

Desautels Capital Management

Adobe Systems, Inc. (NASDAQ:ADBE)

TMT

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November-22-2018



What Comes to Mind When You Think of Adobe?





Misunderstanding Adobe? - Adobe Systems Overview

Thesis 1 – Business Shift: MarTech

Thesis 2 – Recession-Proof / Quasi-Monopoly

Thesis 3 – Complimentary Products / Cross-Selling

Valuation

Adobe Systems Overview

SECTION I



Misunderstanding Adobe?

Adobe Systems (NASDAQ:ADBE)

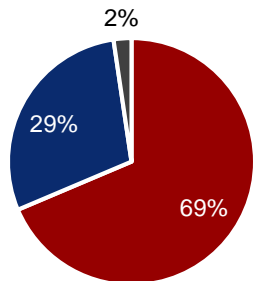
(in \$US millions, unless noted)

Business Overview

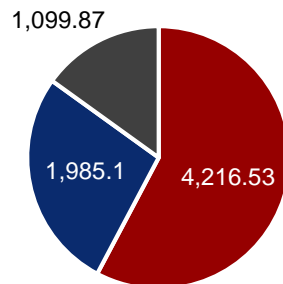
- Adobe Inc. operates in the software subsector
- The company develops programs that focus on print and electronic content creation, management and distribution
- The company's core segments are Digital Media and Digital Marketing
- Some of its biggest products include:
 - Flash
 - Photoshop
 - Illustrator

Revenue Segmentation

Product



Geography

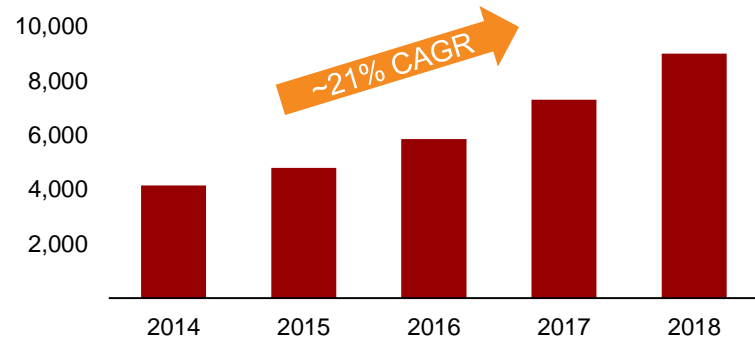


▪ Digital Media ▪ Digital Experience ▪ Publishing ▪ Americas ▪ EMEA ▪ APAC

Financial Summary

Current Market Valuation	
Share Price	\$218.72
Shares Outstanding	488.1M
Market Cap	\$110.3B
+ Total Debt	\$1,885.0
+ Minority Interest	0.,0
+ Preferred Shares	0.0
- Cash	\$4,847.10
Enterprise Value	\$107.3B

Revenue Growth (FY2014-FY2018E)



Adobe has an extensive history in the Digital Media space, but is lesser known for its Digital Marketing products

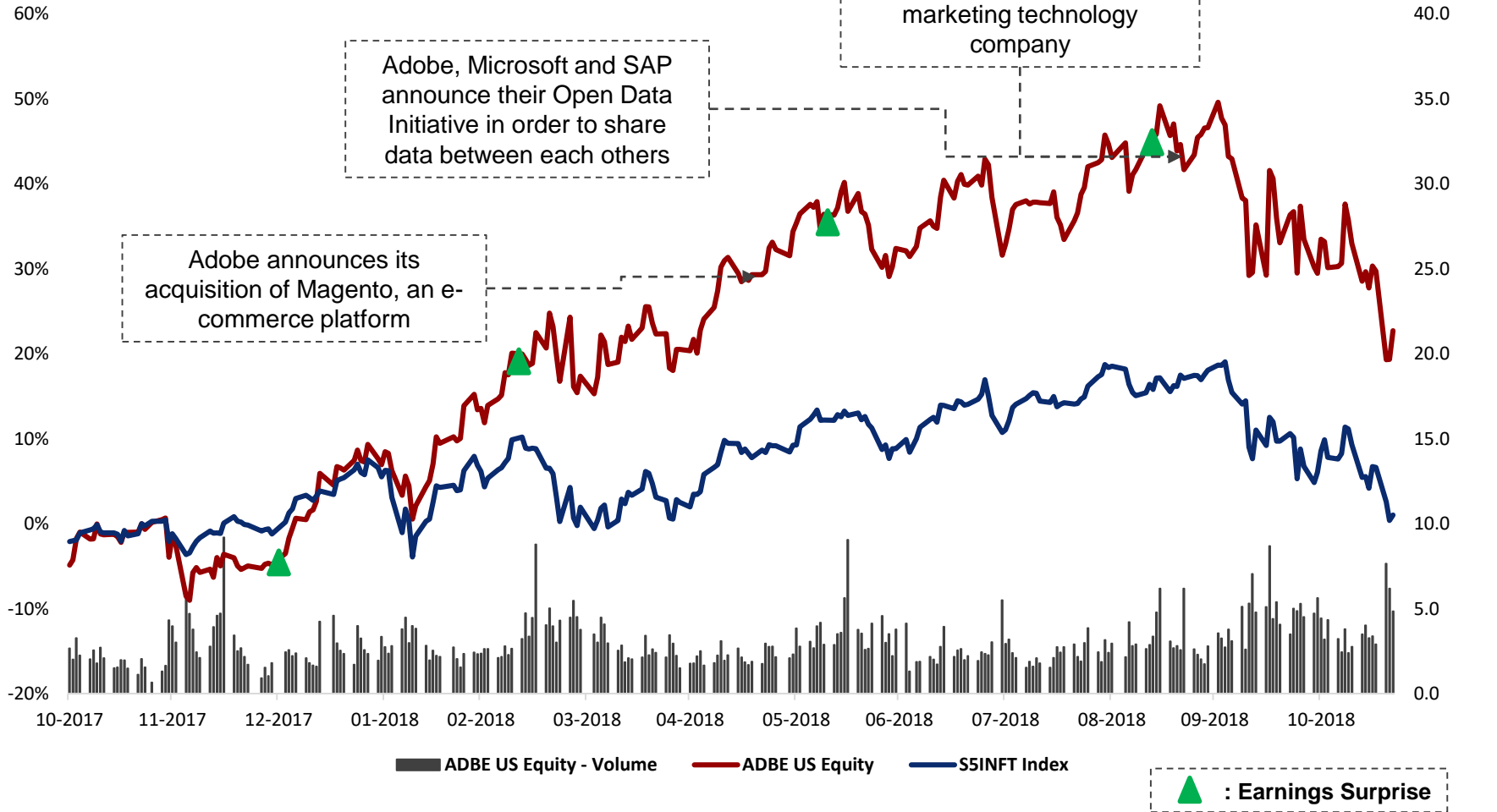
Source: Bloomberg. CapIQ 11/20/2018

Stock Price Chart



Adobe's stock price is up 20.3% over the last 12 months

Performance

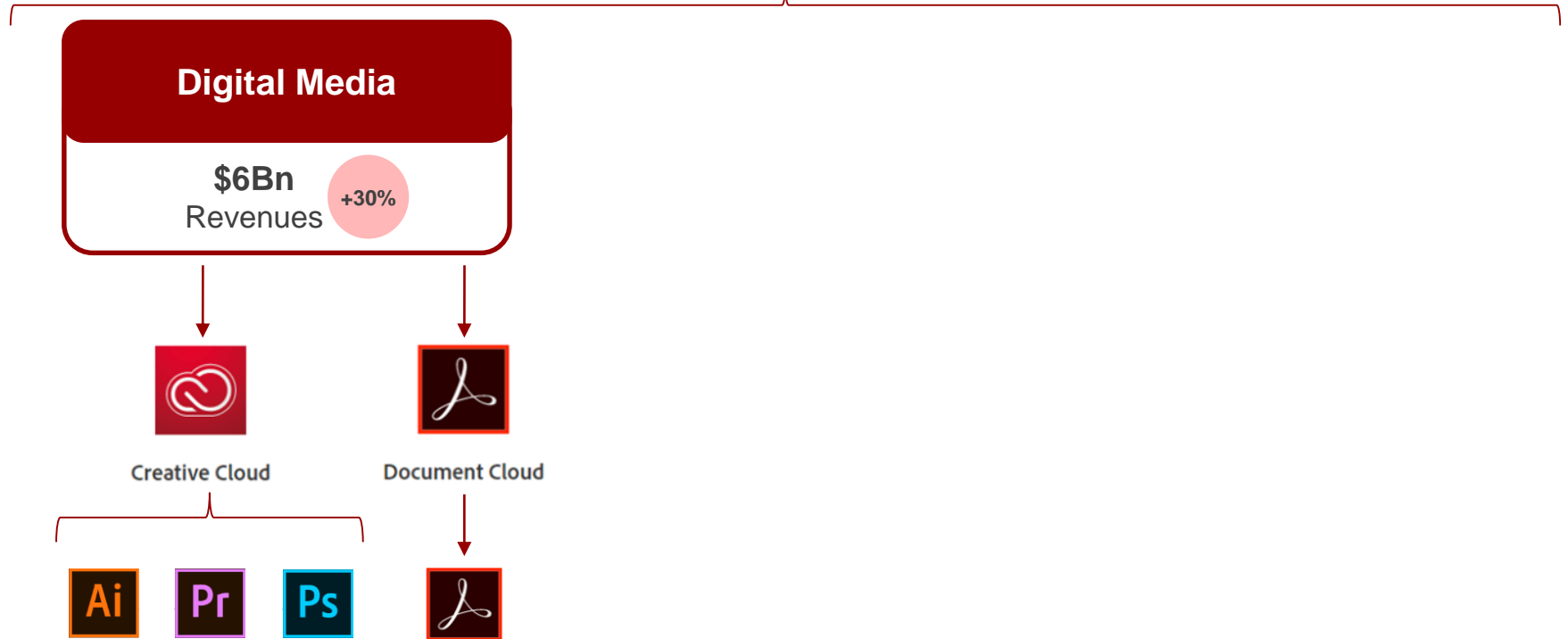


Adobe has significantly outperformed the information technology index, but has also been affected by the tech sell-off in the past months

Source: Bloomberg, CapIQ

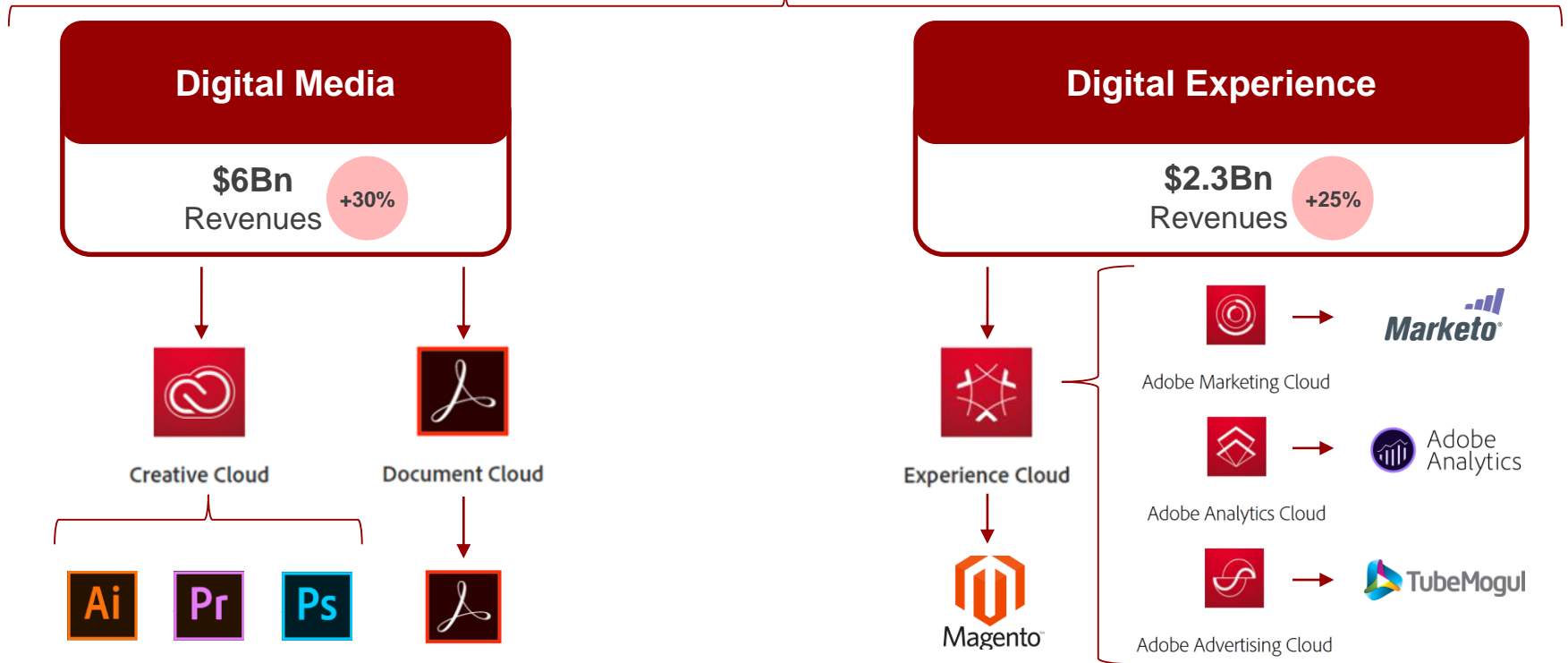
See Below, pls. Thx.

Revenue Streams



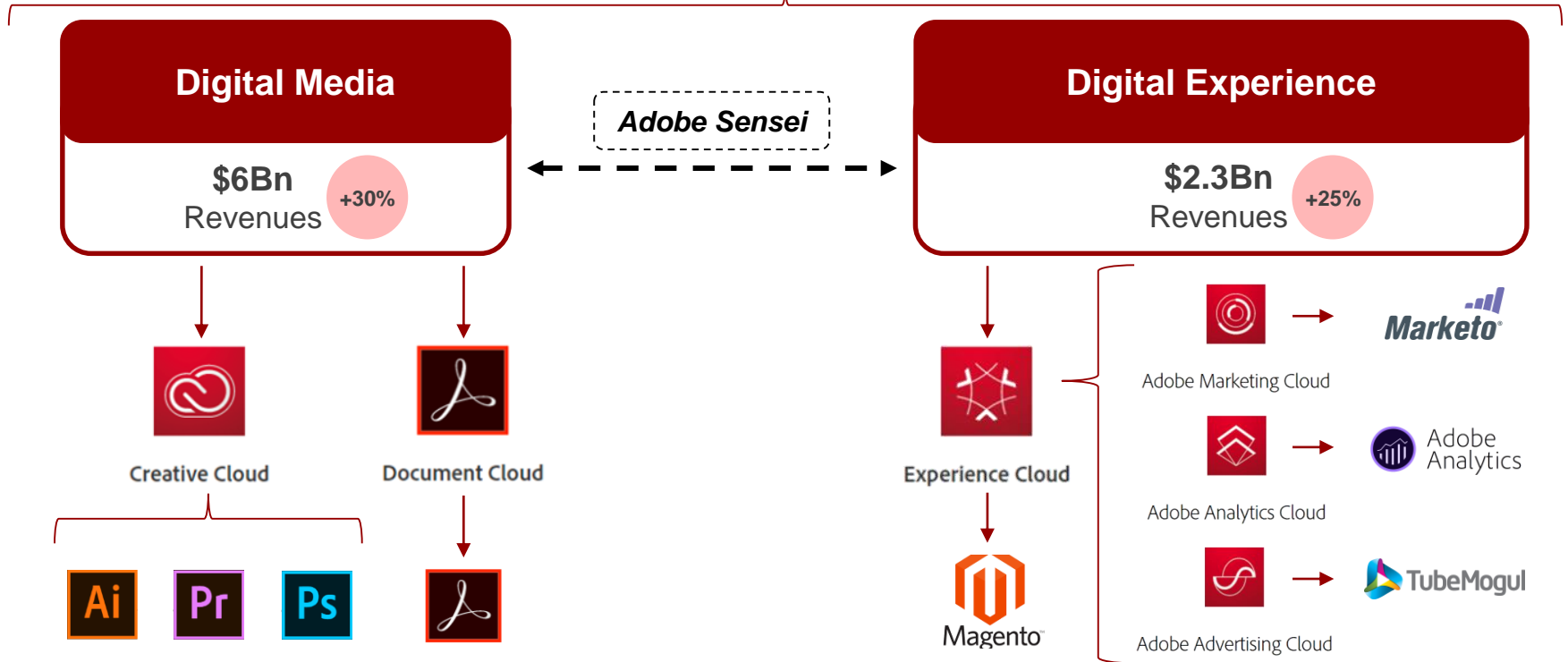
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Revenue Streams



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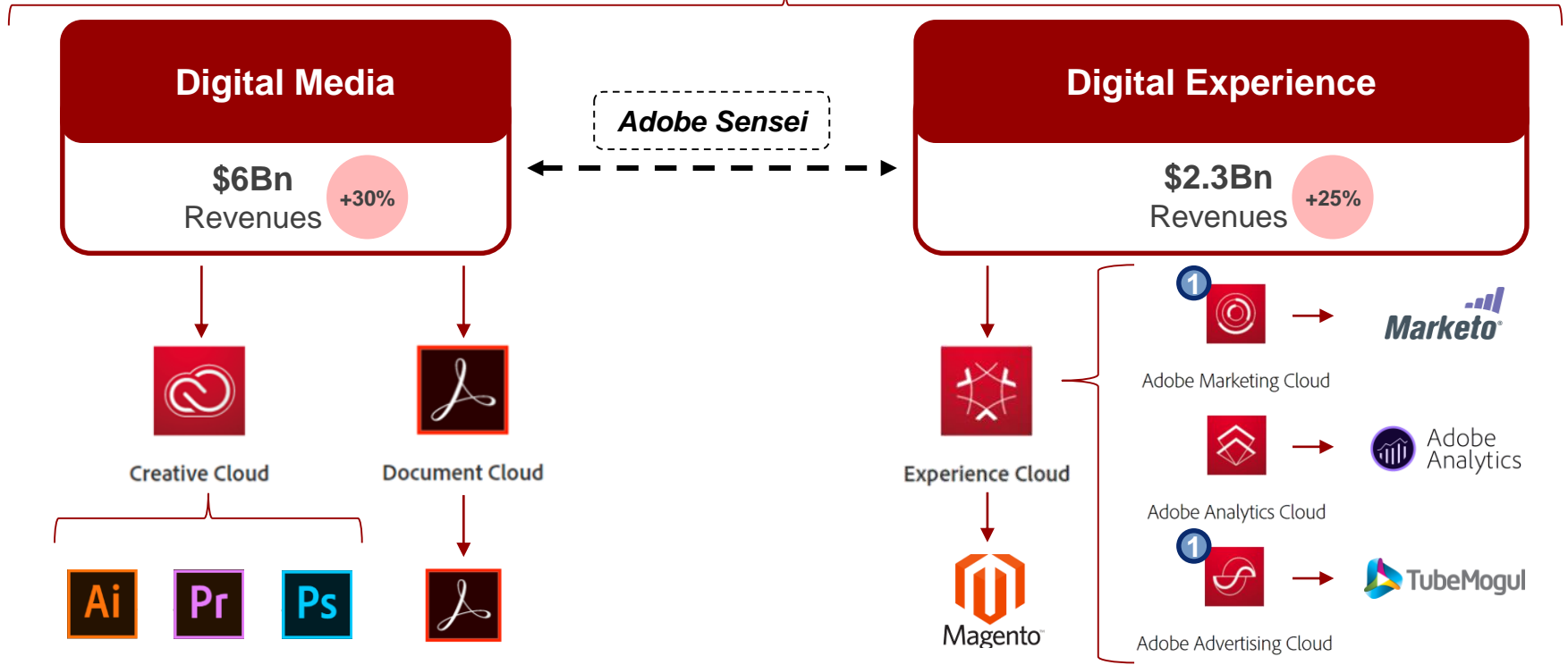
Revenue Streams



Industry-leading artificial intelligence platform that uses predictive analytics to help tailor a bespoke customer experience, leveraging data collected from both revenue streams

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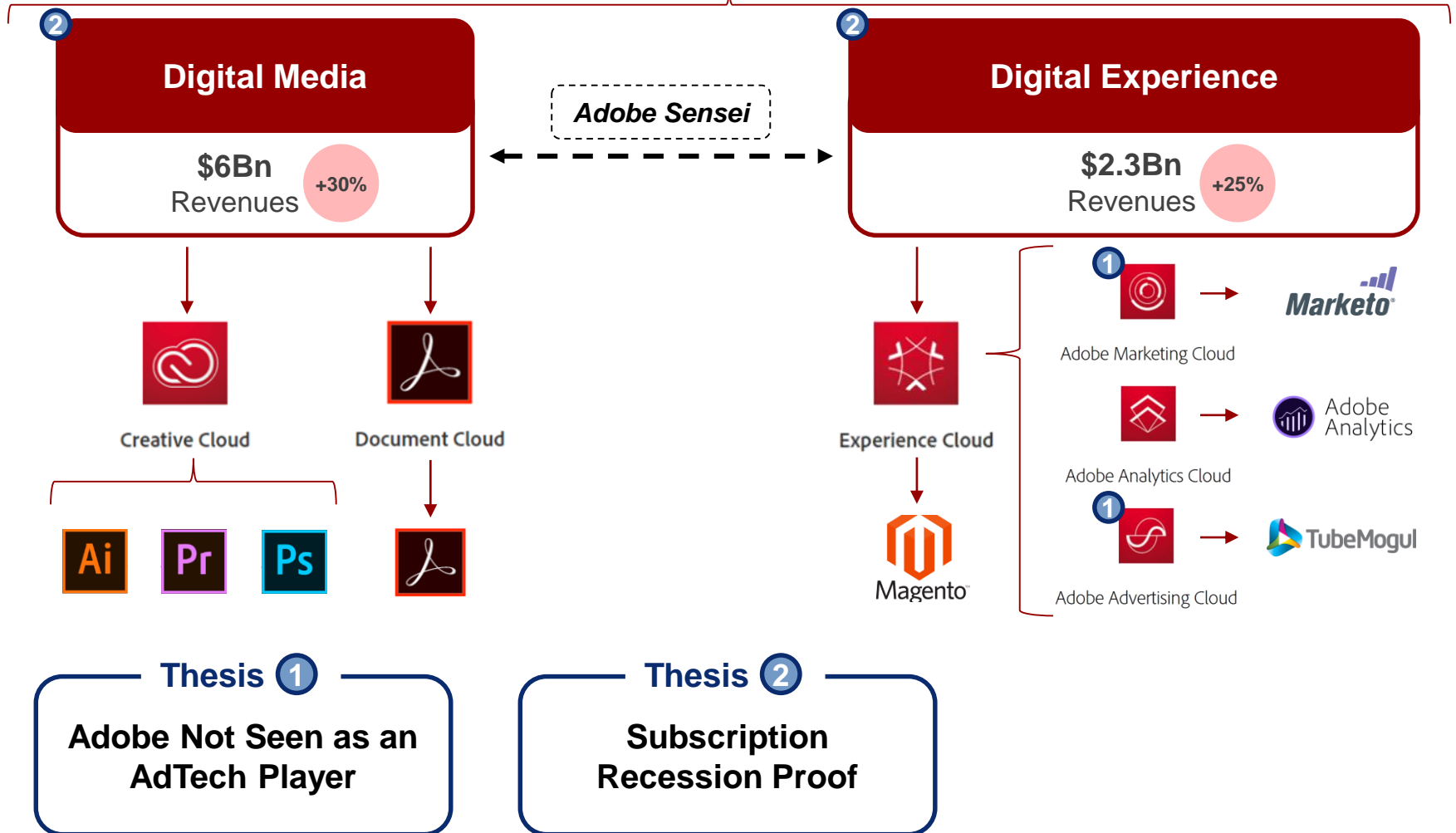
Revenue Streams



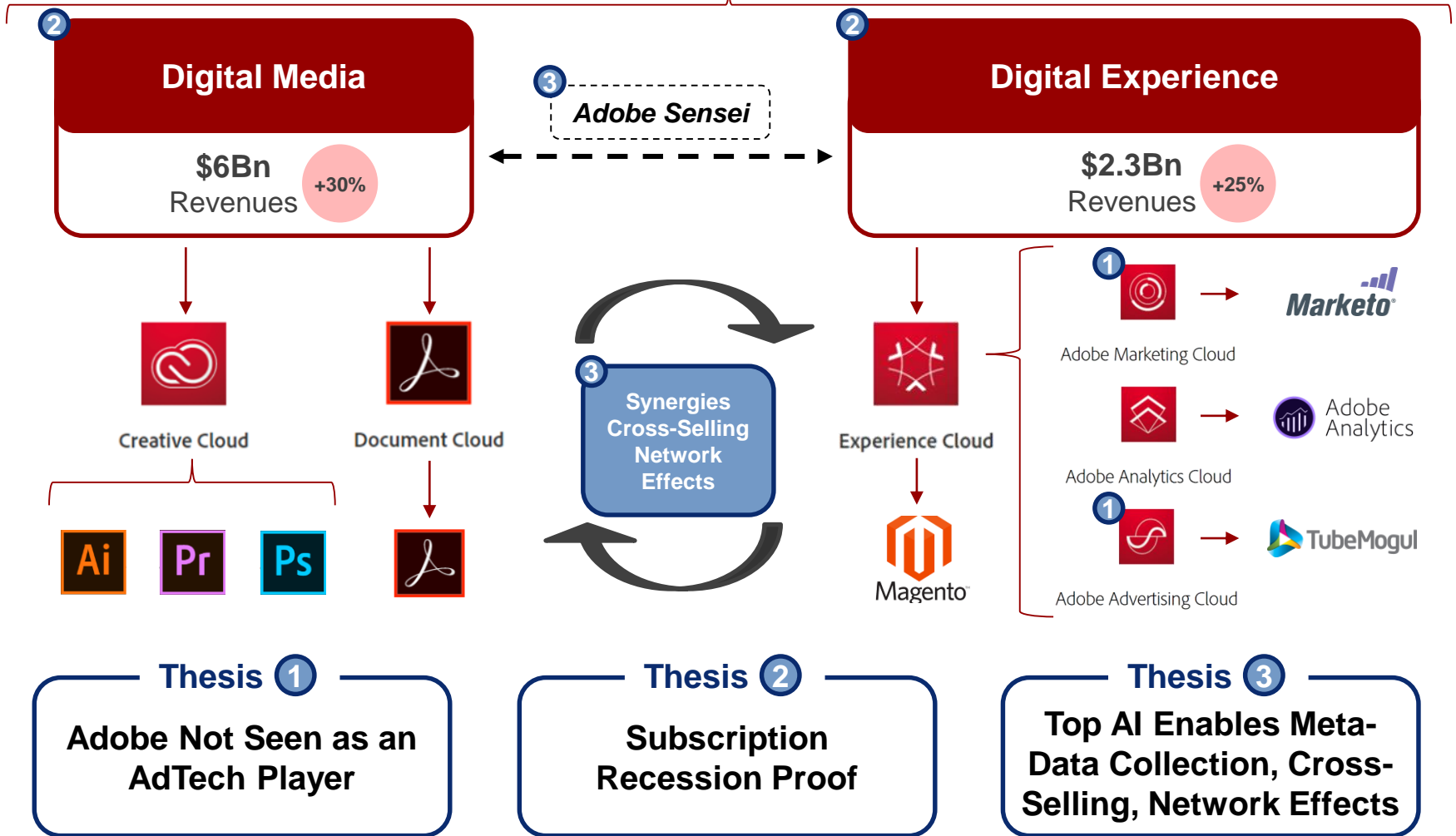
Thesis 1
Adobe Not Seen as an AdTech Player

See Below, pls. Thx.

Revenue Streams



Revenue Streams



Thesis 1 – Business Shift: MarTech

SECTION I



What is Marketing Tech?

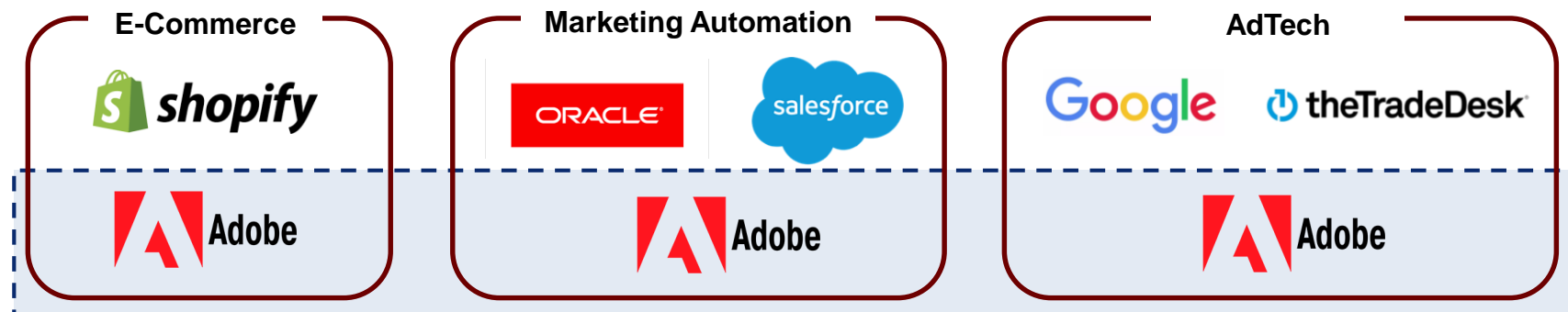
Technology here to switch things up again

Marketing Tech

A collection of solutions for marketing, analytics, advertising and commerce, usually offered over the cloud as a SaaS model. This helps companies optimize their marketing strategies, from managing content and delivering email campaigns to automating their ad buying and measuring their success



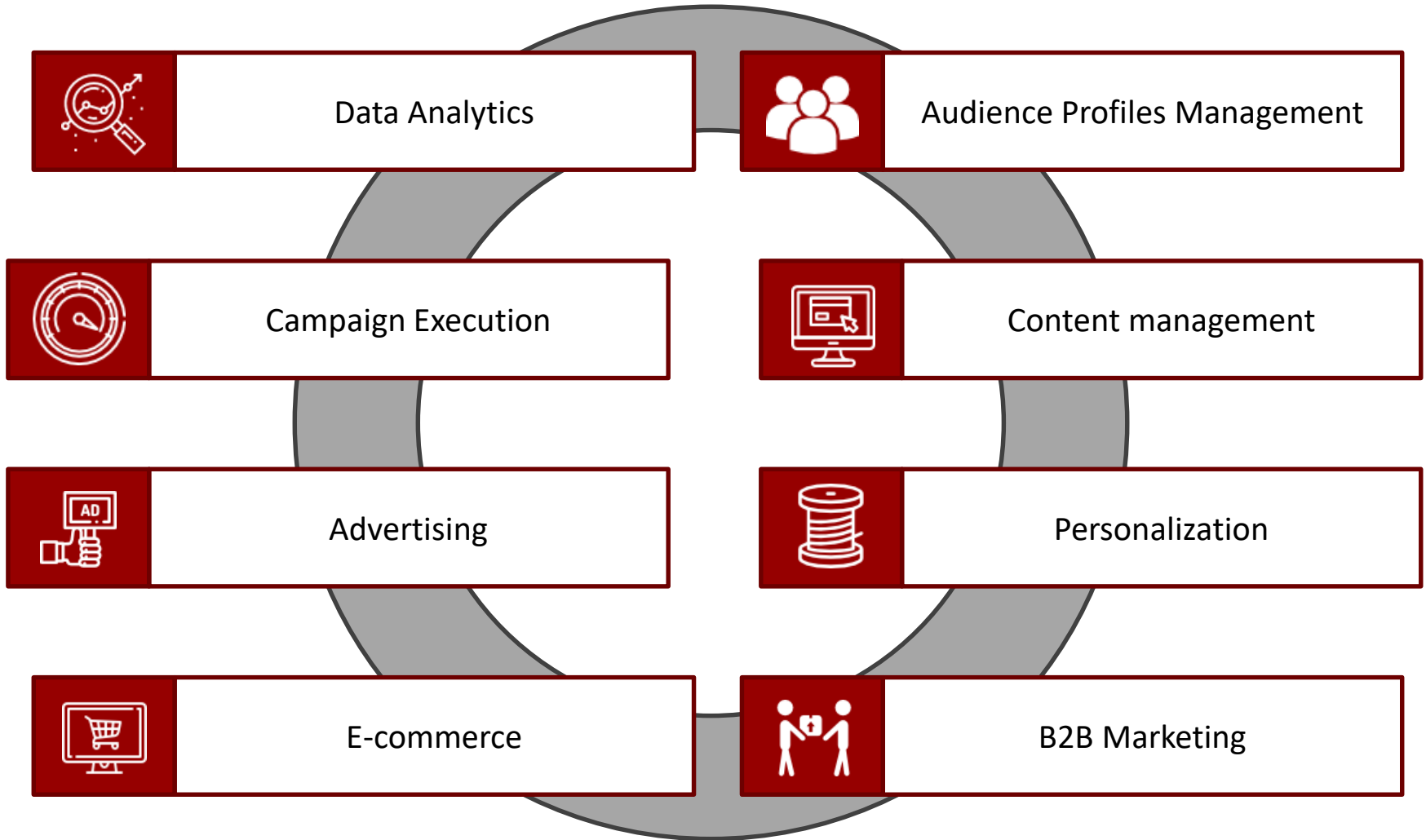
Main Players in Marketing Technology



MarTech leads to faster revenue growth, cost and time savings & optimization of marketing investments

Source: Forrester, Nucleus Research

A fully integrated platform

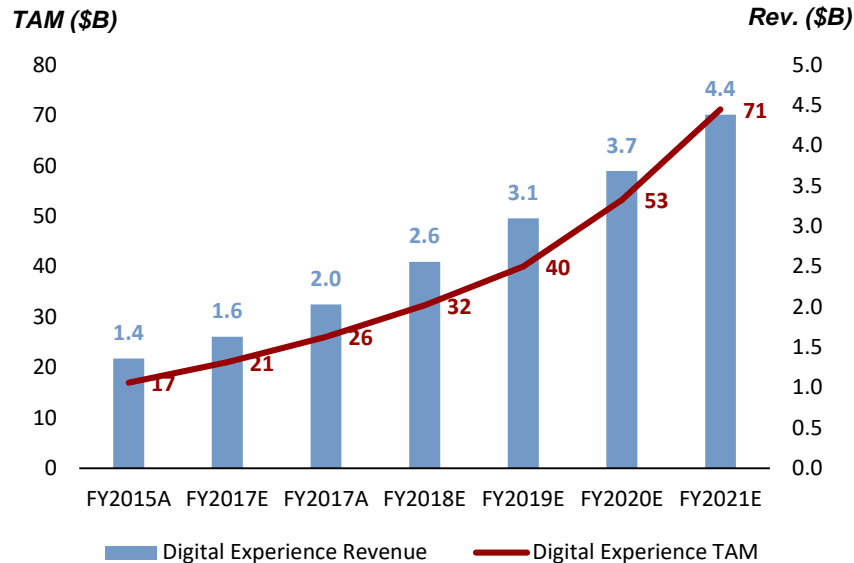


The integration between all of Adobe's solutions leads to a large amount of cross-selling

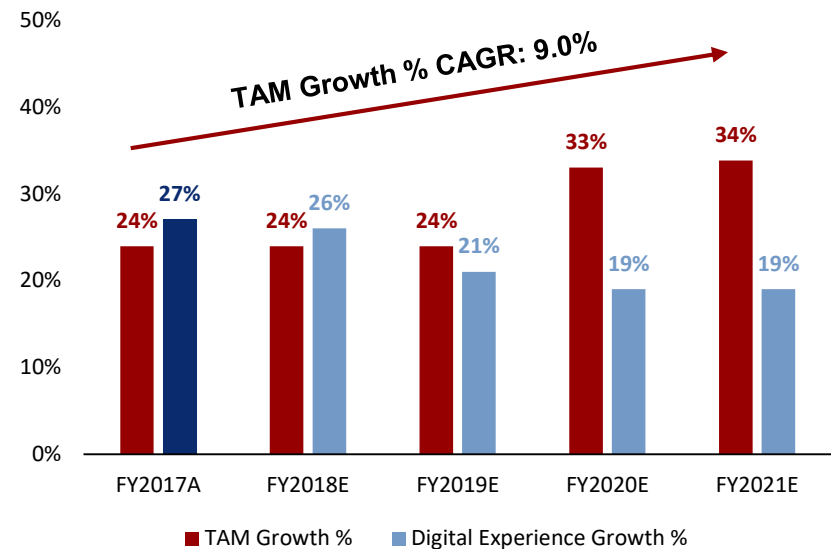
Forecasted Growth Trailing TAM Growth

Fast growth ahead

Digital Experience: Revenue vs TAM



Digital Experience: Revenue Growth % vs TAM Growth %



The market currently forecasts Adobe’s Digital Experience revenue growth to slow down, despite the TAM’s exponential growth and Adobe’s leader position in a winner-takes-it-all industry

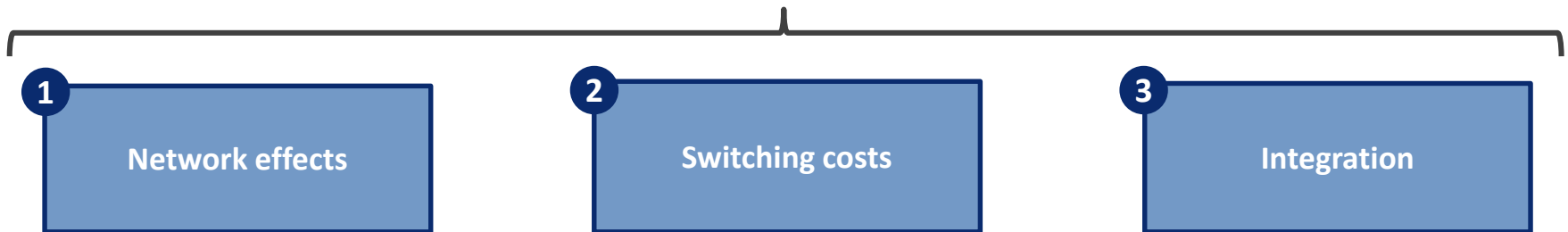
“Human brains are not able to understand exponential trends.”
 - Paraphrase of Vincent Bérubé, McKinsey Partner

Adobe’s Digital Experience segment will grow much faster than the market expects, mainly due to its market leader position

Source: Company Filings, Equity Research, Bloomberg

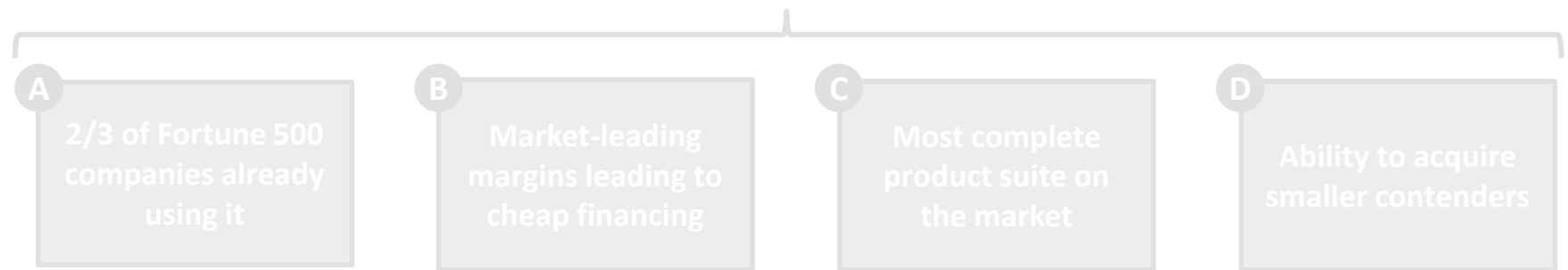
“The most important thing is trying to find a business with a wide and long-lasting moat around it” – Warren Buffet

Marketing Technology is a winner-takes-it-all industry



*“Adobe is clearly a leader with content and data driving its advantage in this competitive market. We believe Adobe will remain **one of two clear winners in this massive market.**”*

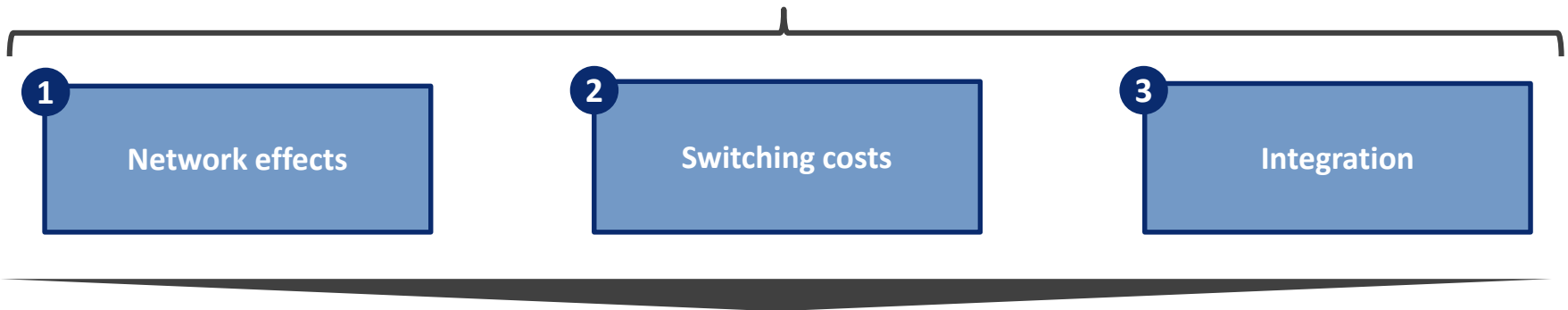
- Credit Suisse Equity Research



Adobe is in a great position to use its Digital Media cash cow to win in the Digital Marketing industry

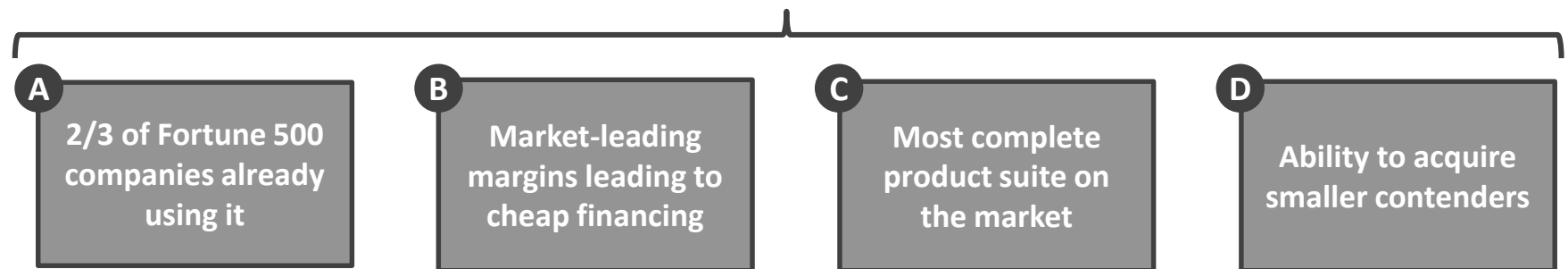
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Growth Through Accretive Acquisitions



Top of the food chain

Adobe has closed 2 large acquisitions so far in FY2018



\$1.68B

In Cash

- ✓ Closed in May 2018
- ✓ E-commerce software
- ✓ Supports more than \$155 billion in gross merchandise volume



\$4.75B

In Cash and Debt

- ✓ Closed in September 2018
- ✓ Cloud platform for B2B marketing
- ✓ Over 5,000 customers

Strong opportunity for other acquisitions

\$4.9B

Strong Cash Balance

\$1.9B

Low LT Debt

0.0x

Net Debt/EBITDA

5,000+ cos

Extremely
Fragmented Market

Adobe is a leader in a nascent, fragmented market that will be a winner-takes-it-all industry

Source: Adobe, Press releases, Bloomberg, Quarterly reports

Thesis 2 – Recession-Proof / Quasi-Monopoly

SECTION III

What is Digital Media?

Adobe Has a Quasi-Monopoly in the Creative Cloud and Document Cloud Industries

Creative Cloud

Apps and services for video, design, photography, and the web - built-in tutorials and templates, helping beginners and pros, alike

Document Cloud

Adobe Acrobat Reader, Adobe Scan, and Adobe Sign – the full suite of PDF applications and solutions: create, edit, scan, and sign PDFs

>90%¹

of World's Creative Professionals Use Creative Cloud

90%¹

Cost Savings & Environmental Impact Reduction

>50%¹

of Fortune 100 Use Document Cloud

8Bn¹

e-Signature Transactions

200Bn¹

PDFs opened in Adobe Products¹

Main Players in Creative Cloud Industry



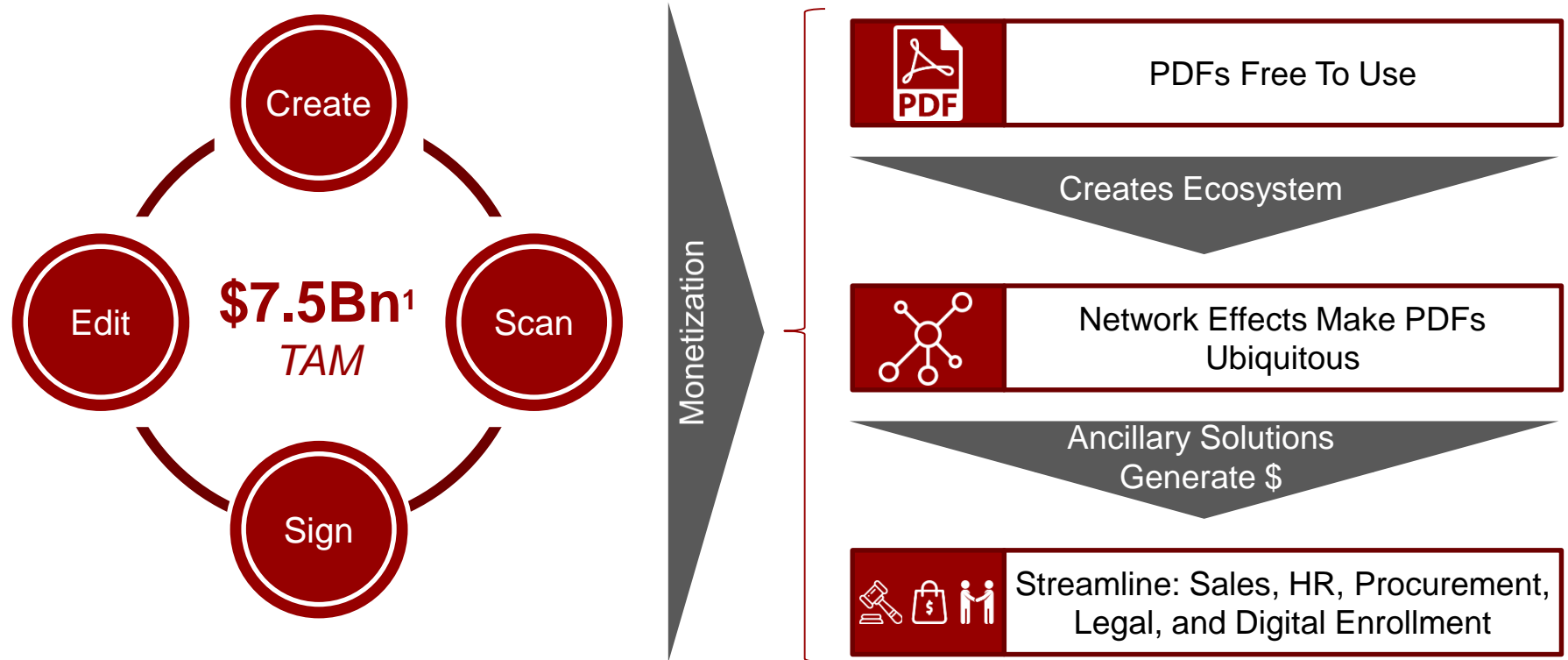
Main Players in Document Cloud Industry



Creative cloud and document cloud have strong clouds and virtually no competition in their markets, respectively

Source: Forrester, Nucleus Research

Razor and Blade Model Allows Creates a Quasi-Monopoly

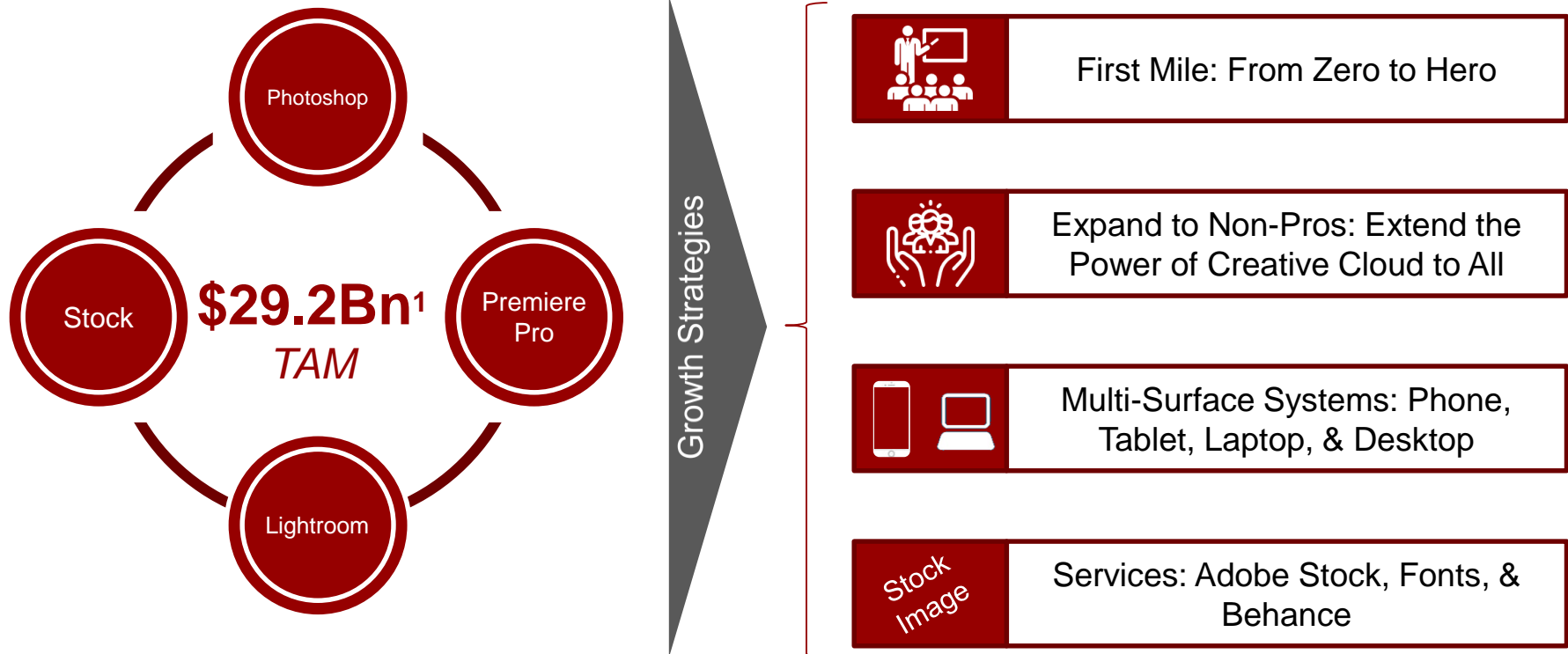


- 1) With scale, security becomes more and more important
- 2) Seamless integration saves time (scan, edit, sign, send)
- 3) Tiered subscription model attractive to users needs

PDFs can be considered a loss-leader which helps enable Adobe to build an monopolistic ecosystem

Creative Cloud Business Model

High Switching Costs Creates a Quasi-Monopoly



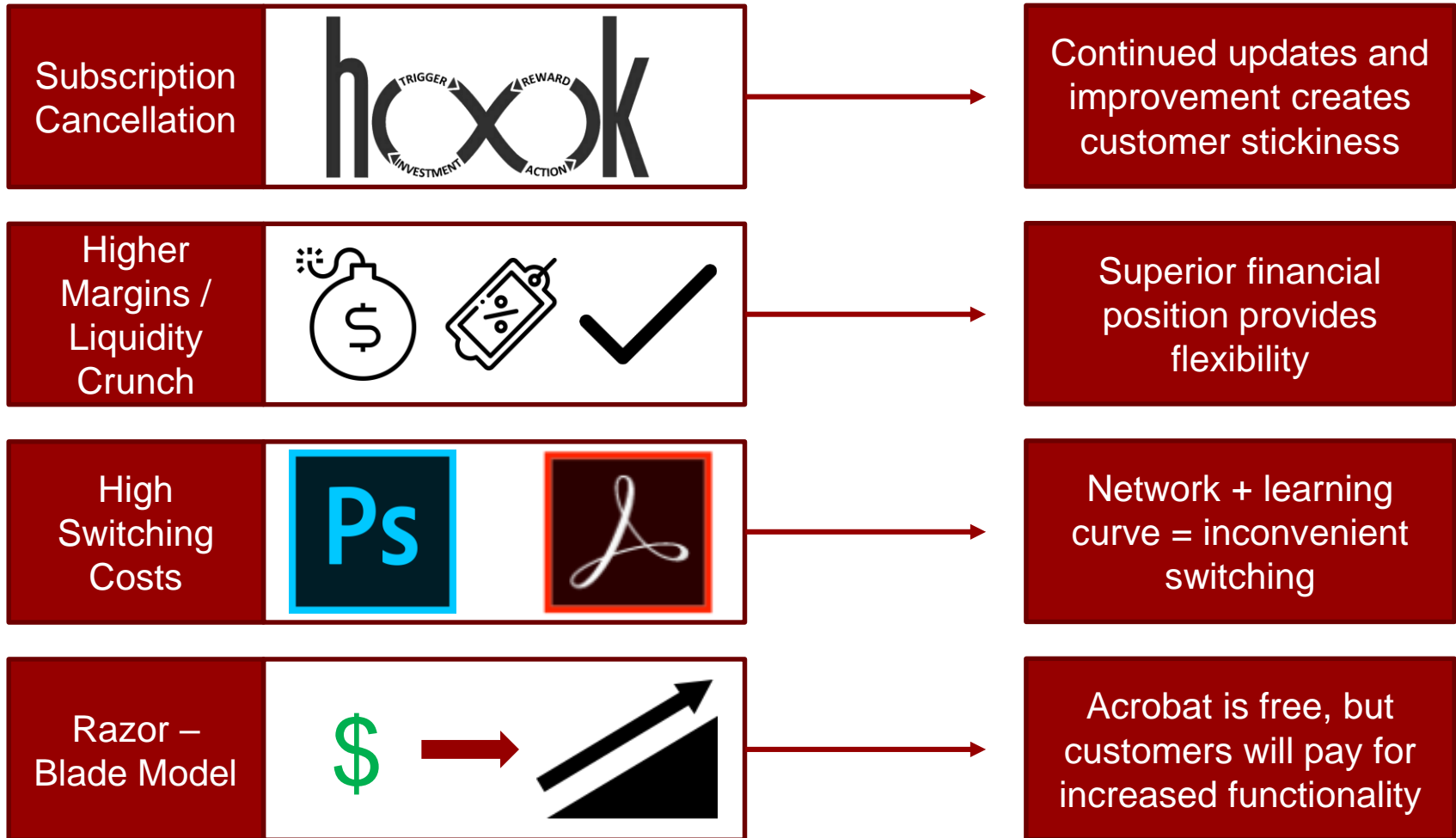
- 1) High switching costs – difficult to train people in Photoshop and have to re-train them
- 2) Lots of cross-selling and add-on sales

The Creative Cloud is a good revenue anchor due to its high switching costs and subscription-based model

Source: Company Website

Drivers of Recession-Proof / Monopoly Power

“If you stand by the river long enough, you’ll see the bodies of your enemies float by”- JP Morgan **CHASE** MD



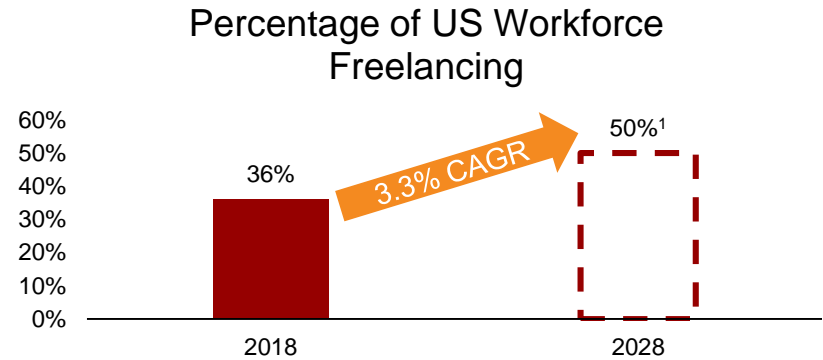
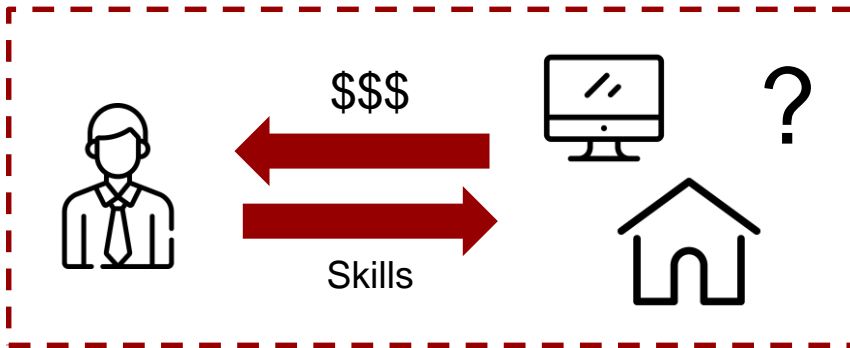
Source: Freepik, monkik, CapitalIQ

Thesis 2 Assumptions Explained

A combination of factors will continue to grow Adobe's Digital Media segment

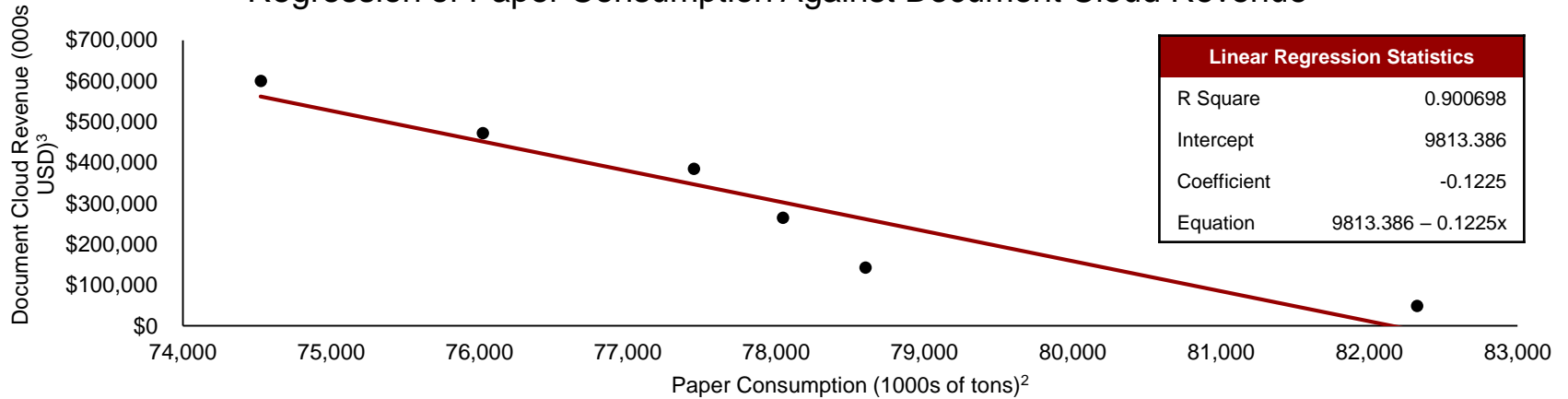
(in \$US millions, unless noted)

More people are engaging in DIY projects and freelancing for their work, representing a need for Creative Cloud products



The decline of paper usage and the movement to electronic documents represents a tailwind for PDF usage...

Regression of Paper Consumption Against Document Cloud Revenue



Numerous workplace, cultural and sustainability tailwinds support increasing adoption of Adobe products

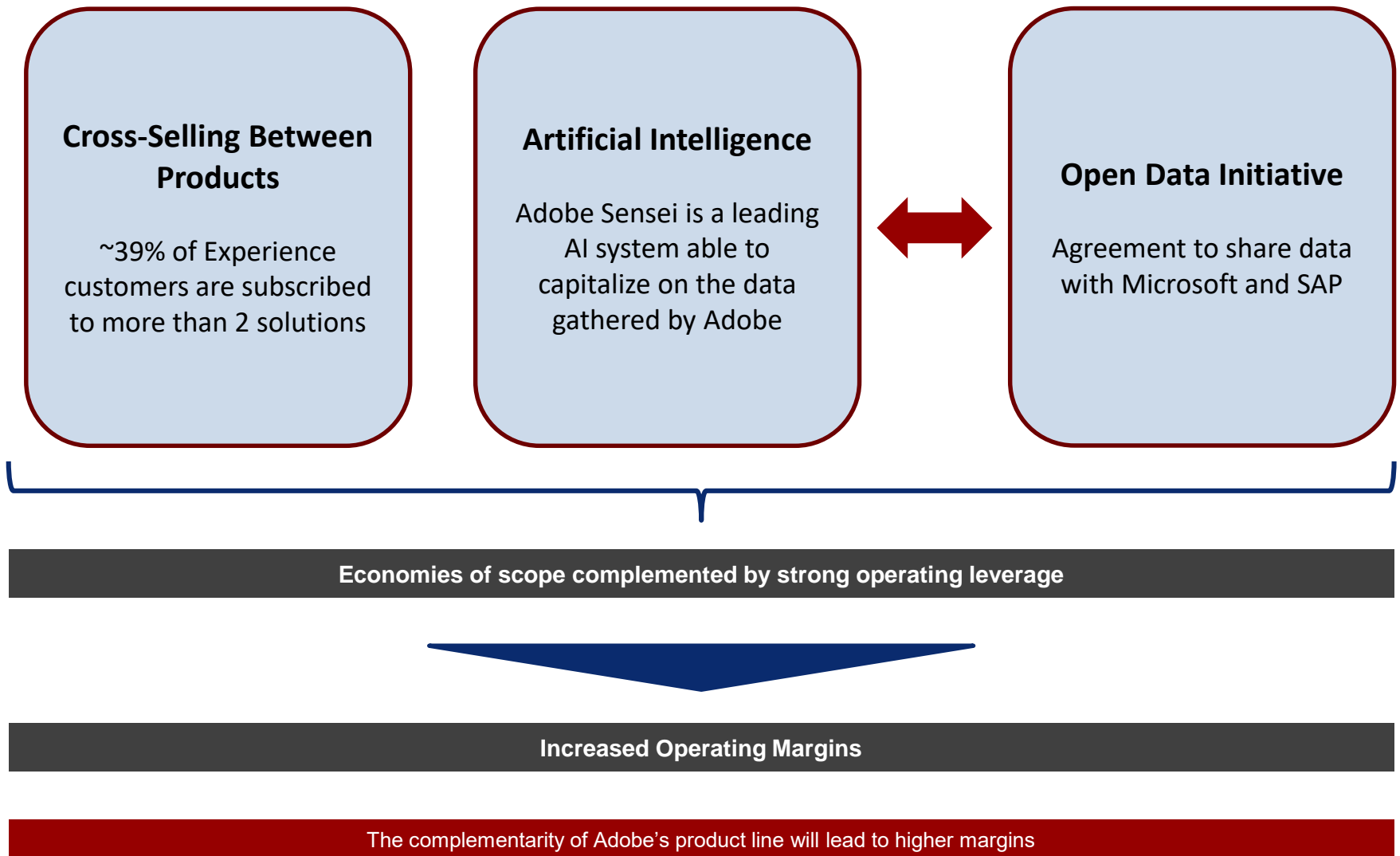
Source: Company Filings, Morgan Stanley, Statista, Freepik

Thesis 3 – Complementary Products

SECTION V



Product segments made for each other



Valuation

SECTION V



Valuation Implications

DCM vs. Market Implied Valuation

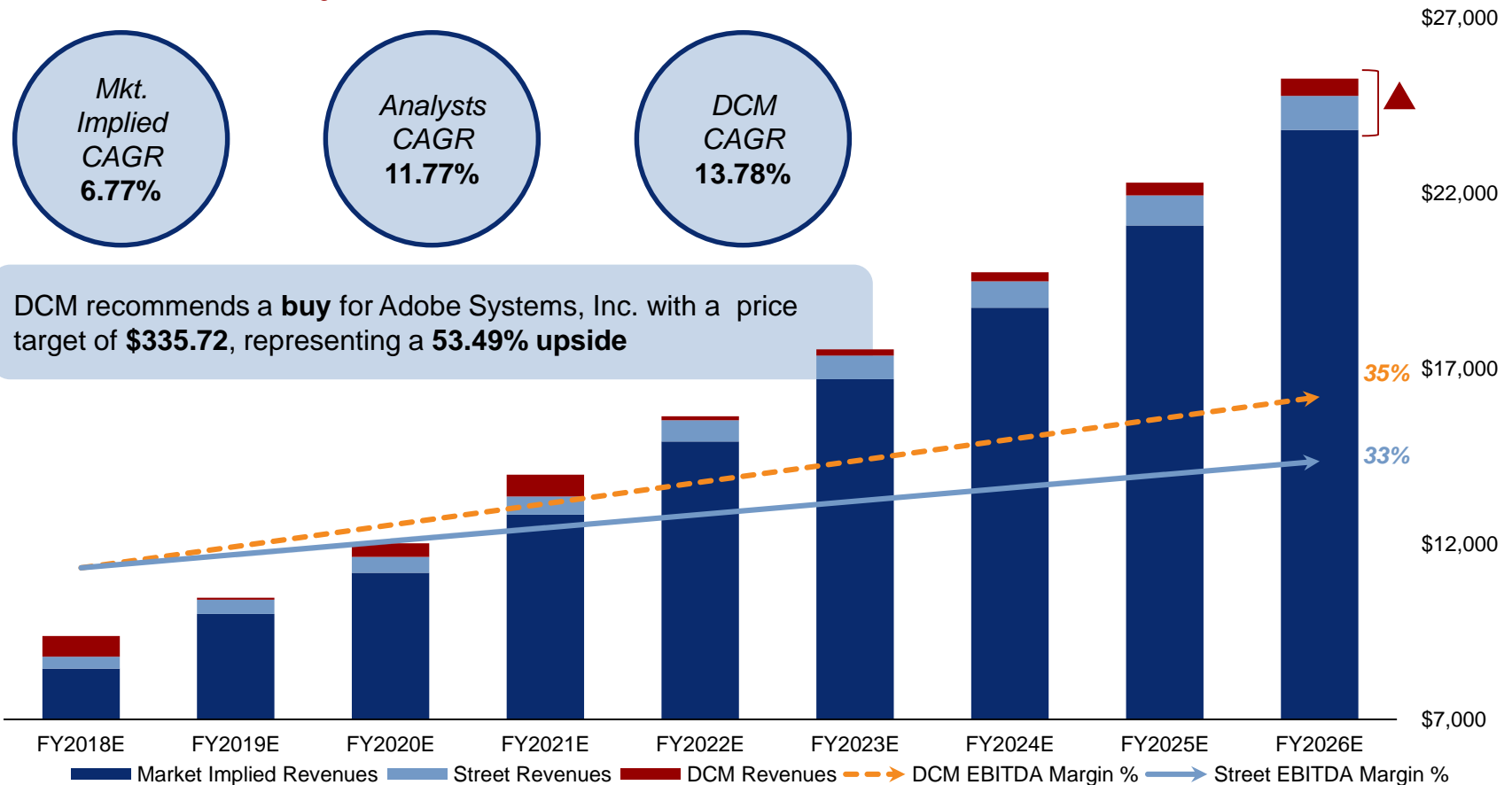
(in \$ millions, unless noted)

Revenue: Adobe has strong **network effects** that protect it from high **churn** and **international** exposure will **increase** their user base

Mkt. Implied: 33% EBITDA margin & ~\$23,815Bn revenue in FY26E

DCM: 35% EBITDA margin & ~\$25,272Bn revenue in FY26E

FY26E Delta: 2% EBITDA margin, ~\$1,5Bn in FY26E ▲



Source: DCM Model

Adobe SaaS & AdTech Peers



Despite Trading at a Premium to Its Peers, Adobe is a Unique Company and Many MarTech Peers are Private

Overview		Operating Metrics					Valuation Metrics	
Company Name	EV (\$mm)	Market Cap (\$mm)	Levered Beta 2-Yr	Revenue Growth 18E-19E	Net Debt / EBITDA LTM	EBITDA Margin FY 19E	EV/Sales	
							FY18E	FY19E
Software								
SAP	109,088	106,111	0.93	7.93%	0.47x	33.64%	4.53x	4.20x
Oracle	186,429	187,727	1.31	0.91%	-0.11x	47.03%	4.67x	4.63x
Microsoft	750,569	803,086	1.07	10.76%	nm	42.42%	6.53x	5.90x
Cerner Corp	18,161	18,534	1.29	9.19%	nm	29.30%	3.48x	3.19x
Intuit Inc	50,260	51,538	1.21	10.72%	-0.52x	35.61%	8.28x	7.48x
Salesforce.com Inc	92,539	91,568	1.07	22.67%	nm	24.69%	7.85x	6.40x
Vmware Inc	53,638	62,700	1.57	9.18%	nm	40.44%	6.38x	5.84x
Digital Media/Marketing								
The Trade Desk Inc.	4,752	4,918	2.30	36.29%	nm	30.58%	11.33x	8.31x
Alliance Data	31,539	10,512	1.37	154.24%	nm	26.80%	9.71x	3.82x
Omnicom Group Inc.	20,861	17,223	0.56	-0.15%	1.21x	15.73%	1.36x	1.36x
OUTFRONT Media Inc.	5,266	2,947	0.91	51.59%	nm	29.59%	4.85x	3.20x
Median	50,260	51,538	1.21	10.72%	0.18x	30.58%	6.38x	4.63x
25th Percentile	18,161	10,512	0.93	7.93%	-0.42x	26.80%	4.53x	3.20x
75th Percentile	109,088	106,111	1.37	36.29%	1.03x	40.44%	8.28x	6.40x
Adobe Systems Inc	104,179	107,238	1.03	20.48%	-0.99x	45.82%	12.15x	10.09x
Premium / (Discount)	-4.50%	1.06%	-25.21%	-43.56%	-196.59%	13.28%	46.78%	57.69%

Source: Bloomberg, CapIQ

Appendices



Sensitivity Analysis



(in \$ millions, unless noted)

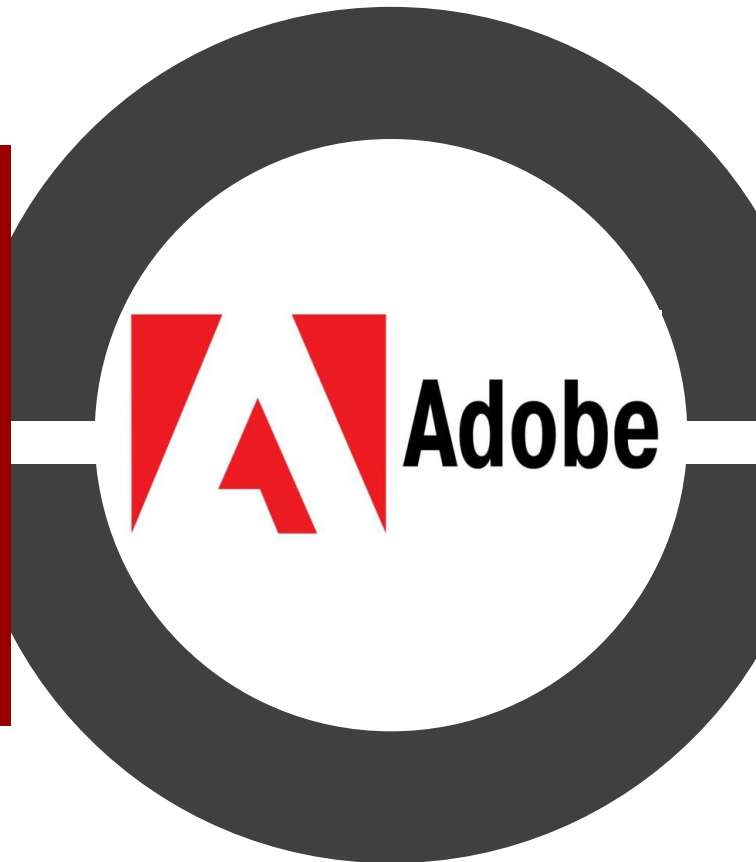
		WACC				
		12.61%	12.11%	11.61%	11.11%	10.61%
Terminal g%	1.50%	\$ 306.66	\$ 323.97	\$ 343.12	\$ 364.41	\$ 388.20
	1.75%	\$ 311.37	\$ 329.30	\$ 349.17	\$ 371.32	\$ 396.12
	2.00%	\$ 316.31	\$ 334.89	\$ 355.53	\$ 378.60	\$ 404.51
	2.25%	\$ 321.48	\$ 340.76	\$ 362.24	\$ 386.29	\$ 413.39
	2.50%	\$ 326.91	\$ 346.94	\$ 369.31	\$ 394.43	\$ 422.83

Adobe's risks and catalysts depend on the strengths and weaknesses of its applications

(in \$ millions, unless noted)

Risks:

- Data privacy laws limit digital marketing capabilities
- A competitor creates a substitute for any Adobe platform
- Any weakness in data protections



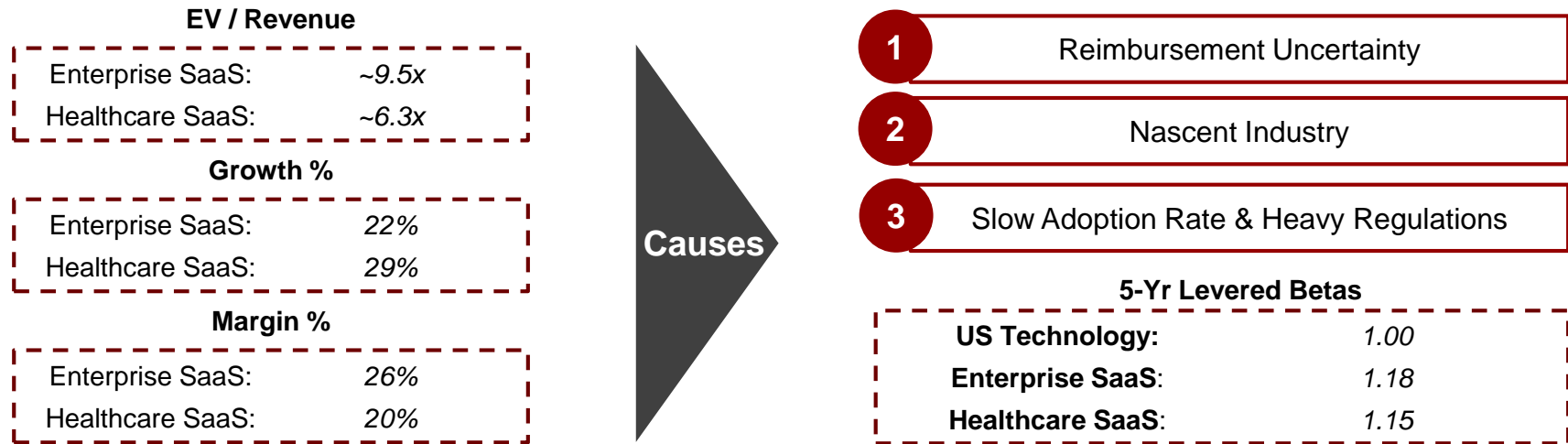
Catalysts:

- Adobe is acquired by a larger competitor
- Further accelerated growth of DIY/freelancing
- Adobe develops a new way to integrate current products

Why SaaS?

Technology disrupting another industry

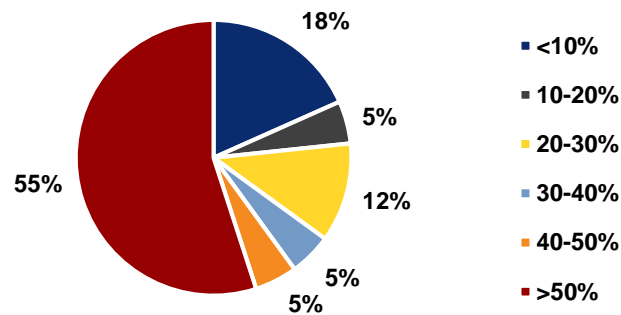
Healthcare SaaS companies currently trade at a discount to the SaaS market as a whole



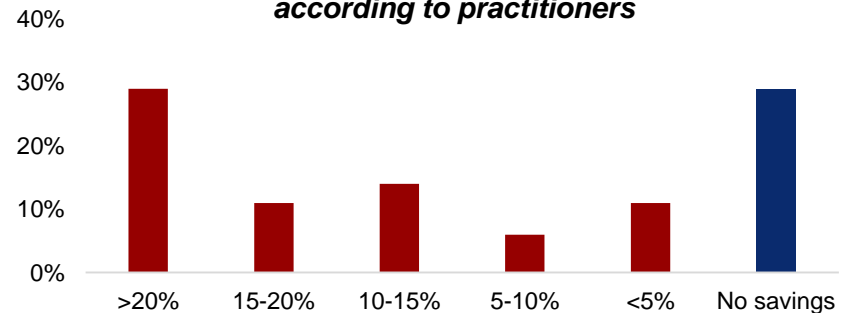
Adoption rate will start increasing

Significant cost savings

US telemedicine customer retention rate



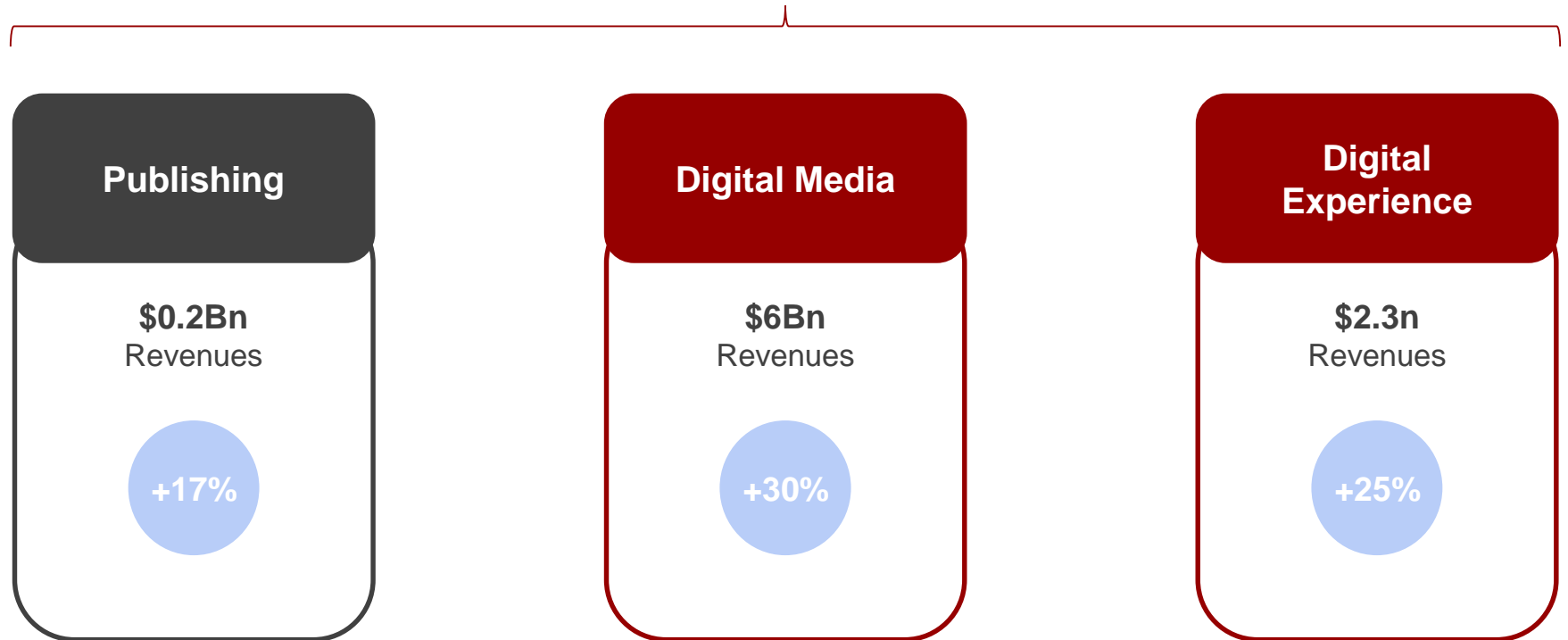
Cost savings from using health SaaS according to practitioners



Healthcare SaaS companies currently trade at a discount to the SaaS market, which is not warranted

Source:

Revenue Streams



Key People:

CEO & President: Shantanu Narayen

CFO: John Murphy

Headquarters:

San Jose, CA, USA

Main Revenue Drivers:

Digital Experience Growth

Market Cap:

\$110.3B

Valuation Metrics:

EV/Revenue: 11.9x

EV/EBITDA: 22.8x

P/E: 46.7x

Investment Theses:

- 1) Digital Experience segment misunderstood*
- 2) Recession-proof*
- 3) Cross-selling*

Price Target:

\$335.72