartered on a 40-acre tree farm in Nebraska. Lee Wheeler, a member of the shelter's founding family, runs HUA's Web site and the Jet Set Dogs long-distance adoption program. "We rescue 1,500 dogs a year from all over the United States," she explains. "We've saved nearly 2,700 puppies over the last three years. In 1996, more than 1,000 dogs were flown to new homes in 46 U.S. states and Canada."



Kipling's first owner left him at the Hearts United for Animals shelter. A family in Wisconsin saw his picture on the HUA Web site and asked to adopt him. Kipling traveled by jet to his new home, where he now lives with (and licks) Tom and Elizabeth.

"Our Web site and Adobe software make that possible. We're able to bring people and pets together throughout the country and to attract contributors from Japan to Italy to Bahrain. Saving these wonderful animals' lives is important and satisfying. We simply couldn't do what we do—in print or on the Web," Wheeler says, "without Adobe PageMaker, Adobe Photoshop, Adobe Illustrator, Adobe PostScript technology, and Adobe PageMill. Nor could we have achieved this level of success without Adobe products. I'm very grateful to Adobe—not only for the lives that have been saved," she laughs, "but for saving my sanity!"

www.hua.org



Thingz OZ

Schroeder's Bakery

Demonstrating dentistry's potential

Paul Geller, D.D.S.

In homes and offices around the world, the challenge is there. Always. It arrives every morning and stays late into the night. Every project begins with questions. How can I make information

Paul Geller, D.D.S.

How do you take the guesswork out of redesigning a smile? Just say Aaaa...Adobe.

Dr. Paul Geller is a dentist in White Plains, New York. "I have a general practice," Geller explains, "but cosmetic dentistry, such as bleaching, bonding, and porcelain veneers, is a part of most practices these days. I've found that Adobe PhotoDeluxe software is ideal for demonstrating cosmetic dentistry's potential. PhotoDeluxe enables me to quickly create a visual representation that simulates the final result. Showing patients how their teeth and their smile will be improved helps alleviate anxiety."

Both of Dr. Geller's treatment rooms are equipped with chair-side computers and intraoral cameras. "I use the system to capture and digitize an image of the patient's mouth," he says. "Then, while the patient watches on another monitor, I bring up Adobe PhotoDeluxe."

"A few Adobe PhotoDeluxe tools allow me to accomplish most anything I want in five to ten minutes. In some cases, I've taken a 'before' picture, saved my Adobe PhotoDeluxe file of the retouch, and then later compared it with a photo of the completed cosmetic work. The Adobe PhotoDeluxe simulation and the final result are incredibly close."

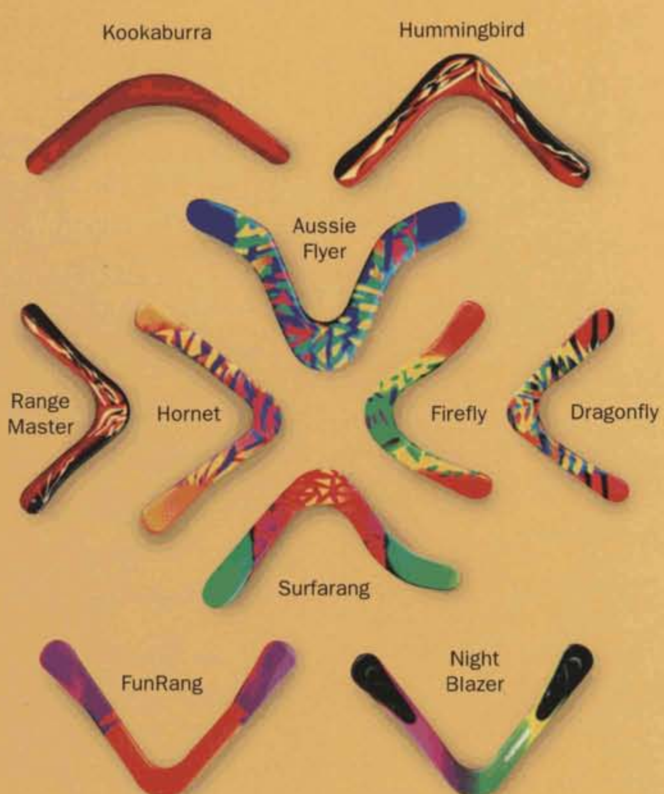
Before incorporating Adobe PhotoDeluxe into his practice, Geller tested considerably more expensive dedicated imaging software. "Those other systems were a huge investment," he says. "And there's nothing I can do with the dedicated software that I can't do with Adobe PhotoDeluxe. Not only is it extremely easy to use, but it's a powerful tool!"

Thingz OZ

Selling Australiana to the world

Schroeder's Bakery

Taking baking global



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Thingz OZ

How do you sell things from Down Under all over? Online.

Not long ago, Bob Bryan of Perth, Australia, decided to change careers by starting a catalog business selling Australiana, such as boomerangs, bush hats, and aboriginal art. Using Adobe software, he launched the Thingz OZ site on the World Wide Web. Bryan had little experience in marketing, but he had an abundance of energy and good ideas. "With Adobe PageMaker and Adobe Photoshop," he says, "I'm able to put well-designed new product listings and high-quality photos online in no time at all, which gives us a real advantage over the competition."

Thingz OZ also features jewelry based on Celtic designs. "Dozens of people download the jewelry catalog every week," Bryan says. "Adobe Acrobat has been terrific for that. Now we get orders from as far away as Europe, Asia, and the Middle East. We even have people in Malta ordering Irish jewelry! The online market has been fantastic. Thingz OZ started turning a tidy little profit within three months."

www.thingzoz.com

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Schroeder's Bakery

Can a family-owned bakery in Buffalo reach 400,000 people a month while selling apple strudel in Brazil? Piece of cake!

In 1928, Rudolph and Caroline Schroeder opened a bakery in Buffalo, New York. Today, their sons and other relatives run the business at its original location, though they recently added another retail outlet: the World Wide Web.

"We're a small business," says Michael Golebiewski, Webmaster and grandson of Rudolph and Caroline. "Awhile back we were looking at expanding into mail order. We determined that printing catalogs was going to cost a lot of money. So I suggested we put our catalog on the Web. That was the fastest, most economical solution, and I knew we could do it in-house."

"Adobe PageMill was simple and straightforward, and I learned it quickly," Golebiewski says. When the Schroeder's Bakery Web site first went online, it offered just a few items for sale. "That first month we got maybe 5,000 hits," Golebiewski remarks. "What we were doing was fairly innovative for a bakery," and it started to attract attention. Lots of it. After *U.S. News & World Report* published an article about Schroeder's online business,

the bakery began getting orders from around the world. And as the world discovered just how delicious Schroeder's baked goods are, the site attracted more and more potential customers.

Today, the Schroeder family is extremely satisfied with the response the site receives. "We're averaging about 400,000 hits per month. We get orders from as far away as Brazil, Japan, and even Yugoslavia. And I continue to use Adobe PageMill and Adobe Photoshop for all the work I do on the site," says Golebiewski.

But with a success like that, what's Schroeder's going to do for an encore? "We publish a printed newsletter using Adobe PageMaker," Golebiewski explains. "Soon we'll start converting it to Portable Document Format (PDF) with Adobe Acrobat software. We'll post it on the Web and distribute it as a PDF file via e-mail, which means customers will get it faster."

In the bakery business, whether it's a newsletter or cinnamon Danish, freshness counts.

www.schroedersbakery.com

Schroeder's Bakery

Taking baking global

At Adobe, the foundation of our business is helping people and companies make their ideas stand out, and enabling them to express themselves exactly as they intend, with impact and precision.

In 1997, customers in offices, homes, and design studios around the world used Adobe software and technologies to make ideas come alive with clarity and color, in print and online.

We're grateful to individuals and businesses like John Benson, Digital Clubhouse Network, Cisco Systems, NASA—and thousands more—who've let Adobe play a part in transforming their ideas into reality.

Adobe

Company Profile

Based in San Jose, California, Adobe Systems Incorporated, the award-winning provider of graphics and publishing solutions, gives you the power to make your ideas come alive—exactly as you intend. Whether you work in a design studio, an office, or at home, Adobe's software, images, type, and printing technologies offer you a seamless workflow for creating and distributing graphically rich communications in print and electronic media.

Financial Highlights

(In thousands, except per share and employee data)

	Years Ended				
	November 28, 1997	**November 29, 1996**	**December 1, 1995**	**November 25, 1994**	**November 26, 1993**
Operations:					
Revenue	**$ 911,894**	$ 786,563	$ 762,339	$ 675,617	$ 580,103
Merger transaction and restructuring costs	**—**	4,955	31,534	72,183	25,800
Income before income taxes	**296,090**	244,824	163,853	52,946	72,358
Net income	**186,837**	153,277	93,485	15,337	42,007
Net income per share	**2.52**	2.04	1.26	0.22	0.62
Cash dividends declared per common share	**0.20**	0.20	0.20	0.20	0.20
Financial position:					
Cash and short-term investments	**502,956**	564,116	516,040	444,768	344,714
Working capital	**454,299**	506,092	506,472	402,837	347,683
Total assets	**940,071**	1,001,393	872,827	710,000	597,696
Stockholders' equity	**715,424**	706,514	698,417	514,315	457,216
Additional data:					
Worldwide employees	**2,654**	2,222	2,322	2,055	2,500

Financial Review

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

In addition to historical information, this Annual Report contains forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations—Factors That May Affect Future Results of Operations." Readers should carefully review the risks described in other documents the Company files from time to time with the Securities and Exchange Commission, including the Quarterly Reports on Form 10-Q to be filed by the Company in 1998. Readers are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this Annual Report. The Company undertakes no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.

Results of Operations

Overview

Adobe Systems Incorporated ("Adobe" or the "Company") develops, markets, and supports computer software products and technologies that enable users to express and use information across all print and electronic media. 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 systems integrators. The Company has operations in North America, Europe, Japan, and Asia, Pacific, and Latin America.

In January 1996, the Company divested its prepress applications product business to a newly established company, Luminous Corporation ("Luminous"). Under the terms of the agreement, Luminous continued to develop, market, and distribute Adobe's prepress application products, and Adobe maintained ownership of certain core technologies for Adobe prepress products. Revenue from the prepress application business unit was approximately $10.4 million in fiscal year 1995. In October 1996, the Company sold its remaining interest in Luminous for approximately $6.8 million, which was recorded as a realized gain.

Revenue

	1997	Change	1996	Change	1995
Total revenue	$911.9	16%	$786.6	3%	$762.3

Revenue growth in 1997 is attributable primarily to increased application products shipments resulting from the release of new and enhanced products. In 1996, revenue grew due to increases in both licensing activity related to the Company's PostScript interpreter and application products. Product unit volume (as opposed to price) growth was the principal factor in the Company's revenue growth in application products revenue in both 1997 and 1996. No customer accounted for more than 10 percent of the Company's total revenue in 1997, 1996, or 1995.

	1997	Change	1996	Change	1995
Product group revenue—Licensing	$196.2	—	$196.7	7%	$183.4
Percentage of total revenue	21.5%		25.0%		24.1%

Licensing revenue is derived from shipments by OEM customers of products containing the Adobe PostScript interpreter, Adobe PrintGear software, and the Display PostScript® system. Such Adobe PostScript products include: (1) standard roman printers as well as printers that work with Japanese, Chinese, and Korean languages; (2) imagesetters; and (3) workstations. Licensing revenue is also derived from shipments of products containing the Configurable PostScript Interpreter ("CPSI") by OEM customers. CPSI is a fully functional Adobe 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 Adobe PostScript products independently of controller hardware development. Adobe PostScript products sell to the small office/home office ("SOHO") market, as well as the corporate enterprise and high-end imagesetter markets. Adobe PrintGear software is targeted to the SOHO and home computer market.

Royalty per unit is generally calculated as a percentage of the end user list price of a printer, although some components of licensing revenue based on a flat dollar amount per unit typically do not change with list prices. Licensing revenue in 1997 was unchanged from 1996 licensing revenue. Increased demand for CPSI, color capability, and Adobe PrintGear products was offset by a number of factors affecting OEMs, primarily in the Japanese and Macintosh markets. These factors included, but were not limited to, continuing weakness in Macintosh-related printer sales and in Japanese personal computer and printer markets, as well as a slow pace of new Adobe PostScript 3 and Adobe PrintGear products being brought to market by OEMs.

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 Adobe PostScript software, as well as the diversification of the Company's customer base across multiple platforms. During 1997, a number of OEM customers introduced new Adobe PrintGear products that serve the SOHO market. Late in 1997, some OEM customers began to transition from Adobe PostScript Level 2 products to Adobe PostScript 3 products. This transition is expected to continue through 1998. Also in the fall of 1997, one of Adobe's largest PostScript customers, Hewlett-Packard Company ("HP"), introduced a non-Adobe clone version of PostScript in one family of monochrome laser printers. The Company continues to be cautious about licensing revenue in the short term because of the factors identified in the previous paragraph and the anticipated loss of revenue from monochrome laser printer products from HP.

	1997	Change	1996	Change	1995
Product group revenue—					
Application products	$715.7	21%	$589.9	2%	$578.9
Percentage of total revenue	78.5%		75.0%		75.9%

Application products revenue is derived from shipments of application software programs marketed primarily through retail and distribution channels; however, Adobe PageMill, Adobe SiteMill,® Adobe FrameMaker, and Adobe Acrobat products are becoming more widely distributed through VARs and systems integrators. Adobe PhotoDeluxe is primarily distributed through OEM bundling agreements with digital camera, scanner, and personal computer manufacturers.

Application products revenue growth in 1997 was primarily due to increased demand for Adobe Photoshop, the Adobe Acrobat family of products, Adobe PhotoDeluxe, Adobe Illustrator, and Adobe PageMaker. A new version of Adobe Photoshop was released in late fiscal 1996, and new versions of Adobe PageMaker and Adobe Illustrator were released in the first and second quarters of fiscal 1997, respectively. In addition, during the second half of 1997, a new version of Adobe FrameMaker across multiple platforms and in multiple languages, the Windows version of Adobe PhotoDeluxe 2.0, and various other products in localized international versions were released. The 1996 revenue growth in this area resulted from increased demand for Adobe Photoshop, Adobe PageMill, Adobe SiteMill, Adobe Illustrator, and the Adobe Acrobat family of products, as well as demand for new products. The increase was partially offset by decreased demand for Adobe FrameMaker and Adobe PageMaker products. The Company released Adobe Photoshop 4.0 for both the Macintosh and Windows platforms and Adobe Acrobat 3.0 near the end of the fourth quarter of 1996. In addition, Adobe PageMill and Adobe SiteMill, which were both released in late 1995, added revenue in 1996.

Overall, revenue from the Company's application products on the Windows platform increased by 64 percent in 1997 over 1996, while application products revenue from the Macintosh platform increased one percent. In 1997, the Windows and Macintosh platforms accounted for 50.6 percent and 49.4 percent, respectively, of application products revenue, excluding platform-independent and UNIX products, compared to 38.6 percent and 61.4 percent, respectively, in 1996. The Company expects this trend toward the Windows platform to continue for the foreseeable future.

At the end of 1997, the Company experienced a decline in revenue from the Japanese market, due to reductions in sell-through rates by the Company's Japanese distributors and corresponding higher inventory levels. The Company remains cautious about the economic conditions in Japan as well as the fluctuating economic conditions in other Asian countries in the short term.

Direct costs

	1997	Change	1996	Change	1995
Direct costs	$126.3	(11)%	$141.1	8%	$130.3
Percentage of total revenue	13.8%		17.9%		17.1%

Direct costs include direct product, packaging, and shipping costs, as well as royalties, localization costs, and amortization of acquired technologies.

Gross margin (expressed as a percentage of revenue), in general, is affected by the mix of licensing revenue versus application products revenue, as well as the product mix within application products. Direct costs for application products decreased during 1997 as the Company transitioned from distribution of its products on disk to distribution on CD-ROM media, which has a lower cost per unit. In addition, certain acquired technologies became fully amortized during 1997, and localization costs were lower in 1997 than in 1996. Localization costs will vary from year-to-year depending on the timing of the release of new versions of products. Direct costs were slightly higher in 1996 compared to 1995 as a percentage of revenue due to higher localization costs. Also, there was a general decline in 1996 in Adobe FrameMaker revenue and associated gross margins.

Gross margin in 1998 is expected to be approximately the same as in 1997 as the cost savings from the continued shift to CD-ROM media is offset by higher localization costs.

Operating expenses

	1997	Change	1996	Change	1995
Software development costs—					
Research and development	$170.9	12%	$152.9	10%	$138.6
Percentage of total revenue	18.7%		19.4%		18.2%

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 over the last three years as the Company has 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 these efforts. The Company continues to make significant investments in the development of its Adobe PostScript and application software products, including those targeted for the growing Internet market.

The Company believes that 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 1998 will increase in absolute dollars, such expenditures are expected to remain approximately the same as a percentage of revenue.

	1997	Change	1996	Change	1995
Software development costs—					
Amortization of capitalized software development costs	—	(100)%	$2.5	(77)%	$11.1
Percentage of total revenue	—		0.3%		1.5%

During 1997, software development expenditures on all products, after reaching technological feasibility, were immaterial and therefore were expensed as incurred. Certain software development expenditures on products developed by Frame Technology Corporation ("Frame") and Aldus Corporation ("Aldus") prior to their acquisition by Adobe were capitalized and were amortized over the lives of the respective products. Amortization of capitalized software development costs decreased in 1997 and 1996 as a result of achieving full amortization of all Frame products by the end of 1996 and all Aldus products by the end of 1995.

The Company expects that software development expenditures on all products, after achieving technological feasibility, will continue to be immaterial in the future and therefore will be expensed as incurred.

	1997	Change	1996	Change	1995
Sales, marketing, and customer support	$303.3	19%	$255.0	5%	$242.7
Percentage of total revenue	33.3%		32.4%		31.8%

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 in both 1997 and 1996 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 addition, a portion of the 1997 increase relates to new product releases, increased investment in the Windows market, and programs related to furthering worldwide recognition of the Adobe brand.

For fiscal 1998, sales, marketing, and customer support expenditures are expected to increase in absolute dollars and may increase as a percentage of revenue.

	1997	Change	1996	Change	1995
General and administrative	$75.4	21%	$62.0	6%	$58.5
Percentage of total revenue	8.3%		7.9%		7.7%

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 executive and administrative personnel of the Company. General and administrative expenses also include outside legal and accounting fees, provision for bad debts, and expenses associated with computer equipment and software used in the administration of the business.

General and administrative expenses increased from 1997 compared to 1996 due to higher information system costs, legal costs, and employee costs primarily associated with a more comprehensive administrative infrastructure. The 1996 increase over 1995 resulted primarily from Frame integration costs in the first quarter of 1996 and a higher headcount entering fiscal 1996. In addition, the increase was driven by salary increases as well as higher systems and legal costs in 1996.

The Company expects general and administrative spending in 1998 to be slightly higher than 1997 levels in absolute dollars as the Company continues to invest in an expanded and more comprehensive executive and administrative infrastructure.

	1997	Change	1996	Change	1995
Write-off of acquired in-process research and development	$6.0	(72)%	$21.3	42%	$15.0
Percentage of total revenue	0.7%		2.7%		2.0%

During 1997, 1996, and 1995, the Company acquired seven software companies, in separate transactions, and accounted for them using the purchase method. 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.

	1997	Change	1996	Change	1995
Merger transaction and restructuring costs	—	(100)%	$ 5.0	(84)%	$31.5
Percentage of total revenue	—		0.6%		4.1%

Merger transaction and restructuring costs for 1996 were $5.0 million. This represents charges of $5.7 million less the reversal of $0.7 million of excess reserves related to restructuring costs recorded in prior years. The 1996 charges were recorded in connection with the disposition of two business units previously owned by Frame.

During the fourth quarter of 1995, the Company recorded merger transaction and restructuring costs primarily associated with the acquisition of Frame of $32.5 million and reversed approximately $1.0 million of excess restructuring reserves related to the acquisition of Aldus in 1994 as well as the remaining accrued restructuring costs related to a 1993 restructuring implemented by Frame.

At November 28, 1997, the remaining accrued restructuring balance of $8.4 million, included in other accrued expenses on the balance sheet, related to lease and third-party contract termination payments, resulting from the planned closure of duplicate offices in Europe and the United States. These payments are expected to continue through the lease terms or negotiated early termination date, if applicable.

	1997	Change	1996	Change	1995
Other nonrecurring items	$(0.6)	—	—	—	—
Percentage of total revenue	(0.1)%		—		—

Nonrecurring items in 1997 included a gain of $2.4 million related to the divestiture of a product line partially offset by a $1.8 million charge related to the acquisition of an intellectual property.

Nonoperating income

	1997	Change	1996	Change	1995
Investment gain (loss)	$34.3	(50)%	$68.9	9,223%	$(0.8)
Percentage of total revenue	3.8%		8.8%		(0.1)%

Investment gain (loss) consists principally of realized gains or losses from direct investments as well as mark-to-market valuation adjustments for Adobe Ventures L.P. investments.

In 1997, the investment gain relates primarily to the Company's liquidation of its investment in Netscape Communications Corporation ("Netscape") through the distribution to its stockholders of 554,660 shares of Netscape as a dividend-in-kind and the sale of its remaining Netscape shares. The 1996 gain arose primarily as a result of realized gains of approximately $43.6 million and approximately $6.8 million for the sale of a portion of the Company's investment in Netscape and its entire investment in Luminous Corporation, respectively. Also, a portion of one of the equity investments included in the Adobe Ventures L.P. portfolio was sold for a gain of $13.9 million during 1996, and at November 29, 1996, the remaining portion of this investment was marked-to-market for an unrealized gain of approximately $3.7 million. These and other gains were partially offset by write-downs on certain other investments.

	1997	Change	1996	Change	1995
Interest and other income	$31.0	6%	$29.2	(3)%	$30.0
Percentage of total revenue	3.4%		3.7%		3.9%

Interest and other income consists principally of interest earned on cash, cash equivalents, and short-term investments as well as foreign exchange transaction gains and losses.

The increase in interest and other income in 1997 from 1996 is primarily due to higher interest income in 1997 on higher average cash balances. The slight decrease in 1996 from 1995 is primarily due to foreign exchange gains in 1995 compared to foreign exchange losses in 1996.

Income tax provision

	1997	Change	1996	Change	1995
Income tax provision	$109.3	19%	$91.5	30%	$70.4
Percentage of total revenue	12.0%		11.6%		9.2%
Effective tax rate	36.9%		37.4%		42.9%

The Company's effective tax rate decreased in 1997 from 1996 primarily due to lower nondeductible charges for the write-off of acquired in-process research and development and higher tax-exempt income. The 1996 tax rate decreased significantly from 1995 primarily as a result of lower nondeductible charges, including merger costs, goodwill, and the write-off of acquired in-process research and development. An analysis of the differences between the statutory and effective income tax rates is provided in Note 7 of Notes to Consolidated Financial Statements.

The Company expects that the effective tax rate for fiscal 1998 will be between 37 percent and 38 percent due to lower tax-exempt interest income as a result of cash requirements for the Company's stock repurchase programs.

Net income and net income per share

	1997	Change	1996	Change	1995
Net income	$186.8	22%	$153.3	64%	$93.5
Percentage of total revenue	20.5%		19.5%		12.3%
Net income per share	$2.52	24%	$2.04	62%	$1.26
Weighted average shares (in thousands)	74,132	(1)%	75,064	1%	74,253

Net income in each of the three years included several one-time charges and, in 1997 and 1996, significant investment gains 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:

1997

(In thousands, except per share amounts)	Income Before Income Taxes	Income Tax Provision	Net Income	Net Income Per Share
Reported results of operations	$ 296,090	$ 109,253	$ 186,837	$ 2.52
Write-off of acquired in-process research and development costs	5,969	—	5,969	0.08
Other nonrecurring items	(590)	(218)	(372)	—
Net investment gain	(34,290)	(11,255)	(23,035)	(0.31)
Results of operations excluding one-time charges (gains)	$ 267,179	$ 97,780	$ 169,399	$ 2.29

1996

(In thousands, except per share amounts)	Income Before Income Taxes	Income Tax Provision	Net Income	Net Income Per Share
Reported results of operations	$ 244,824	$ 91,547	$ 153,277	$ 2.04
Write-off of acquired in-process research and development costs	21,251	1,837	19,414	0.26
Restructuring costs	4,955	1,505	3,450	0.05
Other one-time charges	2,917	886	2,031	0.03
Net investment gain	(68,875)	(18,873)	(50,002)	(0.67)
Results of operations excluding one-time charges (gains)	$ 205,072	$ 76,902	$ 128,170	$ 1.71

1995

(In thousands, except per share amounts)	Income Before Income Taxes	Income Tax Provision	Net Income	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	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

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 delays in shipment of the Company's new products and major new versions of existing products, market acceptance of new products and upgrades, continuing weakness in demand for Macintosh application software and Macintosh-related printers, renegotiation of royalty arrangements, growth in worldwide personal computer and printer sales and sales price adjustments, consolidation in the OEM printer business, industry transitions to new business and information delivery models, ongoing weakness in the Japanese and other Asian economies, and adverse changes in general economic conditions in any of the countries in which the Company does business.

The Company's ability to develop and market products, including upgrades of current products that successfully adapt to changing customer needs, may also have an impact on the results of operations. The Company's ability to extend its core technologies into new applications and to anticipate or respond to technological changes could affect its ability to develop these products. 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 revenue or results of operations.

Although the Company generally offers its application products on Macintosh, Windows, and UNIX platforms, a majority of the overall revenue from these products prior to 1997 has been for the Macintosh platform, particularly for the higher end Macintosh computers. In 1997, Windows-based application revenue exceeded that for the Macintosh platform for the first time. If there is a continuing slowdown of customer purchases in the higher end Macintosh market, or if the Company is unable to increase its sales to Windows customers, the Company's operating results could be materially adversely affected. Also, if the Company broadens its customer base to achieve greater penetration in the corporate business and consumer markets, the Company may need to adapt its application software distribution channels. The Company could experience decreases in average selling prices and some transitions in its distribution channel, which could materially adversely affect its operating results. In addition, to the extent that there is a slowdown of customer purchases of personal computers in general, the Company's operating results could be materially adversely affected.

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, which could result in lower licensing revenue for the Company. In the fall of 1997, HP began to ship non-Adobe clone software in some HP LaserJet printers, resulting in somewhat lower licensing revenue to the Company, although the impact was minimal. The Company expects a more significant impact on its 1998 licensing revenue, although it continues to work with HP printer operations to incorporate Adobe PostScript and other technologies in other HP products.

During late 1997, the Company experienced a decline in both application and licensing revenue from the Japanese market, due to a weak Japanese computer market and general economic conditions in Japan. In addition, at the end of fiscal 1997, inventory levels for application products at the Company's Japanese distributors remained higher than what the Company considers normal. The Company expects these adverse economic conditions to continue in the short term, and they may adversely affect the Company's revenue and earnings. Although there are also adverse conditions in other Asian economies, the countries affected represent a much smaller portion of the Company's revenue and thus have less impact on the Company's operational results.

Through its acquisitions, the Company has experienced significant growth. The Company's ability to effectively manage its growth will require it to continue to improve its operational and financial controls and information management systems, and to attract, retain, motivate, and manage employees effectively. The failure of the Company to effectively manage growth and transition in multiple areas of its business could have a material adverse effect on its results of operations.

The Internet market is rapidly evolving and is characterized by an increasing number of market entrants that have introduced or developed products addressing authoring and communications 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 for and communications over the Internet is young and has few proven products. In addition, new models for licensing software will be needed to accommodate new information delivery practices. Moreover, critical issues concerning the commercial use of the Internet (including security, reliability, ease of use and access, cost, and quality of service) remain unresolved and may affect the growth of Internet use, together with the software standards and electronic media employed in such markets.

The Company derives a significant portion of its revenue and operating income from its subsidiaries located in Europe, Japan, and Asia, Pacific, and Latin America. The Company generally experiences lower revenue from its European operations in the third quarter because many customers reduce their business activities in the summer months. While most of the revenue of the European subsidiaries is denominated in U.S. dollars, the majority of revenue derived from Japan is denominated in yen, and the majority of all subsidiaries' operating expenses are denominated in their local currencies. As a result, the Company's operating results are subject to fluctuations in foreign currency exchange rates. To date, the accounting impact of such fluctuations has been insignificant. The Company's hedging policy attempts to mitigate some of these risks, based on management's best judgment of the appropriate trade-offs among risk, opportunity, and expense. The Company has established a hedging program as described below in "Derivatives and Financial Instruments." The program is used to hedge its exposure to foreign currency exchange rate fluctuations, primarily of the Japanese yen. The Company's hedging program is not comprehensive, and there can be no assurance that the program will offset more than a portion of the adverse financial impact resulting from unfavorable movement in foreign currency exchange rates.

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 February 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share." SFAS No. 128 establishes a different method of computing net income per share than is currently required under the provisions of Accounting Principles Board Opinion No. 15. Under SFAS No. 128, the Company will be required to present both basic net income per share and diluted net income per share. Basic net income per share is expected to be higher than the currently presented net income per share, as the effect of dilutive stock options will not be considered in computing basic net income per share. Diluted net income per share is expected to be comparable to the currently presented net income per share.

The Company plans to adopt SFAS No. 128 in its fiscal quarter ending February 27, 1998, and at that time, all historical net income per share data presented will be restated to conform to the provisions of SFAS No.128.

In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes standards for reporting and displaying comprehensive income and its components in the financial statements. It does not, however, require a specific format for the disclosure, but requires the Company to display an amount representing total comprehensive income for the period in its financial statements. The Company will be required to implement SFAS No. 130 for its fiscal year 1999.

Also in June 1997, the FASB issued SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information." SFAS No. 131 establishes standards for the manner in which public companies report information about operating segments in annual and interim financial statements. The Company is currently evaluating the operating segment information that it will be required to report. The Company will be required to implement SFAS No. 131 for its fiscal year 1999.

In October 1997, the American Institute of Certified Public Accountants issued Statement of Position ("SOP") 97-2, "Software Revenue Recognition." SOP 97-2 establishes standards relating to the recognition of all aspects of software revenue. SOP 97-2 is effective for transactions entered into in fiscal years beginning after December 15, 1997 and will require the Company to modify certain aspects of its revenue recognition policies. The Company does not expect the adoption of SOP 97-2 to have a material impact on the Company's consolidated results of operations.

"Year 2000" Issues

The Company is aware of the issues associated with the programming code in existing computer systems as the year 2000 approaches. The "Year 2000" problem is pervasive and complex, as many computer systems will be affected in some way by the rollover of the two-digit year value to 00. Systems that do not properly recognize such information could generate erroneous data or cause a system to fail. The "Year 2000" issue creates risk for the Company from unforeseen problems in its own computer systems and from third parties with whom the Company deals on financial transactions worldwide. Failures of the Company's and/or third parties' computer systems could have a material impact on the Company's ability to conduct its business.

The Company's financial information systems include an SAP system recently implemented in the United States and Japan and an Oracle system in Europe that will be upgraded to the most recent version in the first quarter of fiscal 1998. These systems are believed to be "Year 2000" compliant. The Company is analyzing its remaining computer systems to identify any potential "Year 2000" issues and will take appropriate corrective action based on the results of such analysis. Management has not yet determined the cost related to achieving "Year 2000" compliance.

In addition, the "Year 2000" issue could affect the products that the Company sells. The Company believes that the current versions of its products are "Year 2000" compliant. The Company's products are subject to ongoing analysis and review.

Financial Condition

Cash, cash equivalents, and short-term investments

	1997	Change	1996	Change	1995
Cash, cash equivalents, and short-term investments	$503.0	(11)%	$564.1	9%	$516.0

The Company's cash, cash equivalents, and short-term investments decreased in 1997 from 1996, primarily as a result of cash expended for the Company's stock repurchase program. These expenditures were partially offset by cash generated from operations.

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, auction rate certificate 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 stockholders' equity.

Noncurrent liabilities and stockholders' equity

	1997	Change	1996	Change	1995
Noncurrent liabilities and stockholders' equity	$715.4	(8)%	$781.7	12%	$698.4

Included above is stockholders' equity, and at November 29, 1996 deferred income taxes of $3.8 million related to unrealized gains and losses on equity investments, and obligations for put warrants of $71.3 million. The Company has no long-term debt. Stockholders' equity as of November 28, 1997 was $715.4 million, compared to $706.5 million as of November 29, 1996 and $698.4 million as of December 1, 1995. The year-to-year increases in stockholders' equity include issuances of common stock under the Company's stock option and employee stock purchase plans and, in 1997, the reclassification of the put warrant obligation back to stockholders' equity. In 1997 and 1996, the increase in stockholders' equity was substantially offset by the repurchase of stock.

In September 1997, the Board of Directors authorized, subject to certain business and market conditions, the purchase of up to 15,000,000 shares of the Company's stock over the next two years. Under this program, as well as under previously authorized programs, the Company repurchased 6,150,656 shares and 3,321,500 shares in 1997 and 1996, respectively. The Company may continue to directly repurchase common shares and arrange options to purchase common shares, depending on market conditions and the Company's cash requirements.

The Company has paid cash dividends on its common stock each quarter since the second quarter of 1988. During 1997, the Company paid cash dividends of $0.20 per common share. In addition, during 1997, the Company distributed its holdings in Netscape Communications Corporation and Siebel Systems, Inc. to the Company's stockholders as a dividend-in-kind. The declaration of future dividends, whether in cash or in-kind, is within the discretion of the Company's Board of Directors and will depend upon business conditions, the Company's results of operations and financial condition, and other factors.

Working capital

	1997	Change	1996	Change	1995
Working capital	**$454.3**	(10)%	$506.1	—	$506.5

The decrease in working capital in fiscal 1997 from 1996 is primarily due to lower cash and short-term investment balances as a result of the Company's stock repurchase program. Cash flow provided by operations during fiscal 1997 was $208.6 million compared to $198.1 million in fiscal 1996.

Expenditures for property and equipment in 1997 totaled $33.9 million. Such expenditures are expected to continue, including expenditures for computer systems for research and development, sales and marketing, product support, and administrative staff. In the future, additional cash may be used to acquire software products or technologies complementary to the Company's business. Net cash used by financing activities during 1997 was $219.2 million, or $117.7 million greater than in fiscal 1996, primarily resulting from the repurchase of common stock and payment of cash dividends partially offset by issuance of common stock under employee stock plans.

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.

Derivatives and Financial Instruments

Foreign currency hedging instruments

The Company transacts business in various foreign currencies, primarily in certain European countries and Japan. Accordingly, the Company is subject to exposure from adverse movements in foreign currency exchange rates. This exposure is primarily related to yen denominated sales in Japan and local currency denominated operating expenses in Europe, where the Company sells primarily in U.S. dollars.

The Company's Japanese operating expenses are in yen, which mitigates the exposure related to yen denominated sales in Japan. In addition, the Company hedges firmly committed transactions using primarily forward contracts with maturities of less than three months. At November 28, 1997, the Company held $1.9 million of aggregate foreign currency forward exchange contracts for the sale of Japanese yen, all of which expire at various times through February 25, 1998. The unrealized gains and losses associated with these contracts are not material.

The Company's accounting policies for these instruments are based on the Company's designation of such instruments as hedging transactions. Gains and losses associated with the mark-to-market of outstanding foreign exchange forward contracts that are designated and effective as hedges of existing transactions, for which a firm commitment has been attained, are recognized in income in the current period. Corresponding gains and losses on the foreign currency denominated assets and transactions being hedged are recognized in income in that same period. In this manner, the gains and losses on foreign currency denominated transactions will be offset by the gains and losses on the foreign currency contracts. The Company does not anticipate any material adverse effect on its consolidated financial position, results of operations, or cash flows as a result of these instruments.

The Company does not use derivative financial instruments for speculative trading purposes, nor does the Company hedge its foreign currency exposure in a manner that entirely offsets the effects of changes in foreign exchange rates.

The Company currently does not use financial instruments to hedge local currency denominated operating expenses in Europe. Instead, the Company believes that a natural hedge exists, in that local currency revenue from product upgrades substantially offsets the local currency denominated operating expenses. The Company assesses the need to utilize financial instruments to hedge European currency exposure on an ongoing basis.

The Company regularly reviews its hedging program and may as part of this review determine at any time to change its hedging program.

Fixed income investments

At November 28, 1997, the Company had an investment portfolio of fixed income securities, including those classified as cash equivalents, of $523.9 million. These securities are subject to interest rate fluctuations. An increase in interest rates could affect the market value of the Company's fixed income securities.

A sensitivity analysis was performed on the Company's investment portfolio as of November 28, 1997. This sensitivity analysis is based on a modeling technique that measures the hypothetical market value changes that would result from a parallel shift in the yield curve of plus 50, plus 100, or plus 150 basis points over a 12-month time horizon. The market value changes for a 50, 100, or 150 basis point increase in short-term treasury security yields were not material due to the limited duration of the Company's portfolio.

The Company does not use derivative financial instruments in its investment portfolio to manage interest rate risk. The Company does, however, limit its exposure to interest rate and credit risk by establishing and strictly monitoring clear policies and guidelines for its fixed income portfolios. At the present time, the maximum duration of all portfolios is limited to 2.3 years. The guidelines also establish credit quality standards, limits on exposure to one issue, issuer, as well as the type of instrument. Due to the limited duration and credit risk criteria established in the Company's guidelines, the exposure to market and credit risk is not expected to be material.

Put warrants and call options

To facilitate the Company's stock repurchase program, the Company sold put warrants in a series of private placements in 1997 and 1996. Each warrant entitled the holder to sell one share of Adobe's common stock to the Company at a specified price. Approximately 4.6 million and 4.5 million put warrants were written in 1997 and 1996, respectively. At November 28, 1997, approximately 2.9 million put warrants were outstanding that expire on various dates through May 1998 and have exercise prices ranging from $37.07 to $47.98 per share, with an average exercise price of $43.09 per share. In addition, in 1997 and 1996, the Company purchased call options from an independent third party that entitled the Company to buy 2.3 million and 4.5 million shares, respectively, of its common stock. At November 28, 1997, approximately 0.5 million call options were outstanding and expire on various dates through April 1998 and have exercise prices ranging from $37.32 to $46.86 per share, with an average exercise price of $41.32 per share. Under these arrangements, the Company, at its option, can settle with physical delivery or net shares equal to the difference between the exercise price and the market value at the date of exercise.

Commitments

The Company's principal commitments as of November 28, 1997 consisted of obligations under operating leases, a real estate development agreement, and various service agreements with a related party.

During 1994, the Company entered into a real estate development agreement and an operating lease agreement in connection with the construction of an office facility. In August 1996, the construction was completed, and the operating lease commenced. The Company will have the option to purchase the facility at the end of the lease term, in October 2001. 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 $57.3 million. During the construction period, the Company was required to pledge certain interest-bearing instruments to the lessor as collateral to secure the performance of its obligations under the lease. As of November 28, 1997, the Company's deposits under this agreement totaled approximately $66.7 million in United States government treasury notes and money market mutual funds. These deposits are included in "Other assets" in the Consolidated Balance Sheets.

In 1996, the Company exercised its option under the development agreement to begin a second phase of development for an additional office facility. In August 1996, the Company entered into a construction agreement and an operating lease agreement for this facility. The operating lease will commence on completion of construction in 1998. The Company will have the option to purchase the facility at the end of the lease term (five years after occupancy). 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 $64.3 million. The Company also is required, periodically during the construction period, to deposit funds with the lessor as an interest-bearing security deposit to secure the performance of its obligations under the lease. During 1997, the Company deposited approximately $33.0 million, and as of November 28, 1997, the Company's deposits under this agreement totaled approximately $36.3 million. These deposits are included in "Other assets" in the Consolidated Balance Sheets.

At November 28, 1997, the Company held a 13 percent equity interest in McQueen International Limited ("McQueen") and accounted for the investment using the cost method. 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. Effective December 31, 1997, McQueen was acquired by Sykes Enterprises, Incorporated ("Sykes"), a publicly traded company. In connection with the acquisition, the Company exchanged its shares of McQueen for 486,676 shares of Sykes' restricted common stock and will record a gain on the exchange of $6.7 million in fiscal 1998. The Company's equity interest in Sykes is less than two percent. The Company expects that McQueen will continue to provide services to the Company for the foreseeable future.

Consolidated Balance Sheets

(In thousands, except per share data)	**November 28, 1997**	November 29, 1996
Assets		
Current assets:		
Cash and cash equivalents	$ 267,576	$ 110,745
Short-term investments	235,380	453,371
Receivables, net of allowances for doubtful accounts of $3,634 and $5,196, respectively	130,974	115,823
Other current assets	45,016	45,875
Total current assets	678,946	725,814
Property and equipment	80,978	80,231
Deferred income taxes	16,999	—
Other assets	163,148	195,348
	$ 940,071	$ 1,001,393
Liabilities and Stockholders' Equity		
Current liabilities:		
Trade and other payables	$ 57,857	$ 43,056
Accrued expenses	102,741	93,919
Income taxes payable	48,343	67,210
Deferred revenue	15,706	15,537
Total current liabilities	224,647	219,722
Deferred income taxes	—	3,809
Put warrants	—	71,348
Stockholders' equity:		
Preferred stock, $0.0001 par value; 2,000 shares authorized; none issued	—	—
Common stock, $0.0001 par value;		
Authorized: 200,000 shares;		
Issued: 73,941 and 71,476 shares in 1997 and 1996, respectively;		
Outstanding: 68,765 and 71,476 shares in 1997 and 1996, respectively	7	7
Additional paid-in capital	291,274	148,595
Retained earnings	663,861	529,546
Unrealized gains on investments, net	3,590	33,514
Cumulative translation adjustment	(4,620)	(5,148)
Treasury stock, at cost (5,176 shares in 1997)	(238,688)	—
Total stockholders' equity	715,424	706,514
	$ 940,071	$ 1,001,393

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Income

(In thousands, except per share data)	Years Ended **November 28, 1997**	 November 29, 1996	 December 1, 1995
Revenue:			
Licensing	**$ 196,230**	$ 196,693	$ 183,437
Application products	**715,664**	589,870	578,902
Total revenue	**911,894**	786,563	762,339
Direct costs	**126,271**	141,147	130,301
Gross profit	**785,623**	645,416	632,038
Operating expenses:			
Software development costs:			
Research and development	**170,862**	152,914	138,616
Amortization of capitalized software development costs	**—**	2,504	11,095
Sales, marketing, and customer support	**303,268**	254,972	242,713
General and administrative	**75,358**	62,034	58,526
Write-off of acquired in-process research and development	**5,969**	21,251	14,983
Merger transaction and restructuring costs	**—**	4,955	31,534
Other nonrecurring items	**(590)**	—	—
Total operating expenses	**554,867**	498,630	497,467
Operating income	**230,756**	146,786	134,571
Nonoperating income:			
Investment gain (loss)	**34,290**	68,875	(755)
Interest and other income	**31,044**	29,163	30,037
Total nonoperating income	**65,334**	98,038	29,282
Income before income taxes	**296,090**	244,824	163,853
Income tax provision	**109,253**	91,547	70,368
Net income	**$ 186,837**	$ 153,277	$ 93,485
Net income per share	**$ 2.52**	$ 2.04	$ 1.26
Shares used in computing net income per share	**74,132**	75,064	74,253

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Stockholders' Equity

(In thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Unrealized Gains on Investments, Net	Cumulative Translation Adjustment	Treasury Stock Shares	Treasury Stock Amount	Total
Balances as of November 25, 1994	69,390	$ 7	$ 204,026	$ 315,611	$ (1,277)	$ (4,052)	—	$ —	$ 514,315
Stock issued under employee stock and stock option plans	3,914	—	70,367	—	—	—	—	—	70,367
Tax benefit from employee stock option plans	—	—	32,445	—	—	—	—	—	32,445
Stock compensation expense	—	—	4,433	—	—	—	—	—	4,433
Adjustment for change in Frame Technology Corporation fiscal year-end	(10)	—	(171)	(1,784)	—	—	—	—	(1,955)
Dividends declared	—	—	—	(13,177)	—	—	—	—	(13,177)
Subchapter S distributions of Mastersoft	—	—	—	(3,342)	—	—	—	—	(3,342)
Repurchase of common stock	(460)	—	(17,849)	—	—	—	—	—	(17,849)
Unrealized gains on investments, net	—	—	—	—	20,108	—	—	—	20,108
Cumulative translation adjustment	—	—	—	—	—	(413)	—	—	(413)
Net income	—	—	—	93,485	—	—	—	—	93,485
Balances as of December 1, 1995	72,834	$ 7	$ 293,251	$ 390,793	$ 18,831	$ (4,465)	—	$ —	$ 698,417

(continued)

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Stockholders' Equity

(continued)

(In thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Unrealized Gains on Investments, Net	Cumulative Translation Adjustment	Treasury Stock Shares	Treasury Stock Amount	Total
Balances as of December 1, 1995	72,834	$ 7	$ 293,251	$ 390,793	$ 18,831	$ (4,465)	—	$ —	$ 698,417
Stock issued under employee stock and stock option plans	2,032	—	39,870	—	—	—	—	—	39,870
Tax benefit from employee stock option plans	—	—	10,828	—	—	—	—	—	10,828
Stock compensation expense	—	—	2,772	—	—	—	—	—	2,772
Dividends declared	—	—	—	(14,524)	—	—	—	—	(14,524)
Repurchase of common stock	(3,390)	—	(126,778)	—	—	—	—	—	(126,778)
Reclassification of put warrant obligations	—	—	(71,348)	—	—	—	—	—	(71,348)
Unrealized gains on investments, net	—	—	—	—	14,683	—	—	—	14,683
Cumulative translation adjustment	—	—	—	—	—	(683)	—	—	(683)
Net income	—	—	—	153,277	—	—	—	—	153,277
Balances as of November 29, 1996	71,476	$ 7	$ 148,595	$ 529,546	$ 33,514	$ (5,148)	—	$ —	$ 706,514

(continued)

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Stockholders' Equity

(continued)

(In thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Unrealized Gains on Investments, Net	Cumulative Translation Adjustment	Treasury Stock Shares	Treasury Stock Amount	Total
Balances as of November 29, 1996	71,476	$ 7	$148,595	$ 529,546	$ 33,514	$ (5,148)	—	—	$ 706,514
Stock issued under employee stock and stock option plans	3,631	—	70,995	—	—	—	—	—	70,995
Tax benefit from employee stock option plans	—	—	29,607	—	—	—	—	—	29,607
Stock compensation expense	—	—	1,329	—	—	—	—	—	1,329
Dividends declared	—	—	—	(52,522)	—	—	—	—	(52,522)
Repurchase of common stock	(1,166)	—	(36,956)	—	—	—	(5,176)	(238,688)	(275,644)
Proceeds from sale of put warrants	—	—	6,356	—	—	—	—	—	6,356
Reclassification of expired put warrant obligations	—	—	71,348	—	—	—	—	—	71,348
Unrealized gains on investments, net	—	—	—	—	(29,924)	—	—	—	(29,924)
Cumulative translation adjustment	—	—	—	—	—	528	—	—	528
Net income	—	—	—	186,837	—	—	—	—	186,837
Balances as of November 28, 1997	73,941	$ 7	$291,274	$ 663,861	$ 3,590	$ (4,620)	(5,176)	$(238,688)	$ 715,424

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

(In thousands)	Years Ended November 28, 1997	November 29, 1996	December 1, 1995
Cash flows from operating activities:			
Net income	$ 186,837	$ 153,277	$ 93,485
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	59,384	55,621	60,435
Deferred income taxes	(4,172)	(9,420)	(7,167)
Equity in net (income) loss of Adobe Ventures	1,326	(19,001)	755
Gains on sales of equity securities	(35,616)	(53,216)	—
Tax benefit from employee stock option plans	29,607	10,828	32,445
Stock compensation expense	1,329	2,772	4,433
Write-off of acquired in-process research and development	5,969	21,251	14,983
Noncash restructuring costs	—	2,525	4,714
Changes in operating assets and liabilities:			
Receivables	(15,151)	8,556	(24,548)
Other current assets	(2,351)	(1,173)	628
Trade and other payables	14,802	8,534	(7,032)
Accrued expenses	(1,192)	(27,427)	4,996
Income taxes payable	(32,294)	48,768	(4,845)
Deferred revenue	169	(3,781)	4,474
Net cash provided by operating activities	208,647	198,114	177,756

(continued)

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

(continued)

(In thousands)	Years Ended **November 28, 1997**	November 29, 1996	December 1, 1995
Cash flows from investing activities:			
Purchases of short-term investments	**$(2,657,302)**	$(2,363,993)	$ (2,614,349)
Maturities and sales of short-term investments	**2,875,294**	2,363,793	2,403,631
Acquisitions of property and equipment	**(33,882)**	(45,869)	(34,071)
Additions to other assets	**(42,122)**	(65,399)	(96,721)
Acquisitions, net of cash acquired	**(6,121)**	(8,027)	(15,158)
Proceeds from sales of equity securities	**30,993**	72,630	—
Net cash provided by (used for) investing activities	**166,860**	(46,865)	(356,668)
Cash flows from financing activities:			
Proceeds from issuance of common stock and put warrants	**77,351**	39,870	70,367
Repurchase of common stock	**(275,644)**	(126,778)	(17,849)
Payment of dividends	**(20,911)**	(14,586)	(12,310)
Payment of Subchapter S distributions of Mastersoft	**—**	—	(3,342)
Net cash provided by (used for) financing activities	**(219,204)**	(101,494)	36,866
Effect of foreign currency exchange rates on cash and cash equivalents	**528**	2,497	10
Net increase (decrease) in cash and cash equivalents	**156,831**	52,252	(142,036)
Adjustment for change in acquired company's fiscal year-end	**—**	—	(3,591)
Cash and cash equivalents at beginning of year	**110,745**	58,493	204,120
Cash and cash equivalents at end of year	**$ 267,576**	$ 110,745	$ 58,493
Supplemental disclosures:			
Cash paid during the year for income taxes	**$ 85,062**	$ 30,463	$ 44,470
Noncash investing and financing activities:			
Cash dividends declared but not paid	**$ 3,558**	$ 3,582	$ 3,645
Dividends in-kind declared but not distributed	**$ 10,032**	$ —	$ —
Dividends in-kind distributed	**$ 21,603**	$ —	$ —
Issuance of notes for acquisition	**$ —**	$ 9,473	$ —

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 express and use information across all print and electronic media. 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 systems integrators. The Company has operations in North America, Europe, Japan, and Asia, Pacific, and Latin America.

Fiscal year

The Company's 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 subsidiaries, after elimination of all significant intercompany accounts and transactions.

Recapitalization

In May 1997, the Company was reincorporated in the State of Delaware. As part of this reincorporation, each outstanding share of the predecessor California Corporation preferred stock and common stock was converted automatically to one share of the new Delaware Corporation $0.0001 par value preferred stock and common stock. All prior periods presented have been restated to reflect this change.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities, at the date of the financial statements, and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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 and short-term investments, and certain noncurrent investments in equity securities, free of trading restrictions or to become free of trading restrictions within one year, are classified as "available-for-sale." These investments are carried at fair value, based on quoted market prices, and unrealized gains and losses, net of taxes, are reported as a separate component of stockholders' equity. Realized gains and losses upon sale or maturity of these investments are determined using the specific identification method.

Foreign currency translation

Assets and liabilities of certain foreign subsidiaries, whose functional currency is the local currency, are translated 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 stockholders' equity. Certain other transaction gains or losses, which have not been material, are reported in results of operations.

Property and equipment

Property and equipment are recorded at cost. Depreciation and amortization are calculated using the straight-line method over the shorter of the estimated useful lives (thirty-five years for the building; two to seven years for furniture and equipment) or lease terms (five to nine years for leasehold improvements) of the respective assets.

Other assets

Purchased technology, goodwill, and certain other intangible assets 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 to seven years. Capitalization of computer software development costs, when material, begins upon the establishment of technological feasibility. 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 over the software's estimated economic life, generally 9 to 36 months. The Company periodically reviews the net realizable value of its intangible assets and adjusts the carrying amount accordingly.

The Company owns a minority interest in certain technology companies. Such investments are accounted for under the cost method, as the Company does not have significant influence or control over the investee companies. The Company owns a majority interest in two limited partnerships that were established to invest in technology companies. The limited partnership investments are accounted for under the equity method because contractually the partnerships are controlled by the general partner, a third party.

Long-lived assets

The Company reviews property and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of property and equipment is measured by comparison of its carrying amount to future net cash flows the property and equipment are expected to generate. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the property and equipment exceeds its fair market value, as determined by discounted cash flows. The Company assesses the recoverability of enterprise-level goodwill by determining whether the unamortized goodwill balance can be recovered through undiscounted future results of the acquired operation. The amount of enterprise-level goodwill impairment, if any, is measured based on projected discounted future results using a discount rate reflecting the Company's average cost of funds.

Employee stock plans

The Company accounts for its employee stock plans, which consist of fixed stock option plans, an employee stock purchase plan, and a performance and restricted stock plan, using the intrinsic value method.

Revenue recognition

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 at the time the related revenue is recorded.

Licensing revenue is recognized when the Company's OEM customers ship their products incorporating Adobe's software. Revenue associated with adapting the Company's software products to an OEM customer's hardware products is recognized based on the percentage-of-completion method and is included in licensing revenue. Deferred revenue includes customer advances under OEM licensing agreements. Additionally, maintenance revenue for application products is deferred and recognized ratably over the term of the contract, generally 12 months.

Direct costs

Direct costs include direct product, packaging, and shipping costs, as well as royalties, localization costs, and amortization of acquired technologies.

Advertising costs

Advertising costs are expensed as incurred.

Income taxes

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, 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. A valuation allowance is recorded to reduce tax assets to an amount whose realization is more likely than not.

Foreign currency hedging instruments

The Company enters into foreign exchange contracts to hedge its foreign currency risks. Such contracts must be effective at reducing the foreign currency risk associated with the underlying transaction being hedged and must be designated as a hedge at the inception of the contract. The Company, as a matter of policy, does not engage in speculative transactions.

The Company currently uses forward contracts as hedges of firmly committed transactions. For these contracts, mark-to-market gains and losses are recognized as other income or expense in the current period, generally consistent with the period in which the gain or loss of the underlying transaction is recognized. All forward foreign currency contracts currently entered into by the Company have maturities of 90 days or less.

Put warrants and call options

The Company utilizes put warrants and call option arrangements to facilitate the repurchase of its common stock. In 1997, the Company can settle, at its option, all outstanding puts and calls with physical delivery or net shares equal to the difference between the exercise price and the market value at the date of exercise. Accordingly, the potential repurchase obligation under these arrangements is included in stockholders' equity. In 1996, the arrangements required physical delivery, and accordingly, the potential buyback obligation was removed from stockholders' equity and recorded as put warrants. Proceeds from the sale of put warrants are recorded in stockholders' equity.

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. The difference between primary and fully diluted net income per share is not significant in all periods presented.

Recent accounting pronouncements

In February 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings Per Share." SFAS No. 128 establishes a different method of computing net income per share than is currently required under the provisions of Accounting Principles Board Opinion No. 15. Under SFAS No. 128, the Company will be required to present both basic net income per share and diluted net income per share. Basic net income per share is expected to be higher than the currently presented net income per share, as the effect of dilutive stock options will not be considered in computing basic net income per share. Diluted net income per share is expected to be comparable to the currently presented net income per share.

The Company plans to adopt SFAS No. 128 in its fiscal quarter ending February 27, 1998, and at that time, all historical net income per share data presented will be restated to conform to the provisions of SFAS No. 128.

In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes standards for reporting and displaying comprehensive income and its components in the financial statements. It does not, however, require a specific format for the disclosure but requires the Company to display an amount representing total comprehensive income for the period in its financial statements. The Company will be required to implement SFAS No. 130 for its fiscal year 1999.

Also in June 1997, the FASB issued SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information." SFAS No. 131 establishes standards for the manner in which public companies report information about operating segments in annual and interim financial statements. The Company is currently evaluating the operating segment information that it will be required to report. The Company will be required to implement SFAS No. 131 for its fiscal year 1999.

In October 1997, the American Institute of Certified Public Accountants issued Statement of Position ("SOP") 97-2, "Software Revenue Recognition." SOP 97-2 establishes standards relating to the recognition of all aspects of software revenue. SOP 97-2 is effective for transactions entered into in fiscal years beginning after December 15, 1997 and will require the Company to modify certain aspects of its revenue recognition policies. The Company does not expect the adoption of SOP 97-2 to have a material impact on the Company's consolidated results of operations.

Reclassifications

Certain reclassifications were made to the 1996 and 1995 consolidated financial statements to conform to the 1997 presentation.

Note 2. Acquisitions

During 1997, 1996, and 1995, the Company acquired seven software companies, in separate transactions, for an aggregate consideration of approximately $45.8 million in cash, notes payable, and the assumption of certain liabilities. These acquisitions were accounted for using the purchase method of accounting and resulted in the write-off of acquired in-process research and development of $6.0 million, $21.3 million, and $15.0 million during fiscal 1997, 1996, and 1995, respectively. The operating results of the acquired companies have been included in the accompanying consolidated financial statements from their dates of acquisition. The operating results of each company acquired are not considered material to the consolidated financial statements of Adobe, and accordingly, pro forma information has not been presented.

Note 3. Cash Equivalents and Investments

All cash equivalents, short-term investments, and certain noncurrent investments consisted of the following:

	As of November 28, 1997			
	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Classified as current assets:				
Money market mutual funds	$ 53,051	$ —	$ —	$ 53,051
State and municipal bonds and notes	394,295	757	(36)	395,016
Corporate and bank notes	6,400	—	—	6,400
Auction-rate securities	2,800	—	—	2,800
Equity securities	4,082	5,292	—	9,374
Total current	460,628	6,049	(36)	466,641
Classified as noncurrent assets:				
Money market mutual funds	46	—	—	46
United States government treasury notes	66,607	9	(9)	66,607
Total noncurrent	66,653	9	(9)	66,653
Total securities	$ 527,281	$ 6,058	$ (45)	$ 533,294

	As of November 29, 1996			
	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Classified as current assets:				
Money market mutual funds	$ 39,381	$ —	$ —	$ 39,381
United States government treasury notes and agency discount notes	90,617	424	(247)	90,794
State and municipal bonds and notes	358,612	1,894	(36)	360,470
Corporate and bank notes	38,598	405	(33)	38,970
Auction-rate securities	10,000	—	—	10,000
Asset-backed securities	11,740	91	(110)	11,721
Total current	548,948	2,814	(426)	551,336
Classified as noncurrent assets:				
Money market mutual funds	15,977	—	—	15,977
United States government treasury notes	50,327	—	(183)	50,144
Equity securities	3,882	54,216	(19)	58,079
Total noncurrent	70,186	54,216	(202)	124,200
Total securities	$ 619,134	$ 57,030	$ (628)	$ 675,536

Approximately $231.2 million and $97.9 million in investments are classified as cash equivalents as of November 28, 1997 and November 29, 1996, respectively, and all noncurrent investments are included in other assets. Unrealized gains (losses) on all securities are reported as a separate component of stockholders' equity, net of taxes of $2.4 million and $23.0 million as of November 28, 1997 and November 29, 1996, respectively. Net realized gains for the years ended November 28, 1997 and November 29, 1996 of $38.4 million and $48.4 million, respectively, are included in nonoperating income.

As of November 28, 1997, the cost, which approximated fair value, of current debt securities and money market mutual funds with a maturity of one year or less was $257.0 million, and the cost and estimated fair value of current debt securities with maturities ranging from one to five years was $196.7 million and $197.4 million, respectively. Other debt securities include auction-rate securities of $2.8 million. Included in auction-rate securities are Auction Rate Certificate Securities whose stated maturities exceed ten years. However, the Company has the option of adjusting the respective interest rates or liquidating these investments at auction on stated auction dates every 35 days.

Note 4. Property and Equipment

Property and equipment consisted of the following:

	November 28, 1997	November 29, 1996
Land	$ 782	$ 782
Building	4,477	4,615
Equipment	141,067	121,044
Furniture and fixtures	21,243	18,126
Leasehold improvements	19,916	13,036
	187,485	157,603
Less accumulated depreciation and amortization	106,507	77,372
	$ 80,978	$ 80,231

Note 5. Other Assets

Other assets consisted of the following:

	November 28, 1997	November 29, 1996
Equity investments	$ 35,689	$ 97,679
Purchased technology and licensing agreements	5,043	32,211
Restricted funds and security deposits	102,962	69,443
Intangibles and other assets	45,097	35,470
	188,791	234,803
Less accumulated amortization	25,643	39,455
	$ 163,148	$ 195,348

Included above in equity investments at November 29, 1996, are unrealized gains and losses. The equity investment in Netscape Communications Corporation ("Netscape") was marked-to-market for an unrealized gain of $47.7 million in 1996.

In 1997, the Company recorded realized gains of $32.8 million related to the disposal of its holdings in Netscape through the distribution of 554,660 Netscape shares to the Company's stockholders as a dividend-in-kind and the sale of its remaining Netscape shares. The Company recorded additional realized gains in 1997 of $4.5 million related to the sale of other equity investments. During 1996, the Company recorded realized gains of approximately $43.6 million and approximately $6.8 million for the sale of a portion of its investment in Netscape and its entire investment in Luminous, respectively.

Amortization expense related to purchased technology and other intangibles was $26.2 million and $42.8 million in fiscal 1997 and fiscal 1996, respectively.

Note 6. Accrued Expenses

Accrued expenses consisted of the following:

	November 28, 1997	November 29, 1996
Accrued compensation and benefits	$ 37,833	$ 24,673
Sales and marketing allowances	13,028	13,753
Other	51,880	55,493
	$ 102,741	$ 93,919

Note 7. Income Taxes

Income before income taxes includes net income from foreign operations of approximately $59.3 million, $25.4 million, and $19.2 million for the years ended November 28, 1997, November 29, 1996, and December 1, 1995, respectively.

The provision for income taxes consisted of the following:

	Years Ended		
	November 28, 1997	November 29, 1996	December 1, 1995
Current:			
United States federal	$ 42,238	$ 65,118	$ 21,466
Foreign	29,260	12,290	18,418
State and local	12,320	12,731	5,206
Total current	83,818	90,139	45,090
Deferred:			
United States federal	(1,721)	(6,825)	(6,305)
Foreign	(2,071)	(780)	(986)
State and local	(380)	(1,815)	124
Total deferred	(4,172)	(9,420)	(7,167)
Charge in lieu of taxes attributable to employee stock plans	29,607	10,828	32,445
	$ 109,253	$ 91,547	$ 70,368

Total income tax expense differs from the expected tax expense (computed by multiplying the United States federal statutory rate of approximately 35 percent for 1997, 1996, and 1995 by income before income taxes) as a result of the following:

	Years Ended		
	November 28, 1997	November 29, 1996	December 1, 1995
Computed "expected" tax expense	$ 103,632	$ 85,689	$ 57,349
State tax expense, net of federal benefit	10,301	9,819	6,442
Nondeductible merger costs	—	—	4,078
Nondeductible write-off of acquired in-process research and development	1,791	5,310	5,244
Nondeductible goodwill	825	772	3,689
Tax-exempt income	(5,559)	(3,304)	(3,532)
Tax credits	(4,604)	(4,912)	(3,904)
Foreign losses, not benefited	—	—	2,706
Foreign tax rate differential	1,864	(4,003)	1,130
Other, net	1,003	2,176	(2,834)
	$ 109,253	$ 91,547	$ 70,368

The tax effects of the temporary differences that give rise to significant portions of the deferred tax assets and liabilities as of 1997 and 1996 are presented below:

	November 28, 1997	November 29, 1996
Deferred tax assets:		
Acquired technology	**$ 12,720**	$ 12,037
Reserves and deferred revenue	**25,511**	24,615
Depreciation and amortization	**3,558**	7,662
Net operating loss carryforwards	**3,260**	4,278
Tax credits and other carryforwards	**—**	1,614
Other	**5,652**	5,800
Total gross deferred tax assets	**50,701**	56,006
Deferred tax asset valuation allowance	**(3,643)**	(5,950)
Total deferred tax assets	**47,058**	50,056
Deferred tax liabilities:		
Investments	**(2,423)**	(22,888)
Other	**(1,812)**	(1,943)
Total deferred tax liabilities	**(4,235)**	(24,831)
Net deferred tax assets	**$ 42,823**	$ 25,225

The Company provides United States income taxes on the earnings of foreign subsidiaries unless the subsidiaries' earnings are considered permanently reinvested outside the United States. As of November 28, 1997, the cumulative amount of earnings upon which United States income taxes have not been provided are approximately $32.7 million. The unrecognized deferred tax liability for these earnings is approximately $4.0 million.

As of November 28, 1997, the Company has foreign operating loss carryovers in various jurisdictions of approximately $3.1 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. A valuation allowance has also been established for certain deductions related to investments. 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.

The Company's federal tax returns have been examined by the Internal Revenue Service for all years through 1993. The Internal Revenue Service has proposed assessments that the Company is contesting in Tax Court. Management believes that any related adjustments that might be required will not have a material effect on the Company's financial position or results of operations.

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. The Company matches approximately 25 percent of employee contributions and contributed approximately $1.8 million, $1.6 million, and $1.2 million in 1997, 1996, and 1995, respectively. Matching contributions can be terminated at the Company's discretion.

Adobe Incentive Partners

In March 1997, as part of its venture investing program, the Company established an internal limited partnership, Adobe Incentive Partners L.P. ("AIP"), which allows certain of the Company's executive officers to participate in cash or stock distributions from Adobe's venture investments. Adobe is both the general partner and a limited partner. Other limited partners are executive officers of the Company who are involved in Adobe's venture investing activities and whose participation is deemed critical to the success of the program.

Adobe's Class A senior limited partnership interest includes both a liquidation preference and a preference in recovery of the cost basis of each specific investment. The executives' Class B junior limited partnership interest qualifies for partnership distributions only after: (a) Adobe has fully recovered the cost basis of its investment in the specific investee company for which a distribution is made; and (b) the participating executive has vested in his or her distribution rights. The distribution rights generally vest on a monthly basis over three years, such that the rights are 25 percent vested after one year, 50 percent vested after two years, and fully vested at the end of three years. The limited partnership investments are restricted to investments in companies that are private at the time of the establishment of AIP or when the investment is made, whichever is later. Partnership interests may be allocated to designated officers only while the investee company is still private. Class B interests may not exceed a maximum of 20 percent of the venture investments included in AIP.

Assets held by AIP include Adobe's entire interests in Adobe Ventures L.P. and Adobe Ventures II L.P. and equity securities of privately held companies. At November 28, 1997, the cost basis of all investments included in AIP was approximately $34.8 million. No distributions were made to the participating officers in fiscal 1997, and expense related to AIP in fiscal 1997 was immaterial. At November 28, 1997, the minority interest held by the participating officers was immaterial and is included in accrued expenses on the balance sheet.

Note 9. Employee Stock Plans

Stock option plans

As of November 28, 1997, the Company has reserved 29,200,000 shares of common stock for issuance under its employee stock option plan. The employee stock option 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 25 percent after the first year and ratably thereafter such that 50 percent and 100 percent are vested after the second and third year, respectively. The option terms range from five to ten years.

The Company has reserved, as of November 28, 1997, 500,000 shares of common stock for issuance under its Outside Directors Stock Option Plan, which provides for the granting of nonqualified stock options to nonemployee directors. 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 election as a director. All options are immediately exercisable within a ten-year term. Any exercised, unvested option shares are subject to repurchase by the Company at the original purchase price upon termination of the director's service. Options generally vest over three years: 25 percent in each of the first two years and 50 percent in the third year.

On March 22, 1996, the Company offered its employees a stock option repricing program that allowed the employees to exchange on a two-for-three share basis any options priced above the March 29, 1996 closing price of Adobe stock, which was $32.25. As a result, approximately 1,252,000 options were surrendered by eligible employees for approximately 834,000 repriced options. The repriced options were not exercisable until November 1, 1996.

Stock option activity for 1997, 1996, and 1995 is presented below:

	Years Ended					
	November 28, 1997		November 29, 1996		December 1, 1995	
	Number of Shares	**Weighted Average Exercise Price**	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of year	**9,297,188**	**$ 25.68**	10,125,792	$ 26.30	11,173,336	$ 19.61
Granted	**2,452,117**	**40.85**	2,670,673	33.53	2,391,568	47.72
Exercised	**(3,063,778)**	**20.29**	(1,470,762)	17.37	(3,008,917)	19.04
Canceled	**(539,292)**	**33.75**	(2,028,515)	45.15	(430,195)	26.57
Outstanding, end of year	**8,146,235**	**31.74**	9,297,188	25.68	10,125,792	26.30
Exercisable, end of year	**4,562,954**	**26.50**	6,057,500	21.63	5,783,226	18.71
Weighted-average fair value of options granted during the year		**15.68**		12.91		

Information regarding the stock options outstanding at November 28, 1997 is summarized below:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Shares Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Shares Exercisable	Weighted Average Exercise Price
\$ 3.45 – \$ 9.45	480,163	1.67 years	\$ 8.64	477,979	\$ 8.67
10.13 – 19.63	538,026	4.38 years	14.79	536,576	14.78
20.00 – 29.88	1,927,381	5.18 years	25.15	1,883,067	25.13
30.00 – 39.88	3,131,671	8.13 years	34.21	1,145,311	32.97
40.38 – 49.81	1,724,524	8.72 years	42.44	313,080	42.15
50.75 – 67.00	344,470	7.57 years	51.20	206,941	51.14
3.45 – 67.00	8,146,235	6.91 years	31.74	4,562,954	26.50

Performance and Restricted Stock Plan

The Performance and Restricted Stock Plan ("the Plan") provides for the granting of restricted stock and/or performance units to officers and key employees. As of November 28, 1997, the Company had reserved 1,500,000 shares of its common stock for issuance under this plan. Restricted shares issued under this plan generally vest annually over three years but are considered outstanding at the time of grant, as the stockholders are entitled to dividends and voting rights. As of November 28, 1997, 110,511 shares were outstanding and not yet vested.

In fiscal 1997, the Company granted 129,550 shares of restricted stock with a weighted-average fair value of \$39.04, and in fiscal 1996, the Company granted 26,750 shares of restricted stock with a weighted-average fair value of \$37.71.

Performance units issued under this plan entitle the recipient to receive, at the discretion of the Company, shares or cash 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 in 1997 by comparing the Company's return on equity to the return on equity of a group of comparable companies. In 1996 and 1995, the factor was 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 November 28, 1997, November 29, 1996, and December 1, 1995, performance units for 170,874; 94,745; and 75,420 shares were outstanding, respectively, and \$(2.1) million, \$(0.2) million, and \$2.5 million was charged (credited) to expense in 1997, 1996, and 1995, respectively. In fiscal 1997 and 1996, performance units were granted for 156,500 and 48,965 shares, respectively, and the weighted-average fair value of the shares were \$39.04 and \$64.03, respectively.

Employee Stock Purchase Plan

The Company's Employee Stock Purchase Plan allows eligible employee participants to purchase shares of the Company's common stock at a discount through payroll deductions. The plan consists of two-year offering periods with four six-month purchase periods in each offering period. Employees purchase shares at 85 percent of the market value at either the beginning of the offering period or the end of the purchase period, whichever price is lower. As of November 28, 1997, the Company had reserved 7,000,000 shares of its common stock for issuance under this plan, and 3,383,780 shares remain available for future issuance.

The weighted-average fair value of the purchase rights granted in fiscal 1997 and 1996 was \$16.36 and \$14.01, respectively.

Pro forma fair value disclosures

The Company accounts for its employee stock plans, consisting of fixed stock option plans, an employee stock purchase plan, and a performance and restricted stock plan, using the intrinsic value method. The table below sets forth the pro forma amounts of net income and net income per share that would have resulted if the Company accounted for its employee stock plans under the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation."

	Years Ended	
	November 28, 1997	November 29, 1996
Net income:		
As reported	$ 186,837	$ 153,277
Pro forma	$ 161,790	$ 144,368
Net income per share:		
As reported	$ 2.52	$ 2.04
Pro forma	$ 2.21	$ 1.92

For purposes of computing pro forma net income, the fair value of each option grant, restricted stock grant, and Employee Stock Purchase Plan purchase right is estimated on the date of grant using the Black-Scholes option pricing model. The assumptions used to value the option grants and purchase rights are stated below:

	Years Ended	
	November 28, 1997	November 29, 1996
Expected life of options	3 years	3 years
Expected life of restricted stock	3 years	3 years
Expected life of purchase rights	1.25 years	1.25 years
Volatility	50%	50%
Risk-free interest rate	5.01 – 6.60%	5.54 – 6.66%
Dividend yield	0.5%	0.5%

Options and restricted stock grants vest over several years, and new option and restricted stock grants are generally made each year. Because of this and because the provisions of SFAS No. 123 are effective only for fiscal years 1996 and 1997, the pro forma amounts shown above may not be representative of the pro forma effect on reported net income in future years.

Note 10. Stockholders' Equity

Stockholder Rights Plan

The Company's Stockholder Rights Plan is intended to protect stockholders 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 by the Company thereafter. Each right entitles the registered holder to purchase from the Company a share of common stock at $115. The rights become exercisable in certain circumstances, including upon an entity acquiring or announcing the intention to acquire beneficial ownership of 20 percent or more of the Company's common stock without the approval of the Board of Directors or upon the Company being acquired by any person in a merger or business combination transaction. The rights are redeemable by the Company prior to exercise at $0.01 per right and expire on July 24, 2000.

Stock repurchase program

In September 1997, the Board of Directors authorized, subject to certain business and market conditions, the purchase of up to 15,000,000 shares of the Company's stock over the next two years. The Company purchased 6,342,395 shares and 3,390,240 shares of its common stock in 1997 and 1996, respectively, at a cost of $275.6 million and $126.8 million, respectively, under its stock repurchase programs as well as through employee stock option exercise transactions. Prior to the Company's reincorporation in the State of Delaware in May 1997, the shares purchased were returned to the status of authorized and unissued as required by California law. The 5,175,851 shares purchased at a cost of $238.7 million subsequent to the Company's reincorporation are presented as treasury stock in the Stockholders' Equity section of the balance sheet.

Put warrants

To facilitate the Company's stock repurchase programs, the Company sold put warrants in a series of private placements in 1997 and 1996. Each warrant entitled the holder to sell one share of Adobe's common stock to the Company at a specified price. Approximately 4.6 million and 4.5 million put warrants were written in 1997 and 1996, respectively. At November 28, 1997, approximately 2.9 million put warrants were outstanding that expire on various dates through May 1998 and have exercise prices ranging from $37.07 to $47.98 per share, with an average exercise price of $43.09 per share. In addition, in 1997 and 1996, the Company purchased call options from an independent third party that entitled the Company to buy 2.3 million and 4.5 million shares, respectively, of its common stock. At November 28, 1997, approximately 0.5 million call options were outstanding that expire on various dates through April 1998 and have exercise prices ranging from $37.32 to $46.86 per share, with an average exercise price of $41.32 per share.

As part of the Company's current stock repurchase programs, the Company may, from time to time, enter into additional put warrant and call option arrangements. Under these arrangements, the Company, at its option, can settle with physical delivery or net shares equal to the difference between the exercise price and market value at the date of exercise. Accordingly, the arrangements do not require the reclassification of the obligation under put warrants from equity, and no such reclassification of the Company's obligation at November 28, 1997 has been made. Such arrangements were not in place at November 29, 1996, and therefore, the Company's potential buyback obligation of $71.3 million as of November 29, 1996 was removed from stockholders' equity and recorded as put warrants. In the future, the Company may consider other methods to acquire the Company's stock, including direct purchases, open market purchases, accelerated stock purchase programs, and other potential methods.

Venture stock dividend program

In March 1997, the Company established the venture stock dividend program under which the Company may, from time to time, distribute as a dividend-in-kind shares of its equity holdings in investee companies to Adobe stockholders. In 1997, the Company dividended one share of Netscape common stock for each 100 shares of Adobe common stock held by stockholders of record on July 31, 1997. An equivalent cash dividend was paid for holdings of less than 2,500 Adobe shares and for fractional Netscape shares. Also on December 1, 1997, the Company dividended one share of Siebel common stock for each 300 shares of Adobe common stock held by stockholders of record on October 31, 1997. An equivalent cash dividend was paid for holdings of less than 7,500 Adobe shares and for fractional Siebel shares. The declaration of future dividends under this program is within the discretion of the Board of Directors of the Company and will depend upon business conditions, the Company's results of operations and financial condition, and other factors.

Note 11. 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 \$17.8 million, \$18.3 million, and \$21.0 million during 1997, 1996, and 1995, respectively. As of November 28, 1997, future minimum lease payments under noncancelable operating leases are as follows: 1998—\$17.9 million; 1999—\$12.8 million; 2000—\$9.3 million; 2001—\$7.8 million; 2002—\$3.0 million; and \$13.2 million, thereafter.

Real estate development agreement

During 1994, the Company entered into a real estate development agreement and an operating lease agreement in connection with the construction of an office facility. In August 1996, the construction was completed, and the operating lease commenced. The Company will have the option to purchase the facility at the end of the lease term in October 2001. 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 \$57.3 million. During the construction period, the Company was required to pledge certain interest-bearing instruments to the lessor as collateral to secure the performance of its obligations under the lease. As of November 28, 1997, the Company's deposits under this agreement totaled approximately \$66.7 million in United States government treasury notes and money market mutual funds. These deposits are included in "Other assets" in the Consolidated Balance Sheets.

In 1996, the Company exercised its option under the development agreement to begin a second phase of development for an additional office facility. In August 1996, the Company entered into a construction agreement and an operating lease agreement for this facility. The operating lease will commence on completion of construction in 1998. The Company will have the option to purchase the facility at the end of the lease term (five years after occupancy). 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 \$64.3 million. The Company also is required, periodically during the construction period, to deposit funds with the lessor as an interest-bearing security deposit to secure the performance of its obligations under the lease. During 1997, the Company deposited approximately \$33.0 million, and as of November 28, 1997, the Company's deposits under this agreement totaled approximately \$36.3 million. These deposits are included in "Other assets" in the Consolidated Balance Sheets.

Royalties

The Company has certain royalty commitments associated with the shipment and licensing of certain products. While royalty expense is generally based on a dollar amount per unit shipped, ranging from \$0.25 to \$312, certain royalties are based on a percentage, ranging from 0.03 percent to 12 percent, of the underlying revenue. Royalty expense was approximately \$25.0 million, \$19.8 million, and \$23.1 million in 1997, 1996, and 1995, 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 that the ultimate outcome of these actions will not have a material effect on the Company's financial position and results of operations.

Note 12. Transactions with Affiliate

At November 28, 1997, the Company held a 13 percent equity interest in McQueen International Limited ("McQueen") and accounts for the investment using the cost method. 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. Adobe makes minimum annual payments to McQueen for certain services which amounted to $5.2 million and $4.8 million in 1997 and 1996, respectively, and will be approximately $1.4 million in 1998. Purchases from McQueen amounted to $35.0 million, $34.3 million, and $23.6 million during 1997, 1996, and 1995, respectively.

Effective December 31, 1997, McQueen was acquired by Sykes Enterprises, Incorporated ("Sykes"), a publicly traded company. In connection with the acquisition, the Company exchanged its shares of McQueen for 486,676 shares of Sykes' restricted common stock and will record a gain on the exchange of $6.7 million in fiscal 1998. The Company's equity interest in Sykes is less than two percent.

Note 13. Financial Instruments

Fair value of financial instruments

The Company's cash equivalents, short-term investments, restricted funds, and marketable equity securities are carried at fair value, based on quoted market prices for these or similar investments. (See Note 3.)

The Company's majority interest in Adobe Ventures L.P. and Adobe Ventures II L.P. is carried at a combined value of $25.7 million, which is believed to approximate the fair value of underlying investments in technology companies. Substantially all of the technology companies held by the limited partnerships at November 28, 1997 are not publicly traded, and therefore there is no established market for these investments. As such, these investments are valued based on the most recent round of financing involving new non-strategic investors and estimates made by the general partner, a third party. When investments held by the limited partnerships are publicly traded, the fair value of such investments is based on quoted market prices, and mark-to-market adjustments are included in investment income. In general, as a matter of policy of the limited partnerships, the investments in the technology companies held by the limited partnerships will be distributed to the partners prior to the investee company's initial public offering.

Foreign currency hedging instruments

The Company enters into forward exchange contracts to hedge foreign currency exposures on a continuing basis for periods consistent with its committed exposures. These transactions generally do not subject the Company to risk of accounting loss because gains and losses on these contracts offset losses and gains on the assets, liabilities, and transactions being hedged. However, the Company is exposed to credit-related losses in the event of nonperformance by the counterparties in these contracts. These contracts have maturities of less than three months, and the amounts of unrealized gains and losses are immaterial. The Company held $1.9 million of aggregate foreign currency forward exchange contracts for the sale of the Japanese yen outstanding at the end of fiscal year 1997. There were no foreign currency forward exchange contracts outstanding at the end of fiscal 1996.

Concentration of 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 OEM customers, 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.

A significant portion of the Company's licensing revenue is derived from a small number of OEM customers. 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, which could result in lower licensing revenue for the Company. Also, in the fall of 1997, one of Adobe's largest PostScript customers, Hewlett-Packard Company ("HP"), introduced a non-Adobe clone version of PostScript in one family of monochrome laser printers.

Industry segment

Adobe and its subsidiaries operate in one dominant industry segment, as defined by SFAS No. 14, "Financial Reporting for Segments of a Business Enterprise." 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 1997, 1996, or 1995.

Note 14. Foreign Operations

Geographic information for each of the years in the three-year period ended November 28, 1997, is presented below:

	Years Ended		
	November 28, 1997	November 29, 1996	December 1, 1995
Revenue:			
North America	**$ 606,633**	$ 526,251	$ 533,332
Europe	**226,557**	134,879	133,982
Japan and Asia, Pacific, and Latin America	**222,911**	176,490	107,357
Eliminations	**(144,207)**	(51,057)	(12,332)
	$ 911,894	$ 786,563	$ 762,339
Operating income:			
North America	**$ 87,035**	$ 31,186	$ 26,446
Europe	**69,371**	16,408	37,319
Japan and Asia, Pacific, and Latin America	**135,657**	103,002	70,416
Eliminations	**(61,307)**	(3,810)	390
	$ 230,756	$ 146,786	$ 134,571
Identifiable assets:			
North America	**$ 923,704**	$ 1,015,065	$ 934,705
Europe	**79,291**	67,506	62,993
Japan and Asia, Pacific, and Latin America	**32,161**	22,102	13,946
Eliminations	**(95,085)**	(103,280)	(138,817)
	$ 940,071	$ 1,001,393	$ 872,827

Independent Auditors' Report

To the Board of Directors and
Stockholders of Adobe Systems Incorporated:

We have audited the accompanying consolidated balance sheets of Adobe Systems Incorporated and subsidiaries as of November 28, 1997 and November 29, 1996, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended November 28, 1997. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Adobe Systems Incorporated and subsidiaries as of November 28, 1997 and November 29, 1996, and the results of their operations and their cash flows for each of the years in the three-year period ended November 28, 1997, in conformity with generally accepted accounting principles.

KPMG Peat Marwick LLP

KPMG Peat Marwick LLP
San Jose, California, USA
December 16, 1997

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 controls. 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.

P Jackson Bell

P. Jackson Bell,
Executive Vice President,
Chief Financial Officer,
Chief Administrative Officer,
and Assistant Secretary
(Principal Financial Officer)
December 16, 1997

Quarterly Results of Operations

1997

	Quarter Ended				Year Ended
	Feb. 28	May 30	Aug. 29	Nov. 28	Nov. 28
Revenue	$ 226,459	$ 228,264	$ 230,039	$ 227,132	$ 911,894
Gross profit	192,170	195,606	197,350	200,497	785,623
Income before income taxes	73,167	63,204	85,528	74,191	296,090
Net income	46,484	40,106	53,428	46,819	186,837
Net income per share	0.63	0.54	0.72	0.64	2.52
Shares used in computing net income per share	73,939	74,416	74,528	73,646	74,132
Common stock price per share:					
High	$ 43.13	$ 49.00	$ 45.25	$ 53.13	$ 53.13
Low	34.63	32.50	34.00	39.75	32.50

1996

	Quarter Ended				Year Ended
	Mar. 1	May 31	Aug. 30	Nov. 29	Nov. 29
Revenue	$ 193,642	$ 204,337	$ 180,909	$ 207,675	$ 786,563
Gross profit	158,434	168,259	147,292	171,431	645,416
Income before income taxes	53,861	39,787	48,686	102,490	244,824
Net income	33,663	22,009	29,847	67,758	153,277
Net income per share	0.44	0.29	0.40	0.92	2.04
Shares used in computing net income per share	76,394	75,638	74,309	73,913	75,064
Common stock price per share:					
High	$ 74.25	$ 45.13	$ 37.88	$ 44.13	$ 74.25
Low	30.00	30.75	28.50	31.50	28.50

The Company's common stock is traded on The NASDAQ National Stock Market under the symbol "ADBE." On December 26, 1997, there were 2,084 holders of record of the Company's common stock.

Executive Committee

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

Charles M. Geschke
Chairman of the Board
and President

Robert A. Roblin
Executive Vice President,
Marketing

Ross A. Bott
Executive Vice President,
Product Divisions

P. Jackson Bell
Executive Vice President,
Chief Financial Officer,
Chief Administrative Officer,
and Assistant Secretary

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

Colleen M. Pouliot
Senior Vice President,
General Counsel,
and Secretary

Frederick A. Schwedner
Senior Vice President
and General Manager,
Printing and Systems Division

Board of Directors

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

Charles M. Geschke
Chairman of the Board
and President

Gene P. Carter
Director

William R. Hambrecht
Director

Robert Sedgewick
Director

William J. Spencer
Director

Delbert W. Yocam
Director

Form 10-K

A copy of the Company's Annual Report filed with the Securities and Exchange Commission (Form 10-K) is available free of charge by writing or calling:

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Transfer Agent/Registrar

Harris Trust Company of California
Chicago, Illinois, USA

Stock Exchange Listing

The NASDAQ Stock Market
Ticker symbol "ADBE"

Independent Auditors

KPMG Peat Marwick LLP
San Jose, California, USA

This Annual Report contains forward-looking statements that involve risks and uncertainties and actual results may differ materially. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the Letter to Stockholders and Management's Discussion and Analysis of Financial Condition and Results of Operations as well as those discussed elsewhere in the Company's SEC reports. Readers are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this Annual Report. The Company undertakes no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.

Colophon

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Adobe

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