

ADOBE SYSTEMS INC  
Form 10-Q  
July 02, 2010

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

(Mark One)

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

For the quarterly period ended June 4, 2010

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)

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Delaware  
(State or other jurisdiction of  
incorporation or organization)

77-0019522  
(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)

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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 check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer     Accelerated filer     Non-accelerated filer   
(Do not check if a smaller reporting company)    Smaller reporting company

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

The number of shares outstanding of the registrant’s common stock as of June 25, 2010 was 525,224,418.

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ADOBE SYSTEMS INCORPORATED  
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## PART I—FINANCIAL INFORMATION

## ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## ADOBE SYSTEMS INCORPORATED

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

(Unaudited)

	June 4, 2010	November 27, 2009
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$1,137,606	\$999,487
Short-term investments	1,507,116	904,986
Trade receivables, net of allowances for doubtful accounts of \$14,295 and \$15,225, respectively	439,151	410,879
Deferred income taxes	70,955	77,417
Prepaid expenses and other current assets	121,243	80,855
Total current assets	3,276,071	2,473,624
Property and equipment, net	407,621	388,132
Goodwill	3,488,252	3,494,589
Purchased and other intangibles, net	447,372	527,388
Investment in lease receivable	207,239	207,239
Other assets	180,376	191,265
Total assets	\$8,006,931	\$7,282,237
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Trade payables	\$50,273	\$58,904
Accrued expenses	468,587	419,646
Accrued restructuring	16,504	37,793
Income taxes payable	71,978	46,634
Deferred revenue	362,566	281,576
Total current liabilities	969,908	844,553
Long-term liabilities:		
Debt	1,493,651	1,000,000
Deferred revenue	41,777	36,717
Accrued restructuring	7,729	6,921
Income taxes payable	218,153	223,528
Deferred income taxes	66,142	252,486
Other liabilities	30,816	27,464
Total liabilities	2,828,176	2,391,669
Stockholders' equity:		
Preferred stock, \$0.0001 par value; 2,000 shares authorized, none issued	—	—
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Common stock, \$0.0001 par value; 900,000 shares authorized; 600,834 shares issued; 525,068 and 522,657 shares outstanding, respectively

Additional paid-in-capital	2,376,202	2,390,061
Retained earnings	5,570,097	5,299,914
Accumulated other comprehensive income	39,995	24,446
Treasury stock, at cost (75,766 and 78,177 shares, respectively), net of reissuances	(2,807,600)	(2,823,914 )
Total stockholders' equity	5,178,755	4,890,568
Total liabilities and stockholders' equity	\$8,006,931	\$7,282,237

See accompanying Notes to Condensed Consolidated Financial Statements.

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## ADOBE SYSTEMS INCORPORATED

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 4, 2010	May 29, 2009	June 4, 2010	May 29, 2009
Revenue:				
Products	\$795,260	\$647,985	\$1,499,198	\$1,377,846
Subscription	92,279	12,070	187,786	24,408
Services and support	55,496	44,618	114,751	88,809
Total revenue	943,035	704,673	1,801,735	1,491,063
Cost of revenue:				
Products	39,645	47,678	63,155	99,113
Subscription	50,190	8,080	95,925	15,563
Services and support	17,998	16,250	38,121	34,685
Total cost of revenue	107,833	72,008	197,201	149,361
Gross profit	835,202	632,665	1,604,534	1,341,702
Operating expenses:				
Research and development	167,318	138,470	341,658	288,387
Sales and marketing	320,976	243,209	618,270	492,700
General and administrative	89,953	70,818	180,999	144,869
Restructuring charges	11,541	3,531	23,163	15,801
Amortization of purchased intangibles	18,129	15,284	36,326	30,676
Total operating expenses	607,917	471,312	1,200,416	972,433
Operating income	227,285	161,353	404,118	369,269
Non-operating income (expense):				
Interest and other income (expense), net	(6,313 )	4,802	(5,702 )	18,086
Interest expense	(16,076 )	(620 )	(23,771 )	(1,412 )
Investment gains (losses), net	(10,723 )	(1,805 )	(14,257 )	(19,051 )
Total non-operating income (expense), net	(33,112 )	2,377	(43,730 )	(2,377 )
Income before income taxes	194,173	163,730	360,388	366,892
Provision for income taxes	45,562	37,659	84,623	84,386
Net income	\$148,611	\$126,071	\$275,765	\$282,506
Basic net income per share	\$0.28	\$0.24	\$0.53	\$0.54
Shares used in computing basic net income per share	526,148	524,159	525,124	524,219
Diluted net income per share	\$0.28	\$0.24	\$0.52	\$0.53
Shares used in computing diluted net income per share	533,259	528,013	533,305	528,233

See accompanying Notes to Condensed Consolidated Financial Statements.

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## ADOBE SYSTEMS INCORPORATED

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended	
	June 4, 2010	May 29, 2009
Cash flows from operating activities:		
Net income	\$ 275,765	\$ 282,506
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	143,487	133,465
Stock-based compensation	124,577	86,577
Deferred income taxes	(178,038 )	19,984
Unrealized losses on investments	12,222	16,498
Tax benefit from employee stock option plans	38,743	2,711
Other non-cash items	21,158	7,773
Excess tax benefits from stock-based compensation	(8,485 )	(84 )
Changes in operating assets and liabilities, net of acquired assets and assumed liabilities:		
Trade receivables, net	(27,999 )	201,354
Prepaid expenses and other current assets	(8,808 )	13,210
Trade payables	(8,631 )	(13,582 )
Accrued expenses	33,098	(32,639 )
Accrued restructuring	(18,962 )	(24,139 )
Income taxes payable	25,580	(4,357 )
Deferred revenue	87,186	(62,005 )
Net cash provided by operating activities	510,893	627,272
Cash flows from investing activities:		
Purchases of short-term investments	(1,202,326 )	(782,362 )
Maturities of short-term investments	285,889	197,709
Proceeds from sales of short-term investments	318,092	273,243
Purchases of property and equipment	(75,175 )	(26,228 )
Purchases of long-term investments and other assets	(18,998 )	(16,580 )
Proceeds from sale of long-term investments	719	1,904
Other	2,177	3,000
Net cash used for investing activities	(689,622 )	(349,314 )
Cash flows from financing activities:		
Purchases of treasury stock	(250,020 )	(13 )
Proceeds from issuance of treasury stock	84,060	48,819
Excess tax benefits from stock-based compensation	8,485	84
Proceeds from debt	1,493,439	—
Repayment of debt	(1,000,000)	—
Debt issuance costs	(10,662 )	—
Net cash provided by financing activities	325,302	48,890
Effect of foreign currency exchange rates on cash and cash equivalents	(8,454 )	13,482
Net increase in cash and cash equivalents	138,119	340,330



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Cash and cash equivalents at beginning of period	999,487	886,450
Cash and cash equivalents at end of period	\$1,137,606	\$1,226,780
Supplemental disclosures:		
Cash paid for income taxes, net of refunds	\$198,512	\$58,024
Cash paid for interest	\$2,742	\$1,488

See accompanying Notes to Condensed Consolidated Financial Statements.

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

We have prepared the accompanying unaudited Condensed Consolidated Financial Statements pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Pursuant to these rules and regulations, we have condensed or omitted certain information and footnote disclosures we normally include in our annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). In management’s opinion, we have made all adjustments (consisting only of normal, recurring adjustments, except as otherwise indicated) necessary to fairly present our financial position, results of operations and cash flows. Our interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These financial statements and accompanying notes should be read in conjunction with the consolidated financial statements and notes thereto in our Annual Report on Form 10-K for the fiscal year ended November 27, 2009 on file with the SEC. The three months ended March 5, 2010 and the six months ended June 4, 2010 financial results benefitted from an extra week in the first quarter of fiscal 2010 due to our 52/53 week financial calendar whereby fiscal 2010 is a 53-week year compared with fiscal 2009 which was a 52-week year.

With the exception of the adoption of an accounting pronouncement related to revenue recognition, discussed below, there have been no material changes to our significant accounting policies, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended November 27, 2009.

In October 2009, the FASB amended the accounting standards for certain multiple deliverable revenue arrangements to:

- provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the consideration should be allocated;
- require an entity to allocate revenue in an arrangement using the best estimated selling price (“BESP”) of deliverables if a vendor does not have vendor-specific objective evidence (“VSOE”) of selling price or third-party evidence (“TPE”) of selling price; and
- eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method.

We elected to early adopt this accounting guidance at the beginning of our first quarter of fiscal 2010 on a prospective basis for applicable transactions originating or materially modified after November 27, 2009.

Multiple Element Arrangements

We enter into multiple element revenue arrangements in which a customer may purchase a combination of software, upgrades, hosting services, maintenance and support, and consulting.

For multiple element arrangements that contain non-software related elements, for example our software as a service (“SaaS”) offerings, we allocate revenue to each non-software element based upon the relative selling price of each and if software and software-related elements are also included in the arrangement, to those elements as a group based on our BESP for the group. When applying the relative selling price method, we determine the selling price for each deliverable using VSOE of selling price, if it exists, or TPE of selling price. If neither VSOE nor TPE of selling price exist for a deliverable, we use our BESP for that deliverable. Revenue allocated to each element is then recognized when the basic revenue recognition criteria is met for each element. The manner in which we account for multiple element arrangements that contain only software and software-related elements remains unchanged.

Consistent with our methodology under previous accounting guidance, we determine VSOE for each element based on historical stand-alone sales to third-parties or from the stated renewal rate for the elements contained in the initial arrangement.

In certain instances, we were not able to establish VSOE for all deliverables in an arrangement with multiple elements. This may be due to us infrequently selling each element separately, not pricing products or services within a narrow range, or

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

only having a limited sales history. When VSOE cannot be established, we attempt to establish the selling price of each element based on TPE. TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, our offerings contain significant differentiation such that the comparable pricing of products with similar functionality cannot be obtained. Furthermore, we are unable to reliably determine what similar competitor products' selling prices are on a stand-alone basis. Therefore, we typically are not able to obtain TPE of selling price.

When we are unable to establish selling prices using VSOE or TPE, we use BESP in our allocation of arrangement consideration. The objective of BESP is to determine the price at which we would transact a sale if the product or service were sold on a stand-alone basis. BESP is generally used for offerings that are not typically sold on a stand-alone basis or for new or highly customized offerings.

We determine BESP for a product or service by considering multiple factors including, but not limited to, geographies, market conditions, competitive landscape, internal costs, gross margin objectives and pricing practices. The determination of BESP is made through consultation with and formal approval by our management, taking into consideration our go-to-market strategy.

We regularly review VSOE and have established a review process for TPE and BESP and maintain internal controls over the establishment and updates of these estimates. There was no material impact to revenue during the three and six months ended June 4, 2010 resulting from changes in VSOE, TPE or BESP, nor do we expect a material impact from such changes in the near term.

Given the nature of our transactions, which are primarily software and software-related, our go-to-market strategies and our pricing practices, total net revenue as reported during the three and six months ended June 4, 2010 is materially consistent with total net revenue that would have been reported if the transactions entered into or materially modified after November 27, 2009 were subject to previous accounting guidance.

The new accounting standards for revenue recognition, if applied in the same manner to the year ended November 27, 2009, would not have had a material impact on total net revenues for that fiscal year. In terms of the timing and pattern of revenue recognition, the new accounting guidance for revenue recognition is not expected to have a significant effect on total net revenues in periods after the initial adoption.

#### Recent Accounting Pronouncements

There have also been no new accounting pronouncements during the six months ended June 4, 2010, with the exception of those discussed below, as compared to the recent accounting pronouncements described in our Annual Report on Form 10-K for the fiscal year ended November 27, 2009, that are of significance, or potential significance, to us.

#### Fair Value Measurements

In January 2010, the FASB issued new accounting guidance related to the disclosure requirements for fair value measurements and provided clarification for existing disclosures requirements. More specifically, this update will require an entity to disclose separately (a) the amounts of significant transfers in and out of Levels 1 and 2 fair value measurements and to describe the reasons for the transfers; and (b) information about purchases, sales, issuances and settlements to be presented separately (i.e. present the activity on a gross basis rather than net) in the reconciliation for fair value measurements using significant unobservable inputs (Level 3 inputs). This guidance clarifies existing disclosure requirements for the level of disaggregation used for classes of assets and liabilities measured at fair value and requires disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements using Level 2 and Level 3 inputs. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosure requirements related to the purchases, sales, issuances and settlements in the rollforward activity of Level 3 fair value measurements. Those disclosure requirements are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. We adopted the new disclosures in the second quarter of fiscal 2010, which included changing the description of certain asset classes in the tables in Notes 3 and 4 to conform with the requirements of the new guidance. We will adopt the Level 3 requirements in the first quarter of fiscal 2012. Since the adoption of the new standards only required additional disclosure, the adoption did not have an impact on our consolidated financial position, results of operations and cash flows.

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Variable Interest Entities

In June 2009, the FASB issued amended standards for determining whether to consolidate a variable interest entity. These new standards amend the evaluation criteria to identify the primary beneficiary of a variable interest entity and requires ongoing reassessment of whether an enterprise is the primary beneficiary of the variable interest entity. The provisions of the new standards are effective for annual reporting periods beginning after November 15, 2009 and interim periods within those fiscal years. These standards were effective for us beginning in the first quarter of fiscal 2010. The adoption of the new standards did not have an impact on our consolidated financial position, results of operations and cash flows.

Intangible Assets Useful Lives

In April 2008, the FASB issued new standards which provided guidance on how to determine the useful life of intangible assets by amending the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets. This new guidance applies prospectively to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. These standards are effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years and was effective for us beginning in the first quarter of fiscal 2010. There was no impact to our current consolidated financial statements as we did not purchase any intangible assets during the three and six months ended June 4, 2010.

Business Combinations and Non-Controlling Interests

In December 2007, the FASB revised their guidance for business combinations and non-controlling interests. The new standards change how business acquisitions are accounted for and impact financial statements both on the acquisition date and in subsequent periods. The changes also impact the accounting and reporting for minority interests, which are recharacterized as non-controlling interests and classified as a component of equity. The new standards were effective for us beginning in the first quarter of fiscal 2010. We currently believe that depending on the size and frequency of acquisitions, the adoption of these standards may have a material effect on our future consolidated financial statements. There was no impact to our current consolidated financial statements as we did not have any business combinations during the three and six months ended June 4, 2010.

NOTE 2. ACQUISITIONS

On October 23, 2009, we completed the acquisition of Omniture, Inc. (“Omniture”), an industry leader in Web analytics and online business optimization based in Orem, Utah, for approximately \$1.8 billion. Under the terms of the agreement, we completed our tender offer to acquire all of the outstanding shares of Omniture common stock at a price of \$21.50 per share, net to the seller in cash, without interest. Acquiring Omniture accelerates our strategy of delivering more effective solutions for creating, delivering, measuring and optimizing Web content and applications. The transaction was accounted for using the purchase method of accounting. We have included the financial results of Omniture in our Condensed Consolidated Financial Statements beginning on the acquisition date. Following the

closing, we integrated Omniture as a new reportable segment for financial reporting purposes.

The total purchase price for Omniture was approximately \$1.8 billion which consisted of \$1.7 billion in cash paid for outstanding common stock, \$85.0 million for the estimated fair value of earned stock options and restricted stock units assumed and converted and \$14.4 million for direct transaction costs. The preliminary allocation of the purchase price was based upon a preliminary valuation and our estimates and assumptions. During the six months ended June 4, 2010, we finalized our purchase accounting after adjustments were made to the preliminary purchase price allocation to reflect the finalization of the valuation of intangible assets and deferred revenue. Additional adjustments were also made to restructuring liabilities, taxes and residual goodwill. Of the total final purchase price, \$1.34 billion has been allocated to goodwill, \$436.1 million to identifiable intangible assets, \$33.4 million to net tangible assets and \$11.3 million to restructuring liabilities. We also expensed \$4.6 million for in-process research and development charges.

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table presents the results of Adobe and Omniture for the three and six months ended May 29, 2009, on a pro forma basis, as though the companies had been combined as of the beginning fiscal 2009. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of fiscal 2009 or of results that may occur in the future.

	Three Months Ended May 29, 2009	Six Months Ended May 29, 2009
Net revenues	\$758,405	\$1,631,952
Net income	\$88,191	\$230,016
Basic net income per share	\$0.17	\$0.44
Shares used in computing basic net income per share	524,159	524,219
Diluted net income per share	\$0.17	\$0.43
Shares used in computing diluted net income per share	529,488	529,553

## NOTE 3. CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

Cash equivalents consist of instruments with remaining maturities of three months or less at the date of purchase. We classify all of our cash equivalents and short-term investments as “available-for-sale.” In general, these investments are free of trading restrictions. We carry these investments at fair value, based on quoted market prices or other readily available market information. Unrealized gains and losses, net of taxes, are included in accumulated other comprehensive income, which is reflected as a separate component of stockholders’ equity in our Condensed Consolidated Balance Sheets. Gains and losses are recognized when realized in our Condensed Consolidated Statements of Income. When we have determined that an other-than-temporary decline in fair value has occurred, the amount of the decline that is related to a credit loss is recognized in earnings. Gains and losses are determined using the specific identification method.

Cash, cash equivalents and short-term investments consisted of the following as of June 4, 2010 (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Current assets:				
Cash	\$101,436	\$—	\$—	\$101,436
Cash equivalents:				
Money market mutual funds	876,042	—	—	876,042
Time deposits	44,915	—	—	44,915
U.S. Treasury securities	54,998	1	—	54,999
U.S. agency securities	14,999	—	—	14,999



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Municipal securities	1,295	—	—	1,295
Corporate bonds	43,920	—	—	43,920
Total cash equivalents	1,036,169	1	—	1,036,170
Total cash and cash equivalents	1,137,605	1	—	1,137,606
Short-term fixed income investments:				
U.S. Treasury securities	414,286	2,668	(4 )	416,950
U.S. agency securities	268,304	447	(5 )	268,746
Municipal securities	118,697	31	(6 )	118,722
Corporate bonds	627,916	5,819	(845 )	632,890
Foreign government securities	51,709	404	(5 )	52,108
Subtotal	1,480,912	9,369	(865 )	1,489,416
Marketable equity securities	6,680	11,020	—	17,700
Total short-term investments	1,487,592	20,389	(865 )	1,507,116
Total cash, cash equivalents and short-term investments	\$2,625,197	\$20,390	\$(865 )	\$2,644,722

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Cash, cash equivalents and short-term investments consisted of the following as of November 27, 2009 (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Current assets:				
Cash	\$75,110	\$—	\$—	\$75,110
Cash equivalents:				
Money market mutual funds	884,240	—	—	884,240
Time deposits	40,137	—	—	40,137
Total cash equivalents	924,377	—	—	924,377
Total cash and cash equivalents	999,487	—	—	999,487
Short-term fixed income investments:				
U.S. Treasury securities	373,180	3,199	(1 )	376,378
U.S. agency securities	59,447	273	—	59,720
Corporate bonds	407,465	8,111	(1 )	415,575
Foreign government securities	47,620	666	—	48,286
Subtotal	887,712	12,249	(2 )	899,959
Marketable equity securities	2,527	2,500	—	5,027
Total short-term investments	890,239	14,749	(2 )	904,986
Total cash, cash equivalents and short-term investments	\$1,889,726	\$14,749	\$(2 )	\$1,904,473

See Note 4 for further information regarding the fair value of our financial instruments.

The following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category that have been in a continuous unrealized loss position for less than twelve months, as of June 4, 2010 and November 27, 2009 (in thousands):

	2010		2009	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. Treasury and agency securities	\$44,430	\$(9 )	\$11,179	\$(1 )
Corporate bonds	225,694	(845 )	5,041	(1 )
Foreign government securities	994	(5 )	—	—
Municipal securities	22,225	(6 )	—	—
Total	\$293,343	\$(865 )	\$16,220	\$(2 )

As of June 4, 2010 and November 27, 2009, there were no securities in a continuous unrealized loss position for more than twelve months. There were 102 securities and 4 securities that were in an unrealized loss position at June 4, 2010 and at November 27, 2009, respectively.

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The following table summarizes the cost and estimated fair value of debt securities classified as short-term investments based on stated maturities as of June 4, 2010 (in thousands):

	Amortized Cost	Estimated Fair Value
Due within one year	\$846,670	\$847,886
Due within two years	384,145	387,736
Due within three years	183,702	185,288
Due after three years	66,395	68,506
Total	\$1,480,912	\$1,489,416

As of June 4, 2010, we did not consider any of our investments to be other-than-temporarily impaired.

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

## NOTE 4. FAIR VALUE MEASUREMENTS

We measure certain financial assets and liabilities at fair value on a recurring basis.

The fair value of these financial assets and liabilities was determined using the following inputs at June 4, 2010 (in thousands):

	Fair Value Measurements at Reporting Date Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Money market mutual funds	\$ 876,624	\$ 876,624	\$ —	\$ —
Time deposits	44,915	44,915	—	—
U.S. Treasury securities	471,949	—	471,949	—
U. S. agency securities	283,745	—	283,745	—
Municipal securities	120,017	—	120,017	—
Corporate bonds	676,810	—	676,810	—
Foreign government securities	52,108	—	52,108	—
Marketable equity securities	17,700	17,700	—	—
Investments of limited partnership	24,130	—	—	24,130
Foreign currency derivatives	46,671	—	46,671	—
Equity and fixed income mutual funds	8,556	—	8,556	—
Total assets	\$ 2,623,225	\$ 939,239	\$ 1,659,856	\$ 24,130
<b>Liabilities:</b>				
Foreign currency derivatives	\$ 617	\$ —	\$ 617	\$ —
Total liabilities	\$ 617	\$ —	\$ 617	\$ —

There have been no transfers between fair value measurement levels during the three months ended June 4, 2010.

The fair value of these financial assets and liabilities was determined using the following inputs at November 27, 2009 (in thousands):

	Fair Value Measurements at Reporting Date Using		
	Quoted Prices in Active	Significant Other Observable	Significant Unobservable Inputs

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	Total	Markets for Identical Assets (Level 1)	Inputs (Level 2)	(Level 3)
<b>Assets:</b>				
Money market mutual funds	\$ 884,958	\$ 884,958	\$ —	\$ —
Time deposits	40,137	40,137	—	—
U.S. Treasury securities	376,379	—	376,379	—
U.S. agency securities	59,720	—	59,720	—
Municipal securities	—	—	—	—
Corporate bonds	415,575	—	415,575	—
Foreign government securities	48,286	—	48,286	—
Marketable equity securities	5,026	5,026	—	—
Investments of limited partnership	37,121	—	—	37,121
Foreign currency derivatives	4,307	—	4,307	—
Equity and fixed income mutual funds	8,328	—	8,328	—
<b>Total assets</b>	<b>\$ 1,879,837</b>	<b>\$ 930,121</b>	<b>\$ 912,595</b>	<b>\$ 37,121</b>
<b>Liabilities:</b>				
Foreign currency derivatives	\$ 1,589	\$ —	\$ 1,589	\$ —
<b>Total liabilities</b>	<b>\$ 1,589</b>	<b>\$ —</b>	<b>\$ 1,589</b>	<b>\$ —</b>

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(Unaudited)

The following table summarizes our assets and liabilities measured at fair value on a recurring basis as presented on our Condensed Consolidated Balance Sheets as of June 4, 2010 (in thousands):

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Cash equivalents	\$1,036,170	\$920,957	\$115,213	\$—
Short-term investments	1,507,116	17,700	1,489,416	—
Prepaid expenses and other current assets	46,671	—	46,671	—
Other assets	33,268	582	8,556	24,130
<b>Total assets measured at fair value</b>	<b>\$2,623,225</b>	<b>\$939,239</b>	<b>\$1,659,856</b>	<b>\$24,130</b>
<b>Liabilities:</b>				
Other current liabilities	\$617	\$—	\$617	\$—
<b>Total liabilities measured at fair value</b>	<b>\$617</b>	<b>\$—</b>	<b>\$617</b>	<b>\$—</b>

The following table summarizes our assets and liabilities measured at fair value on a recurring basis as presented on our Condensed Consolidated Balance Sheets as of November 27, 2009 (in thousands):

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Cash equivalents	\$925,095	\$925,095	\$—	\$—
Short-term investments	904,986	5,026	899,960	—
Prepaid expenses and other current assets	4,307	—	4,307	—
Other assets	45,449	—	8,328	37,121
<b>Total assets measured at fair value</b>	<b>\$1,879,837</b>	<b>\$930,121</b>	<b>\$912,595</b>	<b>\$37,121</b>
<b>Liabilities:</b>				
Other current liabilities	\$1,589	\$—	\$1,589	\$—
<b>Total liabilities measured at fair value</b>	<b>\$1,589</b>	<b>\$—</b>	<b>\$1,589</b>	<b>\$—</b>

See Note 3 for further information regarding the fair value of our financial instruments.

Our fixed income available-for-sale securities consist of high quality, investment grade securities from diverse industries with a minimum credit rating of A- and a weighted average credit rating of AA+. We value these securities based on pricing from pricing vendors, who may use quoted prices in active markets for identical assets (Level 1 inputs) or inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs) in determining fair value. However, we classify all of our fixed income available-for-sale securities as having Level 2 inputs. The valuation techniques used to measure the fair value of our financial instruments having Level 2 inputs were derived from non-binding market consensus prices that are corroborated by observable market data, quoted market prices for similar instruments, or pricing models, such as discounted cash flow techniques. Our procedures include controls to ensure that appropriate fair values are recorded such as comparing prices obtained from multiple independent sources.

The investments of limited partnership relate to our interest in Adobe Ventures IV L.P. (“Adobe Ventures”), which are consolidated in our Condensed Consolidated Financial Statements. The Level 3 investments consist of investments in privately-held companies. These investments are remeasured at fair value each period with any gains or losses recognized in investment gains (losses), net in our Condensed Consolidated Statements of Income. There was no impact to other comprehensive income (“OCI”) related to our Level 3 investments. We estimated fair value of the Level 3 investments by

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(Unaudited)

considering available information such as pricing in recent rounds of financing, current cash positions, earnings and cash flow forecasts, recent operational performance and any other readily available market data.

A reconciliation of the beginning and ending balances for investments of limited partnership using significant unobservable inputs (Level 3) as of June 4, 2010 and November 27, 2009 was as follows (in thousands):

Balance as of November 28, 2008	\$38,753
Purchases and sales of investments, net	1,921
Unrealized net investment losses included in earnings	(3,553 )
Balance as of November 27, 2009	37,121
Purchases and sales of investments, net	268
Unrealized net investment losses included in earnings	(13,259 )
Balance as of June 4, 2010	\$24,130

We also have direct investments in privately-held companies accounted for under the cost method, which are periodically assessed for other-than-temporary impairment. If we determine that an other-than-temporary impairment has occurred, we write-down the investment to its fair value. We estimate fair value of our cost method investments considering available information such as pricing in recent rounds of financing, current cash positions, earnings and cash flow forecasts, recent operational performance and any other readily available market data. During the three and six months ended June 4, 2010, we determined that certain of our direct cost method investments were other-than-temporarily impaired which resulted in a charge of \$0.4 million for both periods which is included in investment gains (losses), net in our Condensed Consolidated Statements of Income.

See Note 7 for further information regarding our limited partnership interest in Adobe Ventures and our cost method investments.

## NOTE 5. DERIVATIVES AND HEDGING ACTIVITIES

In countries outside the U.S., we transact business in U.S. dollars and in various other currencies. Therefore, we are subject to exposure from movements in foreign currency rates. We may use foreign exchange option contracts or forward 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 any contract is twelve months. We enter into these foreign exchange contracts to hedge a portion of our forecasted foreign currency denominated revenue in the normal course of business and accordingly, they are not speculative in nature.

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. 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 on our Condensed Consolidated Balance Sheets, 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 to interest and other income, net on our Condensed Consolidated Statements of Income at that time.

We also hedge our net recognized foreign currency assets and liabilities with foreign exchange forward contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in 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 to interest and other income, net on our Condensed Consolidated Statement of 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.

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We mitigate concentration of risk related to foreign currency hedges as well as interest rate hedges through a policy that establishes counterparty limits. 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 who meet our minimum requirements under our counterparty risk assessment process. In addition, our hedging policy establishes maximum limits for each counterparty. We monitor ratings, credit spreads and potential downgrades on at least a quarterly basis. Based on our on-going assessment of counterparty risk, we will adjust our exposure to various counterparties.

The aggregate fair value of derivative instruments in net asset positions as of June 4, 2010 and November 27, 2009 was \$46.7 million and \$4.3 million, respectively. These amounts represent the maximum exposure to loss at the reporting date as a result of all of the counterparties failing to perform as contracted. This exposure could be reduced by up to \$0.6 million and \$1.6 million, respectively, of liabilities included in master netting arrangements with those same counterparties.

The fair value of derivative instruments on our Condensed Consolidated Balance Sheets as of June 4, 2010 and November 27, 2009 were as follows (in thousands):

	2010 Fair Value Asset Derivatives(1)	Fair Value Liability Derivatives(2)	2009 Fair Value Asset Derivatives(1)	Fair Value Liability Derivatives(2)
Derivatives designated as hedging instruments:				
Foreign exchange option contracts(3)	\$38,918	\$—	\$4,175	\$—
Derivatives not designated as hedging instruments:				
Foreign exchange forward contracts	7,753	617	132	1,589
Total derivatives	\$46,671	\$617	\$4,307	\$1,589

(1) Included in prepaid expenses and other current assets on our Condensed Consolidated Balance Sheets.

(2) Included in accrued expenses on our Condensed Consolidated Balance Sheets.

(3) Hedging effectiveness expected to be recognized to income within the next twelve months.

The effect of derivative instruments designated as cash flow hedges and of derivative instruments not designated as hedges in our Condensed Consolidated Statements of Income for three and six months ended June 4, 2010 was as follows (in thousands):

Three Months

Six Months

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	Foreign Exchange Option Contracts	Foreign Exchange Forward Contracts	Foreign Exchange Option Contracts	Foreign Exchange Forward Contracts
Derivatives in cash flow hedging relationships:				
Net gain (loss) recognized in OCI, net of tax(1)	\$28,425	\$—	\$38,789	\$—
Net gain (loss) reclassified from accumulated OCI into income, net of tax(2)	\$6,206	\$—	\$6,206	\$—
Net gain (loss) recognized in income(3)	\$(5,845)	) \$—	\$(9,766)	) \$—
Derivatives not designated as hedging relationships:				
Net gain (loss) recognized in income(4)	\$—	\$10,761	\$—	\$21,801

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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The effect of derivative instruments designated as cash flow hedges and of derivative instruments not designated as hedges in our Condensed Consolidated Statements of Income for three and six months ended May 29, 2009 was as follows (in thousands):

	Three Months		Six Months	
	Foreign	Foreign	Foreign	Foreign
	Exchange	Exchange	Exchange	Exchange
	Option	Forward	Option	Forward
	Contracts	Contracts	Contracts	Contracts
Derivatives in cash flow hedging relationships:				
Net gain (loss) recognized in OCI, net of tax(1)	\$ (8,737 )	\$ —	\$ (14,187 )	\$ —
Net gain (loss) reclassified from accumulated OCI into income, net of tax(2)	\$ 5,913	\$ —	\$ 26,389	\$ —
Net gain (loss) recognized in income(3)	\$ (7,416 )	\$ —	\$ (9,048 )	\$ —
Derivatives not designated as hedging relationships:				
Net gain (loss) recognized in income(4)	\$ —	\$ (5,305 )	\$ —	\$ (8,550 )

(1) Net change in the fair value of the effective portion classified in OCI.

(2) Effective portion classified as revenue.

(3) Ineffective portion and amount excluded from effectiveness testing classified in interest and other income, net.

(4) Classified in interest and other income, net.

## NOTE 6. GOODWILL AND PURCHASED AND OTHER INTANGIBLES

Goodwill as of June 4, 2010 and November 27, 2009 was \$3.488 billion and \$3.495 billion, respectively. The change includes adjustments to our Omniture and Macromedia purchase price allocation in addition to foreign currency translation adjustments. During the second quarter of fiscal 2010, we completed our annual goodwill impairment test. Based on this analysis, we determined that there was no impairment of goodwill.

Purchased and other intangible assets subject to amortization as of June 4, 2010 and November 27, 2009 were as follows (in thousands):

2010			2009		
Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
\$ 219,298	\$ (40,455 )	\$ 178,843	\$ 586,952	\$ (387,731 )	\$ 199,221

Purchased technology							
Localization	\$ 13,181	\$ (7,494 )	\$ 5,687	\$ 20,284	\$ (15,222 )	\$ 5,062	
Trademarks	172,009	(120,687 )	51,322	172,030	(104,953 )	67,077	
Customer contracts and relationships	364,057	(177,846 )	186,211	363,922	(159,450 )	204,472	
Other intangibles	47,069	(21,760 )	25,309	54,535	(2,979 )	51,556	
Total other intangible assets	\$ 596,316	\$ (327,787 )	\$ 268,529	\$ 610,771	\$ (282,604 )	\$ 328,167	
Purchased and other intangible assets	\$ 815,614	\$ (368,242 )	\$ 447,372	\$ 1,197,723	\$ (670,335 )	\$ 527,388	

During the six months ended June 4, 2010, purchased and other intangible assets from prior acquisitions, primarily Macromedia, became fully amortized and were removed from the balance sheet. Amortization expense related to purchased and other intangible assets was \$42.2 million and \$79.1 million for the three and six months ended June 4, 2010, respectively. Comparatively, amortization expense was \$36.4 million and \$75.4 million for the three and six months ended May 29, 2009, respectively. Of these amounts, \$24.0 million and \$42.7 million were included in cost of sales for the three and six months ended June 4, 2010, respectively, and \$21.1 million and \$44.7 million were included in cost of sales for the three and six months ended May 29, 2009, respectively.

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(Unaudited)

As of June 4, 2010, we expect amortization expense in future periods to be as follows (in thousands):

Fiscal Year	Purchased Technology	Other Intangible Assets
Remainder of 2010	\$17,842	\$46,521
2011	32,301	52,526
2012	30,694	22,338
2013	26,766	21,674
2014	25,144	21,274
Thereafter	46,096	104,196
Total expected amortization expense	\$178,843	\$268,529

## NOTE 7. OTHER ASSETS

Other assets as of June 4, 2010 and November 27, 2009 consisted of the following (in thousands):

	2010	2009
Acquired rights to use technology	\$77,917	\$84,313
Investments	42,157	63,526
Security and other deposits	10,927	11,692
Prepaid royalties	10,404	12,059
Debt issuance costs	10,228	—
Deferred compensation plan assets	9,138	9,045
Restricted cash	2,470	4,650
Prepaid land lease	14,207	3,209
Prepaid rent	1,082	1,377
Other	1,846	1,394
Other assets	\$180,376	\$191,265

Included in investments are our indirect investments through our limited partnership interest in Adobe Ventures of approximately \$24.1 million and \$37.1 million as of June 4, 2010 and November 27, 2009, respectively. We consolidate Adobe Ventures in accordance with the provisions for consolidating variable interest entities as we have determined we have the power to direct the activities that most significantly impact the entity's economic performance and we have the obligation to absorb losses or the right to receive benefits through our limited partnership interest in Adobe Ventures. The partnership is controlled by Granite Ventures, an independent venture capital firm and sole general partner of Adobe Ventures. We are the primary beneficiary of Adobe Ventures and bear virtually all of the risks and rewards related to our ownership. Our investment in Adobe Ventures does not have a significant impact on our consolidated financial position, results of operations or cash flows.

The primary purpose of our limited partnership interest in Adobe Ventures is to invest in securities of private companies which either operate in, or are expected to operate in, industries where technology and business model trends are expected to have an impact on our core business. Our maximum capital commitment to Adobe Ventures is \$104.6 million, of which, approximately \$95.4 million has been invested.

Adobe Ventures carries its investments in equity securities at estimated fair value and investment gains and losses are included in our Condensed Consolidated Statements of Income. Substantially all of the investments held by Adobe Ventures at June 4, 2010 and November 27, 2009 are not publicly traded and, therefore, there is no established market for these securities. In order to determine the fair value of these investments, we use the most recent round of financing involving new non-strategic investors or estimates of fair value made by Granite Ventures. We evaluate the fair value of these investments held by Adobe Ventures on a regular basis. This evaluation includes, but is not limited to, reviewing each company's cash position, financing needs, earnings and revenue outlook, operational performance, management and 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.

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(Unaudited)

Also included in investments are our direct investments in privately-held companies of approximately \$18.1 million and \$26.4 million as of June 4, 2010 and November 27, 2009, respectively, which are accounted for based on the cost method. We assess these investments for impairment in value as circumstances dictate.

## NOTE 8. ACCRUED EXPENSES

Accrued expenses as of June 4, 2010 and November 27, 2009 consisted of the following (in thousands):

	2010	2009
Accrued compensation and benefits	\$ 199,570	\$ 164,352
Taxes payable	19,627	11,879
Sales and marketing allowances	28,643	32,774
Other	220,747	210,641
Accrued expenses	\$468,587	\$419,646

Other primarily includes general corporate accruals for corporate marketing programs, local and regional expenses, and technical support. Other is also comprised of deferred rent related to office locations with rent escalations, accrued royalties, foreign currency derivatives and accrued interest on our outstanding debt.

## NOTE 9. INCOME TAXES

The gross liability for unrecognized tax benefits at June 4, 2010 was \$210.1 million, exclusive of interest and penalties. If the total unrecognized tax benefits at June 4, 2010 were recognized in the future, \$192.9 million of unrecognized tax benefits would decrease the effective tax rate, which is net of an estimated \$17.2 million federal benefit related to deducting certain payments on future state tax returns.

As of June 4, 2010, the combined amount of accrued interest and penalties related to tax positions taken on our tax returns was approximately \$17.5 million. This amount is included in non-current income taxes payable.

The timing of the resolution of income tax examinations is highly uncertain as are the amounts and timing of tax payments that are part of any audit settlement process. These events could cause large fluctuations in the balance sheet classification of current and non-current assets and liabilities. We believe that within the next 12 months, it is reasonably possible that either certain audits will conclude or statutes of limitations on certain income tax examination periods will expire, or both. Given the uncertainties described, we can only determine a range of estimated potential decreases in underlying unrecognized tax benefits equal to \$0 to approximately \$10 million. These amounts would decrease income tax expense.

In December 2009, we repatriated \$700 million of undistributed foreign earnings for which a deferred tax liability had been previously accrued. As such, a long-term deferred tax liability of approximately \$200 million was reclassified from deferred income taxes to income taxes payable. During the second quarter of fiscal 2010, a portion of these



liabilities in income taxes payable were paid.

#### NOTE 10. STOCK-BASED COMPENSATION

The assumptions used to value option grants during the three and six months ended June 4, 2010 and May 29, 2009 were as follows:

	Three Months		2009		Six Months		2009	
	2010				2010			
Expected life (in years)	3.9 – 5.1		3.0 – 3.8		3.8 – 5.1		3.0 – 3.8	
Volatility	29 – 30	%	48 – 55	%	29 – 36	%	48 – 57	%
			1.27 –		1.76 –			
Risk free interest rate	2.06 – 2.66%		1.61	%	2.66	%	1.16 – 1.61%	

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The expected term of employee stock purchase plan (“ESPP”) shares is the average of the remaining purchase periods under each offering period. The assumptions used to value employee stock purchase rights during the three and six months ended June 4, 2010 and May 29, 2009 were as follows:

	Three Months		Six Months	
	2010	2009	2010	2009
Expected life (in years)	0.5 – 2.0	0.5 – 2.0	0.5 – 2.0	0.5 – 2.0
Volatility	32 %	49 – 57 %	32 %	49 – 57 %
Risk free interest rate	0.18 – 1.09%	0.27 – 0.88 %	0.18 – 1.09 %	0.27 – 0.88 %

## Summary of Stock Options

Option activity for the six months ended June 4, 2010 and the fiscal year ended November 27, 2009 was as follows (in thousands):

	2010	2009
Beginning outstanding balance	41,251	40,704
Granted	3,094	5,758
Exercised	(3,936 )	(7,560 )
Cancelled	(1,121 )	(3,160 )
Increase due to acquisition	—	5,509
Ending outstanding balance	39,288	41,251

Information regarding stock options outstanding at June 4, 2010 and May 29, 2009 is summarized below:

	Number of Shares (thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value(*) (millions)
<b>2010</b>				
Options outstanding	39,288	\$30.52	4.15	\$153.5
Options vested and expected to vest	37,542	\$30.58	4.05	\$145.5
Options exercisable	26,486	\$30.88	3.38	\$96.6
<b>2009</b>				
Options outstanding	40,803	\$29.20	4.01	\$143.8
Options vested and expected to vest	38,951	\$29.19	3.92	\$137.3
Options exercisable	27,319	\$28.19	3.23	\$108.7

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(\*)The intrinsic value is calculated as the difference between the market value as of the end of the fiscal period and the exercise price of the shares. As reported by the NASDAQ Global Select Market, the market values as of June 4, 2010 and May 29, 2009 were \$31.59 and \$28.18, respectively.

#### Summary of Employee Stock Purchase Plan Shares

Employees purchased 1.3 million shares at an average price of \$20.20 and 1.2 million shares at an average price of \$18.10 for the six months ended June 4, 2010 and May 29, 2009, respectively. The intrinsic value of shares purchased during the six months ended June 4, 2010 and May 29, 2009 was \$21.4 million and \$3.7 million, respectively. The intrinsic value is calculated as the difference between the market value on the date of purchase and the purchase price of the shares.

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## Summary of Restricted Stock Units

Restricted stock unit activity for the six months ended June 4, 2010 and the fiscal year ended November 27, 2009 was as follows (in thousands):

	2010	2009
Beginning outstanding balance	10,433	4,261
Awarded	6,197	6,176
Released	(1,743 )	(1,162 )
Forfeited	(523 )	(401 )
Increase due to acquisition	—	1,559
Ending outstanding balance	14,364	10,433

Information regarding restricted stock units outstanding at June 4, 2010 and May 29, 2009 is summarized below:

	Number of Shares (thousands)	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value(*) (millions)
2010			
Restricted stock units outstanding	14,364	1.88	\$453.8
Restricted stock units vested and expected to vest	11,016	1.71	\$347.8
2009			
Restricted stock units outstanding	6,272	1.89	\$176.8
Restricted stock units vested and expected to vest	4,805	1.72	\$135.3

(\*)The intrinsic value is calculated as the market value as of the end of the fiscal period. As reported by the NASDAQ Global Select Market, the market values as of June 4, 2010 and May 29, 2009 were \$31.59 and \$28.18, respectively.

## Summary of Performance Shares

Effective January 25, 2010, the Executive Compensation Committee adopted the 2010 Performance Share Program (the "2010 Program"). The purpose of the 2010 Program is to align key management and senior leadership with stockholders' interests and to retain key employees. The measurement period for the 2010 Program is our fiscal 2010 year. All members of our executive management and other key senior leaders are participating in the 2010 Program. Awards granted under the 2010 Program were granted in the form of performance shares pursuant to the terms of our 2003 Equity Incentive Plan. If pre-determined performance goals are met, shares of stock will be granted

to the recipient, with one third vesting on the later of the date of certification of achievement or the first anniversary date of the grant, and the remaining two thirds vesting evenly on the following two annual anniversary dates of the grant, contingent upon the recipient's continued service to Adobe. Participants in the 2010 Program have the ability to receive up to 150% of the target number of shares originally granted.

The following table sets forth the summary of performance share activity under our 2010 Program for the six months ended June 4, 2010 (in thousands):

	Shares Granted	Maximum Shares Eligible to Receive
Beginning outstanding balance	—	—
Awarded	263	394
Forfeited	—	—
Ending outstanding balance	263	394

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The performance metrics under the 2009 Performance Share Program were not achieved and therefore no shares were awarded. The following table sets forth the summary of performance share activity under our 2007 and 2008 programs, based upon share awards actually achieved, for the six months ended June 4, 2010 and the fiscal year ended November 27, 2009 (in thousands):

	2010	2009
Beginning outstanding balance	950	383
Achieved	—	1,022
Released	(339 )	(382 )
Forfeited	(18 )	(73 )
Ending outstanding balance	593	950

Information regarding performance shares outstanding at June 4, 2010 and May 29, 2009 is summarized below:

	Number of Shares (thousands)	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value(*) (millions)
2010			
Performance shares outstanding	593	1.06	\$18.7
Performance shares vested and expected to vest	509	1.01	\$15.9
2009			
Performance shares units outstanding	1,005	1.53	\$28.3
Performance shares vested and expected to vest	807	1.44	\$22.7

(\*)The intrinsic value is calculated as the market value as of the end of the fiscal period. As reported by the NASDAQ Global Select Market, the market values as of June 4, 2010 and May 29, 2009 were \$31.59 and \$28.18, respectively.

## Compensation Costs

As of June 4, 2010, there was \$396.7 million of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock-based awards which will be recognized over a weighted average period of 2.8 years. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

Total stock-based compensation costs that have been included in our Condensed Consolidated Statements of Income for the three months ended June 4, 2010 and May 29, 2009 were as follows (in thousands):

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Income Statement Classifications	2010		2009	
	Option Grants and Stock Purchase Rights(*)	Restricted Stock and Performance Share Awards(*)	Option Grants and Stock Purchase Rights (*)	Restricted Stock and Performance Share Awards (*)
Cost of revenue— subscription	\$341	\$ 324	\$—	\$ —
Cost of revenue—services and support	268	67	1,249	143
Research and development	10,871	11,990	9,264	6,489
Sales and marketing	11,773	13,001	9,714	4,598
General and administrative	5,636	5,826	8,094	2,009
Total	\$28,889	\$ 31,208	\$28,321	\$ 13,239

(\*)For the three months ended June 4, 2010, there were no amounts associated with cash recoveries of fringe benefit tax from employees in India. For the three months ended May 29, 2009, we recorded \$0.6 million associated with cash recoveries of fringe benefit tax from employees in India.

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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Total stock-based compensation costs that have been included in our Condensed Consolidated Statements of Income for the six months ended June 4, 2010 and May 29, 2009 were as follows (in thousands):

	2010		2009	
	Option Grants and Stock Purchase Rights(*)	Restricted Stock and Performance Share Awards(*)	Option and Stock Purchase Rights (*)	Restricted Stock and Performance Share Awards (*)
Income Statement Classifications				
Cost of revenue—subscription	\$680	\$ 604	\$—	\$ —
Cost of revenue—services and support	685	598	1,158	337
Research and development	22,925	27,350	23,396	14,933
Sales and marketing	23,520	25,157	18,581	9,835
General and administrative	11,246	11,812	14,282	4,875
Total	\$59,056	\$ 65,521	\$57,417	\$ 29,980

(\*)For the six months ended June 4, 2010, there were no amounts associated with cash recoveries of fringe benefit tax from employees in India. For the six months ended May 29, 2009, we recorded \$0.8 million associated with cash recoveries of fringe benefit tax from employees in India.

## NOTE 11. RESTRUCTURING CHARGES

## Fiscal 2009 Restructuring Plan

On November 10, 2009, in order to appropriately align our costs in connection with our fiscal 2010 operating plan, we initiated a restructuring plan consisting of reductions of up to approximately 630 full-time positions worldwide and the consolidation of facilities. In connection with this restructuring plan, in the fourth quarter of fiscal 2009, we recorded restructuring charges of approximately \$25.5 million related to ongoing termination benefits for the elimination of approximately 340 of these full-time positions worldwide. As of November 27, 2009, approximately \$2.5 million was paid. The restructuring activities related to this program affected only those employees that were associated with Adobe prior to the acquisition of Omniture on October 23, 2009.

In the first quarter of fiscal 2010, we continued to implement restructuring activities under this program. We vacated approximately 8,000 square feet of sales facilities in Australia, Canada, Denmark and the U.S. We accrued \$0.4 million for the fair value of our future contractual obligations under these operating leases. We also recorded charges of \$11.9 million for termination benefits for the elimination of approximately 159 of the remaining full-time positions expected to be terminated worldwide.



In the second quarter of fiscal 2010, we vacated approximately 40,000 square feet of research and development facilities in Canada and the U.S. We accrued \$6.1 million for the fair value of our future contractual obligations under these operating leases. Total costs incurred to date and expected to be incurred for closing redundant facilities are \$6.4 million and \$12.8 million respectively. We also recorded charges of \$5.7 million for termination benefits for the elimination of approximately 86 of the remaining full-time positions expected to be terminated worldwide.

#### Omniture Restructuring Plan

We completed our acquisition of Omniture on October 23, 2009. In the fourth quarter of fiscal 2009, we initiated a plan to restructure the pre-merger operations of Omniture to eliminate certain duplicative activities, focus our resources on future growth opportunities and reduce our cost structure. In connection with this restructuring plan, we accrued a total of approximately \$10.6 million in costs related to termination benefits for the elimination of approximately 100 regular positions and for the closure of duplicative facilities. We also accrued approximately \$0.2 million in costs related to the cancellation of certain contracts associated with the wind-down of subsidiaries and other service contracts held by Omniture. These costs were recorded as a part of the purchase price allocation, as discussed in Note 2.

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(Unaudited)

Additionally, approximately \$1.5 million of restructuring costs related to facilities were included in the liabilities assumed by us upon acquisition of Omniture on October 23, 2009 for which subsequent payments of \$0.1 million were made during the fourth quarter of fiscal 2009.

**Fiscal 2008 Restructuring Plan**

In the fourth quarter of fiscal 2008, we initiated a restructuring program, consisting of reductions in workforce of approximately 560 full-time positions globally and the consolidation of facilities, in order to reduce our operating costs and focus our resources on key strategic priorities. In connection with this restructuring program, we recorded restructuring charges in the fourth quarter of fiscal 2008 totaling \$29.2 million related to ongoing termination benefits for the elimination of approximately 460 of the 560 full-time positions globally.

During fiscal 2009, we continued to implement restructuring activities under this program. We vacated approximately 89,000 square feet of research and development and sales facilities in the U.S., the United Kingdom and Canada. We accrued \$8.5 million for the fair value of our future contractual obligations under these operating leases using our credit-adjusted risk-free interest rate, estimated at approximately 6% as of the date we ceased to use the leased properties. This amount is net of the fair value of future estimated sublease income of approximately \$4.4 million. Total costs incurred to date and expected to be incurred for closing redundant facilities are \$8.7 million and \$9.0 million, respectively. We also recorded additional charges of \$6.7 million for termination benefits for the elimination of substantially all of the remaining 100 full-time positions expected to be terminated.

**Macromedia Restructuring Plan**

We completed our acquisition of Macromedia on December 3, 2005. In connection with this acquisition, we initiated plans to restructure both the pre-merger operations of Adobe and Macromedia to eliminate certain duplicative activities, focus our resources on future growth opportunities and reduce our cost structure. In connection with the worldwide restructuring plan, we recognized costs related to termination benefits for employee positions that were eliminated and for the closure of duplicative facilities. We also recognized costs related to the cancellation of certain contracts associated with the wind-down of subsidiaries and other service contracts held by Macromedia. Costs for termination benefits and contract terminations were completed during fiscal 2007. Total costs incurred were \$27.0 million and \$3.2 million, respectively.

**Summary of Restructuring Plans**

The following table sets forth a summary of restructuring activities related to all of our restructuring plans described above during the six months ended June 4, 2010 (in thousands):

	November 27, 2009	Costs Incurred	Cash Payments	Other Adjustments	June 4, 2010
Fiscal 2009 Plan:					
Termination benefits	\$22,984	\$17,635	\$(32,217 )	\$(1,598 )	\$6,804

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Cost of closing redundant facilities	—	6,430	(192 )	(25 )	6,213
<b>Omniture Plan:</b>					
Termination benefits	6,712	—	(5,602 )	(517 )	593
Cost of closing redundant facilities	5,324	—	(975 )	235	4,584
Contract termination	242	—	(142 )	276	376
<b>Fiscal 2008 Plan:</b>					
Termination benefits	1,057	—	(211 )	(270 )	576
Cost of closing redundant facilities	3,382	—	(642 )	(130 )	2,610
<b>Macromedia Plan:</b>					
Cost of closing redundant facilities	5,006	—	(2,126 )	(410 )	2,470
Other	8	—	(1 )	—	7
<b>Total restructuring plans</b>	<b>\$44,715</b>	<b>\$24,065</b>	<b>\$(42,108 )</b>	<b>\$(2,439 )</b>	<b>\$24,233</b>

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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Accrued restructuring charges of approximately \$24.2 million at June 4, 2010 includes \$16.5 million recorded in accrued restructuring, current and \$7.7 million related to long-term facilities obligations recorded in accrued restructuring, non-current on our Condensed Consolidated Balance Sheets. We expect to pay accrued termination benefits through fiscal 2010 and facilities-related liabilities per contract through fiscal 2021 of which over 90% will be paid through 2013.

Included in the other adjustments column are \$(0.9) million related to changes to previous estimates and \$(1.5) million related to foreign currency translation adjustments.

## NOTE 12. STOCKHOLDERS' EQUITY

## Retained Earnings

The changes in retained earnings for the six months ended June 4, 2010 were as follows (in thousands):

Balance as of November 27, 2009	\$5,299,914
Net income	275,765
Re-issuance of treasury stock	(5,582 )
Balance as of June 4, 2010	\$5,570,097

We account for treasury stock under the cost method. When treasury stock is re-issued at a price higher than its cost, the difference is recorded as a component of additional paid-in-capital in our Condensed Consolidated Balance Sheets. When treasury stock is re-issued at a price lower than its cost, the difference is recorded as a component of additional paid-in-capital to the extent that there are gains to offset the losses. If there are no treasury stock gains in additional paid-in-capital, the losses upon re-issuance of treasury stock are recorded as a component of retained earnings in our Condensed Consolidated Balance Sheets.

## Comprehensive Income (Loss)

The following table sets forth the activity for each component of comprehensive income, net of related taxes, for the three and six months ended June 4, 2010 and May 29, 2009 (in thousands):

	Three Months		Six Months	
	2010	2009	2010	2009
Net income	\$148,611	\$126,071	\$275,765	\$282,506
Other comprehensive income (loss):				
Available-for-sale securities:				
Unrealized gains (losses) on available-for-sale securities	212	3,547	(546 )	1,578
Reclassification adjustment for (gains) losses on available-for-sale securities recognized during the period	(359 )	(1,267 )	(703 )	(2,577 )
Subtotal available-for-sale securities	(147 )	2,280	(1,249 )	(999 )

Derivative instruments:				
Unrealized gains (losses) on derivative instruments	28,425	(8,737 )	38,789	(14,187 )
Reclassification adjustment for (gains) losses on derivative instruments recognized during the period	(6,206 )	(5,913 )	(6,206 )	(26,389 )
Subtotal derivative instruments	22,219	(14,650 )	32,583	(40,576 )
Foreign currency translation adjustments	(11,187 )	14,585	(15,786 )	11,663
Other comprehensive income (loss)	10,885	2,215	15,548	(29,912 )
Total comprehensive income, net of taxes	\$159,496	\$128,286	\$291,313	\$252,594

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(Unaudited)

The following table sets forth the components of accumulated other comprehensive income, net of related taxes, as of June 4, 2010 and November 27, 2009 (in thousands):

	2010	2009
Net unrealized gains on available-for-sale securities:		
Unrealized gains on available-for-sale securities	\$13,432	\$13,818
Unrealized losses on available-for-sale securities	(864 )	(2 )
Total net unrealized gains on available-for-sale securities	12,568	13,816
Net unrealized gains (losses) on derivative instruments	32,577	(5 )
Cumulative foreign currency translation adjustments	(5,150 )	10,635
Total accumulated other comprehensive income, net of taxes	\$39,995	\$24,446

## Stock Repurchase Program

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 also enter into structured repurchases with third-parties.

During the six months ended June 4, 2010, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of \$250.0 million. We did not enter into any new structured repurchase agreements during the six months ended May 29, 2009. We entered into this agreement in order to take advantage of repurchasing shares at a guaranteed discount to the Volume Weighted Average Price (“VWAP”) of our common stock over a specified period of time. We only enter into such transactions when the discount that we receive is higher than the foregone return on our cash prepayments to the financial institutions. There were no explicit commissions or fees on these structured repurchases. Under the terms of the agreements, there is no requirement for the financial institutions to return any portion of the prepayment to us.

The financial institutions agree to deliver shares to us at monthly intervals during the contract term. The parameters used to calculate the number of shares deliverable are: the total notional amount of the contract, the number of trading days in the contract, the number of trading days in the interval and the average VWAP of our stock during the interval less the agreed upon discount. During the six months ended June 4, 2010, we repurchased approximately 4.2 million shares at an average price of \$34.72 through structured repurchase agreements entered into during fiscal 2009 and fiscal 2010. During the six months ended May 29, 2009, we repurchased approximately 5.9 million shares at an average price of \$22.70 through structured repurchase agreements entered into during fiscal 2008.

As of June 4, 2010 and November 27, 2009, the prepayments were classified as treasury stock on our Condensed Consolidated Balance Sheets at the payment date, though only shares physically delivered to us by the financial statement date are excluded from the denominator in the computation of earnings per share. As of June 4, 2010, approximately \$165.3 million of up-front payments remained under these agreements. As of May 29, 2009, there were no up-front payments remaining under these agreements.

In June 2010, subsequent to the end of our second quarter, our Board of Directors approved an amendment to our stock repurchase program authorized in April 2007 from a non-expiring share-based authority to a time-constrained

dollar-based authority. As part of this amendment, the Board of Directors granted authority to repurchase up to \$1.6 billion in common stock through the end of fiscal 2012.

In June 2010, as part of this amended program, we entered into structured stock repurchase agreements with large financial institutions whereupon we provided them with prepayments of \$400.0 million. This amount will be classified as treasury stock on our Condensed Consolidated Balance Sheets.

This amended program will not affect the \$250.0 million structured stock repurchase agreement entered into in March 2010. As of June 4, 2010, approximately \$165.3 million remains under that agreement. See Note 18 for further discussion of our stock repurchase program.

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## NOTE 13. NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted net income per share for the three and six months ended June 4, 2010 and May 29, 2009 (in thousands, except per share data):

	Three Months		Six Months	
	2010	2009	2010	2009
Net income	\$148,611	\$126,071	\$275,765	\$282,506
Shares used to compute basic net income per share	526,148	524,159	525,124	524,219
Dilutive potential common shares:				
Unvested restricted stock and performance share awards	2,374	1,054	3,099	1,166
Stock options	4,737	2,800	5,082	2,848
Shares used to compute diluted net income per share	533,259	528,013	533,305	528,233
Basic net income per share	\$0.28	\$0.24	\$0.53	\$0.54
Diluted net income per share	\$0.28	\$0.24	\$0.52	\$0.53

For the three and six months ended June 4, 2010, options to purchase approximately 18.5 million and 17.7 million shares, respectively, of common stock with exercise prices greater than the average fair market value of our stock of \$34.32 and \$34.73, respectively, were not included in the calculation because the effect would have been anti-dilutive. Comparatively, for the three and six months ended May 29, 2009, options to purchase approximately 31.6 million and 30.8 million shares, respectively, of common stock with exercise prices greater than the average fair market value of our stock of \$23.38 and \$22.20, respectively, were not included in the calculation because the effect would have been anti-dilutive.

## NOTE 14. COMMITMENTS AND CONTINGENCIES

## Lease Commitments

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 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 our election. In June 2009, we submitted notice to the lessor that we intended to exercise our option to renew this agreement for an additional five years effective August 2009. As stated in the original lease agreement, in conjunction with the lease renewal, we were required to obtain a standby letter of credit for approximately \$16.5 million which enabled us to secure a lower interest rate and reduce the number of covenants. As defined in the lease agreement, the standby letter of credit primarily represents the lease investment balance equity which is callable in the event of default. In March 2007, the Almaden Tower lease was extended for five years, with a renewal option for an additional five years solely at our election. As part of the lease extensions, we purchased the lease receivable from the lessor of the East and West Towers for \$126.8 million and a portion of the lease receivable from the lessor of the Almaden Tower for \$80.4 million, both of which are recorded as investments in



lease receivables on our Condensed Consolidated Balance Sheets. This purchase may be credited against the residual value guarantee if we purchase the properties or will be repaid from the sale proceeds if the properties are sold to third-parties. Under the agreement for the East and West Towers and the agreement for the Almaden Tower, we have the option to purchase the buildings at anytime during the lease term for approximately \$143.2 million and \$103.6 million, respectively. The residual value guarantees under the East and West Towers and the Almaden Tower obligations are \$126.8 million and \$89.4 million, respectively.

These two leases are both subject to standard covenants including certain financial ratios that are reported to the lessors quarterly. As of June 4, 2010, 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 and, as such, the buildings and the related obligations are not included on our Condensed Consolidated Balance Sheets. 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, purchase the buildings for the lease balance, remarket or

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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 residual value guarantee amount.

#### Guarantees

The lease agreements for our corporate headquarters provide for residual value guarantees as noted above. 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 Condensed Consolidated Balance Sheets. As such, we recognized \$5.2 million and \$3.0 million in liabilities, related to the extended East and West Towers and Almaden Tower leases, respectively. These liabilities are 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 leases. As of June 4, 2010 and November 27, 2009, the unamortized portion of the fair value of the residual value guarantees, for both leases, remaining in other long-term liabilities and prepaid rent was \$1.0 million and \$1.3 million, respectively.

#### Royalties

We have 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.

#### Indemnifications

In the ordinary 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 reduces 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 interest 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 partnership. 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 Proceedings

Between September 23, 2009 and September 25, 2009, three putative class action lawsuits were filed in the Fourth Judicial District Court for Utah County, Provo Department, State of Utah, seeking to enjoin Adobe's acquisition of Omniture, Inc. and to recover damages in the event the transaction were to close. The cases were captioned Miner v. Omniture, Inc., et. al., (the "Miner"), Barrell v. Omniture, Inc. et. al., (the "Barrell"), and Lodhia v. Omniture, Inc. et al., (the "Lodhia"). At a hearing on October 20, 2009, the court consolidated the Miner, Barrell, and Lodhia cases into a single case under the Lodhia caption and denied the plaintiffs' motion to preliminarily enjoin the closing of the transaction. On December 30, 2009, the plaintiffs served the defendants with a consolidated amended complaint for damages arising out of the closing of the transaction. In the consolidated amended complaint, plaintiffs allege that the members of Omniture's board of directors breached their fiduciary duties to Omniture's stockholders by failing to seek the highest possible price for Omniture and that both Adobe and Omniture induced or aided and abetted in the alleged breach. The plaintiffs also allege that the Schedule 14D-9 Solicitation/Recommendation Statement filed by Omniture on September 24, 2009 in connection with the transaction

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contained inadequate disclosures and was materially misleading. Plaintiffs seek unspecified damages on behalf of the former public stockholders of Omniture. On March 8, 2010, Adobe and the other defendants moved to dismiss the complaint for failure to state a claim. Adobe intends to defend the lawsuits vigorously. As of June 4, 2010, no amounts have been accrued as a loss is not probable or estimable.

In October 2009, Eolas Technologies Incorporated filed a complaint against us and 22 other companies for patent infringement in the United States District Court for the Eastern District of Texas. The complaint alleges, among other things, that a number of our Web pages and products infringe two patents owned by plaintiff purporting to cover “Distributed Hypermedia Method for Automatically Invoking External Application Providing Interaction and Display of Embedded Objects within a Hypermedia Document” (U.S. Patent No. 5,838,906) and “Distributed Hypermedia Method and System for Automatically Invoking External Application Providing Interaction and Display of Embedded Objects within a Hypermedia Document” (U.S. Patent No. 7,599,985) and seeks injunctive relief, monetary damages, costs and attorneys fees. We dispute these claims and intend to vigorously defend ourselves in this matter. As of June 4, 2010, no amounts have been accrued as a loss is not probable or estimable.

In September 2008, ThinkVillage-Kiwi LLC filed a complaint against Adobe and Adobe Macromedia Software LLC, a wholly-owned subsidiary of Adobe, in the United States District Court for the Northern District of California alleging misappropriation of trade secrets under California state law, unfair competition under federal and state law, and breach of fiduciary duty. An amended complaint was filed in April 2009, which added claims for breach of confidence under state law (a claim which was later dismissed with prejudice by the court) and a claim for common law misappropriation. The amended complaint seeks monetary damages for asserted unjust enrichment, punitive damages, and injunctive relief. In November 2009, the court denied defendants’ motion for summary judgment. During the second fiscal quarter of 2010, the parties notified the Court that they had resolved the matter. The resolution of this matter did not have a material effect on our financial statements.

In connection with our anti-piracy efforts, conducted both internally and through organizations such as 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 laws. 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.

From time to time, Adobe is subject to legal proceedings, claims and investigations 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. 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 negatively affected by an unfavorable resolution of one or more of such proceedings, claims or investigations.

NOTE 15. DEBT

Notes

In February 2010, we issued \$600.0 million of 3.25% senior notes due February 1, 2015 (the “2015 Notes”) and \$900.0 million of 4.75% senior notes due February 1, 2020 (the “2020 Notes” and, together with the 2015 Notes, the “Notes”). Our proceeds were approximately \$1.494 billion which is net of an issuance discount of \$6.561 million. The Notes rank equally with our other unsecured and unsubordinated indebtedness. In addition, we incurred issuance costs of approximately \$10.7 million. Both the discount and issuance costs are being amortized to interest expense over the respective terms of the Notes using the effective interest method. Interest is payable semi-annually, in arrears, on February 1 and August 1, commencing on August 1, 2010. The proceeds from this offering are available for general corporate purposes, including repayment of any balance outstanding on our credit facility. As of June 4, 2010, the amount outstanding under the Notes was \$1.494 billion, which is included in long-term liabilities on our Condensed Consolidated Balance Sheets. Based on quoted market prices, the fair value of the Notes was approximately \$1.524 billion as of June 4, 2010.

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We may redeem the Notes at any time, subject to a make whole premium. In addition, upon the occurrence of certain change of control triggering events, we may be required to repurchase the Notes, at a price equal to 101% of their principal amount, plus accrued and unpaid interest to the date of repurchase. The Notes also include covenants that limit our ability to grant liens on assets and to enter into sale and leaseback transactions, subject to significant allowances. As of June 4, 2010, we were in compliance with all the covenants.

## Credit Agreement

In August 2007, we entered into an Amendment to our Credit Agreement dated February 2007 (the "Amendment"), which increased the total senior unsecured revolving facility from \$500.0 million to \$1.0 billion. The Amendment also permits us to request one-year extensions effective on each anniversary of the closing date of the original agreement, subject to the majority consent of the lenders. We also retain an option to request an additional \$500.0 million in commitments, for a maximum aggregate facility of \$1.5 billion.

In February 2008, we entered into a Second Amendment to the Credit Agreement dated February 26, 2008, which extended the maturity date of the facility by one year to February 16, 2013. The facility would terminate at this date if no additional extensions have been requested and granted. All other terms and conditions remain the same.

The facility contains a financial covenant requiring us not to exceed a certain maximum leverage ratio. At our option, borrowings under the facility accrue interest based on either the London interbank offered rate ("LIBOR") for one, two, three or six months, or longer periods with bank consent, plus a margin according to a pricing grid tied to this financial covenant, or a base rate. The margin is set at rates between 0.20% and 0.475%. Commitment fees are payable on the facility at rates between 0.05% and 0.15% per year based on the same pricing grid. The facility is available to provide loans to us and certain of our subsidiaries for general corporate purposes. At November 27, 2009, the amount outstanding under the credit facility was \$1.0 billion, which is included in long-term liabilities on our Condensed Consolidated Balance Sheets. The carrying value of the outstanding liability at November 27, 2009 approximated fair value. On February 1, 2010, we paid the outstanding balance on the credit facility and as of June 4, 2010 this facility has no outstanding balance.

## NOTE 16. NON-OPERATING INCOME (EXPENSE)

Non-operating income (expense) for the three and six months ended June 4, 2010 and May 29, 2009 included the following (in thousands):

	Three Months		Six Months	
	2010	2009	2010	2009
Interest and other income (expense), net:				
Interest income	\$4,986	\$9,923	\$10,091	\$21,039
Foreign exchange losses	(12,190 )	(6,710 )	(17,275 )	(6,076 )
Realized gains on fixed income investment(1)	355	1,265	698	2,578
Other, net	536	324	784	545

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Interest and other income (expense), net	\$ (6,313 )	\$ 4,802	\$ (5,702 )	\$ 18,086
Interest expense	\$ (16,076 )	\$ (620 )	\$ (23,771 )	\$ (1,412 )
Investment gains (losses), net:				
Realized investment gains	\$ 3	\$ 52	\$ 187	\$ 52
Unrealized investment gains(2)	—	2,186	—	1,377
Realized investment losses	(358 )	(793 )	(764 )	(1,985 )
Unrealized investment losses	(10,368 )	(3,250 )	(13,680 )	(18,495 )
Investment gains (losses), net	\$ (10,723 )	\$ (1,805 )	\$ (14,257 )	\$ (19,051 )
Non-operating income (expense), net	\$ (33,112 )	\$ 2,377	\$ (43,730 )	\$ (2,377 )

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

- (1) There were no realized losses on fixed income investments during the three and six months ended June 4, 2010 and May 29, 2009.
- (2) During the three and six months ended June 4, 2010 and May 29, 2009, we recorded \$(0.4) million and \$(0.2) million and \$1.8 million and \$0.9 million, respectively, in unrealized holding gains and losses associated with our deferred compensation plan assets (classified as trading securities).

## NOTE 17. SEGMENTS

We have the following reportable segments: Creative Solutions, Knowledge Worker, Enterprise, Omniture, Platform, and Print and Publishing. Our Creative Solutions segment focuses on delivering a complete professional line of integrated tools for a full range of creative and developer tasks to an extended set of customers. The Knowledge Worker segment focuses on the needs of knowledge worker customers, providing essential applications and services to help them share information and collaborate. This segment contains revenue generated by our Acrobat family of products. Our Enterprise segment provides server-based Customer Interaction Solutions for the enterprise and collaboration and conferencing solutions. This segment contains revenue generated by our LiveCycle and Adobe Connect lines of products. Our Omniture segment provides web analytics and online business optimization products and services to manage and enhance online, offline and multi-channel business initiatives. The Platform segment includes client and developer technologies, such as Adobe Flash Player, Adobe Flash Lite, Adobe AIR, Adobe Flex, Adobe Flash Builder, ColdFusion, and also encompasses products and technologies created and managed in other Adobe segments. Finally, the Print and Publishing segment addresses market opportunities ranging from the diverse publishing needs of technical and business publishing to our legacy type and OEM printing businesses.

Effective in the first quarter of fiscal 2010, to better align our marketing efforts and go-to-market strategies, we moved management responsibility for the Connect Solutions product line from our Knowledge Worker segment to our Enterprise segment. Prior year information in the table below has been reclassified to reflect this change.

We report segment information based on the “management” approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of our reportable segments.

Our chief operating decision maker reviews revenue and gross margin information for each of our reportable segments. Operating expenses are not reviewed on a segment by segment basis. In addition, with the exception of goodwill and intangible assets, we do not identify or allocate our assets by the reportable segments.

(in thousands)	Creative Solutions	Knowledge Worker	Enterprise	Omniture(*)	Platform	Print and Publishing	Total
Three months ended							



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June 4, 2010

Revenue	\$532,697	\$156,012	\$76,685	\$83,488	\$45,416	\$48,737	\$943,035
Cost of revenue	36,909	5,094	14,127	46,041	2,913	2,749	107,833
Gross profit	\$495,788	\$150,918	\$62,558	\$37,447	\$42,503	\$45,988	\$835,202
Gross profit as a percentage of revenue	93	% 97	% 82	% 45	% 94	% 94	% 89

Three months ended May 29, 2009

Revenue	\$411,749	\$137,820	\$71,899	\$—	\$36,819	\$46,386	\$704,673
Cost of revenue	39,572	7,787	14,387	—	5,418	4,844	72,008
Gross profit	\$372,177	\$130,033	\$57,512	\$—	\$31,401	\$41,542	\$632,665
Gross profit as a percentage of revenue	90	% 94	% 80	% —	85	% 90	% 90

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(\*)The three months ended June 4, 2010 includes Omniture as a new reportable segment following our acquisition of Omniture on October 23, 2009. The three months ended May 29, 2009 does not include the impact of our acquisition of Omniture. Of the \$83.5 million in revenue from our Omniture segment, approximately \$74.0 million represents subscription revenue and the remaining amount represents professional services and support.

(in thousands)	Creative Solutions	Knowledge Worker	Enterprise	Omniture(*)	Platform	Print and Publishing	Total
Six months ended June 4, 2010							
Revenue	\$964,720	\$321,874	\$156,585	\$171,160	\$92,052	\$95,344	\$1,801,735
Cost of revenue	59,744	9,735	29,370	88,126	5,140	5,086	197,201
Gross profit	\$904,976	\$312,139	\$127,215	\$83,034	\$86,912	\$90,258	\$1,604,534
Gross profit as a percentage of revenue	94 %	97 %	81 %	49 %	94 %	95 %	89 %
Six months ended May 29, 2009							
Revenue	\$872,477	\$287,765	\$148,939	\$—	\$89,118	\$92,764	\$1,491,063
Cost of revenue	82,322	15,552	29,884	—	11,474	10,129	149,361
Gross profit	\$790,155	\$272,213	\$119,055	\$—	\$77,644	\$82,635	\$1,341,702
Gross profit as a percentage of revenue	91 %	95 %	80 %	— %	87 %	89 %	90 %

(\*)The six months ended June 4, 2010 includes Omniture as a new reportable segment following our acquisition of Omniture on October 23, 2009. The six months ended May 29, 2009 does not include the impact of our acquisition of Omniture. Of the \$171.2 million in revenue from our Omniture segment, approximately \$150.8 million represents subscription revenue and the remaining amount represents professional services and support.

NOTE 18. SUBSEQUENT EVENTS

In June 2010, subsequent to the end of our second quarter, our Board of Directors approved an amendment to our stock repurchase program authorized in April 2007 from a non-expiring share-based authority to a time-constrained dollar-based authority. As part of this amendment, the Board of Directors granted authority to repurchase up to \$1.6 billion in common stock through the end of fiscal 2012.

In June 2010, as part of this amended program, we entered into structured stock repurchase agreements with large financial institutions whereupon we provided them with prepayments of \$400.0 million. This amount will be classified as treasury stock on our Condensed Consolidated Balance Sheets.

This amended program will not affect the \$250.0 million structured stock repurchase agreement entered into in March 2010. As of June 4, 2010, approximately \$165.3 million remains under that agreement. See Note 12 for further discussion of our stock repurchase program.

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ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements and Notes thereto.

In addition to historical information, this Quarterly Report on Form 10-Q 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 from these forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section entitled “Risk Factors” in Part II, Item 1A of this report. You should carefully review the risks described herein and in other documents we file from time to time with the Securities and Exchange Commission (the “SEC”), including our Annual Report on Form 10-K for fiscal 2009. When used in this report, the words “expects,” “could,” “would,” “may,” “anticipate,” “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 Quarterly Report on Form 10-Q. 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.

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, Web and mobile software and services used by creative professionals, knowledge workers, consumers, original equipment manufacturers (“OEMs”), developers and enterprises for creating, managing, delivering, optimizing and engaging with compelling content and experiences across multiple operating systems, devices and media. We distribute our products through a network of distributors, value-added resellers (“VARs”), systems integrators, independent software vendors (“ISVs”) and OEMs, direct to end users and through our own Website at [www.adobe.com](http://www.adobe.com). We also license our technology to 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 Mac OS, Linux, UNIX and various non-PC platforms, depending on the product.

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 Website at [www.adobe.com](http://www.adobe.com). Investors can obtain copies of our SEC filings from this site free of charge, as well as from the SEC Website at [www.sec.gov](http://www.sec.gov).

ACQUISITION OF OMNITURE

On October 23, 2009, we completed the acquisition of Omniture, Inc. (“Omniture”), an industry leader in Web analytics and online business optimization based in Orem, Utah, for approximately \$1.8 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 revenue and cost saving synergies. Coinciding with the integration of Omniture, we created a new reportable segment for financial reporting purposes. The discussions in this section of the Quarterly Report on Form 10-Q, as well as the financial statements contained herein, reflect the impact of the acquisition. See Note 2 of our Notes to Condensed Consolidated Financial Statements for further information regarding this acquisition.

OPERATIONS OVERVIEW

During the second quarter of fiscal 2010, we reported record revenue and strong financial results. This performance was driven by the launch and delivery of Adobe Creative Suite 5 (“CS5”), which is our flagship product family. In addition to strong CS5 revenue, our worldwide business continued to experience stability that we initially started to see during the last half of fiscal 2009. With a more stable economic environment in our major markets, end-user demand for most of our products, including our Adobe Acrobat family of products, continued to be consistent during the quarter when compared to the prior quarter. The three months ended March 5, 2010 and the six months ended June 4, 2010 financial results benefitted from an extra week in the first quarter of fiscal 2010 due to our 52/53 week financial calendar whereby fiscal 2010 is a 53-week year compared with fiscal 2009 which was a 52-week year.

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In our Creative Solutions segment, revenue for our Adobe Creative Suite 4 (“CS4”) family of products was strong in the weeks leading up to the shipment of CS5. This strength improved the overall revenue performance of CS4 when compared to the prior Adobe Creative Suite 3 (“CS3”) cycle. At the end of the first quarter of fiscal 2010, CS4 revenue had lagged CS3 revenue by approximately 20% when comparing the two releases. With a strong finish by the end of second quarter of fiscal 2010, CS4 revenue lagged CS3 revenue by approximately 17%, an improvement of 3 percentage points.

In the second quarter of fiscal 2010, the shipment of new CS5 versions of our creative professional family of products drove strong revenue performance due to increased demand for the products which we attribute to pent-up demand for the new release, as well as strong reviews and industry commentary about the CS5 products. Product cycle-to-date, CS5 revenue has grown approximately 15% when compared to a comparable period of time for the CS4 products. Assuming a stable economic environment in our major markets, we expect this strength in demand and revenue to continue through the remainder of fiscal 2010.

Our Knowledge Worker segment achieved 13% year-over-year growth due to continued solid demand for our Acrobat product family. We attribute this performance to the stable and improving economic conditions in the major markets and geographies where we focus on Acrobat adoption.

Our Enterprise segment grew 7% on a year-over-year basis. Adoption of our Connect web-conferencing solutions and our LiveCycle family of products contributed to this growth.

In our Omniture business, we maintained strong momentum in the second quarter of fiscal 2010. Driving this success was increased awareness of our Online Marketing Suite value proposition in the marketplace as well as strong bookings performance. The number of Omniture user transactions grew to 1.26 trillion, an increase of 12% year-over-year versus the comparable period of time a year ago.

Our Platform and our Print and Publishing business segments achieved revenue results in the second quarter of fiscal 2010 which were consistent with our expectations.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

In preparing our Condensed Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and pursuant to the rules and regulations of the SEC, we make assumptions, judgments and estimates that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosures of contingent assets and liabilities. 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. We also discuss our critical accounting policies and 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, stock-based compensation, goodwill impairment and income taxes have the greatest potential impact on our Condensed Consolidated Financial Statements. These areas are key components of our results of operations and are based on complex rules which require us to make judgments and estimates, so we consider these to be our critical accounting policies. Historically, our assumptions, judgments and estimates relative to our critical accounting policies have not differed materially from actual results.

With the exception of the discussion below, there have been no significant changes in our critical accounting policies and estimates during the six months ended June 4, 2010, as compared to the critical accounting policies and estimates

disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended November 27, 2009.

### Revenue Recognition

We recognize revenue when all four revenue recognition criteria have been met: 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. Determining whether and when some of these criteria have been satisfied often involves assumptions and judgments that can have a significant impact on the timing and amount of revenue we report. For example, for multiple element arrangements, we must: (1) determine whether and when each element has been delivered; (2) determine whether undelivered products or services are essential to the functionality of the delivered products and services; (3) determine the fair value of each element using the selling price hierarchy of vendor-specific objective evidence ("VSOE"), third-party evidence ("TPE") or estimated

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selling price (“ESP”), as applicable; and (4) allocate the total price among the various elements based on the relative selling price method. Changes in assumptions or judgments or changes to the elements in a software arrangement could cause a material increase or decrease in the amount of revenue that we report in a particular period.

In October 2009, the Financial Accounting Standards Board (“FASB”) amended the accounting standards for certain multiple deliverable revenue arrangements to:

- provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the consideration should be allocated;
- require an entity to allocate revenue in an arrangement using the best estimated selling price (“BESP”) of deliverables if a vendor does not have vendor-specific objective evidence (“VSOE”) of selling price or third-party evidence (“TPE”) of selling price; and
- eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method.

We elected to early adopt this accounting guidance at the beginning of our fiscal quarter of fiscal 2010 on a prospective basis for applicable transactions originating or materially modified after November 27, 2009.

For multiple element arrangements that contain non-software related elements, for example our software as a service (“SaaS”) offerings, we allocate revenue to each non-software element based upon the relative selling price of each and if software and software-related elements are also included in the arrangement, to those elements as a group based on our BESP for the group. When applying the relative selling price method, we determine the selling price for each deliverable using VSOE of selling price, if it exists, or TPE of selling price. If neither VSOE nor TPE of selling price exist for a deliverable, we use our BESP for that deliverable. Revenue allocated to each element is then recognized when the basic revenue recognition criteria is met for each element. The manner in which we account for multiple element arrangements that contain only software and software-related elements remains unchanged.

Consistent with our methodology under previous accounting guidance, we determine VSOE for each element based on historical stand-alone sales to third-parties or from the stated renewal rate for the elements contained in the initial arrangement.

In certain instances, we were not able to establish VSOE for all deliverables in an arrangement with multiple elements. This may be due to us infrequently selling each element separately, not pricing products or services within a narrow range, or only having a limited sales history. When VSOE cannot be established, we attempt to establish the selling price of each element based on TPE. TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, our offerings contain significant differentiation such that the comparable pricing of products with similar functionality cannot be obtained. Furthermore, we are unable to reliably determine what similar competitor products’ selling prices are on a stand-alone basis. Therefore, we typically are not able to obtain TPE of selling price.

When we are unable to establish selling prices using VSOE or TPE, we use BESP in our allocation of arrangement consideration. The objective of BESP is to determine the price at which we would transact a sale if the product or service were sold on a stand-alone basis. BESP is generally used for offerings that are not typically sold on a stand-alone basis or for new or highly customized offerings.

We determine BESP for a product or service by considering multiple factors including, but not limited to, geographies, market conditions, competitive landscape, internal costs, gross margin objectives and pricing practices.



The determination of BESP is made through consultation with and formal approval by our management, taking into consideration our go-to-market strategy.

We regularly review VSOE and have established a review process for TPE and BESP and maintain internal controls over the establishment and updates of these estimates. There was no material impact to revenue during the three and six months ended June 4, 2010 resulting from changes in VSOE, TPE or BESP, nor do we expect a material impact from such changes in the near term.

Given the nature of our transactions, which are primarily software and software-related, our go-to-market strategies and our pricing practices, total net revenue as reported during the three and six months ended June 4, 2010 is materially consistent

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with total net revenue that would have been reported if the transactions entered into or materially modified after November 27, 2009 were subject to previous accounting guidance.

The new accounting standards for revenue recognition, if applied in the same manner to the year ended November 27, 2009, would not have had a material impact on total net revenues for that fiscal year. In terms of the timing and pattern of revenue recognition, the new accounting guidance for revenue recognition is not expected to have a significant effect on total net revenues in periods after the initial adoption. However, we expect that this new accounting guidance will facilitate our efforts to optimize our offerings due to better alignment between the economics of an arrangement and the accounting. This may lead to us to engage in new go-to-market practices in the future. In particular, we expect that the new accounting standards will enable us to better integrate products and services without VSOE into existing offerings and solutions. As these go-to-market strategies evolve, we may modify our pricing practices in the future, which could result in changes in selling prices, including both VSOE and BESP. As a result, our future revenue recognition for multiple element arrangements could differ materially from the results in the current period. Changes in the allocation of the sales price between elements may impact the timing of revenue recognition, but will not change the total revenue recognized on the contract. We are currently unable to determine the impact that the newly adopted accounting principles could have on our revenue as these go-to-market strategies evolve.

In addition to multiple element arrangements, we must estimate certain royalty revenue amounts due to the timing of securing information from our customers. While we believe we can make reliable estimates regarding these matters, these estimates are inherently subjective. Accordingly, our assumptions and judgments regarding future products and services as well as our estimates of royalty revenue could differ from actual events, thus materially impacting our financial position and results of operations.

Product revenue is recognized when the above criteria are met. We reduce the revenue recognized for estimated future returns, price protection and rebates at the time the related revenue is recorded. 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. Product returns may be more or less than 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.

We offer price protection to our distributors that allows for the right to a credit if we permanently reduce the price of a software product. When evaluating the adequacy of the price protection allowance, we analyze historical returns, current sell-through of distributor and retailer inventory of our products, changes in customer demand and acceptance of our products and other related factors. In addition, we monitor the volume of sales to our channel partners and their inventories. Changes to these assumptions or in the economic environment could result in higher returns or higher price protection costs in subsequent periods.

In the future, actual returns and price protection may materially exceed our estimates as unsold products in the distribution channels are exposed to rapid changes in consumer preferences, market conditions or technological obsolescence due to new platforms, product updates or competing products. While we believe we can make reliable estimates regarding these matters, these estimates are inherently subjective. Accordingly, if our estimates change, our returns and price protection reserves would change, which would impact the total net revenue we report.

We recognize revenues for hosting services that are based on a committed number of transactions, including implementation and set-up fees, ratably beginning on the date the customer commences use of our services and continuing through the end of the customer term. Over-usage fees, and fees billed based on the actual number of transactions from which we capture data, are billed in accordance with contract terms as these fees are incurred. We record amounts that have been invoiced in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

Our consulting revenue is recognized using the proportionate performance method and a time and materials basis 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. Accordingly, our estimates of consulting revenue could differ from actual events and may materially impact our financial position and results of operations.

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## Goodwill Impairment

During the second quarter of fiscal 2010, we completed our annual goodwill impairment test. Based on this analysis, we determined that there was no impairment of goodwill. We currently believe that there is no significant risk of material goodwill impairment in any of our reporting units in the foreseeable future.

## RESULTS OF OPERATIONS

Revenue for the Three and Six Months Ended June 4, 2010 and May 29, 2009 (dollars in millions)

	Three Months		Percent Change	Six Months		Percent Change
	2010	2009		2010	2009	
Product	\$795.3	\$648.0	23 %	\$1,499.2	\$1,377.9	9 %
Percentage of total revenue	84 %	92 %		84 %	92 %	
Subscription	92.3	12.1	*	187.8	24.4	*
Percentage of total revenue	10 %	2 %		10 %	2 %	
Services and support	55.4	44.6	24 %	114.7	88.8	29 %
Percentage of total revenue	6 %	6 %		6 %	6 %	
Total revenue	\$943.0					