

Mu Capital Group



[Date]

Adobe Inc.

Adobe is a company that continually adapts to the tech market to stay relevant through acquisitions and user experience. Moreover, with continued positive earnings, Adobe will prosper from the digital transformation market boom in the coming years.

COMPANY OVERVIEW

Adobe was founded in 1982 as an American multinational computer software company. They are known for a variety of products that range from graphics to photography, to animation and multimedia to video picture production. Today, they specialize in digital marketing management software and have millions of users worldwide. Recently, at the end of the 2020 fiscal year, Adobe achieved record annual revenue of \$12.87 billion, a 15% growth rate year-to-year. In their specific sectors in 2020, Digital Experience Segment Revenue grew 19% and their digital experience subscription grew 22%. As to the current period in 2021, Adobe is eyeing \$15B in revenue as through three quarters they have already amassed \$11.69B in revenue.

Period	FY 2020	Q1 2021	Q2 2021	Q3 2021
Revenue Growth (YOY)	15%	26%	23%	22%

Revenue Growth (YOY)	FY 2020	Q1 2021	Q2 2021	Q3 2021
Creative Cloud	19%	31%	24%	21%
Document Cloud	23%	37%	30%	31%
Total digital media	20%	32%	25%	23%

INVESTMENT RATIONALE

Adobe is in a perfect position for Mu Capital to buy for this upcoming year. With a current price sitting around \$590 - \$600 and a target price of just over \$703 come next year, Adobe is looking to ride the wave of the digital transformation boom. Cloud computing software has already taken over the corporate world making business operations more efficient and intuitive. Moreover, a statistic shared from a tech researcher that was cited by an Adobe Peer and

ADBE

Price (15/10/2021)	\$606.43
Market Cap (bn)	\$276.29
EV (bn)	\$274.81
Beta (5Y monthly)	1.03

SaaS

Mean Price Target	\$0.00
% Upside	[0.0%]

24m performance:



Market Data:

52- Week Range	420.78-673.88
Shares Out. (bn)	0.4758
P/E (ttm)	48.07x
PEG (5-yr expected)	2.10
EPS (ttm)	10.83
EPS growth	[0.0]%
Div./Yield	N/A
Payout ratio	0.0%

Profitability:

Profit margin	38.67%
Op margin	36.53%
ROA (ttm)	44.70%
ROE (ttm)	14.20%

Financial Data:

Revenue (bn) (ttm)	15.1
Revenue growth	22%
EBITDA (bn)	6.1
EBITDA growth	24.07%
EBITDA margin	40.4%

Leverage:

Net debt (bn)	4.69
Total debt/equity	32.5x
Current ratio	1.39
Cash ratio	

salesforce.com during its investors day, they predict that no less than \$10 trillion will be spent on initiatives for digital transformation between the years 2019 – 2024. Moreover, they predict that come 2024, 57% of all global IT spending will be on digital transformation compared to 42% this past year in 2020. While Adobe obviously will not absorb all predicted \$10 Trillion, with the third largest market share in the Saas (Software as a Service) industry at 10%, they will have the opportunity to vastly benefit from this boom in initiatives. Pairing this massive opportunity in their industry for growth, Adobe also keeps an extremely clean balance sheet. Adobe is highly profitable and on hand, holds \$2.04 billion in cash and equivalents net of debt on hand. As of earlier September 2021, Adobe had \$4.12 billion of debt on their books offset by their \$6.16 Billion in cash and equivalents.

Although Adobe's growth is incredibly appealing, it wouldn't mean as much if its industry competitors were growing at an equivalent rate. Therefore, take Oracle, an industry peer of Adobe. The chart below dates from August 2021 and puts Adobe's incredible Revenue growth and recovery rates into perspective.

Peer Comparison: Recovery

	◆ Oracle ◆	◆ Adobe ◆
Recovery: Revenue Growth	worse	better
QoQ	11%	14%
Q (yoy)	7.5%	26%
Q (yoy) vs <u>LTM</u>	7.5% vs <u>3.6%</u>	26% vs <u>17%</u>

This proves that Adobe's growth is not only impressive as an individual company, but also in comparison with direct competitors as well.

Long term for Adobe, they benefit vastly from the ubiquitous nature of their software. Although the PDF is now public domain, it receives over 50 million searches each month, PDFs combined with some Adobes other services such as Photoshop, creates a massive network effect of free marketing for Adobe. Social Media has now become the most powerful marketing tool, with the possibility of hundreds of millions of eyes to be on your brand daily. Especially with the emergence of medias such as Tik Tok, in which users can gain millions of followers in just a few days, Adobe having the support and being referenced by popular creators in the photography and creative field is a massive competitive advantage. On top of their frequent free advertising, Adobe has a very easy to adapt to user-friendly interface that makes using their software easy to learn. Moreover, because it is the software of choice of most professional artists alike, aspiring photographers, artists etc. all turn to Adobe as the premier brand to use.

Because Adobe is so widespread in brand recognition—especially for a software company—they can keep their focus and strategy on investing in additional features to continue to better their products and make them more cohesive with one another. Adobe has already implemented features using AI (Artificial Intelligence) as well as Machine learning with Adobe Sensei, as well as preparing for the budding markets of augmented reality and 3D content. These long-term aspirations will ensure that Adobe continues to stay relevant assuming they are able to ride at the forefront of the tech wave as they have. The long-term goal is to drive more growth in new users and average spending per user by upgrading them to higher-priced offerings.

Lastly, through acquisitions (which will also be explained in the growth opportunities section of the report) Adobe has been able to keep competitive by acquiring companies that suit the direction Adobe is branching towards.

In 2018, acquisitions included Marketo, which was a marketing cloud platform company purchased for \$4.73B and Magento which helped develop their ecommerce and was integrated into their digital experience segment purchased for \$1.64B.

In 2019, they acquired the remaining interest in Allegorithmic SAS, which is a privately held 3D editing and authorizing software company for gaming and entertainment for \$106M in cash.

In 2020, Adobe acquired Workfront, which provided work management platforms for marketers for \$1.5B in cash considerations.

Lastly, as recent as August 2021, Adobe announced that they acquired Frame.io for \$1.275B in cash. Frame.io is a video review and collaboration platform with over a million customers. This recent acquisition is a perfect example of Adobe taking the initiative in acquiring relevant companies for budding future markets. Industries such as video editing and production is a market that is sure to explode in the coming years. Now more than ever, there is an incredible percentage of kids that aspire to be online influencers and digital workers that rely on video editing tools that a company such as Adobe supplies.

Number of social network users worldwide from 2017 to 2025

(in billions)



Characteristic	Number of users in billions
2025*	4.41
2024*	4.27
2023*	4.12
2022*	3.96
2021*	3.78
2020	3.6
2019	3.4
2018	3.14
2017	2.86

Most popular social networks worldwide as of July 2021, ranked by number of active users

(in millions)



Characteristic	Number of active users in millions
Facebook	2,853
YouTube	2,291
WhatsApp*	2,000
Instagram	1,386
Facebook Messenger*	1,300
Weixin / WeChat	1,242
TikTok	732
QQ	606
Douyin**	600
Telegram	550
Sina Weibo	530
Snapchat	514
Kuaishou	481

As these two figures above outline, come 2025, social media usage is predicated to be up to 22.5% to 4.41 billion people. With the world growing in population and technological connections, social media will continue to grow and connect people globally. Therefore, one of the main points behind the future of Adobe as an investment rationale, is that their services such as Photoshop is a household name across the world in comparison with companies such as Oracle that is not. If Adobe is able to keep their stronghold on photo/video production and editing, their services and subscriptions will continue to grow and match the increasing number of social media users.

Gartner



Lastly, pictured above is Gartner's Magic Quadrant for Digital Experience Platforms. Adobe was positioned highest for their ability to execute as well as for their completeness of vision. Gartner is an information technology research and consultancy company whose corporate divisions include: research, executive programs, consulting and events. The Magic Quadrant is one of their two main data visualization tools and is revered and respected throughout the business world. The Magic Quadrant is a series of market research reports that Gartner publishes that relies on proprietary qualitative data analysis methods to demonstrate market trends such as direction, maturity and participants.

MARKET POSITION

Adobe operates in the Digital Media, Digital Experience and Publishing markets. Their main competitors across the board are Google, IBM, Oracle, Microsoft, SAP, Autodesk, and Salesforce. In the SaaS Market (Software as a Service) Adobe has the 3rd largest Market share at 10%. Upon first thought, it may seem that a 10% market share is not a dominant hold, however, Microsoft—a company valued over \$2 trillion-- leads the entire SaaS market with just a 17% market share.

MANAGEMENT STRUCTURE

The management team is filled with individuals who have long standing careers within the Adobe organisation. For example, the CEO of Adobe, Shantanu Narayen, has worked with the company since 1998, and has been the CEO of Adobe since 2007. Under his leadership Adobe has achieved record revenue and industry recognition for its inclusive, innovative and exceptional workplace, including being continuously named a Great Place to Work and a Most Admired Company by Fortune. Shantanu has been recognized by several publications as one of the world’s leading executives, including Barron’s World’s Best CEOs and Fortune Businessperson of the Year lists and named a Top CEO by Glassdoor based on employee feedback.

Moreover, as to their CFO and executive VP, John Murphy, during his tenure, Adobe’s market cap has almost tripled to over \$310 billion. While driving a growth agenda for the Company leading to accelerated growth in revenue and earnings, Adobe has invested over \$10 billion to acquire leading technology businesses.

INTEGRITY AND ESG ANALYSIS

Adobe, Inc.

Industry Group: Software & Services

Country: United States

Identifier: NAS:ADBE

ESG Risk Rating

10.8

Low Risk



Ranking

INDUSTRY GROUP

Software & Services

9 out of 929

UNIVERSE

Global Universe

223 out of 14462

Last Update: Oct 7, 2021

As seen by the rating report above Adobe is considered a low risk company ranked 9th / 929 in the Software & Services group.

As to company violations, they have 3 total incidents since 2000. The first violation came in 2006 after a wage and violation dispute and was settled for under 10K. Secondly, in 2016, Adobe had another violation incident that totalled in 1M in fines.

Lastly, in 2015, Adobe was involved in a large scandal that resulted in Adobe paying over 100M. This case involved allegations that high-tech companies conspired not to hire each other's employees, thus suppressing salary levels. Apple, Google, Intel and Adobe Systems together agreed to settle the matter for \$415 million. The settlement did not specify how much each of the companies would pay, but it is assumed the companies equally split the fine.

Lastly, as to the CSR, Adobe has partnered with organizations such as the Red Cross in which they have outstanding donations of up to \$4.5M. Moreover, statistically, Adobe deploys energy that is 4x more renewable, and as to diversity, Adobe was ranked #8 on Forbes best workplaces for diversity in 2019 and as of this past year, their board is comprised of 45% women and people of color.

KEY RISKS

Disruptive technology and changes in customer preferences

If a disruptive technology is widely accepted and is not compatible with solutions provided by Adobe, this could disrupt their operating result and business.

Furthermore, if Adobe is unable to anticipate customers' rapidly changing needs, market share could reduce. An example is more consumers are using tablets and mobile phones instead of personal computers. Adobe offers its services to various hardware platforms; hence if they do not shift their services to mobile phones and tablets fast enough compared to competitors, its customer base and revenue will drop.

Acquisition and partnerships could have an adverse impact.

Suppose Adobe is unable to capitalize on the benefit of an investment or acquisition. In that case, this could lead to numerous risks such as not achieving the companies' financial goals, disruption of ongoing business operations, inability to retain acquired business customers. These factors will contribute to higher costs or a reduction in revenue, lowering net income, increasing investors' pessimism and lower share price. However, Adobe has been acquiring firms that synergize well with their digital media or digital experience sector.

The revenue decline in the Publishing and Advertising sector

The COVID 19 pandemic impacted the Adobe publishing sector, which led to lower revenue generated in this sector in 2020 compared to 2019. However, this sector only contributes to 3% of the company's total revenue and is making a recovery in 2021.

High Valuations

With a P/E ratio of 46.83(ttm) and a PEG of 1.62, the company's share price is relatively high and suggest that the company is considered overvalued. However, this also indicates that investors have high expectations for the company to reach its target price of \$700 per share. In 2020, the company authorized a \$15 billion stock repurchase program, suggesting confidence in share price value.

A full explanation of each risk can be found in 2020 10K report:

<https://www.adobe.com/content/dam/cc/en/investor-relations/pdfs/ADBE-10K-FY20-FINAL.pdf>

OPPORTUNITIES FOR GROWTH

Growth in the Digital media and Digital experience sector through acquisitions

In recent years, Adobe has acquired multiple companies integrated into their digital media and digital experience segment, contributing to the companies 2-figures revenue growth year after year. (Recent Acquisitions has been outlined in the investment rationale) These acquisitions act as a product and market development strategy, allowing the company to market new services to their pre-existing customers and gain new customers from the acquired company, contributing to revenue growth over time. The acquisitions are low risk as they synergize with the core business model and

Growth in the Digital media and Digital experience sector through leveraging technological advancements

An example of this is Adobe Sensei, which improves the design and delivery of digital experiences. Adobe Sensei leverages its massive content and data assets and compiles them into a unified AI and machine learning framework that helps customers discover opportunities and offer more relevant experiences.

Synergy through partnerships with well-known multinational corporations

The company has partnered up with other well-known corporations. The partnership with IBM allows them to provide marketing software for the banking industry. The partnership with Microsoft offers a competitive edge against SalesForce in the Digital Experience segment. Furthermore, Walgreens Booths Alliance allowed the Adobe and Microsoft partnership to help power up the pharmaceutical chain digital transformation.

FINANCIAL EVALUATION



Fiscal Year	2016	2017	2018	2019	2020	Qs	Current (Ex-Qs)
Profitability Ratios							
Return on Equity	16%	20%	28%	28%	40%	41%	
Profit Margin	20%	23%	29%	27%	41%	39%	
Internal Rate of Return							
Asset Turnover	45%	49%	47%	52%	53%	58%	
Profitability	20%	23%	29%	27%	41%	39%	
Leverage	175%	175%	206%	201%	183%	181%	
Liquidity Ratios							
Current Ratio	2.08	2.06	1.13	0.77	1.45	1.39	
Cash Ratio	1.69	1.65	0.75	0.51	1.09	1.00	
Debt Ratios							
Debt to Equity	75%	75%	106%	101%	83%	81%	
Interest Coverage Ratio	31.43	39.36	45.27	28.35	50.68	257.26	
Interest Coverage Ratio Applicable?	YES	YES	YES	YES	YES	YES	
Valuation Ratios							
Earnings Per Share	2.32	3.38	5.20	6.00	10.82	12.27	
Price to Earnings	0.00	0.00	0.00	0.00	0.00	0.00	46.83
PEG	0	0	0	0	0	0	1.62
PEG Including Dividends	0	0	0	0	0	0	1.62
FCF Per Share	3.96	5.46	7.56	8.18	10.92	13.86	-
Price to Free Cash Flow	-	-	-	-	51.89	40.89	51.89
Dividend Per Share	0.00	0.00	0.00	0.00	0.00	0.00	-
Dividend Yield	-	-	-	-	-	-	0.00%

Profitability and past performance

- Revenue growth slowed down in 2020 due to non-core businesses being impacted by COVID 19.
- However, in 2021, revenue growth is expected to be 22% as the company grows its portfolio in both the Digital Experience and Digital Media segment
- High Net income and EPS growth in 2020 due to tax benefits of \$1.38 billion

Liquidity

- Adobe's current ratio and cash ratio improved in 2020, and is now above 1, suggesting an improvement in financial health.

Debt

- Having gone public in 1986, Adobe has strong financial credibility and financial health
- A reduction in debt/equity and an increase in interest coverage ratio indicates that the company can take on more debts to acquire more firms in order to remain competitive.

Valuation and Comparative Analysis

Company Name	Revenue	EBIT	(margin)	Net Income	(margin)	FCF Per Share	EPS	P/E	P/FCF	P/Sales	P/Book	P/EBITDA	EV/Rev	EV/EBITDA
Apple	347,155	103,476	30%	86,802	25%	5.57	5.11	27.89		7	36.72	0.0412734	6.97	21.15
Autodesk	4,040	634	16%	1,314	33%	6.57	5.44	46.17		15.21	45.79	0.0716683	15.33	79.66
Alphabet Inc.	220,265	75,569	34%	62,929	29%	62.36	58.61	30.14		8.61	7.79	1.2829064	7.92	19.71
Salesforce	23,539	1,103	5%	2,352	10%	5.81	2.50	110.38		10.97	4.83	0.1226562	11.63	67.69
Mean	148749.8	45195.5	0.211235	38349.25	0.240225	20.0775	17.915	53.645	#DIV/0!	10.4475	23.7825	0.3796261	10.4625	47.0525
Median	121902	38336	0.2275	32640.5	0.267867	6.19	5.275	38.155	#NUM!	9.79	22.255	0.0971623	9.775	44.42
ADBE INC. (XNAS:ADBE)	15,134	5,551	37%	5,839	39%	13.86	12.27	46.83	40.89	17.82	18.71	0.09	18.29	43.76

ALL FIGURES TTM (LTM).
ALL FIGURES \$USD (in millions).

- Adobe does not have direct comparables as it operates in many different segments, and no single company has offerings that match the capabilities of Adobe creative software.
- Adobe outperforms market peers in most indicators.
- However, Adobe does have a higher P/E ratio than market peers, as mentioned this could be a risk to the investment thesis.

SHAREHOLDER STRUCTURE

- Adobe's free float currently sits at 474.32



Some of the largest shareholders include

- The Vanguard Group, Inc, - 7.60%
- BlackRock – 4.79%
- Fidelity Management and research Co – 4.73%
- SSgA Funds Management – 3.98%