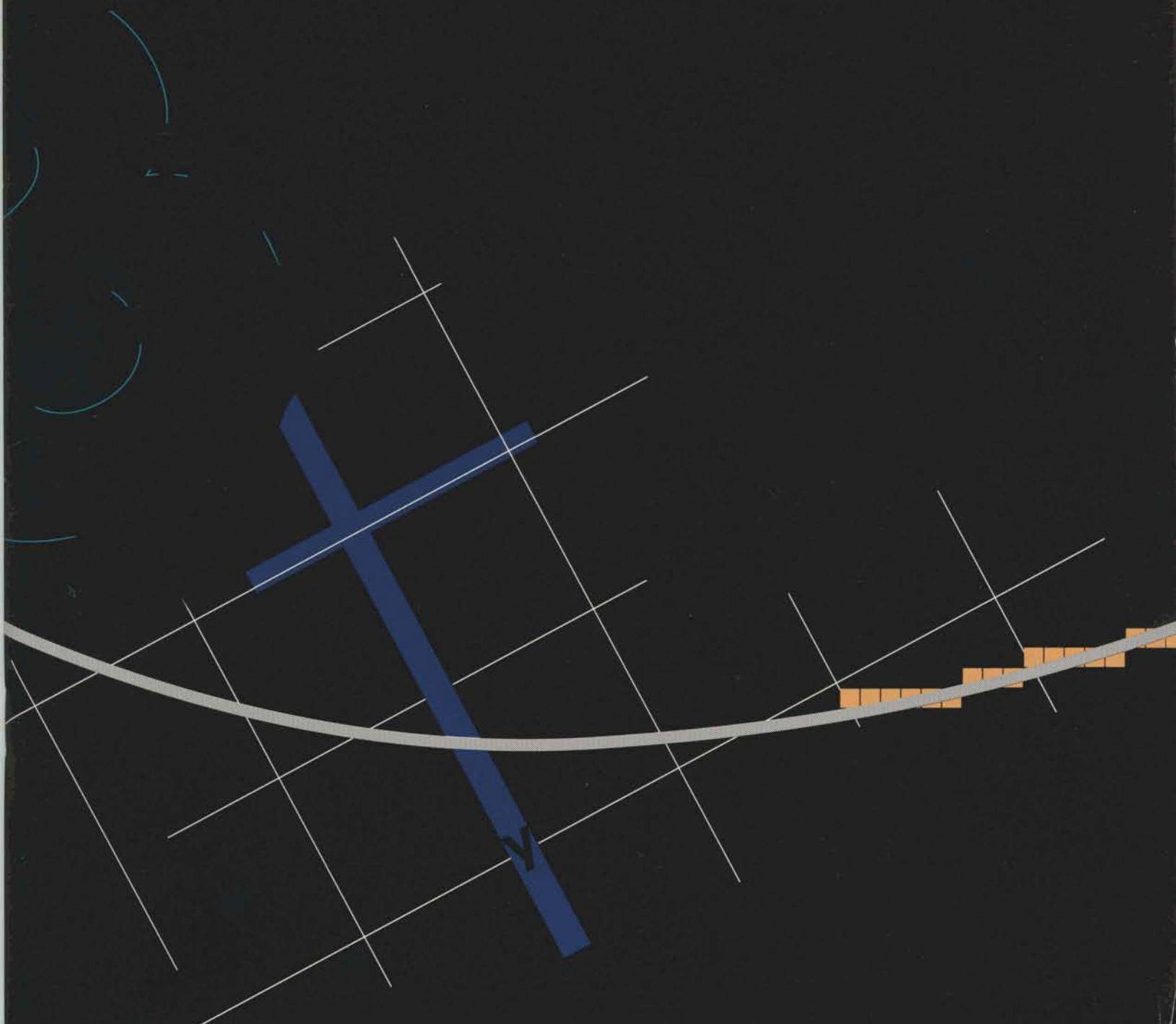Adobe Systems Incorporated
1987 Annual Report

Adobe Systems Incorporated is a software technology company that designs, develops, and markets systems software that brings graphic arts production quality to a wide variety of applications, computers, laser printers, typesetters, displays, and other raster output devices.

The Company's principal product, Adobe's POSTSCRIPT® interpreter, provides electronic publishing and printing a device- and resolution-independent graphics standard capable of producing documents that integrate multiple typefaces, graphics, and photo images at any size or rotation.

In addition, Adobe has extended the POSTSCRIPT page description language to workstation platforms with the announcement of a dynamic DISPLAY POSTSCRIPT™ system for computer monitors, a sophisticated POSTSCRIPT language illustration program, and an expanding library of high-quality typefaces. Along with the POSTSCRIPT page description language and the POSTSCRIPT language interpreter, these support products have established the POSTSCRIPT language as a graphics standard among third-party software developers, major computer vendors, and large corporations.

Adobe Systems Incorporated's Common Stock trades on the NASDAQ National Market System under the symbol ADBE.

1.8
Adobe announces Adobe Illustrator program for the Macintosh at the San Francisco MACWORLD Conference.

1.12
Release of additional downloadable fonts for the Adobe Type Library, licensed from the prestigious Mergenthaler, ITC, and Letraset houses.

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2.16
Adobe Board of
Directors approves
a two-for-one
common stock
split.

To Our Shareholders

1987 was an eventful year for Adobe Systems. We not only broadened our business base by extending the systems software area, we also strengthened our end-user software products group. In addition, Adobe has started to build the technical and customer frameworks needed for us to grow both the systems and application software businesses in the future.

We have also significantly broadened our revenue base in fiscal 1987, both by increasing the number of our royalty-paying customers from two in fiscal 1986 to eight in fiscal 1987, and by increasing the revenue generated in the application software business. Our revenue for 1987 was $39.3 million, compared to $16.1 million in fiscal 1986 — an increase of 145%. Net income was $9.0 million or $.85 per share, up from $3.6 million or $.38 per share reported in fiscal 1986 — an increase of 150% in net income and 123% in earnings per share. Revenue in the fourth quarter of fiscal 1987 was $12.3 million, compared to $5.2 million in fiscal 1986 — an increase of 135%. Net income for the same fourth quarter of fiscal 1987 was $2.7 million, versus a fiscal 1986 fourth quarter figure of $1.0 million. Fourth quarter net income per share was $.26, up from $.10 in 1986 — an increase of 171% in net income and 160% in earnings per share.

In 1985, Adobe worked with Apple Computer, QMS, and Linotype to bring to the marketplace the first device-independent printers based on Adobe's POSTSCRIPT® software. The message was clear. Here were the first low-cost printers to bring the graphic arts standards of quality to computer printing. Here were printers that could be used from any computer. Here was a technology that enabled a document to be printed on a high resolution typesetter without any reformatting. And here were printers that would be the models for the mainstream computer printers of the future. Because of these devices, and our customers' commitment to introduce reliable and affordable equipment that supports Adobe's POSTSCRIPT language, the new area of desktop publishing emerged.

In the last three years Adobe and its 22 OEM customers have brought 29 different printers to market. Our OEM customer list now includes most major computer, printer, and typesetting vendors: Agfa-Gevaert N.V., Apple Computer, Inc., Apollo Computer Inc., AST Research Inc., Dataproducts Corporation, Diconix, Inc., Digital Equipment Corporation, Fujitsu Limited, General Computer, International Business Machines Corporation, Linotype Company, Mass Micro Systems, Inc., NBI, Inc., NEC Corporation (Japan), NEC Information Systems, Inc. (U. S.), NeXT, Inc., Quadram Operating L.P., QMS, Inc., Qume Corporation, Texas Instruments Incorporated, Varityper, a Division of AM International, Inc., and Wang Laboratories, Inc.

Although the POSTSCRIPT-equipped printers produced and marketed by these companies vary greatly in their speeds, resolution and paper handling capabilities, they are all compatible from the application program's POSTSCRIPT-language perspective. These printers now form a basis on which corporations, large and small, can develop a consistent multiple vendor printing strategy.
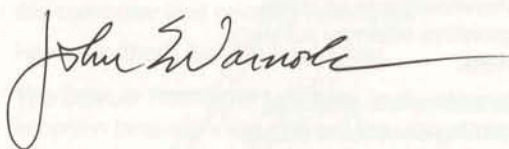
Support of the PostScript language from the application program developers has also been extensive. As of January 1988, over 550 commercial application programs support the PostScript language directly. These applications span word processing, page layout, illustration, presentation graphics, computer aided design and more.

In short, Adobe's PostScript language has become an industry standard for representing the printed page.

In March 1987, Adobe released its first end-user application program called Adobe Illustrator™. This program has been widely accepted by the graphic arts community, and has provided capabilities not found in other personal computer-based illustration programs. As a result, graphics departments of major newspapers, national magazines, manufacturing companies, and others have embraced Adobe Illustrator as their primary illustration tool.

As we move to the future, our newest software, the Display PostScript™ system, will provide computer display independence in much the same way that our PostScript interpreters provide printer independence. Interest in this new technology has been high, and we intend to aggressively pursue new customers for this business during the coming year. Meanwhile, we will continue to support our current market base with both the system and application software technology that has made Adobe's PostScript language an industry standard for visual communication. And in the following pages, we present a comprehensive description of Adobe's PostScript interpreter and language, as well as our own PostScript language software applications. We believe they illustrate the pivotal role Adobe's products play in the growth of computer-based visual communication.

John E. Warnock

John E. Warnock
President and Chief Executive Officer

4 13
Varityper ships the high-resolution VT600, the first 600 dots-per-inch PostScript-equipped laser printer.

3

A Keystone of Computerized Visual Communication

If the Information Age has a unifying principle, it is convergence and integration. For instance, mass visual communication technology and its related disciplines emerged in the modern sense over 500 years ago with the techniques to combine woodcuts and movable type on the same printing press. And since then printed communication has varied only slightly from its original approach — physically impressing a carefully prepared image of type and graphics on paper.

Fifteen years ago, in contrast, the publishing and graphic arts industries witnessed their first revolutionary transformation in centuries with the use of "cold type" on phototypesetting machines. Then over the last five years — just one percent of all modern printing history — computer innovations hybridized traditional tasks in printing and graphic arts at an even more astounding rate. The result has been a fast-forward metamorphosis of traditional printing and graphics into quality electronic presentations with complete flexibility in design and typography.

Adobe Systems Incorporated is proud to have helped construct a foundation for this convergence, as well as for its continued evolution. In fact, Adobe has emerged as one of the keystones of the most visible arena of integrated text and graphics — electronic publishing.

Electronic publishing relies on three independently developed breakthroughs, all since 1983. The first two prerequisites were graphical computers (as exemplified by the Macintosh) and low-cost laser printers.

The POSTSCRIPT interpreter is the third breakthrough — and Adobe's flagship product. The POSTSCRIPT interpreter offers a software bridge. It precisely transfers graphics and text from the graphical computer and "tells" the laser printer or other raster output device how to print the complete page. Although a simple idea, the achievement was an enormous technical challenge, requiring a close cooperative effort by Adobe's team of scientists, typographers, and graphic artists.

Adobe's POSTSCRIPT page description language is a complete graphics programming language that offers several compelling benefits. It allows software developers to write applications with predefined commands that specify fonts at any size or rotation, and incorporate halftones and high-quality line art. The POSTSCRIPT interpreter, licensed to equipment manufacturers, normally resides on a controller board in the laser printer or other raster output device. The POSTSCRIPT interpreter describes the page's appearance by translating it into a mathematical representation to be sent and interpreted in a way completely independent of either the computer or the printer hardware. Therefore, the POSTSCRIPT language's device independence eliminates the traditional burden on software developers to write hardware-specific protocol drivers for the entire range of output devices in their application's user market — a time-consuming and potentially endlessly repetitive task.

As a result, software written with a POSTSCRIPT language driver works with any raster output device that has a POSTSCRIPT interpreter. Using the POSTSCRIPT language and interpreter reduces development time for both software and hardware manufacturers — and makes life simpler for end users who want to choose the best computer, software, and printer for their needs without worrying about vendor compatibility.

National Bureau of Standards requests Adobe's assistance in establishing the bureau's first Electronic Publishing Laboratory.

AST Research announces development of the TurboLaser/PS — priced under $4,000 and the lowest-cost POSTSCRIPT-equipped printer to date.

POSTSCRIPT, a device-independent page description language, provides developers and manufacturers a systems-level graphic software standard. The POSTSCRIPT language allows the creation of complex pages integrating text, line art, and digitized photographs for output on low-cost laser printers or high-resolution typesetters without any changes to the document.

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Besides device independence, the POSTSCRIPT language also introduces flexibility and resolution independence. Unlike other graphic solutions, a POSTSCRIPT language image can be rotated to any angle or scaled up and down to any size the print medium allows. Even more significant, a POSTSCRIPT language image created at one resolution can be printed at any other resolution on another POSTSCRIPT-equipped output device. This is a significant point since the resolutions of printers equipped with POSTSCRIPT interpreters range from 150 to 2,540 dots per inch, and include printing technologies such as laser xerography, ink jet, laser film recorders, and in 1988 — color thermal. Thus a corporate newsletter, price catalog, specification sheet, or other presentation document can be created on an inexpensive microcomputer, previewed on a POSTSCRIPT-equipped laser printer, then output on a typesetter equipped with a POSTSCRIPT interpreter for the highest quality professional print job.

From this initial niche in desktop publishing, the POSTSCRIPT language has broadened its appeal and established itself as an accepted industry standard in systems-level software. The POSTSCRIPT language took off from a standing start in 1985, and since then more than 550 software applications have appeared that drive printers with POSTSCRIPT interpreters. These applications span the mini/mainframe environment, the IBM PC and PS/2 computers, as well as the Apple II and Macintosh user base. An entire range of printer and typesetter manufacturers also embraces the POSTSCRIPT interpreter as a standard, marketing machines with varying speeds and prices.

In other words, Adobe's contribution inspired an Information Age convergence in graphics systems software, an important landmark in setting a standard among virtually every major manufacturer and developer in the computer and printing industries.

However, that's just the beginning.

The DISPLAY POSTSCRIPT system: In developing the POSTSCRIPT page description language, we realized the importance of a similarly advanced graphics imaging model for workstation displays. Without such a model, limitations in the various workstation graphics models could restrict printers using POSTSCRIPT interpreters. Adobe removed that limitation with the January 1988 demonstration of the DISPLAY POSTSCRIPT system, based on the same imaging model and language used in printers with POSTSCRIPT interpreters.

Like our original POSTSCRIPT interpreter, the DISPLAY POSTSCRIPT system will be licensed to computer suppliers. In fact, NeXT, Inc. and Digital Equipment Corporation have already announced license agreements with Adobe to develop and incorporate in their products the DISPLAY POSTSCRIPT system. With DISPLAY POSTSCRIPT software, on-screen images in color, black-and-white, and grayscale bear the highest possible fidelity to the printed output — a breakthrough in the long quest for WYSIWYG (what-you-see-is-what-you-get).

The benefits of the DISPLAY POSTSCRIPT system do not end with its previewing capability. The DISPLAY POSTSCRIPT system essentially will turn the screen into an interactive POSTSCRIPT printer, a creative tool capable of responding to a user's manipulation of graphic elements on screen for immediate responsiveness. Of course, the DISPLAY POSTSCRIPT system will

The DISPLAY POSTSCRIPT system will offer an advanced graphics imaging model based on the POSTSCRIPT page description language, but adapted to workstation monitors. With the DISPLAY POSTSCRIPT system, monitors function as interactive POSTSCRIPT-equipped printers, offering the highest possible fidelity between the on-screen image and the printed output.

9 9
Adobe and NeXT, Inc. announce joint development of DISPLAY POSTSCRIPT software, a high-performance interactive version of the POSTSCRIPT interpreter for use on workstation screens.

7

handle simple images like spreadsheets and charts, too. But with such power, we think the DISPLAY POSTSCRIPT system will be an ideal model to enhance text and graphic applications, such as page layout, business charting, painting and drawing, CAD/CAM, scanned image manipulation, and line art creation. And in the same spirit as our POSTSCRIPT interpreter, the DISPLAY POSTSCRIPT software will give developers the advantage of platform independence by keeping the imaging model independent of hardware, operating systems, and window systems. Once the display and printer portions of an application are written, they can go anywhere the POSTSCRIPT and DISPLAY POSTSCRIPT software go.

Adobe Illustrator: In March 1987, Adobe released Adobe Illustrator — a major POSTSCRIPT graphics software product that integrates professional-quality graphic illustration capabilities with computer productivity.

By combining the fine detail control of hand drawing with computer precision, the Adobe Illustrator program quickly developed a devoted following among technical illustrators, engineers, and graphic and professional artists.

As an application based on the ideas found in the POSTSCRIPT language, the Adobe Illustrator program produces virtually any kind of artwork. It uses smoothly contoured curves and precise lines instead of pixels, allows entire shapes scaled to any size without distortion, and generates camera ready art. It also provides control over line weights, creates screens and solids, rotates or combines images and text, and of course outputs to any printer or typesetter equipped with a POSTSCRIPT interpreter. In short, it takes advantage of the power of the POSTSCRIPT language to offer a natural alternative to manual work with equal if not better craftsmanship. Best of all, those using the Adobe Illustrator program find their productivity is three to four times greater than it is with traditional manual illustration methods.

But where black and white begin, color should follow, and in January of 1988 we announced the Adobe Illustrator 88™ program — an enhanced version of the Adobe Illustrator program with even more sophisticated professional tools, yet easier to use. As a result, professionals in publishing, advertising, the graphic arts, and in corporations will find it even more convenient to use POSTSCRIPT language software for illustrating technical publications and color textbooks, developing logos, and creating production illustrations and advertising art.

Then as an added support to Adobe's graphic arts production system, in January of 1988 we announced a library of prebuilt Adobe Illustrator graphic shapes — dubbed the Adobe® Collector's Edition I — with hundreds of elements to insert and modify for special effects.

Adobe® Type Library: Before electronic publishing, the art of typography was a tradition confined to a small elite of professionals. Thanks to the POSTSCRIPT language's device independence, typography now finds its way as a common coin into fundamental computer-based business communications.
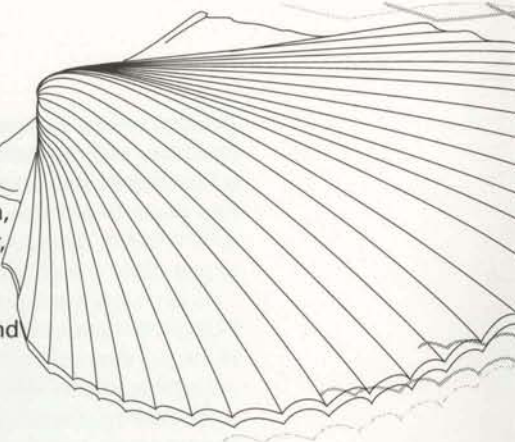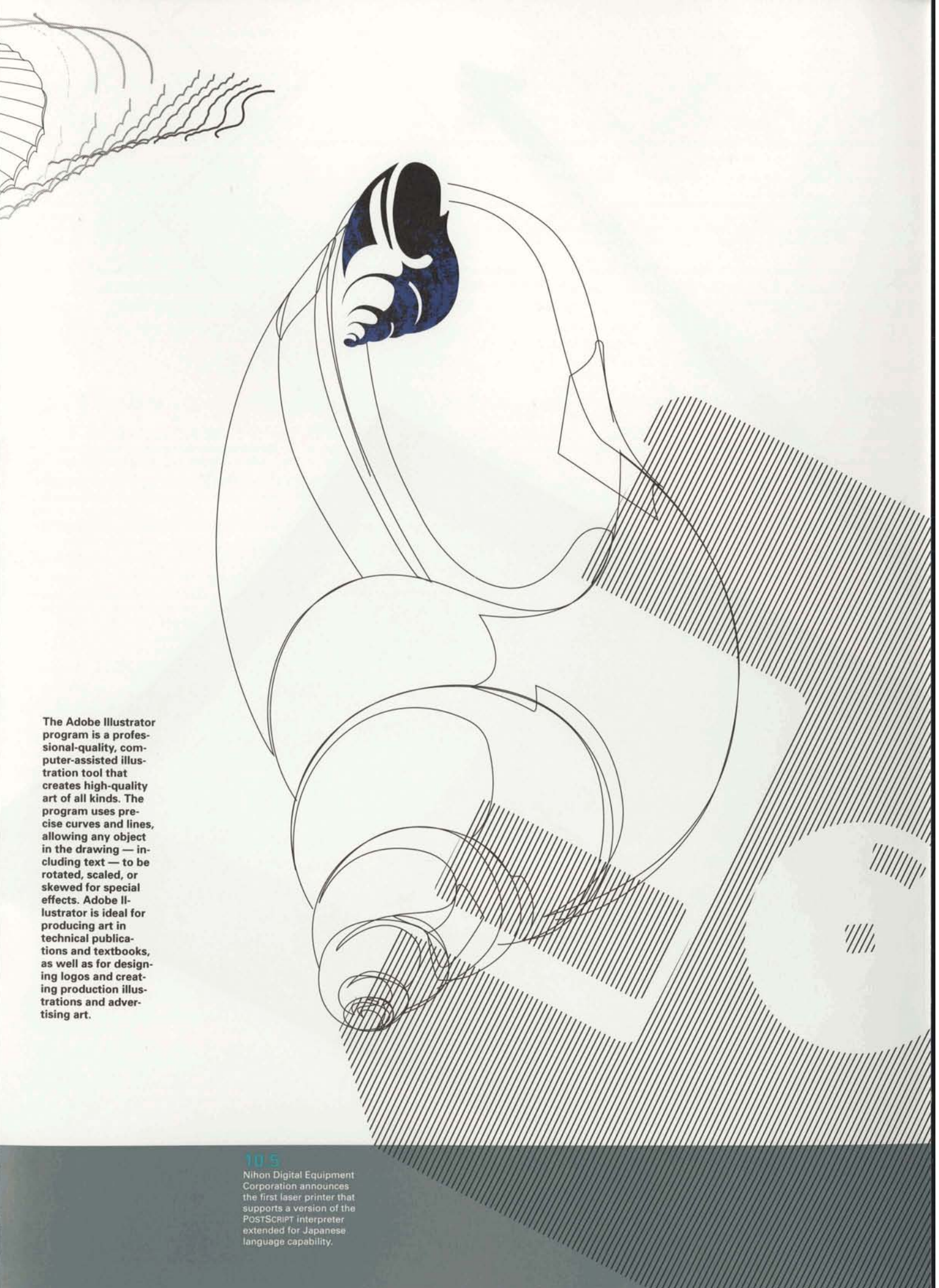
9.10
QMS signs contract to become the first company to manufacture and market a color printer using the POSTSCRIPT interpreter.

10.1
Adobe announces its first software distributor, Softsel Computer Products, for distribution of the Adobe Illustrator and Adobe Type Library programs.

8

The Adobe Illustrator
program is a profes-
sional-quality, com-
puter-assisted illus-
tration tool that
creates high-quality
art of all kinds. The
program uses pre-
cise curves and lines,
allowing any object
in the drawing — in-
cluding text — to be
rotated, scaled, or
skewed for special
effects. Adobe Il-
lustrator is ideal for
producing art in
technical publica-
tions and textbooks,
as well as for design-
ing logos and creat-
ing production illus-
trations and adver-
tising art.

The Stone typeface family, Adobe's first set of original alphabet designs using POSTSCRIPT language technology, announced at the Type 1987 Conference in New York City.

Adobe announces bonsu Corporation as software distributor for Adobe Illustrator and Adobe Type Library.

Adobe Forum, an on-line customer support service through Compu-Serve, offers news and information on Adobe's retail products, as well as technical details and utilities for POSTSCRIPT language programming.

To bring the time-honored standards of fine type into the POSTSCRIPT language, Adobe teamed up top computer scientists with leading type designers. Using our proprietary software, our people have painstakingly developed over 200 existing typefaces from the world's great type houses to offer the Adobe Type Library. Some of the library's typefaces are provided as standard in POSTSCRIPT-equipped printers; others are available separately for downloading.

Then we decided to originate some of our own typefaces. The first was a musical typeface, called Sonata® the second a set of map symbols named Carta." Both were well received by musical composition application developers and cartographers for their clean look and convenience. In October 1987, we unveiled the first set of original alphabet designs, the Stone™ typeface family. In the Stone typeface family, Adobe's Director of Typography, Sumner Stone, designed a unified set of serif, sans serif, and informal typefaces in the best of typographic traditions.

In July 1987, we signed an agreement with Linotype to license that company our POSTSCRIPT type design software to convert additional type families from Linotype's library of over 1,700 typefaces. In the meantime, in January 1988 Adobe announced the Publishing Packs, three business support products that bundle selected typefaces with commentary from recognized experts for using the type in either newsletters, forms and schedules, or for displays and presentations.

Because of the POSTSCRIPT language's graphical abilities, the Asian language market holds special potential for Adobe. In February 1987, we formed an alliance with Morisawa Company of Japan, a major Japanese typeface designer and manufacturer of typesetting machines, to develop POSTSCRIPT language versions of Kanji typefaces. Adobe is also developing a Kanji version of the POSTSCRIPT interpreter, along with our licensees — Fujitsu Limited., NEC, and Nihon Digital Equipment Corporation.

Appending the Future: In his recent work entitled *July 20, 2019: Life in the 21st Century,* the eminent science writer Arthur C. Clarke described the POSTSCRIPT language as "the future of words on paper." Of course, we're extremely gratified at Adobe to read this prediction — especially since it comes from the same far-sighted man of letters who accurately envisioned the idea of communications satellites in 1945. However, we would add that the POSTSCRIPT language provides a potential standard for more than words on paper, but for *all* computerized visual communication.

Moreover, the POSTSCRIPT language also opens the way for continued integration and convergence. We intend to improve our current products and extend the POSTSCRIPT language into new opportunities. Indeed, we think the power of the POSTSCRIPT language is its promise for the future: the possibilities of using the POSTSCRIPT language as a standard for describing images are virtually endless.

The Adobe Type Library brings the traditional craft of fine type into the POSTSCRIPT language with a growing selection of over 200 existing and original typefaces. In partnership with Morisawa and Co. Ltd., Adobe is also converting two major Kanji typefaces for the Japanese market. Like other POSTSCRIPT language graphics, the library's typefaces can be scaled to any size and rotated freely.

Hewlett-Packard announces distribution agreement for the QMS JetScript POSTSCRIPT language controller for all HP LaserJet Series II printers.
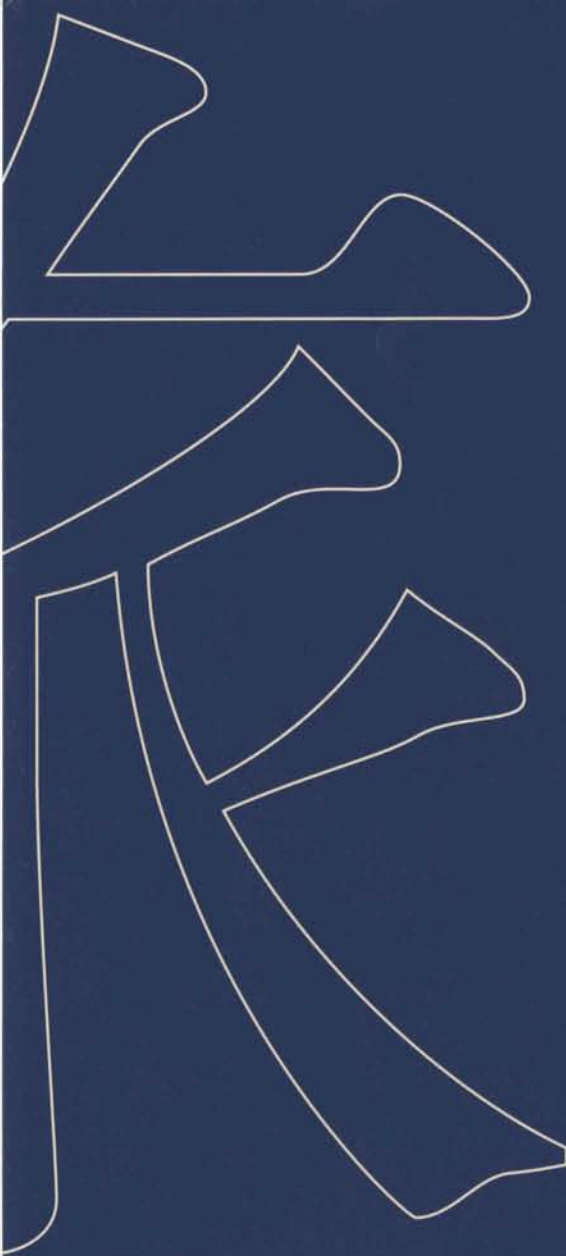
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Financial Highlights

(In thousands, except per share and ratio data)

		Year Ended November 30			
	1987	**1986**	**1985**	**1984**	**1983**
Income Statement					
Revenue	$ 39,324	16,055	4,604	2,209	—
Income (loss) before income taxes	16,892	7,220	838	(27)	(892)
Net income (loss)	8,982	3,586	496	58	(1,008)
Net income (loss) per share	$ .85	.38	.05	.01	(.29)
Shares used in per share computation	10,517	9,456	9,064	7,220	3,516
Balance Sheet					
Working Capital	$ 17,543	11,151	3,148	3,263	947
Total assets	32,302	20,016	6,074	4,543	1,781
Shareholders' equity	23,525	13,719	4,646	4,150	1,562
Key Ratios					
Current ratio	3.2	3.0	3.8	9.3	6.4
Return on revenue	22.8%	22.4%	10.8%	2.6%	n/a
Revenue per employee	$ 307	251	140	116	n/a

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following table sets forth items from the Consolidated Statements of Income as a percentage of total revenue for the fiscal periods indicated.

		Percentage of Revenue Year Ended November 30			Percentage Change Year Ended November 30	
		1987	1986	1985	1986 to1987	1985 to 1986
Revenue						
	Royalties	69.4%	84.3%	73.3%	101.6%	301.2%
	Product sales	26.1	8.4	8.6	663.6	240.2
	Contract revenue	4.5	7.3	18.1	50.7	40.5
	Total revenue	100.0	100.0	100.0	144.9	248.7
Costs and expenses						
	Direct costs	14.3	10.0	5.8	247.6	502.2
	Research, development and contract costs	10.5	17.6	37.7	46.7	62.6
	Sales, marketing and customer support	27.3	22.2	27.5	201.3	181.1
	General and administrative	6.9	7.4	15.1	128.1	71.4
	Total costs and expenses	59.0	57.2	86.1	152.5	131.7
Operating income		41.0	42.8	13.9	134.8	976.2
Interest income		1.9	2.2	4.3	116.7	77.0
Income before income taxes		42.9	45.0	18.2	134.0	761.6
Income tax expense		20.1	22.6	7.4	117.7	962.6
Net income		22.8%	22.4%	10.8%	150.5%	623.0%

Results of Operations

Net revenue grew significantly during the three fiscal years ended November 30, 1987, because of growing customer acceptance of the Company's products as reflected in substantial increases in royalties and product sales.

In fiscal 1985, Apple Computer began shipments of its LaserWriter printer and was the only customer paying royalties to the Company. The number of royalty paying OEM customers of the Company increased to two in fiscal 1986 and to eight by the end of fiscal 1987.

Revenue from product sales increased in fiscal 1986 over fiscal 1985 due to the introduction of typeface software packages for the Apple Macintosh computer. Significant increases in product sales in fiscal 1987 over fiscal 1986 resulted from the introduction of the Adobe Illustrator product, additional typeface software for the Macintosh computer and initial typeface software for IBM personal computers.

Contract revenue has continued to grow but has become a much smaller part of overall sales.

Apple Computer continues to be the Company's largest OEM customer at 49% of total revenue but Apple's share of the Company's total revenue has declined substantially as new OEM customers have begun to pay royalties and as the Company generates more revenue in product sales.

Direct costs consist primarily of royalties paid to third parties for their typeface styles which are incorporated in the POSTSCRIPT interpreter, distributed as enhancements to OEMs and distributed on diskettes to end users. Other direct costs beginning in fiscal 1986 consist of the packaging and shipping costs associated with the downloadable type-face software shipments. This component of direct costs continued to grow in fiscal 1987 due to the Adobe Illustrator program which commenced shipment in March 1987. The final component of direct costs is the amortization of typeface production costs (see Note 1 to the Consolidated Financial Statements). Royalty costs for typeface styles initially were incurred in 1985 when the first printers equipped with the POSTSCRIPT interpreter were shipped. In fiscal 1986 the first packaging and shipping costs were incurred as downloadable typeface software was shipped. Consistent with the Company's accounting policies, amortization of capitalized typeface production costs commenced when the typefaces involved were released for sale. The increase in direct costs each year reflects these facts and is a function of the increased revenue generated from royalties and product sales.

Research, development and contract costs increased by 62.6% in fiscal 1986 and 46.7% in fiscal 1987 as a result of increases in staff and expenditures to meet the technical demands of the Company's increasing customer base and new product development efforts. Separate groups of technical staff are devoted to the porting of the POSTSCRIPT interpreter to new customer hardware products, enhancing the POSTSCRIPT interpreter to enable the Company to enter new markets, such as developing Kanji characters required for the Japanese market, and developing the DISPLAY POSTSCRIPT system. The Company expects expenses in this area to continue to grow as a result of planned increases in the development staff to handle growth and new product development.

Sales, marketing and customer support expenses increased by 181.1% in 1986 and 201.3% in 1987. The Company increased its activities in these years in all areas of sales, marketing and customer support. Additional personnel were added in all areas, particularly in the staff devoted to downloadable typeface software and Adobe Illustrator sales. Adobe Illustrator and downloadable typeface software programs are sold through dealers and distributors and during 1987 the Company has built a direct sales force located in various parts of the country to handle the sales of these products to dealers and distributors and to call on large corporate accounts. Marketing communication expenses increased because of higher levels of advertising, public relations, trade show participation and new product introduction expenses. Customer support staff was added in both years to support the needs of additional OEM customers utilizing the POSTSCRIPT interpreter, as well as the growing base of end user customers for typeface software and Adobe Illustrator software.

Sales, marketing and customer support expenses will continue to grow in fiscal 1988 to service the Company's growing number of customers and products.

General and administrative expenses increased 71.4% in 1986 and 128.1% in 1987. Growth in these expenses is attributable to expansion in the Company and additions to personnel, necessitating more administrative expenses such as insurance, benefits and facilities. The Company moved into its new facilities in Mountain View, California in August 1987 which more than doubled the amount of space it occupies at its headquarters location. The Company expects administrative expenses to increase to keep pace with the growth in the rest of the Company. The Company has acquired new financial and administrative computer systems and will be implementing these during fiscal 1988.

Non-operating income of $767,000, $354,000 and $200,000 for the years ended November 30, 1987, 1986, and 1985 consists almost entirely of interest income on short-term investments and is a function of the average cash and short-term investments balances held by the Company during the year. The Company's cash balances have increased during the last three years as the Company's operations have generated positive cash flow.

The Company's 1987, 1986, and 1985 effective income tax rates were 46.8%, 50.3%, and 40.8%, respectively. For an analysis of the differences between the statutory and effective income tax rates see Note 7 to the Consolidated Financial Statements. The Company will adopt Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes," beginning in fiscal 1988. Adopting this standard will not result in a material adjustment to the Company's financial statements.

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

Liquidity and Capital Resources

In August 1986 the Company sold 1,100,000 shares (adjusted for a 2 for 1 split effective in February 1987) of its Common Stock in its initial public offering. The Company's proceeds, net of expenses, were $5.2 million. Prior to its public offering, the Company had funded its growth through cash flow from operations and private sales of equity securities. The Company's cash and short-term investments balance at November 30, 1987, was $17.4 million. In addition the Company had available a $1.0 million unsecured line of credit. The Company believes that the existing cash balance together with funds generated from operations will be sufficient to meet its cash requirements through fiscal 1988.

Consolidated Balance Sheets

November 30, 1987 and 1986

	1987	1986
Assets		
Current assets:		
Cash and short-term investments	$ 17,444,000	12,941,000
Receivables (Notes 2 and 10)	7,501,000	3,622,000
Inventory (Note 3)	530,000	46,000
Total current assets	25,475,000	16,609,000
Property and equipment (Note 4)	3,712,000	1,736,000
Typeface production costs	2,916,000	1,665,000
Other assets	199,000	6,000
	$ 32,302,000	20,016,000
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 1,659,000	735,000
Accrued expenses (Note 6)	2,884,000	958,000
Income taxes payable (Note 7)	2,760,000	3,125,000
Unearned contract revenue	629,000	640,000
Total current liabilities	7,932,000	5,458,000
Deferred income taxes (Note 7)	845,000	839,000
Shareholders' equity (Notes 8 and 9):		
Common stock, no par value.		
50,000,000 shares authorized; 10,200,795 and 10,153,520 shares issued and outstanding at November 30, 1987 and 1986, respectively	10,226,000	9,418,000
Retained earnings	13,333,000	4,351,000
	23,559,000	13,769,000
Less shareholder notes receivable	34,000	50,000
Total shareholders' equity	23,525,000	13,719,000
Commitments (Note12)		
	$ 32,302,000	20,016,000

See accompanying notes to consolidated financial statements.

Consolidated Statements of Income

Years Ended November 30, 1987, 1986 and 1985

	1987	1986	1985
Revenue (Note 10)			
Royalties	$ 27,293,000	13,538,000	3,374,000
Product sales	10,263,000	1,344,000	395,000
Contract revenue	1,768,000	1,173,000	835,000
Total revenue	39,324,000	16,055,000	4,604,000
Costs and expenses (Note 11)			
Direct costs	5,610,000	1,614,000	268,000
Research, development and contract costs	4,139,000	2,821,000	1,735,000
Sales, marketing and customer support	10,729,000	3,561,000	1,267,000
General and administrative	2,721,000	1,193,000	696,000
Total costs and expenses	23,199,000	9,189,000	3,966,000
Operating income	16,125,000	6,866,000	638,000
Interest income	767,000	354,000	200,000
Income before income taxes	16,892,000	7,220,000	838,000
Income tax expense (Note 7)	7,910,000	3,634,000	342,000
Net income	$ 8,982,000	3,586,000	496,000
Net income per share	$ .85	.38	.05
Shares used in computing net income per share	10,517,000	9,456,000	9,064,000

See accompanying notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

Years Ended November 30, 1987, 1986 and 1985
(In thousands, except share data)

		Shareholders' Equity				
	Convertible Preferred Stock	Common Stock		Shareholder Notes Receivable	Retained Earnings	Total Shareholders' Equity
		Shares	Amount			
Balances as of Nov. 30, 1984	$ 3,781	3,175,156	$ 123	(23)	269	4,150
Repurchase of Common Stock from employees under stock purchase plan	—	(11,248)	(2)	1	—	(1)
Collections on shareholder notes receivable	—	—	—	1	—	1
Net income	—	—	—	—	496	496
Balances as of Nov. 30, 1985	3,781	3,163,908	121	(21)	765	4,646
Issuance of 52,466 shares of Series C Preferred Stock upon exercise of warrant	153	—	—	—	—	153
Conversion of Preferred Stock	(3,934)	5,468,844	3,934	—	—	—
Issuance of Common Stock to employees under stock purchase plan	—	18,000	5	(3)	—	2
Repurchase of Common Stock from employees under stock purchase plan	—	(61,052)	(3)	1	—	(2)
Issuance of Common Stock under stock option plan	—	463,820	78	(36)	—	42
Initial public Common Stock offering, net of expenses	—	1,100,000	5,239	—	—	5,239
Collections on shareholder notes receivable	—	—	—	9	—	9
Stock option compensation expense	—	—	44	—	—	44
Net income	—	—	—	—	3,586	3,586
Balances as of Nov. 30, 1986	—	10,153,520	9,418	(50)	4,351	13,719
Issuance of Common Stock under stock option plan	—	43,275	48	—	—	48
Issuance of Common Stock to employee	—	4,000	53	—	—	53
Tax benefit from exercise of stock options	—	—	618	—	—	618
Collections on shareholder notes receivable	—	—	—	16	—	16
Stock option compensation expense	—	—	89	—	—	89
Net income	—	—	—	—	8,982	8,982
Balances as of Nov. 30, 1987	$ —	10,200,795	$ 10,226	(34)	13,333	23,525

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Financial Position

Years Ended November 30, 1987, 1986 and 1985

	1987	1986	1985
Cash flows from operating activities			
Net income	$ 8,982,000	3,586,000	496,000
Items not using (providing) cash:			
Stock option compensation expense	89,000	44,000	—
Depreciation and amortization	1,621,000	705,000	337,000
Deferred income taxes	6,000	538,000	301,000
Cash provided from operations	10,698,000	4,873,000	1,134,000
Changes in items affecting operations			
Receivables	(3,879,000)	(2,219,000)	(1,332,000)
Inventory	(484,000)	(46,000)	—
Other current assets	—	68,000	83,000
Accounts payable	924,000	547,000	131,000
Accrued expenses	1,926,000	657,000	215,000
Income taxes payable	(365,000)	3,103,000	22,000
Unearned contract revenue	(11,000)	55,000	335,000
Deferred income taxes	—	(31,000)	31,000
Net cash provided from operations	8,809,000	7,007,000	619,000
Cash flows from investment activities			
Purchases of property and equipment	(3,027,000)	(1,226,000)	(507,000)
Capitalized typeface production costs	(1,821,000)	(1,090,000)	(744,000)
Other assets	(193,000)	3,000	2,000
Cash required by investment activities	(5,041,000)	(2,313,000)	(1,249,000)
Cash flows from financing activities			
Proceeds from issuance of Preferred Stock	—	153,000	—
Proceeds from issuance of Common Stock, net	101,000	5,283,000	—
Collections on shareholder notes receivable	16,000	9,000	1,000
Conversion of Preferred Stock to Common Stock	—	(3,934,000)	—
Issuance of Common Stock in exchange for Preferred Stock	—	3,934,000	—
Repurchase of Common Stock, net	—	(2,000)	(1,000)
Tax benefit from exercise of stock options	618,000	—	—
Cash generated by financing activities	735,000	5,443,000	—
Total cash generated (used)	4,503,000	10,137,000	(630,000)
Cash and short-term investments at beginning of year	12,941,000	2,804,000	3,434,000
Cash and short-term investments at end of year	$ 17,444,000	12,941,000	2,804,000

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

November 30, 1987, 1986 and 1985

1. Significant Accounting Policies

a) Basis of Presentation

Adobe Systems Incorporated (Adobe or the Company), formed in 1983, has developed a software product (the POSTSCRIPT® interpreter) that controls the printing of integrated text, graphics and scanned images in a high quality and cost-effective printing system. The accompanying consolidated financial statements include those of Adobe and its wholly-owned subsidiaries, Old Adobe Systems, Inc. and Adobe Systems, Europe, B.V., after elimination of all significant intercompany accounts and transactions.

b) Short-term Investments

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

c) Inventory

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

d) Property and Equipment

Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation is provided on the straight-line method over the estimated useful lives of the respective assets, generally three to eight years. Leasehold improvements are amortized using the straight-line method over the lesser of the lease term or the estimated useful lives of the related assets, generally seven years.

e) Typeface Production Costs

Typeface production costs, less $739,000 and $169,000 accumulated amortization in 1987 and 1986, respectively, comprise direct and indirect costs associated with the production of typefaces to be used with the POSTSCRIPT interpreter. Costs incurred prior to the November 1984 market introduction of the POSTSCRIPT interpreter were expensed as incurred. Subsequent to the market introduction of the POSTSCRIPT interpreter, Adobe has capitalized the costs related to the production of several product lines of individual new typeface software programs that are marketed to POSTSCRIPT software users. These costs are amortized on a straight-line basis over four years, commencing with the market release of each new typeface software program.

f) Revenue Recognition

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

Product sales comprise direct sales of new typeface software, Adobe Illustrator and POSTSCRIPT Language instruction manuals. Revenue from product sales is recognized upon shipment.

Contract revenue relates to Adobe research and development performed under contracts entered into with the Company's OEM licensees. These contracts normally stipulate that Adobe will provide the research and development required to adapt the Company's software products to the OEM's hardware products. In most such contracts, the OEM pays a contract advance to Adobe which is normally not refundable after the Company has completed certain specified research and development milestones. These payments are treated as research and development contract revenue, which is recognized based on the achievement of project objectives on a basis representative of the number of research and development hours incurred to date as a percentage of total estimated contract hours. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. The costs incurred in performing under the contracts are classified as research, development and contract costs in the accompanying consolidated statements of income.

g) Direct Costs

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

h) Income Taxes

Income taxes are provided for all items included in the consolidated statements of income, regardless of when such items are reported for tax purposes. Investment tax credits and research and experimental tax credits are treated as a reduction of the provision for Federal income taxes in the year realized.

i) Net Income Per Share

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

j) Foreign Operations and Currency Translation

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

k) Reclassifications

Amounts in the Consolidated Statements of Income for 1986 and 1985 have been reclassified to conform with the 1987 presentation.

2. Receivables

A summary of receivables follows:

	1987	1986
Royalties	$ 5,755,000	3,043,000
Product sales	1,831,000	448,000
Contracts	—	105,000
Employee notes and advances	15,000	3,000
Interest	69,000	61,000
	7,670,000	3,660,000
Less allowance for doubtful accounts	169,000	38,000
	$ 7,501,000	3,622,000

3. Inventory

A summary of inventory follows:

	1987	1986
Purchased components	$ 424,000	29,000
Finished goods	106,000	17,000
	$ 530,000	46,000

4. Property and Equipment

A summary of property and equipment follows:

	1987	1986
Computers and peripherals	$ 2,955,000	1,545,000
Production and development equipment	1,187,000	849,000
Furniture and fixtures	1,486,000	433,000
Leasehold improvements	60,000	53,000
	5,688,000	2,880,000
Less accumulated depreciation and amortization	1,976,000	1,144,000
	$ 3,712,000	1,736,000

5. Line of Credit

The Company has available a $1,000,000 unsecured bank line of credit which expires on August 31, 1988. Interest on borrowings is at the bank's reference rate (prime rate). At November 30, 1987, there were no borrowings outstanding under this agreement.

6. Accrued Expenses

A summary of accrued expenses follows:

	1987	1986
Rent	$ 563,000	—
Royalties	929,000	370,000
Officers' and employees' bonuses	665,000	413,000
Vacation	130,000	75,000
Other	597,000	100,000
	$ 2,884,000	958,000

7. Income Taxes

The components of income tax expense are as follows:

	1987	1986	1985
Current:			
Federal	$ 6,370,000	2,680,000	—
State	1,534,000	603,000	10,000
Total current	7,904,000	3,283,000	10,000
Deferred:			
Federal	(79,000)	256,000	260,000
State	85,000	95,000	72,000
Total deferred	6,000	351,000	332,000
	$ 7,910,000	3,634,000	342,000

The 1986 Federal provision reflects a $323,000 reclassification from
deferred to reflect the actual difference between depreciation expense
for financial statement and tax reporting purposes.

The actual expense differs from the expected tax expense (computed
by applying the U.S. Federal weighted average statutory tax rate of 41%
in 1987 and 46% in 1986 and 1985 to income before income taxes)
as follows:

	1987	1986	1985
Tax at Federal statutory rate	$ 6,926,000	3,322,000	385,000
Tax rate differential	—	—	(20,000)
State income taxes, net of Federal benefit	955,000	377,000	44,000
Investment tax credits	—	(2,000)	(26,000)
Research and experimental tax credits	—	—	(46,000)
Other	29,000	(63,000)	5,000
	$ 7,910,000	3,634,000	342,000

The sources of deferred tax expense and their tax
effects, are as follows:

	1987	1986	1985
Typeface production costs	$ 642,000	550,000	380,000
Accelerated depreciation	(20,000)	(169,000)	62,000
State income taxes	(421,000)	(316,000)	(38,000)
Accrued rent	(226,000)	—	—
Investment tax credits	—	64,000	(26,000)
Research and experimental tax credits	—	217,000	(46,000)
Tax net operating loss carryforward	—	41,000	—
Other	31,000	(36,000)	—
	$ 6,000	351,000	332,000

8. Convertible Preferred Stock

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

9. Common Stock

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

Under the terms of the Company's stock purchase plan, employees could elect to purchase common shares issued to them by Adobe, at the fair market value of the shares on the issue date, through a 9% note payable to Adobe. Shares issued under this plan vest over five years. In the event of employment termination, unvested shares may be repurchased by the Company at the original purchase price. At November 30, 1987, there were 205,482 unvested shares. The Company does not contemplate issuing any further shares under this plan.

At November 30, 1987, the Company had reserved 1,900,000 shares (500,000 of which are subject to shareholder approval) of Common Stock for issuance under its 1984 Stock Option Plan. This plan, which was amended in 1987 to exclude non-employee directors, provides for the granting of stock options to employees and officers at the fair market value of the Company's Common Stock at the grant date. Options generally vest over three years: 25% of the granted options at the end of each of the first two years and 50% at the end of the third year. On June 16, 1986, the Company accelerated to that date the exercisability of 498,320 outstanding options. Unvested shares remain subject to certain Company repurchase rights. All options have a five year term.

The following table summarizes option activity under this plan:

	Shares Available For Grant	Options Outstanding Shares	Average Price Per Share
Balances at November 30, 1985	444,820	418,600	$ .15
Increase in shares reserved	536,580	—	—
Options granted	(287,720)	287,720	.15 – 11.44
Options exercised	—	(463,820)	.15 – .25
Options cancelled	8,600	(8,600)	.15
Balances at November 30, 1986	702,280	233,900	.15 – 11.44
Increase in shares reserved	500,000	—	—
Options granted	(895,024)	895,024	11.75 – 48.75
Options exercised	—	(43,275)	.15 – 11.44
Options cancelled	183,300	(183,300)	.15 – 48.75
Balances at November 30, 1987	490,556	902,349	$ .15 – 22.50

(202,899 Shares Exercisable)

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

10. Major Customer

One major customer accounted for 49%, 84% and 73% of Adobe's total revenue for 1987, 1986 and 1985, respectively. Receivables from this customer aggregated approximately $3,560,000 at November 30, 1987. At November 30, 1987, this customer was also a major shareholder, owning approximately 17% of the Company's common shares.

11. Supplementary Statements of Income Information

The following items are included in costs and expenses in the accompanying Consolidated Statements of Income:

	1987	1986	1985
Maintenance and repairs	$ 297,000	165,000	72,000
Depreciation	1,051,000	536,000	337,000
Amortization of typeface production costs	570,000	169,000	—
Royalties	3,484,000	1,272,000	182,000
Advertising	1,647,000	580,000	171,000

12. Lease Commitments

The Company has operating leases for the corporate headquarters facility, field sales offices and certain office equipment which expire at various dates through 1995. Rental expense for these operating leases was $1,064,000, $590,000 and $316,000 during the years ended November 30, 1987, 1986 and 1985.

At November 30, 1987, future minimum lease payments for noncancellable operating leases were:

1988	$ 966,000
1989	1,302,000
1990	1,556,000
1991	1,591,000
1992	1,591,000
1993 and thereafter	3,581,000
	$ 10,587,000

Subsequent to November 30, 1987, the Company consummated three capital lease agreements with aggregate future minimum lease payments of $1,538,000, and two operating lease agreements with future minimum lease payments of $450,000.

The Board of Directors and Shareholders
Adobe Systems Incorporated:

We have examined the consolidated balance sheets of Adobe Systems
Incorporated and subsidiaries as of November 30, 1987 and 1986 and
the related consolidated statements of income, shareholders' equity and
changes in financial position for each of the years in the three-year period
ended November 30, 1987. Our examinations were made in accordance
with generally accepted auditing standards and, accordingly, included
such tests of the accounting records and such other auditing procedures
as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements
present fairly the financial position of Adobe Systems Incorporated and
subsidiaries as of November 30, 1987 and 1986 and the results of their
operations and the changes in their financial position for each of the
years in the three-year period ended November 30, 1987, in conformity
with generally accepted accounting principles applied on a consistent
basis.

Peat Marwick Main & Co.

San Jose, California
December 18, 1987

Quarterly Results of Operations (Unaudited)

(In thousands, except per share data)

	1987, Quarter Ended				Year Ended
	Feb 28	May 31	Aug 31	Nov 30	Nov 30
Revenue	$ 6,901	9,563	10,552	12,308	39,324
Income before income taxes	2,994	4,318	4,628	4,952	16,892
Net income	1,584	2,313	2,370	2,715	8,982
Net income per share	$ .15	.22	.23	.26	.85
Shares used in per share calculation	10,326	10,544	10,527	10,588	10,517
Common Stock price per share*					
High	23	54	47 1/2	45	54
Low	11 7/8	22 7/8	30 1/4	14 3/4	11 7/8

	1986, Quarter Ended				Year Ended
	Feb 28	May 31	Aug 31	Nov 30	Nov 30
Revenue	$ 2,392	3,498	4,932	5,233	16,055
Income before income taxes	1,109	1,751	2,358	2,002	7,220
Net income	550	868	1,168	1,000	3,586
Net income per share	$ .06	.10	.13	.10	.38
Shares used in per share calculation	9,064	9,024	9,290	10,324	9,456
Common Stock price per share*					
High	—	—	5 3/4	12 1/2	12 1/2
Low	—	—	7 5/8	6 5/8	5 3/4

The Company has never paid cash dividends on its Common Stock. The Company's Common Stock has been traded on the NASDAQ National Market System since February 3, 1987. Prior to that the stock was traded on the NASDAQ bid and ask market since its initial public offering in August 1986. On January 31, 1988, there were 716 holders of record of the Company's Common Stock.

Previously reported amounts for the quarters ended May 31,1987, and August 31,1987, for revenue, $8,682,000 and $9,872,000, respectively, income before income taxes, $3,548,000 and $4,048,000, respectively, net income, $1,988,000 and $2,289,000, respectively, and net income per share, $.19 and $.22, respectively, were restated to reflect more accurately the timing of royalties earned.

*All share and per share amounts have been retroactively adjusted to reflect a two-for-one stock split effective February 27, 1987.

Corporate Directory

From left to right:
John E. Warnock,
Diane W. Savage,
R. Daniel Putman,
Stephen A. MacDonald,
M. Bruce Nakao,
Charles M. Geschke.

Corporate Officers

John E. Warnock
President and Chief Executive Officer

Charles M. Geschke
Executive Vice President and Chief Operating Officer

Stephen A. MacDonald
Vice President Sales and Marketing

M. Bruce Nakao
Vice President Finance, Chief Financial Officer,
Treasurer and Assistant Secretary

R. Daniel Putman
Vice President Engineering

Diane W. Savage
General Counsel and Secretary

Legal Counsel

Ware & Freidenrich, A Professional Corporation
Palo Alto, CA

Independent Certified Public Accountants

Peat Marwick Main & Co.
San Jose, CA

Registrar and Transfer Agent

Manufacturers Hanover Trust Company
San Francisco, CA

Annual Meeting

The Annual Meeting of Shareholders of Adobe Systems Incorporated will be held at 1:00 p.m. on Thursday, May 26, 1988, at the Stanford Park Hotel, Menlo Park, CA. All Adobe Systems shareholders are encouraged to attend.

For additional copies of this annual report contact the Corporate Communications Department, Adobe Systems Incorporated, 1585 Charleston Road, P. O. Box 7900, Mountain View, CA 94039-7900.

Form 10-K

A copy of the Company's Form 10-K, filed with the Securities and Exchange Commission, is available without charge upon written request to the Corporate Communications Department, Adobe Systems Incorporated, 1585 Charleston Road, P. O. Box 7900, Mountain View, CA 94039-7900.

Common Stock

Adobe Systems Incorporated's Common Stock is traded on the NASDAQ National Market System under the symbol ADBE.

ADOBE
SYSTEMS INCORPORATED