

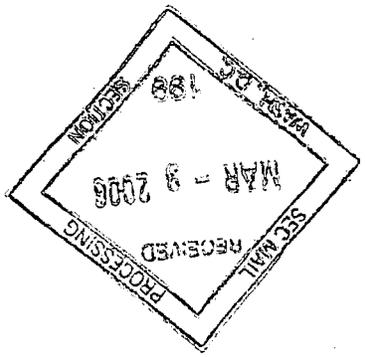
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In this age of information overload, people focused on connecting with their audiences have discovered how to cut through the clutter and create truly engaging experiences. Around the world, they can be found producing independent and feature films, publishing innovative magazines, delivering digital content to a world on the run, or dramatically increasing productivity across global enterprises and government agencies.

They are a diverse lot—from creative professionals and digital photography hobbyists to knowledge workers and business executives. At first glance, you might not think there was much to connect them, but upon reflection, you would discover a commonality: Adobe.

For more than two decades, Adobe's award-winning technologies and software have redefined business, entertainment, and personal communications by setting new standards for digital content that engages people virtually anywhere at any time. From rich images in print, video, and film to dynamic digital content for a variety of media, the impact of Adobe solutions is evident across industries and experienced by anyone who creates, views, and interacts with information.

There are thousands of stories about Adobe revolutionizing how people engage with ideas and information. On the following pages, we present six of them (and you can find more at www.adobe.com/stories).

Justified Experiences

[REDACTED]

**Beth Israel Deaconess Medical Center,
Harvard Medical School**

A teaching hospital of Harvard Medical School, Beth Israel Deaconess Medical Center (BIDMC) has an outstanding history of patient care, as well as a healthy regard for the role that leading-edge technology plays in its ongoing success.

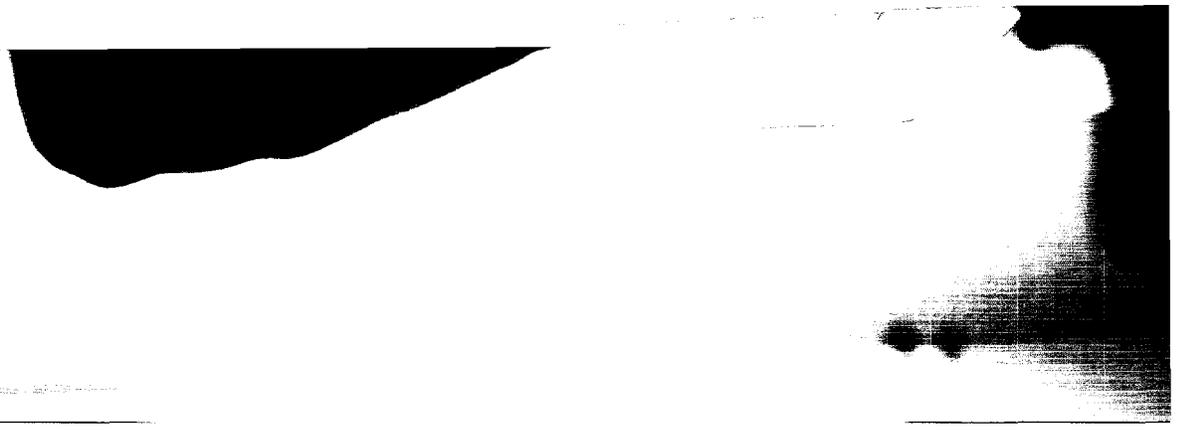
"When medicine was an entirely paper-based world, a patient's chart didn't always arrive with the right information at the right time," recalls John Halamka, chief information officer of BIDMC and Harvard Medical School. "Now, using Adobe® LiveCycle™ products, we can create an entire digital record for each patient—even including information from outside doctors' offices—helping us deliver quality care."

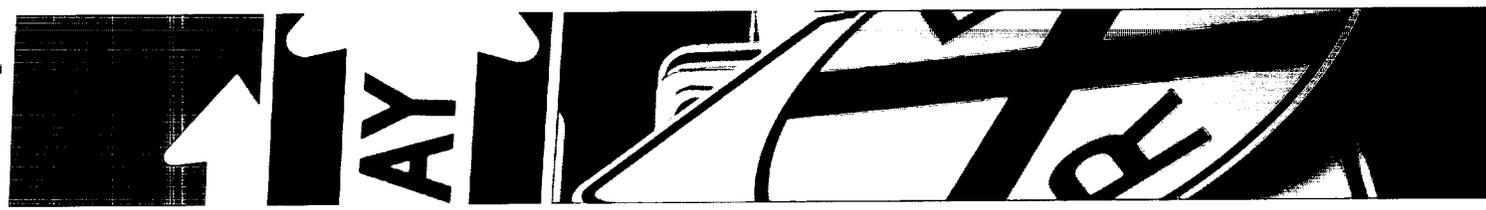
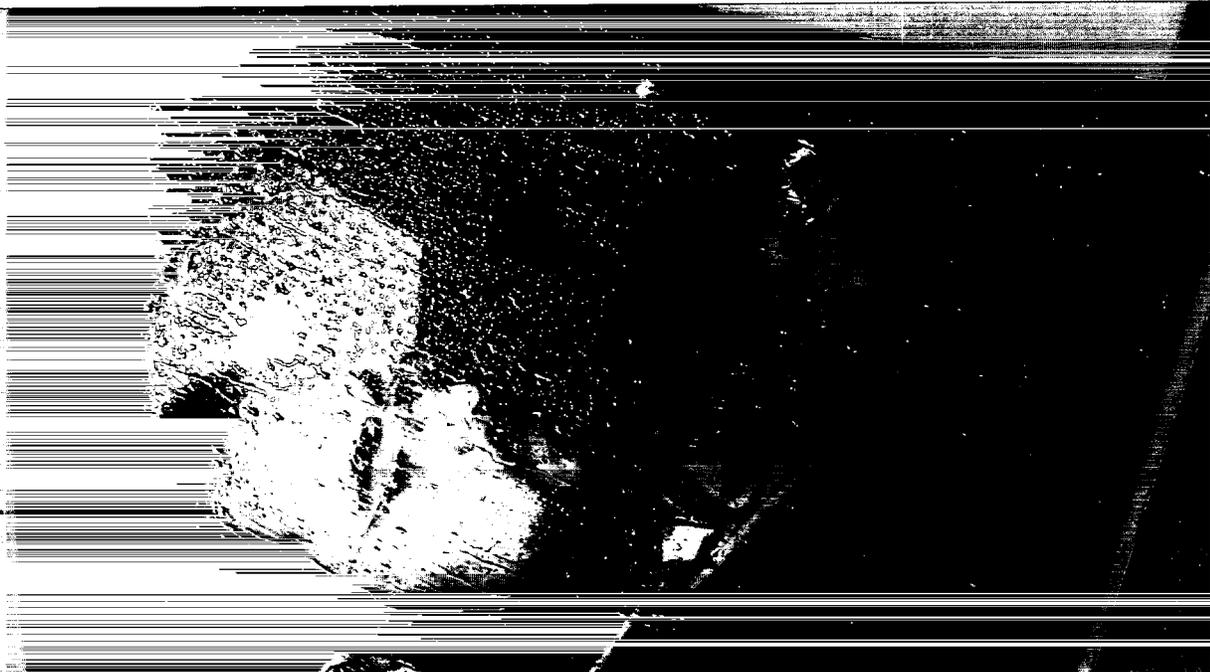
While providing patient care, a hospital must address privacy issues. "Enforcing HIPAA regulations involves things like digital signatures and policies around who can see what at what time," explains Halamka. "Adobe's LiveCycle suite provides the security features we need to protect patient privacy."

The medical center also relies on Macromedia® Flash® software to teach future clinicians. "Today, we have 200 simulations created in Flash that let our students experience the nature of patient care if there isn't a patient with a specific disease at hand," says Halamka.

And what about cost savings that can be realized from using Adobe products? Halamka estimates that "by using Adobe products to create electronic medical records and share them across the community, we have the potential to save \$4.5 billion a year in Massachusetts alone." That would certainly be a healthy cost savings.

- Products/solutions used:
Adobe LiveCycle
Adobe PDF
Macromedia Flash







Justin Everett-Church

Justin Everett-Church's working title is rich media evangelist for Yahoo! Inc. His work is always in progress as a Flash developer for mobile devices. His latest project, *NYC Traffic*, lets Manhattanites with handheld devices (and similarly armed bridge-and-tunnel road warriors) access real-time webcams to get up-to-the-second commute information. It took Grand Prize for "Best Business & Productivity Application" in this year's Flash Lite™ contest.

"Flash Lite enabled me to make my application interactive in ways that are more similar to those on game consoles, rather than the typical mobile experiences that simply aren't as good," explains Everett-Church. "Plus, Flash Lite gives me the ability to make my application more fun, and that's never a bad thing."

Using Adobe tools in his daily work has enabled Everett-Church to help people navigate important aspects of their own lives—like actually *getting* to work.

"Flash really is the future platform of mobile devices because it has the wow factor that attracts users," says Everett-Church. "It has the power that lets developers create applications that people actually want to use. And it's so versatile across all devices that it will move faster than any other technology." Which is important for people traveling in life's fast lane. As mobile devices proliferate, Flash software is lighting the way for a whole new industry of on-the-go applications.

Products used:

Macromedia Flash and Flash Lite



NOVA

Publisher

Tokion Magazine

Translated from Japanese as “the sound of now,” Tokion is like a sociological guidebook for today’s pop-culture generation. With a desire to connect to what is genuine in today’s world, Tokion bridges global popular culture by offering an in-depth perspective on great talent in music, fashion, art, design, and current events.

“Tokion’s goal in its design and content is to create something that does not have boundaries,” says Senior Editor Daisuke Nishimura. “We try to create something unique and new, something that you haven’t seen before.”

Each issue investigates a single theme—“Cold,” “Warm,” or “Dangerous,” for example—from multiple angles. Stories and cover art feature cutting-edge typography and design (thanks in large part to Adobe Creative Suite software), as befits a magazine that reports on—and reflects—the international zeitgeist.

“Using Adobe software and PDF enables us to easily collaborate between our New York and Tokyo offices,” says Nishimura.

“The Adobe Creative Suite is the perfect tool for us because it makes it so easy to render whatever we imagine. We use Adobe Photoshop® for our major portraits, Adobe Illustrator® for the decorative aspects, and Adobe InDesign® to bring all the elements together.”

Products/solutions used:

Adobe Creative Suite
Adobe Photoshop
Adobe Illustrator
Adobe InDesign
Adobe PDF

Hussein Chalayan

Design is being turned inside out as the fashion world embraces the precedent-setting creations of Cyprus-born, London-based Hussein Chalayan. His industry-defining work has been included in numerous international exhibitions, including "Radical Fashion" at the Victoria and Albert Museum in London, "Fashion" at the Kyoto Costume Institute in Japan, and "Airmail Clothing" at the Musée de la Mode Palais du Louvre in Paris and the Istanbul Biennial.

Twice crowned "British Designer of the Year," Chalayan is now, in another clever deconstruction of fashion norms, designing the first wearable PDF document. A single Adobe PDF design will contain all the materials and detailed directions to assemble your own printable dress or top. "You can give it life in the way you print or make it—whether from Tyvek, which will include all the instructions on it and resemble an actual document, or from fabric—and in the way you wear it," says Chalayan.

"I'm interested in process, because process in itself is a piece of work," says Chalayan. "It's important for me to discover something new in each project. In this case, Adobe's technology has enabled me to turn fantasy into reality."

In the international world of fashion, one size may not fit all, but one software company does.

Solutions used:
Adobe PDF

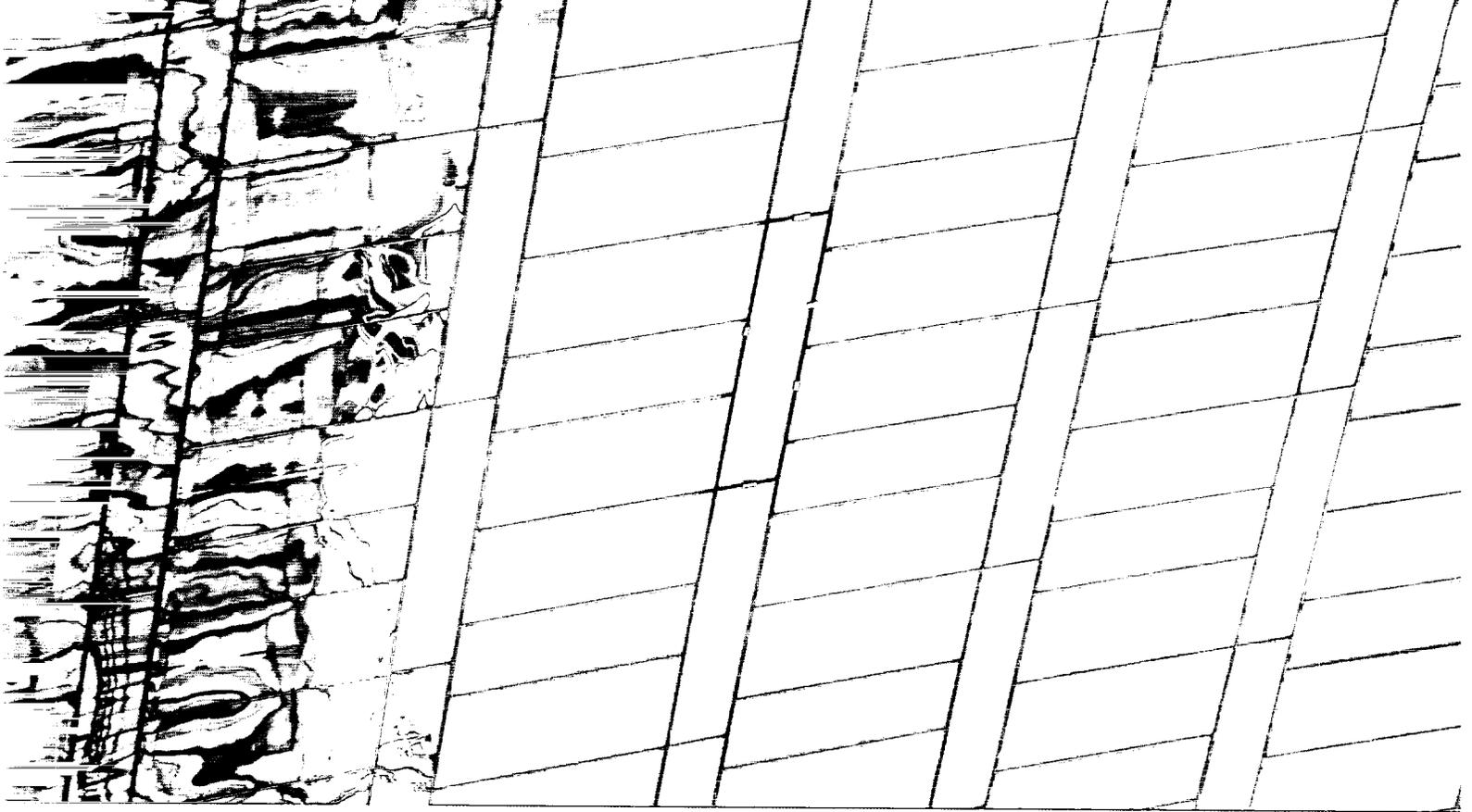




Fashion Designer



Nonprofit Organization



U.S. Green Building Council

The U.S. Green Building Council (USGBC) is the nation's leading nonprofit coalition for advancing buildings that are environmentally responsible, profitable, and healthy places in which to live and work. Its annual International Green Building Conference and Expo, Greenbuild, also provides an important meeting place for the rapidly expanding green building industry worldwide.

All construction projects involve extensive paperwork, but "building green" requires even more. From submitting initial plans to obtaining final certifications can require as many as 15,000 sheets of paper, which typically reside in multiple binders. Using so much paper is definitely not compatible with environmentally conscious building. Enter Adobe and its Acrobat® and Adobe LiveCycle solutions for generating PDF-based Intelligent Documents.

"To certify a green building, every single material, every nail and screw, must be documented," explains Rick Fedrizzi, USGBC's president and CEO. "The Adobe templates let us do this now with clicks and bytes instead of trees and forests."

Going digital also means that the paper-filled binders, which required a huge amount of physical storage space, can be jettisoned.

"A really great thing about using Adobe LiveCycle and Acrobat Professional software is that thousands of binders can be replaced by a single server," says Fedrizzi. "When I think of the space saving and the efficiency involved, I have to wonder why we didn't do this a long time ago."

Products/solutions used:
Adobe LiveCycle
Adobe Acrobat Professional
Adobe PDF



Filmmaker



TOURNIS

François Vogel

Moviemaking has come a long way since Louis Lumière—who invented the groundbreaking Cinématographe camera-projector back in 1895—famously remarked, “the cinema is an invention without a future.”

Fast forward to fellow Frenchman François Vogel, who today continues to invent the future of cinema with cutting-edge music videos and experimental short films that are winning awards on the international film circuit.

Vogel likes working with Adobe After Effects® software because while it is powerful enough for making feature films, it also is extremely easy to use.

“The short film I’m doing right now is being made 100% with Adobe After Effects,” says Vogel. “I could have used different software, but it would have taken a lot longer. Plus, with After Effects, it’s very easy to use photos and videos at the same time and to mix everything together.”

Talking about what inspires him, Vogel says, “I want to see something I haven’t seen.” When people view his work, that is exactly what they will see, too.

Products used:
Adobe After Effects

OnePlatform

From mobile applications and experimental films to digital medical records and construction plans to cutting-edge magazines and wearable art, Adobe tools continue to help people and organizations find new and better ways to engage with ideas and information.

Virtually every image you see today in magazines, on billboards, in business documents and government forms, and in advertisements—or experience in movies, on television screens, and on digital devices—has likely been touched by Adobe software.

Now, Adobe's powerful new Engagement Platform will combine the ubiquitous Adobe PDF and Adobe Reader® technologies with the also-ubiquitous Macromedia Flash and Macromedia Flash Player technologies as well as with HTML, allowing anybody who wants to create compelling experiences, actionable applications, and rich content to do so in a reliable, more secure, and engaging manner.

With open standards and APIs, the Adobe Engagement Platform also will allow solution providers and partners to develop their own rich solutions based on it. And it will allow Adobe to continue to revolutionize how individuals and organizations engage with ideas and information—across platforms, in virtually any medium, and on virtually any device, from cell phones to servers.

To connect with more stories and information about how Adobe is revolutionizing communication, visit www.adobe.com/stories.

adobe.com/stories

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Adobe's worldwide presence also includes
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Czech Republic
Denmark
Finland
France
Germany
India
Ireland
Italy
Korea
Mexico
The Netherlands
Norway
People's Republic of China
Scotland
Singapore
Spain
Sweden
Switzerland
Taiwan

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 2, 2005

OR

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

For the transition period from _____ to _____

Commission file Number: 0-15175

ADOBE SYSTEMS INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

77-001952
(I.R.S. Employer
Identification No.)



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

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

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock

Indicate by checkmark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by checkmark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by checkmark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by checkmark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Act). Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of the registrant's common stock, \$0.0001 par value per share, held by non-affiliates of the registrant on June 3, 2005, the last business day of the registrant's most recently completed second fiscal quarter, was \$14,128,765,011 (based on the closing sales price of the registrant's common stock on that date). Shares of the registrant's common stock held by each officer and director and each person who owns 5% or more of the outstanding common stock of the registrant have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes. As of January 27, 2006, 599,810,699 shares of the registrant's common stock, \$.0001 par value per share, were issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2006 Annual Meeting of Stockholders (the "Proxy Statement"), to be filed within 120 days of the end of the fiscal year ended December 2, 2005, are incorporated by reference in Part III hereof. Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part hereof.

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Forward-Looking Statements

In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements, including statements regarding product plans, future growth and market opportunities, which 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 this section under "Risk Factors." You should carefully review the risks described herein and in other documents we file from time to time with the Securities and Exchange Commission ("SEC"), including the Quarterly Reports on Form 10-Q to be filed in 2006. When used in this report, the words "expects," "could," "would," "may," "anticipates," "intends," "plans," "believes," "seeks," "targets," "estimates," "looks for," "looks to," and similar expressions, as well as statements regarding our focus for the future, are generally intended to identify forward-looking statements. You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.

PART I

ITEM 1. BUSINESS

Founded in 1982, Adobe Systems Incorporated is one of the largest and most diversified software companies in the world. We offer a line of creative, business and mobile software and services used by high-end consumers, creative professionals, designers, knowledge workers, original equipment manufacturers ("OEM"), developers and enterprises for creating, managing, delivering and engaging with compelling content and experiences across multiple operating systems, devices and media. We distribute our products through a network of distributors and dealers, value-added resellers ("VARs"), systems integrators, independent software vendors ("ISVs") and OEMs, direct to end users, and through our own Web site at www.adobe.com. We also license our technology to major hardware manufacturers, software developers and service providers and we offer integrated software solutions to businesses of all sizes. We have operations in the Americas; Europe, Middle East and Africa ("EMEA"); and Asia. Our software runs on personal computers with Microsoft Windows, Apple OS, Linux, UNIX and various other platforms, depending on the product.

Adobe was originally incorporated in California in October 1983 and was reincorporated in Delaware in May 1997. We maintain executive offices and principal facilities at 345 Park Avenue, San Jose, California 95110-2704. Our telephone number is 408-536-6000. We maintain a Web site at www.adobe.com. Investors can obtain copies of our SEC filings from this site free of charge, as well as from the SEC Web site at www.sec.gov.

BUSINESS OVERVIEW

Since the early 1980's, Adobe software and technologies have helped redefine how people engage with ideas and information—anytime, anywhere and through any medium. From rich images in print, video, film, and on personal computers and mobile devices to dynamic digital content for a variety of media, the impact of Adobe solutions is evident across industries and felt by anyone who creates, views and interacts with information.

In the simplest of terms, Adobe helps people and businesses communicate better. By delivering powerful graphic design, publishing, animation and imaging software for print, Web and video production and by delivering ubiquitous platforms, we help people express, share, manage and collaborate on their ideas in imaginative and meaningful new ways. For businesses, we provide solutions to improve the way customers and employees interact with information and with each other.

Our strategy is to address the needs of a variety of customers, which include creative professionals—graphic designers, Web designers, videographers, photographers and professional publishers; knowledge

workers—teams of workers and those who deliver presentations; enterprise users—IT managers, line of business managers and executives; high-end consumers—digital imaging and digital video hobbyists and enthusiasts; OEM partners—mobile device manufacturers, printer manufacturers, Internet service providers and developers. We execute against this strategy by delivering products that support industry standards and can be deployed on multiple computing environments, depending on the product.

PRODUCTS OVERVIEW

In fiscal 2005, we categorized our products into four principal business segments: Digital Imaging and Video, Creative Professional, Intelligent Document and OEM PostScript and Other. On December 3, 2005, we completed the acquisition of Macromedia, Inc. (“Macromedia”), a provider of software technologies that enables the development of a wide range of Web and mobile application solutions, for approximately \$3.4 billion. Coinciding with the integration of Macromedia and the start of our 2006 fiscal year, we changed our reported business segments to be aligned with our market opportunities and how we internally manage our combined businesses. Our new business segments are: Creative Solutions, Knowledge Worker Solutions, Mobile and Device Solutions, Enterprise and Developer Solutions, and Other.

This overview combines a review of our fiscal year 2005 business by our prior business segment classifications with a discussion of our market opportunities and products as classified in our new business segment organization.

Fiscal Year 2005 Business Segment Review

Creative Professional Business Summary

In fiscal 2005, we maintained our focus on meeting the software needs of creative professional users through the release of new versions of the Adobe Creative Suite. Available in two options (Standard and Premium), the Adobe Creative Suite incorporates several of our technologies used by creative professionals into one product and is a complete design solution that provides efficiency through improved product integration and powerful Adobe Portable Document Format (“PDF”) workflow capabilities.

After achieving record revenue for our Adobe Creative Suite products in the first quarter of fiscal 2005, we delivered a new version 2 of the Creative Suite products beginning in the second quarter of fiscal 2005. In addition, we delivered version “CS2” of our individual Creative Professional software application products (Illustrator, InCopy, InDesign and GoLive, as well as Photoshop from our Digital Imaging and Video business segment) in the second quarter. These new releases combined to achieve record Creative Suite and Creative Professional revenue for Adobe in the second quarter. This performance was followed by another quarter of record Creative Suite and Creative Professional revenue in our third quarter, when the majority of the foreign language versions of the CS2 product family began shipping to customers. As was the case in fiscal 2004, many of our Creative Professional customers chose to migrate from licensing individual products such as Photoshop to licensing the Creative Suite products during fiscal 2005.

Another key component of our Creative Professional business strategy was to grow revenue for InDesign, our professional page layout product. In fiscal 2005, due in part to the new features available in the CS2 version of InDesign and favorable industry reviews, we enjoyed increased adoption by our professional publishing customer, resulting in increased market share in the professional page layout segment. This success resulted in record revenue for InDesign in fiscal 2005.

Digital Imaging and Video Business Summary

In fiscal 2005, we maintained our focus on meeting the digital imaging and video software needs of creative professionals, professional photographers, professional videographers, business users and

hobbyists. These customers rely on Adobe's digital imaging and video editing solutions to create and enhance many of the pictures and video we see everyday in print, on television, in movies and on the Web.

During fiscal 2005, we delivered several new releases of our digital imaging and video software applications. In the second quarter of fiscal 2005, we released the CS2 version of Photoshop—our industry-leading product for digital imaging. This English version release was followed by the delivery of the foreign language versions of the product, which began shipping during the early part of our third quarter of fiscal 2005. The release of Photoshop CS2 received positive reviews from industry press and analysts, and generated strong revenue. However, as indicated previously, many customers began licensing Photoshop capabilities via the Creative Suite products, as opposed to licensing the product via its standalone version. This planned migration has impacted standalone Photoshop revenue, and thus Digital Imaging and Video segment revenue, as we predicted last year.

During fiscal 2005, we also maintained our focus on our digital video products, including Adobe Premiere Pro software for video editing, Adobe After Effects software for adding special effects to video, Adobe Audition software for audio editing and Adobe Encore DVD software for DVD creation. In addition to these individual digital video products, we continued to focus on marketing the Adobe Video Collection which contains these products and comes in two versions: Standard and Professional.

In the fourth quarter of fiscal 2005, we released version 4.0 of our Adobe Photoshop Elements software, which is our digital imaging application targeted for amateur photographers and digital imaging hobbyists. In the same quarter, we released version 2.0 of Adobe Premiere Elements software, which is our video editing software that can be used by hobbyists to enhance and share their digital video memories on DVDs. In addition, we released a software bundle that includes the new versions of Photoshop Elements and Adobe Premiere Elements to target hobbyists who desire both applications in one affordable package.

Intelligent Document Business Summary

In fiscal 2005, we achieved strong year-over-year growth and record revenue in our Intelligent Document business. Driving this performance was the release of version 7.0 of our Acrobat family of products, which began shipping in the first quarter of the fiscal year. The updated product family offers enhanced features that allow workgroups to manage a range of essential business activities such as assembling documents from multiple sources, creating intelligent forms and more securely collaborating on projects. In addition, the new Acrobat 7.0 family of products offers new functionality to address specific customer workflow issues in vertical markets such as architecture, engineering, construction, manufacturing, education, government and financial services. This vertical market focus helped to significantly increase our penetration of Acrobat desktop licenses.

Our focus on the enterprise software server market targeting the document service needs of governments and enterprises also drove record revenue in fiscal 2005. Focusing primarily on our targeted vertical markets of financial services and government, we continued to gain traction in marketing and licensing the capabilities of our Adobe LiveCycle server products. In addition, we made progress with integration of our document generation technologies with other software vendors' platforms, such as those from SAP AG and EMC. As a result, we began generating revenue based on the inclusion of our technologies within their platforms.

OEM Postscript and Other Business Summary

In fiscal 2005, graphics professionals and professional publishers continued to rely on our Postscript technology to meet their sophisticated printing requirements. OEM Postscript revenue, generated by licensing our technology to OEMs that manufacture printers and other output devices, decreased slightly in fiscal 2005 when compared to fiscal 2004. This performance was consistent with our expectations, due to the mature nature of this market.

Fiscal 2006 Business Segments, Products and Market Opportunities

This section provides an overview of our new principal business reporting segments that we began using at the beginning of fiscal year 2006. For each segment, a discussion of the market opportunities, our strategies and our products is provided.

Creative Solutions Business Segment

Creative Solutions Market Opportunity

Our Creative Solutions business unit focuses primarily on the needs of the creative customer. This new segment combines most of the products of our prior Creative Professional and Digital Imaging and Video business units, along with the creative professional-focused products and solutions that we obtained through our acquisition of Macromedia.

Over the past twenty years, our core customers have been creative professionals. Graphic designers, production artists, Web designers, user interface designers, technical writers, videographers, photographers and prepress professionals who use and rely on Adobe's solutions for professional publishing, Web design, professional photography, video production, animation and motion graphic production, and printing visually rich information. Our software tools are used by creative professionals to create printed and on-line information people see and read every day, including newspapers, magazines, Web sites, catalogs, advertisements, brochures, product documentation, books, memos, reports and banners. Our tools are also used to create and enhance visually rich content, including video, animation and mobile content, that is created by multimedia, film, television, audio and video producers who work in advertising, Web design, music, entertainment, corporate and marketing communications, product design, user interface design, sales training, printing, architecture, and fine arts.

As technology continues to improve, the market dynamics for these creative professionals continue to evolve. Due to the ever changing ways in which people choose to receive information, creative professionals look to their software tools as a means to make their information impactful and repurpose content across a variety of media and applications. They desire greater efficiency from the software they use to streamline their publishing and content creation workflows and to effectively manage their assets. They also look for new and innovative ways to deliver their content and information to hand-held devices such as mobile handsets and consumer electronic devices.

Adobe's brand and customer loyalty in this market continues to be strong. Creative professional customers license upgrade and new units of our Creative Solutions products due to the high degree of innovative new features and significant productivity gained through their use. In addition, business users at work and hobbyists at home purchase our Creative Solutions products because they desire professional-quality products to accomplish tasks such as creating visually-rich sales presentations, real estate flyers, school year books, photo albums, community newsletters, as well as animations and videos that can be shared or be viewed from Web sites.

The businesses of creative professionals are sensitive to the economy as they derive their revenue mainly from corporate marketing, product marketing and ad spending in corporations. In difficult economic times, corporations tend to reduce marketing spending and the businesses of creative professionals often may decline. Conversely, in an environment where the economy is stable or improving, corporations tend to increase their marketing spending, which leads to stable or improved business conditions for creative professionals. Thus, depending on economic conditions and the status of their businesses, these users adjust their spending on items such as hardware and software, and the staffing levels within their company. Due to this correlation, our Creative Solutions opportunity is closely linked to the performance of the economy in each of the countries we do business.

With the increasing use of the Web as a means for marketing and advertising, we believe a key driver of our Creative Solutions business will also be the growing amount of Web site and mobile device content

created by our customers to deliver impactful and compelling Web-based experiences for their constituents.

Another driver of our Creative Solutions business is the growth in the use of digital devices such as digital cameras, digital video cameras, multimedia-enabled computers, DVD players, scanners, Web-capable image and video-enabled handheld devices, cellular phones, and other non-PC Internet-connected devices. In addition, Internet broadband adoption makes the Web a viable platform for the delivery of rich media, especially digital video. In turn, the growth in the use of high definition ("HD") televisions and video is driving the need for HD-enhanced video tools to produce HD content for movies, and cable and commercial television.

As the use of digital photography and digital videography grows, we believe creative professionals and professional photographers throughout the world will continue to require software solutions to edit, enhance and manage their digital photographs and digital videos. In addition, we believe video professionals are upgrading their systems to support HD video content creation, enhancement and delivery. We also believe hobbyists will use, with more frequency, digital imaging and digital video software as they purchase more affordable digital SLR cameras and digital video cameras.

In fiscal 2006, our Creative Solutions strategy focuses on driving revenue growth and increasing market share of our products through the continued delivery of comprehensive software platforms that meet the evolving needs of our customers. Initially, we have released software bundles that combine our existing Creative Suite products with various Macromedia products to creative professional customers who desire these applications in one affordable package. Over the course of fiscal 2006 and beyond, we will focus on developing improved integration of our Creative Solutions products to enhance product functionality and to enable more efficient collaboration and workflow.

In addition, the creation and enhancement of digital video and motion graphics by creative professionals, and opportunities for the creation, workflow, and delivery of this type of content to mobile and other non-PC related devices, represent an emerging opportunity we intend to address as part of our Creative Solution offerings.

We believe that, while many customers have made or will make the switch to our Creative Suite and/or our Studio products from individual applications over time, there continues to exist an opportunity of upgrading existing individual application users to newer versions of these individual applications. In addition, we will market the benefits of newer versions of the Creative Suite and Studio products to existing Creative Suite and Studio users to drive Creative Suite-to-Creative Suite and Studio-to-Studio upgrades. We also will market the features of these products to new users of creative applications—those who aspire to be creative professionals, or those at home or at work who wish to use the professional-level capabilities of our solutions, but are not trained creative professionals.

We plan to continue to enhance our Photoshop product offerings to meet the evolving needs of professional photographers and creative professional customers, including graphic designers, Web designers, video producers and imaging enthusiasts to drive upgrades and new user adoption. We also plan to improve integrated digital photography workflows by expanding our digital imaging platform to include Adobe Lightroom, a new product designed for professional photographers. In addition, as we have seen during the past two fiscal years, we believe many customers will continue to license Photoshop capabilities via our Creative Suite products as opposed to licensing the standalone version.

For the digital imaging hobbyist, we plan to continue to enhance our Photoshop Elements product and partner with other digital imaging vendors to deliver integrated photo services. With our strong brand in digital imaging, we hope to attract additional digital camera users and migrate them from the low-end and free imaging software they use to our more advanced Photoshop product offerings.

With our set of professional digital video and motion graphic products, we strive to provide the strongest, market-leading digital video, motion graphic and animation authoring platform for our

customers. To grow this business, we will continue to market the benefits of this platform to creative professionals and videographers in the film, broadcast, corporate and event videography market segments, and we are working with partners to deliver integrated video systems. With broad adoption of Macromedia Flash Player and its high-quality video playback features, we will work to provide a seamless video authoring-to-playback capability for those wishing to provide a rich video experience on the Web. In addition, as the number of hobbyists desiring easy-to-use video editing solutions grows, we intend to enhance the video editing and DVD creation capabilities of our Adobe Premiere Elements product for the sharing of digital video memories.

Creative Solutions Products

Adobe After Effects—professional software used to create sophisticated animation, motion graphics and visual effects found in television broadcast, film, DVD authoring and the Web; available in two versions: After Effects Standard provides basic 2D and 3D compositing, animation and visual effects tools; After Effects Professional adds advanced features such as motion tracking and stabilization, advanced keying and warping tools, more than 30 additional visual effects, and additional audio effects.

Adobe Audition—a professional audio editing environment designed for demanding audio and video professionals; provides advanced audio mixing, editing and effects processing capabilities.

Adobe Creative Suite Premium Edition—an integrated software solution that creative professionals can use as a platform to modify and enhance digital images, create graphics, produce professional-quality printed publications, create and maintain dynamic Web sites, author visually rich content for wireless Web devices, and share content reliably for print and screen display. The suite combines Adobe Acrobat Professional, Adobe GoLive, Adobe Illustrator, Adobe InDesign and Adobe Photoshop technologies with file management and integration technology called Version Cue and a new navigational control center called Adobe Bridge.

Adobe Creative Suite Standard Edition—an integrated software solution that creative professionals can use as a platform to modify and enhance digital images, create graphics, and produce professional-quality printed publications. The suite combines Adobe Illustrator, Adobe InDesign and Adobe Photoshop technologies with file management and integration technology called Version Cue and a new navigational control center called Adobe Bridge.

Adobe Encore DVD—a professional DVD authoring and creation software; provides a comprehensive set of design tools and integration with other Adobe software to create a streamlined DVD creation workflow; provides ability to output projects to recordable DVD formats, ensuring a wide degree of playback compatibility.

Adobe GoLive—Web design and publishing software that provides innovative tools that Web authors use to design, layout, produce and maintain content for Web sites and wireless Web devices without the need for complex multimedia programming.

Adobe Graphics Server—imaging server software used to create and maintain digital graphics and images on frequently updated data-driven content, such as Web sites and printed catalogs, by automating the creation and the reuse of images; integrates with content management and e-commerce systems to automate workflows, and eliminates the tedious manual tasks of refining and reformatting images for specific purposes.

Adobe Illustrator—a vector-based illustration design tool used to create compelling graphic artwork for print publications and the Web.

Adobe InCopy—an editorial tool for collaboration between writers, editors and copy-fitters; Adobe InCopy is a companion to Adobe InDesign.

Adobe InDesign—a page-layout application for publishing professionals; based on an open, object-oriented architecture it enables Adobe and its industry partners to deliver powerful publishing solutions for magazine, newspaper and other publishing applications.

Adobe Lightroom—new, innovative, pre-release beta version software that addresses the unique photography workflow needs of professional photographers; enables users to easily import, develop, enhance, and showcase large volumes of digital images.

Adobe Photoshop—provides photo design, enhancement and editing capabilities for print, the Web, and multi-media; used by graphic designers, professional photographers, Web designers, professional publishers and video professionals, as well as amateur photographers and digital imaging hobbyists.

Adobe Photoshop Album—offers easy-to-use interface to find, organize, share and edit digital photographs; designed for consumers to manage their collections of digital photographs, easily share photos via e-mail and the Web, create digital slide shows and photo albums, and get their photographs printed via on-line photo finishing services.

Adobe Photoshop Album Starter Edition—a limited-feature version of Photoshop Album available for free; lets consumers find photos fast, fix common flaws and easily share images with others.

Adobe Photoshop Elements—offers powerful yet easy-to-use photo editing functionality plus intuitive organizing, printing and sharing capabilities for amateur photographers and hobbyists who want to create professional-quality images for print and the Web.

Adobe Premiere Elements—a new, powerful yet easy-to-use video-editing software for home video editing; provides tools for hobbyists to quickly edit and enhance video footage with fun effects and transitions, and create custom DVDs for sharing video with friends and family.

Adobe Premiere Pro—professional digital video-editing software used to create broadcast-quality content for video, film, DVD, multimedia and streaming over the Web.

Adobe Production Studio Premium Edition—a new suite of integrated application products that provides a complete digital video post-production environment and allows users to produce professional-quality video, film and DVDs; includes Adobe After Effects Professional Edition, Adobe Audition, Adobe Encore DVD, Adobe Illustrator, Adobe Photoshop, and Adobe Premiere Pro, along with Creative Suite 2 features for timesaving workflow features such as Adobe Dynamic Link and Adobe Bridge.

Adobe Production Studio Standard Edition—a new suite of integrated application products that provides a digital video post-production environment and allows users to produce professional-quality video; includes Adobe After Effects Standard Edition, Adobe Photoshop, and Adobe Premiere Pro, along with Creative Suite 2 features for timesaving workflow features such as Adobe Dynamic Link and Adobe Bridge.

Macromedia Dreamweaver—a professional software development application used by designers and developers to create a broad range of Web solutions for publishing online commerce, customer service and online educational content; includes capabilities for visually designing HTML pages, coding HTML and application logic and working with application server technologies.

Macromedia Flash Basic—a software development application for creating internet and rich interactive applications which integrate animations, motion graphics, sound, text and video functionality; solutions built with Macromedia Flash are deployed via the Web to browsers and to devices that run the Macromedia Flash Player.

Macromedia Flash Professional—provides an advanced development environment for creating internet applications which integrate animations, motion graphics, sound, text and additional video functionality; solutions built with Macromedia Flash Professional are deployed via the Web to browsers and to devices that run Macromedia Flash Player.

Macromedia Fireworks—a professional graphics design tool for building interactive Web graphics; gives professional designers and developers tools for creating images that can be deployed to Web browsers and the Macromedia Flash Player; integrates with Macromedia Flash and Macromedia Dreamweaver.

Macromedia Studio Professional—an advanced suite of integrated application tools for developers and experienced designers who develop internet and mobile solutions, and require additional video capabilities when developing Flash content; includes Macromedia Dreamweaver, Macromedia Flash Professional, Macromedia Fireworks, Macromedia Contribute and Macromedia Flash Player.

Knowledge Worker Solutions Business Segment

Knowledge Worker Solutions Market Opportunity

Our Knowledge Worker Solutions Business Unit focuses on the needs of the knowledge worker customer, who we define as someone focused on creating and disseminating information as part of their job on a regular basis. Knowledge workers include a wide variety of job functions such as accountants, administrative assistants, architects, educators, graphic designers, insurance underwriters, software developers and stock brokers. These jobs typically require the sharing of information, either in an information dissemination (one-way) format, or in a collaborative (multi-way) format.

Knowledge workers must create information and content from a variety of applications, and be able to exchange this information within a reliable and ubiquitous format that ensures coworkers and constituents can reliably and securely access the information. When appropriate, this information often needs to be protected or securely managed.

Collaboration among knowledge workers can occur through face-to-face meetings, via phone calls, through e-mail, or through Web conferencing technologies. Knowledge workers that participate in collaborations with their colleagues may be located in offices next door to each other, or in different parts of the world. These team members may change with every project and either be part of an organization's employee base, or, be a consultant or third party partner.

Adobe Knowledge Worker Solutions enable knowledge workers to effectively and more securely engage, communicate and collaborate within their local and extended workgroups. They can collaborate and efficiently manage feedback from their colleagues in both real time and on-demand, and control how, when and by whom information is accessed.

Our Acrobat family of products provides for the reliable creation and exchange of electronic documents, regardless of platform or application source type. Users can collaborate on documents with electronic comments and tailor the security of a file in order to distribute reliable Adobe PDF documents.

We offer three versions of Acrobat to meet the needs of our customers:

- Acrobat Elements—a low-cost version of Acrobat that contains Adobe PDF creation features targeted for enterprise knowledge workers. It provides easy, one-button Adobe PDF creation from Microsoft Office applications such as Excel, Word and Outlook, allowing knowledge workers to reliably share electronic documents within and outside the walls of their organization.
- Acrobat Standard—targets business professionals with its Adobe PDF creation, collaboration, and digital signature features. Workgroups and entire enterprises can utilize Acrobat Standard to implement electronic document workflow solutions that improve business processes.
- Acrobat Professional—contains expert features targeted for customers such as creative professionals, print service personnel, IT personnel, engineers, architects and other similar users. They use Acrobat Professional for advanced capabilities such as complex electronic document creation from multiple source formats, pre-flighting of documents that are to be professionally

printed, color separation preview and output, electronic form creation, and one-button PDF creation from software applications such as AutoCAD, Visio and Microsoft Project. Acrobat Professional also contains all of the features found in Acrobat Standard.

In addition, from our Web site we offer a "Create Adobe PDF Online" subscription service which provides knowledge workers with an easy way to create Adobe PDF documents without having to buy the desktop application.

Our Breeze product line leverages the installation of Macromedia Flash Player on more than 98% of the internet-connected PCs in the world and allows for knowledge workers to meet, present and train online in a live format, or through on-demand, rich-media presentations which can be experienced at any time. It provides capabilities via the Flash Player for live Web conferencing, as well as on-demand rich presentations. We believe the use of Breeze increases the reach, effectiveness and usability of online communications at lower cost. Leveraging existing infrastructure, users of Breeze can control Web communication costs across their enterprise. Our business model allows for Breeze to be licensed as a server product and as a hosted service.

In fiscal 2006, we plan to continue to market the benefits of our Knowledge Worker Solutions to small and medium-sized businesses, large enterprises, and government institutions around the world. With our Acrobat family of products, we intend to continue to increase our seat penetration in these markets. We also intend to increase our focus on vertical markets such as education, financial services, manufacturing, and the architecture, engineering, and construction markets. To address the needs of the manufacturing market, we have launched a new version of Acrobat called Acrobat 3D, which contains capabilities which enable document-based collaboration between extended teams of designers and engineers. With our Breeze product line, we intend to increase awareness of our solution in targeted horizontal markets such as training and marketing, as well as targeted vertical markets such as manufacturing, financial services and telecommunications. Finally, during the course of fiscal 2006, we intend to market the benefits of how our Acrobat and Breeze solutions can be used together to meet the synchronous and asynchronous collaboration needs in the marketplace.

Knowledge Worker Solutions Products

Adobe Acrobat 3D—enables collaboration between extended teams of designers and engineers to more securely and reliably communicate, visualize, and document architectural and manufacturing designs using 3D data; allows users to insert and publish 3D designs from major CAD applications in Adobe PDF documents that can easily be shared with suppliers, partners, and customers using the free Adobe Reader software.

Adobe Acrobat Elements—desktop software that enables enterprises to extend the value of their Microsoft Office investment by standardizing on Adobe PDF for reliable document distribution; provides for the easy conversion of Microsoft Office documents to Adobe PDF, preserving document integrity for reliable viewing and printing on other operating systems and hardware platforms inside and outside the enterprise's IT firewall.

Adobe Acrobat Messenger—software that works with a scanner or digital copier and is designed for workgroups and departments to transform paper documents into electronic Adobe PDF files and deliver them via e-mail, Web, or fax; allows users to preview their documents on-screen, crop or rotate pages, and add electronic annotations.

Adobe Acrobat Standard—creates secure, reliable and compact Adobe PDF files from desktop authoring applications such as Microsoft Office software, graphics applications and more. Supports automated collaborative workflows with a rich set of commenting tools and review tracking features; includes everything needed to create and distribute rich electronic documents that can be viewed easily within leading Web browsers or on computer desktops via the free Adobe Reader.

Adobe Acrobat Professional—in addition to all the capabilities of Acrobat Standard, Acrobat Professional delivers specialized capabilities for creative professional and engineering users, such as pre-flighting, color separation and measuring tools.

Create PDF Online—a Web-based subscription service that provides for the easy conversion of Microsoft Office documents and other application files to Adobe PDF for the secure and reliable sharing of rich electronic documents that can be viewed easily within leading Web browsers or on computer desktops via the free Adobe Reader.

Macromedia Breeze—a rich Web-based communication system which enables organizations to deliver online training, marketing, sales and Web conferencing solutions which are instantly accessible by customers, partners and employees using Macromedia Flash content; consists of a core Breeze Server and modules that provide specific application functionality, including Breeze Training and Breeze Meeting; can be deployed with either some or all of these components together; Breeze Training allows organizations to build a complete online training system with Microsoft PowerPoint presentations that include surveys, analysis, course administration and content management; Breeze Meeting allows users to meet instantly with colleagues in virtual online meetings, to provide seminar and training sessions as well as to conduct business presentations through the Web.

Macromedia Flash Media Server—offers streaming media capabilities and a flexible development environment for creating and delivering interactive media applications; utilized as part of our Breeze solution.

Mobile and Device Solutions Business Segment

Mobile and Device Solutions Market Opportunity

As hundreds of millions of people around the world adopt cellular phones, consumer devices such as digital cameras and electronic educational toys, and internet-connected hand-held devices as a means to communicate, collaborate and entertain, we believe a significant opportunity exists to offer solutions for these devices which provide for the creation and delivery of rich content, user interfaces, and data services which allow users to engage with information more easily and effectively.

Our strategy in addressing the Mobile and Device Solutions market is to license Macromedia Flash Player and Adobe Reader technology to device manufacturers and telecommunications carriers that embed our technology on their platforms, enabling them to provide multimedia content, documents and services to their customers. As Flash Player and Adobe Reader technology penetrates digital devices and platforms, millions of developers will be able to use our content creation products to create engaging consumer content and rich mobile business applications.

To support the delivery of content and services in these millions of devices, we offer client-server solutions which leverage the broad deployment of our Flash Player and Adobe Reader technologies. FlashCast, the first of these service delivery solutions, consists of client software built upon Macromedia Flash Lite runtime technology, as well as server technology that manages the content being delivered to the mobile phone. Just as other Adobe solutions such as Breeze are built upon the Adobe Engagement Platform, we see market opportunities to bring similar solutions to the mobile and device ecosystems.

In fiscal 2006, we intend to continue to grow the use of our Mobile and Device Solutions in these emerging markets. We plan to work closely with mobile device manufacturers, telecommunications carriers, and news and entertainment organizations to have them embed our technology on their platforms, enabling them to provide multimedia content and deliver Flash-based information to their customers. In addition, we plan to offer solutions to these customers that include a mobile device version of the Adobe Reader called Adobe Reader LE which will provide the ability for viewing of, and interaction with, PDF-based content.

Mobile and Device Solutions Products

Adobe Reader LE—a version of the Adobe Reader specifically developed for mobile phones that renders PDF documents on small-sized devices.

Macromedia Flash Lite—a version of the Macromedia Flash player specifically developed for mobile phones and other consumer electronic devices; designed to require fewer device resources and can therefore operate on many devices from feature phones to TVs and digital video recorders.

Macromedia Flash SDK—a software development kit specifically developed for bringing Flash-based content to consumer electronic devices; designed to require fewer device resources and can therefore operate on many devices from game devices to TVs and digital video recorders.

Macromedia FlashCast—an end-to-end, client-server solution that is designed to effectively create, deliver and use rich data services which are viewed as “channels” of information on mobile handsets; consists of the FlashCast client software which is embedded on mobile devices such as cellular phones and is built based on the Flash Lite runtime engine, and FlashCast server software which manages subscriber accounts, aggregates and delivers FlashCast channel updates to subscribers, and generates billing transactions for fulfillment.

Enterprise and Developer Solutions Business Segment

Enterprise and Developer Solutions Opportunity

Enterprises are under increasing pressure to save money, offer improved customer service, adhere to regulatory requirements and leverage existing investments in core systems. As a means to address these issues, a critical component of an organization’s business processes is the need to interact with data stored in enterprise applications. As this need expands beyond the core users of those applications, adapting systems to accommodate a diverse group of users has become an expensive and time-consuming endeavor. The outcome is a proliferation of manual workarounds that result in process inefficiencies, delays and poor quality of information.

In addition, enterprises have built Web applications which enjoy the reach of the Web but often fail to deliver a user interface with the ease of use and richness that users expect. This impedes utilization of these applications and increases training costs, reducing the overall return on investment (“ROI”) that enterprises expect. Organizations are now looking to Rich Internet Applications (“RIA”) to boost their ROI for these Web applications by combining a rich graphical application interface with the universal reach of the Web.

We believe significant opportunities exist to help enterprises address these issues by making their business processes more efficient and their Web applications more engaging. To address these opportunities, we offer Adobe Enterprise and Developer Solutions to securely extend the reach of information, processes and services to engage with customers and constituents. Our solutions leverage our Adobe Engagement Platform, which provides a development platform for delivering applications that dramatically improve how businesses engage with people, processes and information.

Adobe’s Engagement Platform utilizes our universal Adobe Reader and Macromedia Flash Player software, which ensure reliable, secure and rich application experiences across browsers, desktops and devices. The Adobe Engagement Platform provides developers with an RIA programming model to integrate and optimize workflows, and a server software framework to simplify integration and leverage existing enterprise infrastructures. We also offer services and other software components to accelerate the creation of compelling, relevant and actionable applications, either through RIAs or through intelligent documents.

We believe our Adobe Engagement Platform revolutionizes how enterprises and government agencies present, deliver, consume and interact with information and content. By providing an integrated client-

server framework and toolset for developers, designers and IT organizations, we believe our Enterprise and Developer Solutions allow our customers to:

- Engage their constituents with compelling experiences and intelligent documents—providing them with the ability to act upon information or tasks presented to them for improved and effective collaboration;
- Streamline and accelerate document-based processes so more work gets done;
- Simplify the creation and deployment of compelling, relevant and actionable applications;
- Augment existing enterprise infrastructures to deliver the next level of engagement with their stakeholders;
- Scale these solutions needs regardless of the size of their constituent populations; and
- Leverage the ubiquitous Adobe Reader and Macromedia Flash Player clients to reach people inside and outside of their organizations, and across all desktops and devices.

Although our Enterprise and Developer Solutions address the needs of a diverse set of enterprise customers, we focus primarily on key vertical industries such as financial services, telecommunications, media and publishing, education, manufacturing, government and life sciences. For these customers, we offer comprehensive, scalable, secure and reliable server products and tools to develop applications tailored to their specific information and business process requirements.

Our Enterprise and Developer Solutions currently offer several families of products that we market to these customers:

- Adobe LiveCycle—provides document services to automate paper-based processes, leveraging the ubiquitous Adobe Reader for viewing, printing and interaction with information provided in Adobe PDF-based documents;
- Macromedia ColdFusion MX—provides a server-scripting environment and a set of features used by organizations for building database-driven applications that are accessible through Web browsers and the Macromedia Flash Player; and
- Macromedia Flex—provides a standards-based programming framework for building and deploying enterprise-class RIAs; an Eclipse-based Integrated Development Environment (IDE); and a powerful set of server-side services for connecting with Enterprise infrastructure.

These solution sets are built on a common server architecture based on J2EE and XML, allowing for easy integration into enterprise infrastructures.

Our Macromedia Flex solutions utilize the Flash file format and leverage our widely-used Flash Player technology. With Flex, enterprise-class applications are able to combine the rich user interface of desktop software with the reach and ease of deployment of the Web, and the processing power of desktop computers and mobile devices. This combination enables the delivery of more complex interactions than are currently supported by the Web browser model. Flex applications extend the server-based object model to client systems, improving interactivity by eliminating the constant page refreshes and context switches that users frequently experience. As a result, Flex applications enable organizations to provide users with a dramatically improved experience that supports the manipulation of data and information in ways that are impractical in a traditional browser-based environment.

Sample uses of Macromedia Flex applications to build RIAs include the following:

- Guided selling—Macromedia Flex can aid the design and development of product-oriented applications, such as configurators, selectors, comparison engines and shopping carts. Such applications can provide customers with an integrated experience from initial inquiry to final

purchase. By reducing customer search time and leading customers directly to the items they want, guided selling can increase conversion rates, drive larger sales and reduce shopping cart abandonment;

- Data dashboards—Macromedia Flex can provide charting, graphing and drill-down capabilities that make it easy to consolidate data from disparate systems without slow page refreshes. Businesses can benefit from faster decision cycles and improved access to information; and
- Process and data integration—With Flex, businesses can consolidate data and information, and align processes to meet the unique needs of internal and external users. Automated process and data integration can increase accuracy, improve efficiency and enhance customer service through faster response times.

To build and deliver enterprise-class RIAs, the following components are required:

- Macromedia Flex Presentation Server—Our Flex Presentation Server is an application that acts as the application and services intermediary between Flex applications and the existing enterprise environment. The Flex Presentation Server easily integrates with existing enterprise application servers, and leverages existing resources and policies for functions such as deployment, session management and security;
- Industry-standard IDE—Flex applications can be built and tested using Macromedia Flex Builder or a third-party IDE such as Borland JBuilder, Microsoft Visual Studio and others; and
- Macromedia Flash client—The ubiquitous Macromedia Flash client runtime application provides the user interface to Flex applications.

Our Adobe LiveCycle solutions utilize Adobe PDF documents which interact with core business applications and integrate information contained in those documents into business processes. In addition to being reliable electronic replicas, Adobe PDF documents are “intelligent”—they retain the best characteristics of paper documents, such as a familiar look, but add powerful business logic capabilities such as data validation and automated routing instructions. In addition, arbitrary data (including XML-based data) can be embedded inside of intelligent PDF documents for use or access later on in a business process. These features allow for more efficient interaction with enterprise applications while still providing the ability for people to manually access and interact with the data when necessary.

Our LiveCycle products leverage our Adobe Reader software—with more than 500 million distributed copies of Adobe Reader, we have created a ubiquitous platform for accessing and interacting with intelligent documents. Adobe Reader is available on the most common operating system platforms free of charge, including Microsoft Windows, Apple Macintosh, Linux, various Unix-based platforms, and portable device systems such as Palm OS, Pocket PC and the Symbian operating system for cellular phones. As a universal client, Adobe Reader enables users inside and outside the firewall to interact with intelligent PDF documents on most platforms, including desktops, laptops, PDAs, mobile phones and kiosks, regardless of the application used to author the document.

To address the specific needs of our customers, we offer “document services.” Document services are sets of technologies that create, integrate and manage intelligent documents, and leverage the use of our Adobe Reader software for our customers’ constituents to interact with data within the document. Document services that we currently provide include:

- Document generation—enables users to generate high-quality documents in real time and via batch processes. This can be done from desktop applications or dynamically from core systems. These products and solutions dynamically generate personalized, customer-facing documents from enterprise applications for enhanced customer communications;

- Document process management—products and solutions which allow organizations to automate form-based workflows deploying intelligent data capture systems and rules-based process management to automate business transactions;
- Document collaboration—products and solutions to streamline collaborative processes securely among users, with a goal to accelerate review cycles and reduce costs; and
- Document control and security—products and solutions to control document access and usage, enable the use of digital signatures as a replacement for paper and pen-based signatures and certify document authenticity.

Our ColdFusion products provide fast and easy ways to build and deploy powerful Internet applications. Developers can extend or integrate ColdFusion with Java or .NET applications, connect to enterprise data and applications, create and interact via Web services, or interface with SMS on mobile devices or Instant messaging clients. ColdFusion can also be used for business reporting, rich-forms generation, printable document generation, full-text search, and graphing and charting—enabling customers to more fully engage their constituents with better Web experiences.

Enterprise and Developer Solutions Products

Adobe Acrobat Capture—enables conversion of legacy paper-based documents into indexed, searchable, platform-independent electronic PDF files for archiving and distribution purposes.

Adobe Acrobat Distiller Server—a server-based software application that provides workgroups with a centralized solution for converting PostScript files to Adobe PDF files over a network; gives IT and creative professionals the power of increased productivity and the assurance of consistent, high-quality output.

Adobe Acrobat Elements Server—a server-based software application that enables organizations to centrally deploy and manage Adobe PDF creation capabilities across the enterprise; flexible, server-based deployment options, combined with a Web services Application Programming Interface (“API”), make it easy to integrate Adobe PDF generation into document-based business processes and existing enterprise applications.

Adobe Central Pro Output Server—a server-based software application for document generation that allows organizations to create personalized, customer-facing documents from any data source—including legacy, line-of-business, ERP, or CRM applications; merges data with an electronic document template using a powerful processing engine to dynamically generate electronic documents such as purchase orders, invoices, statements and checks for delivery via Adobe PDF, the Web, e-mail, fax, or print; works with Adobe Output Designer, which is a companion tool used to create sophisticated document templates.

Adobe Document Server—a server-based software application for the creation, manipulation and assembly of customized Adobe PDF documents; XML-based data can be inserted into templates to create complex, content-rich documents for more targeted and effective customer communications; integrates with leading enterprise applications as well as custom systems.

Adobe LiveCycle Designer—a desktop software application which simplifies the creation and maintenance of intelligent XML form templates for deployment as Adobe PDF forms or HTML applications; provides an intuitive, graphical design tool for creating XML templates that look exactly as the author intended, and previewing them before deployment. It also simplifies adding intelligence to documents, such as calculations and validations, and binding form fields to arbitrary XML schemes for seamless integration with enterprise applications.

Adobe Output Designer—a design tool that allows users to create electronic document templates for use with Adobe solutions for document generation; aids in the creation of electronic documents that exactly replicate existing paper documents.

Adobe LiveCycle Form Manager—a server-based software application which simplifies form management and increases user satisfaction by centralizing the management of all forms, regardless of file type, into a single point of access via a Web-based portal; allows administrators to manage form publication, version control and user access, as well as establish ebXML relationships with business partners and customers inside and outside the enterprise.

Adobe LiveCycle Forms—offers a range of solutions for deploying intelligent forms that can be completed online or offline, across diverse platforms and devices; identifies a user's environment to deliver the richest form-filling capabilities supported and integrates with enterprise applications to pre-populate form fields, save captured data, and initiate data-driven workflows.

Adobe LiveCycle Barcoded Forms—enables organizations to accurately capture user-supplied information from fill-and-print paper forms by using dynamic 2D barcodes; barcodes are initially set up through creation of the form with Adobe's Designer application; after the form is printed, signed and returned by users of the form, the barcode on the form is scanned and decoded, and form data obtained from the barcode is routed to the appropriate enterprise application through Adobe's LiveCycle server products.

Adobe LiveCycle Document Security Server—a server-based software application that helps organizations automate the processing of electronic documents by providing batch-based capabilities to digitally sign and certify PDF files, validate digital signatures, and encrypt/decrypt PDF documents; safeguards information when it leaves a company's network and integrates with existing public key infrastructures.

Adobe LiveCycle Policy Server—a server-based software application that helps organizations manage information access securely with dynamic, persistent document control; allows for the control and monitoring of electronic document usage inside or outside the firewall, online or offline, and across multiple document platforms; lets organizations know when a document has been viewed, printed, or altered, and restricts access so that only intended recipients can open, use and forward a document; allows for previously granted document permissions and access to be revoked; leverages Adobe Acrobat and Adobe Reader software to author and view protected documents.

Adobe LiveCycle Reader Extensions Server—a server-based software application which lets enterprises easily create and share interactive PDF files with external parties who must interact with these documents—without requiring recipients of the documents to acquire Acrobat software that normally would be necessary to interact with the PDF files they receive. On an individual PDF document, it unlocks features so that when such a file is opened in the free Adobe Reader, users have access to functionality that normally would not be available in Adobe Reader. Examples of document collaboration features that can be enabled in Adobe Reader by this server product include the use of digital signatures to electronically sign PDF documents, the ability to provide comments by using electronic sticky notes and other collaborative mark-up tools, the capability to save the document and the ability to fill-in form information.

Adobe LiveCycle Workflow Server—a server-based workflow application that allows for the design, deployment and management of forms-based business processes to improve organizational agility and productivity; uses a rules-and roles-based design tool that defines business rules a process must follow, as well as the roles of each individual involved in the process.

Adobe Output Pak for mySAP.com—an SAP-certified server-based software application for document generation that enables organizations to optimize their investment in their SAP solution by creating personalized, professional-looking, customer-facing documents; provides an easy, fast, and cost-effective way to create and maintain documents for the SAP environment; integrates directly with an SAP system to extract information which is merged with a document template that defines the layout and formatting of the document; output can be in a variety of formats, including Adobe PDF, print, fax, e-mail and the Web.

Adobe Output Pak for Oracle e-Business Suite—a server-based software application for document generation; expands the scope of the Oracle E-Business Suite by allowing customers to easily create, maintain and integrate high-quality, professional-looking electronic documents with their Oracle business processes in an easy, fast and cost-effective way; integrates directly with Oracle Reports to extract XML data from other applications which is then merged with a document template that defines the layout and formatting of the document output; used to dynamically generate documents such as purchase orders, invoices, statements and checks which can then be delivered via Adobe PDF, print, fax, e-mail and the Web.

Adobe Web Output Pak—a server-based software application for document generation; creates documents in PDF and HTML for presentation on the Web, and in Wireless Markup Language (“WML”) for presentation to a wireless device; allows users to personalize and control the look of documents based on the data the documents contain.

Macromedia ColdFusion MX—provides a server-scripting environment and a set of features used by organizations for building database-driven scalable applications that are accessible through Web browsers and the Macromedia Flash Player; built on an open Java technology architecture and can be deployed on third-party Java application servers that support the J2EE specification.

Macromedia Flex—provides a solution for enterprise programmers that build and deploy enterprise class RIAs and leverage Adobe’s widely used Flash Player technology. The Flex Product line includes the Flex Framework and compiler; Flex Builder, an Eclipse based IDE for designing, coding, debugging and deploying Flex applications; and Flex Enterprise Services, a powerful server for connecting Flex applications to enterprise infrastructure, including Web services, remote Java objects and real-time data and messaging systems.

Macromedia Flex Builder—bundled with Flex, Flex Builder is a new tool that can be used by designers and enterprise developers for visually architecting and developing RIAs; tightly integrated with Flex, Flex Builder provides features for quickly prototyping, coding, debugging and deploying Flash-based RIAs.

Other Business Segment

Our Other Business Segment contains several of our products and services which address market opportunities ranging from the diverse publishing needs of technical and business publishing, to our legacy type and OEM printing businesses, to new strategic opportunities such as OEM revenue generated from our desktop Adobe Engagement Platform—which includes the ubiquitous Adobe Reader and Macromedia Flash Player clients. These opportunities, and the products we offer to address them, are reviewed below in the following categories: Platform, OEM PostScript, and Print and Classic Publishing.

Platform Opportunities

As previously discussed, central to our long term strategy is the creation of an Adobe Engagement Platform which provides a development platform for delivering applications that dramatically improve how businesses engage with people, processes and information. Today, our new Platform Business Unit focuses on the development and delivery of this Adobe Engagement Platform, utilizing our universal Adobe Reader and Macromedia Flash Player software. These solutions will ensure reliable, secure and rich application experiences across browsers, operating systems and devices.

Based on how these solutions allow enterprises and government agencies to present, deliver, consume and interact with information and content, there exists an opportunity to monetize the use of our Reader and Flash Player software. While typically provided for free, the widely used nature of both desktop applications has created new opportunities with partners whereby we can generate revenue based on the deployment of partner technology as part of our Adobe Engagement Platform products.

In fiscal 2006, we will continue to explore monetization opportunities for our Adobe Engagement Platform solutions, as well as focus on the long-term strategic goal of providing a single ubiquitous Adobe Engagement Platform solution that combines Adobe Reader and Flash Player capabilities.

Platform Products

Adobe Reader—software for reliable reviewing and printing of Adobe PDF files on a variety of hardware and operating system platforms; when used with certain Adobe PDF files created with Adobe LiveCycle Reader Extensions Server or Adobe Acrobat 7.0 Professional, Adobe Reader also can be used to enable collaborative workflows through the addition of collaboration features built into the Adobe PDF file; these features include review and markup tools that normally are not present in the standard Adobe Reader product.

Macromedia Flash Player—the most widely distributed rich client software on PCs and consumer electronic devices, the Flash Player provides a runtime environment for text, graphics, animations, sound, video, application forms and two-way communications.

Macromedia Shockwave Player—a rich media player used for deploying multimedia content for use in internet solutions including education, training, games and commerce.

OEM PostScript Opportunities

Graphics professionals and professional publishers require quality, reliability and efficiency in production printing, and we believe our printing technology provides advanced functionality to meet the sophisticated requirements of this marketplace. As high-end printing systems evolve and transition to fully digital, composite workflows, we believe we are uniquely positioned to be a supplier of software and technology based on the Adobe PostScript and Adobe PDF standards for use by hardware manufacturers in this industry. We generate revenues by licensing our technology to OEMs that manufacture printers and other output devices.

OEM PostScript Products

Adobe PostScript—a printing and imaging page description language that delivers high quality output, cross-platform compatibility and top performance for graphically-rich printing output from corporate desktop printers to high-end publishing printers; gives users the power to create and print visually rich documents with total precision; licensed to printing equipment manufacturers for integration into their printing products.

Print and Classic Publishing Opportunities

In addition to the market opportunities and our businesses discussed previously, we offer a variety of products and solutions which address many different and unique publishing market needs. Our Print and Classic Publishing Business Unit focuses on these solutions, which address the diverse customer needs in markets such as: business document publishing, CD-ROM publishing, e-learning solutions, on-line help systems, technical document publishing and typography.

Print and Classic Publishing Products

Adobe Font Folio OpenType Edition—contains more than 2,200 typefaces from the Adobe Type Library in OpenType format, offering a complete type solution for print, the Web, digital video or electronic documents.

Adobe FrameMaker—an application for authoring and publishing long, structured, content-rich documents including books, documentation, technical manuals and reports; provides users a way to publish their content to multiple output formats, including print, Adobe PDF, HTML, XML and Microsoft Word.

Adobe PageMaker—software used to create high-quality documents simply and reliably with robust page layout tools, templates and stock art.

Adobe SVG Viewer—a plug-in for Web browsers that allows users to view Web graphics created in Scalable Vector Graphics (“SVG”) format.

Adobe Type Library—includes Adobe’s best-selling typefaces, plus Adobe Type Manager; makes it easy to create beautiful text for print, Web and video projects.

Adobe Type Classics for Learning—a low-cost, introductory font library designed for students and educators.

Adobe Type Manager—available in Light (free) and Deluxe versions; provides powerful, easy management of all PostScript Type 1, OpenType and TrueType fonts.

Adobe Type Sets—various Collection packages of Adobe’s best-selling typefaces; makes it easy to create beautiful text for print, Web and video projects.

Macromedia Authorware—a rich media authoring tool used to develop caption based e-learning on Windows and Macintosh based platforms; use of the product ranges from creating Web-based tutorials to simulations incorporating audio and video; applications developed with Macromedia Authorware can be delivered on the Web, over corporate networks or on CD-ROM.

Macromedia Captivate—enables users to create interactive demonstrations and software simulations in the Flash file format; records users’ actions in any application and instantly creates Flash simulations with visible and audible mouse movements; the small file size and high resolution make Macromedia Captivate simulations and demonstrations easy to publish online or burn onto a CD for use in training, sales, marketing or user support; often used in combination with Macromedia Breeze, Macromedia Captivate provides a robust technology solution to bring understanding and retention to the end users of rapid training and e-learning solutions.

Macromedia Contribute—an easy way to update, add and publish Web content; non-technical business users can make changes to intranet and internet Websites while automatically maintaining site standards for style, layout and code; as a server application, Macromedia Contribute provides a Web publishing system which enables IT professionals to manage and administer users and permissions as part of the Web publishing process; also content providers and Web professionals to save time and streamline the Web-content maintenance process.

Macromedia Director—a tool for creating professional multimedia content that combines images, text, audio and video into presentations and interactive experiences; for Websites, it provides users with the ability to deliver multimedia content that supports three dimensional images and animations for use in various markets, including education, games and commerce; also enables the creation of fixed-media content for CD titles and DVD titles in the entertainment, education and corporate training markets.

Macromedia FreeHand MX—a professional vector graphics tool designers and illustrators use to create high quality images that can be scaled; supports developing images for print, the Web and the Macromedia Flash Player.

Macromedia JRun—an application server based on the J2EE specification; integrates with our development tool offerings and is used to deploy applications for functions such as online banking and customer service.

Macromedia RoboHelp—an authoring tool used by developers and technical writers to create professional help systems and documentation for desktop and Web-based applications; utilizes support for XML, PDF import/export, content management, distributed workforces, team authoring capabilities, as well as JavaHelp.

COMPETITION

The markets for our products are characterized by intense competition, evolving industry standards, rapid software and hardware technology developments, and frequent new product introductions. Our future success will depend on our ability to enhance our existing products, introduce new products on a timely and cost-effective basis, meet changing customer needs, extend our core technology into new applications, and anticipate and respond to emerging standards and other technological changes.

Creative Solutions

In our Creative Solutions segment, we offer the Adobe Creative Suite in two versions, which consist of combinations of several of our technologies. The Adobe Creative Suite Standard Edition combines the capabilities of Adobe InDesign, Adobe Illustrator and Adobe Photoshop, as well as file management and integration technology called Version Cue, and Adobe Bridge which provides a simple interface to easily organize, browse, and locate files. The Adobe Creative Suite Premium Edition adds to this the capabilities of Adobe Acrobat Professional and Adobe GoLive. Similarly, we offer Macromedia Studio, which is a product that combines the capabilities of Macromedia Dreamweaver, Macromedia Flash Professional, Macromedia Fireworks, Macromedia Contribute and Macromedia FlashPaper. We also offer various bundles for customers who desire some of these applications in one affordable package.

Our Creative Solutions products compete with many companies, including Apple Computer, Avid, Corel, Google, Microsoft and Quark, as they increase their presence in the creative software and solutions markets, as well as from Open Source initiatives.

With respect to Microsoft, it announced in September, 2005 a new suite of products, called Expression Studio, scheduled to be released in 2006 and which will compete with our Adobe Creative Suite and Macromedia Studio products and individual Creative Solutions segment products. Expression Studio includes Microsoft Expression Graphic Designer which will compete with our Adobe Photoshop and Adobe Illustrator products; Microsoft Expression Interactive Designer, which will compete with our Macromedia Flash product line; and Microsoft Expression Web Designer, which will compete with our Macromedia Dreamweaver and Adobe GoLive products. Microsoft's new operating system, Windows Vista, which is expected to ship in late 2006, will also include some features in its Presentation Foundation that will compete with Macromedia Flash.

We believe our Adobe Creative Suite products and our Macromedia Studio product compete favorably on the basis of features and functionality, ease of use, product reliability, price and performance characteristics. The individual technologies within the Suite and Studio products also work well together, providing broader functionality and shortened product training time for the individual who uses multiple applications to complete a project.

In addition to our Adobe Creative Suite and Macromedia Studio products, we offer the technologies within them as individual software applications. The competitive nature for these individual Creative Solutions products is discussed below.

Drawing and illustration products are characterized by feature-rich competition, brand awareness and price sensitivity. In addition to competition with Microsoft's Expression Graphic Designer product, our Adobe Illustrator product faces competition from companies such as Autodesk, Corel, Deneba, Mediascape and Xara and the Open Source product called Karbon14. We believe Adobe Illustrator competes favorably due to high awareness of the rich features in our product, especially the drawing and illustration functionalities, the technical capabilities of the product, and our ability to leverage core technologies from our other established products.

The demand for Web page layout and Web content creation tools is constantly evolving and highly volatile. In addition to competition with Microsoft's Expression Interactive Designer and Web Designer products, we believe Macromedia Dreamweaver, Adobe GoLive and Macromedia Flash face direct and indirect competition from desktop software companies such as Bare Bones Software and various proprietary and open source Web authoring tools. We also face competition from Microsoft's Front Page and Visual Studio products, and other integrated development environments that enable developers to create Web applications from companies such as BEA Systems, Borland and IBM. We believe our products compare favorably to these applications; however, our market share may be constrained by Microsoft's ability to target its Web software to users in markets they dominate, including users of Microsoft Office, Microsoft Windows operating system and the Microsoft Internet Explorer Web browser.

The needs of digital imaging and video editing software users are constantly evolving due to rapid technology and hardware advancements in digital cameras, digital video cameras, printers, personal computers, cellular phones and other new devices. Our software offerings, including Macromedia Fireworks, Adobe Photoshop, Adobe Photoshop Album, Adobe Photoshop Album Starter Edition, Adobe Photoshop Elements, Adobe After Effects, Adobe Audition, Adobe Encore DVD, Adobe Premiere Elements and Adobe Premiere Pro software, face significant competition from companies offering similar products and will continue to face competition from emerging products, including those coming from the Open Source movement.

Our mid-range consumer offerings, including Photoshop Elements and Adobe Premiere Elements, are subject to intense competition, price sensitivity, brand awareness and strength in OEM bundling and retail distribution. We face direct and indirect competition from a number of companies that market software which competes with ours, including ACD Systems, AI Soft (Japan), Apple Computer, ArcSoft, Corel, i4 (Japan), Google, Kodak, Nova Development, Magix, Micrografx, Microsoft, Paessler GmbH (Germany), Pegasus Imaging Company, Phase One, Photodex Corporation, Sonic Pinnacle, Sony and Ulead Systems. In addition, we face competition from device, hardware and camera manufacturers such as Apple Computer, Canon, Dell, Hewlett-Packard, Nikon, Sony and others as they try to differentiate their offerings by bundling their own digital imaging software, or those of our competitors. Similarly, we face potential competition from operating system manufacturers such as Apple Computer and Microsoft as they integrate hobbyist-level digital imaging and image management features in future versions of their operating systems. Finally, we face potential competition from Open Source products, including Gimp for Linux.

We believe we compete favorably against other mid-range digital imaging, digital video and consumer-focused image management software applications with our Adobe Photoshop Elements, Adobe Premiere Elements and Adobe Photoshop Album products due to strong consumer awareness of our brand in digital imaging and digital video, our relationships with significant OEMs, positive recommendations for our products by market influencers, our increased focus on the retail software channel, and strong feature sets.

In professional digital imaging, software applications compete based on product features, brand awareness and price sensitivity. In addition to competition with Microsoft's Expression Graphic Designer product, our Adobe Photoshop product faces direct and indirect competition from a number of companies including Apple Computer and Corel. Our Adobe Photoshop product competes favorably due to high awareness of the Photoshop brand in digital imaging, the positive recommendations for our Photoshop product by market influencers, the features and technical capabilities of the product, and our ability to leverage core features from our other established products.

Our Adobe InDesign product, used for professional page layout, faces substantial competition. The main competitor, Quark, has a competitive product, Quark XPress, which has maintained a historically strong market share in the professional page layout market. Quark also benefits from an established industry infrastructure that has been built around the use of their XPress product in print shops and service bureaus, and through the development of third party plug-in products. Barriers to the adoption of Adobe InDesign by Quark XPress customers include this infrastructure, as well as the cost of conversion, training

and software/hardware procurement required to switch to InDesign. We have seen an increase in the adoption of InDesign software and we believe we will continue to see market share gains going forward due to a product offering that contains new innovative features, our strong brand among users, positive reviews by industry experts, adoption of InDesign by major accounts which are influencers in their industries and improved infrastructure support by the industry for our overall solution.

Applications for digital video editing, motion graphics, special effects, audio creation and DVD authoring face increasing competition as video professionals and hobbyists migrate away from analog video and audio tools towards the use of digital camcorders and digital video production on their computers and DVD systems for rich media playback. Our Adobe After Effects, Adobe Audition, Adobe Encore DVD and Adobe Premiere Pro software products, as well as the Adobe Production Studio which contains these products, face competition from companies such as Apple Computer, Avid, Canopus, Discreet, Sonic Pinnacle, ULead Systems and Sony. Our Adobe Premiere Elements software product, which is targeted for use by hobbyists, faces competition from companies such as Aist, ArcSoft, Avid, Broderbund, Cyberlink, Magix, Microsoft and Muvee.

Adobe After Effects is a leader in professional compositing and visual effects due to its strong feature set and its integration with our other products that helps create a broad video editing platform for our customers. In professional digital video editing, we are an industry leader on the Microsoft Windows platform with Adobe Premiere Pro and compete favorably due to our strong feature set, our OEM relationships and the integration with our other products to create a broad digital video publishing platform for our customers.

Knowledge Worker Solutions

With our Adobe Acrobat business, we are seeing an increase in competition from Microsoft. Microsoft has announced its next generation operating system, called Windows Vista, which is expected to ship in late 2006. Windows Vista will include a proprietary digital rights management technology and a new document format, called XML Paper Specification ("XPS"), which will compete with Adobe PDF. In addition, Microsoft has announced that the next version of its widely used Office product, which also is expected to ship in late 2006, will contain a feature to save Microsoft Office documents as PDF files. This new PDF feature in Office could compete with Adobe Acrobat. Given Microsoft's market dominance, XPS, the PDF feature in Office and any other competitive Microsoft product or technology that is bundled as part of its Office product or operating system, could harm our overall Knowledge Worker Solutions market opportunity.

Our Adobe Acrobat product family also faces competition in the PDF file creation market from many clone products marketed by companies such as AdLib, Active PDF, Ansy Technology, Apple Computer, eHelp Corporation, Global Graphics, Scansoft, Software995, Sourcnext and others. In addition, other PDF creation solutions can be found at a low cost, or for free, on the Web.

For customers that use Adobe Acrobat Standard and Adobe Acrobat Professional as part of document collaboration and document process management solutions, where electronic document delivery, exchange, collaboration, security and archival needs exist, our Acrobat product family faces competition from entrenched office applications such as Microsoft Office. In the higher end of the electronic document market, Acrobat Professional provides features which compete with other creative professional PDF tool providers, such as Enfocus, Dalim, TeamPDF and Zinio. In addition, we are targeting the architecture, engineering and construction worker electronic document collaboration market with our Acrobat Professional product market. The capabilities of our product in this market compete with some aspects of Autodesk's solution.

To address the threats from Microsoft and others, we are working to ensure our Adobe Acrobat applications stay at the forefront of innovation in emerging opportunities such as PDF document generation, document collaboration and document process management.

Breeze faces competition from many Web conferencing vendors, including WebEx and Microsoft. WebEx is a market share leader, and Microsoft has steadily increased its marketing of Microsoft Office Live Meeting since its acquisition of Placeware in 2003. To address the threats from Microsoft and others in the Web conferencing space, we focus on providing a differentiated and enhanced user experience through our ubiquitous Macromedia Flash Player.

Mobile and Device Solutions

The markets we address with our Mobile and Device solutions are influenced by evolving industry standards, rapid software and hardware technology developments, and frequent new product and technology introductions by companies or open-source initiatives targeting similar opportunities. Technologies and products which could compete with Macromedia Flash Lite include Java, Brew, SVG, WAP and Microsoft Windows Mobile.

We believe Macromedia Flash Lite solution competes favorably against these technologies and/or solutions due to the ubiquitous distribution of Macromedia Flash Player technology on a broad set of platforms (including PCs and cellular phones), our robust programming model and developer tools used to create Flash content, the large Flash developer community and ecosystem, and the rich expressiveness of Flash, which allows the capability to deliver audio, video, motion graphics, vector graphics and visual effects—resulting in rich user experiences and interfaces on mobile devices which compare favorably to those created by alternate solutions.

Enterprise and Developer Solutions

The markets we address with our Macromedia ColdFusion, Adobe LiveCycle and Macromedia Flex server products are influenced by evolving industry standards, rapid software and hardware technology developments, and new product introductions from competitors such as Microsoft and IBM.

Microsoft has already brought to market new products and technologies to address many of the emerging market needs we focus on with our Adobe LiveCycle family of products. In the Professional version of Microsoft Office 2003, it introduced a new information gathering program called InfoPath 2003. They also introduced Windows Rights Management Services in their Windows Server 2003 product, which is designed to allow corporate networks to manage and enforce restrictions built into documents.

As discussed previously, Microsoft has also announced its next generation operating system, called Windows Vista, which is expected to ship in late 2006. Windows Vista will include a new document format, called XPS, which will compete with Adobe PDF. Windows Vista will also include a proprietary digital rights management technology which will compete with Adobe LiveCycle Policy Server. In addition, Microsoft's new version of Office will include an updated version of its SharePoint product which will compete with certain aspects of our Adobe LiveCycle products. Microsoft has also announced the Windows Presentation Foundation (formerly known as Avalon) which is expected to ship as part of the Windows Vista release in 2006, and which will offer an alternative to building RIA applications within the Microsoft.NET framework.

In the electronic forms solution market, in addition to competition from Microsoft Infopath-based solutions, we face competition from IBM through their acquisition of an eForms solution company called PureEdge, other regional based eForm solution providers, and from FileNET's electronic form solutions. Similarly, we face competition for document process management solutions from workflow solution vendors such as FileNET, MetaStorm, Scansoft and Ultimus.

We believe that our Adobe LiveCycle server product family competes favorably against these companies and formats in terms of the combined benefits of superior functionality, cross-platform visual page fidelity/reliability, multi-platform capability, file compression, printing and security of documents expressed using Adobe PDF. We also believe that Adobe PDF and its integration with XML, combined

with the broad distribution of Adobe Reader on all leading hardware platforms, provide a ubiquitous universal multi-platform solution that is more compelling than our competitors' offerings.

As we broaden the scope of products and solutions offered with our Enterprise and Developer Solutions products, we face increased competition from entrenched office applications, emerging products/technologies and potentially, enterprise collaboration system providers. Additionally, current office applications and content creation/management tools that use HTML, Microsoft Word, Tagged Information File Format ("TIFF") and various XML-based formats for electronic document distribution provide alternate solutions to customers, and indirectly compete with our enterprise server products and the use of Adobe PDF.

Our Macromedia Flex server product provides a solution for Java, C++ and C Sharp programmers wanting to deploy Enterprise class, rich Web applications and leverages Macromedia Flash Player technology. Beyond the competitive Microsoft threats previously discussed, vendors such as Tibco and NexaWeb offer competitive solutions in the RIA market that we target with Flex. In addition, new open source technologies like AJAX provide alternative methods for creating RIAs. Numerous open source groups, as well as a number of commercial software vendors are working to build tools and frameworks that could make AJAX competitive with Flex.

Our Macromedia ColdFusion products face competition from major vendors including Microsoft, IBM, BEA and Sun. In addition, ColdFusion competes with several technologies available today at no cost including the PHP and PERL programming environments that are available for the Apache Web server.

Other

In technical authoring and publishing, our Adobe FrameMaker product faces competition from large-scale electronic publishing systems, XML-based publishing companies such as PTC (via their acquisition of Arbortext), as well as lower-end desktop publishing products such as Microsoft Word. Competition is based on the quality and features of products, the level of customization and integration with other publishing system components, the number of hardware platforms supported, service and price. We believe we can successfully compete based upon the quality and features of the Adobe FrameMaker product and our extensive application programming interface.

In desktop publishing, our Adobe PageMaker product faces competition from other software products, including Microsoft Publisher. Competition is based on the quality and features of products, ease-of-use, printer service support, and price. We believe we have a strong product and can successfully compete with these types of applications based upon the quality and features of the Adobe PageMaker product, its strong brand among users, and its widespread adoption among printer service bureaus.

In printing technologies, we believe the principal competitive factors for OEMs in selecting a page description language or a printing technology are product capabilities, market leadership, reliability, price, support and engineering development assistance. We believe that our competitive advantages include our technology competency, OEM customer relationships and intellectual property portfolio. Adobe PostScript faces competition from Hewlett-Packard's proprietary PCL page description language and from developers of other page description languages based on the PostScript language standard, including Global Graphics and Xionics. In addition, as previously discussed, Microsoft has announced its next generation operating system, called Windows Vista, which is expected to ship in late 2006. Windows Vista will include a new document format called XPS, which will compete with Adobe PDF. Certain aspects of XPS may also compete with our Adobe PostScript technologies and solutions.

In e-learning content authoring, our Authorware product faces competition from vertically focused e-learning content authoring solutions. Competition is based on the quality and features of products, ease-of-use and price. We believe we have a strong product and can successfully compete based upon the quality and features of the Macromedia Authorware product and its strong brand among users, and its widespread adoption among e-learning content publishers.

In interactive simulations/e-learning, our Captivate product faces competition from general content development tools such as Microsoft PowerPoint, screen recording tools such as Techsmith's Camtasia and more advanced e-learning and software simulation solutions such as Firefly or OnDemand. Competition is based on speed of development and features of products, ease-of-use and price. We believe we have a strong product and can successfully compete based upon the quality and features of the Macromedia Captivate product, its strong brand among users and its widespread adoption among training developers.

In Web content management, our Contribute products face competition from basic content publishing products such as Microsoft Word and Microsoft Sharepoint, as well as large-scale Web content management systems from companies such as Interwoven, Vignette, IBM and Oracle. Competition is based on the usability, quality and features of products, the level of customization and integration with other Web content management components, the integration with Web design tools, the number of hardware platforms supported, service, and price. We believe we can successfully compete based upon the usability and price of the Macromedia Contribute product, strong brand among users and integration with other Web content management components.

In multimedia content authoring, our Director product faces competition from a variety of multimedia content authoring tools. Competition is based on the quality and features of products, ease-of-use and price. We believe we have a strong product and can successfully compete based upon the quality and features of the Macromedia Director product, its strong brand among users, and its widespread adoption among content developers and publishers.

In technical Web authoring and publishing, our Macromedia RoboHelp product faces competition from large-scale Web publishing systems, XML-based Web publishing companies, as well as lower-end publishing products such as Microsoft Word. Competition is based on the quality and features of products, the level of customization and integration with other publishing system components, the number of hardware platforms supported, service, and price. We believe we can successfully compete based upon the quality and features of the Macromedia RoboHelp product.

Our Macromedia JRun product competes with large Java application server vendors as well as products available at no cost including the Tomcat Java Servlet Engine provided by the Apache Foundation.

OPERATIONS

Marketing and Sales

We market and distribute our products through sales channels, which include distributors, retailers, software developers, systems integrators, ISV's and VARs, as well as through OEM and hardware bundle customers. We also market and license our products directly using our sales force and through our own Web site at www.adobe.com.

We support our worldwide distribution network and end-user customers with international offices around the world, including locations in Australia, Austria, Belgium, Brazil, Canada, China, Czech Republic, Denmark, England, Finland, France, Germany, India, Ireland, Italy, Japan, Korea, Mexico, the Netherlands, Norway, Portugal, Scotland, Singapore, Spain, Sweden, Switzerland and Taiwan.

We also license software with maintenance and support, which includes rights to upgrades, when and if available, support, updates and enhancements.

For information regarding our market segments and segment revenue, geographic areas and significant customers, please refer to Note 16 of our Notes to Consolidated Financial Statements.

Order Fulfillment

The procurement of the various components of packaged products, including CDs and printed materials, and the assembly of packages for retail and other applications products is controlled by our

Global Supply Chain Management operations. We outsource our order fulfillment activities to third parties in the United States, Europe and Asia.

To date, we have not experienced significant difficulties in obtaining raw materials for the manufacture of our products or in the replication of CDs, printing and assembly of components, although an interruption in production by a supplier could result in a delay in shipment of our products. The backlog of orders from customers, as of January 20, 2006 and January 21, 2005, was approximately \$30.9 million and \$13.9 million, respectively.

Services and Support

We provide professional services, technical support and customer service to a wide variety of customers including consumers, creative professionals and business users. Our service and support revenue consists primarily of consulting fees, software maintenance and support fees, and training fees.

Services

We have a global Adobe Consulting team dedicated to developing and implementing solutions for enterprise customers in key vertical markets and to transfer technical expertise to our solution partners. The Adobe Consulting team uses a comprehensive, customer-focused methodology to develop high quality solutions, which in turn deliver a competitive advantage to our enterprise customers. A portfolio of technical training courses is also available for desktop and server-based products to meet the needs of our enterprise customers and solution partners.

Support

A significant portion of our support revenue is composed of our extended enterprise maintenance and support offerings, which entitles customers to the right to receive product upgrades and enhancements during the term of the maintenance and support period, which is typically one year. Regional Support Centers are charged with providing timely, high quality technical expertise on Enterprise and Knowledge Worker Solutions products and solutions to meet the growing needs of our customers.

Our support revenue also includes support for our desktop products. We offer a range of support programs, from fee-based incidents to annual support contracts. Additionally, we provide extensive self-help and online technical support capabilities via the Web, which allows customers quick and easy access to possible solutions. We provide product support through a combination of outsourced vendors and internal support centers.

We also offer Developer Support to partners and developer organizations. The Adobe Solution Network Developer Program focuses on providing developers with high-quality tools, software development kits, information and services.

As a registered owner of the current version of an Adobe desktop product, customers are eligible to receive complimentary person-to-person support on certain matters. Support for some products and in some countries may vary.

Training

We inform customers about the use of our products through on-line informational services on our Web site (www.adobe.com) and through a growing series of how-to books published by Adobe Press pursuant to a joint publishing agreement with Peachpit Press. In addition, we develop tests to certify independent trainers who teach Adobe software classes. We sponsor workshops, work with professional associations and user groups, and conduct regular beta-testing programs.

Investments

We own limited partnership interests in three venture capital limited partnerships, Adobe Ventures L.P., Adobe Ventures III, L.P. and Adobe Ventures IV, L.P. (collectively "Adobe Ventures"), that have invested in early stage companies with innovative technologies. We also make direct investments in privately held companies. We view these investments as primarily strategic as they often increase our knowledge of emerging markets and technologies, as well as expand our opportunities to provide Adobe products and services. The partnerships are managed by Granite Ventures, an independent venture capital firm and sole general partner of Adobe Ventures.

We intend to continue investing in new technologies.

PRODUCT DEVELOPMENT

Since the personal computer and enterprise software industries are characterized by rapid technological change, a continuous high level of investment is required for the enhancement of existing products and the development of new products. We primarily develop our software internally. We occasionally acquire products developed by others by purchasing the stock or assets of the business entity that held ownership rights to the technology. In other instances, we have licensed or purchased the intellectual property ownership rights of programs developed by others with license or technology transfer agreements that may obligate us to pay royalties, typically based on a dollar amount per unit shipped or a percentage of the revenues generated by those programs.

During fiscal years ended December 2, 2005, December 3, 2004 and November 28, 2003, our research and development expenses, including costs related to contract development, were \$365.3 million, \$311.3 million and \$277.0 million, respectively.

During fiscal 2005, we acquired OKYZ S.A., a privately held company, which provided three dimensional ("3D") technology and expertise to our Intelligent Document platform.

During fiscal 2004, we acquired Q-Link Technologies, Inc ("Q-Link"), a privately held company, which provided Java-based workflow technology that was integrated with our enterprise server products to enable customers to integrate document process management with core applications. For further information regarding this acquisition, see Note 2 of our Notes to Consolidated Financial Statements.

PRODUCT PROTECTION

We regard our software as proprietary and protect it under the laws of copyrights, patents, trademarks and trade secrets. We protect the source code of our software programs as trade secrets, and make source code available to third parties only under limited circumstances and specific security and confidentiality constraints.

Our products are generally licensed to end users on a "right to use" basis pursuant to a license that restricts the use of the products to a designated number of devices. We also rely on copyright laws and on "shrink wrap" and electronic licenses that are not physically signed by the end user. Copyright protection may be unavailable under the laws of certain countries, and the enforceability of "shrink wrap" and electronic licenses has not been conclusively determined in all jurisdictions. We have obtained many patents and have registered numerous copyrights, trademarks, domain names and logos in the United States and foreign countries.

Policing unauthorized use of computer software is difficult and software piracy is a persistent problem for the software industry. This problem is particularly acute in international markets. We conduct vigorous anti-piracy programs directly and through certain external software associations. Although our products generally do not contain copy protection or network copy-detection features, we have recently included activation technology in certain products to guard against illegal use and will continue to do so in certain future products.

EMPLOYEES

As of January 27, 2006, we employed 5,734 people. We have not experienced work stoppages and believe our employee relations are good. Competition in recruiting personnel in the software industry, especially highly skilled engineers, is intense. We believe our future success will depend in part on our continued ability to recruit and retain highly skilled technical, management and sales and marketing personnel.

AVAILABLE INFORMATION

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed or furnished pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available free of charge on our Investor Relations Web site at www.adobe.com as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The information posted on our Web site is not incorporated into this Annual Report on Form 10-K.

EXECUTIVE OFFICERS

Adobe's executive officers as of January 27, 2006 are as follows:

<u>Name</u>	<u>Age</u>	<u>Positions</u>
Bruce R. Chizen	50	Chief Executive Officer
Karen O. Cottle	56	Senior Vice President, General Counsel and Corporate Secretary
Murray J. Demo	44	Executive Vice President and Chief Financial Officer
Stephen A. Elop	42	President, Worldwide Field Operations
Shantanu Narayen	42	President and Chief Operating Officer
Peg Wynn	54	Senior Vice President, Human Resources

Mr. Chizen joined Adobe upon the closing of the acquisition of Aldus in August 1994 as Vice President and General Manager, Consumer Products Division. In December 1997, he was promoted to Senior Vice President and General Manager, Graphic Products Division and in August 1998, Mr. Chizen was promoted to Executive Vice President, Products and Marketing. In April 2000, Mr. Chizen was promoted to President of Adobe and in December 2000, he also became Adobe's Chief Executive Officer and joined the Adobe Board of Directors in December 2000. In January 2005, Mr. Chizen relinquished the title of President, but remains as Adobe's Chief Executive Officer and a member of Adobe's Board of Directors. Mr. Chizen is a member of the Board of Directors of Synopsys, Inc.

Ms. Cottle joined Adobe in February 2002 as Senior Vice President, General Counsel and Secretary. Prior to joining Adobe, Ms. Cottle served as General Counsel for Vitria Technology, Inc. from February 2000 to February 2002. From 1996 to 1999, Ms. Cottle served as Vice President, General Counsel and Secretary of Raychem Corporation.

Mr. Demo joined Adobe in August 1996 as the Director of Operations Finance. In July 1998 he was promoted to Corporate Controller. In October 1999, he was promoted to Vice President and Corporate Controller and in June 2000 was promoted to Senior Vice President and Chief Financial Officer. In April 2005, Mr. Demo was promoted to Executive Vice President and Chief Financial Officer. On

December 13, 2005, Mr. Demo announced his intention to resign as Chief Financial Officer of Adobe Systems Incorporated. Mr. Demo will remain as the Chief Financial Officer through March 31, 2006, or longer if his successor has not been hired by then. Mr. Demo is a member of the Board of Directors of Citrix Systems, Inc. and is the Vice Chairman of the national Board of Directors of AeA, the nation's largest high-tech trade association.

Mr. Elop joined Adobe upon the closing of the acquisition of Macromedia in December 2005 as President, Worldwide Field Operations. Prior to joining Adobe, Mr. Elop served as Chief Executive Officer and a director of Macromedia from January 2005 to December 2005. Prior to this, Mr. Elop served as Chief Operating Officer of Macromedia from July 2004 to January 2005, Executive Vice President of Worldwide Field Operations of Macromedia from April 2001 to January 2005, General Manager, eBusiness Solutions of Macromedia from December 1999 to April 2001, and Chief Information Officer of Macromedia from March 1998 to December 1999.

Mr. Narayan joined Adobe in January 1998 as Vice President and General Manager of Adobe's engineering technology group. In January 1999, he was promoted to Senior Vice President, Worldwide Products and in March 2001 he was promoted to Executive Vice President, Worldwide Product Marketing and Development. In January 2005, Mr. Narayan was promoted to President and Chief Operating Officer of Adobe. Prior to joining Adobe, Mr. Narayan co-founded Pictra Inc., a digital photo sharing software company, in 1996. He was Director of Desktop and Collaboration products at Silicon Graphics Inc. and held various senior manager positions at Apple Computer Inc. before founding Pictra.

Ms. Wynn joined Adobe in January 2006 as Senior Vice President, Human Resources. Prior to joining Adobe, Ms. Wynn served as Vice President of Human Resources at Xilinx, Inc. from October 1999 to January 2006, and Director of Human Resources from October 1998 to October 1999.

ITEM 1A. RISK FACTORS

As previously discussed, our actual results could differ materially from our forward looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed below. These and many other factors described in this report could adversely affect our operations, performance and financial condition.

Adverse changes in general economic or political conditions in any of the major countries in which we do business could adversely affect our operating results.

If the economy worsens in any geographic areas where we do business, it would likely cause our future results to vary materially from our targets. A slower economy also may adversely affect our ability to grow. Political instability in any of the major countries in which we do business also may adversely affect our business.

Delays in development or shipment of new products or major new versions of existing products could cause a decline in our revenue.

As part of our transition to new business models and markets, we are planning the release of new products and new versions of current products. Additionally, following our acquisition of Macromedia, we plan to release products that integrate our existing products with products acquired in the Macromedia acquisition. Any delays or failures in developing and marketing our products, including upgrades of current products and the integration of Macromedia products into our product line, may have a harmful impact on our results of operations. We may have particular difficulty and delays developing products that integrate Adobe and Macromedia products, since our products are highly complex, have been designed independently and were designed without regard to such integration. Our inability to extend our core technologies into new applications and new platforms and to anticipate or respond to technological changes could affect continued market acceptance of our products and our ability to develop new products.

Delays in product or upgrade introductions could cause a decline in our revenue, earnings or stock price. We cannot determine the ultimate effect these delays or the introduction of new products or upgrades will have on our revenue or results of operations.

Introduction of new products by existing and new competitors could harm our competitive position and results of operations.

The end markets for our software products are intensely and increasingly competitive, and are significantly affected by product introductions and market activities of industry competitors. If these competing products achieve widespread acceptance, our operating results could suffer. In addition, consolidation has occurred among some of the competitors in our markets. Any further consolidations among our competitors may result in stronger competitors and may therefore harm our results of operations. For information regarding our competition and the risks arising out of the competitive environment in which we operate, see the section entitled "Competition" contained in Item 1 of this report.

If we fail to successfully manage transitions to new business models and markets, our results of operations could be negatively impacted.

We are devoting significant resources to the development of technologies and service offerings where we have a limited operating history, including the enterprise and government markets and the mobile and device markets. In the enterprise and government markets, we intend to increase our focus on vertical markets such as education, financial services, manufacturing, and the architecture, engineering and construction markets. With our Breeze product line, we intend to increase awareness in targeted horizontal markets such as training and marketing and vertical markets such as manufacturing, financial services and telecommunications. These new offerings and markets require a considerable investment of technical, financial and sales resources, and a scaleable organization. Many of our competitors may have advantages over us due to their larger presence, larger developer network, deeper experience in the enterprise and government markets and the mobile and device markets, and greater sales and marketing resources. In the mobile and device markets, our intent is to license our technology to device makers manufacturers and telecommunications carriers that embed our technology on their platforms, and in the enterprise and government market our intent is to form strategic alliances with leading enterprise and government solutions and service providers to provide additional resources to further enable penetration of such markets. If we are unable to successfully enter into strategic alliances with device maker manufacturers, telecommunication carriers and leading enterprise and government solutions and service providers, or if they are not as productive as we anticipate, our market penetration may not proceed as rapidly as we anticipate and our results of operations could be negatively impacted.

Revenues from our new business segments may be difficult to predict.

As previously discussed, we are devoting significant resources to the development of product and service offerings where we have a limited operating history. This makes it difficult to predict revenues. For example, we intend to expand the use of our Mobile and Device Solutions by licensing our products for use in mobile phones, set-top boxes, game devices, personal digital assistants, hand-held computers and other consumer electronic devices; however, we have a limited history of licensing products in these markets and may experience a number of factors that will make our revenue less predictable, including longer than expected sales and implementation cycles, potential deferral of revenue due to multiple-element revenue arrangements and alternate licensing arrangements.

If we fail to anticipate and develop new products in response to changes in demand for application software, computers and printers, our business could be harmed.

Any failure to anticipate changing customer requirements and develop and deploy new products in response to changing market conditions may have a material impact on our results of operations. As previously discussed, we plan to release numerous new product offerings and upgrade versions of our current products in connection with our transition to new business models and the acquisition of Macromedia. Market acceptance of our new product or version releases will be dependent on our ability to include functionality and usability in such releases that address the requirements of customer demographics with which we have limited prior experience. To the extent we incorrectly estimate customer requirements for such products and version releases or if there is a delay in market acceptance of such products and version releases, our business could be harmed.

We offer our Creative Solutions and Knowledge Worker Solutions application-based products primarily on Windows and Macintosh platforms and on some UNIX platforms. We generally offer our server-based products, but not desktop application products, on the Linux platform as well as the Windows and UNIX platforms. To the extent that there is a slowdown of customer purchases of personal computers on either the Windows or Macintosh platform or in general, or to the extent that significant demand arises for our products or competitive products on the Linux desktop platform before we choose and are able to offer our products on this platform, our business could be harmed. Additionally, to the extent that we have difficulty transitioning product or version releases to new Windows and Macintosh operating systems or to the extent new releases of operating systems or other third party products make it more difficult for our products to perform, our business could be harmed.

We may incur substantial costs enforcing our intellectual property rights and defending against third-party claims as a result of litigation or other proceedings.

In connection with the enforcement of our own intellectual property rights or in connection with disputes relating to the validity or alleged infringement of third-party rights, including patent rights, we have been, are currently and may in the future be subject to claims, negotiations or complex, protracted litigation. Intellectual property disputes and litigation are typically very costly and can be disruptive to our business operations by diverting the attention and energies of management and key technical personnel. Although we have successfully defended or resolved past litigation and disputes, we may not prevail in any ongoing or future litigation and disputes. Adverse decisions in such litigation or disputes could have negative results, including subjecting us to significant liabilities, requiring us to seek licenses from others, preventing us from manufacturing or licensing certain of our products, or causing severe disruptions to our operations or the markets in which we compete, any one of which could seriously harm our business.

We may not be able to protect our intellectual property rights, including our source code, from third-party infringers, or unauthorized copying, use, disclosure or malicious attack.

Although we defend our intellectual property rights and combat unlicensed copying and use of software and intellectual property rights through a variety of techniques, preventing unauthorized use or infringement of our rights is inherently difficult. We actively pursue software pirates as part of our enforcement of our intellectual property rights, but we nonetheless lose revenue due to illegal use of our software. If piracy activities increase, it may further harm our business.

Additionally, we take significant measures to protect the secrecy of large portions of our source code, the detailed program commands for our software programs. If unauthorized disclosure of a significant portion of our source code occurs, we could potentially lose future trade secret protection for that source code. The loss of future trade secret protection could make it easier for third parties to compete with our products by copying functionality, which could adversely affect our revenue and operating margins.

We also devote significant resources to maintaining the security of our products from malicious hackers who develop and deploy viruses, worms, and other malicious software programs that attack our products. Nevertheless, actual or perceived security vulnerabilities in our products could harm our reputation and lead some customers to seek to return products, to reduce or delay future purchases, to use competitive products or to make claims against us. Also, with the introduction of hosted services with some of our product offerings, our customers may use such services to share confidential and sensitive information. If a breach of security occurs on these hosted systems, we could be held liable to our customers. Additionally, such breaches could lead to interruptions, delays and data loss and protection concerns as well as harm our reputation.

We may not realize the anticipated benefits of past or future acquisitions, and integration of these acquisitions may disrupt our business and management.

We have in the past and may in the future acquire additional companies, products or technologies. Most recently, we completed the acquisition of Macromedia in December 2005. We may not realize the anticipated benefits of this or any other acquisition and each acquisition has numerous risks. These risks include:

- difficulty in assimilating the operations and personnel of the acquired company;
- difficulty in effectively integrating the acquired technologies or products with our current products and technologies;
- difficulty in maintaining controls, procedures and policies during the transition and integration;
- disruption of our ongoing business and distraction of our management and employees from other opportunities and challenges due to integration issues;
- difficulty integrating the acquired company's accounting, management information, human resources and other administrative systems;
- inability to retain key technical and managerial personnel of the acquired business;
- inability to retain key customers, distributors, vendors and other business partners of the acquired business;
- inability to achieve the financial and strategic goals for the acquired and combined businesses;
- incurring acquisition-related costs or amortization costs for acquired intangible assets that could impact our operating results;
- potential impairment of our relationships with employees, customers, partners, distributors or third-party providers of technology or products;
- potential failure of the due diligence processes to identify significant issues with product quality, architecture and development, or legal and financial contingencies, among other things;
- incurring significant exit charges if products acquired in business combinations are unsuccessful;
- potential inability to assert that internal controls over financial reporting are effective;
- potential inability to obtain, or obtain in a timely manner, approvals from governmental authorities, which could delay or prevent such acquisitions; and
- potential delay in customer and distributor purchasing decisions due to uncertainty about the direction of our product offerings.

Mergers and acquisitions of high technology companies are inherently risky, and ultimately, if we do not complete the integration of acquired businesses successfully and in a timely manner, we may not

realize the anticipated benefits of the acquisitions to the extent anticipated, which could adversely affect our business, financial condition or results of operations.

We rely on distributors to sell our products and any adverse change in our relationship with our distributors could result in a loss of revenue and harm our business.

We distribute our application products primarily through distributors, resellers, retailers and increasingly systems integrators, ISVs and VARs (collectively referred to as "distributors"). A significant amount of our revenue for application products is from two distributors, Ingram Micro, Inc. and Tech Data Corporation. In addition, our channel program focuses our efforts on larger distributors, which has resulted in our dependence on a relatively small number of distributors licensing a large amount of our products. Our distributors also sell our competitors' products, and if they favor our competitors' products for any reason, they may fail to market our products as effectively or to devote resources necessary to provide effective sales, which would cause our results to suffer. In addition, the financial health of these distributors and our continuing relationships with them are important to our success. Some of these distributors may be unable to withstand adverse changes in business conditions. Our business could be seriously harmed if the financial condition of some of these distributors substantially weakens.

Catastrophic events may disrupt our business.

We are a highly automated business and rely on our network infrastructure and enterprise applications, internal technology systems and our Website for our development, marketing, operational, support and sales activities. A disruption or failure of these systems in the event of a major earthquake, fire, telecommunications failure, cyber-attack, terrorist attack, or other catastrophic event could cause system interruptions, delays in our product development and loss of critical data and could prevent us from fulfilling our customers' orders. Our corporate headquarters, a significant portion of our research and development activities, and certain other critical business operations are located in San Jose, California, which is near major earthquake faults. We have developed disaster recovery plans and backup systems to reduce the potentially adverse effect of such events, but a catastrophic event that results in the destruction or disruption of any of our critical business or information technology systems could severely affect our ability to conduct normal business operations and, as a result, our future operating results could be adversely affected.

We rely on turnkey assemblers and any adverse change in our relationship with our turnkey assemblers could result in a loss of revenue and harm our business.

We currently rely on six turnkey assemblers of our products, with at least two turnkeys located in each major region we serve. If any significant turnkey assembler terminates its relationship with us, or if our supply from any significant turnkey assembler is interrupted or terminated for any other reason, we may not have enough time or be able to replace the supply of products replicated by that turnkey assembler to avoid serious harm to our business.

Our future operating results are difficult to predict and are likely to fluctuate substantially from quarter to quarter and as a result the market price of our common stock may be volatile and our stock price could decline.

As a result of a variety of factors discussed herein, our quarterly revenues and operating results for a particular period are difficult to predict. Our revenues may grow at a slower rate than experienced in previous periods and, in particular periods, may decline. Additionally, we periodically provide operating model targets. These targets reflect a number of assumptions, including assumptions about product pricing and demand, economic and seasonal trends, manufacturing costs and volumes, the mix of shrink-wrap and licensing revenue, full and upgrade products, distribution channels and geographic markets. If one or more

of these assumptions prove incorrect, our actual results may vary materially from those anticipated, estimated or projected.

Due to the factors noted above, our future earnings and stock price may be subject to volatility, particularly on a quarterly basis. Shortfalls in revenue or earnings or delays in the release of products or upgrades compared to analysts' or investors' expectations have caused and could cause in the future an immediate and significant decline in the trading price of our common stock. Additionally, we may not learn of such shortfalls or delays until late in the fiscal quarter, which could result in an even more immediate and greater decline in the trading price of our common stock. Finally, we participate in a highly dynamic industry. In addition to factors specific to us, changes in analysts' earnings estimates for us or our industry, and factors affecting the corporate environment, our industry, or the securities markets in general, have resulted, and may in the future result, in volatility of our common stock price.

We are subject to risks associated with international operations which may harm our business.

We typically generate over 50% of our total revenue from sales to customers outside of the Americas. Sales to these customers subject us to a number of risks, including (i) foreign currency fluctuations, (ii) changes in government preferences for software procurement, (iii) international economic and political conditions, (iv) unexpected changes in, or impositions of, international legislative or regulatory requirements, (v) inadequate local infrastructure, (vi) delays resulting from difficulty in obtaining export licenses for certain technology, tariffs, quotas and other trade barriers and restrictions, (vii) transportation delays, (viii) the burdens of complying with a variety of foreign laws, including more stringent consumer and data protection laws, and other factors beyond our control, including terrorism, war, natural disasters and diseases. If sales to any of our customers outside of the Americas are delayed or cancelled because of any of the above factors, our revenue may be negatively impacted.

We may incur losses associated with currency fluctuations and may not be able to effectively hedge our exposure.

Our operating results are subject to fluctuations in foreign currency exchange rates. We attempt to mitigate a portion of these risks through foreign currency hedging, based on our judgment of the appropriate trade-offs among risk, opportunity and expense. We have established a hedging program to partially hedge our exposure to foreign currency exchange rate fluctuations, primarily the Japanese yen and the euro. We regularly review our hedging program and will make adjustments as necessary based on the judgment factors discussed above. Our hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movement in foreign currency exchange rates, which could adversely affect our financial condition or results of operations.

Changes in, or interpretations of, accounting principles, such as expensing of stock options, could result in unfavorable accounting charges.

We prepare our consolidated financial statements in conformity with U.S. generally accepted accounting principles. These principles are subject to interpretation by the SEC and various bodies formed to interpret and create appropriate accounting principles. A change in these principles can have a significant effect on our reported results and may even retroactively affect previously reported transactions. Our accounting principles that recently have been or may be affected by changes in the accounting principles are as follows:

- software revenue recognition
- accounting for share-based payments
- accounting for income taxes
- accounting for business combinations and related goodwill

In particular, the FASB recently issued SFAS 123R which requires the measurement of all share-based payments to employees, including grants of employee stock options, using a fair-value-based method and the recording of such expense in our consolidated statements of income. The accounting provisions of SFAS 123R are effective for annual periods beginning after June 15, 2005. We are required to adopt SFAS 123R in the first quarter of fiscal year 2006. We believe that the adoption of SFAS 123R will have a significant adverse effect on our reported financial results and may impact the way in which we conduct our business. Please refer to the section entitled "Recent Accounting Pronouncements" for further information regarding SFAS 123R.

If our goodwill or amortizable intangible assets become impaired we may be required to record a significant charge to earnings.

Under generally accepted accounting principles, we review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization, future cash flows, and slower growth rates in our industry. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined resulting in an impact on our results of operations.

Changes in, or interpretations of, tax rules and regulations may adversely affect our effective tax rates.

Unanticipated changes in our tax rates could affect our future results of operations. Our future effective tax rates could be unfavorably affected by changes in tax laws or the interpretation of tax laws, by unanticipated decreases in the amount of revenue or earnings in countries with low statutory tax rates, or by changes in the valuation of our deferred tax assets and liabilities

In addition, we are subject to the continual examination of our income tax returns by the Internal Revenue Service and other domestic and foreign tax authorities. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. Any adverse outcome from these continual examinations may have an adverse effect on our operating results and financial position.

If we are unable to recruit and retain key personnel our business may be harmed.

Much of our future success depends on the continued service and availability of our senior management, including our Chief Executive Officer and other members of our executive team. These individuals have acquired specialized knowledge and skills with respect to Adobe. The loss of any of these individuals could harm our business. Our business is also dependent on our ability to retain, hire and motivate talented, highly skilled personnel. Experienced personnel in the information technology industry are in high demand and competition for their talents is intense, especially in the Silicon Valley, where the majority of our employees are located. We have relied on our ability to grant equity compensation as one mechanism for recruiting and retaining such highly skilled personnel. Recently enacted accounting regulations requiring the expensing of equity compensation may impair our ability to provide these incentives without incurring significant compensation costs. If we are unable to continue to successfully attract and retain key personnel, our business may be harmed.

We may suffer losses from our equity investments which could harm our business.

We hold equity investments in public companies that have experienced significant declines in market value. We also have investments and may continue to make future investments in privately held companies, many of which are considered in the start-up or development stages. These investments are inherently

risky, as the market for the technologies or products these companies have under development is typically in the early stages and may never materialize. Our investment activities can impact our net income. Future price fluctuations in these securities and any significant long-term declines in value of any of our investments could reduce our net income in future periods.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The following table sets forth the location, approximate square footage and use of each of the principal properties used by Adobe during fiscal 2005. We lease or sublease all of these properties with the exception of our property in India, where we own the building and lease the land. All properties are leased under operating leases. Such leases expire at various times through 2025, with the exception of the land lease that expires in 2091. The annual base rent expense (including operating expenses, property taxes and assessments, as applicable) for all facilities, excluding those assumed in the acquisition of Macromedia, is currently approximately \$49.7 million and is subject to annual adjustments as well as changes in interest rates.

<u>Location</u>	<u>Approximate Square Footage</u>	<u>Use</u>
North America:		
345 Park Avenue San Jose, California, USA	378,000	Research, product development, sales and marketing
321 Park Avenue San Jose, California, USA	321,000	Research, product development, sales and marketing
151 Almaden Boulevard San Jose, California, USA	267,000	Administration, product development and sales
801 N. 34th Street-Waterfront Seattle, WA 98103-88	255,000	Product development, marketing, technical support and administration
560 Rochester St. Ottawa, Ontario Canada K1S 5K2	152,000	Product development, marketing, technical support and administration
India:		
Adobe Towers, 1-1A, Sector 25A Noida, 201301, U.P. India	200,000	Product development, sales and marketing, and administration
Japan:		
Gate City Ohsaki East Tower 1-11-2 Ohsaki, Shinagawa-ku Tokyo 141-0032 Japan	57,000	Product development, sales and marketing
Germany:		
Grobe Elbstrable 27 Hamburg, 22767	27,000	Product development
UK:		
3 Roundview Avenue Stockley Park, Middlesex	21,000	Sales, marketing and administration

In general, all facilities are in good condition and are operating at an average capacity of approximately 74%.

In addition to the facilities listed above, we also lease other office space in the United States and various other countries under operating leases. We have one leased set of offices in San Jose, California that was vacated in connection with the restructuring program implemented in fiscal 1998. We have subleased the offices but still have a commitment under the lease agreement until 2007.

With the close of the acquisition of Macromedia on December 3, 2005, the following table sets forth the location, approximate square footage and use of each principal property that we assumed in the acquisition. We lease or sublease all of these properties with the exception of our property in San Francisco, California, where we own the building and the land.

<u>Location</u>	<u>Approximate Square Footage</u>	<u>Use</u>
North America:		
1-3 Riverside Center Newton, California, USA	348,000*	Research, product development and sales
601 and 625 Townsend San Francisco, California, USA	263,000	Research, product development, sales, marketing, and general and administrative
India:		
Salapuria Infinity Bangalore, India	56,000	Research and product development
UK:		
12 Park Crescent London	82,000	Sales

* We use approximately 24% of this facility.

ITEM 3. LEGAL PROCEEDINGS

On September 6, 2002, Plaintiff Fred B. Dufresne filed suit against Adobe, Microsoft Corporation, Macromedia, Inc. and Trellix Corporation in the U.S. District Court, District of Massachusetts, alleging infringement of U.S. Patent No. 5,835,712, entitled "Client-Server System Using Embedded Hypertext Tags for Application and Database Development." The Plaintiff's complaint asserts that "defendants have infringed, and continue to infringe, one or more claims of the '712 patent by making, using, selling and/or offering for sale, *inter alia*, products supporting Microsoft Active Server Pages technology." Plaintiff seeks unspecified compensatory damages, preliminary and permanent injunctive relief, trebling of damages for "willful infringement," and fees and costs. We believe the action has no merit and are vigorously defending against it.

On June 13, 2005, Plaintiff Steve Staehr filed a shareholder derivative action entitled "Steve Staehr, Derivatively on Behalf of Adobe Systems Incorporated v. Bruce R. Chizen, et. al.," in the Superior Court of the State of California for the County of Santa Clara against Adobe's directors and naming Adobe as a nominal defendant. The complaint alleges that the defendants breached their fiduciary duties of loyalty and due care and caused Adobe to waste corporate assets by failing to renegotiate or terminate the acquisition agreement with Macromedia following the announcement by Macromedia that it would restate its financial results for the fiscal years ended March 31, 1999 through 2004. The complaint seeks, among other things, unspecified monetary damages, attorneys' fees and certain forms of equitable relief. On August 18, 2005, Plaintiff amended his complaint to add a purported class action. Adobe has obligations

under certain circumstances to hold harmless and indemnify each of the defendant directors against judgments, fines, settlements and expenses related to claims against such directors and otherwise to the fullest extent permitted under Delaware law and Adobe's bylaws and certificate of incorporation. Such obligations may apply to this lawsuit. We believe the action has no merit and are vigorously defending against it.

In connection with our anti-piracy efforts, conducted both internally and through the Business Software Alliance, from time to time we undertake litigation against alleged copyright infringers. Such lawsuits may lead to counter-claims alleging improper use of litigation or violation of other local law and have recently increased in frequency, especially in Latin American countries. We believe we have valid defenses with respect to such counter-claims; however, it is possible that our consolidated financial position, cash flows or results of operations could be affected in any particular period by the resolution of one or more of these counter-claims.

One such case is Consultores en Computación y Contabilidad, S.C. ("CCC") v. Microsoft, Adobe, Symantec, and Autodesk (the "Defendants"). On March 1, 2002, CCC, a Mexican hardware/software reseller, filed a lawsuit in the Mexico Court of First Instance against the Defendants (all members of the Business Software Alliance). CCC had previously been the target of a criminal anti-piracy enforcement action carried out by the Mexican police authorities on the basis of a piracy complaint filed by the Defendants based on evidence provided to the Defendants. CCC alleged in the lawsuit that it had suffered damages to its reputation as a result of the enforcement action. CCC did not claim economic damages. On November 11, 2002, the trial court judge ruled in favor of the Defendants, holding that no moral damage occurred. After subsequent appeals which were favorable to the Defendants, a court of appeals held that the Defendants were liable to CCC for "moral" damages, and the court remanded the case to the Court of First Instance for a determination of the amount. In December 2005, the Court of First Instance awarded CCC \$90 million in damages. The Defendants are appealing the verdict, as are the plaintiffs who seek additional damages. If, after all appeals have been exhausted, the existing verdict stands and is enforceable, Adobe would be responsible for approximately \$15 million of the judgment.

From time to time, in addition to those identified above, Adobe is subject to legal proceedings, claims, investigations and proceedings in the ordinary course of business, including claims of alleged infringement of third-party patents and other intellectual property rights, commercial, employment and other matters. In accordance with U.S. generally accepted accounting principles, Adobe makes a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case. Litigation is inherently unpredictable. However, we believe that we have valid defenses with respect to the legal matters pending against Adobe. It is possible, nevertheless, that our consolidated financial position, cash flows or results of operations could be affected by the resolution of one or more of such contingencies.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the quarter ended December 2, 2005.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

(a) Our common stock is traded on the Nasdaq National Market under the symbol "ADBE." On January 27, 2006, there were 1,758 holders of record of our common stock. Because many of such shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders. The following table sets forth the high and low sales price per share of our common stock and the cash dividends paid per share, for the periods indicated. All per share amounts in the following table have been adjusted to reflect the two-for-one stock split in the form of a stock dividend effected May 23, 2005.

	<u>Price Range</u>		<u>Cash Dividend</u>
	<u>High</u>	<u>Low</u>	<u>Per Share</u>
Fiscal 2005:			
First Quarter	\$32.56	\$27.40	\$0.00625
Second Quarter	34.48	26.57	—
Third Quarter	32.92	25.80	—
Fourth Quarter	35.68	26.67	—
Fiscal Year	35.68	25.80	0.00625
Fiscal 2004:			
First Quarter	\$21.50	\$17.78	\$0.00625
Second Quarter	23.44	17.15	0.00625
Third Quarter	23.68	19.66	0.00625
Fourth Quarter	31.57	23.27	0.00625
Fiscal Year	31.57	17.15	0.02500

Under the terms of our lease agreements for our San Jose headquarters, we are not prohibited from paying cash dividends unless an event of default occurs. We discontinued our quarterly cash dividend after the payment of the dividend for the first quarter of fiscal 2005. We intend to use the cash previously used to pay the quarterly dividend for our ongoing stock repurchase programs.

For information on our equity compensation plans, refer to Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the sections titled "Employee and Director Stock Options."

(c) Below is a summary of stock repurchases for the quarter ended December 2, 2005 (in thousands, except average price per share). See Note 11 of our Notes to Consolidated Financial Statements for information regarding our stock repurchase programs.

<u>Plan/Period</u>	<u>Shares Repurchased(1)</u>	<u>Average Price Per Share</u>	<u>Maximum Number of Shares that May Yet be Purchased</u>
Stock Repurchase Program I			
Beginning shares available to be repurchased as of September 2, 2005			60,314,885
September 3 - 30, 2005			
From employees(2)	31	\$29.43	
October 1 - 28, 2005			
From employees(2)	168	30.11	
Structured repurchases	6,205,809	29.34	
October 29, 2005 - December 2, 2005			
From employees(2)	31	32.31	
Structured repurchases	5,002,423	32.59	
Total shares repurchased	<u>11,208,462</u>		(11,208,462)
Adjustments to repurchase authority for net dilution			<u>6,933,376(3)</u>
Ending shares available to be repurchased as of December 2, 2005			<u>56,039,799(4)</u>

- (1) All shares were purchased as part of publicly announced plans.
- (2) The repurchases from employees represent shares canceled when surrendered in lieu of cash payments for withholding taxes due.
- (3) Adjustment of authority to reflect changes in the dilution from outstanding shares and options.
- (4) The remaining authorization for the ongoing stock repurchase program is determined by combining all stock issuances, net of any canceled, surrendered or exchanged shares less all stock repurchases under the ongoing plan, beginning in the first quarter of fiscal 1998.

ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data (presented in thousands, except per share amounts and employee data) are derived from our consolidated financial statements. This data should be read in conjunction with the consolidated financial statements and notes thereto, and with Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations. All per share amounts referred to in the table below have been adjusted to reflect the two-for-one stock split in the form of stock dividends effected May 23, 2005.

	Fiscal Years				
	2005	2004	2003	2002	2001
Operations:					
Revenue	\$1,966,321	\$1,666,581	\$1,294,749	\$1,164,788	\$1,229,720
Gross profit	1,853,743	1,562,203	1,201,727	1,060,500	1,148,269
Income before income taxes	765,776	608,645	380,492	284,689	306,931
Net income*	602,839	450,398	266,344	191,399	205,644
Net income per share*					
Basic	1.23	0.94	0.57	0.41	0.43
Diluted	1.19	0.91	0.55	0.40	0.42
Cash dividends declared per common share	0.00625	0.025	0.025	0.025	0.025
Financial position:					
Cash, cash equivalents and short- term investments	1,700,834	1,313,221	1,096,533	617,737	581,613
Working capital	1,528,183	1,107,142	892,498	436,883	453,713
Total assets	2,440,315	1,958,632	1,555,045	1,051,610	932,173
Stockholders' equity	1,864,326	1,423,477	1,100,800	674,321	616,972
Additional data:					
Worldwide employees	4,285	3,848	3,515	3,319	3,043

* In 2005, includes investment loss of \$1.3 million. In 2004, includes investment gain of \$2.5 million. In 2003, includes investment loss of \$12.9 million and reversal of restructuring and other charges of \$0.5 million. In 2002, includes investment loss of \$17.2 million, restructuring and other charges of \$12.1 million, acquired in-process research and development of \$5.8 million, and amortization and impairment of goodwill and purchased and other intangibles of \$21.0 million. In 2001, includes investment loss of \$93.4 million, restructuring and other charges of \$12.1 million, and amortization of goodwill and purchased and other intangibles of \$14.3 million.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion (presented in millions, except share and per share amounts) should be read in conjunction with our consolidated financial statements and notes thereto. The share and per share data below have been adjusted to give effect to our stock split as of May 23, 2005.

In addition to historical information, this Annual Report on Form 10-K contains forward-looking statements, including statements regarding product plans, future growth and market opportunities, which 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 titled "Business—Risk Factors." You should carefully review the risks described herein and in other documents we file from time to time with the SEC, including the Quarterly Reports on Form 10-Q to be filed in 2006. When used in this report, the words "expects," "could," "would," "may," "anticipates," "intends," "plans," "believes," "seeks," "targets," "estimates," "looks for," "looks to," and similar expressions, as well as statements regarding our focus for the future, are generally intended to identify forward-looking statements. You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.

ACQUISITION OF MACROMEDIA

On December 3, 2005, we completed the acquisition of Macromedia for approximately \$3.4 billion. We expect the acquisition to have a significant impact on our consolidated financial position, results of operations and cash flows. We expect our revenues, cost of revenues and operating expenses to increase in the future, but we also anticipate cost saving synergies. In addition, we expect to incur estimated restructuring charges of \$20 million to \$25 million in the next fiscal year, primarily in the first quarter. Coinciding with the integration of Macromedia and the start of our 2006 fiscal year, we changed the reporting of our principal business segments to be aligned with our market opportunities and how we manage our various businesses. The discussions in this section of the Annual Report on Form 10-K, as well as the financial statements contained herein, relate to Adobe as a standalone entity and do not reflect the impact of the acquisition.

BUSINESS OVERVIEW

Founded in 1982, Adobe Systems Incorporated is one of the largest and most diversified software companies in the world. We offer a line of creative, business and mobile software and services used by high-end consumers, creative professionals, designers, knowledge workers, OEM partners, developers and enterprises for creating, managing, delivering and engaging with compelling content and experiences across multiple operating systems, devices and media. We distribute our products through a network of distributors and dealers, VARs, systems integrators, ISVs and OEMs; direct to end users; and through our own Web site at www.adobe.com. We also license our technology to major hardware manufacturers, software developers and service providers and we offer integrated software solutions to businesses of all sizes. We have operations in the Americas, EMEA and Asia. Our software runs on Microsoft Windows, Apple OS, Linux, UNIX and various non-personal computer platforms, depending on the product.

CRITICAL ACCOUNTING ESTIMATES

In preparing our consolidated financial statements, we make assumptions, judgments and estimates that can have a significant impact on amounts reported in our consolidated financial statements. We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. On a regular basis we evaluate our assumptions, judgments and estimates and make changes accordingly. We also discuss our critical accounting estimates

with the Audit Committee of the Board of Directors. We believe that the assumptions, judgments and estimates involved in the accounting for revenue recognition and income taxes have the greatest potential impact on our consolidated financial statements, so we consider these to be our critical accounting policies. We discuss below the critical accounting estimates associated with these policies. Historically, our assumptions, judgments and estimates relative to our critical accounting policies have not differed materially from actual results. For further information on our critical accounting policies, see the discussion in the section titled "Recent Accounting Pronouncements" below and Note 1 of our Notes to Consolidated Financial Statements.

Revenue Recognition

We recognize revenue in accordance with current U.S. generally accepted accounting principles that have been prescribed for the software industry. Revenue recognition requirements in the software industry are very complex and are subject to change. Our revenue recognition policy is one of our critical accounting policies because revenue is a key component of our results of operations and is based on complex rules which require us to make judgments and estimates. In applying our revenue recognition policy we must determine which portions of our revenue are recognized currently and which portions, if any, must be deferred. In order to determine current and deferred revenue, we make judgments and estimates with regard to future deliverable products and services and the appropriate pricing for those products and services. Our assumptions and judgments regarding future products and services could differ from actual events, thus materially impacting our financial position and results of operations.

We have to estimate provisions for returns which are recorded against our revenues. In determining our estimate for returns, and in accordance with our internal policy regarding global channel inventory which is used to determine the level of product held by our distributors on which we have recognized revenue, we rely upon historical data, the estimated amount of product inventory in our distribution channel, the rate at which our product sells through to the end user, product plans and other factors. Our estimated provisions for returns can vary from what actually occurs. More or less product may be returned from what was estimated. The amount of inventory in the channel could be different than what is estimated. Our estimate of the rate of sell through for product in the channel could be different than what actually occurs. There could be a delay in the release of our products. These factors and unanticipated changes in the economic and industry environment could make our return estimates differ from actual returns, thus materially impacting our financial position and results of operations.

Accounting for Income Taxes

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Management must make assumptions, judgments and estimates to determine our current provision for income taxes and also our deferred tax assets and liabilities and any valuation allowance to be recorded against a deferred tax asset. Our judgments, assumptions and estimates relative to the current provision for income tax take into account current tax laws, our interpretation of current tax laws and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. Changes in tax law or our interpretation of tax laws and the resolution of current and future tax audits could significantly impact the amounts provided for income taxes in our consolidated financial statements. Our assumptions, judgments and estimates relative to the value of a deferred tax asset take into account predictions of the amount and category of future taxable income, such as income from operations or capital gains income. Actual operating results and the underlying amount and category of income in future years could render our current assumptions, judgments and estimates of recoverable net deferred taxes inaccurate. Any of the assumptions, judgments and estimates mentioned above could cause our actual income tax obligations to differ from our estimates, thus materially impacting our financial position and results of operations.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards 123—revised 2004 ("SFAS 123R"), "Share-Based Payment" which replaces Statement of Financial Accounting Standards No. 123 ("SFAS 123"), Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees." SFAS 123R requires the measurement of all employee share-based payments to employees, including grants of employee stock options, using a fair-value-based method and the recording of such expense in our consolidated statements of income. In April 2005, the SEC announced that the accounting provisions of SFAS 123R are to be applied in the first quarter of the fiscal year beginning after June 15, 2005. As a result, we are now required to adopt SFAS 123R in the first quarter of fiscal 2006 and will recognize stock-based compensation expense using the modified prospective method. The pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition. See Note 1 in our Notes to Consolidated Financial Statements for the pro forma net income and net income per share amounts as if we had used a fair-value-based method similar to the methods required under SFAS 123R to measure compensation expense for employee stock incentive awards. We are evaluating the requirements under SFAS 123R and expect the adoption to have a significant adverse impact on our consolidated statements of income and net income per share.

See Note 1 in our Notes to Consolidated Financial Statements for information regarding other recent accounting pronouncements.

RESULTS OF OPERATIONS

Overview of 2005

During fiscal 2005, we continued to focus on delivering comprehensive technology platforms to our customers to drive revenue and earnings growth. In our Intelligent Document business, we achieved year-over-year growth primarily due to our Acrobat 7.0 family of products which began shipping in the first quarter. Acrobat 7.0 has numerous new features to help drive increased adoption by users in enterprises, governments and specialized vertical markets such as architecture, engineering and construction. We also achieved year-over-year growth in our Creative Professional business due primarily to the release of version 2 of our Adobe Creative Suite products beginning in the second quarter of the fiscal year. Creative Suite 2.0 integrates new full-versions of Adobe's design and publishing software, along with Version Cue CS2 and a new visual file browser called Adobe Bridge. Beginning in fiscal 2004, many customers began licensing Photoshop capabilities via the Creative Suite products, as opposed to licensing the standalone version of the product. This planned migration has impacted the revenues from our Digital Imaging and Video business segment. However, our total revenue in the Digital Imaging and Video business grew in fiscal 2005 due to the strength of our Adobe Photoshop Elements and Adobe Premiere Elements software bundle, new versions of which were released in the fourth quarter of fiscal 2005.

Revenue

	Fiscal 2005	% Change 2005 to 2004	Fiscal 2004	% Change 2004 to 2003	Fiscal 2003
Product	\$1,923.3	18%	\$1,634.0	29%	\$1,269.0
Percentage of total revenues	98%		98%		98%
Services and support	43.0	32%	32.6	27%	25.7
Percentage of total revenues	2%		2%		2%
Total revenues	<u>\$1,966.3</u>	18%	<u>\$1,666.6</u>	29%	<u>\$1,294.7</u>

In fiscal 2005, we had four reportable segments: Digital Imaging and Video, Creative Professional, Intelligent Document, and OEM PostScript and Other. The Digital Imaging and Video segment provides

users with software for creating, editing, enhancing and sharing digital images and photographs, digital video, audio and animations. The Creative Professional segment provides software for professional page layout, professional Web page layout, graphic and illustration creation, technical document publishing and business publishing. Additionally, this segment includes Photoshop and Acrobat Professional as part of its Adobe Creative Suite products. The Intelligent Document segment provides electronic document distribution software that allows users to create, enhance, annotate and securely send Adobe PDF files that can be shared, viewed, navigated and printed exactly as intended on a broad range of hardware and software platforms. In addition, this segment provides server-based solutions for enterprises, in the areas of document generation, document process management, document collaboration, and document control and security. The OEM PostScript and Other segment includes printing technology used to create and print simple or visually rich documents with precision.

Our services and support revenue is composed of professional services (such as consulting services and training) and maintenance and support, primarily related to the licensing of our Intelligent Document server solution products. Our support revenue also includes technical support and developer support to partners and developer organizations related to our desktop products. Our professional services revenue is recognized using the proportional performance method and is measured monthly based on input measures, such as hours incurred to date compared to total estimated hours to complete, with consideration given to output measures, such as contract milestones, when applicable. Our maintenance and support offerings, which entitle customers to receive product upgrades and enhancements or technical support, depending on the offering, are recognized ratably over the term of the arrangement.

Segment Information

	Fiscal 2005	% Change 2005 to 2004	Fiscal 2004	% Change 2004 to 2003	Fiscal 2003
Digital Imaging and Video	\$ 432.8	1%	\$ 430.2	10%	\$ 392.4
Percentage of total revenues	22%		26%		30%
Creative Professional	743.8	21%	613.1	66%	368.5
Percentage of total revenues	38%		37%		29%
Intelligent Document	708.0	31%	541.8	22%	444.1
Percentage of total revenues	36%		32%		34%
OEM PostScript and Other	81.7	—%	81.5	(9)%	89.7
Percentage of total revenues	4%		5%		7%
Total revenues	<u>\$1,966.3</u>	18%	<u>\$1,666.6</u>	29%	<u>\$1,294.7</u>

Beginning in the first quarter of fiscal year 2006 with the completion of our acquisition of Macromedia, we changed the reporting of our business segments to be aligned with our market opportunities and how we manage our combined businesses. Our new business segments are Creative Solutions, Knowledge Worker Solutions, Enterprise and Developer Solutions, Mobile and Device Solutions, and Other. The management discussion and analysis that follows is based on the segment reporting that was in effect throughout fiscal 2005.

Fiscal 2005 Revenue Compared to Fiscal 2004 Revenue

Revenue from our Digital Imaging and Video segment grew slightly for fiscal 2005 as compared to fiscal 2004. The growth in the segment was due to the 3% increase in revenues from our digital imaging software products as a result of new releases of our Adobe Photoshop Elements product as well as the new software bundle that combines our Adobe Photoshop Elements and Adobe Premiere Elements products.

Revenue from our Creative Professional segment increased during fiscal 2005 as compared to fiscal 2004 primarily due to a 32% increase in revenues from the new versions of our Adobe Creative Suite

products which were released during the second quarter of fiscal 2005. There were no notable decreases for fiscal 2005.

Revenue from our Intelligent Document segment increased during fiscal 2005 as compared to fiscal 2004 primarily due to a 36% increase in revenues from our Acrobat desktop products. The increase in revenues from our Acrobat desktop products is due to continued adoption of Acrobat desktop products by enterprises and technical professionals, as well as the release of Acrobat 7.0 during the first quarter of fiscal 2005. Revenue from our Intelligent Document LiveCycle products increased approximately 10% during fiscal 2005 due to increased licensing and server support revenue, as we continue to focus on both the government sector and financial services. Additionally, revenue from our Intelligent Document segment increased during fiscal 2005 due to an increase in consulting revenues. There were no notable decreases for fiscal 2005.

Revenue from our OEM PostScript and Other segment remained relatively flat during fiscal 2005 as compared to fiscal 2004. Revenue from this segment has declined over the last few years and we expect this trend to continue.

Fiscal 2004 Revenue Compared to Fiscal 2003 Revenue

Revenue from our Digital Imaging and Video segment increased during fiscal 2004 as compared to fiscal 2003 due to increases in revenues from both our digital video and digital imaging software products. Revenue from our digital video software products increased 9% during fiscal 2004 which was attributable to new releases during fiscal 2004. Revenue from our digital imaging software products increased 10% during fiscal 2004 due to continued success with Adobe Photoshop CS which was released at the end of fiscal 2003 as well as the release of Photoshop Elements 3.0 in fiscal 2004.

Revenue from our Creative Professional segment increased during fiscal 2004 as compared to fiscal 2003 primarily due to the continued strength of our Adobe Creative Suite products which were initially released in the fourth quarter of fiscal 2003. The increase in revenues from our Adobe Creative Suite products were partially offset by decreases in revenues in our business and technical page layout software products due to product lifecycle timing.

Revenue from our Intelligent Document segment increased during fiscal 2004 as compared to fiscal 2003 primarily due to a 17% increase in revenues from our Acrobat desktop products as a result of continued adoption of Acrobat desktop products launched in fiscal 2003. Additionally, revenue from our Intelligent Document server-based products increased 50% due to increased licensing and server support revenue.

Revenue from our OEM PostScript and Other segment decreased during fiscal 2004 as compared to fiscal 2003 due to a decline in pricing resulting from competition from clone PostScript technologies and lower prices of output devices.

Geographic Information

	Fiscal 2005	% Change 2005 to 2004	Fiscal 2004	% Change 2004 to 2003	Fiscal 2003
Americas	\$ 939.7	22%	\$ 770.6	20%	\$ 640.2
Percentage of total revenues	48%		46%		49%
EMEA	612.7	13%	541.5	46%	370.2
Percentage of total revenues	31%		33%		29%
Asia	413.9	17%	354.5	25%	284.3
Percentage of total revenues	21%		21%		22%
Total revenues	<u>\$1,966.3</u>	18%	<u>\$1,666.6</u>	29%	<u>\$1,294.7</u>

Revenue in the Americas increased during fiscal 2005 as compared to fiscal 2004 due to the strength of our Digital Imaging and Video, Creative Professional and Intelligent Document products.

Revenue in EMEA and Asia increased during fiscal 2005 as compared to fiscal 2004 due to the strength of our Creative Professional and Intelligent Document products.

The increase in revenues, in fiscal 2004 as compared to fiscal 2003, in each of our geographic segments was primarily due to the strength of our Creative Professional products.

Additionally, due to the strength of the euro and the yen, revenues in EMEA and Asia increased approximately \$15.0 million and \$3.0 million, respectively, during fiscal 2005 over fiscal 2004 and increased \$50.2 million and \$18.0 million, respectively, during fiscal 2004 over fiscal 2003.

Platform Information

	<u>Fiscal 2005</u>	<u>Fiscal 2004</u>	<u>Fiscal 2003</u>
Windows	75%	73%	74%
Macintosh	25%	27%	26%

We expect a growth trend towards the Windows platform over the long term due to our targeting of business users with our Intelligent Document desktop products, where the majority of users run the Windows operating system.

Inventory Information

At the end of fiscal 2005 our overall channel inventory position was within our global inventory policy which allows, on an overall basis, up to 4.5 weeks of anticipated total product supply at our distributors.

With regard to our product backlog, our experience is that the actual amount of backlog at any particular time may not be a meaningful indicator of future business prospects. For example, prior to the finalization and release of new products, we may have significant levels of orders for new product releases. Our backlog of unfulfilled orders at the end of fiscal 2005, other than those associated with new product releases, those pending credit review and those due to the application of our global channel inventory policy, was approximately 8% of fourth quarter fiscal 2005 revenue. The comparable backlog at the end of third quarter of fiscal 2005 was approximately 2% of third quarter fiscal 2005 revenue.

Cost of Revenues

	<u>Fiscal 2005</u>	<u>% Change 2005 to 2004</u>	<u>Fiscal 2004</u>	<u>% Change 2004 to 2003</u>	<u>Fiscal 2003</u>
Product	\$ 90.0	4%	\$ 86.6	8%	\$79.9
Percentage of total revenues	5%		5%		6%
Services and support	22.6	27%	17.8	36%	13.1
Percentage of total revenues	1%		1%		1%
Total cost of revenues	<u>\$112.6</u>	8%	<u>\$104.4</u>	12%	<u>\$93.0</u>

Product

Cost of product revenue includes product packaging, third-party royalties, excess and obsolete inventory, amortization related to localization costs and acquired technologies and the costs associated with the manufacturing of our products.

Cost of product revenue increased 5% during fiscal 2005 as compared to fiscal 2004 due to material costs related to higher shrink-wrap revenue, 3% due to an increase in our localization costs related to our

product launches, 2% related to royalties for licensed technologies, 1% related to excess and obsolete inventory and other expenses. These increases were partially offset by an 8% decrease in cost of product revenue due to a one time charge related to a litigation settlement that occurred during the second quarter of fiscal 2004. The remaining 1% increase in cost of product revenue for fiscal 2005 was due to various individually insignificant items.

Cost of product revenue increased during fiscal 2004 as compared to fiscal 2003 primarily due to licensing costs as a result of litigation settlements that occurred in fiscal 2004 and an increase in localization costs related to our product launches. These increases were partially offset by a decrease in overall material costs.

Services and Support

Cost of services and support revenue is composed primarily of employee-related costs and related costs incurred to provide consulting services, training and product support.

Cost of services and support revenue increased during fiscal 2005 as compared to fiscal 2004 primarily due to increases in headcount related expenses, including higher compensation and related benefits, as well as outsourced consulting fees.

Cost of services and support revenue increased during fiscal 2004 as compared to fiscal 2003 due to costs associated with our Expert Support program that was initiated during the second quarter of fiscal 2004. Additionally, cost of services and support revenue increased due to compensation and related benefits as a result of higher headcount and incentive compensation related to increases in services and support activities in fiscal 2004.

Operating Expenses

Research and Development

	<u>Fiscal 2005</u>	<u>% Change 2005 to 2004</u>	<u>Fiscal 2004</u>	<u>% Change 2004 to 2003</u>	<u>Fiscal 2003</u>
Expenses	\$365.3	17%	\$311.3	12%	\$277.0
Percentage of total revenues	19%		19%		21%

Research and development expenses consist of salary and benefit expenses for software developers, contracted development efforts, related facilities costs and expenses associated with computer equipment used in software development.

Research and development expenses fluctuated due to the following:

	<u>% Change 2005 to 2004</u>	<u>% Change 2004 to 2003</u>
Compensation and related benefits associated with headcount growth and higher incentive compensation	10%	8%
Increased use of contractors	1	—
Increased purchases of equipment and software licenses	2	—
Various individually insignificant items	4	4
Total change	<u>17%</u>	<u>12%</u>

We believe that investments in research and development, including the recruiting and hiring of software developers, are critical to remain competitive in the marketplace and are directly related to continued timely development of new and enhanced products. We will continue to focus on long-term opportunities available in our end markets and make significant investments in the development of our software products.

Sales and Marketing

	Fiscal 2005	% Change 2005 to 2004	Fiscal 2004	% Change 2004 to 2003	Fiscal 2003
Expenses	\$593.3	14%	\$521.1	23%	\$423.4
Percentage of total revenues	30%		31%		33%

Sales and marketing expenses include salary and benefit expenses, sales commissions, travel expenses and related facilities costs for our sales, marketing, customer support, order management and global supply chain management personnel. Sales and marketing expenses also include the costs of programs aimed at increasing revenue, such as advertising, trade shows, public relations and other market development programs.

Sales and marketing expenses fluctuated due to the following:

	% Change 2005 to 2004	% Change 2004 to 2003
Compensation and related benefits associated with headcount growth and higher incentive compensation	7%	12%
Increased marketing spending related to product launches and overall marketing efforts to further increase revenues	4	9
Various individually insignificant items	3	2
Total change	<u>14%</u>	<u>23%</u>

General and Administrative

	Fiscal 2005	% Change 2005 to 2004	Fiscal 2004	% Change 2004 to 2003	Fiscal 2003
Expenses	\$166.7	21%	\$138.0	13%	\$122.4
Percentage of total revenues	8%		8%		9%

General and administrative expenses consist of compensation and benefit expenses, travel expenses, and related facilities costs for our finance, facilities, human resources, legal, information services and executive personnel. 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 fluctuated due to the following:

	% Change 2005 to 2004	% Change 2004 to 2003
Compensation and related benefits associated with headcount growth and higher incentive compensation	8%	10%
Increased professional fees	6	3
Increased depreciation and amortization	3	—
Increased repairs and maintenance	2	—
Decreased legal fees	(2)	—
Various individually insignificant items	4	—
Total change	<u>21%</u>	<u>13%</u>

Restructuring and Other Charges

	Fiscal 2005	% Change 2005 to 2004	Fiscal 2004	% Change 2004 to 2003	Fiscal 2003
Expenses	\$—	—%	\$—	*%	\$(0.5)
Percentage of total revenues	—		—		*%

* Percentage is not meaningful.

We did not incur any restructuring and other charges in fiscal 2005 and 2004. During fiscal 2003, we revised our estimates of certain costs associated with our restructuring program that was implemented in the fourth quarter of fiscal 2002. As a result, we revised the accrual related to severance and other charges and facilities.

Non-operating Income

	Fiscal 2005	% Change 2005 to 2004	Fiscal 2004	% Change 2004 to 2003	Fiscal 2003
Investment gain (loss)	\$(1.3)	*%	\$ 2.5	*%	\$(12.9)
Percentage of total revenues	*%		*%		(1)%
Interest and other income	38.6	*%	14.3	3%	13.9
Percentage of total revenues	2%		1%		1%
Total non-operating income	<u>\$37.3</u>	*%	<u>\$16.8</u>	*%	<u>\$ 1.0</u>

* Percentage is not meaningful.

Investment Gain (Loss)

Investment gain (loss) consists principally of realized gains or losses from the sale of marketable equity investments, other-than-temporary declines in the value of marketable and non-marketable equity securities, and gains and losses of Adobe Ventures.

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net losses related to our investments in Adobe Ventures and cost method investments	\$(1.0)	\$(0.1)	\$(12.0)
Write-downs due to other-than-temporary declines in value of our marketable equity securities	(0.6)	—	(4.0)
Gains from sale of short-term investments	0.1	2.5	3.1
Gains on stock warrants	0.2	0.1	—
Total investment gain (loss)	<u>\$(1.3)</u>	<u>\$ 2.5</u>	<u>\$(12.9)</u>

We are uncertain of future investment gains or losses as they are primarily dependent upon market conditions and the operations of the underlying investee companies.

Interest and Other Income

The largest component of interest and other income is interest earned on cash, cash equivalents and short-term fixed income investments, but also includes gains and losses on the sale of fixed income investments, foreign exchange transactions including hedging gains and losses, and interest expense.

Interest and other income increased in fiscal 2005 as compared to fiscal 2004 primarily due to higher interest income as a result of higher levels of cash and higher interest rates during fiscal 2005, as well as higher gains on our foreign currency hedging program.

Interest and other income increased in fiscal 2004 as compared to fiscal 2003 due to higher levels of cash during fiscal 2004.

Income Tax Provision

	Fiscal 2005	% Change 2005 to 2004	Fiscal 2004	% Change 2004 to 2003	Fiscal 2003
Provision	\$162.9	3%	\$158.2	39%	\$114.1
Percentage of total revenues	8%		10%		9%
Effective tax rate	21%		26%		30%

Our effective tax rate decreased 4 percentage points during fiscal 2005 as compared to fiscal 2004 due to a \$29.3 million tax benefit recognized for the repatriation of certain foreign earnings under FASB Staff Position No. FAS 109-2 (“FAS 109-2”), “Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creations Act of 2004 (“AJCA”).” See Note 1 in our Notes to Consolidated Financial Statements for information regarding FAS 109-2. The net tax benefit includes a \$72.8 million reversal for taxes on foreign earnings for which a deferred tax liability had been previously accrued. In addition, our effective tax rate decreased 1 percentage point due to a variety of factors, including higher profits earned by our international trading company which are taxed at a lower statutory rate and a reduction of a valuation allowance against certain deferred tax assets.

Our effective tax rate decreased in fiscal 2004 from fiscal 2003 due to higher profits earned by our international trading company which are taxed at a lower statutory rate.

EMPLOYEE AND DIRECTOR STOCK OPTIONS

Option Program Description

Our stock option program is a long-term retention program that is intended to attract, retain and provide incentives for talented employees, officers and directors, and to align stockholder and employee interests. We consider our stock option program critical to our operation and productivity; essentially all of our employees participate. Option vesting periods are generally three years for all of the plans within our stock option program. For further information regarding our stock option program, see Note 10 of our Notes to Consolidated Financial Statements.

All stock option grants to executive officers are made after a review by and with the approval of the Executive Compensation Committee of the Board of Directors. All members of the Executive Compensation Committee are independent directors, as defined in the rules applicable to issuers traded on the Nasdaq Stock Market. See the “Report of the Executive Compensation Committee” appearing in our 2006 Proxy Statement for further information concerning the policies and procedures, of Adobe and the Executive Compensation Committee, regarding the use of stock options for executive officers.

Distribution and Dilutive Effect of Options

The table below provides information about stock options granted for fiscal years 2005, 2004 and 2003 to our Chief Executive Officer and our four other most highly compensated executive officers. This group is referred to as the Named Executive Officers.

Options granted to employees, directors and Named Executive Officers for fiscal 2003 through 2005 are summarized as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net grants† during the period as % of outstanding shares	2%	4%	(3)%
Net grants to Named Executive Officers during the period as % of total options granted	12%	9%	0%
Net grants to Named Executive Officers during the period as % of outstanding shares	*%	*%	0%
Cumulative options held by Named Executive Officers as % of total options outstanding	15%	16%	16%

† “Net grants” equals the sum of the number of shares subject to options granted to all employees, directors and Named Executive Officers during the specified period reduced by the number of shares subject to options which were canceled or otherwise terminated during such period. Net grants during fiscal 2004 reflect the new options granted in exchange for options cancelled under our stock option exchange program in fiscal 2003. Net grants during fiscal 2003 reflect the cancellation of options under our stock option exchange program. Net grants as a percentage of outstanding shares are based on 488.7 million shares, 484.4 million shares and 476.6 million shares of our common stock outstanding as of December 2, 2005, December 3, 2004 and November 28, 2003 respectively.

* Less than 1%.

For additional information about our employee stock option plan activity and pro forma earnings presentation as if we had accounted for our grant of employee stock options using the fair value method of accounting under Statement of Financial Accounting Standards No. 123 (“SFAS No. 123”), “Accounting for Stock-Based Compensation,” refer to Notes 1 and 11 of our Notes to Consolidated Financial Statements.

Options granted to the Named Executive Officers as a percentage of the total options granted to all employees and directors vary from year to year. For additional information about the compensation of our executive officers and stock option grants to our Named Executive Officers, refer to our 2006 Proxy Statement we will deliver to our stockholders in connection with our Annual Meeting of Stockholders to be held on March 28, 2006.

General Option Information

The following table sets forth the summary of option activity under our stock option program for fiscal 2005, 2004 and 2003:

	Options Available for Grant	Outstanding Options	
		Number of Shares	Weighted Average Exercise Price
November 29, 2002	11,133,942	115,694,100	\$17.82
Granted	(3,988,260)	3,988,260	16.56
Exercised	—	(15,956,108)	11.91
Canceled	18,777,070	(18,786,946)	29.00
Expired	(16,012)	—	—
November 28, 2003	25,906,740	84,939,306	16.40
Granted	(20,759,510)	20,759,510	21.07
Exercised	—	(26,587,728)	13.55
Canceled	2,578,456	(2,578,456)	20.46
Expired	(18,518)	—	—
Increased authorization	9,000,000	—	—
December 3, 2004	16,707,168	76,532,632	18.52
Granted	(11,418,499)	11,418,499	31.88
Exercised	—	(20,494,162)	15.32
Canceled	2,205,685	(2,205,685)	21.52
Increased authorization	16,800,000	—	—
December 2, 2005	<u>24,294,354</u>	<u>65,251,284</u>	\$21.76

The following table sets forth a comparison, as of December 2, 2005, of the number of shares subject to our options whose exercise prices were at or below the closing price of our common stock on December 2, 2005 (“In-the-Money” options) to the number of shares subject to options whose exercise prices were greater than the closing price of our common stock on such date (“Out-of-the-Money” options):

	Exercisable	Unexercisable	Total	Percentage of Total Options Outstanding
In-the-Money*	41,989,006	23,152,478	65,141,484	100%
Out-of-the-Money*	109,800	—	109,800	†%
Total Options Outstanding	<u>42,098,806</u>	<u>23,152,478</u>	<u>65,251,284</u>	<u>100%</u>

* The closing price of our common stock was \$34.97 on December 2, 2005, as reported by the Nasdaq National Market.

† Less than 1%

Equity Compensation Plan Information

The following table gives information about our common stock that may be issued under our existing equity compensation plans as of December 2, 2005:

Plan Category	Number of Securities to Be Issued Upon Exercise of Outstanding Options (a)	Weighted Average Exercise Price of Outstanding Options (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)
Equity compensation plans approved by stockholders	65,251,284	\$21.76	52,533,618*

* Includes 5.5 million shares and 22.8 million shares, respectively, which are reserved for issuance under the 1994 Performance and Restricted Stock Plan and the 1997 Employee Stock Purchase Plan as of December 2, 2005.

LIQUIDITY AND CAPITAL RESOURCES

	Fiscal 2005	% Change 2005 to 2004	Fiscal 2004	% Change 2004 to 2003	Fiscal 2003
Cash, cash equivalents and short-term investments	\$1,700.8	30%	\$1,313.2	20%	\$1,096.5
Working capital	1,528.2	38%	1,107.1	24%	892.5
Stockholders' equity	\$1,864.3	31%	\$1,423.5	29%	\$1,100.8

Our primary source of cash is receipts from revenue. The primary uses of cash are payroll (salaries, bonuses, and benefits), general operating expenses (marketing, travel, office rent) and cost of product revenue. Another source of cash is proceeds from the exercise of employee options and another use of cash is our stock repurchase program, which is detailed below.

In fiscal 2005, we reclassified all auction rate securities and variable rate demand obligations to short-term investments pursuant to an interpretation of Statement of Financial Accounting Standards No. 95 ("SFAS 95"), "Statement of Cash Flows" relating to the definition of cash equivalents. This interpretation and subsequent reclassification has resulted in a presentation of our consolidated balance sheet that may understate the true liquidity of our fixed income portfolio. As of December 2, 2005, \$158.2 million of the securities now classified as short-term investments have structural features that allow us to sell the securities at par within 90 days and thus retain similar liquidity characteristics as cash equivalents.

Cash provided by operating activities for fiscal 2005, of \$730.4 million, primarily comprised net income, net of non-cash related expenses. Working capital sources of cash were increases in accrued expenses, income taxes payable and deferred revenue. Accrued expenses increased primarily due to compensation related costs and marketing expenses. Income taxes payable increased as a result of higher current tax liabilities related to repatriation of certain foreign earnings and overall increased taxable income. Deferred revenue increased primarily due to increased maintenance and support obligations. Working capital uses of cash included increases in trade receivables and other current assets. Our accounts receivable increased due to higher revenue during the period. As compared to fiscal 2004, our days sales outstanding in trade receivables ("DSO") was 31 days, one day higher than fiscal 2004. Other current assets increased due to an increase in prepaid expenses primarily related to acquisition costs.

Cash provided by operating activities for fiscal 2004, of \$683.7 million primarily comprised net income, net of non-cash related expenses. Working capital sources of cash were increases in accrued expenses, deferred revenue and a decrease in accounts receivable. Accrued expenses increased primarily

due to compensation related costs. Deferred revenue increased primarily due to increased maintenance and support obligations. Our accounts receivable decreased due to increased levels of cash collections. Our trade DSO decreased from 37 days at November 28, 2003 to 30 days at December 3, 2004. Working capital uses of cash included a decrease in income taxes payable due to tax payments made for both agreed and disputed tax assessments.

Cash provided by operating activities for fiscal 2003, of \$433.1 million, primarily comprised net income, net of non-cash related expenses, and increases in accrued expenses, income taxes payable and deferred revenue. Accrued expenses increased primarily due to incentive compensation related costs, sales and marketing programs, legal fees and accruals for major product releases. Income taxes payable increased due to an increase in taxable income. Deferred revenue increased primarily due to increased maintenance obligations. These increases were partially offset by an increase in receivables at the end of the year and a decrease in accrued restructuring charges. The increase in receivables was primarily due to the increase in revenues during the year and the launch of our new Creative Suites and related CS products at the end of the year. The decrease in accrued restructuring is primarily due to the payments of severance and facility costs.

Net cash used for investing activities in fiscal 2005 of \$320.4 million decreased from net cash used in fiscal 2004 of \$330.3 million because there was not an investment in a lease receivable (related to our corporate headquarter office buildings) in 2005 as there was in 2004. This was partially offset by higher net purchases of short-term investments in fiscal 2005. Net cash used for investing activities in fiscal 2004 decreased from net cash used in fiscal 2003 of \$577.8 million due primarily to lower net purchases of short-term investments in fiscal 2004.

Cash used for financing activities in fiscal 2005 of \$246.6 million increased from cash used in fiscal 2004 of \$224.5 million primarily due to a decrease in proceeds received from the re-issuance of treasury stock as a result of a lower number of options being exercised. Cash used for financing activities in fiscal 2004 increased from the cash provided in fiscal 2003 of \$117.0 million primarily due to repurchases of stock. Cash used for stock repurchases during fiscal 2004 increased from fiscal 2003 due to a higher average cost per share, a higher number of shares being repurchased and remaining prepayments related to stock repurchase agreements (see the section titled "Stock Repurchase Program I—On-Going Dilution").

We discontinued our quarterly cash dividend after the payment of the dividend for the first quarter of fiscal 2005. We intend to use the cash previously used to pay the quarterly dividend for our ongoing stock repurchase programs. Under the terms of our lease agreements for our San Jose headquarters, we are not prohibited from paying cash dividends unless an event of default occurs.

We expect to continue our investing activities, including investments in short-term and long-term investments and purchases of computer systems for research and development, sales and marketing, product support, and administrative staff. Furthermore, cash reserves may be used to repurchase stock under our stock repurchase programs and strategically acquire software companies, products or technologies that are complementary to our business.

Adobe uses professional investment management firms to manage most of our invested cash. External investment firms managed, on average, 88% of Adobe's invested balances during fiscal 2005. Within the U.S., the fixed income portfolio is primarily invested in municipal bonds. Outside of the U.S., our fixed income portfolio is primarily invested in U.S. Treasury notes and other sovereign obligations, and highly rated corporate notes. The balance of the fixed income portfolio is managed internally and invested primarily in money market funds for working capital purposes. All investments are made according to policies approved by the Board of Directors.

During fiscal 2005, we completed our evaluation of the repatriation provisions of the AJCA and repatriated \$558.3 million of certain foreign earnings. The effect of the repatriation was to increase liquidity in the United States with a corresponding reduction in liquidity in foreign subsidiaries. We expect

that our foreign subsidiaries will have sufficient positive cash flow from operations to meet ongoing liquidity needs over the next 12 months. Further information regarding the tax effects of the AJCA can be found in Note 8 of our Notes to Consolidated Financial Statements.

Our existing cash, cash equivalents and investment balances may decline during fiscal 2006 in the event of a weakening of the economy or changes in our planned cash outlay. However, based on our current business plan and revenue prospects, we believe that our existing balances together with our anticipated cash flows from operations will be sufficient to meet our working capital and operating resource expenditure requirements for the next twelve months. Cash from operations could be affected by various risks and uncertainties, including, but not limited to the risks detailed in the section entitled "Business—Risk Factors." Also, while we currently have no committed lines of credit, we believe that our banking relationships and good credit should afford us the opportunity to raise sufficient debt in the bank or public market, if required.

Acquisition of Macromedia

On December 3, 2005, we completed the acquisition of Macromedia, Inc. for approximately \$3.4 billion. Under the terms of the agreement, which was approved by the boards of directors and the stockholders of both companies, Macromedia stockholders received, at a fixed exchange ratio, 1.38 shares of Adobe common stock for every share of Macromedia common stock in a tax-free exchange. This fixed exchange ratio gives effect to the two-for-one stock split in the form of a stock dividend paid on May 23, 2005 to the stockholders of Adobe. We expect to incur significant incremental costs, such as direct costs related to the acquisition and costs associated with restructuring our operations. We believe that our existing cash and cash equivalents, short-term investments and cash generated from operations will be sufficient to meet these cash outlays.

Stock Repurchase Program I—On-going Dilution Coverage

To facilitate our stock repurchase program, designed to return value to our stockholders and minimize dilution from stock issuances, we repurchase shares in the open market and from time to time enter into structured stock repurchase agreements with third parties.

Authorization to repurchase shares to cover on-going dilution is not subject to expiration. However, this repurchase program is limited to covering net dilution from stock issuances and is subject to business conditions and cash flow requirements as determined by our Board of Directors from time to time. Refer to Part II, Item 5(c) in this report for share repurchases during the quarter ended December 2, 2005.

During fiscal 2005, we entered into several structured stock repurchase agreements with large financial institutions. Under these agreements, we provided the financial institutions with up-front payments totaling \$600.0 million. The financial institutions agreed to deliver to us, at certain intervals during the contract term, a certain number of our shares based on the volume weighted average price during such intervals less a specified discount. Upon payment, the \$600.0 million was classified as treasury stock on our balance sheet. As of December 2, 2005, approximately \$154.9 million of the up-front payments remained under the agreements which expired on December 22, 2005.

On April 17, 2005, the Board of Directors approved the use of \$1.0 billion for stock repurchase commencing upon the close of the Macromedia acquisition. At the beginning of our fiscal 2006, we entered into additional structured stock repurchase agreements with large financial institutions. Under these agreements, we provided the financial institutions with up-front payments totaling \$500.0 million. The financial institutions agreed to deliver to us, at certain intervals during the contract term, a certain number of shares based on the volume weighted average price during such intervals less a specified discount. The \$500.0 million will be classified as treasury stock on our balance sheet.

Stock Repurchase Program II—Additional Authorization above Dilution Coverage

On September 25, 2002, our Board of Directors authorized a program to purchase up to an additional 10.0 million shares of our common stock over a three-year period, subject to certain business and cash flow requirements. We have not made any purchases under this 10.0 million share repurchase program. The authorization for this program expired in September 2005.

Summary of Stock Repurchases for fiscal 2005, 2004 and 2003 (in thousands, except average amounts)

Board Approval Date	Repurchases Under the Plan	2005		2004		2003	
		Shares	Average	Shares	Average	Shares	Average
December 1997	From employees(1)	7	\$29.16	10	\$25.65	36	\$17.50
	Open market	—	—	12,414	20.82	2,370	16.48
	Option exercises(2)	—	—	—	—	3,168	14.23
	Structured repurchases(3)	18,708	30.61	9,532	23.33	—	—
Total shares		18,715	\$30.61	21,956	\$21.91	5,574	\$15.21
Total cost		\$572,930		\$481,075		\$84,777	

- (1) The repurchases from employees represent shares canceled when surrendered in lieu of cash payments for the option exercise price or withholding taxes due.
- (2) Exercises of outstanding put and call options.
- (3) Stock repurchase agreements executed with large financial institutions. See "Stock Repurchase Program I—On-going Dilution Coverage" above.

Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

Our principal commitments as of December 2, 2005, consist of obligations under operating leases, royalty agreements and various service agreements. We expect to fulfill all of the following commitments from our working capital.

Lease Commitments

The two lease agreements discussed in Note 14 of our Notes to Consolidated Financial Statements are subject to standard financial covenants. As of December 2, 2005 we were in compliance with all of our financial covenants. We expect to remain within compliance in the next 12 months. We are comfortable with these limitations and believe they will not impact our credit or cash in the coming year or restrict our ability to execute our business plan. See Note 14 of our Notes to Consolidated Financial Statements for further information regarding our lease commitments.

The following table summarizes our contractual commitments as of December 2, 2005:

	Total	Less than 1 year	1-3 years	3-5 years	Over 5 years
Non-cancelable operating leases, net of sublease income	\$160.4	\$29.9	\$44.9	\$27.2	\$58.4

Indemnifications

In the normal course of business, we provide indemnifications of varying scope to customers against claims of intellectual property infringement made by third parties arising from the use of our products. Historically, costs related to these indemnification provisions have not been significant and we are unable to estimate the maximum potential impact of these indemnification provisions on our future results of operations.

To the extent permitted under Delaware law, we have agreements whereby we indemnify our officers and directors for certain events or occurrences while the officer or director is, or was serving, at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the officer's or director's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that limits our exposure and enables us to recover a portion of any future amounts paid. We believe the estimated fair value of these indemnification agreements in excess of applicable insurance coverage is minimal.

As part of our limited partnership interests in Adobe Ventures, we have provided a general indemnification to Granite Ventures, an independent venture capital firm and sole general partner of Adobe Ventures, for certain events or occurrences while Granite Ventures is, or was serving, at our request in such capacity provided that Granite Ventures acts in good faith on behalf of the partnerships. We are unable to develop an estimate of the maximum potential amount of future payments that could potentially result from any hypothetical future claim, but believe the risk of having to make any payments under this general indemnification to be remote.

Royalties

We have certain royalty commitments associated with the shipment and licensing of certain products. Royalty expense is generally based on a dollar amount per unit shipped or a percentage of the underlying revenue and are not included in the table above. Royalty expense, which was recorded under our cost of products revenue on our consolidated statements of income, was approximately \$17.8 million, \$15.9 million and \$14.5 million in fiscal 2005, 2004 and 2003, respectively. Certain royalty commitments have minimum commitment obligations, however, as of December 2, 2005 all such obligations were immaterial.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

All market risk sensitive instruments were entered into for non-trading purposes.

Foreign Currency Hedging Instruments

We transact business in foreign countries, in U.S. dollars and in various foreign currencies. In Europe and Japan, transactions that are denominated in euro or yen subject us to exposure from movements in foreign currency exchange rates. This exposure is primarily related to yen-denominated product and support revenue in Japan and euro-denominated product and support revenue in certain European countries. In fiscal 2005, 2004 and 2003, our revenue exposures were 26.4 billion yen, 24.1 billion yen and 21.3 billion yen, respectively. In fiscal 2005, 2004 and 2003, our revenue exposures were 411.4 million euros, 375.4 million euros and 274.0 million euros, respectively.

Our Japanese operating expenses are in yen and our European operating expenses are primarily in euro, which mitigates a portion of the exposure related to yen and euro denominated product revenue. In addition, we hedge firmly committed transactions using forward contracts. These contracts do subject us to risk of accounting gains and losses; however, the gains and losses on these contracts largely offset gains and losses on the assets, liabilities and transactions being hedged. We also hedge a percentage of forecasted international revenue with forward and purchased option contracts. Our revenue hedging policy is intended to reduce the negative impact on our forecasted revenue due to foreign currency exchange rate movements. At December 2, 2005, total outstanding contracts were \$339.3 million which included the

notional equivalent of \$133.0 million in foreign currency forward exchange contracts which hedged our balance sheet exposures and the notional equivalent of \$206.3 million in put option contracts which hedged our forecasted revenue. As of December 2, 2005, all contracts were set to expire at various times through April 2006. The bank counterparties in these contracts expose us to credit-related losses in the event of their nonperformance. However, to mitigate that risk we only contract with counterparties with specific minimum rating requirements. In addition, our hedging policy establishes maximum limits for each counterparty.

In addition we also have long term investment exposures consisting of the capitalization and retained earnings in our non-USD functional currency foreign subsidiaries. For the fiscal years ending December 2, 2005 and December 3, 2004 this long term investment exposure totaled a notional equivalent of \$56.7 million and \$40.1 million, respectively. At this time we do not hedge these long term investment exposures.

Economic Hedging—Hedges of Forecasted Transactions

We use option foreign exchange contracts to hedge certain operational (“cash flow”) exposures resulting from changes in foreign currency exchange rates. These foreign exchange contracts, carried at fair value, may have maturities between one and twelve months. Such cash flow exposures result from portions of our forecasted revenues denominated in currencies other than the U.S. dollar, primarily the Japanese yen and the euro. We enter into these foreign exchange contracts to hedge forecasted product licensing revenue in the normal course of business, and accordingly, they are not speculative in nature.

We record changes in the intrinsic value of these cash flow hedges in accumulated other comprehensive income (loss), until the forecasted transaction occurs. When the forecasted transaction occurs, we reclassify the related gain or loss on the cash flow hedge to revenue. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, we reclassify the gain or loss on the related cash flow hedge from accumulated other comprehensive income (loss) to interest and other income (loss) on the consolidated statement of income at that time. For the fiscal year ended December 2, 2005, there were no such net gains or losses recognized in other income relating to hedges of forecasted transactions that did not occur.

See also Note 15 in our Notes to Consolidated Financial Statements.

Balance Sheet Hedging—Hedging of Foreign Currency Assets and Liabilities

We hedge our net recognized foreign currency assets and liabilities with forward foreign exchange contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in foreign currency exchange rates. These derivative instruments hedge assets and liabilities that are denominated in foreign currencies and are carried at fair value with changes in the fair value recorded as other income (loss). These derivative instruments do not subject us to material balance sheet risk due to exchange rate movements because gains and losses on these derivatives are intended to offset gains and losses on the assets and liabilities being hedged. At December 2, 2005, the outstanding balance sheet hedging derivatives had maturities of 150 days or less.

A sensitivity analysis was performed on all of our foreign exchange derivatives as of December 2, 2005. This sensitivity analysis was based on a modeling technique that measures the hypothetical market value resulting from a 10% and 15% shift in the value of exchange rates relative to the U.S. dollar. For option contracts, the Black-Scholes equation model was used. For forward contracts, duration modeling was used where hypothetical changes are made to the spot rates of the currency. A 10% and 15% increase in the value of the U.S. dollar (and a corresponding decrease in the value of the hedged foreign currency asset) would lead to an increase in the fair value of our financial hedging instruments by \$26.2 million and \$39.9 million, respectively. Conversely, a 10% and 15% decrease in the value of the U.S. dollar would result in a decrease in the fair value of these financial instruments by \$16.9 million and \$22.1 million, respectively.

We do not use derivative financial instruments for speculative trading purposes, nor do we hedge our foreign currency exposure in a manner that entirely offsets the effects of changes in foreign exchange rates.

As a general rule, we do not use financial instruments to hedge local currency denominated operating expenses in countries where a natural hedge exists. For example, in many countries revenue from the local currency product licenses substantially offsets the local currency denominated operating expenses. We assess the need to utilize financial instruments to hedge currency exposures, primarily related to operating expenses, on an ongoing basis.

We regularly review our hedging program and may as part of this review determine at any time to change our hedging program.

See also Note 15 in our Notes to Consolidated Financial Statements.

Equity Investments

We are exposed to equity price risk on our portfolio of marketable equity securities. As of December 2, 2005, our total equity holdings in publicly traded companies were valued at \$1.8 million compared to \$2.8 million at December 3, 2004, a decrease of 34%. The decrease was due to sales of \$1.2 million and \$0.6 million write-downs due to an other-than-temporary decline in value of our marketable equity securities offset by an increase of \$0.8 in market value adjustments. We believe that it is reasonably possible that the fair values of these securities could adversely change in the near term. We have a policy in place to review our equity holdings on a regular basis to evaluate whether or not each security has experienced an other-than-temporary decline in fair value. Our policy includes, but is not limited to, reviewing each company's cash position, earnings/revenue outlook, stock price performance over the past six months, liquidity and management/ownership. If we believe that an other-than-temporary decline in value exists in one of our marketable equity securities, it is our policy to write down these equity investments to the market value and record the related write-down in our consolidated statements of income.

The following table represents the potential decrease in fair values of our marketable equity securities that are sensitive to changes in the stock market. Fair value deteriorations of 50%, 35% and 15% were selected based on the probability of their occurrence.

	<u>50%</u>	<u>35%</u>	<u>15%</u>
Marketable equity securities	<u>\$(0.9)</u>	<u>\$(0.6)</u>	<u>\$(0.3)</u>

Fixed Income Investments

At December 2, 2005, we had an investment portfolio of fixed income securities, including those classified as cash equivalents, of \$1,657.3 million compared to \$1,272.8 million at December 3, 2004, an increase of 30%. Changes in interest rates could adversely affect the market value of our fixed income investments. The table below separates the remaining maturities of our fixed income securities into segments, based on stated maturities, to show the approximate exposure to interest rates. A significant proportion of securities classified as "due after three years," based on the stated maturity, have structural features that allow us to sell the securities, at par, in less than three years.

Due within one year	\$ 818.6
Due within two years	315.3
Due within three years	114.1
Due after three years	<u>409.3</u>
Total	<u>\$1,657.3</u>

A sensitivity analysis was performed on our investment portfolio as of December 2, 2005. This sensitivity analysis was 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, 100, or 150 basis points over six-month and twelve-month time horizons. The following table represents the potential decrease to the value of our fixed income securities given a negative shift in the yield curve used in our sensitivity analysis.

	<u>0.5%</u>	<u>1.0%</u>	<u>1.5%</u>
6 month horizon	<u>\$(3.7)</u>	<u>\$(7.2)</u>	<u>\$(10.9)</u>
12 month horizon	<u>\$(1.3)</u>	<u>\$(2.5)</u>	<u>\$(3.8)</u>

We limit our exposure to interest rate and credit risk by establishing and monitoring clear policies and guidelines for our fixed income portfolios. Our investment policy limits the maximum weighted average duration of all invested funds to 2.5 years. The guidelines also establish credit quality standards, limits on exposure to any one security issue, limits on exposure to any one issuer and limits on exposure to the type of instrument.

Privately Held Investments

We have direct investments, as well as indirect investments through Adobe Ventures, in several privately held companies, many of which can still be considered in the start-up or development stages. These investments are inherently risky, as the technologies or products these companies have under development are typically in the early stages and may never materialize, and we could lose a substantial part of our initial investment in these companies.

It is our policy to review privately-held investments on a regular basis to evaluate the carrying amount and economic viability of these companies. This policy includes, but is not limited to, reviewing each of the companies' cash position, financing needs, earnings/revenue outlook, operational performance, management/ownership changes and competition. The evaluation process is based on information that we request from these privately-held companies. This information is not subject to the same disclosure regulations as U.S. publicly traded companies, and as such, the basis for these evaluations is subject to the timing and the accuracy of the data received from these companies.

See also Note 1 in our Notes to Consolidated Financial Statements.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

FINANCIAL STATEMENTS

Our financial statements required by this item are submitted as a separate section of this Form 10-K. See Item 15 (a)(1) for a listing of financial statements provided in the section titled "Financial Statements."

SUPPLEMENTARY DATA

The following tables (presented in thousands, except per share amounts) set forth supplementary data for each of the quarters (unaudited) in the two-year period ended December 2, 2005. The share and per share data below have been adjusted to give effect to our stock split as of May 23, 2005.

	2005				
	Quarter Ended				Year Ended December 2
	March 4	June 3	September 2	December 2	
Revenue	\$472,882	\$496,029	\$487,039	\$510,371	\$1,966,321
Gross profit	445,913	468,595	459,559	479,676	1,853,743
Income before income taxes	176,785	187,808	193,964	207,219	765,776
Net income(1)	151,894	149,778	144,916	156,251	602,839
Basic net income per share(1)	0.31	0.31	0.29	0.32	1.23
Shares used in computing basic net income per share	486,260	488,765	491,710	492,517	489,921
Diluted net income per share	0.30	0.29	0.29	0.31	1.19
Shares used in computing diluted net income per share	506,182	508,156	507,821	508,562	508,070
	2004				
	Quarter Ended				Year Ended December 3
	March 5	June 4	September 3	December 3	
Revenue	\$423,281	\$410,085	\$403,713	\$429,502	\$1,666,581
Gross profit	399,099	382,830	380,144	400,130	1,562,203
Income before income taxes	166,263	147,839	141,163	153,380	608,645
Net income(2)	123,035	109,401	104,461	113,501	450,398
Basic net income per share(2)	0.26	0.23	0.22	0.24	0.94
Shares used in computing basic net income per share	476,768	477,238	476,942	479,740	477,658
Diluted net income per share	0.25	0.22	0.21	0.23	0.91
Shares used in computing diluted net income per share	492,174	493,946	494,226	500,620	495,626

- (1) In fiscal 2005, net income and net income per share includes the following: the first quarter includes investment loss of \$1.6 million; the second quarter includes investment loss of \$2.7 million; the third quarter includes investment loss of \$2.0 million; the fourth quarter includes investment gain of \$5.0 million.
- (2) In fiscal 2004, net income and net income per share includes the following: the first quarter includes investment loss of \$1.0 million; the second quarter includes investment gain of \$0.9 million; the third quarter includes investment loss of \$1.5 million; the fourth quarter includes investment gain of \$4.2 million.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

(a) Disclosure Controls and Procedures

Based on their evaluation as of December 2, 2005, our Chief Executive Officer and Chief Financial Officer, have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were sufficiently effective to ensure that the information required to be disclosed by us in this Annual Report on Form 10-K was recorded, processed, summarized and reported within the time periods specified in the SEC's rules and instructions for Form 10-K.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Adobe have been detected.

(b) Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Our management assessed the effectiveness of our internal control over financial reporting as of December 2, 2005. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control-Integrated Framework. Our management has concluded that, as of December 2, 2005, our internal control over financial reporting is effective based on these criteria. Our independent registered public accounting firm, KPMG LLP, have issued an audit report on our assessment of our internal control over financial reporting, which is included herein.

(c) Changes in Internal Control over Financial Reporting

There were no changes in our internal controls over financial reporting during the quarter ended December 2, 2005 that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

(d) Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Adobe Systems Incorporated:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting appearing under Item 9A(b), that Adobe Systems Incorporated maintained effective internal control over financial reporting as of December 2, 2005, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management of Adobe Systems Incorporated is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on

management's assessment and an opinion on the effectiveness of the internal control over financial reporting of Adobe Systems Incorporated based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Adobe Systems Incorporated maintained effective internal control over financial reporting as of December 2, 2005, is fairly stated, in all material respects, based on criteria established in *Internal Control—Integrated Framework* issued by COSO. Also, in our opinion, Adobe Systems Incorporated maintained, in all material respects, effective internal control over financial reporting as of December 2, 2005, based on the criteria established in *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Adobe Systems Incorporated and subsidiaries as of December 2, 2005 and December 3, 2004, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 2, 2005, and our report dated February 8, 2006 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP
Mountain View, California
February 8, 2006

ITEM 9B. OTHER INFORMATION

Attached as Exhibit 100 to this Annual Report on Form 10-K are the following materials, formatted in Extensible Business Reporting Language ("XBRL"): (i) the Consolidated Balance Sheets at December 2, 2005 and December 3, 2004, (ii) the Consolidated Statements of Income for the years ended December 2, 2005, December 3, 2004 and November 28, 2003 and (iii) the Consolidated Statements of Stockholders' Equity for the years ended December 2, 2005, December 3, 2004 and November 28, 2003 and (iv) the

Consolidated Statements of Cash Flows for the years ended December 2, 2005, December 3, 2004 and November 28, 2003. The financial information contained in the XBRL documents is unaudited and these are not the official publicly filed financial statements of the Registrant. The purpose of submitting these XBRL documents is to test the related format and technology and, as a result, investors should continue to rely on the official filed version of the furnished documents and not rely on this information in making investment decisions.

The information in Exhibit 100 attached hereto shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934 (the "Exchange Act") or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Exchange Act, regardless of any general incorporation language in such filing.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

For information regarding our Directors, Code of Ethics and compliance with Section 16(a) of the Securities Exchange Act of 1934, we direct you to the sections entitled "Proposal 1—Election of Directors," "Code of Ethics" and "Section 16(a) Beneficial Ownership Reporting Compliance," respectively, in the Proxy Statement we will deliver to our stockholders in connection with our Annual Meeting of Stockholders to be held on March 28, 2006. Information regarding our Executive Officers is contained in this report in Part I, Item 1 titled "Business."

We are incorporating the information contained in those sections of our Proxy Statement here by reference.

ITEM 11. EXECUTIVE COMPENSATION

For information regarding our Executive Compensation, we direct you to the section entitled "Executive Compensation" in the Proxy Statement we will deliver to our stockholders in connection with our Annual Meeting of Stockholders to be held on March 28, 2006.

We are incorporating the information contained in that section of our Proxy Statement here by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

You will find this information in the section captioned "Security Ownership of Certain Beneficial Owners and Management," in the Proxy Statement we will deliver to our stockholders in connection with our Annual Meeting of Stockholders to be held on March 28, 2006. We are incorporating the information contained in that section here by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

You will find this information in the section captioned "Certain Relationships and Related Transactions," in the Proxy Statement we will deliver to our stockholders in connection with our Annual Meeting of Stockholders to be held on March 28, 2006. We are incorporating the information contained in that section here by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

You will find this information in the section captioned "Principal Accounting Fees and Services," in the Proxy Statement we will deliver to our stockholders in connection with our Annual Meeting of Stockholders to be held on March 28, 2006. We are incorporating the information contained in that section here by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of this report

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1. Financial statements	
• Report of Independent Registered Public Accounting Firm	69
• Consolidated Balance Sheets December 2, 2005 and December 3, 2004 .	70
• Consolidated Statements of Income Years Ended December 2, 2005, December 3, 2004 and November 28, 2003	71
• Consolidated Statements of Stockholders' Equity Years Ended December 2, 2005, December 3, 2004 and November 28, 2003	72
• Consolidated Statements of Cash Flows Years Ended December 2, 2005, December 3, 2004 and November 28, 2003	73
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The exhibits listed in the accompanying Index to Exhibits are filed or incorporated by reference as part of this report.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Adobe Systems Incorporated:

We have audited the accompanying consolidated balance sheets of Adobe Systems Incorporated and subsidiaries as of December 2, 2005 and December 3, 2004, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 2, 2005. In connection with our audits of the consolidated financial statements. These consolidated financial statements are the responsibility of the management of Adobe Systems Incorporated. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 December 2, 2005 and December 3, 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended December 2, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Adobe Systems Incorporated's internal control over financial reporting as of December 2, 2005, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 8, 2006 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/KPMG LLP
Mountain View, California
February 8, 2006

ADOBE SYSTEMS INCORPORATED
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	<u>December 2, 2005</u>	<u>December 3, 2004</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 420,818	\$ 259,061
Short-term investments	1,280,016	1,054,160
Trade receivables, net of allowances for doubtful accounts of \$5,376 and \$6,191, respectively	173,245	141,945
Other receivables	31,504	25,495
Deferred income taxes	58,710	51,751
Prepaid expenses and other assets	44,285	18,617
Total current assets	<u>2,008,578</u>	<u>1,551,029</u>
Property and equipment, net	103,549	99,675
Goodwill	118,683	110,287
Purchased and other intangibles, net	16,477	15,513
Investment in lease receivable	126,800	126,800
Other assets	66,228	55,328
	<u>\$ 2,440,315</u>	<u>\$ 1,958,632</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Trade and other payables	\$ 41,042	\$ 43,192
Accrued expenses	226,985	202,762
Income taxes payable	154,529	145,913
Deferred revenue	57,839	52,020
Total current liabilities	<u>480,395</u>	<u>443,887</u>
Other long term liabilities:		
Deferred revenue	9,731	7,521
Deferred income taxes	78,800	78,909
Other liabilities	7,063	4,838
Total liabilities	<u>575,989</u>	<u>535,155</u>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.0001 par value; 2,000 shares authorized; none issued	—	—
Common stock, \$0.0001 par value; 900,000 shares authorized; 591,528 shares issued and outstanding, respectively	29,600	29,576
Additional paid-in-capital	1,321,146	1,164,643
Retained earnings	2,838,566	2,238,807
Accumulated other comprehensive loss	(914)	(2,289)
Treasury stock, at cost (102,799 and 107,154 shares, respectively), net of re- issuances	<u>(2,324,072)</u>	<u>(2,007,260)</u>
Total stockholders' equity	<u>1,864,326</u>	<u>1,423,477</u>
	<u>\$ 2,440,315</u>	<u>\$ 1,958,632</u>

See accompanying Notes to Consolidated Financial Statements.

ADOBE SYSTEMS INCORPORATED
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)

	Years Ended		
	December 2, 2005	December 3, 2004	November 28, 2003
Revenue:			
Products	\$1,923,278	\$1,633,959	\$1,269,004
Services and support	43,043	32,622	25,745
Total revenue	<u>1,966,321</u>	<u>1,666,581</u>	<u>1,294,749</u>
Costs of revenue:			
Products	89,942	86,572	79,902
Services and support	22,636	17,806	13,120
Total cost of revenue	<u>112,578</u>	<u>104,378</u>	<u>93,022</u>
Gross profit	1,853,743	1,562,203	1,201,727
Operating expenses:			
Research and development	365,328	311,296	276,980
Sales and marketing	593,323	521,143	423,417
General and administrative	166,658	137,970	122,427
Restructuring and other charges	—	—	(544)
Total operating expenses	<u>1,125,309</u>	<u>970,409</u>	<u>822,280</u>
Operating income	728,434	591,794	379,447
Non-operating income:			
Investment gain (loss), net	(1,301)	2,506	(12,875)
Interest and other income	38,643	14,345	13,920
Total non-operating income	<u>37,342</u>	<u>16,851</u>	<u>1,045</u>
Income before income taxes	765,776	608,645	380,492
Provision for income taxes	162,937	158,247	114,148
Net income	<u>\$ 602,839</u>	<u>\$ 450,398</u>	<u>\$ 266,344</u>
Basic net income per share	<u>\$ 1.23</u>	<u>\$ 0.94</u>	<u>\$ 0.57</u>
Shares used in computing basic income per share	<u>489,921</u>	<u>477,658</u>	<u>468,492</u>
Diluted net income per share	<u>\$ 1.19</u>	<u>\$ 0.91</u>	<u>\$ 0.55</u>
Shares used in computing diluted income per share	<u>508,070</u>	<u>495,626</u>	<u>482,900</u>
Cash dividends declared per share	<u>\$ 0.00625</u>	<u>\$ 0.025</u>	<u>\$ 0.025</u>

See accompanying Notes to Consolidated Financial Statements.

ADOBE SYSTEMS INCORPORATED
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive (Loss)	Treasury Stock		Total
	Shares	Amount				Shares	Amount	
Balances at November 29, 2002 . . .	591,528	\$29,576	\$ 710,273	\$1,545,776	\$ (3,950)	(127,618)	\$(1,607,354)	\$ 674,321
Comprehensive income:								
Net income	—	—	—	266,344	—	—	—	266,344
Other comprehensive income, net of taxes	—	—	—	—	2,951	—	—	2,951
Total comprehensive income, net of taxes								269,295
Tax benefit from employee stock option plans	—	—	37,436	—	—	—	—	37,436
Issuance of compensatory stock . .	—	—	2,320	—	—	102	506	2,826
Dividends declared	—	—	—	(11,722)	—	—	—	(11,722)
Purchase of treasury stock	—	—	—	—	—	(5,574)	(84,777)	(84,777)
Reissuance of treasury stock under employee stock purchase and stock option plans	—	—	124,097	—	—	18,162	89,324	213,421
Balances at November 28, 2003 . . .	591,528	\$29,576	\$ 874,126	\$1,800,398	\$ (999)	(114,928)	\$(1,602,301)	\$ 1,100,800
Comprehensive income:								
Net income	—	—	—	450,398	—	—	—	450,398
Other comprehensive loss, net of taxes	—	—	—	—	(1,290)	—	—	(1,290)
Total comprehensive income, net of taxes								449,108
Tax benefit from employee stock option plans	—	—	97,794	—	—	—	—	97,794
Issuance of compensatory stock . .	—	—	225	—	—	20	115	340
Dividends declared	—	—	—	(11,989)	—	—	—	(11,989)
Purchase of treasury stock	—	—	—	—	—	(21,956)	(608,681)	(608,681)
Reissuance of treasury stock under employee stock purchase and stock option plans	—	—	192,498	—	—	29,710	203,607	396,105
Balances at December 3, 2004 . . .	591,528	\$29,576	\$1,164,643	\$2,238,807	\$ (2,289)	(107,154)	\$(2,007,260)	\$ 1,423,477
Comprehensive income:								
Net income	—	—	—	602,839	—	—	—	602,839
Other comprehensive income, net of taxes	—	—	—	—	1,375	—	—	1,375
Total comprehensive income, net of taxes								604,214
Tax benefit from employee stock option plans	—	—	82,852	—	—	—	—	82,852
Issuance of compensatory stock . .	—	—	189	—	—	16	202	391
Dividends declared	—	—	—	(3,056)	—	—	—	(3,056)
Purchase of treasury stock	—	—	—	—	—	(18,715)	(600,099)	(600,099)
Reissuance of treasury stock under employee stock purchase and stock option plans	—	—	73,462	—	—	23,054	283,085	356,547
Stock dividend	—	24	—	(24)	—	—	—	—
Balances at December 2, 2005 . . .	591,528	\$29,600	\$1,321,146	\$2,838,566	\$ (914)	(102,799)	\$(2,324,072)	\$ 1,864,326

See accompanying Notes to Consolidated Financial Statements.

ADOBE SYSTEMS INCORPORATED
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Years Ended		
	December 2, 2005	December 3, 2004	November 28, 2003
Cash flows from operating activities:			
Net income	\$ 602,839	\$ 450,398	\$ 266,344
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	64,335	60,808	49,014
Stock-based compensation expense	391	340	2,826
Deferred income taxes	(7,068)	46,270	36,460
Provision for (recovery of) losses on receivables	394	(443)	2,038
Tax benefit from employee stock option plans	82,852	97,794	37,436
Retirements of property and equipment	1,093	804	—
Net (gains) losses on sales and impairments of investments	1,322	(2,506)	12,875
Non-cash restructuring and other charges	—	—	(544)
Changes in operating assets and liabilities:			
Receivables	(36,091)	9,221	(29,148)
Other current assets	(20,181)	4,908	(2,055)
Trade and other payables	(2,456)	5,755	(328)
Accrued expenses	26,278	44,896	32,930
Accrued restructuring charges	—	(871)	(9,300)
Income taxes payable	8,616	(47,571)	20,173
Deferred revenue	8,029	13,941	14,415
Net cash provided by operating activities	<u>730,353</u>	<u>683,744</u>	<u>433,136</u>
Cash flows from investing activities:			
Purchases of short-term investments	(1,851,962)	(1,867,337)	(1,186,192)
Maturities and sales of short-term investments	1,620,873	1,772,008	677,946
Purchases of long-term investments and other assets	(32,196)	(35,286)	(20,699)
Acquisitions of property and equipment	(48,875)	(63,226)	(39,454)
Cash paid for acquisitions	(9,541)	(15,545)	(16,500)
Investment in lease receivable	—	(126,800)	—
Proceeds from sale of equity securities and other assets	1,338	5,933	7,063
Net cash used for investing activities	<u>(320,363)</u>	<u>(330,253)</u>	<u>(577,836)</u>
Cash flows from financing activities:			
Purchase of treasury stock	(600,099)	(608,681)	(84,777)
Proceeds from re-issuance of treasury stock	356,547	396,105	213,421
Payment of dividends	(3,044)	(11,942)	(11,626)
Net cash provided by (used for) financing activities	<u>(246,596)</u>	<u>(224,518)</u>	<u>117,018</u>
Effect of exchange rates on cash and cash equivalents	(1,637)	3,566	4,471
Net increase (decrease) in cash and cash equivalents	161,757	132,539	(23,211)
Cash and cash equivalents at beginning of year	259,061	126,522	149,733
Cash and cash equivalents at end of year	<u>\$ 420,818</u>	<u>\$ 259,061</u>	<u>\$ 126,522</u>
Supplemental disclosures:			
Cash paid for income taxes, net of refunds	<u>\$ 78,633</u>	<u>\$ 61,423</u>	<u>\$ 18,695</u>
Non-cash investing and financing activities:			
Cash dividends declared but not paid	<u>\$ —</u>	<u>\$ 3,027</u>	<u>\$ 2,979</u>
Unrealized gains (losses) on available-for-sale securities, net of taxes	<u>\$ (2,306)</u>	<u>\$ (7,345)</u>	<u>\$ 2,451</u>

See accompanying Notes to Consolidated Financial Statements.

ADOBE SYSTEMS INCORPORATED
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 offers a line of creative, business and mobile software and services used by high-end consumers, creative professionals, designers, knowledge workers, OEM partners, developers and enterprises for creating, managing, delivering and engaging with compelling content and experiences across multiple operating systems, devices and media. We distribute our products through a network of distributors and dealers, VARs, systems integrators, ISVs and OEMs; direct to end users; and through our own Web site at www.adobe.com. We also license our technology to major hardware manufacturers, software developers and service providers and we offer integrated software solutions to businesses of all sizes. We have operations in the Americas, EMEA and Asia. Our software runs on Microsoft Windows, Apple Macintosh, Linux, UNIX and various non-personal computer platforms, depending on the product.

Basis of Presentation

The accompanying consolidated financial statements include those of Adobe and our subsidiaries, after elimination of all intercompany accounts and transactions. Adobe has prepared the accompanying consolidated financial statements in conformity with accounting principles generally accepted in the United States of America.

Use of Estimates

In the preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, we must make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, at the date of the balance sheet, and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fiscal Year

Our fiscal year is a 52/53-week year ending on the Friday closest to November 30.

Reclassification

Certain amounts in fiscal 2004, as reported on the Consolidated Balance Sheet, and in fiscal 2004 and 2003, as reported on the Consolidated Statements of Cash Flows, have been reclassified to conform to the current year presentation. We reclassified \$117.1 million in auction rate securities and variable rate demand obligations from cash and cash equivalents to short-term investments on the December 3, 2004, Consolidated Balance Sheet. The reclassification to short-term investments is based on an interpretation of cash equivalents pursuant to SFAS 95. We also reclassified deferred revenue, of \$7.5 million, from short-term liabilities on the Consolidated Balance Sheet.

Stock Dividend

On March 16, 2005, our Board of Directors approved a two-for-one stock split, in the form of a stock dividend, of our common stock payable on May 23, 2005 to stockholders of record as of May 2, 2005. Share and per share data, for all periods presented, have been adjusted to give effect to this stock split.

Cash Equivalents and Short-term Investments

Cash equivalents consist of instruments with remaining maturities of three months or less at the time of purchase.

We classify all of our cash equivalents and short-term investments that are free of trading restrictions or become free of trading restrictions within one year as "available-for-sale." We carry these investments at fair value, based on quoted market prices. Unrealized gains and losses, net of taxes, are included in accumulated other comprehensive income (loss), which is reflected as a separate component of stockholders' equity. Gains are recognized when realized in our consolidated statements of income. Losses are recognized as realized or when we have determined that an other-than-temporary decline in fair value has occurred.

It is our policy to review our marketable equity securities classified as short-term investments on a regular basis to evaluate whether or not any security has experienced an other-than-temporary decline in fair value. Our policy includes, but is not limited to, reviewing the cash position, earnings/revenue outlook, stock price performance over the past six months, liquidity and management/ownership of each company we invest in. If we believe that an other-than-temporary decline exists in one of our marketable equity securities, it is our policy to write down these equity investments to the market value and record the related write-down as an investment loss on our consolidated statements of income.

Allowance for doubtful accounts

We maintain an allowance for doubtful accounts to reserve for potentially uncollectible trade receivables. We review our trade receivable by aging category to identify significant customers with known disputes or collection issues. For accounts not specifically identified, we provide reserves based on the age of the receivable. In determining the reserve, we make judgments about the creditworthiness of significant customers based on ongoing credit evaluations. We also consider our historical level of credit losses and current economic trends that might impact the level of future credit losses.

	<u>Beginning Balance</u>	<u>Charged/ (Credited) to Operating Expenses</u>	<u>Deductions*</u>	<u>Ending Balance</u>
Allowance for doubtful accounts:				
Year Ended:				
December 2, 2005	\$6,191	\$ 394	\$(1,209)	\$5,376
December 3, 2004	7,903	(443)	(1,269)	6,191
November 28, 2003	7,531	2,038	(1,666)	7,903

* Deductions related to the allowance for doubtful accounts represent amounts written off against the allowance, less recoveries.

Foreign Currency Translation

We translate assets and liabilities of foreign subsidiaries, whose functional currency is the local currency, at exchange rates in effect at the balance sheet date. We translate revenues and expenses at the monthly average rates of exchange prevailing during the year. We include the adjustment resulting from translating the financial statements of such foreign subsidiaries in accumulated other comprehensive income (loss), which is reflected as a separate component of stockholders' equity.

Property and Equipment

We record property and equipment at cost. Depreciation and amortization are calculated using the straight-line method over the shorter of the estimated useful lives (thirty-five years for buildings; two to

seven years for furniture and equipment) or lease terms (five to ten years for leasehold improvements) of the respective assets. Additionally, it is our policy to capitalize certain costs for internal-use software incurred during the application development stage, in accordance with Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." Amortization begins once the software is ready for its intended use.

Goodwill and Purchased and Other Intangibles

In accordance with Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets," we review our goodwill for impairment annually, or more frequently, if facts and circumstances warrant a review. The provisions of SFAS 142 require that a two-step test be performed to assess goodwill for impairment. First, the fair value of each reporting unit is compared to its carrying value. If the fair value exceeds the carrying value, goodwill is not impaired and no further testing is performed. The second step is performed if the carrying value exceeds the fair value. The implied fair value of the reporting unit's goodwill must be determined and compared to the carrying value of the goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, an impairment loss equal to the difference will be recorded.

We completed our annual goodwill impairment test during the second quarter of fiscal 2005 and determined that the carrying amount of goodwill was not impaired.

SFAS 142 also requires that intangible assets with definite lives be amortized over their estimated useful life and reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144 ("SFAS 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets."

We are currently amortizing acquired intangible assets with definite lives. Purchased technology is amortized over its useful life, which is generally three years and other intangibles assets are amortized over periods from 1 to 13 years. The amortization expense is primarily classified as cost of product revenue in our consolidated statements of income.

Software Development Costs

Capitalization of software development costs begins upon the establishment of technological feasibility, which is generally the completion of a working prototype that has been certified as having no critical bugs and is a release candidate or when alternative future use exists. To date, software development costs incurred between completion of a working prototype and general availability of the related product have not been material and have not been capitalized.

Other Assets

Other assets include long-term investments, security deposits and a land deposit. Other assets also include the fair value, at inception, of the residual value guarantee associated with our lease on two buildings we occupy as part of our headquarters, in accordance with FASB Interpretation No. 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." Our long-term investments include investments in privately held companies that we make either directly or indirectly through venture capital limited partnerships. We own limited partnership interests in three venture capital limited partnerships—Adobe Ventures L.P., Adobe Ventures III, L.P. and Adobe Ventures IV, L.P. (collectively "Adobe Ventures")—that invest in early stage companies with innovative technologies. The partnerships are managed by Granite Ventures, an independent venture capital firm and sole general partner of Adobe Ventures.

The investments in Adobe Ventures are consolidated in accordance with FASB Interpretation No. 46R ("FIN 46R") a revision to FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities." Adobe Ventures carry their investments in equity securities at estimated fair market

value and unrealized gains and losses are included in investment gain (loss) on our consolidated statements of income. The stock of a number of technology investments held by Adobe Ventures at December 2, 2005 and December 3, 2004 is not publicly traded and, therefore, there is no established market for these securities. In order to determine the fair market value of these investments, we use the most recent round of financing involving new non-strategic investors or estimates of current market value made by Granite Ventures. It is our policy to review the fair value of these investments held by Adobe Ventures, as well as our direct investments, on a regular basis to evaluate the carrying value of the investments in these companies. This evaluation includes, but is not limited to, reviewing each company's cash position, financing needs, earnings/revenue outlook, operational performance, management/ownership changes and competition. In the case of privately held companies, this evaluation is based on information that we request from these companies. This information is not subject to the same disclosure regulations as U.S. publicly traded companies and as such, the basis for these evaluations is subject to the timing and the accuracy of the data received from these companies. If we believe the carrying value of a company is in excess of fair value, it is our policy to write-down the investments to reduce its carrying value to fair value.

Revenue Recognition

Our revenue is derived from the licensing of desktop and server-based application software products, professional services, and maintenance and support. We recognize revenue when persuasive evidence of an arrangement exists, we have delivered the product or performed the service, the fee is fixed or determinable and collection is probable.

Product revenue

We recognize our product revenue upon shipment, provided collection is determined to be probable and no significant obligations remain. Our desktop application products revenue from distributors is subject to agreements allowing limited rights of return, rebates and price protection. Our direct sales and OEM sales are also subject to limited rights of return. Accordingly we reduce revenue recognized for estimated future returns, price protection and rebates at the time the related revenue is recorded. The estimates for returns are adjusted periodically based upon historical rates of returns, inventory levels in the distribution channel and other related factors.

We record the estimated costs of providing free technical phone support to customers for our software products.

We record OEM licensing revenue, primarily royalties, when OEM partners ship products incorporating Adobe software, provided collection of such revenue is deemed probable.

Our product-related deferred revenue includes maintenance upgrade revenue and customer advances under OEM license agreements. Our maintenance upgrade revenue for our desktop application products is included in our product revenue line item as the maintenance primarily entitles customers to receive product upgrades. In cases where we provide a specified free upgrade to an existing product, we defer the fair value for the specified upgrade right until the future obligation is fulfilled or when the right to the specified free upgrade expires.

Services and support revenue

Our services and support revenue is composed of professional services (such as consulting services and training) and maintenance and support, primarily related to the licensing of our Intelligent Document server solution products. Our support revenue also includes technical support and developer support to partners and developer organizations related to our desktop products.

Our professional services revenue is recognized using the proportionate performance method and is measured monthly based on input measures, such as on hours incurred to date compared to total estimated

hours to complete, with consideration given to output measures, such as contract milestones when applicable. Our maintenance and support offerings, which entitle customers to receive product upgrades and enhancements or technical support, depending on the offering, are recognized ratably over the term of the arrangement.

Multiple element arrangements

We enter into revenue arrangements in which a customer may purchase a combination of software, upgrades, maintenance and support, and professional services (multiple-element arrangements). When vendor-specific objective evidence (“VSOE”) of fair value exists for all elements, we allocate revenue to each element based on the relative fair value of each of the elements. VSOE of fair value is established by the price charged when that element is sold separately. For maintenance and support, VSOE of fair value is established by renewal rates. For arrangements where VSOE of fair value exists only for the undelivered elements, we defer the full fair value of the undelivered elements and recognize the difference between the total arrangement fee and the amount deferred for the undelivered items as revenue, assuming all other criteria for revenue recognition have been met.

We perform ongoing credit evaluations of our customers’ financial condition and in some cases we require various forms of security. We also maintain allowances for estimated losses on receivables.

Stock-Based Incentive Compensation

We account for our fixed stock option plans and our employee stock purchase plan under APB 25, using the intrinsic value method. The following table sets forth the pro forma amounts of net income and net income per share that would have resulted if we had accounted for our employee stock plans under the fair value recognition provisions of SFAS 123.

	Fiscal Years		
	2005	2004	2003
Net income:			
As reported	\$602,839	\$450,398	\$266,344
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	255	221	1,837
Less: Total stock-based employee compensation expense determined under fair value based method, net of related tax effects	(88,603)	(105,883)	(188,427)
Pro forma	<u>\$514,491</u>	<u>\$344,736</u>	<u>\$ 79,754</u>
Basic net income per share:			
As reported	\$ 1.23	\$ 0.94	\$ 0.57
Pro forma	\$ 1.05	\$ 0.72	\$ 0.17
Diluted net income per share:			
As reported	\$ 1.19	\$ 0.91	\$ 0.55
Pro forma	\$ 1.01	\$ 0.70	\$ 0.16

For purposes of computing pro forma net income, we estimate the fair value of option grants and employee stock purchase plan purchase rights using the Black-Scholes option pricing model. The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable, characteristics not present in our option grants and employee stock purchase plan shares. Additionally, option valuation models require the input of highly subjective assumptions, including the expected volatility of the stock price. Because our employee stock

options and employee stock purchase plan shares have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimates, in management's opinion, the existing models do not provide a reliable single measure of the fair value of its stock-based awards.

For purposes of the pro forma disclosures, we give consideration to historical volatility and implied volatility in market traded options and will continue to monitor these and other relevant factors used to measure expected volatility for future option grants.

The assumptions used to value the option grants are as follows:

	Fiscal Years		
	2005	2004	2003
Expected life (in years)	3.0 - 3.9	2.5	2.5 - 3.0
Volatility	30 - 37%	34 - 40%	40 - 66%
Risk free interest rate	3.38 - 4.49%	2.18 - 3.11%	1.37 - 2.23%
Dividend yield	—	0.093 - 0.125%	0.125%

The assumptions used to value the purchase rights are as follows:

	Fiscal Years		
	2005	2004	2003
Expected life (in years)	1.25	1.25	1.25
Volatility	32 - 37%	34 - 40%	40 - 66%
Risk free interest rate	3.03 - 3.58%	1.24 - 1.76%	1.12 - 1.74%
Dividend yield	—	0.093 - 0.125%	0.125%

Advertising Expenses

We expense all advertising costs as incurred and classify these costs under sales and marketing expense. Advertising expenses for fiscal 2005, 2004 and 2003 were \$39.0 million, \$31.9 million and \$24.0 million, respectively.

Foreign Currency and Other Hedging Instruments

We transact business in foreign countries, in U.S. dollars and in various foreign currencies. In Europe and Japan, transactions that are denominated in euro and yen subject us to exposure from movements in foreign currency exchange rates. We hedge our net recognized foreign currency assets and liabilities with forward foreign exchange contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in foreign currency exchange rates. We use options and forward foreign exchange contracts to reduce our exposure to foreign currency rate changes on non-functional currency denominated forecasted product licensing revenue, primarily yen-denominated and euro-denominated revenue.

Adobe accounts for its derivative instruments as either assets or liabilities on the balance sheet and measures them at fair value. Derivatives that are not defined as hedges in Statement of Financial Accounting Standards No. 133 ("SFAS 133"), "Accounting for Derivative Instruments and Hedging Activities," must be adjusted to fair value through earnings. As described in Note 15, gains and losses resulting from changes in fair value are accounted for depending on the use of the derivative and whether it is designated and qualifies for hedge accounting.

Gains and losses from the forward foreign exchange contracts hedging certain balance sheet positions, primarily non-functional currency denominated assets, such as trade receivable, and liabilities, such as accounts payable, are recorded each period in other income (expense) in the consolidated statements of

operations. Forward foreign exchange contracts hedging forecasted non-functional currency denominated forecasted product licensing revenue, are designated as cash flow hedges under SFAS 133, with gains and losses recorded net of tax, as a component of other comprehensive income in stockholders' equity and reclassified into revenue at the time the forecasted transactions occur.

Income Taxes

We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. In addition, deferred tax assets and liabilities are recognized for expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. We record a valuation allowance to reduce deferred tax assets to an amount for which realization is more likely than not. We also account for any income tax contingencies in accordance with Statement of Financial Accounting Standards No. 5 ("SFAS 5"), "Accounting for Contingencies."

Recent Accounting Pronouncements

In May 2005 the FASB issued Statement of Financial Accounting Standards No. 154 ("SFAS 154"), "Accounting Changes and Error Corrections," which replaces Accounting Principles Board No. 20 ("APB 20"), "Accounting Changes," and Statement of Financial Accounting Standards No. 3, "Reporting Accounting Changes in Interim Financial Statements." SFAS 154 applies to all voluntary changes in accounting principle, and changes the requirements for accounting for and reporting of a change in accounting principle. SFAS 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. APB 20 previously required that most voluntary changes in accounting principle be recognized with a cumulative effect adjustment in net income of the period of the change. SFAS 154 is effective for accounting changes made in annual periods beginning after December 15, 2005.

In December 2004, the FASB issued SFAS 123R requires the measurement of all employee share-based payments to employees, including grants of employee stock options, using a fair-value-based method and the recording of such expense in our consolidated statements of income. In April 2005, the SEC announced that the accounting provisions of SFAS 123R are to be applied in the first quarter of the fiscal year beginning after June 15, 2005. As a result, we are now required to adopt SFAS 123R in the first quarter of fiscal 2006 and will recognize stock-based compensation expense using the modified prospective method. The pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition. See "Stock-Based Incentive Compensation" above for the pro forma net income and net income per share amounts, for fiscal 2003 through fiscal 2005, as if we had used a fair-value-based method similar to the methods required under SFAS 123R to measure compensation expense for employee stock incentive awards. We are evaluating the requirements under SFAS 123R and expect the adoption to have a significant adverse impact on our consolidated statements of income and net income per share.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-1 ("FAS 109-1"), "Application of FASB Statement No. 109, "Accounting for Income Taxes," to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004." The AJCA introduced a special 9% tax deduction on qualified production activities. FAS 109-1 clarifies that this tax deduction should be accounted for as a special tax deduction in accordance with Statement 109. Pursuant to the AJCA, Adobe will not be able to claim this tax benefit until the first quarter of fiscal 2006. We do not expect the adoption of these new tax provisions to have a material impact on our consolidated financial position, results of operations or cash flows.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-2 (“FAS 109-2”), “Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creations Act of 2004.” The AJCA introduced a limited time 85% dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer (repatriation provision), provided certain criteria are met. Starting in the first quarter of fiscal 2005, Adobe adopted the accounting and disclosure requirements as outlined in FAS 109-2. See Note 8 for further information regarding this provision.

Note 2. Acquisitions

On May 3, 2004, we acquired Q-Link Technologies, Inc (“Q-Link”), a privately held company, for \$15.9 million in cash. Q-Link provided Java-based workflow technology that was integrated with our Intelligent Document platform to enable customers to integrate document process management with core applications. Goodwill was allocated to our Intelligent Document segment. Purchased technology is being amortized to cost of product revenue over its estimated useful life of three years. The consolidated financial statements include the operating results of Q-Link from the date of purchase. Pro forma results of operations have not been presented because the effect of this acquisition was not material.

Note 3. Cash, cash equivalents and short-term investments

Cash, cash equivalents and short-term investments consisted of the following as of December 2, 2005:

	<u>Carrying Value</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Estimated Fair Value</u>
Classified as current assets:				
Cash	\$ 41,682	\$ —	\$ —	\$ 41,682
Cash equivalents:				
Money market mutual funds	334,933	—	—	334,933
Bank time deposits	24,339	—	—	24,339
Corporate bonds	19,864	—	—	19,864
Total cash equivalents	<u>379,137</u>	<u>—</u>	<u>—</u>	<u>379,137</u>
Total cash and cash equivalents	<u>420,818</u>	<u>—</u>	<u>—</u>	<u>420,818</u>
Short-term investments:				
State and municipal bonds	1,091,538	22	(8,168)	1,083,392
United States Treasury notes	112,093	—	(614)	111,479
Corporate bonds	74,449	101	(240)	74,310
Obligations of foreign sovereigns	9,004	—	(25)	8,979
Marketable equity securities*	131	1,725	—	1,856
Total short-term investments	<u>1,287,215</u>	<u>1,848</u>	<u>(9,047)</u>	<u>1,280,016</u>
Total cash, cash equivalents, and short-term investments	<u>\$1,708,034</u>	<u>\$1,848</u>	<u>\$(9,047)</u>	<u>\$1,700,835</u>

* The carrying value of marketable equity securities has been reduced by other-than-temporary declines in the fair value of these securities.

Cash, cash equivalents and short-term investments consisted of the following as of December 3, 2004:

	Carrying Value	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Classified as current assets:				
Cash	\$ 37,546	\$ —	\$ —	\$ 37,546
Cash equivalents:				
Money market mutual funds	180,400	—	—	180,400
Bank time deposits	16,507	—	—	16,507
United States Treasury notes	20,790	—	(6)	20,784
Corporate bonds	3,825	—	(1)	3,824
Total cash equivalents	<u>221,522</u>	<u>—</u>	<u>(7)</u>	<u>221,515</u>
Total cash and cash equivalents	<u>259,068</u>	<u>—</u>	<u>(7)</u>	<u>259,061</u>
Short-term investments:				
State and municipal bonds	653,315	200	(3,287)	650,228
United States Treasury notes	278,738	5	(926)	277,817
Corporate bonds	98,995	5	(555)	98,445
Obligations of foreign sovereigns	11,865	—	(71)	11,794
Bonds of multi-lateral government agencies	13,070	—	(25)	13,045
Marketable equity securities*	1,923	908	—	2,831
Total short-term investments	<u>1,057,906</u>	<u>1,118</u>	<u>(4,864)</u>	<u>1,054,160</u>
Total cash, cash equivalents, and short-term investments	<u>\$1,316,974</u>	<u>\$1,118</u>	<u>\$(4,871)</u>	<u>\$1,313,221</u>

* The carrying value of marketable equity securities has been reduced by other-than-temporary declines in the fair value of these securities.

In accordance with EITF 03-1, the following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 2, 2005:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
State and municipal bonds	\$630,745	\$(4,753)	\$279,231	\$(3,415)	\$ 909,976	\$(8,168)
United States Treasury notes	94,253	(407)	17,226	(207)	111,479	(614)
Corporate bonds	19,000	(9)	22,013	(231)	41,013	(240)
Obligations of foreign sovereigns	—	—	8,979	(25)	8,979	(25)
Total	<u>\$743,998</u>	<u>\$(5,169)</u>	<u>\$327,449</u>	<u>\$(3,878)</u>	<u>\$1,071,447</u>	<u>\$(9,047)</u>

Market values were determined for each individual security in the investment portfolio. The declines in value of these investments are primarily related to changes in interest rates and are considered to be temporary in nature.

See Note 1 for our policy on recording other-than-temporary declines in our marketable equity securities. We recognize realized gains and losses upon sale of investments using the specific identification method. See Note 6 for net realized gains from the sale of our short-term investments and losses related to other-than-temporary declines in the fair value of our marketable equity securities.

The following table summarizes the cost and estimated fair value of current debt securities and money market mutual funds, classified by the stated maturity of the security. A significant proportion of securities classified as "due after three years," based on the stated maturity, have structural features that allow us to sell the securities, at par, in less than three years.

	<u>Cost</u>	<u>Estimated Fair Value</u>
Due within one year	\$ 820,549	\$ 818,588
Due within two years	318,550	315,250
Due within three years	115,450	114,140
Due after three years	411,672	409,319
Total	<u>\$1,666,221</u>	<u>\$1,657,297</u>

Note 4. Property and Equipment

Property and equipment consisted of the following as of December 2, 2005 and December 3, 2004:

	<u>2005</u>	<u>2004</u>
Computers and equipment.	\$196,912	\$194,605
Furniture and fixtures.	37,604	33,563
Capital projects in-progress.	565	18,117
Leasehold improvements.	68,100	55,861
Buildings	9,611	4,782
	<u>312,792</u>	<u>306,928</u>
Less accumulated depreciation and amortization.	<u>(209,243)</u>	<u>(207,253)</u>
Property and equipment, net	<u>\$103,549</u>	<u>\$ 99,675</u>

During fiscal 2005, we continued our deployment of a new Customer Relations Management ("CRM") system. The capitalized costs in connection with the CRM system were included in capital projects-in-progress for the modules that were to be deployed. As the modules were deployed, they were reclassified to computers and equipment. The reclassification of CRM costs to computers and equipment were partially offset by the retirement of fully depreciated assets.

Depreciation expense for fiscal 2005, 2004 and 2003 was \$43.9 million, \$39.8 million and \$33.7 million, respectively.

Note 5. Goodwill and Purchased and Other Intangibles

As of December 2, 2005, the goodwill balance relates to our acquisitions of Accelio, Q-Link, Syntrillium, OKYZ, GoLive Systems, Inc and GoLive Systems GmbH and Co. KG (together "GoLive") and Insciber Technology Corporation. As required by SFAS 142, we have allocated goodwill to our reportable segments. Below is our goodwill reported by segment as of December 2, 2005 and December 3, 2004:

	<u>2005</u>	<u>2004</u>
Digital Imaging and Video	\$ 14,112	\$ 14,112
Creative Professional	4,650	4,650
Intelligent Document	99,921	91,525
Total goodwill	<u>\$118,683</u>	<u>\$110,287</u>

During fiscal 2005, our goodwill increased due to the acquisition of OKYZ. OKYZ provides three dimensional ("3D") technology and expertise to our Intelligent Document platform.

Purchased and other intangible assets, subject to amortization, were as follows as of December 2, 2005:

	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>
Purchased technology	\$18,785	\$ (11,153)	\$ 7,632
Localization	\$20,512	\$ (11,901)	\$ 8,611
Trademarks	225	(82)	143
Other intangibles	301	(210)	91
Total other intangible assets	<u>\$21,038</u>	<u>\$ (12,193)</u>	<u>\$ 8,845</u>
Total purchased and other intangible assets	<u>\$39,823</u>	<u>\$ (23,346)</u>	<u>\$16,477</u>

Purchased and other intangible assets, subject to amortization, were as follows as of December 3, 2004:

	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>
Purchased technology	\$41,009	\$(29,266)	\$11,743
Localization	\$10,404	\$ (7,109)	\$ 3,295
Trademarks	300	(133)	167
Other intangibles	1,105	(797)	308
Total other intangible assets	<u>\$11,809</u>	<u>\$ (8,039)</u>	<u>\$ 3,770</u>
Total purchased and other intangible assets	<u>\$52,818</u>	<u>\$(37,305)</u>	<u>\$15,513</u>

Amortization expense of identifiable intangible assets is primarily included in costs of product revenue. Amortization expense related to identifiable intangible assets was \$20.4 million, \$21.1 million and \$15.4 million for fiscal 2005, 2004 and 2003, respectively. Amortization expense, as of December 2, 2005, is expected to be as follows:

<u>Fiscal Year</u>	<u>Purchased Technology</u>	<u>Other Intangible Assets</u>
2006	\$3,782	\$ 7,705
2007	2,338	1,009
2008	559	40
2009	315	17
2010	315	17
Thereafter	323	57
Total expected amortization expense	<u>\$7,632</u>	<u>\$ 8,845</u>

Note 6. Other Assets

Other assets consisted of the following as of December 2, 2005 and December 3, 2004:

	<u>2005</u>	<u>2004</u>
Investments	\$51,707	\$41,382
Security deposits and other	7,419	5,768
Land deposit	3,301	3,340
Prepaid rent	3,801	4,838
Total other assets	<u>\$66,228</u>	<u>\$55,328</u>

We own limited partnership interests in Adobe Ventures which are consolidated in accordance with FASB Interpretation No. 46R a revision to FASB Interpretation No. 46, "Consolidation of Variable Interest Entities." The partnerships are controlled by Granite Ventures, an independent venture capital firm and sole general partner of Adobe Ventures.

The following table summarizes the net realized gains and losses from our investments for fiscal 2005, 2004 and 2003.

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net losses related to our investments in Adobe Ventures and cost method investments	\$(1,021)	\$ (81)	\$(11,981)
Write-downs due to other-than-temporary declines in value of our marketable equity securities	(558)	—	(3,984)
Gains from sale of short-term investments	104	2,493	3,090
Gains on stock warrants	153	94	—
Other investment gains	21	—	—
Total investment gain (loss)	<u>\$(1,301)</u>	<u>\$2,506</u>	<u>\$(12,875)</u>

During fiscal 2004, we restructured the lease for two of our headquarter office buildings. See Note 14 for additional information. The lease agreement provides for a residual value guarantee. In accordance with FIN 45, we recognized the fair value of the residual value guarantee of \$5.2 million as a long-term liability on our balance sheet with the offsetting entry to prepaid rent in other assets. The balance will be amortized to the income statement over five years, the life of the lease. As of December 2, 2005, the unamortized portion of the fair value of the residual value guarantee remaining in prepaid rent was \$3.8 million.

Note 7. Accrued Expenses

Accrued expenses consisted of the following as of December 2, 2005 and December 3, 2004:

	<u>2005</u>	<u>2004</u>
Accrued compensation and benefits	\$112,362	\$ 98,108
Sales and marketing allowances	16,306	11,857
Other	98,317	92,797
Total accrued expenses	<u>\$226,985</u>	<u>\$202,762</u>

Note 8. Income Taxes

Income before income taxes includes income from foreign operations of approximately \$348.7 million, \$298.0 million and \$197.0 million for fiscal 2005, 2004 and 2003, respectively.

The provision for income taxes consisted of the following for fiscal 2005, 2004 and 2003:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Current:			
United States federal	\$ 63,932	\$ 1,769	\$ 32,751
Foreign	18,550	11,728	11,814
State and local	<u>4,671</u>	<u>1,638</u>	<u>1,090</u>
Total current	<u>87,153</u>	<u>15,135</u>	<u>45,655</u>
Deferred:			
United States federal	(7,653)	56,641	31,815
Foreign	93	(970)	(1,072)
State and local	<u>492</u>	<u>(10,353)</u>	<u>314</u>
Total deferred	<u>(7,068)</u>	<u>45,318</u>	<u>31,057</u>
Charge in lieu of taxes attributable to employee stock plans	<u>82,852</u>	<u>97,794</u>	<u>37,436</u>
	<u>\$162,937</u>	<u>\$158,247</u>	<u>\$114,148</u>

Total income tax expense differs from the expected tax expense (computed by multiplying the United States federal statutory rate of 35% by income before income taxes) as a result of the following:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Computed "expected" tax expense	\$268,022	\$213,026	\$133,172
State tax expense, net of federal benefit	9,878	6,826	2,473
Tax-exempt income	(7,196)	(4,284)	(3,786)
Tax credits	(8,977)	(9,500)	(4,878)
Differences between statutory rate and foreign effective tax rate	(62,561)	(47,622)	(24,816)
Change in deferred tax asset valuation allowance	(5,836)	(1,238)	11,856
Tax benefit for repatriation of certain foreign earnings under the AJCA	(29,271)	—	—
Other, net	<u>(1,122)</u>	<u>1,039</u>	<u>127</u>
	<u>\$162,937</u>	<u>\$158,247</u>	<u>\$114,148</u>

During fiscal 2005, we completed our evaluation of the repatriation provisions of the AJCA. The AJCA introduced a limited time 85% dividends received deduction on the repatriation of certain foreign earnings to a U.S. taxpayer, provided certain criteria are met. Although the AJCA contains a number of limitations related to the repatriation and some uncertainty remains on key elements of the provision, we made a determination for a planned repatriation of \$558.3 million of certain foreign earnings, of which \$500.0 million qualifies for the 85% dividends received deduction. We completed the repatriation of \$558.3 million of certain foreign earnings during fiscal 2005.

The total income tax provision of \$162.9 million, for fiscal 2005, includes a tax provision of \$43.5 million for the repatriation of certain foreign earnings. Additionally, it includes a reversal of \$72.8 million for income taxes on certain foreign earnings for which a deferred tax liability had been previously accrued. As a result, a net income tax benefit of \$29.3 million was recognized for the difference between income taxes previously provided on certain foreign earnings at the federal statutory tax rate and income taxes at the lower rate under the repatriation provisions of the AJCA. The tax provision of

\$43.5 million for the repatriation of certain foreign earnings is based upon currently available U.S. Treasury Department guidance.

The tax effects of the temporary differences that give rise to significant portions of the deferred tax assets and liabilities as of December 2, 2005 and December 3, 2004 are presented below:

	<u>2005</u>	<u>2004</u>
Deferred tax assets:		
Acquired technology	\$ 9,048	\$ 7,886
Reserves	29,716	16,515
Deferred revenue	11,409	8,475
Unrealized losses on investments	8,238	12,336
Credits	<u>24,899</u>	<u>30,600</u>
Total gross deferred tax assets	83,310	75,812
Deferred tax asset valuation allowance	<u>(8,238)</u>	<u>(12,336)</u>
Total deferred tax assets	<u>75,072</u>	<u>63,476</u>
Deferred tax liabilities:		
Depreciation and amortization	(22,650)	(8,138)
Undistributed earnings of foreign subsidiaries	(71,373)	(81,585)
Other	<u>(1,139)</u>	<u>(911)</u>
Total deferred tax liabilities	<u>(95,162)</u>	<u>(90,634)</u>
Net deferred tax assets (liabilities)	<u>\$(20,090)</u>	<u>\$(27,158)</u>

We provide United States income taxes on the earnings of foreign subsidiaries unless the subsidiaries' earnings are considered permanently reinvested outside the United States. To the extent that the foreign earnings previously treated as permanently reinvested are repatriated, the related United States tax liability may be reduced by any foreign income taxes paid on these earnings. As of December 2, 2005, the cumulative amount of earnings upon which U.S. income taxes have not been provided is approximately \$230.4 million. The unrecognized deferred tax liability for these earnings is approximately \$78.3 million.

For financial reporting purposes, a valuation allowance has been established for certain deferred tax assets related to the write-down of investments. At the end of fiscal 2005, our valuation allowance was \$8.2 million.

We are currently under examination by the Internal Revenue Service for our fiscal 2001, 2002, and 2003 tax returns. Although the ultimate outcome is unknown, we have reserved for potential adjustments that may result from the current examination and we believe that the final outcome will not have a material effect on our results of operations.

At the end of fiscal 2005, we had state tax credit carry-forwards of approximately \$24.9 million that can be carried forward indefinitely.

Below is a summary of our income tax payable activity for fiscal 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Beginning balance	\$145,913	\$193,484
Add: Current year liability	87,153	15,135
Less: Payments and reclassifications	<u>(78,537)</u>	<u>(62,706)</u>
Ending balance	<u>\$154,529</u>	<u>\$145,913</u>

Note 9. Benefit Plans

Pretax Savings Plan

In 1987, we 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 our United States employees. Under the plan, eligible employees may contribute up to 30% of their pretax salary, subject to the Internal Revenue Service annual contribution limits. In fiscal 2005, we matched 50% of the first 6% of the employee's contribution. We contributed approximately \$8.9 million, \$6.5 million and \$6.1 million in fiscal 2005, 2004 and 2003, respectively. We can terminate matching contributions at our discretion.

Profit Sharing Plan

We have a profit sharing plan that provides for profit sharing payments to all eligible employees following each quarter in which we achieve at least 80% of our budgeted earnings for the quarter. The plan, as well as the annual operating budget on which the plan is based, is approved by our Board of Directors. We contributed approximately \$45.7 million, \$42.6 million and \$28.8 million to the plan in fiscal 2005, 2004 and 2003, respectively.

Note 10. Employee and Director Stock Plans

Stock Options

Our stock option program is a long-term retention program that is intended to attract, retain and provide incentives for talented employees, officers and directors, and to align stockholder and employee interests.

Currently, we grant options from the 1) 2003 Equity Incentive Plan ("2003 Plan"), under which options could be granted to all employees, including executive officers, and outside consultants and 2) 1996 Outside Directors Stock Option Plan (the "Directors Plan"), as amended, under which options are granted automatically under a pre-determined formula to non-employee directors. The plans listed above are collectively referred to in the following discussion as "the Plans." We consider the Plans critical to our operation and productivity. Option vesting periods are generally three years for the Plans. As of December 2, 2005, we had reserved 53.7 million and 5.2 million shares of common stock for issuance under our 2003 Plan and Directors Plan, respectively. As of December 2, 2005, we had 23.0 million and 1.3 million shares available for grant under our 2003 Plan and Directors Plan, respectively.

All stock option grants to current executive officers are made after a review by and with the approval of the Executive Compensation Committee of the Board of Directors. All members of the Executive Compensation Committee are independent directors, as defined in the rules applicable to issuers traded on the Nasdaq Stock Market.

The Directors Plan provides for the granting of nonqualified stock options to non-employee directors. Option grants are limited to 25,000 shares per person in each fiscal year, except for a new non-employee director to whom 50,000 shares are granted upon election as a director. Options have a ten-year term and are exercisable and vest over three years: 25% on the day preceding each of Adobe's next two annual meetings of stockholders and 50% on the day preceding Adobe's third annual meeting of stockholders after the grant of the option. The exercise price of the options that are issued is equal to the fair market value of our common stock on the date of grant.

Options granted to directors for fiscal 2005, 2004 and 2003 are as follows:

	2005	2004	2003
Options granted to existing directors	400,000	350,000	560,000
Exercise price	\$ 29.74	\$ 20.83	\$ 16.21
Options granted to new directors	50,000	100,000	—
Exercise price	\$ 26.83	\$ 21.05	\$ —

As of December 2, 2005, approximately 2.3 million shares were reserved for issuance upon exercise of outstanding options under the Directors Plan. The Directors Plan will continue until the earlier of (i) termination by the Board or (ii) the date on which all of the shares available for issuance under the plan have been issued and restrictions on issued shares have lapsed.

Stock option activity for fiscal 2005, 2004 and 2003 is presented below (in actual amounts):

	December 2, 2005		December 3, 2004		November 28, 2003	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	76,532,632	\$18.52	84,939,306	\$16.40	115,694,100	\$17.82
Options granted	11,418,499	31.88	20,759,510	21.07	3,988,260	16.56
Options exercised	(20,494,162)	15.32	(26,587,728)	13.55	(15,956,108)	11.91
Options canceled	(2,205,685)	21.52	(2,578,456)	20.46	(18,786,946)	29.00
Outstanding at end of year	<u>65,251,284</u>	21.76	<u>76,532,632</u>	18.52	<u>84,939,306</u>	16.40
Exercisable at end of year	<u>42,098,806</u>		<u>44,873,414</u>	18.51	<u>54,481,080</u>	17.30
Weighted average fair value of options granted during the year		\$ 9.08		\$ 5.63		\$ 5.85

Information regarding the stock options outstanding at December 2, 2005 is summarized below:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$3.42 - 13.24	8,888,158	3.04 years	\$10.65	8,761,321	\$10.62
\$13.37 - 13.84	7,529,423	3.58 years	13.67	7,471,181	13.68
\$13.97 - 17.84	7,615,413	2.64 years	17.39	7,064,075	17.47
\$17.94 - 20.14	7,560,403	4.32 years	19.54	3,682,253	19.54
\$20.29 - 21.36	1,262,743	6.24 years	20.78	706,429	20.65
\$21.78 - 21.78	7,795,296	5.46 years	21.78	2,521,526	21.77
\$21.97 - 28.17	7,358,914	3.27 years	26.39	5,827,701	27.16
\$28.45 - 32.20	8,254,548	4.16 years	31.25	5,781,120	31.99
\$32.42 - 40.75	8,986,386	6.39 years	32.63	283,200	35.68
	<u>65,251,284</u>	4.18 years	\$21.76	<u>42,098,806</u>	\$19.32

Performance and Restricted Stock

The 1994 Performance and Restricted Stock Plan (“the Restricted Stock Plan”) provides for the granting of restricted stock and/or performance awards to officers and key employees. As of December 2, 2005, we had reserved 16.0 million shares of our common stock for issuance under the Plan.

Restricted shares issued under the Restricted Stock Plan generally vest annually over two to three years but are considered outstanding at the time of grant, as the stockholders are entitled to dividends and voting rights. As of December 2, 2005, 0.4 million shares were outstanding and not yet vested. Additionally, we charged \$0.4 million, \$0.3 million and \$2.8 million to expense associated with restricted stock in fiscal 2005, 2004 and 2003, respectively. As of December 2, 2005, approximately 5.5 million shares were available for grant under this Plan.

Restricted stock issued for fiscal 2005, 2004 and 2003 are as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Restricted stock granted	25,832	13,786	6,554
Average fair value of shares	\$ 30.86	\$ 21.44	\$16.19

Performance awards issued under the Restricted Stock Plan entitle the recipient to receive, at our discretion, shares or cash upon completion of the performance period subject to attaining identified performance goals. We did not grant performance awards in fiscal 2005, 2004 and 2003. As of December 2, 2005 and December 3, 2004, there were no performance awards outstanding.

The Restricted Stock Plan will continue until the earlier of (i) termination by the Board or (ii) the date on which all of the shares available for issuance under the plan have been issued and restrictions on issued shares have lapsed.

Employee Stock Purchase Plan

Our 1997 Employee Stock Purchase Plan (the "ESPP") allows eligible employee participants to purchase shares of our common stock at a discount through payroll deductions. The ESPP consists of twenty-four-month offering periods with four six-month purchase periods in each offering period. Employees purchase shares in each purchase period at 85% of the market value of our common stock at either the beginning of the offering period or the end of the purchase period, whichever price is lower. As of December 2, 2005, we had reserved 76.0 million shares of our common stock for issuance under the ESPP and approximately 22.8 million shares remain available for future issuance.

The weighted average fair value of the purchase rights granted in fiscal 2005, 2004 and 2003 were \$9.08, \$6.27 and \$5.49, respectively.

The ESPP will continue until the earlier of (i) termination by the Board or (ii) the date on which all of the shares available for issuance under the plan have been issued.

Stock Appreciation Rights

Under the 2003 Plan, we are authorized to grant Stock Appreciation Rights ("SARs"), a form of phantom stock, to designated key employees based on their performance. Additionally, we grant SARs to employees in certain countries outside of the U.S. in lieu of stock options, generally with similar vesting schedules to our option vesting schedule; these SARs generally expire eight years after the grant date.

The performance-based SARs generally vest four years from the date of grant but contain an acceleration feature that allows for a two-year vesting period based on Adobe achieving predetermined performance goals. These performance-based SARs expire five years from the date of grant. Under our SAR plan, designated employees are awarded rights that are equal to one share of Adobe's common stock for each right awarded with an exercise price based on the fair market value on the grant date. When the award vests, employees generally have the right to exercise the award and receive the then-current value in cash of the appreciation from the exercise price of the exercised number of rights of our common stock. We did not grant SARs in fiscal 2005, 2004 and 2003. We charged approximately \$0.1 million, \$0.2 million and \$0.1 million to expense in 2005, 2004 and 2003, respectively, for outstanding SARs. As of December 2, 2005, there were no SARs outstanding.

Note 11. Stockholders' Equity

Stockholder Rights Plan

Our 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 our common stock held as of July 24, 1990 and on each share of common stock issued by Adobe thereafter. In July 2000, the Stockholder Rights Plan was amended to extend it for ten years so that each right entitles the holder to purchase one unit of Series A Preferred Stock, which is equal to 1/1000 share of Series A Preferred Stock, par value \$0.0001 per share, at a price of \$700 per unit. As adjusted for our 2000 and 2005 stock splits each in the form of a dividend, each share of common stock now entitles the holder to one-quarter of such a purchase right. Each whole right still entitles the registered holder to purchase from Adobe a unit of preferred stock at \$700. The rights become exercisable in certain circumstances, including upon an entity's acquiring or announcing the intention to acquire beneficial ownership of 15% or more of our common stock without the approval of the Board of Directors or upon our being acquired by any person in a merger or business combination transaction. The rights are redeemable by Adobe prior to exercise at \$0.01 per right and expire on July 23, 2010.

Stock Repurchase Program I—On-going Dilution Coverage

To facilitate our stock repurchase program, designed to return value to our stockholders and minimize dilution from stock issuances, we repurchase shares in the open market and from time to time enter into structured stock repurchase agreements with third parties.

Authorization to repurchase shares to cover on-going dilution is not subject to expiration. However, this repurchase program is limited to covering net dilution from stock issuances and is subject to business conditions and cash flow requirements as determined by our Board of Directors from time to time.

On April 17, 2005, the Board of Directors approved the use of \$1.0 billion for stock repurchases commencing upon the close of the Macromedia acquisition.

During fiscal 2005, we entered into several structured stock repurchase agreements with large financial institutions. Under these agreements, we provided the financial institutions with up-front payments totaling \$600.0 million. The financial institutions agreed to deliver to us, at certain intervals during the contract term, a certain number of our shares based on the volume weighted average price during such intervals less a specified discount. Upon payment, the \$600.0 million was classified as treasury stock on our balance sheet. As of December 2, 2005, approximately \$154.9 million of the up-front payments remained under the agreements.

During fiscal 2005, we repurchased 18.7 million shares at an average price of \$30.61 through structured repurchase agreements. During fiscal 2004, we repurchased 22.0 million shares at an average price of \$21.91 through open market repurchases and structured repurchase agreements. During fiscal 2003, we repurchased 5.6 million shares at an average price of \$15.21 through open market repurchases and the exercise of put and call options.

Stock Repurchase Program II—Additional Authorization above Dilution Coverage

On September 25, 2002, our Board of Directors authorized a program to purchase up to an additional 10.0 million shares of our common stock over a three-year period, subject to certain business and cash flow requirements. We have not made any purchases under this 10.0 million share repurchase program. The authorization for this program expired in September 2005.

Note 12. Comprehensive Income

Statement of Financial Accounting Standards No. 130 ("SFAS 130"), "Reporting Comprehensive Income," establishes standards for the reporting and display of comprehensive income and its components in the financial statements. Items of comprehensive income that we currently report are unrealized gains and losses on marketable securities categorized as available-for-sale and foreign currency translation adjustments. We also report gains and losses on derivative instruments qualifying as cash flow hedges such as (i) hedging a forecasted foreign currency transaction, (ii) the variability of cash flows to be received or paid related to a recognized asset or liability and (iii) interest rate hedges.

The following table sets forth the components of other comprehensive income for fiscal 2005, 2004 and 2003:

	Unrealized Gain (Loss) on			Total
	Available- for-Sale Securities	Derivative Instruments	Foreign Currency Translation	
Balance at November 29, 2002	\$ 3,411	\$(1,929)	\$(5,432)	\$(3,950)
Unrealized gain (loss)	416	(3,383)	—	(2,967)
Reclassification adjustment for (gains) losses recognized during the period	(685)	3,489	—	2,804
Tax effect of above	(691)	(666)	—	(1,357)
Translation adjustments	—	—	4,471	4,471
Other comprehensive income (loss)	(960)	(560)	4,471	2,951
Balance at November 28, 2003	2,451	(2,489)	(961)	(999)
Unrealized gain (loss)	(6,696)	3,097	—	(3,599)
Reclassification adjustment for (gains) losses recognized during the period	(3,283)	405	—	(2,878)
Tax effect of above	2,634	(1,013)	—	1,621
Translation adjustments	—	—	3,566	3,566
Other comprehensive income (loss)	(7,345)	2,489	3,566	(1,290)
Balance at December 3, 2004	(4,894)	—	2,605	(2,289)
Unrealized gain (loss)	(4,529)	12,771	—	8,242
Reclassification adjustment for (gains) losses recognized during the period	2,223	(7,453)	—	(5,230)
Translation adjustments	—	—	(1,637)	(1,637)
Other comprehensive income (loss)	(2,306)	5,318	(1,637)	1,375
Balance at December 2, 2005	\$ (7,200)	\$ 5,318	\$ 968	\$ (914)

Note 13. Net Income Per Share

Basic net income per share is computed using the weighted average number of common shares outstanding for the period, excluding unvested restricted stock. Diluted net income per share is based upon the weighted average common shares outstanding for the period plus dilutive potential common shares, including unvested restricted common stock and stock options using the treasury stock method.

The following table sets forth the computation of basic and diluted net income per share for fiscal 2005, 2004 and 2003.

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net income	\$602,839	\$450,398	\$266,344
Shares used to compute basic net income per share (weighted average shares outstanding during the period, excluding unvested restricted stock)	489,921	477,658	468,492
Dilutive common equivalent shares:			
Unvested restricted stock	35	22	50
Stock options	18,114	17,946	14,358
Shares used to compute diluted net income per share	<u>508,070</u>	<u>495,626</u>	<u>482,900</u>
Basic net income per share	\$ 1.23	\$ 0.94	\$ 0.57
Diluted net income per share	<u>\$ 1.19</u>	<u>\$ 0.91</u>	<u>\$ 0.55</u>

For the years ended December 2, 2005, December 3, 2004 and November 28, 2003, options to purchase approximately 11.6 million, 14.0 million and 33.4 million shares, respectively, of common stock with exercise prices greater than the annual average fair market value of our stock of \$30.33, \$22.23 and \$16.98, respectively, were not included in the calculation because the effect would have been antidilutive.

Note 14. Commitments and Contingencies

Lease Commitments

We lease certain of our facilities and some of our equipment under noncancelable operating lease arrangements that expire at various dates through 2025. We also have one land lease that expires in 2091. Rent expense and sublease income for these leases for fiscal 2003 through 2005 were as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Rent expense	\$58,215	\$55,333	\$39,376
Sublease income	4,995	5,681	6,962
Net rent expense	<u>\$53,220</u>	<u>\$49,652</u>	<u>\$32,414</u>

We occupy three office buildings in San Jose, California where our corporate headquarters are located. We reference these office buildings as the "Almaden tower" and the "East and West towers."

In December 2003, upon completion of construction, we began a five year lease agreement for the Almaden tower. Under the agreement, we have the option to purchase the building at any time during the lease term for the lease balance, which is approximately \$103.0 million. The maximum recourse amount ("residual value guarantee") under this obligation is \$90.8 million.

In August 2004, we extended the lease agreement for our East and West towers for an additional five years with an option to extend for an additional five years solely at Adobe's election. As part of the lease extension, we purchased a portion of the lease receivable of the lessor for \$126.8 million, which is recorded as an investment in lease receivable on our consolidated balance sheet. This purchase may be credited against the residual value guarantee if we purchase the properties or repaid from the sale proceeds if the properties are sold to third parties. Under the agreement for the East and West towers, we have the option to purchase the buildings at any time during the lease term for the lease balance, which is approximately \$143.2 million. The maximum recourse amount ("residual value guarantee") under this obligation is \$126.8 million.

These two leases are both subject to standard covenants including liquidity, leverage and profitability ratios that are reported to the lessors quarterly. As of December 2, 2005, we were in compliance with all covenants. In the case of a default, the lessor may demand we purchase the buildings for an amount equal to the lease balance, or require that we remarket or relinquish the buildings. Both leases qualify for operating lease accounting treatment under Statement of Financial Accounting Standards No. 13, "Accounting for Leases," and, as such, the buildings and the related obligations are not included on our consolidated balance sheet. We utilized this type of financing in order to access bank-provided funding at the most favorable rates and to provide the lowest total cost of occupancy for the headquarter buildings. At the end of the lease term, we can extend the lease for an additional five year term (for the East and West towers lease only), purchase the buildings for the lease balance, remarket or relinquish the buildings. If we choose to remarket or are required to do so upon relinquishing the buildings, we are bound to arrange the sale of the buildings to an unrelated party and will be required to pay the lessor any shortfall between the net remarketing proceeds and the lease balance, up to the maximum recourse amount.

As of December 2, 2005, future minimum lease payments under noncancelable operating leases and future minimum sublease income under noncancelable subleases are as follows:

<u>Fiscal Year</u>	<u>Future Minimum Lease Payments</u>	<u>Future Minimum Sublease Income</u>
2006	\$ 35,265	\$ 5,328
2007	26,616	3,250
2008	23,155	1,678
2009	19,824	1,719
2010	10,221	1,093
Thereafter	58,398	—
Total	<u>\$173,479</u>	<u>\$13,068</u>

Guarantees

The lease agreements for our corporate headquarters provide for residual value guarantees. Under FIN 45, the fair value of a residual value guarantee in lease agreements entered into after December 31, 2002, must be recognized as a liability on our consolidated balance sheet. As such, we recognized a \$5.2 million liability related to the East and West tower lease that was extended in August 2004. This liability is recorded in other long-term liabilities with the offsetting entry recorded as prepaid rent in other assets. The balance will be amortized to the income statement over the life of the lease. As of December 2, 2005, the unamortized portion of the fair value of the residual value guarantee remaining in other long-term liabilities and prepaid rent was \$3.8 million.

Royalties

We have certain royalty commitments associated with the shipment and licensing of certain products. Royalty expense is generally based on a dollar amount per unit shipped or a percentage of the underlying revenue. Royalty expense, which was recorded under our cost of products revenue on our consolidated statements of income, was approximately \$17.8 million, \$15.9 million and \$14.5 million in fiscal 2005, 2004 and 2003, respectively.

Indemnifications

In the normal course of business, we provide indemnifications of varying scope to customers against claims of intellectual property infringement made by third parties arising from the use of our products. Historically, costs related to these indemnification provisions have not been significant and we are unable

to estimate the maximum potential impact of these indemnification provisions on our future results of operations.

To the extent permitted under Delaware law, we have agreements whereby we indemnify our officers and directors for certain events or occurrences while the officer or director is, or was serving, at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the officer's or director's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that limits our exposure and enables us to recover a portion of any future amounts paid. We believe the estimated fair value of these indemnification agreements in excess of applicable insurance coverage is minimal.

As part of our limited partnership interests in Adobe Ventures, we have provided a general indemnification to Granite Ventures, an independent venture capital firm and sole general partner of Adobe Ventures, for certain events or occurrences while Granite Ventures is, or was serving, at our request in such capacity provided that Granite Ventures acts in good faith on behalf of the partnerships. We are unable to develop an estimate of the maximum potential amount of future payments that could potentially result from any hypothetical future claim, but believe the risk of having to make any payments under this general indemnification to be remote.

Legal Actions

On September 6, 2002, Plaintiff Fred B. Dufresne filed suit against Adobe, Microsoft Corporation, Macromedia, Inc. and Trellix Corporation in the U.S. District Court, District of Massachusetts, alleging infringement of U.S. Patent No. 5,835,712, entitled "Client-Server System Using Embedded Hypertext Tags for Application and Database Development." The Plaintiff's complaint asserts that "defendants have infringed, and continue to infringe, one or more claims of the '712 patent by making, using, selling and/or offering for sale, *inter alia*, products supporting Microsoft Active Server Pages technology." Plaintiff seeks unspecified compensatory damages, preliminary and permanent injunctive relief, trebling of damages for "willful infringement," and fees and costs. We believe the action has no merit and are vigorously defending against it. We cannot estimate any possible loss at this time.

On June 13, 2005, Plaintiff Steve Staehr filed a shareholder derivative action entitled "Steve Staehr, Derivatively on Behalf of Adobe Systems Incorporated v. Bruce R. Chizen, et. al.," in the Superior Court of the State of California for the County of Santa Clara against Adobe's directors and naming Adobe as a nominal defendant. The complaint alleges that the defendants breached their fiduciary duties of loyalty and due care and caused Adobe to waste corporate assets by failing to renegotiate or terminate the acquisition agreement with Macromedia following the announcement by Macromedia that it would restate its financial results for the fiscal years ended March 31, 1999 through 2004. The complaint seeks, among other things, unspecified monetary damages, attorneys' fees and certain forms of equitable relief. On August 18, 2005, Plaintiff amended his complaint to add a purported class action. Adobe has obligations under certain circumstances to hold harmless and indemnify each of the defendant directors against judgments, fines, settlements and expenses related to claims against such directors and otherwise to the fullest extent permitted under Delaware law and Adobe's bylaws and certificate of incorporation. Such obligations may apply to this lawsuit. We believe the action has no merit and are vigorously defending against it. We cannot estimate any possible loss at this time.

In connection with our anti-piracy efforts, conducted both internally and through the Business Software Alliance, from time to time we undertake litigation against alleged copyright infringers. Such lawsuits may lead to counter-claims alleging improper use of litigation or violation of other local law and have recently increased in frequency, especially in Latin American countries. We believe we have valid defenses with respect to such counter-claims; however, it is possible that our consolidated financial position, cash flows or results of operations could be affected in any particular period by the resolution of one or more of these counter-claims.

One such case is *Consultores en Computación y Contabilidad, S.C. (“CCC”) v. Microsoft, Adobe, Symantec, and Autodesk* (the “Defendants”). On March 1, 2002, CCC, a Mexican hardware/software reseller, filed a lawsuit in the Mexico Court of First Instance against the Defendants (all members of the Business Software Alliance). CCC had previously been the target of a criminal anti-piracy enforcement action carried out by the Mexican police authorities on the basis of a piracy complaint filed by the Defendants based on evidence provided to the Defendants. CCC alleged in the lawsuit that it had suffered damages to its reputation as a result of the enforcement action. CCC did not claim economic damages. On November 11, 2002, the trial court judge ruled in favor of the Defendants, holding that no moral damage occurred. After subsequent appeals which were favorable to the Defendants, a court of appeals held that the Defendants were liable to CCC for “moral” damages, and the court remanded the case to the Court of First Instance for a determination of the amount. In December 2005, the Court of First Instance awarded CCC \$90 million in damages. The Defendants are appealing the verdict, as are the plaintiffs who seek additional damages. If, after all appeals have been exhausted, the existing verdict stands and is enforceable, Adobe would be responsible for approximately \$15 million of the judgment. No amounts have been accrued as a loss is not considered probable or estimable at this time.

From time to time, in addition to those identified above, Adobe is subject to legal proceedings, claims, investigations and proceedings in the ordinary course of business, including claims of alleged infringement of third-party patents and other intellectual property rights, commercial, employment and other matters. In accordance with U.S. generally accepted accounting principles, Adobe makes a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel, and other information and events pertaining to a particular case. Litigation is inherently unpredictable. However, we believe that we have valid defenses with respect to the legal matters pending against Adobe. It is possible, nevertheless, that our consolidated financial position, cash flows or results of operations could be affected by the resolution of one or more of such contingencies.

Note 15. Financial Instruments

Fair Value of Financial Instruments

In accordance with Statement of Financial Accounting Standards No. 133 (“SFAS 133”), “Accounting for Derivative Instruments and Hedging Activities,” we recognize derivative instruments and hedging activities as either assets or liabilities on the balance sheet and measure them at fair value. Gains and losses resulting from changes in fair value are accounted for depending on the use of the derivative and whether it is designated and qualifies for hedge accounting.

As of December 2, 2005, our cash equivalents, short-term investments, and marketable equity securities, are carried at fair value, based on quoted market prices for these or similar investments. For further information, see Note 3.

Our portfolio of investments in privately held companies, which includes our direct investments, as well as indirect investments through Adobe Ventures, is included in other assets on our Consolidated Balance Sheet. For further information, see Note 6.

Foreign Currency Hedging Instruments

We transact business in foreign countries, in U.S. dollars and in various foreign currencies. In Europe and Japan, transactions that are denominated in euro or yen subject us to exposure from movements in foreign currency exchange rates. This exposure is primarily related to yen-denominated product and support revenue in Japan and euro-denominated product and support revenue in certain European countries. In fiscal 2005, 2004 and 2003, our exposures were 26.4 billion yen, 24.1 billion yen and 21.3 billion yen, respectively. In fiscal 2005, 2004 and 2003, our exposures were 411.4 million euros, 375.4 million euros and 274.0 million euros, respectively.

Our Japanese operating expenses are in yen, and our European operating expenses are primarily in euro, which mitigates a portion of the exposure related to yen and euro denominated product revenue. In addition, we hedge firmly committed transactions using forward contracts. These contracts do subject us to risk of accounting gains and losses; however, the gains and losses on these contracts largely offset gains and losses on the assets, liabilities and transactions being hedged. We also hedge a percentage of forecasted international revenue with forward and purchased option contracts. Our revenue hedging policy is intended to reduce the negative impact on our forecasted revenue due to foreign currency exchange rate movements. At December 2, 2005, total outstanding contracts were \$339.3 million which included the notional equivalent of \$133.0 million in foreign currency forward exchange contracts which hedged our balance sheet exposures and the notional equivalent of \$206.3 million in put option contracts which hedged our forecasted revenue. As of December 2, 2005, all contracts were set to expire at various times through April 2006. The bank counterparties in these contracts expose us to credit-related losses in the event of their nonperformance. However, to mitigate that risk we only contract with counterparties with specific minimum rating requirements. In addition, our hedging policy establishes maximum limits for each counterparty.

In addition we also have long term investment exposures consisting of the capitalization and retained earnings in our non-USD functional foreign subsidiaries. For the fiscal years ending December 2, 2005 and December 3, 2004 this long term investment exposure totaled a notional equivalent of \$56.7 million and \$40.1 million, respectively. At this time we do not hedge these long term investment exposures.

Economic Hedging—Hedges of Forecasted Transactions

We use option and forward foreign exchange contracts to hedge certain operational (“cash flow”) exposures resulting from changes in foreign currency exchange rates. These foreign exchange contracts, carried at fair value, may have maturities between one and twelve months. The maximum original duration of options and forward foreign exchange contracts is twelve months. Such cash flow exposures result from portions of our forecasted revenues denominated in currencies other than the U.S. dollar, primarily the Japanese yen and the euro. We enter into these foreign exchange contracts to hedge forecasted product licensing revenue in the normal course of business, and accordingly, they are not speculative in nature.

To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge and the hedges must be highly effective in offsetting changes to future cash flows on hedged transactions. We record changes in the intrinsic value of these cash flow hedges in accumulated other comprehensive income (loss) until the forecasted transaction occurs. As of December 2, 2005, we estimate that \$5.3 million of existing gains will be reclassified into revenue from accumulated other comprehensive income (loss) within the next twelve months.

When the forecasted transaction occurs, we reclassify the related gain or loss on the cash flow hedge to revenue. During fiscal 2005, 2004 and 2003, net gains (losses) of \$7.5 million, \$(0.4) million and \$(3.5) million, respectively, were reclassified from accumulated other comprehensive income (loss) to revenue. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, the related hedge gains and losses on the cash flow hedge are reclassified from accumulated other comprehensive income (loss) to interest and other income (loss) on the consolidated statement of income at that time. For fiscal 2005, there were no such net gains or losses recognized in other income relating to hedges of forecasted transactions that did not occur.

We evaluate hedging effectiveness prospectively and retrospectively and record any ineffective portion of the hedging instruments in other income (loss) on the consolidated statement of income. The net gain (loss) recognized in other income (expense) for cash flow hedges due to hedge ineffectiveness was insignificant for fiscal 2005, 2004 and 2003. The time value of purchased derivative instruments is deemed to be ineffective and is recorded in other income (loss) over the life of the contract. Other income (loss)

for fiscal 2005, 2004 and 2003 included \$2.6 million, \$(2.6) million and \$(1.1) million of net gains (losses), respectively, representing the cost of the purchased options.

Balance Sheet Hedging—Hedging of Foreign Currency Assets and Liabilities

We hedge our net recognized foreign currency assets and liabilities with forward foreign exchange contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in foreign currency exchange rates. These derivative instruments hedge assets and liabilities that are denominated in foreign currencies and are carried at fair value with changes in the fair value recorded as other income. These derivative instruments do not subject us to material balance sheet risk due to exchange rate movements because gains and losses on these derivatives are intended to offset gains and losses on the assets and liabilities being hedged. At December 2, 2005, the outstanding balance sheet hedging derivatives had maturities of 150 days or less.

Net gains in other income relating to balance sheet hedging for fiscal 2005, 2004 and 2003

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Gain (loss) on foreign currency assets and liabilities:			
Net realized gain (loss) recognized in other income	\$ (9,604)	\$ 4,586	\$ 13,535
Net unrealized gain (loss) recognized in other income	(4,088)	3,949	132
	<u>(13,692)</u>	<u>8,535</u>	<u>13,667</u>
Gain (loss) on hedges of foreign currency assets and liabilities:			
Net realized gain (loss) recognized in other income	9,893	(11,123)	(8,726)
Net unrealized gain (loss) recognized in other income	5,747	3,150	(3,483)
	<u>15,640</u>	<u>(7,973)</u>	<u>(12,209)</u>
Net gain recognized in other income	<u>\$ 1,948</u>	<u>\$ 562</u>	<u>\$ 1,458</u>

Fair Value Hedges—Hedging of Foreign Currency Denominated Available for Sale Securities

During fiscal 2004, a portion of our investment portfolio was invested in euro denominated securities. In order to mitigate the currency risk of those euro denominated securities, we entered into forward currency contracts designated as fair value hedges. During fiscal 2005 we did not invest in euro denominated securities.

Net gains recognized in other income relating to fair value hedges for fiscal 2004 were as follows:

	<u>2004</u>
Gain on foreign currency assets and liabilities:	
Net realized gain recognized in other income	\$ 2,234
Net unrealized loss recognized in other income	<u>(1,935)</u>
	299
Loss on hedges of foreign currency assets and liabilities:	
Net realized gain recognized in other income	3,026
Net unrealized loss recognized in other income	<u>(3,482)</u>
	(456)
Net loss recognized in other income	<u>\$ (157)</u>

Concentration of Risk

Financial instruments that potentially subject us to concentrations of credit risk are short-term investments, primarily fixed-income securities, derivatives, hedging foreign currency and interest rate risk, and accounts receivable.

Our investment portfolio consists of investment-grade securities diversified among security types, industries, and issuers. Our cash and investments are held and managed by recognized financial institutions that follow Adobe's investment policy. Our policy limits the amount of credit exposure to any one security issue or issuer, and we believe no significant concentration of credit risk exists with respect to these investments.

We mitigate concentration of risk related to foreign currency hedges as well as interest rate hedges through a policy that establishes counterparty limits. We also have minimum rating requirements for all bank counterparties.

Credit risk in receivables is limited to OEM partners, dealers and distributors of hardware and software products to the retail market, and to customers whereby we license software directly. Management believes that any risk of loss is reduced due to the diversity of our customers and geographic sales areas. A credit review is completed for our new distributors, dealers, and OEM partners. We also perform ongoing credit evaluations of our customers' financial condition and require letters of credit or other guarantees, whenever deemed necessary. The credit limit given to the customer is based on our risk assessment of their ability to pay, country risk, and other factors and is not contingent on the resale of the product or on the collection of payments from their customers. We also purchase credit insurance to mitigate credit risk in some foreign markets where we believe it is warranted. If we license our software to a customer where we have a reason to believe the customer's ability to pay is not probable, due to country risk or credit risk, we will not recognize the revenue. We will revert to recognizing the revenue on a cash basis, assuming all other criteria for revenue recognition has been met. For discussion of significant customers as of December 2, 2005, see Note 16.

We derive a significant portion of our OEM PostScript and Other licensing revenue from a small number of OEM partners. Our OEM partners on occasion seek to renegotiate their royalty arrangements. We evaluate 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 us.

Note 16. Industry Segment, Geographic Information, and Significant Customers

We have four reportable segments: Digital Imaging and Video, Creative Professional, Intelligent Document, and OEM PostScript and Other. The Digital Imaging and Video segment provides users with

software for creating, editing, enhancing and sharing digital images and photographs, digital video, audio and animations. The Creative Professional segment provides software for professional page layout, professional Web page layout, graphic and illustration creation, technical document publishing and business publishing. Additionally, this segment includes Photoshop and Acrobat Professional as part of its Adobe Creative Suite products. The Intelligent Document segment provides electronic document distribution software that allows users to create, enhance, annotate and securely send Adobe PDF files that can be shared, viewed, navigated and printed exactly as intended on a broad range of hardware and software platforms. In addition, this segment provides server-based solutions for enterprises, in the areas of document generation, document process management, document collaboration, document workflow and document control and security. The OEM PostScript and Other segment includes printing technology used to create and print simple or visually rich documents with precision.

The accounting policies of the operating segments are the same as those described in Note 1. With the exception of goodwill, we do not identify or allocate our assets by operating segment. See Note 5 for the allocation of goodwill to our reportable segments.

Coinciding with the integration of Macromedia and the start of our 2006 fiscal year, we changed the reporting of our principal business segments to be aligned with our market opportunities and how we manage our combined businesses. Our new business segments are Creative Solutions, Knowledge Worker Solutions, Enterprise and Developer Solutions, Mobile and Device Solutions, and Other. The tables that follow are based on our segment reporting that was in effect throughout fiscal 2005.

Our results for fiscal years 2005, 2004 and 2003 are reported by operating segments below:

	Digital Imaging and Video	Creative Professional	Intelligent Document	OEM PostScript and Other	Total
Fiscal 2005					
Revenue	\$432,800	\$743,825	\$708,035	\$81,661	\$1,966,321
Cost of revenue	36,390	23,400	46,354	6,434	112,578
Gross profit	<u>\$396,410</u>	<u>\$720,425</u>	<u>\$661,681</u>	<u>\$75,227</u>	<u>\$1,853,743</u>
Gross profit as a percentage of revenues . .	92%	97%	93%	92%	94%
Fiscal 2004					
Revenue	\$430,177	\$613,062	\$541,804	\$81,538	\$1,666,581
Cost of revenue	40,149	21,125	38,077	5,027	104,378
Gross profit	<u>\$390,028</u>	<u>\$591,937</u>	<u>\$503,727</u>	<u>\$76,511</u>	<u>\$1,562,203</u>
Gross profit as a percentage of revenues . .	91%	97%	93%	94%	94%
Fiscal 2003					
Revenue	\$392,442	\$368,549	\$444,056	\$89,702	\$1,294,749
Cost of revenue	33,501	20,818	33,501	5,202	93,022
Gross profit	<u>\$358,941</u>	<u>\$347,731</u>	<u>\$410,555</u>	<u>\$84,500</u>	<u>\$1,201,727</u>
Gross profit as a percentage of revenues . .	92%	94%	92%	94%	93%

A reconciliation of the totals reported for the operating segments to the applicable line items in the consolidated financial statements for fiscal 2005, 2004 and 2003 is as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Total gross profit from operating segments			
above	\$1,853,743	\$1,562,203	\$1,201,727
Total operating expenses*	<u>1,125,309</u>	<u>970,409</u>	<u>822,280</u>
Total operating income	728,434	591,794	379,447
Non-operating income (loss)	<u>37,342</u>	<u>16,851</u>	<u>1,045</u>
Income before income taxes	<u>\$ 765,776</u>	<u>\$ 608,645</u>	<u>\$ 380,492</u>

* Total operating expenses include research and development, sales and marketing and general and administrative. For fiscal 2003, operating expenses also included restructuring and other charges.

For fiscal 2005, 2004 and 2003, our revenues and property and equipment, net of accumulated depreciation, are presented below by geographic area. With the exception of property and equipment, we do not identify or allocate our assets by operating segment.

<u>Revenue</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Americas:			
United States	\$ 864,274	\$ 706,064	\$ 588,631
Other	<u>75,443</u>	<u>64,500</u>	<u>51,551</u>
Total Americas	<u>939,717</u>	<u>770,564</u>	<u>640,182</u>
EMEA	<u>612,721</u>	<u>541,528</u>	<u>370,181</u>
Asia:			
Japan	284,528	262,685	212,505
Other	<u>129,355</u>	<u>91,804</u>	<u>71,881</u>
Total Asia	<u>413,883</u>	<u>354,489</u>	<u>284,386</u>
Total revenue	<u>\$1,966,321</u>	<u>\$1,666,581</u>	<u>\$1,294,749</u>
 <u>Property and Equipment</u>	 <u>2005</u>	 <u>2004</u>	 <u>2003</u>
Americas:			
United States	\$ 65,351	\$ 72,857	\$ 57,753
Other	<u>4,060</u>	<u>4,771</u>	<u>4,903</u>
Total Americas	<u>69,411</u>	<u>77,628</u>	<u>62,656</u>
EMEA	<u>19,891</u>	<u>10,543</u>	<u>7,032</u>
Asia:			
India	13,060	10,306	6,357
Other	<u>1,187</u>	<u>1,198</u>	<u>962</u>
Total Asia	<u>14,247</u>	<u>11,504</u>	<u>7,319</u>
Total long-lived assets	<u>\$ 103,549</u>	<u>\$ 99,675</u>	<u>\$ 77,007</u>

Significant Customers

The table below lists our significant customers for fiscal 2003 through 2005. As listed, our significant customers are distributors and thus impact each of our reporting segments. The amounts listed below are a percentage of our net revenues.

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Ingram Micro	26%	23%	28%
Tech Data	11%	13%	13%

The amounts listed below are receivables, from our significant customers, as a percentage of our gross trade receivables for fiscal 2005 and 2004.

	<u>2005</u>	<u>2004</u>
Ingram Micro	26%	21%
Tech Data	10%	12%

Note 17. Subsequent Events

On December 3, 2005, we completed the acquisition of Macromedia, a provider of software technologies that enables the development of a wide range of internet and mobile application solutions, for approximately \$3.4 billion. Under the terms of the agreement, which was approved by the boards of directors and the stockholders of both companies, Macromedia stockholders received, at a fixed exchange ratio, 1.38 shares of Adobe common stock for every share of Macromedia common stock in a tax-free exchange. This fixed exchange ratio gives effect to the two-for-one stock split in the form of a stock dividend paid on May 23, 2005 to the stockholders of Adobe. The \$3.4 billion estimated purchase price for the acquisition includes the estimated fair value of Adobe common stock issued, stock options and restricted stock assumed, as well as estimated direct transaction costs. We derived this estimate using an average market price per share of Adobe common stock of \$29.43, which was based on an average of the closing prices for a range of trading days (April 14, 2005 through April 20, 2005) around the announcement date (April 18, 2005) of the proposed transaction.

In conjunction with the acquisition of Macromedia, on December 3, 2005, the Adobe board of directors approved a restructuring plan to better align Adobe's resources among its client and product groups. We expect to incur restructuring charges in fiscal year 2006, primarily in the first quarter. These restructuring expenses relate only to those employees and facilities that were associated with Adobe prior to the acquisition of Macromedia on December 3, 2005. These expenses will be a charge to earnings in the respective quarter in which they are incurred. We expect to incur additional restructuring expenses relating to Macromedia's operations. These costs will be included in the assumed liabilities of Macromedia as of December 3, 2005 and will be recorded as part of the total acquisition purchase price of Macromedia.

In December 2005, we entered into additional structured stock repurchase agreements with large financial institutions. Under these agreements, we provided the financial institutions with up-front payments totaling \$500.0 million. The financial institutions agreed to deliver to us, at certain intervals during the contract term, a certain number of shares based on the volume weighted average price during such intervals less a specified discount. The \$500.0 million will be classified as treasury stock on our balance sheet.

<u>Signature</u>	<u>Title</u>
<u>/s/ CAROL MILLS</u> Carol Mills	Director
<u>/s/ COLLEEN M. POULIOT</u> Colleen M. Pouliot	Director
<u>/s/ ROBERT SEDGEWICK</u> Robert Sedgewick	Director
<u>/s/ DELBERT W. YOCAM</u> Delbert W. Yocam	Director
<u>/s/ MURRAY J. DEMO</u> Murray J. Demo	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

SUMMARY OF TRADEMARKS

The following trademarks of Adobe Systems Incorporated or its subsidiaries, which may be registered in the United States and/or other countries, are referenced in this Form 10-K:

Adobe
Acrobat
Acrobat Capture
Acrobat Messenger
Adobe Audition
Adobe Encore
Adobe LiveCycle
Adobe Premiere
Adobe Type Manager
After Effects
Authorware
Breeze
Captivate
ColdFusion
Contribute
Director
Distiller
Dreamweaver
Fireworks
Flash
FlashCast
Flash Lite
Flex
Flex Builder
Font Folio
FrameMaker
FreeHand
GoLive
Illustrator
InCopy
InDesign
JRun
Macromedia
PageMaker
Photoshop
PostScript
Reader
RoboHelp
Shockwave
Version Cue

All other trademarks are the property of their respective owners.

EXHIBITS

As required under Item 15, Exhibits and Financial Statement Schedules, the exhibits filed as part of this report are provided in this separate section. The exhibits included in this section are as follows:

Exhibit Number	Exhibit Description	Incorporated by Reference**			Filed Herewith
		Form	Date	Number	
3.1	Amended and Restated Bylaws	8-K	9/23/05	3.1	
3.2	Restated Certificate of Incorporation, as filed with the Secretary of State of the State of Delaware on 5/22/01	10-Q	7/16/01	3.6	
3.2.1	Certificate of Correction of Restated Certificate of Incorporation as filed with the Secretary of State of the State of Delaware	10-Q	4/11/03	3.6.1	
3.3	Certificate of Designation of Series A Preferred Stock of Adobe Systems Incorporated	10-Q	7/8/03	3.3	
4.1	Fourth Amended and Restated Rights Agreement between the Company and Computershare Investor Services, LLC	8-K	7/3/00	1	
4.1.1	Amendment No. 1 to Fourth Amended and Restated Rights Agreement between the Company and Computershare Investor Services, LLC	8-A/2G/A	5/23/03	7	
10.1	1984 Stock Option Plan, as amended*	10-Q	7/02/93	10.1.6	
10.2	Amended 1994 Performance and Restricted Stock Plan*	10-Q	10/5/05	10.2	
10.3	Form of Restricted Stock Agreement used in connection with the Amended 1994 Performance and Restricted Stock Plan*	10-Q	10/7/04	10.7	
10.4	1994 Stock Option Plan, as amended*	S-8	5/30/97	10.40	
10.5	1997 Employee Stock Purchase Plan, as amended*	10-K	12/1/00	10.70	
10.6	1996 Outside Directors' Stock Option Plan, as amended*	DEF 14A	3/14/05	Appendix B	
10.7	Forms of Stock Option Agreements used in connection with the 1996 Outside Directors' Stock Option Plan*	S-8	6/16/00	4.8	
10.8	1999 Nonstatutory Stock Option Plan, as amended*	S-8	10/29/01	4.6	
10.9	1999 Equity Incentive Plan, as amended*	10-K	2/26/03	10.37	
10.10	2003 Equity Incentive Plan, as amended*	DEF 14A	3/14/05	Appendix A	

Exhibit Number	Exhibit Description	Incorporated by Reference**			Filed Herewith
		Form	Date	Number	
10.11	Forms of Stock Option and Restricted Stock Agreement used in connection with the 2003 Equity Incentive Plan	10-Q	10/7/04	10.11	
10.12	Form of Indemnity Agreement*	10-Q	5/30/97	10.25.1	
10.13	Forms of Retention Agreement*	10-K	11/28/97	10.44	
10.14	Second Amended and Restated Master Lease of Land and Improvements by and between SMBC Leasing and Finance, Inc. and Adobe Systems Incorporated	10-Q	10/7/04	10.14	
10.15	Lease agreement between Adobe Systems and Selco Service Corporation	10-K	2/21/02	10.77	
10.16	Participation agreement among Adobe Systems, Selco Service Corporation, et al.	10-K	2/21/02	10.78	
10.17	Amendment No. 1 to Lease Agreement between Adobe and Selco Services Corporation	10-K	2/26/03	10.81	
10.18	Lease Agreement by and between Allaire Corporation and EOP Riverside Project LLC dated November 23, 1999	10-K	3/30/00	10.23	
10.19	First Amendment to Lease Agreement by and between Allaire Corporation and EOP Riverside Project LLC dated May 31, 2000	10-Q	8/14/00	10.3	
10.20	Executive Severance Plan in the Event of a Change of Control*	10-K	2/21/02	10.80	
10.21	Amendment to the Executive Severance Plan in the Event of a Change of Control*	8-K	4/18/05	10.2	
10.22	Adobe Systems Incorporated 2004 Annual Executive Incentive Plan*	8-K	1/13/05	10.1	
10.23	Adobe Systems Incorporated 2005 Annual Executive Incentive Plan*	8-K	1/13/05	10.2	
10.24	Description of 2005 Director Compensation*	10-K	2/2/05	10.21	
10.25	Description of 2006 Director Compensation*	8-K	9/23/05	10.1	
10.26	Adobe Systems Incorporated 2006 Management Team Annual Incentive Plan*	8-K	1/13/06	10.1	
10.27	2005 Equity Incentive Assumption Plan*	8-K	12/07/05	10.2	
10.28	Form of Stock Option Agreement used in connection with the 2005 Equity Incentive Assumption Plan*	8-K	12/07/05	10.3	

Exhibit Number	Exhibit Description	Incorporated by Reference**			Filed Herewith
		Form	Date	Number	
10.29	Allaire Corporation 1997 Stock Incentive Plan*	S-8	03/27/01	4.06	
10.30	Allaire Corporation 1998 Stock Incentive Plan*	S-8	03/27/01	4.07	
10.31	Allaire Corporation 2000 Stock Incentive Plan*	S-8	03/27/01	4.08	
10.32	Andromedia, Inc. 1996 Stock Option Plan*	S-8	12/07/99	4.07	
10.33	Andromedia, Inc. 1997 Stock Option Plan*	S-8	12/07/99	4.08	
10.34	Andromedia, Inc. 1999 Stock Plan*	S-8	12/07/99	4.09	
10.35	ESI Software, Inc. 1996 Equity Incentive Plan*	S-8	10/18/99	4.08	
10.36	eHelp Corporation 1999 Equity Incentive Plan*	S-8	12/29/03	4.08	
10.37	Blue Sky Software Corporation 1996 Stock Option Plan*	S-8	12/29/03	4.07	
10.38	Bright Tiger Technologies, Inc. 1996 Stock Option Plan*	S-8	03/27/01	4.11	
10.39	Live Software, Inc. 1999 Stock Option/Stock Issuance Plan*	S-8	03/27/01	4.10	
10.40	Macromedia, Inc. 1999 Stock Option Plan*	S-8	08/17/00	4.07	
10.41	Macromedia, Inc. 1993 Directors Stock Option Plan*	10-Q	08/03/01	10.02	
10.42	Macromedia, Inc. 1992 Equity Incentive Plan*	10-Q	08/03/01	10.01	
10.43	Macromedia, Inc. 2002 Equity Incentive Plan*	S-8	08/10/05	4.08	
10.44	Form of Macromedia, Inc. Stock Option Agreement*	S-8	08/10/05	4.09	
10.45	Middlesoft, Inc. 1999 Stock Option Plan*	S-8	08/17/00	4.09	
10.46	Form of Macromedia, Inc. Revised Non-Plan Stock Option Agreement*	S-8	11/23/04	4.10	
10.47	Form of Macromedia, Inc. Restricted Stock Purchase Agreement*	10-Q	2/8/05	10.01	
10.48	Restricted Stock Purchase Agreement between Macromedia, Inc. and Stephen Elop, dated January 24, 2005*	10-Q	2/8/05	10.02	
10.49	Restricted Stock Purchase Agreement between Macromedia, Inc. and Robert Burgess, dated January 24, 2005*	10-Q	2/8/05	10.03	

Exhibit Number	Exhibit Description	Incorporated by Reference**			Filed Herewith
		Form	Date	Number	
10.50	Amended and Restated Employment Agreement by and between Robert K. Burgess, dated January 21, 2005*	8-K	1/21/05	10.01	
10.51	Amendment to Employment Agreement by and between Adobe Systems Incorporated, Adobe Macromedia Software LLC and Robert K. Burgess, dated December 7, 2005*	8-K	12/12/05	10.2	
10.52	Amended and Restated Employment Agreement between Adobe Systems Incorporated and Stephen Elop, dated May 23, 2005*	S-4	6/28/05	10.1	
10.53	Executive Resignation Agreement and General Release of Claims, dated April 15, 2005, between Adobe Systems Incorporated and Jimmie E. Stephens*	8-K	4/18/05	10.1	
10.54	Adobe Systems Incorporated 2006 Performance Share Program pursuant to the 2003 Equity Incentive Plan*	8-K	2/3/06	10.1	
10.55	Adobe Systems Incorporated 2006 Performance Share Program pursuant to the Amended 1994 Performance and Restricted Stock Plan*	8-K	2/3/06	10.2	
10.56	Form of Maximum Award Grant Notice used in connection with grants under the Adobe Systems Incorporated 2006 Performance Share Program pursuant to the 2003 Equity Incentive Plan*	8-K	2/3/06	10.3	
10.57	Form of Performance Share Maximum Award Agreement used in connection with grants under the Adobe Systems Incorporated 2006 Performance Share Program pursuant to the 2003 Equity Incentive Plan*	8-K	2/3/06	10.4	
10.58	Form of Maximum Award Grant Notice used in connection with grants under the Adobe Systems Incorporated 2006 Performance Share Program pursuant to the Amended 1994 Performance and Restricted Stock Plan*	8-K	2/3/06	10.5	

Exhibit Number	Exhibit Description	Incorporated by Reference**			Filed Herewith
		Form	Date	Number	
10.59	Form of Performance Share Maximum Award Agreement used in connection with grants under the Adobe Systems Incorporated 2006 Performance Share Program pursuant to the Amended 1994 Performance and Restricted Stock Plan*	8-K	2/3/06	10.6	
21	Subsidiaries of the Registrant				X
23.1	Independent Registered Public Accounting Firm's Consent				X
31.1	Certification of Chief Executive Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934				X
31.2	Certification of Chief Financial Officer, as required by Rule 13a-14(a) of the Securities Exchange Act of 1934				X
32.1	Certification of Chief Executive Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934†				X
32.2	Certification of Chief Financial Officer, as required by Rule 13a-14(b) of the Securities Exchange Act of 1934†				X
100.INS	XBRL Instance				X
100.SCH	XBRL Taxonomy Extension Schema				X
100.CAL	XBRL Taxonomy Extension				X
100.LAB	XBRL Taxonomy Extension Labels				X
100.PRE	XBRL Taxonomy Extension				X

* Compensatory plan or arrangement

** References to Exhibits 10.18 and 10.19 are to filings made by the Allaire Corporation. References to Exhibits 10.29 through 10.50 are to filings made by Macromedia, Inc.

† The certifications attached as Exhibits 32.1 and 32.2 that accompany this Annual Report on Form 10-K, are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Adobe Systems Incorporated under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Form 10-K, irrespective of any general incorporation language contained in such filing.

ADOBE SYSTEMS INCORPORATED
SUBSIDIARIES OF THE REGISTRANT

<u>Subsidiary Legal Name</u>	<u>Jurisdiction of Incorporation/Formation</u>
The Americas:	
Adobe International LLC	Delaware
Adobe Systems Brasil Limitada	Brazil
Fotiva, Inc.	Delaware
Accelio Corporation	Delaware
Adobe Systems Canada Inc.	Canada
Q-Link Technologies, Inc.	Delaware
Okyz, Inc.	Delaware
Avner Acquisition Sub, Inc.	Delaware
Europe:	
Accelio France SA	France
Accelio UK Ltd.	United Kingdom
Adobe Systems Benelux BV	The Netherlands
Adobe Systems Danmark ApS	Denmark
Adobe Systems Direct Ltd.	Scotland
Adobe Systems Engineering GmbH	Federal Republic of Germany
Adobe Systems Europe Ltd.	Scotland
Adobe Systems France SAS	France
Adobe Systems GmbH	Federal Republic of Germany
Adobe Systems (Schweiz) GmbH	Federal Republic of Switzerland
Adobe Systems Iberica SL	Spain
Adobe Systems Italia SRL	Italy
Adobe Systems Nordic AB	Sweden
Adobe Systems Norge AS	Norway
Adobe Systems s.r.o.	Czech Republic
Adobe Software Trading Company Limited	Ireland
Adobe Systems Software Ireland Limited	Ireland
Frame Technology International Limited	Ireland
Okyz SAS	France
Asia:	
Adobe Systems Company Ltd.	Japan
Adobe Systems India Pvt. Ltd.	India
Adobe Systems Korea Ltd.	Korea
Adobe Systems Pte. Ltd.	Singapore
Adobe Systems Pty. Ltd.	Australia
Adobe Systems Software (Beijing) Co. Ltd.	China

All subsidiaries of the registrant are wholly owned, directly or indirectly by Adobe, and do business under their legal names (although Adobe Systems Benelux BV and Adobe Systems Software Ireland Limited also do business as Adobe Direct).

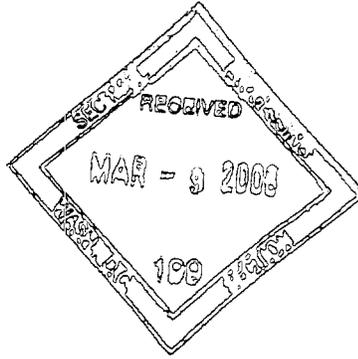
ADOBE SYSTEMS INCORPORATED

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Adobe Systems Incorporated:

We consent to the incorporation by reference in the Registration Statements (No. 33-10753, No. 33-18986, No. 33-23171, No. 33-30976, No. 33-36501, No. 33-38387, No. 33-48210, No. 33-63518, No. 33-78506, No. 33-83030, No. 33-83502, No. 33-83504, No. 33-84396, No. 33-86482, No. 33-59335, No. 33-63849, No. 33-63851, No. 333-28195, No. 333-28203, No. 333-28207, No. 333-57589, No. 333-81191, No. 333-87165, No. 333-39524, No. 333-52214, No. 333-57074, No. 333-72424, No. 333-90518, No. 333-108014, No. 333-130104, and No. 333-130185) on Form S-8 of Adobe Systems Incorporated of our reports dated February 8, 2006, with respect to the consolidated balance sheets of Adobe Systems Incorporated as of December 2, 2005 and December 3, 2004, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the years in the three-year period ended December 2, 2005, management's assessment of the effectiveness of internal control over financial reporting as of December 2, 2005, and the effectiveness of internal control over financial reporting as of December 2, 2005, appearing elsewhere in this Form 10-K.

/s/KPMG LLP
Mountain View, California
February 8, 2006



To Our Stockholders



It was another great year for the entire Adobe community.

Adobe's mission to help people and organizations communicate better gained strong momentum in 2005. A wide variety of businesses and individuals around the world used Adobe products to increase productivity, collaborate more effectively, and design and disseminate content in new and meaningful ways.

Our ongoing focus on meeting the needs of our customers, partners, and investors continued to deliver positive results. Customers, for example, benefited from the increasing capabilities they gained from using our industry-defining platforms and new software releases, while partner relationships flourished and deepened, particularly around innovative, integrated enterprise solutions. All this, plus our success in exceeding our targeted growth objectives in our markets—both business and financial—delivered significant value to Adobe stockholders.

In sum, it was another great year for the entire Adobe community.

And the good news got even better after the close of fiscal 2005, with Adobe's much-anticipated acquisition of Macromedia. In this letter, we'll review some of the highlights of the past year, and then tell you why we believe that by combining the passion and creativity of two industry-leading companies, Adobe will be even better positioned to drive the innovation that is revolutionizing how the world engages with ideas and information.

Adobe delivered double-digit revenue growth for the third consecutive year.

Record financial results

Adobe delivered double-digit revenue growth for the third consecutive year. Annual revenue grew to a record \$1.97 billion in fiscal 2005, an 18 percent increase from fiscal 2004 revenue. Our GAAP diluted earnings per share grew from \$0.91 (adjusted for stock split) to \$1.19, and our operating margin in fiscal 2005 was 37 percent, driven by a 23 percent increase in operating profit when compared to fiscal 2004. Reported net income grew to \$602.8 million, a 34 percent increase year-over-year. Adobe's Creative Professional revenue rose to \$743.8 million, a 21 percent increase from the prior year. Digital Imaging and Video revenue was \$432.8 million, flat year-over-year as many Adobe® Photoshop® software users migrated to our Creative Suite software. Adobe's Intelligent Documents revenue increased to \$708 million, a 31 percent rise from 2004 due to the strong adoption of Adobe Acrobat® software. Finally, revenue from our OEM PostScript® and Other segment was \$81.7 million, flat with the prior year.

With hallmark operational efficiency, Adobe successfully executed on its financial strategy in fiscal year 2005. We continued to strengthen our balance sheet and increased our cash and cash equivalents to \$1.7 billion. Results from our operations once again generated strong cash flow, which we continue to invest for Adobe's future.

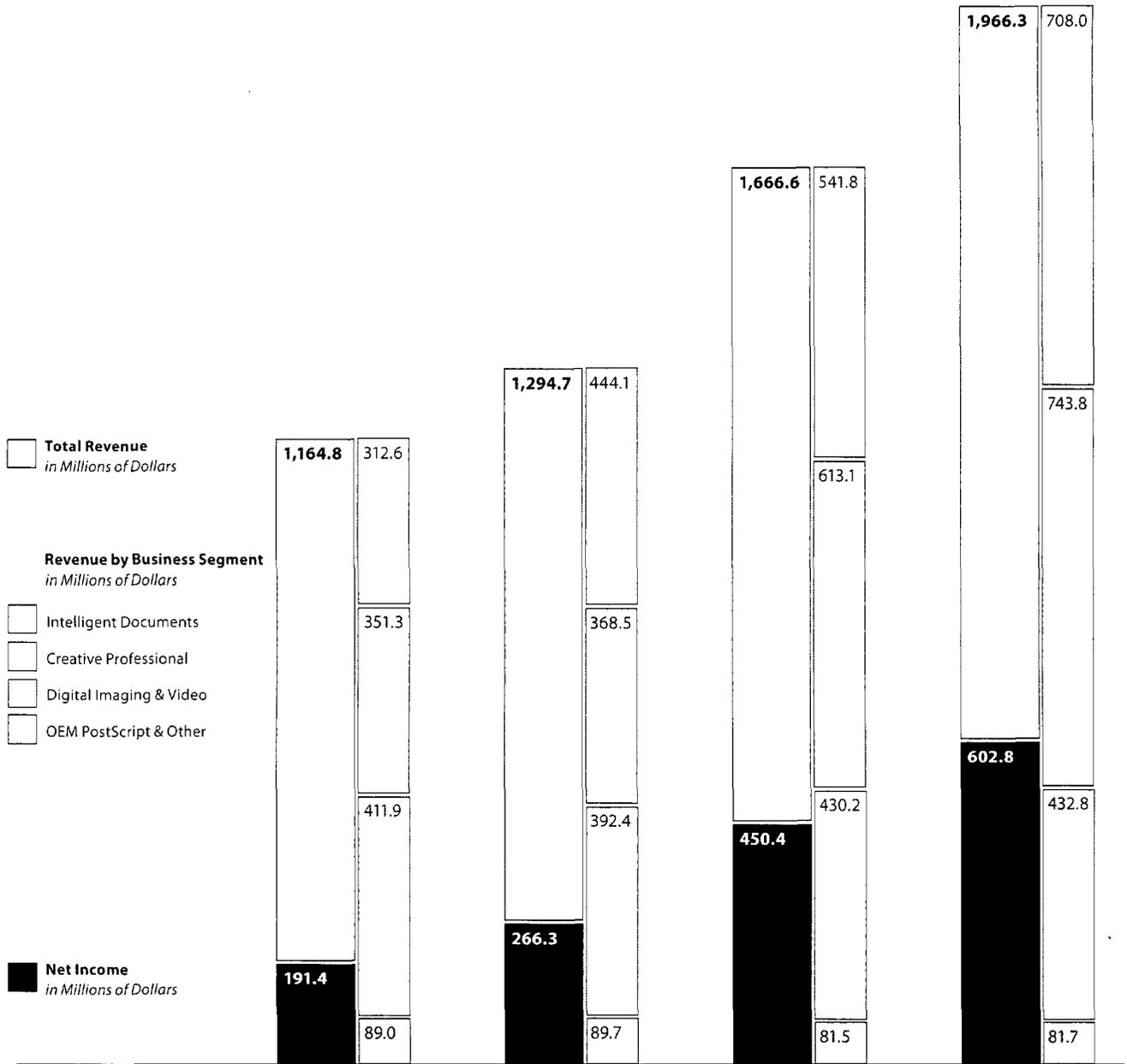
The value of Adobe for our customers

Whether our customers are creative professionals, knowledge workers, enterprises, government agencies, or application developers, we are committed to continually enhancing their experiences with Adobe software platforms and solutions.

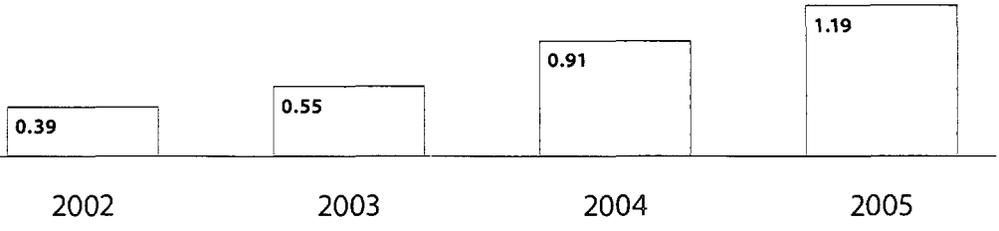
Unleashing creativity for creative professionals and consumers

The global embrace given to our revolutionary Adobe Creative Suite platform, introduced in the fourth quarter of 2003, clearly demonstrated that creative professionals understood the added value our solutions delivered. With the 2005 launch of Adobe Creative Suite 2 software, we delivered still greater value. This latest version is a unified design environment that integrates full versions of Adobe Photoshop CS2, Illustrator® CS2, InDesign® CS2, GoLive® CS2, and Acrobat 7.0 Professional software, plus Version Cue® CS2 (an intuitive file version manager), Adobe Bridge (the suite's new navigational control center), and Adobe Stock Photos (which lets users quickly search more than 575,000 royalty-free images). Now, creative professionals can realize their ideas in a variety of media faster and more easily than ever before.

On its own, Adobe InDesign CS2—with its capabilities for enabling enhanced creativity and streamlined workflows—had a record revenue year as it continued to attract global publishing companies and advertising agencies, including Ogilvy & Mather, DDB Worldwide, and Wunderman.



Diluted Earnings per Share*
in Dollars



*Split adjusted

We are committed to bringing ever-increasing value to customers' experiences with Adobe software platforms and solutions.

For digital imaging professionals, we continued to offer our flagship Adobe Photoshop software, the acknowledged gold standard for photographers around the world. The new Adobe Photoshop CS2 drew rave reviews from a still-expanding universe of customers and received accolades from industry experts, as well as industry awards, for its powerful new capabilities. The growing adoption of digital single-lens reflex cameras continued to be a strong driver for our Photoshop franchise among professional photographers as well as hobbyists.

The proliferation of video—streaming over websites and cell phones, animating kiosks and billboards, even working its way into workflows and business communications—presents exciting opportunities for filmmakers and videographers, and for Adobe. Our leading Adobe Premiere® Pro and Adobe After Effects® software products are among the editing and special effects tools of choice for professional filmmakers and video producers. Now being used as a complete high-definition (HD) workflow solution, the Adobe Video Collection brings together our video and audio software, providing everything needed to produce dazzling HD results. This momentum continued into 2006 with the announcement in January of Adobe Production Studio software, part of the Creative Suite family, which brought integration of Adobe's video solutions to an entirely new level.

And what about the growing legions of aspiring photographers and videographers? Adobe Photoshop Elements 4.0 software is the choice of photography hobbyists, while Adobe Premiere Elements 2.0 software is tailored to meet the demands of home videographers who strive for Hollywood-type effects. Our new bundle puts both of these products into a single, cost-effective package, so serious hobbyists can create even more entertainment for friends and family.

Helping enterprises and governments streamline workflows

Increasing productivity is a key goal of organizations worldwide. Helping businesses and government agencies achieve this goal, Adobe's Intelligent Document Platform bridges the digital and paper divide that is endemic in many enterprises today.

At the heart of our enterprise strategy are the free and ubiquitous Adobe Reader® software and Adobe Portable Document Format (PDF). Adobe Reader enables users to view, print, and interact with documents across a wide variety of platforms. Adobe PDF is recognized by industries and governments worldwide as a de facto standard for more secure, dependable electronic information exchange. The millions of PDF documents on the web today are evidence of the number of organizations that rely on Adobe PDF to capture information. In 2005, PDF/A was formalized as a global ISO standard for archiving, joining what has become a family of industry standards for other document-intensive industries, including PDF/X (for graphics and professional publishing).

In 2005, we delivered Adobe Acrobat 7.0 software, extending the value of Acrobat beyond simple PDF file creation to higher impact uses, such as more secure collaboration, the design of interactive forms, and digital document signing. Acrobat 7.0 gets everyone literally on the same page, enabling teams of knowledge workers within and across organizations to combine all sorts of files—both electronic and paper—into one compact “intelligent” document that streamlines business-critical communications while increasing document control and security. With its exceptional versatility, Adobe Acrobat 7.0 is able to easily address diverse customer needs in specific vertical markets. For example, it supports 3D content within PDF files, which is of enormous value to those working in the field of architecture, engineering, and construction (AEC). Leading AEC publications have called Adobe Acrobat 7.0 “exciting” and “essential,” and it is being embraced by major customers in AEC, as well as by those in other markets such as financial services, manufacturing, government, and education.

Our Adobe LiveCycle™ server software—which makes it easier for organizations to deploy solutions that effectively create, capture, and integrate information across their extended enterprise—gained new ground in 2005. Adobe LiveCycle software is helping governments and enterprises improve customer service and communications with customized, PDF-based Intelligent Documents delivered via virtually any channel; collaborate with business partners more effectively with documents that bridge information with back-end systems; and add security and authentication features to help control who can view and interact with documents. For example, some of the largest financial services companies in the world, including H&R Block and Ameriprise Financial, are using Adobe LiveCycle software to automate and streamline business processes that span systems, business rules, and departments. The latest enhancements to the software automate people-centric processes that improve customer communications, increase internal efficiencies, and help organizations meet compliance initiatives.

In addition to delivering our own solutions, Adobe works closely with industry-leading partners to provide integrated, high-value solutions that benefit our mutual enterprise customers. For example, our work with SAP has resulted in the joint delivery of interactive forms based on Adobe software. By integrating Adobe PDF capabilities into current versions of SAP applications, the solution enables SAP customers to automate and streamline paper-based processes and extend core systems to thousands of users within the enterprise as well as beyond it to customers, partners, and suppliers. And our ongoing partnership with EMC Documentum has led to powerful collaboration and form solutions that help government agencies and enterprises better communicate and interact with their employees, customers, and partners.

Enhancing value by adding Macromedia to the mix

What do you get when you combine two industry-leading companies, both on strong growth trajectories and with tremendous cross-business synergies? When the companies are Adobe and Macromedia, you get an Adobe that's better than ever, an Adobe with more assets and capabilities that enable us to continue to lead in the areas in which we've always been strong while also addressing many new opportunities.

You get more customers who can look to Adobe for all their innovative communications-centric software, a wider world of partners for developing more integrated solutions, and a larger team of employees who are passionately dedicated to helping one powerful industry leader grow faster as a single entity than either company could have grown alone.

You also get something no other company can come close to matching: the new Adobe Engagement Platform.

Redefining how people engage with digital information

This new software platform will combine the ubiquitous Adobe PDF and Adobe Reader technologies with the also-ubiquitous Macromedia® Flash® and Flash Player technologies as well as with HTML. It will allow anybody who wants to create and communicate compelling, actionable applications and content to do so in a rich, reliable, more secure, and engaging manner—across platforms, in virtually any medium, and on devices ranging from cell phones to servers. With open standards and APIs, it will allow solution providers and partners to develop their own rich solutions based on the new platform. And it will allow Adobe to continue to revolutionize the way individuals and organizations communicate information and ideas.

Creative professionals, for example, will be able to create content once and deliver it across multiple operating systems, devices, and media, providing more compelling experiences for a wider range of end users. Helping to make this a reality, Adobe announced three new product bundles upon completion of the Macromedia acquisition. The bundles combine the design and publishing power of Adobe Creative Suite 2 software and Adobe video tools with the interactive strength of Macromedia Flash Professional 8 and Macromedia Studio 8 software.

Knowledge workers will benefit from new collaboration capabilities emerging from our ability to combine Adobe PDF and Adobe Acrobat technologies with Macromedia Breeze® software, which takes advantage of the Flash Player to provide real-time, face-to-face collaboration—including the use of engaging multimedia content—among people in multiple locations and time zones. Industry leaders such as Cisco and Avaya have integrated their communication solutions with Breeze. In fact, Cisco has licensed Breeze as the web conferencing component in its rich communication solutions targeted at the small and medium business and enterprise markets.

We are continuing to push the boundaries of the digital universe as we revolutionize how the world engages with ideas and information.

Enterprises will also benefit from the rich possibility of solutions that combine the power of Adobe LiveCycle server software and the Macromedia Flex™ application framework, which can present information from an enterprise system in a rich, dynamic, and interactive way. SAP, one of Adobe's key partners for enterprise solutions, also has been partnering with Macromedia on integrating Flex capabilities into SAP solutions. Our synergy is strong here, and across the board.

Mobile application developers also will be able to leverage the Adobe Engagement Platform to bring envelope-pushing applications to their on-the-go customers. Before the acquisition, Macromedia already had agreements in place with the top six major handset manufacturers in the world, resulting in Flash Lite™ software now appearing on millions of mobile phones—signaling significant new opportunities for Adobe.

In short, the new Adobe Engagement Platform—with its ability to enhance how people create, manage, deliver, and engage with information—provides a wealth of opportunities for our widening world of customers. We are excited about what lies ahead.

Prior to our acquisition of Macromedia, Adobe was already one of the most diversified software companies in the world. Today, we are larger and even more diversified, in terms of geography (more than half of Adobe revenues are generated outside the United States) and in terms of the number of markets we serve with software franchises (think Adobe PDF, Adobe Acrobat, Adobe Photoshop, and now, Macromedia Flash).

Of course, the acquisition will bring more changes to Adobe. But change is essential to continued success, and we are a company that has already undertaken a number of successful transformations in our more than two decades as an industry leader. We went from being the “PostScript company,” selling predominately to printer manufacturers, to becoming a leading shrinkwrapped software company with millions of end-user customers around the world. More recently, we made the successful transition into the enterprise, where we continue to gain significant traction helping global organizations successfully bridge their paper and digital divide to improve productivity and contain costs.

Our transformation into an industry-leading platform company has now been further strengthened with the new Adobe Engagement Platform, which will give customers and developers a strong, reliable foundation on which to standardize and build applications and services, while giving Adobe a significant competitive advantage that can serve us well for decades.

The next evolution

The world continues to move in our direction. Adobe has always been about creating software that helps people and organizations communicate better. You can see the results of this everywhere. Whether you look at a newspaper, a magazine, a website, a movie, a TV show, a commercial, a billboard, a government form, or a package, you are, in all likelihood, seeing something that was touched by Adobe software.

Now, as the world seeks even richer, more interactive, and engaging ways to communicate, Adobe is uniquely positioned to deliver on the promise of what's come to be known as Web 2.0, the next evolution of what the web experience can be. The fact is, we already are taking our customers to where the markets will be in the future. We're leading with iconic brands and unparalleled technologies. We're leading with industry standards and with our new Engagement Platform, which we're confident will revolutionize how the world communicates information.

As we enter this next phase of our more than two-decade history, we face more competitive threats than ever before. But we believe that our strong team and our leading position in the markets we serve today, combined with our substantial R&D investments to develop breakthrough solutions for the future, will bring us continued success. Our goal, as always, is to deliver ever-higher levels of value to the entire Adobe community—our customers, partners, and investors. Now that community has grown, as we have inherited formidable new assets and amazing talent from Macromedia. The new Adobe, like the old, is home to some of the finest minds in our industry, and they are the ones who ensure our success day in and day out. We thank the entire Adobe team for their brilliant ideas, their unflagging energy, and their commitment—whether new or ongoing—to the company's success. We also thank them for their efforts toward making the world at large a better place. We are proud of our employees who help fulfill Adobe's long-standing commitment to contribute—through volunteerism, cash grants, and software donations—to the communities in which we live and work.

With all we have accomplished, there is still much more to do. We are hard at work, continuing to push the boundaries of the digital universe as we revolutionize how the world engages with ideas and information. We appreciate the trust that you—our stockholders—have put in us, and it is for all of you that we move forward as a new and better Adobe, confident in the knowledge that the best is yet to come.

Sincerely,



John E. Warnock
Chairman of the Board



Charles M. Geschke
Chairman of the Board



Bruce R. Chizen
Chief Executive Officer

Executive Officers

Bruce R. Chizen
Chief Executive Officer

Karen Cottle
Senior Vice President,
General Counsel,
and Corporate Secretary

Murray J. Demo
Executive Vice President and
Chief Financial Officer

Stephen A. Elop
President,
Worldwide Field Operations

Shantanu Narayen
President and Chief Operating Officer

Peg Wynn
Senior Vice President,
Human Resources

Board of Directors

John E. Warnock
Chairman of the Board,
Adobe Systems Incorporated

Charles M. Geschke
Chairman of the Board,
Adobe Systems Incorporated

Bruce R. Chizen
Chief Executive Officer,
Adobe Systems Incorporated

Edward W. Barnholt
Retired, Chairman, President, and
Chief Executive Officer, Agilent
Technologies

Robert K. Burgess
Former Chairman, Macromedia, Inc.

Michael R. Cannon
President and Chief Executive Officer,
Solectron Corporation

James E. Daley
Retired, Executive Vice President,
Electronic Data Systems Corporation

Carol Mills
Former Executive Vice President
and General Manager,
Infrastructure Products Group,
Juniper Networks, Inc.

Colleen M. Pouliot
Attorney

Robert Sedgewick
Professor of Computer Science,
Princeton University

Delbert Yocam
Independent Consultant

Risks and Uncertainties

This Annual Report contains forward-looking statements, including statements regarding product plans, future growth, and market opportunities, which 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 our SEC filings, including the 2005 annual report on Form 10-K, which is included with this Annual Report, and quarterly reports on Form 10-Q to be filed in 2006. When used in this report, the words "expects," "anticipates," "intends," "plans," "believes," "seeks," "targets," "estimates," "looks to," "looks for," "strives," and similar expressions, as well as descriptions of our focus for the future, are generally intended to identify forward-looking statements. You should not place undue reliance on the forward-looking statements, which speak only as of the date of this Annual Report. We undertake no obligation to publicly release any revisions to the forward-looking statements that reflect events or circumstances after the date of this document.

Investor Relations

If you would like to receive additional financial documents, such as prior annual reports, earnings press releases, or Adobe's SEC filings on Form 10-Q or Form 10-K, you can request them without charge by calling 408-536-4700 or sending an e-mail to adobe@kpcorp.com. Please include your contact information with the request.

You can obtain Adobe financial calendar information such as earnings release dates, listen to Adobe management conference calls, view recent Adobe investor presentations, sign up to automatically receive Adobe investor news via e-mail, and obtain other Adobe finance-related documents online at www.adobe.com/ADBE.

To contact Adobe's Investor Relations department, please use the following information:

Investor Relations Department
Adobe Systems Incorporated
345 Park Avenue
San Jose, CA 95110-2704 USA
Tel: 408-536-4416
ir@adobe.com

To report a change of address or lost stock certificates, please notify our Transfer Agent:
Shareholder Communications
Computershare Investor Services LLC
2 North LaSalle Street
Chicago, IL 60602 USA
Tel: 800-455-1130

Annual Meeting

The Annual Meeting of Stockholders will be held March 28, 2006, at 3 P.M. Pacific time at Adobe's headquarters in San Jose, California, USA.

Stock Exchange Listing

The Nasdaq Stock Market
Ticker symbol ADBE

Independent Auditors

KPMG LLP
Mountain View, California, USA

Better by Adobe.™



Adobe

Adobe Systems Incorporated

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San Jose, CA 95110-2704
United States
www.adobe.com

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