

Company update

Adobe Inc.

Research Team
U.S. | Information Technology

Rating BUY (as at 18 December 2020)
 Last Close USD 495.36
 Fair Value USD 576.00

Bigger TAM across key businesses

- **Beating on top and bottom line**
- **Secular tailwinds to drive continued growth; healthy FY21 guidance**
- **Higher FV of US\$576 (previously US\$544)**

Investment thesis

Adobe is a leading provider of software solutions for creative and marketing professionals. The company's 3 main operating segments are (a) digital media, (b) digital experience, and (c) publishing and advertising. Digital experience, in particular, should benefit from significant cross-selling opportunities, given the stickiness of creative professionals to Adobe's products. The company enjoys highly profitable and predictable revenue streams, large TAMs and exposure to secular growth trends, particularly in digital transformation and digitization of content.

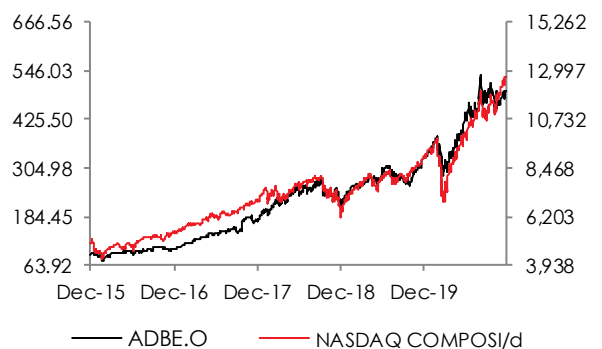
Investment summary

- **Firm results to round off the FY** – Adobe's 4QFY20 results were broadly better than expected. Total revenue grew 14% to US\$3.4b, beating consensus by ~2%. On the Digital Media front, net new Annualized Recurring Revenue (ARR) of US\$548m came in slightly above guidance (by US\$8m). As it relates to Creative Cloud, management highlighted improvement in retention rates and engagement, which have returned to pre-COVID levels. Non-GAAP OPM came in higher-than-consensus at 45%, which we believe was helped by operational efficiencies and lower T&E expenses. All-in, non-GAAP EPS came in at US\$2.81, ~6% higher than previous guidance. Adobe has also announced the authorisation of a new US\$15b stock repurchase programme through FY24 to accelerate share buybacks.
- **Secular tailwinds remain intact** – Management has guided for revenue growth of 18% YoY in FY21, with non-GAAP EPS increasing by ~11% to ~US\$11.20. While management expects FY21 operating margins to come down from its Q4 high, there should still be an expansion on a YoY basis. Management also increased the TAM for 2023, with Digital Media and

Security information

Ticker	ADBE.O
Market Cap (USD b)	237.6
Daily turnover (USD b)	2.8
Free Float	100%
Shares Outstanding (m)	480
Top Shareholder	The Vanguard Group, Inc. 8.1%

Price performance chart



Financial summary

USD (m)	FY20	FY21E	FY22E
Revenue	12,868	15,172	17,504
Adj. Gross Profit	11,405	13,552	15,690
Adj. Op Profit	5,521	6,628	7,776
Adj. Net Income	4,903	5,411	6,373
Adj. EPS (\$, dil.)	10.1	11.2	13.3

Key ratios

	FY20	FY21E	FY22E
Revenue growth	15%	18%	15%
Adj. gross margin	89%	89%	90%
Adj. op margin	43%	44%	44%
Adj. net margin	38%	36%	36%

Source: Refinitiv, Company, Internal estimates

Experience Cloud being increased by 41% and 15% to US\$62b and US\$85b, respectively, vs 2022 TAM. Based on a FY21 guide of US\$15b, this implies only 10% penetration. We also note that the average ARR from Adobe's top 100 marketing customers has grown 3x what it was in 2015, which we believe speaks to the mission criticality of the platform to some of the leading global brands. Recently acquired Workfront was also cited as the marketing system of record enabling better communication and coordination, thereby becoming the UI for marketers as they interact with all of Adobe's solutions, which we believe would help on the Digital Experience front. From a high-level perspective, we agree with management that the secular tailwinds for Adobe remain robust across its main businesses. These include more content creation and consumption benefiting Creative Cloud, usage of electronic documents and automation of business workflows leveraging Document Cloud, and digital transformation and engagement as a tailwind for Digital Experience. Following adjustments and as we roll forward our estimates, our fair value rises from US\$544 to US\$576.

Potential catalysts

- Better-than-expected margin expansion
- Better integration of recent investments to boost Digital Experience's revenue growth

Investment risks

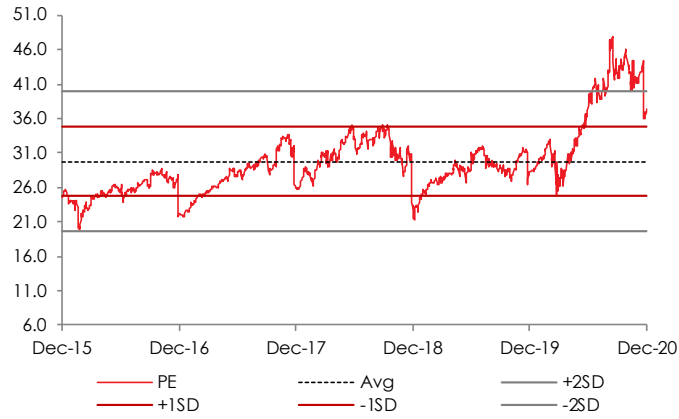
- Slowdown of subscriber adoption
- Impact on Digital Experience from heightened competition
- Prolonged impact from COVID-19

Valuation analysis

	Price/Earnings		Price/Book		EV/EBITDA		Dividend Yield (%)		ROE (%)	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
ADOBE INC (ADBE.O)	44.1	37.4	12.4	10.2	31.3	28.2	0.0	0.0	31.8	30.0
SALESFORCE.COM INC (CRM.N)	48.7	64.6	5.1	4.8	31.5	28.2	0.0	0.0	12.5	8.2
ORACLE CORP (ORCL.N)	14.6	13.5	20.3	15.8	10.7	10.4	1.5	1.6	129.6	152.9
SAP SE (SAPG.DE)	20.3	22.0	4.0	3.7	15.6	15.1	1.6	1.6	18.4	16.7
MICROSOFT CORP (MSFT.O)	32.5	29.4	12.1	10.3	21.7	19.4	1.0	1.1	45.9	36.6

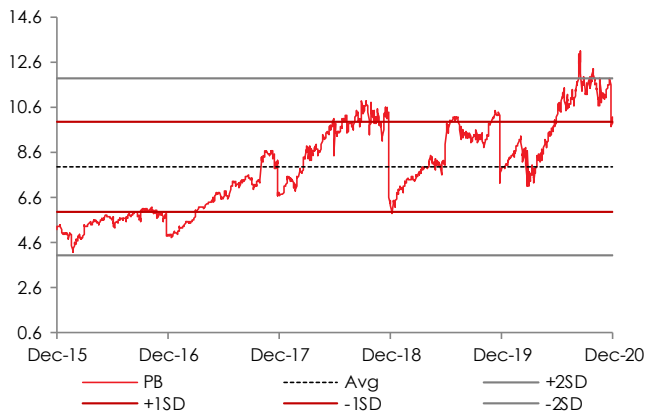
Source: Refinitiv

Price/Earnings chart



Source: Refinitiv

Price/Book chart



Source: Refinitiv

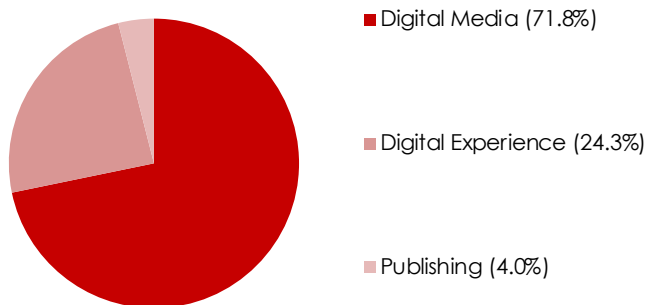
Company overview (as of 29 November 2019)

Company description

Founded in 1982, Adobe Inc. is one of the largest and most diversified software companies in the world. Adobe offers a line of products and services used by creative professionals, marketers, knowledge workers, students, application developers, enterprises and consumers for creating, managing, delivering, measuring, optimizing, engaging and transacting with compelling content and experiences across personal computers, devices and media. Adobe markets its products and services directly to enterprise customers through its sales force and local field offices. Adobe licenses its products to end users through app stores and its own website at www.adobe.com. Adobe offers many of its products via a SaaS model or a managed services model as well as through term subscription and pay-per-use models. Adobe also distributes certain products and services through a network of distributors, value-added resellers, system integrators, independent software vendors, retailers, software developers and original equipment manufacturers. In addition, Adobe licenses its technology to hardware manufacturers, software developers and service providers for use in their products and solutions. Adobe's products run on personal and server-based computers, as well as on smartphone, tablets and other devices, depending on the product. Adobe has operations in the Americas, Europe, Middle East and Africa, and Asia-Pacific.

FY20 segments

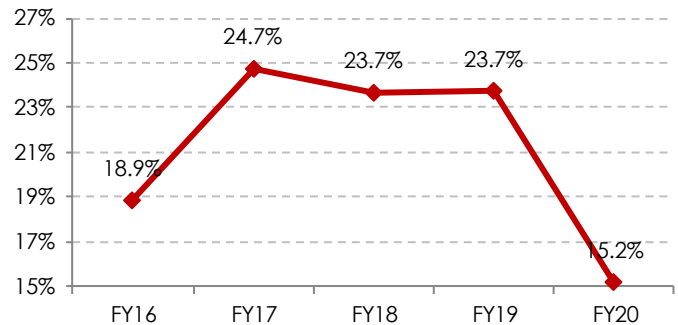
By segment



Source: Company, Internal estimates

Revenue growth

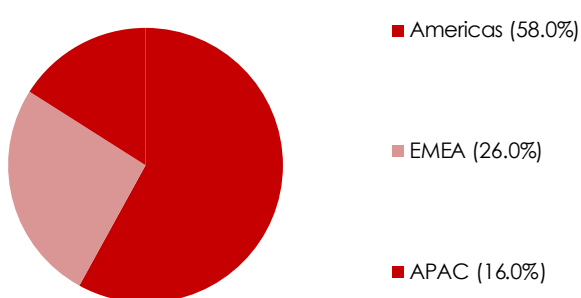
Value



Source: Company, Internal estimates

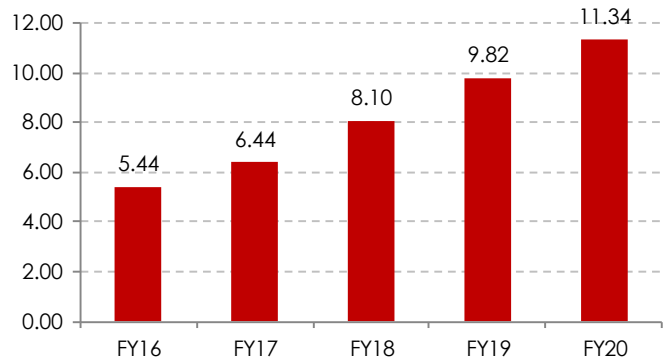
FY20 Geographical breakdown

By segment



Source: Company, Internal estimates

Remaining Performance Obligation (US\$'b)



Source: Company, Internal estimates

Company financials

Income Statement

In Millions of USD except Per Share 12 Months Ending	FY2016 30/11/2016	FY2017 30/11/2017	FY2018 30/11/2018	FY2019 30/11/2019	FY2020 30/11/2020
Revenue	5,854.4	7,301.5	9,030.0	11,171.3	12,868.0
- Cost of Revenue	819.9	1,010.5	1,195.0	1,672.7	1,722.0
Gross Profit	5,034.5	6,291.0	7,835.0	9,498.6	11,146.0
+ Other Operating Income	--	--	--	--	--
- Operating Expenses	3,540.9	4,122.9	4,994.6	6,230.5	6,909.0
Operating Income or Losses	1,493.6	2,168.1	2,840.4	3,268.1	4,237.0
- Interest Expense	70.4	74.4	89.2	157.2	116.0
- Foreign Exchange Losses (Gains)	--	--	--	--	--
- Net Non-Operating Losses (Gains)	-12.0	-43.9	-42.7	-93.8	-55.0
Pretax Income	1,435.1	2,137.6	2,793.9	3,204.7	4,176.0
- Income Tax Expense (Benefit)	266.4	443.7	17.1	250.3	-1,084.0
Income Before XO Items	1,168.8	1,694.0	2,776.8	2,954.4	5,260.0
- Extraordinary Loss Net of Tax	--	--	-186.0	-3.0	--
- Minority/Non Controlling Interests (Credits)	--	--	--	--	--
Net Income/Net Profit (Losses)	1,168.8	1,694.0	2,590.8	2,951.5	5,260.0
Net Inc Avail to Common Shareholders	1,168.8	1,694.0	2,776.8	2,954.4	5,260.0
Abnormal Losses (Gains)	--	--	-186.0	-3.0	--
Tax Effect on Abnormal Items	--	--	--	--	--
Normalized Income	1,167.6	1,694.0	2,776.8	3,112.0	5,260.0
Basic Earnings per Share	2.3	3.4	5.7	6.1	10.9
Basic Weighted Av g Shares	498.3	493.6	490.6	486.3	481.0
Diluted EPS Before Abnormal Items	2.3	3.4	5.6	6.0	10.8
Diluted EPS Before XO Items	2.3	3.4	5.6	6.0	10.8
Diluted EPS	2.3	3.4	5.2	6.0	10.8
Diluted Weighted Av g Shares	504.3	501.1	497.8	491.6	485.0

Profitability Ratios

12 Months Ending	FY2016 30/11/2016	FY2017 30/11/2017	FY2018 30/11/2018	FY2019 30/11/2019	FY2020 30/11/2020
Returns					
Return on Common Equity	16.20	21.33	31.16	29.70	44.21
Return on Assets	9.57	12.44	16.68	14.95	23.35
Return on Capital	57.72	53.51	44.17	37.38	32.82
Return on Invested Capital	64.81	65.12	51.27	39.79	50.41
Margins					
Operating Margin	25.51	29.69	31.45	29.25	32.93
Incremental Operating Margin	1.35	1.16	1.06	0.93	1.13
Pretax Margin	24.51	29.28	30.94	28.69	32.45
Income before XO Margin	19.96	23.20	30.75	26.45	40.88
Net Income Margin	19.96	23.20	30.75	26.45	40.88
Net Income to Common Margin	19.96	23.20	30.75	26.45	40.88
Additional					
Effective Tax Rate	18.56	20.76	0.61	7.81	-25.96
Divid Payout Ratio	0.00	-	-	-	-
Sustainable Growth Rate	16.20	-	-	-	-

Credit Ratios

12 Months Ending	FY2016 30/11/2016	FY2017 30/11/2017	FY2018 30/11/2018	FY2019 30/11/2019	FY2020 30/11/2020
Total Debt/EBIT	1.27	0.87	1.45	1.20	0.97
Net Debt/EBIT	-1.92	-1.82	0.31	-0.01	-0.44
EBIT to Interest Expense	21.18	29.14	31.83	21.87	36.53
Long-Term Debt/Total Assets	14.90	12.94	21.93	4.76	16.95
Net Debt/Equity	-0.39	-0.47	0.09	0.00	-0.14

Source: Refinitiv

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