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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 5, 1999

OR

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

For the transition period from _______________ to ______________

Commission file Number: 0-15175

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

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)	(Zip Code)

Registrant's telephone number, including area code: (408) 536-6000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES √ NO ___

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Class	Shares Outstanding April 2, 1999
Common stock, $0.0001 par value	61,009,148

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PART I — FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ADOBE SYSTEMS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

	Quarter Ended	
	March 5 1999	**February 27 1998**
Revenue:		
Licensing	$ 38,099	$ 41,851
Application products	188,803	155,962
Total revenue	226,902	197,813
Direct costs	22,499	27,805
Gross margin	204,403	170,008
Operating expenses:		
Research and development	44,904	43,338
Sales and marketing	78,480	71,491
General and administrative	26,566	33,507
Total operating expenses	149,950	148,336
Operating income	54,453	21,672
Nonoperating income:		
Investment gain (loss)	(20)	12,462
Interest and other income	5,886	8,501
Total nonoperating income	5,866	20,963
Income before income taxes	60,319	42,635
Provision for income taxes	22,043	15,891
Net income	$ 38,276	$ 26,744
Basic net income per share	$ .63	$ .39
Shares used in computing basic net income per share	60,973	67,762
Diluted net income per share	$ .60	$ .38
Shares used in computing diluted net income per share	63,384	69,585

See accompanying Notes to Condensed Consolidated Financial Statements.

ADOBE SYSTEMS INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)
(Unaudited)

	March 5 1999	November 27 1998
ASSETS		
Current assets:		
Cash and cash equivalents	$ 79,486	$ 110,871
Short-term investments	183,751	161,676
Receivables, net of allowances of $5,144 and $6,399, respectively	132,042	141,180
Deferred income taxes	31,911	32,028
Other current assets	11,573	10,190
Total current assets	438,763	455,945
Property and equipment	93,562	93,887
Deferred income taxes	2,128	16,647
Restricted funds and security deposits	130,029	130,260
Other assets	108,024	70,592
	$ 772,506	$ 767,331
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Trade and other payables	$ 29,250	$ 48,681
Accrued expenses	125,782	117,539
Accrued restructuring charges	6,975	8,867
Income taxes payable	47,659	64,546
Deferred revenue	17,970	11,333
Total current liabilities	227,636	250,966
Stockholders' equity:		
Common stock, $0.0001 par value and additional paid- in capital	315,370	306,859
Retained earnings	750,225	732,730
Accumulated other comprehensive income	16,830	(1,879)
Treasury stock, net of reissuances (13,526 and 13,050 shares in 1999 and 1998, respectively)	(537,555)	(521,345)
Total stockholders' equity	544,870	516,365
	$ 772,506	$ 767,331

See accompanying Notes to Condensed Consolidated Financial Statements.

ADOBE SYSTEMS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Quarter Ended	
	March 5 1999	**February 27 1998**
Cash flows from operating activities:		
Net income	$ 38,276	$ 26,744
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock compensation expense	—	875
Depreciation and amortization	12,393	17,426
Deferred income taxes	1,751	(969)
Provision for losses on accounts receivable	(1,216)	770
Tax benefit from employee stock plans	7,533	2,617
Equity in net loss of Adobe Ventures	(202)	525
Loss (gain) on sale and distribution of equity investments	192	(12,987)
Changes in operating assets and liabilities:		
Receivables	10,354	15,185
Other current assets	(1,382)	(144)
Trade and other payables	(18,756)	(14,928)
Accrued expenses	(336)	2,439
Accrued restructuring charges	(1,892)	(158)
Income taxes payable	(16,887)	(4,245)
Deferred revenue	6,637	(1,805)
Net cash provided by operating activities	36,465	31,345
Cash flows from investing activities:		
Purchases of short-term investments	(121,067)	(392,262)
Maturities and sales of short-term investments	140,730	354,628
Purchases of property and equipment	(7,520)	(11,926)
Acquisitions, net of cash acquired	(31,000)	(1,968)
Additions to other assets	(12,494)	(28,748)
Net cash used for investing activities	(31,351)	(80,276)

(Continued)

See accompanying Notes to Condensed Consolidated Financial Statements.

ADOBE SYSTEMS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Continued)
(Unaudited)

	Quarter Ended	
	March 5 1999	**February 27 1998**
Cash flows from financing activities:		
Proceeds from sale of put warrants	$ 978	$ —
Purchase of treasury stock	(69,864)	(122,779)
Proceeds from reissuance of treasury stock	35,888	17,306
Payment of dividends	(3,057)	(6,281)
Net cash used by financing activities	(36,055)	(111,754)
Effect of foreign currency exchange rates on cash and cash equivalents	(444)	(238)
Net decrease in cash and cash equivalents	(31,385)	(160,923)
Cash and cash equivalents at beginning of period	110,871	267,576
Cash and cash equivalents at end of period	$ 79,486	$ 106,653
Supplemental disclosures:		
Cash paid during the period for income taxes	$ 28,394	$ 12,182
Noncash investing and financing activities:		
Cash dividends declared but not paid	$ 3,020	$ 3,333
Dividends in-kind distributed	$ —	$ 7,197

See accompanying Notes to Condensed Consolidated Financial Statements.

ADOBE SYSTEMS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share data)

NOTE 1. Significant Accounting Policies

Basis of presentation

The accompanying unaudited condensed consolidated financial statements reflect all normal recurring adjustments which are, in the opinion of management, necessary to present a fair statement of the condensed consolidated financial position at March 5, 1999, and the condensed consolidated statements of income and cash flows for the three-month periods ended March 5, 1999 and February 27, 1998.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and, therefore, do not include all information and footnotes necessary for a complete presentation of the results of operations, the financial position, and cash flows, in conformity with generally accepted accounting principles. Adobe Systems Incorporated ("Adobe" or the "Company") filed audited consolidated financial statements which included all information and footnotes necessary for such a presentation of the results of operations, financial position and cash flows for the years ended November 27, 1998, November 28, 1997, and November 29, 1996, in the Company's 1998 Annual Report on Form 10-K.

The results of operations for the interim period ended March 5, 1999, are not necessarily indicative of the results to be expected for the full year.

Revenue Recognition

During the first quarter of fiscal 1999, the Company adopted Statement of Position (SOP) 97-2, "Software Revenue Recognition." The Company modified certain aspects of its business model such that the impact of SOP 97-2 was not significant.

Recent accounting pronouncements

During the first quarter of fiscal 1999, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes standards for reporting and displaying comprehensive income and its components in the financial statements. It does not, however, require a specific format for the disclosure but requires the Company to display an amount representing total comprehensive income for the period in its financial statements.

ADOBE SYSTEMS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except per share data)
(Continued)

NOTE 1. Significant Accounting Policies (Continued)

In June 1997, the FASB issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," and in June 1998, issued SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities." Readers can refer to the "Recent Accounting Pronouncements" section of the Company's 1998 Annual Report on Form 10-K for further discussion.

In December 1998, the AICPA issued SOP 98-9, "Modifications of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions." Readers can refer to the "Recent Accounting Pronouncements" section of the Company's 1998 Annual Report on Form 10-K for further discussion.

Reclassifications

Certain reclassifications were made to the fiscal 1998 consolidated financial statements to conform to the fiscal 1999 presentation, including certain reclassifications within operating expenses and between operating expenses and direct costs that were made to enable management to better analyze financial results. These reclassifications did not impact total operating profit for the first quarter of fiscal 1998.

NOTE 2. Other Assets

Other assets consisted of the following:

	March 5 1999	November 27 1998
Equity investments	$ 58,070	$ 56,332
Goodwill	26,442	3,190
Purchased technology and licensing agreements	15,775	3,502
Miscellaneous other assets	28,564	24,337
	128,851	87,361
Less accumulated amortization	20,827	16,769
	$ 108,024	$ 70,592

ADOBE SYSTEMS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except share and per share data)
(Continued)

NOTE 3. Accrued Expenses

Accrued expenses consisted of the following:

	March 5 1999	November 27 1998
Accrued compensation and benefits	$ 46,600	$ 41,592
Sales and marketing allowances	14,780	13,439
Other	64,402	62,508
	$ 125,782	$ 117,539

NOTE 4. Restructuring and other charges

In the third quarter of fiscal 1998, the Company implemented a restructuring program aimed at streamlining its underlying cost structure to better position the Company for growth and profitability. For a detailed discussion on the restructuring program, the reader can refer to the Company's 1998 Annual Report on Form 10-K.

The following table depicts the restructuring and other activity through March 5, 1999:

	Accrued Balance at November 27 1998	Total Charges (Credits)	Cash Payments	Write-downs	Accrued Balance at March 5 1999
Severance and related charges	$ 894	$ —	$ (462)	$ —	$ 432
Lease termination costs	4,062	—	(1,389)	—	2,673
Canceled contracts	943	—	—	—	943
Other charges	276	—	(1)	—	275
	6,175	—	(1,852)	—	4,323
Accrual related to previous restructuring	2,692	—	(40)	—	2,652
	$ 8,867	$ —	$ (1,892)	$ —	$ 6,975

Severance and related charges consists primarily of COBRA benefits and outplacement costs. The remaining accrual balance of $0.4 million as of March 5, 1999 is expected to be paid by the third quarter of fiscal 1999.

NOTE 4. Restructuring and other charges (Continued)

Lease termination costs include remaining lease liabilities, brokerage fees, and legal fees offset by estimated sublease income related primarily to facilities in San Jose, California that were vacated as part of the restructuring program. As of March 5, 1999, $2.7 million of lease termination costs, net of anticipated sublease income, remains accrued and is expected to be utilized by the third quarter of fiscal 1999.

As of March 5, 1999, the remaining accrual in canceled contracts of $0.9 million is expected to be fully paid by the first quarter of fiscal 2000 in accordance with the settlement agreement.

Other charges relate to legal fees associated with the divestiture of two business units and employee terminations as part of the severance program. The remaining $0.3 million accrual as of March 5, 1999 is expected to be paid by the third quarter of fiscal 1999.

As of March 5, 1999, approximately $2.7 million in accrued restructuring costs remain related to lease termination costs primarily in Europe resulting from the mergers with Aldus and Frame in fiscal 1994 and fiscal 1995, respectively.

NOTE 5. Stockholders' Equity

Stock Repurchase Program

In September 1997, the Company's Board of Directors authorized, subject to certain business and market conditions, the purchase of up to 15.0 million shares of the Company's common stock over a two-year period. This new stock repurchase program was in addition to an existing program whereby the Company has been authorized to repurchase shares to offset issuances under employee stock option and stock purchase plans. The Company repurchased approximately 1.7 million shares in the first quarter of fiscal 1999 and 10.5 million shares in fiscal 1998, at a cost of $69.9 million and $379.2 million, respectively under its stock repurchase programs. As of March 5, 1999, there are no remaining authorized shares to be repurchased under the 15.0 million share repurchase program.

Put warrants and call options

To facilitate the Company's stock repurchase programs, the Company sold put warrants to independent third parties. Each warrant entitles the holder to sell one share of Adobe's common stock to the Company at a specified price. On March 5, 1999, put warrants to sell approximately 779,500 shares of the Company's common stock were outstanding that expire on various dates through July 1999 with an average exercise price of $42.41 per share. Under these put warrant arrangements, the Company, at its option,

(In thousands, except share and per share data)

NOTE 5. Stockholders' Equity (Continued)

can settle with physical delivery or net shares equal to the difference between the exercise price and market value at the date of exercise; therefore the put warrants do not result in a liability on the balance sheet.

In addition, the Company purchased call options from independent third parties that entitle the Company to buy its common stock on certain dates at specified prices. On March 5, 1999, call options to purchase approximately 239,100 of the Company's common stock were outstanding that expire on various dates through July 1999 with an average exercise price of $44.47 per share.

NOTE 6. Comprehensive Income

The following table sets forth the components of comprehensive income, net of income tax expense:

	Quarter Ended	
	March 5 1999	February 27 1998
Net income	$ 38,276	$ 26,744
Change in cumulative translation adjustment	(444)	(238)
Change in unrealized gains on investments, net	19,153	(2,763)
Total comprehensive income	$ 56,985	$ 23,743

NOTE 7. Net income per share

Basic net income per share is computed using the weighted average number of common shares outstanding for the period, excluding unvested restricted stock. Diluted net income per share is based upon the weighted average common shares outstanding for the period plus dilutive common equivalent shares, including unvested restricted common stock, stock options using the treasury stock method, and put warrants using the reverse treasury stock method.

ADOBE SYSTEMS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except share and per share data)
(Continued)

NOTE 7. Net income per share (Continued)

(in thousands except per share data)	Quarter Ended	
	March 5 1999	February 27 1998
Net income	$ 38,276	$ 26,744
Shares used to compute basic net income per share (weighted average shares outstanding during the period, excluding unvested restricted stock)	60,973	67,762
Dilutive common equivalent shares:		
Unvested restricted stock	6	90
Stock options	2,405	1,591
Put warrants	—	142
Shares used to compute diluted net income per share	63,384	69,585
Basic net income per share	$ .63	$ .39
Diluted net income per share	$ .60	$ .38

NOTE 8. Acquisitions

On January 4, 1999, the Company acquired substantially all of the assets, consisting of intellectual property and a minimal amount of fixed assets, of both GoLive Systems, Inc., a Delaware corporation, and GoLive Systems GmbH and Co. KG, a German limited partnership (together "GoLive Systems"). GoLive Systems creates Web site development software which enables users to effectively use the Internet for professional publishing and communication. The acquisition was accounted for under the purchase method of accounting in accordance with Accounting Principles Board Opinions No. 16. The purchase price of the acquisition was approximately $31.0 million, plus additional contingency payments of $8.0 million based on achieving certain technical and employment milestones. The Company determined that certain milestones had been reached as of March 5, 1999 and, as such, $4.0 million in contingent payments were recorded as purchase price.

NOTE 8. Acquisitions (Continued)

Based on an independent appraiser's valuation, $11.7 million of the purchase price was allocated to purchased technology and $23.3 million of the purchase price was allocated to goodwill. The intangible assets are being amortized over a five-year period. The purchased technology consisted of GoLive for the Macintosh which was being sold by GoLive Systems at the time of the acquisition and GoLive for Windows, which the Company determined had reached technological feasibility.

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

The following discussion (presented in millions, except share and per share amounts) should be read in conjunction with the consolidated financial statements and notes thereto.

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations - Factors that may affect future results of operations." Readers should carefully review the risks described in other documents the Company files from time to time with the Securities and Exchange Commission, including the additional Quarterly Reports on Form 10-Q to be filed by the Company in 1999. Readers are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. The Company undertakes no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.

RESULTS OF OPERATIONS

Overview

Adobe Systems Incorporated ("Adobe" or the "Company") develops, markets, and supports computer software products and technologies that enable users to express and use information across both print and electronic media. The Company offers a market-leading line of application software products, type products, and content for creating, distributing, and managing information of all types; licenses its technology to major hardware manufacturers, software developers, and service providers; and offers integrated software solutions to businesses of all sizes. The Company distributes its products through a network of original equipment manufacturer ("OEM") customers, distributors and dealers, and value-added resellers ("VARs") and system integrators, and has operations in North America, Europe, Japan, and Asia Pacific and Latin America.

The following table sets forth for the quarters ended March 5, 1999 and February 27, 1998, the Company's condensed consolidated statements of income expressed as a percentage of total revenue:

	Quarter Ended	
	March 5 1999	**February 27 1998**
Revenue:		
Licensing	16.8%	21.2%
Application products	83.2	78.8
Total revenue	100.0	100.0
Direct costs	9.9	14.1
Gross margin	90.1	85.9
Operating expenses:		
Research and development	19.8	21.9
Sales and marketing	34.6	36.1
General and administrative	11.7	16.9
Total operating expenses	66.1	75.0
Operating income	24.0	10.9
Nonoperating income, net:		
Investment gain (loss)	—	6.3
Interest and other income	2.6	4.3
Total nonoperating income	2.6	10.6
Income before income taxes	26.6	21.5
Provision for income taxes	9.7	8.0
Net income	16.9%	13.5%

Revenue

	1999	1998	Change
First quarter:	(Dollars in millions)		
Total revenue	$226.9	$197.8	14.7%

Total revenue increased $29.1 million, or 14.7%, from the same quarter last year primarily due to the release of new and enhanced application products.

During the first quarter of fiscal 1999, the Company adopted Statement of Position (SOP) 97-2, "Software Revenue Recognition." The Company modified certain aspects of its business model such that the impact of SOP 97-2 was not significant.

	1999	1998	Change
First quarter:	(Dollars in millions)		
Product revenue — Licensing	$38.1	$41.8	(9.0)%
Percentage of total revenue	16.8%	21.2%	

Licensing revenue is made up of royalties received from OEM customers who ship products containing Adobe's PostScript technology, including Adobe PostScript, Adobe PostScript 3, Adobe PrintGear, and PostScript Extreme.

Licensing revenue decreased $3.8 million, or 9.0%, in the first quarter of fiscal 1999 compared to the same period last year primarily due to the ongoing weakness in the Japanese personal computer and printer markets, as well as the continuing decline in royalty revenue from Hewlett-Packard Company's ("HP") desktop monochrome laser printer division which has been incorporating a clone version of Adobe PostScript into its products since the fall of 1997.

The Company continues to be cautious about licensing revenue in the short term because of Japanese market conditions, the uncertain timing of OEM customer introductions of products incorporating Adobe's latest technologies, and the remaining impact of the loss of revenue from HP's monchrome laser printer products, which is expected to occur in the second half of fiscal 1999. Exluding any shrinkwrap printing technology products, the Company anticipates that its traditional licensing revenue will remain relatively flat or decline in fiscal 1999.

	1999	1998	Change
First quarter:	(Dollars in millions)		
Product group revenue — Application products	$188.8	$156.0	21.1%
Percentage of total revenue	83.2%	78.8%	

Application products revenue is derived predominantly from shipments of application software programs marketed through retail and VAR distribution channels, with the exception of Adobe PhotoDeluxe, which is primarily distributed through OEM bundling agreements with digital camera, scanner, and personal computer manufacturers.

Application products revenue increased $32.8 million, or 21.1%, in the first quarter of fiscal 1999 compared to the same period last year due to a number of factors. First, the introduction of GraphicStudio and DynamicStudio in North America, Japan and Asia Pacific and Latin America contributed significantly to revenue growth. GraphicStudio is a collection of Adobe application products, which includes Photoshop, Illustrator, and Pagemaker. DynamicStudio is also a suite of products, containing After Effects, Premiere, Photoshop, and Illustrator. Second, the first quarter of fiscal 1999 benefited from revenue related to major upgrades of Photoshop, Illustrator, and Premiere, all of which were released in mid-to-late fiscal 1998. Third, revenue from Acrobat 3.0 increased as demand for the product continued to grow. These factors were partially offset by a decline in revenue from PageMaker as a result of weakness in the Japanese economy and the extended age of the current release. In addition, the increase was offset by a decline in revenue from divested businesses of $6.4 million, and a decline in PhotoDeluxe Home Edition, which was affected by lower OEM customer pricing.

By comparison, application products revenue for the first quarter of fiscal 1998 was adversely affected by weakness in the Japanese economy, the absence of major product releases or upgrades, and a resulting decline in end-user demand. Further, during the first quarter of fiscal 1998, the Company worked proactively with its distributors in Japan to match lower sell-through rates, thereby decreasing channel inventory levels in anticipation of the new product release cycle.

Total application products revenue (excluding platform independent and UNIX revenues) for the first quarter of fiscal 1999 was split 57% on Windows and 43% on Macintosh as compared to 59% and 41%, respectively, for the first quarter of fiscal 1998.

Direct costs

	1999	1998	Change
First quarter:	(Dollars in millions)		
Direct costs	$22.5	$27.8	(19.1)%
Percentage of total revenue	9.9%	14.1%	
Gross margin	90.1%	85.9%	

Certain reclassifications that affected both direct costs and operating expenses were made to the fiscal 1998 consolidated statements of income to conform to the fiscal 1999 presentation. These reclassifications did not impact total operating profit for fiscal 1998.

Direct costs decreased in the first quarter of fiscal 1999 compared to the same period last year due to lower material costs as a result of an ongoing cost improvement program that was implemented in late fiscal 1998, and improved inventory management resulting in lower excess and obsolete inventory expenses.

The Company anticipates that gross margin throughout fiscal 1999 will be between 89%-90%, due to cost reduction efforts in material costs and management of excess and obsolete inventory. These reductions may be offset by increases in direct costs related to product launches and the amortization of capitalized software in accordance with Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed," as well as amortization of purchased technologies associated with acquired products or technologies.

Operating expenses

Certain reclassifications that affected both direct costs and operating expenses were made to the fiscal 1998 consolidated statements of income to conform to the fiscal 1999 presentation. These reclassifications did not impact total operating profit for fiscal 1998.

	1999	1998	Change
First quarter:	(Dollars in millions)		
Research and development	$44.9	$43.3	3.6%
Percentage of total revenue	19.8%	21.9%	

Research and development expenses increased $1.6 million, or 3.6%, primarily due to higher incentive compensation expenses as the Company's financial performance exceeded that of the first quarter of fiscal 1998. In addition, the increase was attributable to increased salaries and employee-related costs associated with an additional week of operations in the first quarter of fiscal 1999 compared to the same period last year.

The Company believes that investments in research and development, including the recruiting and hiring of software developers, are critical to remain competitive in the marketplace and are directly related to continued timely development of new and enhanced products. The Company will continue to make significant investments in the development of its application software products, including those targeted for the growing Internet market. The Company expects that research and development expenditures for the remainder of fiscal 1999 will increase in absolute dollars. However, such expenditures as a percentage of revenue are expected to remain relatively the same as the first quarter of fiscal 1999.

	1999	1998	Change
First quarter:	(Dollars in millions)		
Sales and marketing	$78.5	$71.5	9.8%
Percentage of total revenue	34.6%	36.1%	

Sales and marketing expenses increased $7.0 million, or 9.8%, in fiscal 1999 compared to the same period last year, primarily due to increased salaries and employee-related costs associated with an additional week of operations in the first quarter of fiscal 1999, and higher incentive compensation expenses as the Company’s financial performance exceeded that of the first quarter of fiscal 1998. In addition, a portion of the increase was attributable to increased advertising and promotional spending for a national publishing conference held during the quarter, and the Company’s worldwide sales meetings also held during the first quarter of fiscal 1999.

Sales and marketing expenses are expected to increase in absolute dollars to support new products and upgrades scheduled to be released later in fiscal 1999. However, sales and marketing expenses as a percentage of revenue are expected to remain relatively the same as the first quarter of fiscal 1998.

	1999	1998	Change
First quarter:	(Dollars in millions)		
General and administrative	$26.6	$33.5	(20.7)%
Percentage of total revenue	11.7%	16.9%	

General and administrative expenses decreased $6.9 million, or 20.7%, in fiscal 1999 compared to the same period last year, primarily due to lower facilities costs related to buildings that were vacated in connection with the 1998 restructuring program, and a reduction in bad debt expense associated with the resolution of disputed items with certain customers and an improved economic environment in Asia. Additionally, the decrease was attributable to lower amortization of goodwill as the first quarter of fiscal 1998 included the write-off of goodwill associated with an acquisition that took place in fiscal 1997. Further, the Company experienced an overall decrease in general and administrative expenses due to cost-cutting measures that were implemented as part of the 1998 restructuring program. These decreases were partially offset by an increase to salaries and employee-related expenses associated with an additional week of operations in the first quarter of fiscal 1999, as well as an increase to incentive compensation expense as the Company’s financial performance exceeded that of the first quarter of fiscal 1999.

The Company expects that general and administrative spending will increase in absolute dollars for the remainder of fiscal 1999 to support ongoing administrative infrastructure needs. However, as a percentage of revenue such expenditures are expected to be lower than the first quarter of fiscal 1999.

Nonoperating income

First quarter:	1999	1998	Change
	(Dollars in millions)		
Investment gain (loss)	$ —	$12.5	(100.2)%
Percentage of total revenue	—	6.3%	

During the first quarter of fiscal 1999, gains and losses resulting from investment activity were minimal. In the first quarter of fiscal 1998, McQueen International Limited ("McQueen"), a former investee of the Company, was acquired by Sykes Enterprises, Incorporated ("Sykes"), a publicly traded company. In connection with the acquisition, the Company exchanged its shares of McQueen for approximately 487,000 shares of Sykes' restricted common stock and recorded a gain on the exchange of $6.7 million.

Also, during the first quarter of fiscal 1998, the Company liquidated its investment in Siebel Systems, Incorporated ("Siebel") through the distribution to its stockholders of approximately 165,000 shares of Siebel as a dividend-in-kind and the sale of its remaining Siebel shares. A gain was recognized on the transaction of approximately $5.7 million.

First quarter:	1999	1998	Change
	(Dollars in millions)		
Interest and other income	$5.9	$8.5	(30.8)%
Percentage of total revenue	2.6%	4.3%	

Interest income decreased in the first quarter of fiscal 1999 compared to fiscal 1998 due to lower average cash balances as a result of cash used for the Company's stock repurchase program.

Interest and other income in the first quarter of fiscal 1998 included foreign exchange gains in Europe offset by a decrease in interest income as a result of lower average cash balances.

Provision for income taxes

First quarter:	1999	1998	Change
	(Dollars in millions)		
Provision for income taxes	$22.0	$15.9	38.7%
Percentage of total revenue	9.7%	8.0%	
Effective tax rate	36.5%	37.3%	

The Company's effective tax rate decreased in the first quarter of fiscal 1999 compared to fiscal 1998 primarily due to a decrease in nondeductible goodwill amortization.

The Company expects that the effective tax rate for the remainder of fiscal 1999 will be between 36% and 37%.

Factors that may affect future results of operations

The Company believes that in the future its results of operations could be affected by various factors, such as delays in shipment of the Company's new products and major new versions of existing products, lack of market acceptance of new products and upgrades, the introduction of competitive products by third parties, weakness in demand for Macintosh application software and Macintosh-related printers, renegotiation of royalty arrangements, growth in worldwide personal computer and printer sales and sales price adjustments, consolidation in the OEM printer business, ongoing weakness in the Company's printing business due to product transitions, industry transitions to new business and information delivery models, ongoing weakness in the Japanese and other Asian economies, "Year 2000" issues (as discussed later under "Year 2000 Issues"), and adverse changes in general economic conditions in any of the countries in which the Company does business.

The Company has stated that in fiscal 1999 its annual revenue growth target is 15% and its operating margin target is 25% of total revenue. These targets are used to assist the Company's management in making decisions about the allocation of resources and investments, not as predictions of future results. The targets reflect a number of assumptions, including assumptions about the Company's pricing, manufacturing costs and volumes and the mix of application products and licensing revenue, full and upgrade products, distribution channels, and geographic distribution. These and many other factors described herein affect the Company's financial performance and may cause the Company's future results, including results for the current quarter, to vary materially from these targets.

The Company's ability to develop and market products, including upgrades of current products that successfully adapt to changing customer needs, may also have an impact on the results of operations. The Company's ability to extend its core technologies into new applications and to anticipate or respond to technological changes could affect its ability to develop these products. A portion of the Company's future revenue will come from these new applications. Delays in product or upgrade introductions, whether by the Company or its OEM customers, could have an adverse effect on the Company's revenue, earnings, or stock price. The Company cannot determine the ultimate effect that these new products or upgrades will have on its revenue or results of operations.

The market for the Company's graphics applications, particularly the consumer products, is intensely and increasingly competitive and is significantly affected by product introductions and market activities of industry competitors. Additionally, Microsoft Corporation has stated its intention to increase its presence in the digital imaging/graphics market by mid-1999; the Company believes that, due to Microsoft's market dominance, any new Microsoft digital imaging products will be highly competitive with the Company's products. If competing new products achieve widespread acceptance, it would have a significant adverse impact on the Company's operating results.

The Company generally offers its application products on Macintosh, Windows, and UNIX platforms. To the extent that there is a slowdown of customer purchases of personal computers in general, the Company's operating results could be materially adversely affected. Also, as the Company seeks to further broaden its customer base to achieve greater penetration in the corporate business and consumer markets, the Company may not successfully adapt its application software distribution channels, which could materially adversely affect the Company's operating results. The Company could experience decreases in average selling prices and some transitions in its distribution channels that could materially adversely affect its operating results.

The Company's primary distribution channel for its application products is currently through retail distributors, and a significant amount of its revenue for application products is from a single distributor. In addition, the Company continues to expand into third-party distribution channels, including value-added resellers and systems integrators, in its effort to further broaden its customer base. As a result, the financial health of these third parties, and the Company's continuing relationships with them, are becoming more important to the Company's success. Some of these companies are thinly capitalized and may be unable to withstand changes in business conditions. The Company's financial results could be adversely affected if the financial condition of certain of these third parties substantially weakens or if the Company's relationships with them deteriorate.

The Company's printing revenue experienced a 9.0% decline in the first quarter of fiscal 1999 compared to the first quarter of fiscal 1998. If this trend continues, the Company's financial results could be adversely affected. The weakness in the Japanese market was a factor causing the revenue decline. In addition, in the fall of fiscal 1997, HP began to ship a clone version of Adobe PostScript in some printers, resulting in lower licensing revenue to the Company in fiscal 1998, even though the Company continues to work with HP printer operations to incorporate Adobe PostScript and other technologies in other HP products. The Company expects continued lower licensing revenue from HP in fiscal 1999. Further, OEM customers on occasion seek to renegotiate their royalty arrangements. The Company evaluates these requests on a case-by-case basis. If an agreement is not reached, a customer may decide to pursue other options, which could result in lower licensing revenue for the Company.

Since the end of fiscal 1997, the Company has experienced a decline in both application and licensing revenue from the Japanese market due to a weak Japanese computer market and general economic conditions in Japan. In addition, at the end of fiscal 1997, inventory levels for application products at the Company's Japanese distributors remained higher than what the Company considers normal. During fiscal 1998, the Company worked with its major distributors in Japan to reduce channel inventory to what the Company considers a reasonable level. The Company expects these adverse economic conditions to continue in the short term, and they may continue to adversely affect the Company's revenue and earnings. Although there are also adverse conditions in other Asian and Latin American economies, the countries affected represent a much smaller portion of the Company's revenue and thus have less impact on the Company's operational results.

The Company has recently implemented a restructuring of its business and reduced its workforce by more than 10%. However, the Company plans to continue to invest in certain areas, which will require it to hire additional employees. Competition for high-quality personnel, especially highly skilled engineers, is extremely intense. The Company's ability to effectively manage its growth will require it to continue to improve its operational and financial controls and information management systems, and to attract, retain, motivate, and manage employees effectively. The failure of the Company to effectively manage growth and transition in multiple areas of its business could have a material adverse effect on its results of operations.

The Internet market is rapidly evolving and is characterized by an increasing number of market entrants that have introduced or developed products addressing authoring and communications over the Internet. As is typical in the case of a new and evolving industry, demand and market acceptance for recently introduced products and services are subject to a high level of uncertainty. The software industry addressing authoring and communications over the Internet is young and has few proven products. Standards defining Web graphics have not yet been finally adopted. In addition, new models for licensing software will be needed to accommodate new information delivery practices. Moreover, critical issues concerning the commercial use of the Internet (including security, reliability, ease of use and access, cost, and quality of service) remain unresolved and may affect the growth of Internet use, together with the software standards and electronic media employed in such markets.

The Company derives a significant portion of its revenue and operating income from its subsidiaries located in Europe, Japan, and Asia Pacific and Latin America. The Company generally experiences lower revenue from its European operations in the third quarter because many customers reduce their purchasing activities in the summer months. Additionally, the Company is uncertain whether the recent weakness experienced in the Japan and Asia Pacific and Latin America markets will continue in the foreseeable future due to possible currency devaluation and liquidity problems in these regions. While most of the revenue of the European subsidiaries is denominated in U.S. dollars, the majority of revenue derived from Japan is denominated in yen and the majority of all subsidiaries' operating expenses are denominated in their local currencies. As a result, the Company's operating results are subject to fluctuations in foreign currency exchange rates. To date, the accounting impact of such fluctuations has been insignificant. The Company's hedging policy attempts to mitigate some of these risks, based on management's best judgment of the appropriate trade-offs among risk, opportunity, and expense. The Company has established a hedging program to hedge its exposure to foreign currency exchange rate fluctuations, primarily of the Japanese yen. The Company's hedging program is not comprehensive, and there can be no assurance that the program will offset more than a portion of the adverse financial impact resulting from unfavorable movement in foreign currency exchange rates.

On January 1, 1999, eleven of the fifteen member countries of the European Union adopted the euro as their common legal currency and established fixed conversion rates between their existing sovereign currencies and the euro. The euro trades on currency exchanges and is available for non-cash transactions. Based on its preliminary assessment, the Company does not believe the conversion will have a material impact on the competitiveness of its products in Europe, where there already exists substantial price transparency, or increase the likelihood of contract cancellations. Further, the Company expects that modifications to comply with euro requirements have been and will continue to be made to its business operations and systems on a timely basis and does not believe that the cost of such modifications will have a material adverse impact on the Company's results of operations or financial condition. There can be no assurance, however, that the Company will be able to continue to complete such modifications on a timely basis; any failure to do so could have a material adverse effect on the Company's results of operations or financial condition. In addition, the Company faces risks to the extent that suppliers, manufacturers, distributors and other vendors upon whom the Company relies and their suppliers are unable to make appropriate modifications to support euro transactions. The inability of such third parties to support euro transactions could have a material adverse effect on the Company's results of operations or financial condition.

In connection with the enforcement of its own intellectual property rights or in connection with disputes relating to the validity or alleged infringement of third party rights, the Company has been and may in the future be subject to complex, protracted litigation as part of its policy to vigorously defend its intellectual property rights. Intellectual property litigation is typically very costly and can be disruptive to business operations by diverting the attention and energies of management and key technical personnel. Although the Company has successfully defended past litigation, there can be no assurance that it will prevail in any ongoing or future litigation. Adverse decisions in such litigation could subject the Company to significant liabilities, require the Company to seek licenses from others, prevent the Company from manufacturing or selling certain of its products, or cause severe disruptions to the Company's operations or the markets in which it competes, any one of which could have a material adverse effect on the results of operations or financial condition of the Company.

The Company prepares its financial statements in conformity with generally accepted accounting principles ("GAAP"). GAAP are subject to interpretation by the American Institute of Certified Public Accountants (the "AICPA"), the Securities and Exchange Commission (the "SEC"), and various bodies formed to interpret and create appropriate accounting policies. A change in these policies can have a significant effect on the Company's reported results, and may even affect the reporting of transactions completed before a change is announced. Accounting policies affecting many other aspects of the Company's business, including rules relating to software revenue recognition, purchase and pooling-of-interests accounting for business combinations, the valuation of in-process research and development, employee stock purchase plans, and stock option grants have recently been revised or are under review by one or more groups. Changes to these rules, or the questioning of current practices, may have a significant adverse effect on the Company's reported financial results or in the way in which the Company conducts its business.

Due to the factors noted above, as well as the Year 2000 issues noted below, the Company's future earnings and stock price may be subject to significant volatility, particularly on a quarterly basis. Any shortfall in revenue or earnings from levels expected by securities analysts could have, and has had in the past, an immediate and significant adverse effect on the trading price of the Company's common stock in any given period. Additionally, the Company may not learn of such shortfalls until late in the fiscal quarter, which could result in an even more immediate and adverse effect on the trading price of the Company's common stock. Finally, the Company participates in a highly dynamic industry. In addition to factors specific to the Company, changes in analysts' earnings estimates for the Company or its industry, and factors affecting the corporate environment, the Company's industry or the securities markets in general will often result in significant volatility of the Company's common stock price.

"Year 2000" Issues

The Company is addressing a broad range of issues associated with the programming code in existing computer systems as the year 2000 approaches. The "Year 2000" problem is complex, as many computer systems will be affected in some way by the rollover of the two-digit year value to 00. Systems that do not properly recognize such information could generate erroneous data or cause a system to fail. The Year 2000 issue creates risk for the Company from unforeseen problems in its products or its own computer and embedded systems and from third parties with whom the Company deals on financial and other transactions worldwide. Failure of the Company's and/or third parties' computer systems or Year 2000 defects in the Company's products could have a material impact on the Company's ability to conduct its business.

The Company has commenced a phased program to inventory, assess, remediate, test, implement, and develop contingency plans for all mission-critical applications and products potentially affected by the Year 2000 issue (the "Y2K Program"). To accelerate overall completion, activities in each phase are often concurrent rather than serial, but all phases, except developing contingency plans, are expected to be completed by mid-1999. Additionally, the Company has opened a dedicated Year 2000 test laboratory for both internal business process and product testing. All Company business groups are involved in the Y2K Program efforts.

The Company has identified three potential areas of impact for review: (1) the software and systems, including embedded systems, used in the Company's internal business processes; (2) third-party vendors, manufacturers and suppliers, and (3) the Company's software products offered to customers. The Company's current estimate of the aggregate costs to be incurred for the Y2K Program is approximately $3.0 million, which is expected to be funded from operating cash flows. If the Company encounters significant unforeseen Year 2000 problems, either in its products or internal business systems or in relation to third party vendors, manufacturers or suppliers, actual costs could materially exceed this estimate.

Internal business processes. The Company has substantially completed its inventory of Year 2000 impacted software and is assessing its centralized computer and embedded systems to identify any potential Year 2000 issues. The Company's financial information systems include an SAP system recently implemented in the United States, Japan, and Asia Pacific and Latin America, and an Oracle system in Europe that has recently been upgraded to a recent version. SAP and Oracle have informed the Company, and the Company believes, that these systems are Year 2000 compliant. The Company has a number of projects underway to replace or upgrade hardware and software that are known to be Year 2000 non-compliant. The Company currently expects to substantially complete remediation, validation and implementation of its internal systems by mid-1999. In addition, in order to protect against the acquisition of additional products that may not be Year 2000 ready, the Company has implemented a policy requiring Year 2000 review of products sold or licensed to the Company prior to their acquisition. However, if implementation of replacement or upgraded systems or software is delayed, or if significant new non-compliance issues are identified, the Company's results of operations or financial condition could be materially adversely affected.

Third-party vendors, manufacturers and suppliers. The Company is also in the process of contacting its critical suppliers, manufacturers, distributors and other vendors to determine that their operations and the products and services that they provide to the Company are Year 2000 compliant. Where practicable, the Company will attempt to mitigate its risks with respect to the failure of third parties to be Year 2000 ready, including developing contingency plans. However, such failures, including failures of any contingency plan, remain a possibility and could have a materially adverse impact on the Company's results of operations or financial condition.

Products. In addition, the Year 2000 issue could affect the products that the Company licenses. The Company is continuing to test its products and gather information about Company technologies and products affected by the Year 2000 transition. Current information about the Company's products is available on the Company's Year 2000 Web site (www.adobe.com/newsfeatures/year2000). Information on the Company's Web site is provided to customers for the sole purpose of assisting in planning for the transition to the Year 2000. Such information is the most currently available concerning the Company's products and is provided "as is" without warranty of any kind. There can be no assurance that the Company's current products do not contain undetected errors or defects associated with Year 2000 that may result in material costs to the Company.

Contingency plans. The Company has not yet developed contingency plans to address situations that may result if the Company is unable to achieve Year 2000 readiness of its critical operations, including operations under the control of third parties. Additionally, the most reasonably likely worst-case scenario has not yet been clearly identified. Development of such contingency plans is in progress and is expected to be completed by September 1999. There can be no assurance that the Company will be able to develop contingency plans that will adequately address all Year 2000 issues that may arise.

Some commentators have stated that a significant amount of litigation will arise out of Year 2000 compliance issues, and the Company is aware of a growing number of lawsuits against other software vendors. Because of the unprecedented nature of such litigation, it is uncertain whether or to what extent the Company may be affected by it. The impact of the Year 2000 on future Company revenue is difficult to discern but is a risk to be considered in evaluating future growth of the Company.

Recent Accounting Pronouncements

In June 1997, the FASB issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," and in June 1998, issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." Readers can refer to the "Recent Accounting Pronouncements" section of the Company's 1998 Annual Report on Form 10-K for further discussion.

In December 1998, the AICPA issued SOP 98-9, "Modifications of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions." Readers can refer to the "Recent Accounting Pronouncements" section of the Company's 1998 Annual Report on Form 10-K for further discussion.

LIQUIDITY AND CAPITAL RESOURCES

	March 5 1999	November 27 1998	Change
	(Dollars in millions)		
Cash, cash equivalents and short-term investments	$263.2	$272.5	(3.4)%
Working capital	$211.1	$205.0	3.0%
Stockholders' equity	$544.9	$516.4	5.5%

The Company's cash, cash equivalents and short-term investments, consisting principally of municipal bonds, and United States government and government agency securities, decreased $9.3 million, or 3.4%, during the first quarter of fiscal 1999 primarily due to the repurchase of Adobe common stock totaling $69.9 million and the purchase of the assets of GoLive Systems, Inc. for $31.0 million. Other uses of cash during the period included additional investments made in Adobe Ventures in the amount of $6.8 million, capital expenditures of $7.5 million, and the payment of dividends totaling $3.1 million. These factors were partially offset by cash generated from operations of $36.5 million and proceeds from the issuance of treasury stock, primarily related to the exercise of stock options and sale of stock under the Employee Stock Purchase Program of $35.9 million.

All of the Company's cash equivalents and short-term investments are classified as available-for-sale under the provisions of Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities." The securities are carried at fair value with the unrealized gains and losses, net of tax, reported as a separate component of stockholders' equity.

In September 1997, the Company's Board of Directors authorized, subject to certain business and market conditions, the purchase of up to an additional 15 million shares of the Company's common stock over a two-year period. This new stock repurchase program was in addition to an existing program whereby the Company has been authorized to repurchase shares to offset issuances under employee stock option and stock purchase plans. The Company repurchased approximately 1.7 million shares in the first quarter of fiscal 1999 and 10.5 million shares in fiscal 1998, at a cost of $69.9 million and $379.2 million, respectively, under its stock repurchase programs. As of March 5, 1999, there are no remaining authorized shares to be repurchased under the 15.0 million share repurchase program. The timing and size of any future stock repurchases are subject to market conditions, stock prices, and the Company's cash position and other cash requirements going forward.

To facilitate the Company's stock repurchase programs, the Company sold put warrants to independent third parties. Each warrant entitles the holder to sell one share of Adobe's common stock to the Company at a specified price. On March 5, 1999, put warrants to sell approximately 779,500 shares of the Company's common stock were outstanding that expire on various dates through July 1999 with an average exercise price of $42.41 per share. Under these put warrant arrangements, the Company, at its option, can settle with physical delivery or net shares equal to the difference between the exercise price and market value at the date of exercise.

In addition, the Company purchased call options from independent third parties that entitle the Company to buy its common stock on certain dates at specified prices. On March 5, 1999, call options to purchase approximately 239,100 shares of the Company's common stock were outstanding that expire on various dates through July 1999 with an average exercise price of $44.47 per share.

The Board of Directors of the Company declared a cash dividend on the Company's common stock of $0.05 per common share, for the first quarter of fiscal 1999. The declaration of future dividends is within the discretion of the Board of Directors of the Company and will depend upon business conditions, results of operations, the financial condition of the Company and other factors.

The Company's principal commitments as of March 5, 1999 consisted of obligations under operating leases, venture investing activities, real estate development agreements, and various service agreements. These arrangements are discussed in more detail in the Company's 1998 Annual Report filed on Form 10-K for the year ended November 27, 1998.

The Company believes that existing cash, cash equivalents and short-term investments, together with cash generated from operations, will provide sufficient funds for the Company to meet its operating cash requirements in the foreseeable future, including planned capital expenditure programs, working capital requirements, the potential put warrant obligation, and the dividend program.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's market risk disclosures set forth in its 1998 Annual Report filed on Form 10-K have not changed significantly.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On April 17, 1997, a derivative action was filed in the Superior Court of the State of California, County of Santa Clara, against the current members of Adobe's Board of Directors and Paul Brainerd, a former member of the Board. The suit was filed by a stockholder purporting to assert on behalf of the Company claims for alleged breach of the Directors' fiduciary duty and mismanagement related to the Company's acquisition of Frame in October 1995. The Court granted Adobe's demurrer to the suit, with leave to amend for the plaintiff. In January 1998, the plaintiff filed an amended complaint making substantially the same claims but not including Mr. Brainerd. In March 1998, Adobe filed a demurrer to the amended complaint, which was overruled by the trial court in May 1998. In June 1998, Adobe filed a writ petition with the California Court of Appeals for review of the trial court's decision, which was denied. In July 1998, Adobe filed a petition for review of the Court of Appeals' refusal to grant the writ with the Supreme Court of California, which was denied in September 1998. The Company intends to continue vigorously defending the action.

On February 6, 1996, a securities class action complaint was filed against Adobe, certain of its officers and directors, certain former officers of Adobe and Frame Technology Corporation ("Frame"), Hambrecht & Quist, LLP ("H&Q"), investment banker for Frame, and certain H&Q employees, in connection with the drop in the price of Adobe stock following its announcement of financial results for the quarter ended December 1, 1995. The complaint was filed in the Superior Court of the State of California, County of Santa Clara. The complaint alleges that the defendants misrepresented material adverse information regarding Adobe and Frame and engaged in a scheme to defraud investors. The complaint seeks unspecified damages for alleged violations of California law. Adobe believes that the allegations against it and its officers and directors are without merit and intends to vigorously defend the lawsuit. The case is currently in the discovery phase.

On October 29, 1998, Heidelberger Druckmaschinen AG, a German company, filed a complaint alleging that Adobe is using Heidelberger's US patent number 4,393,399 for the partial electronic retouching of colors. The complaint was filed in the United States District Court for the District of Delaware, and seeks a permanent injunction and unspecified damages. Adobe believes that the allegations against it are without merit and intends to vigorously defend the lawsuit.

Management believes that the ultimate resolution of these matters will not have a material impact on the Company's financial position or results of operations.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Index to Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference Form	Date	Number	Filed Herewith
3.1	The Registrant's (as successor in-interest to Adobe Systems (Delaware) Incorporated by virtue of a reincorporation effective 5/30/97) Certificate of Incorporation, as filed with the Secretary of State of the State of Delaware on 5/9/97.	10-Q	05/30/97	3.1	
3.2.10	Amended and Restated Bylaws as currently in effect.	10-K	11/28/97	3.2.10	
3.3	Certificate of Designation of the Series A Preferred Stock	10-K	11/28/97	3.3	
3.4	Agreement and Plan of Merger effective 5/30/97 (by virtue of a reincorporation), by and between Adobe Systems Incorporated, a California Corporation and Adobe Systems (Delaware) Incorporated, a Delaware corporation.	10-Q	05/30/97	2.1	
4.1	Second Amended and Restated Rights Agreement between the Company and Harris Trust Company of California	8-K	08/29/97	4	
4.2	Third Amended and Restated Rights Agreement between the Company and Harris Trust Company of California	8-K	12/15/98	1	

(Continued)

Exhibit Number	Exhibit Description	Incorporated by Reference Form	Date	Number	Filed Herewith
10.1.6	1984 Stock Option Plan, as amended*	10-Q	07/02/93	10.1.6	
10.17.1	License Agreement Restatement between the Company and Apple Computer, Inc., dated April 1, 1987 (confidential treatment granted)	10-K	11/30/88	10.17.1	
10.17.2	Amendment No. 1 to the License Agreement Restatement between the Company and Apple Computer, Inc., dated November 27, 1990 (confidential treatment granted)	10-K	11/30/90	10.17.2	
10.21.3	Revised Bonus Plan*	10-Q	02/28/97	10.21.3	
10.24.1	1994 Performance and Restricted Stock Plan*	S-8	07/27/94	10.1	
10.25.0	Form of Indemnity Agreement*	10-K	11/30/90	10.17.2	
10.25.1	Form of Indemnity Agreement*	10-Q	05/30/97	10.25.1	
10.32	Sublease of the Land and Lease of the Improvements By and Between Sumitomo Bank Leasing and Finance Inc. and Adobe Systems Incorporated (Phase 1)	10-K	11/25/94	10.32	
10.36	1996 Outside Directors Stock Option Plan*	10-Q	05/31/96	10.36	
10.37	Confidential Resignation Agreement*	10-Q	05/31/96	10.37	

(Continued)

Exhibit Number	Exhibit Description	Incorporated by Reference Form	Date	Number	Filed Herewith
10.38	Sublease of the Land and Lease of the Improvements By and Between Sumitomo Bank Leasing and Finance Inc. and Adobe Systems Incorporated (Phase 2)	10-Q	08/30/96	10.38	
10.39	1997 Employee Stock Purchase Plan, as amended*	S-8	05/30/97	10.39	
10.40	1994 Stock Option Plan, as amended*	S-8	05/30/97	10.40	
10.42	Amended and Restated Limited Partnership Agreement of Adobe Incentive Partners, L.P.*	10-K	11/28/97	10.42	
10.43	Resignation Agreement*	10-K	11/28/97	10.43	
10.44	Forms of Retention Agreement*	10-K	11/28/97	10.44	
10.45	Confidential Executive Resignation Agreement And General Release of Claims*	10-Q	8/28/98	10.45	
10.46	Confidential Executive Resignation Agreement And General Release of Claims*	10-Q	8/28/98	10.46	
10.47	Confidential Executive Resignation Agreement And General Release of Claims*	10-Q	8/28/98	10.46	
10.48	Letter of Release and Waiver*	10-K	11/27/98	10.48	

(Continued)

Exhibit Number	Exhibit Description	Incorporated by Reference Form	Date	Number	Filed Herewith
10.49	Confidential Executive Resignation Agreement And General Release of Claims*				X
21	Subsidiaries of the Registrant	10-K	11/27/98	21	
27.1	Financial Data Schedule				X
27.2	Financial Data Schedule				X

*Compensatory plan or arrangement

(b) Reports on Form 8-K

Date of report	Filing Date	Item Reported
December 15, 1998	December 21, 1998	5

On December 21, 1998, the Company filed a Report on Form 8-K under Item 5 to report that it had amended its Rights Agreement dated as of July 11, 1990 by entering into the Third Amended and Restated Rights Agreement, dated as of December 15, 1998, with Harris Trust Company of California.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ADOBE SYSTEMS INCORPORATED

By /s/ Harold L. Covert
Harold L. Covert,
Senior Vice President and
Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: April 8, 1999

SUMMARY OF TRADEMARKS

The following trademarks of Adobe Systems Incorporated, which may be registered in certain jurisdictions, are referenced in this Form 10-Q:

Adobe
Acrobat
AfterEffects
DynamicStudio
FrameMaker
GoLive
GraphicStudio
Illustrator
PageMaker
PhotoDeluxe
Photoshop
PostScript
PostScript Extreme
Premiere
PrintGear

All other brand or product names are trademarks or registered trademarks of their respective holders.

ADOBE SYSTEMS INCORPORATED
EXHIBIT 27.1
FINANCIAL DATA SCHEDULE

PART 1. LEGEND

<LEGEND> *This schedule contains summary financial information extracted from the Consolidated Balance Sheet at March 5, 1999, and the Consolidated Statement of Income for the quarter ended March 5, 1999, and is qualified in its entirety by reference to such financial statements.*

PART 2. TAGS REQUIRED WHEN APPLICABLE

Tag	Tag Value	Item Description
1) <RESTATED>		Indicates that this schedule is restated and is to replace the previously provided schedule for this period.
2) <CIK>		Required for coregistrant filings. Identifies each coregistrant CIK.
3) <NAME>		Required for coregistrant filings. Identifies coregistrant name
4) <MULTIPLIER>	1,000	Identifies units of data. Applies to all monetary values, except per-share-data. DEFAULT IS 1. Commas may be omitted.
5) <CURRENCY>		Identifies currency of financial data. DEFAULT IS U.S. DOLLARS
6) <PERIOD-START>	NOV-28-1998	Identifies period start for each column; e.g., JAN-01-1991
7) <EXCHANGE-RATE>		Identifies multiplier of currency for financial data. DEFAULT IS 1.

PART 3. COLUMNS

Column 1 3-MOS

PART 4. REQUIRED TAGS

Tag	Column 1
8)<FISCAL-YEAR-END>	DEC-03-1999
9)<PERIOD-START>	NOV-28-1998
10)<PERIOD-END>	MAR-05-1999
11)<CASH>	79,486

(Continued)

PART 4. REQUIRED TAGS (continued)

Tag	Column 1
12)<SECURITIES>	183,751
13)<RECEIVABLES>	137,186
14)<ALLOWANCES>	5,144
15)<INVENTORY>	1,827
16)<CURRENT-ASSETS>	438,763
17)<PP&E>	229,193
18)<DEPRECIATION>	135,631
19)<TOTAL-ASSETS>	772,506
20)<CURRENT-LIABILITIES>	227,636
21)<BONDS>	0
22)<PREFERRED-MANDATORY>	0
23)<PREFERRED>	0
24)<COMMON>	0
25)<OTHER-SE>	544,870
26)<TOTAL- LIABILITY-AND-EQUITY>	772,506
27)<SALES>	38,099
28)<TOTAL-REVENUES>	226,902
29)<CGS>	22,499
30)<TOTAL-COSTS>	22,499
31)<OTHER-EXPENSES>	151,166
32)<LOSS-PROVISION>	(1,216)
33)<INTEREST-EXPENSE>	0
34)<INCOME-PRETAX>	60,319
35)<INCOME-TAX>	22,043
36)<INCOME-CONTINUING>	38,276
37)<DISCONTINUED>	0
38)<EXTRAORDINARY>	0
39)<CHANGES>	0
40)<NET-INCOME>	38,276
41)<EPS-PRIMARY>	0.63
42)<EPS-DILUTED>	0.60

PART 5. FOOTNOTES

<F1> None

ADOBE SYSTEMS INCORPORATED
EXHIBIT 27.2
FINANCIAL DATA SCHEDULE

PART 1. LEGEND

<LEGEND> *This schedule contains summary financial information extracted from the Consolidated Balance Sheet at February 27, 1998, and the Consolidated Statement of Income for the quarter ended February 27, 1998, and is qualified in its entirety by reference to such financial statements.*

PART 2. TAGS REQUIRED WHEN APPLICABLE

Tag	Tag Value	Item Description
1) <RESTATED>	YES	Indicates that this schedule is restated and is to replace the previously provided schedule for this period.
2) <CIK>		Required for coregistrant filings. Identifies each coregistrant CIK.
3) <NAME>		Required for coregistrant filings. Identifies coregistrant name
4) <MULTIPLIER>	1,000	Identifies units of data. Applies to all monetary values, except per-share-data. DEFAULT IS 1. Commas may be omitted.
5) <CURRENCY>		Identifies currency of financial data. DEFAULT IS U.S. DOLLARS
6) <PERIOD-START>	NOV-29-1997	Identifies period start for each column; e.g., JAN-01-1991
7) <EXCHANGE-RATE>		Identifies multiplier of currency for financial data. DEFAULT IS 1.

PART 3. COLUMNS

Column 1 3-MOS

PART 4. REQUIRED TAGS

Tag	Column 1
8)<FISCAL-YEAR-END>	NOV-27-1998
9)<PERIOD-START>	NOV-29-1997
10)<PERIOD-END>	FEB-27-1998
11)<CASH>	106,653

(Continued)

PART 4. REQUIRED TAGS (continued)

Tag	**Column 1**
12)<SECURITIES>	271,545
13)<RECEIVABLES>	119,328
14)<ALLOWANCES>	4,308
15)<INVENTORY>	8,593
16)<CURRENT-ASSETS>	541,982
17)<PP&E>	198,803
18)<DEPRECIATION>	114,264
19)<TOTAL-ASSETS>	829,659
20)<CURRENT-LIABILITIES>	195,695
21)<BONDS>	0
22)<PREFERRED-MANDATORY>	0
23)<PREFERRED>	0
24)<COMMON>	0
25)<OTHER-SE>	633,964
26)<TOTAL- LIABILITY-AND-EQUITY>	829,659
27)<SALES>	41,851
28)<TOTAL-REVENUES>	197,813
29)<CGS>	27,805
30)<TOTAL-COSTS>	27,805
31)<OTHER-EXPENSES>	147,566
32)<LOSS-PROVISION>	770
33)<INTEREST-EXPENSE>	0
34)<INCOME-PRETAX>	42,635
35)<INCOME-TAX>	15,891
36)<INCOME-CONTINUING>	26,744
37)<DISCONTINUED>	0
38)<EXTRAORDINARY>	0
39)<CHANGES>	0
40)<NET-INCOME>	26,744
41)<EPS-PRIMARY>	0.39
42)<EPS-DILUTED>	0.38

PART 5. FOOTNOTES

<F1> None