ADOBE SYSTEMS INC
Form 10-Q
October 08, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 3, 2010

or

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

For the transition period from to

Commission File Number: 0-15175

ADOBE SYSTEMS INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware	77-0019522
(State or other jurisdiction of incorporation or organization)	(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)

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 x No o

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 x No o

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

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

The number of shares outstanding of the registrant's common stock as of October 1, 2010 was 508,716,666.

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)

	September 3, 2010	November 27, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$814,149	$999,487
Short-term investments	1,764,125	904,986
Trade receivables, net of allowances for doubtful accounts of $13,701 and $15,225, respectively	484,550	410,879
Deferred income taxes	76,765	77,417
Prepaid expenses and other current assets	96,826	80,855
Total current assets	3,236,415	2,473,624
Property and equipment, net	422,920	388,132
Goodwill	3,489,938	3,494,589
Purchased and other intangibles, net	413,091	527,388
Investment in lease receivable	207,239	207,239
Other assets	177,426	191,265
Total assets	$7,947,029	$7,282,237
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Trade payables	$56,465	$58,904
Accrued expenses	468,477	419,646
Captial lease obligations, current	8,698	—
Accrued restructuring	9,222	37,793
Income taxes payable	48,413	46,634
Deferred revenue	375,927	281,576
Total current liabilities	967,202	844,553
Long-term liabilities:		
Debt and captial lease obligations, non-current	1,515,752	1,000,000
Deferred revenue	44,988	36,717
Accrued restructuring	7,831	6,921
Income taxes payable	221,736	223,528
Deferred income taxes	73,108	252,486
Other liabilities	31,554	27,464
Total liabilities	2,862,171	2,391,669
Stockholders' equity:		

Preferred stock, $0.0001 par value; 2,000 shares authorized, none issued	—	—
Common stock, $0.0001 par value; 900,000 shares authorized; 600,834 shares issued; 513,057 and 522,657 shares outstanding, respectively	61	61
Additional paid-in-capital	2,425,083	2,390,061
Retained earnings	5,738,864	5,299,914
Accumulated other comprehensive income	21,571	24,446
Treasury stock, at cost (87,777 and 78,177 shares, respectively), net of reissuances	(3,100,721)	(2,823,914)
Total stockholders’ equity	5,084,858	4,890,568
Total liabilities and stockholders’ equity	$7,947,029	$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		Nine Months Ended	
	September 3, 2010	August 28, 2009	September 3, 2010	August 28, 2009
Revenue:				
Products	$829,096	$636,546	$2,328,294	$2,014,392
Subscription	98,632	13,319	286,418	37,727
Services and support	62,591	47,642	177,342	136,451
Total revenue	990,319	697,507	2,792,054	2,188,570
Cost of revenue:				
Products	29,147	40,754	92,302	139,867
Subscription	50,483	8,611	146,408	24,174
Services and support	19,454	15,682	57,575	50,367
Total cost of revenue	99,084	65,047	296,285	214,408
Gross profit	891,235	632,460	2,495,769	1,974,162
Operating expenses:				
Research and development	168,296	138,902	509,954	427,289
Sales and marketing	303,219	231,320	921,489	724,020
General and administrative	102,177	79,593	283,176	224,462
Restructuring charges	(2,090)	65	21,073	15,866
Amortization of purchased intangibles	17,620	14,978	53,946	45,654
Total operating expenses	589,222	464,858	1,789,638	1,437,291
Operating income	302,013	167,602	706,131	536,871
Non-operating income (expense):				
Interest and other income (expense), net	7,607	6,667	1,905	24,753
Interest expense	(16,395)	(460)	(40,166)	(1,872)
Investment gains (losses), net	3,527	607	(10,730)	(18,444)
Total non-operating income (expense), net	(5,261)	6,814	(48,991)	4,437
Income before income taxes	296,752	174,416	657,140	541,308
Provision for income taxes	66,687	38,371	151,310	122,757
Net income	$230,065	$136,045	$505,830	$418,551
Basic net income per share	$0.44	$0.26	$0.97	$0.79
Shares used to compute basic net income per share	518,710	525,911	523,039	528,015
Diluted net income per share	$0.44	$0.26	$0.95	$0.79
Shares used to compute diluted net income per share	523,179	531,809	530,356	532,846

See accompanying Notes to Condensed Consolidated Financial Statements.

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ADOBE SYSTEMS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended September 3, 2010	August 28, 2009
Cash flows from operating activities:		
Net income	$505,830	$418,551
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	216,641	197,386
Stock-based compensation	174,245	126,231
Deferred income taxes	(176,882)	22,671
Unrealized losses on investments	8,766	13,308
Tax benefit from employee stock option plans	37,987	2,711
Other non-cash items	2,054	8,948
Excess tax benefits from stock-based compensation	(10,172)	(84)
Changes in operating assets and liabilities, net of acquired assets and assumed liabilities:		
Trade receivables, net	(74,722)	182,377
Prepaid expenses and other current assets	(11,953)	15,663
Trade payables	(2,439)	(7,424)
Accrued expenses	52,100	(44,351)
Accrued restructuring	(26,294)	(27,527)
Income taxes payable	3,445	12,619
Deferred revenue	103,758	(57,126)
Net cash provided by operating activities	802,364	863,953
Cash flows from investing activities:		
Purchases of short-term investments	(1,999,341)	(1,142,015)
Maturities of short-term investments	512,534	333,219
Proceeds from sales of short-term investments	629,673	504,958
Purchases of property and equipment	(114,215)	(84,659)
Proceeds from sale of property and equipment	32,151	—
Purchases of long-term investments and other assets	(22,876)	(24,891)
Proceeds from sale of long-term investments	3,586	4,909
Other	2,198	3,271
Net cash used for investing activities	(956,290)	(405,208)
Cash flows from financing activities:		
Purchases of treasury stock	(650,020)	(350,013)
Proceeds from issuance of treasury stock	129,640	122,219
Excess tax benefits from stock-based compensation	10,172	84
Proceeds from debt	1,493,439	—
Repayment of debt and captial lease obligations	(1,001,559)	—
Debt issuance costs	(10,662)	—
Net cash used for financing activities	(28,990)	(227,710)

Effect of foreign currency exchange rates on cash and cash equivalents	(2,422)	14,659
Net (decrease) increase in cash and cash equivalents	(185,338)	245,694
Cash and cash equivalents at beginning of period	999,487	886,450
Cash and cash equivalents at end of period	$814,149	$1,132,144
Supplemental disclosures:		
Cash paid for income taxes, net of refunds	$286,271	$78,635
Cash paid for interest	$34,135	$1,941
Non-cash investing activities:		
Property and equipment acquired under capital leases	$32,151	$—

See accompanying Notes to Condensed Consolidated Financial Statements.

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 nine months ended September 3, 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.

Significant Accounting Policies

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 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 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.

ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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 nine months ended September 3, 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 nine months ended September 3, 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 nine months ended September 3, 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 expanding disclosures about fair value measurements by adding disclosures about the different classes of assets and liabilities measured at fair value, the valuation techniques and inputs used, the activity in Level 3 fair value measurements and the transfers between Levels 1, 2 and 3. 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 activity in 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.

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 nine months ended September 3, 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 material impact to our current consolidated financial statements as we did not have any business combinations close during the three and nine months ended September 3, 2010.

NOTE 2. ACQUISITIONS

Omniture, Inc.

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 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 first half of fiscal 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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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table presents the results of Adobe and Omniture for the three and nine months ended August 28, 2009, on a pro forma basis, as though the companies had been combined as of the beginning of 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.

(in thousands, except per share data)	Three Months Ended August 28, 2009	Nine Months Ended August 28, 2009
Net revenue	$751,602	$2,417,394
Net income	$96,685	$351,213
Basic net income per share	$0.18	$0.67
Shares used to compute basic net income per share	525,911	528,015
Diluted net income per share	$0.18	$0.66
Shares used to compute diluted net income per share	533,284	534,033

Day Software Holding AG

In July 2010, we entered into a definitive agreement with Day Software Holding AG (“Day”). Under the terms of the agreement, we have commenced a public tender offer to acquire all of the publicly held registered shares of Day for 139 Swiss Francs per share in cash in a transaction valued at approximately 254.7 million Swiss Francs on a fully diluted equity-value basis. In order to hedge the economic exposure related to this acquisition, we entered into a forward contract to purchase 254.7 million Swiss Francs for $242.5 million U.S. dollars maturing near the expected closing date of the acquisition. The market value of this forward contract was $8.1 million U.S. dollars as of September 3, 2010 and is included in other assets on our Condensed Consolidated Balance Sheets, with changes in the market value of $8.1 million recorded to interest and other income (expense), net on our Condensed Consolidated Statements of Income. Upon maturity of the forward contract, any remaining changes in the market value will be recorded to interest and other income (expense), net. This forward contract is accounted for as a separate transaction apart from the acquisition.

Day is a provider of web content management solutions that leading global enterprises rely on for Web 2.0 content application and content infrastructure, based in Basel, Switzerland and Boston, Massachusetts. We believe that our acquisition of Day will provide comprehensive solutions to create, manage, deliver and optimize content. The transaction is subject to customary closing conditions and is expected to close in the fourth quarter of our fiscal 2010. Following the closing, we intend to integrate Day as a product line within our Enterprise segment for financial reporting purposes.

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.

ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Cash, cash equivalents and short-term investments consisted of the following as of September 3, 2010 (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Current assets:				
Cash	$93,170	$—	$—	$93,170
Cash equivalents:				
Money market mutual funds	597,801	—	—	597,801
Time deposits	57,238	—	—	57,238
U.S. agency securities	19,599	1	—	19,600
Corporate bonds	46,340	—	—	46,340
Total cash equivalents	720,978	1	—	720,979
Total cash and cash equivalents	814,148	1	—	814,149
Short-term fixed income securities:				
U.S. Treasury securities	401,173	3,155	(8)	404,320
U.S. agency securities	339,476	1,088	(35)	340,529
Municipal securities	120,904	46	(29)	120,921
Corporate bonds	808,745	8,720	(252)	817,213
Foreign government securities	65,475	633	(2)	66,106
Subtotal	1,735,773	13,642	(326)	1,749,089
Marketable equity securities	10,950	4,086	—	15,036
Total short-term investments	1,746,723	17,728	(326)	1,764,125
Total cash, cash equivalents and short-term investments	$2,560,871	$17,729	$(326)	$2,578,274

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 securities:				
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.

ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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 September 3, 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	$89,272	$(43)	$11,179	$(1)
Corporate bonds	117,257	(252)	5,041	(1)
Foreign government securities	4,335	(2)	—	—
Municipal securities	31,092	(29)	—	—
Total	$241,956	$(326)	$16,220	$(2)

As of September 3, 2010 and November 27, 2009, there were no securities in a continuous unrealized loss position for more than twelve months. There were 76 securities and 4 securities that were in an unrealized loss position at September 3, 2010 and at November 27, 2009, respectively.

The following table summarizes the cost and estimated fair value of short-term fixed income securities classified as short-term investments based on stated maturities as of September 3, 2010 (in thousands):

	Amortized Cost	Estimated Fair Value
Due within one year	$854,720	$856,275
Due within two years	472,194	477,545
Due within three years	336,531	340,439
Due after three years	72,328	74,830
Total	$1,735,773	$1,749,089

As of September 3, 2010, we did not consider any of our investments to be other-than-temporarily impaired.

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. There have been no transfers between fair value measurement levels during the three months ended September 3, 2010.

The fair value of our financial assets and liabilities at September 3, 2010 was determined using the following inputs (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)
Assets:				
Cash equivalents:				
Money market mutual funds	$597,801	$ 597,801	$ —	$ —
Time deposits	57,238	57,238	—	—
U.S. agency securities	19,600	—	19,600	—
Corporate bonds	46,340	—	46,340	—
Short-term investments:				
U.S. Treasury securities	404,320	—	404,320	—
U. S. agency securities	340,529	—	340,529	—
Municipal securities	120,921	—	120,921	—
Corporate bonds	817,213	—	817,213	—
Foreign government securities	66,106	—	66,106	—
Marketable equity securities	15,036	15,036	—	—
Prepaid expenses and other current assets:				
Foreign currency derivatives	18,290	—	18,290	—
Other assets:				
Investments of limited partnership	26,793	—	—	26,793
Deferred compensation plan assets	9,873	614	9,259	—
Total assets	$2,540,060	$ 670,689	$ 1,842,578	$ 26,793
Liabilities:				
Accrued expenses:				
Foreign currency derivatives	$1,680	$ —	$ 1,680	$ —
Total liabilities	$1,680	$ —	$ 1,680	$ —

ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The fair value of our financial assets and liabilities at November 27, 2009 was determined using the following inputs (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)
Assets:				
Cash equivalents:				
Money market mutual funds	$884,240	$ 884,240	$ —	$ —
Time deposits	40,137	40,137	—	—
Short-term investments:				
U.S. Treasury securities	376,378	—	376,378	—
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	5,027	5,027	—	—
Prepaid expenses and other current assets:				
Foreign currency derivatives	4,307	—	4,307	—
Other assets:				
Investments of limited partnership	37,121	—	—	37,121
Deferred compensation plan assets	9,045	717	8,328	—
Total assets	$1,879,836	$ 930,121	$ 912,594	$ 37,121
Liabilities:				
Accrued expenses:				
Foreign currency derivatives	$1,589	$ —	$ 1,589	$ —
Total liabilities	$1,589	$ —	$ 1,589	$ —

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 issuers 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 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

A reconciliation of the beginning and ending balances for investments of limited partnership using significant unobservable inputs (Level 3) as of September 3, 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	(2,599)
Unrealized net investment losses included in earnings	(7,729)
Balance as of September 3, 2010	$26,793

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 nine months ended September 3, 2010, we determined that certain of our direct cost method investments were other-than-temporarily impaired which resulted in charges of $1.9 million and $2.3 million, respectively, which were 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 from 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 (expense), 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 (expense), net on our Condensed Consolidated Statements 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.

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 to 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

ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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 September 3, 2010 and November 27, 2009 was $18.3 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 $1.7 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 September 3, 2010 and November 27, 2009 were as follows (in thousands):

	2010		2009	
	Fair Value Asset Derivatives(1)	Fair Value Liability Derivatives(2)	Fair Value Asset Derivatives(1)	Fair Value Liability Derivatives(2)
Derivatives designated as hedging instruments:				
Foreign exchange option contracts(3)	$9,439	$—	$4,175	$—
Derivatives not designated as hedging instruments:				
Foreign exchange forward contracts	8,851	1,680	132	1,589
Total derivatives	$18,290	$1,680	$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 nine months ended September 3, 2010 was as follows (in thousands):

	Three Months		Nine Months	
	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)	$15,208	$—	$23,580	$—

Net gain (loss) reclassified from accumulated OCI into income, net of tax(2)	$13,223	$—	$19,428	$—
Net gain (loss) recognized in income(3)	$(8,383)	$—	$(18,149)	$—
Derivatives not designated as hedging relationships:				
Net gain (loss) recognized in income(4)	$—	$(5,627)	$—	$16,174

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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 nine months ended August 28, 2009 was as follows (in thousands):

	Three Months		Nine Months	
	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)	$(329)	$—	$(14,516)	$—
Net gain (loss) reclassified from accumulated OCI into income, net of tax(2)	$749	$—	$27,138	$—
Net gain (loss) recognized in income(3)	$(3,734)	$—	$(12,782)	$—
Derivatives not designated as hedging relationships:				
Net gain (loss) recognized in income(4)	$—	$(1,650)	$—	$(10,200)

(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 (expense), net.

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

NOTE 6. GOODWILL AND PURCHASED AND OTHER INTANGIBLES

Goodwill as of September 3, 2010 and November 27, 2009 was $3.490 billion and $3.495 billion, respectively. The change includes adjustments to our Omniture purchase price allocation through the second quarter of fiscal 2010 and foreign currency translation adjustments. We also recorded adjustments for restructuring and tax deductions from acquired stock options associated with our Omniture and Macromedia acquisitions.

Purchased and other intangible assets subject to amortization as of September 3, 2010 and November 27, 2009 were as follows (in thousands):

	2010			2009		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Purchased technology	$219,843	$ (51,709)	$ 168,134	$586,952	$ (387,731)	$ 199,221
Localization	$16,090	$ (10,343)	$ 5,747	$20,284	$ (15,222)	$ 5,062

Trademarks	172,015	(128,599)	43,416	172,030	(104,953)	67,077
Customer contracts and relationships	364,231	(187,457)	176,774	363,922	(159,450)	204,472
Other intangibles	46,421	(27,401)	19,020	54,535	(2,979)	51,556
Total other intangible assets	$598,757	$ (353,800)	$ 244,957	$610,771	$ (282,604)	$ 328,167
Purchased and other intangible assets	$818,600	$ (405,509)	$ 413,091	$1,197,723	$ (670,335)	$ 527,388

During the first half of fiscal 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 $38.5 million and $117.6 million for the three and nine months ended September 3, 2010, respectively. Comparatively, amortization expense was $34.4 million and $109.7 million for the three and nine months ended August 28, 2009, respectively. Of these amounts, $21.0 million and $63.6 million were included in cost of sales for the three and nine months ended September 3, 2010, respectively, and $19.4 million and $64.1 million were included in cost of sales for the three and nine months ended August 28, 2009, respectively.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

As of September 3, 2010, we expect amortization expense in future periods to be as follows (in thousands):

Fiscal Year	Purchased Technology	Other Intangible Assets
Remainder of 2010	$8,813	$24,624
2011	31,870	50,740
2012	30,263	22,385
2013	26,403	21,686
2014	24,983	21,286
Thereafter	45,802	104,236
Total expected amortization expense	$168,134	$244,957

NOTE 7. OTHER ASSETS

Other assets as of September 3, 2010 and November 27, 2009 consisted of the following (in thousands):

	2010	2009
Acquired rights to use technology	$74,719	$84,313
Investments	42,831	63,526
Security and other deposits	10,760	11,692
Prepaid royalties	9,359	12,059
Debt issuance costs	9,901	—
Deferred compensation plan assets	9,873	9,045
Restricted cash	2,452	4,650
Prepaid land lease	13,254	3,209
Prepaid rent	934	1,377
Other	3,343	1,394
Other assets	$177,426	$191,265

Included in investments are our indirect investments through our limited partnership interest in Adobe Ventures of approximately $26.8 million and $37.1 million as of September 3, 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 limited partnership interest in Adobe Ventures terminated on September 30, 2010 and no additional investments will be made. Our maximum capital commitment to Adobe Ventures was $104.6 million, of which approximately $95.7 million was 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 September 3, 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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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Also included in investments are our direct investments in privately-held companies of approximately $16.0 million and $26.4 million as of September 3, 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 September 3, 2010 and November 27, 2009 consisted of the following (in thousands):

	2010	2009
Accrued compensation and benefits	$213,630	$164,352
Sales and marketing allowances	29,587	32,774
Accrued marketing	31,130	28,233
Taxes payable	17,664	11,879
Accrued interest expense	5,642	1,355
Other	170,824	181,053
Accrued expenses	$468,477	$419,646

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

NOTE 9. INCOME TAXES

The gross liability for unrecognized tax benefits at September 3, 2010 was $212.7 million, exclusive of interest and penalties. If the total unrecognized tax benefits at September 3, 2010 were recognized in the future, $195.2 million of unrecognized tax benefits would decrease the effective tax rate, which is net of an estimated $17.4 million federal benefit related to deducting certain payments on future state tax returns.

As of September 3, 2010, the combined amount of accrued interest and penalties related to tax positions taken on our tax returns was approximately $18.5 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 ranging from $0 to approximately $100 million. These amounts could 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 and third quarters of fiscal 2010, $150 million 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 nine months ended September 3, 2010 and August 28, 2009 were as follows:

	Three Months		Nine Months	
	2010	2009	2010	2009
Expected life (in years)	3.8 – 4.1	3.7 – 3.8	3.8 – 5.1	3.0 – 3.8
Volatility	35%	37 – 43%	29 – 36%	37 – 57%
Risk free interest rate	1.04 – 1.30%	1.93 – 2.24%	1.04 – 2.66%	1.16 – 2.24%

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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 nine months ended September 3, 2010 and August 28, 2009 were as follows:

	Three Months		Nine 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	37 – 40%	40%	32 – 40%	40 – 57%
Risk free interest rate	0.22 – 0.63%	0.33 – 1.05%	0.18 – 1.09%	0.27 – 1.05%

Summary of Stock Options

Option activity for the nine months ended September 3, 2010 and the fiscal year ended November 27, 2009 was as follows (in thousands):

	2010	2009
Beginning outstanding balance	41,251	40,704
Granted	3,135	5,758
Exercised	(4,503)	(7,560)
Cancelled	(2,397)	(3,160)
Increase due to acquisition	—	5,509
Ending outstanding balance	37,486	41,251

Information regarding stock options outstanding at September 3, 2010 and August 28, 2009 is summarized below:

	Number of Shares (thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value(*) (millions)
2010				
Options outstanding	37,486	$30.63	3.83	$112.5
Options vested and expected to vest	36,184	$30.69	3.77	$107.4
Options exercisable	27,280	$31.06	3.21	$74.7
2009				
Options outstanding	38,549	$29.75	3.92	$176.9
Options vested and expected to vest	36,986	$29.78	3.84	$168.5
Options exercisable	26,573	$29.21	3.23	$127.8

(*) 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

September 3, 2010 and August 28, 2009 were $29.49 and $31.73, respectively.

Summary of Employee Stock Purchase Plan Shares

Employees purchased 3.3 million shares at an average price of $20.19 and 3.2 million shares at an average price of $19.04 for the nine months ended September 3, 2010 and August 28, 2009, respectively. The intrinsic value of shares purchased during the nine months ended September 3, 2010 and August 28, 2009 was $33.9 million and $21.7 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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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Summary of Restricted Stock Units

Restricted stock unit activity for the nine months ended September 3, 2010 and the fiscal year ended November 27, 2009 was as follows (in thousands):

	2010	2009
Beginning outstanding balance	10,433	4,261
Awarded	6,814	6,176
Released	(2,170)	(1,162)
Forfeited	(1,112)	(401)
Increase due to acquisition	—	1,559
Ending outstanding balance	13,965	10,433

Information regarding restricted stock units outstanding at September 3, 2010 and August 28, 2009 is summarized below:

	Number of Shares (thousands)	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value(*) (millions)
2010			
Restricted stock units outstanding	13,965	1.72	$411.8
Restricted stock units vested and expected to vest	10,959	1.55	$322.9
2009			
Restricted stock units outstanding	6,319	1.70	$200.5
Restricted stock units vested and expected to vest	4,978	1.52	$157.8

(*) 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 September 3, 2010 and August 28, 2009 were $29.49 and $31.73, 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 nine months ended September 3, 2010 (in thousands):

	Shares Granted	Maximum Shares Eligible to Receive
Beginning outstanding balance	—	—
Awarded	263	394
Forfeited	(13)	(19)
Ending outstanding balance	250	375

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(Unaudited)

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 nine months ended September 3, 2010 and the fiscal year ended November 27, 2009 (in thousands):

	2010	2009
Beginning outstanding balance	950	383
Achieved	—	1,022
Released	(350)	(382)
Forfeited	(28)	(73)
Ending outstanding balance	572	950

Information regarding performance shares outstanding at September 3, 2010 and August 28, 2009 is summarized below:

	Number of Shares (thousands)	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value(*) (millions)
2010			
Performance shares outstanding	572	0.84	$16.9
Performance shares vested and expected to vest	508	0.79	$14.8
2009			
Performance shares units outstanding	964	1.30	$30.6
Performance shares vested and expected to vest	801	1.21	$25.3

(*) 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 September 3, 2010 and August 28, 2009 were $29.49 and $31.73, respectively.

Compensation Costs

As of September 3, 2010, there was $365.0 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 2.6 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 September 3, 2010 and August 28, 2009 were as follows (in thousands):

	2010	2009

Income Statement Classifications	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	$264	$ 384	$—	$ —
Cost of revenue—services and support	147	278	437	190
Research and development	6,792	11,224	11,922	6,338
Sales and marketing	7,820	13,189	9,100	4,730
General and administrative	4,134	5,436	4,938	2,087
Total	$19,157	$ 30,511	$26,397	$ 13,345

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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 nine months ended September 3, 2010 and August 28, 2009 were as follows (in thousands):

Income Statement Classifications	2010 Option Grants and Stock Purchase Rights	Restricted Stock and Performance Share Awards	2009 Option Grants and Stock Purchase Rights	Restricted Stock and Performance Share Awards
Cost of revenue—subscription	$944	$ 988	$—	$ —
Cost of revenue—services and support	832	876	1,595	527
Research and development	29,717	38,574	35,317	21,271
Sales and marketing	31,340	38,346	27,681	14,565
General and administrative	15,380	17,248	19,220	6,962
Total	$78,213	$ 96,032	$83,813	$ 43,325

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 half of fiscal 2010, we continued to implement restructuring activities under this program. We vacated approximately 48,000 square feet of sales and or research and development facilities in Australia, Canada, Denmark and the U.S. We accrued $6.5 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 7% 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 $10.8 million. We also recorded charges of $17.6 million in termination benefits for the elimination of approximately 245 full-time positions which represents substantially all of the remaining full-time positions expected to be terminated worldwide.

In the third quarter of fiscal 2010, we recorded net adjustments of approximately $2.1 million to reflect net decreases in previously recorded estimates for termination benefits and facilities-related liabilities. Total costs incurred to date and expected to be incurred for closing redundant facilities are $6.7 million and $13.3 million, respectively.

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.

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

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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 $8.9 million, respectively. We also recorded additional charges of $6.7 million in 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. Total costs incurred for termination benefits and contract terminations were $27.0 million and $3.2 million, respectively, and all actions were completed during fiscal 2007.

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 nine months ended September 3, 2010 (in thousands):

	November 27, 2009	Costs Incurred	Cash Payments	Other Adjustments	September 3, 2010
Fiscal 2009 Plan:					
Termination benefits	$22,984	$17,683	$(35,416)	$(3,813)	$1,438
Cost of closing redundant facilities	—	6,586	(446)	145	6,285
Omniture Plan:					
Termination benefits	6,712	—	(5,654)	(609)	449
Cost of closing redundant facilities	5,324	—	(1,863)	187	3,648
Contract termination	242	—	(184)	102	160
Fiscal 2008 Plan:					
Termination benefits	1,057	—	(212)	(279)	566
	3,382	—	(836)	(72)	2,474

Cost of closing redundant facilities					
Macromedia Plan:					
Cost of closing redundant facilities	5,006	—	(2,569)	(410)	2,027
Other	8	—	(2)	—	6
Total restructuring plans	$44,715	$24,269	$(47,182)	$(4,749)	$17,053

Accrued restructuring charges of approximately $17.0 million at September 3, 2010 includes $9.2 million recorded in accrued restructuring, current and $7.8 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 80% will be paid through 2013.

Included in the other adjustments column are $(3.2) million related to changes in previous estimates, $(1.1) million related to foreign currency translation adjustments and $(0.4) million in adjustments to goodwill associated with our acquisitions.

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NOTE 12. STOCKHOLDERS' EQUITY

Retained Earnings

The changes in retained earnings for the nine months ended September 3, 2010 were as follows (in thousands):

Balance as of November 27, 2009	$5,299,914
Net income	505,830
Re-issuance of treasury stock	(66,880)
Balance as of September 3, 2010	$5,738,864

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 nine months ended September 3, 2010 and August 28, 2009 (in thousands):

	Three Months		Nine Months	
	2010	2009	2010	2009
Net income	$230,065	$136,045	$505,830	$418,551
Other comprehensive income (loss):				
Available-for-sale securities:				
Unrealized gains on available-for-sale securities	3,263	278	2,717	1,856
Reclassification adjustment for gains on available-for-sale securities recognized during the period	(605)	(2,449)	(1,308)	(5,026)
Subtotal available-for-sale securities	2,658	(2,171)	1,409	(3,170)
Derivatives designated as hedging instruments:				
Unrealized (losses) gains on derivative instruments	(15,208)	(329)	23,580	(14,516)
Reclassification adjustment for gains on derivative instruments recognized during the period	(13,223)	(749)	(19,428)	(27,138)
Subtotal derivatives designated as hedging instruments	(28,431)	(1,078)	4,152	(41,654)
Foreign currency translation adjustments	7,349	(2,333)	(8,436)	9,330
Other comprehensive income (loss)	(18,424)	(5,582)	(2,875)	(35,494)
Total comprehensive income, net of taxes	$211,641	$130,463	$502,955	$383,057

The following table sets forth the components of accumulated other comprehensive income, net of related taxes, as of September 3, 2010 and November 27, 2009 (in thousands):

	2010	2009
Net unrealized gains on available-for-sale securities:		
Unrealized gains on available-for-sale securities	$15,551	$13,818
Unrealized losses on available-for-sale securities	(326)	(2)
Total net unrealized gains on available-for-sale securities	15,225	13,816
Net unrealized gains (losses) on derivative instruments	4,146	(5)
Cumulative foreign currency translation adjustments	2,200	10,635
Total accumulated other comprehensive income, net of taxes	$21,571	$24,446

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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 third quarter of fiscal 2010, 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. This amended program did not affect the $250.0 million structured stock repurchase agreement entered into during March 2010. As of September 3, 2010, no prepayments remain under that agreement.

During the nine months ended September 3, 2010 and August 28, 2009, we entered into several structured stock repurchase agreements with large financial institutions, whereupon we provided the financial institutions with prepayments of $650.0 million and $350.0 million, respectively. Of the $650.0 million of prepayments in the nine months ended September 3, 2010, $250.0 million was under the stock repurchase program prior to the program amendment and the remaining $400.0 million was under the amended $1.6 billion time-constrained dollar-based authority. We entered into these agreements 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. 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 nine months ended September 3, 2010, we repurchased approximately 19.0 million shares at an average price of $30.32 through structured repurchase agreements entered into during fiscal 2009 and fiscal 2010. During the nine months ended August 28, 2009, we repurchased approximately 9.9 million shares at an average price of $25.31 through structured repurchase agreements, which included prepayments from fiscal 2008 and fiscal 2009.

As of September 3, 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 shares used to compute basic and diluted net income per share. As of September 3, 2010 and August 28, 2009, approximately $132.9 million and $233.9 million, respectively, of up-front payments remained under these agreements.

Subsequent to September 3, 2010, as part of our $1.6 billion stock repurchase program, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of $200.0 million. This amount will be classified as treasury stock on our Condensed Consolidated Balance Sheets. Upon completion of the $200.0 million stock repurchase agreement, $1.0 billion now remains under our time-constrained dollar-based authority. See Note 18 for further discussion of our stock repurchase program.

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 nine months ended September 3, 2010 and August 28, 2009 (in thousands, except per share data):

	Three Months		Nine Months	
	2010	2009	2010	2009
Net income	$230,065	$136,045	$505,830	$418,551
Shares used to compute basic net income per share	518,710	525,911	523,039	528,015
Dilutive potential common shares:				
Unvested restricted stock and performance share awards	2,022	1,940	3,037	1,696
Stock options	2,447	3,958	4,280	3,135
Shares used to compute diluted net income per share	523,179	531,809	530,356	532,846
Basic net income per share	$0.44	$0.26	$0.97	$0.79
Diluted net income per share	$0.44	$0.26	$0.95	$0.79

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For the three and nine months ended September 3, 2010, options to purchase approximately 28.1 million and 18.8 million shares, respectively, of common stock with exercise prices greater than the average fair market value of our stock of $28.97 and $32.82, respectively, were not included in the calculation because the effect would have been anti-dilutive. Comparatively, for the three and nine months ended August 28, 2009, options to purchase approximately 24.5 million and 30.6 million shares, respectively, of common stock with exercise prices greater than the average fair market value of our stock of $30.40 and $24.99, 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 equity balance 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 September 3, 2010, we were in compliance with all of the 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 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.

In June 2010, we entered into a sale-leaseback agreement to sell equipment totaling $32.2 million and leaseback the same equipment over a period of 43 months. This transaction was classified as a capital lease obligation and recorded at fair value. See Note 15 for further discussion of our capital lease obligation.

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The following are our future minimum lease payments under our non-cancellable capital leases for each of the next five years and thereafter as of September 3, 2010 (in thousands):

Fiscal Year	Capital Lease Obligation
Remainder of 2010	$1,666
2011	9,936
2012	9,925
2013	9,925
2014	1,654
Gross lease commitment	$33,106
Less: interest	(2,466)
Net lease commitment	$30,640

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 September 3, 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 $0.9 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.

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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 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. A hearing on this motion has been scheduled for November 2010. Adobe intends to defend the lawsuits vigorously. As of September 3, 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 September 3, 2010, no amounts have been accrued as a loss is not probable or estimable.

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.

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NOTE 15. DEBT

Our debt as of September 3, 2010 and November 27, 2009 consisted of the following (in thousands):

	2010	2009
Notes	$1,493,810	$—
Credit facility	—	1,000,000
Captial lease obligations	30,640	—
Total debt and captial lease obligations	1,524,450	1,000,000
Less: current portion	8,698	—
Total debt and captial lease obligations, non-current	$1,515,752	$1,000,000

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 $1.5 billion which is net of an issuance discount of $6.6 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. In August 2010, we made our first semi-annual payment of $31.1 million. The proceeds from the Notes are available for general corporate purposes, including repayment of any balance outstanding on our credit facility. Based on quoted market prices, the fair value of the Notes was approximately $1.6 billion as of September 3, 2010.

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 September 3, 2010, we were in compliance with all of 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 approximated fair value. On February 1, 2010, we paid the outstanding balance on our credit facility and the entire $1.0 billion credit line under this facility remains available for borrowing.

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Capital Lease Obligation

In June 2010, weentered into a sale-leaseback agreement to sell equipment totaling $32.2 million and leaseback the same equipment over a period of 43 months. This transaction was classified as a capital lease obligation and recorded at fair value. As of September 3, 2010, our captial lease obligations of $30.6 million includes $8.7 million of current debt.

NOTE 16. NON-OPERATING INCOME (EXPENSE)

Non-operating income (expense) for the three and nine months ended September 3, 2010 and August 28, 2009 included the following (in thousands):

	Three Months		Nine Months	
	2010	2009	2010	2009
Interest and other income (expense), net:				
Interest income	$5,883	$7,616	$15,975	$28,655
Foreign exchange gains (losses)	865	(3,545)	(16,409)	(9,621)
Realized gains on fixed income investment	604	2,449	1,302	5,027
Realized losses on fixed income investment	—	—	—	(1)
Other, net	255	147	1,037	693
Interest and other income (expense), net	$7,607	$6,667	$1,905	$24,753
Interest expense	$(16,395)	$(460)	$(40,166)	$(1,872)
Investment gains (losses), net:				
Realized investment gains	$257	$—	$444	$52
Unrealized investment gains(1)	11,526	2,019	11,526	3,396
Realized investment losses	(6,145)	(1,362		